AUTUMN 2017

Forecast Report

CESEE Back on Track to Convergence

Economic Analysis and Outlook for Central, East and Southeast Europe

The Vienna Institute for International Economic Studies
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CESEE Back on Track to Convergence

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The authors of this report wish to thank Alexandra Bykova, Nadya Heger, Beate Muck, Renate Prasch, Monika Schwarzhappel, Galina Vasaros and David Zenz for statistical assistance, as well as Clive Liddiard and Eva Strobl for language editing and proof reading and Michaela Bönisch for text processing.

Press date: 9 November 2017

Executive summary

The outlook for the world economy has improved in the course of 2017 and the economic recovery has been gaining strength in Europe as well – despite persistent geopolitical challenges and related uncertainties. In spite of some modest increases in energy prices and improving labour markets, both wage growth and inflationary pressures are largely being kept in check. Both economic developments and investors' sentiments are thus apparently decoupled from politics. Major commodity prices (oil, metals and grain) are expected to stay relatively flat.

With elections in France and Germany now over, Brexit could open up a window of opportunity for advancing badly needed reforms at the EU level. The Visegrád states, especially those that are still outside the eurozone, fear that a separate eurozone budget would lead to the establishment of a 'two-speed Europe'. None of those countries (Hungary, the Czech Republic and Poland) is eager to join the eurozone, and nor are they willing to accept obligatory quotas for the relocation of migrants. Together with illiberal domestic developments, these latent conflicts with the 'core' EU could easily escalate – during negotiations over the next (post-Brexit) EU budget at the latest.

Particularly the Central and East European EU Member States (EU-CEE) have enjoyed robust growth (which has sometimes even accelerated) over the past couple of years, and this trend has even strengthened recently**.** With annual growth rates close to or even above 4%, their economic convergence with Western Europe has gained momentum in 2017.

The growth performance of the Western Balkans and Turkey has been uneven, and in the Western Balkans growth is less spectacular than in the EU-CEE, though growth rates of around 3% per year have at least helped to somewhat stabilise the local labour markets. Turkey was booming in 2017.

Russia, Kazakhstan and Ukraine are finally also emerging from recession. Even Belarus, which has been hit hard by the Russian crisis, is recovering in 2017. In Belarus, and especially in Kazakhstan and Russia, the current recovery is largely a result of the recent increase in (and subsequent stabilisation of) the price of oil. The upswing in Ukraine is the result of recovery from a very deep recession in 2014-2015. However, with growth forecast to be around 2%, the whole region will not follow the EU-CEE's return to a growth convergence path.

Improvements in labour markets are spectacular. With few exceptions, the number of employed persons in most Central, East and Southeast European (CESEE) countries now exceeds the pre-crisis level. The rising employment levels are on average associated with GDP growth rates of at least 3%, which represents an earlier estimated threshold for employment elasticity to GDP growth in CESEE.

Rising employment levels are mirrored by declining unemployment. Again, with a few exceptions, the number of unemployed persons is not only below the post-crisis peak, but is frequently even below the pre-crisis level. Apart from higher economic growth, demographic factors such as a shrinking labour force, an ageing society and constant outward migration are key factors behind the falling unemployment rates in several EU-CEE countries.

Unemployment rates differ widely across countries. The situation on CESEE labour markets thus currently varies from de facto full employment (Czech Republic) to a still considerable degree of slack (Bosnia and Herzegovina, Macedonia and Kosovo). Yet even in countries where the labour market situation is a long way from full employment, serious labour shortages have become more frequent recently. Many vacancies are being filled by migrant workers, who come mainly from Ukraine, but also from Moldova and Serbia. A large number of migrant workers – mostly from Central Asia, Ukraine and Moldova – are employed in Russia.

Hand in hand with rapidly rising output and emerging labour shortages, we also observe growing wages. Both rising wages and labour shortages are likely to become more widespread in future throughout the CESEE region. However, **CESEE labour cost competitiveness is not yet endangered**. On average, the unit labour costs adjusted for productivity and exchange rate levels are below 50% of the Austrian level (except in Slovenia). Average monthly gross wages in EUR (at the prevailing exchange rate) amount to less than one third of the Austrian level in the Czech Republic, Hungary, Poland and Slovakia.

So far there has not been much wage-cost-induced inflationary pressure (the Baltic States and Romania may be exceptions). The anticipated tightening of monetary policies in the USA, probably followed with some delay by the European Central Bank (ECB), will likely be cautious. In some countries, a moderation of inflationary pressures has been assisted by appreciating currencies, and monetary policy is perceived as excessively restrictive, inhibiting domestic credit growth and investment (this criticism is being voiced especially in Russia).

The current GDP forecast for 2017 was revised upwards in all EU-CEE countries. Despite continuing political uncertainties both within and outside the region, economic convergence is here largely back on its pre-crisis track. Farther east, especially in **Russia, but also in the Western Balkans**, the post-crisis recovery has been much weaker, and economic convergence has been delayed.

Private consumption is the main growth driver throughout most of the CESEE region, underpinned by rising real wages and household incomes. Simultaneously, declining unemployment and emerging labour shortages have already been acting not only as productivity growth drivers, but also as a potential constraint on future growth. Gradually, along with rising private consumption, investments have also gained strength and have increasingly emerged as a driver of growth.

The economic resilience is persisting, regardless of the continuing elevated geopolitical risks. FDI flows into the region increased in 2016 and early 2017, and business prospects generally improved as well. Together with household consumption and investments, it is currently also net exports that are contributing to the rapid CESEE growth. Trade balances have improved, and many EU-CEE countries (as well as Russia) also report current account surpluses. The growth is thus becoming broader-based, more robust and probably also more sustainable.

In terms of current GDP growth prospects, the CESEE region is split into three sub-regions: the EU-CEE, with average growth close to 4% in the forecasting period; the Western Balkans, with GDP growing by around 3%; and finally, the Commonwealth of Independent States (CIS) and Ukraine, where growth will be around 2% in the medium-term perspective. T**he EU-CEE region is catching up again** and the process of economic convergence has resumed at a somewhat greater speed than expected in the Spring Forecast. This catching-up process will continue at least in the medium run and probably for the rest of the decade. Importantly, **economic convergence is not expected to resume in Russia**, where the lack of structural change, lasting investment climate deficiencies and geopolitical conflicts impose a burden on growth. Meagre growth in Russia may well adversely affect the growth prospects of her CIS partners. But in several other CESEE countries, recent political developments are not very conducive to growth and European integration in the medium term. However, for the moment economic growth seems to be unaffected by political instability.

The Forecast Report also includes three special topics on the following issues in CESEE:

(i) The pace of income convergence with Western Europe;
(ii) Whether additional countries in the region should join the euro;
(iii) How well countries in the region are positioned to deal with higher yields on hard currency sovereign debt.

(i) Convergence in terms of per capita GDP levels in CESEE is a long-term process. Per capita GDP levels in the CESEE economies have been catching up with the 'old' EU Member States recently. However, the pace of convergence, which was quite rapid before the outbreak of the global financial crisis, has since slowed. This slowdown has been particularly visible in the more developed EU-CEE countries. We find that by 2026, no country in the region will have caught up with average EU-28 wealth levels. Per capita GDP in the Czech Republic will exceed 90% of the EU-28 level, whereas in Poland and Hungary it will not even reach the 80% mark. For most of the CESEE region, a halving of the current gap between it and the EU-28 in terms of average per capita GDP will take over 24 years.

(ii) Despite sustained criticism since its inception, the euro may yet survive and attract new members in the EU-CEE. The global financial crisis saw many peripheral eurozone countries suffer deep and protracted recession, much of which was blamed on the rigidity inherent in being part of a single currency area. This has contributed (along with political factors) to widespread opposition in many parts of the EU-CEE to possible membership of the euro. However, the reality is that the problems of Southern Europe have had little to do with the euro itself. Our conclusion is that it is in the interests of Croatia and Bulgaria to join, and is potentially advantageous for Hungary and Poland. The case is less clear cut for the Czech Republic and Romania, although in neither case would accession be harmful.

(iii) Many CESEE sovereigns are not in a markedly better shape to deal with a sharp rise in debt yields than they were 10 years ago; and in some cases they are in a worse position. Those countries exposed primarily to euro rates have the advantage that the ECB is set to withdraw liquidity but is unlikely to raise interest rates in the next few years; those reliant on dollar funding will face bigger challenges. For countries with heavy debt loads and little apparent prospect of achieving high and sustained growth, bond markets could panic, leading to funding difficulties. Ukraine stands out as particularly risky from a sovereign risk perspective, while we conclude that Belarus and many countries in the Western Balkans are also in a weak position.

COUNTRY SUMMARIES

ALBANIA

Strong investment in energy infrastructure will keep real GDP growth at around 4% in 2017 and during the remainder of the forecast period. These investments are mostly privately financed. The budget of the re-elected government of Prime Minister Rama is in surplus. In addition, the tourism sector is doing well, and promises to be an ever more important driver of growth in the coming years.

BELARUS

GDP in Belarus grew by 1% in the first half of 2017, thanks to the economic upturn in Russia and the settling of the gas dispute between the two countries. The resumption of normal oil deliveries from Russia enabled a rapid recovery in manufacturing and exports. A tight macroeconomic policy stance contributed to a reduction of inflation in Belarus to single-digit levels. GDP growth could reach 2% for the year as a whole and may strengthen further in 2018 and 2019.

BOSNIA AND HERZEGOVINA

The economy lost momentum in the second quarter, although overall it is likely to post growth of around 3% this year. Growth should pick up even further in the rest of the forecast period, driven by remittances, a gradual improvement in the labour market, tourism and exports. Political risk will remain elevated ahead of the 2018 election, which is having an impact on investment spending, although it is unlikely significantly to derail medium-term growth.

BULGARIA

Bulgaria's broad-based economic upturn has continued, with positive output growth across all sectors of economic activity. The pattern of growth has switched from the export-led model of 2016 to a demand-driven type. However, labour shortages are causing supply constraints. The short-term prospects have improved and GDP growth for 2017 as a whole could come close to 4% and will remain in this range in the foreseeable future. Growth is balanced, with no imminent threats to macroeconomic stability.

CROATIA

Croatia's economy continues on its path of recovery, with annual GDP growth of up to 3% in the period 2017-2019. Household consumption will remain the main driver, but investments, fuelled by EU funding, will play an important role as well. Demographic changes, coupled with continued emigration, will become a major challenge in the future.

CZECH REPUBLIC

Demand, profitability and indebtedness conditions are conducive to rapid, broad-based growth. The emerging labour shortages support a faster rise in wages, yet without eroding profits in industry. Monetary policy faces no serious dilemmas. The fiscal policy orientation of the new government will remain essentially unchanged.

ESTONIA

Investment activity in both the private and the public sector picked up more strongly than expected, pushing GDP growth upwards in both 2017 and 2018. Meanwhile exports have also gained momentum and recovered, particularly towards Russia. Household consumption, backed by a still considerable rise in real wages, continues to be a strong driver of economic activity. A speed-up in economic activity in the short run is projected to result in a GDP growth rate of 3.8% in 2017 and 3.3% in 2018, declining somewhat to 2.9% in 2019.

HUNGARY

Economic growth has accelerated compared to the previous year. The main drivers are investment and household consumption. The foreign trade balance started to deteriorate, but the trade surplus is still significant and will remain so over the forecast horizon. The sharp increase in wages will stimulate domestic demand, but productivity growth is lagging and may increasingly become a problem for firms, primarily for small and medium-sized enterprises. According to the Hungarian Central Bank, introduction of the euro will only be feasible if Hungary's per capita GDP and wages attain 90% of the EU average; this rules out euro adoption, even in the medium term.

KAZAKHSTAN

Strong industry performance accounts for a speeding-up of economic growth in 2017. The oil sector is benefiting from output expansion, higher prices and increased external demand. Real household income has been in decline, and private consumption growth is financed primarily through bank loans. The government is adopting measures to achieve fiscal consolidation and revive the banking sector.

KOSOVO

The new government has a tiny majority and is made up of a diverse set of parties, meaning that significant reform will be difficult. However, the economy is growing strongly, driven in particular by supportive external factors, and this is likely to remain the case over the forecast period. Exports are growing rapidly, but from a very low base, and a significant change in Kosovo's remittance-dependent growth model is unlikely in the medium term.

LATVIA

Our GDP growth forecast for 2017 has been increased to 4.2%. Private and (particularly) public investment activity is expanding faster than expected. The inflow of EU funds is likely to amount to 2.6% of GDP this year. As anticipated, exports to Russia have revived following the upswing in that country. Household consumption is developing rapidly, and this will continue in the coming years thanks to rising minimum wages and the 2018 income tax reform. In both 2018 and 2019, we expect continuously robust GDP growth of 3.8% and 3.2%, respectively.

LITHUANIA

In 2017, economic growth in Lithuania is being driven by a resurgence in external demand, particularly from the CIS, and also for oil products. Moreover, strong growth in investment is underpinned by fresh funds from the EU and by private housing construction. The ongoing decline in unemployment and rapid wage increases have resulted in steady, strong growth in consumer demand. For 2017, we forecast a greater upswing in the GDP growth rate to 3.8%, followed by 3.4% in 2018 and 2.8% in 2019.

MACEDONIA

This year's disappointing growth of at most 2% is due to the prolonged political crisis. Medium-term prospects have improved, though they are dependent on the political ability of the new government. Assuming that stability is preserved, next year should see growth of 3%, which should edge up towards 3.5% in the medium run, driven mostly by investment, both private and public.

MONTENEGRO

In the medium term, growth should return to somewhere above 3%. Improved prospects in the EU and in Russia are supportive of the growth of tourism, which should compensate for the necessary macroeconomic adjustments. If the region as a whole does better – which is likely e.g. in the case of Croatia, if not Serbia – that will also help. So overall, Montenegro could see its growth rate fulfil its potential, which is about 4%.

POLAND

Strong consumption-driven growth has been propelled by rising wages and employment. Economic conditions are conducive to a recovery in investment activities, which has yet to materialise. The positive growth prospects may be endangered by the unwelcome effects of the ongoing evolution of the political system – including the country's progressive alienation from its EU partners.

ROMANIA

Economic growth in Romania is expected to climb to 5.7% in 2017 and to subside to 4.5% in the following two years. Household demand has boomed and investments have stagnated this year. The most recent measures aim to keep the fiscal deficit below 3% of GDP. Inflation has returned to positive figures and is bound to accelerate, putting the National Bank under pressure to hike the prime rate.

RUSSIA

The Russian economy is growing again. The inflation target of 4% has been met and the rouble is appreciating. Yet the expected GDP growth will remain below 2% even in the medium run, and will lag behind most of the country's CESEE peers. No changes in economic policies are expected before next year's presidential elections. Sanctions and the poor investment climate are there to stay.

SERBIA

If there is no sustained recovery of investments, which stand at just around 18% of GDP now, growth cannot speed up too much in the medium term. It should rise to around 2.5% in 2018, and probably some more in 2019. But growth rates above 3%, which are certainly within the economy's potential, can be contemplated only beyond that period.

SLOVAKIA

Slovakia experienced solid growth of 3.2% in the first half of 2017, backed by accelerating household consumption. While investment was still down, it is expected to recover in the second half of 2017. Capacity increases in the automotive industry are going to take off at the end of 2018/2019 and will allow for growth rates of close to 4%.

SLOVENIA

Annual GDP growth will reach close to 4% during the period 2017-2019. Exports, the recovery of investments spurred by EU funding and steady consumption growth will remain the main drivers of GDP growth. Household consumption is expected to be boosted by rising disposable income and a further improvement in the labour market. Demographic changes and labour shortages will become one of the major challenges in the future.

TURKEY

The economy is growing strongly, thanks to both government-driven stimulus and robust foreign demand. However, continued political noise – both at home and abroad – risks knocking the recovery off course. Rapid private credit growth is also a source of concern, although the main risk remains the large external financing requirement, which leaves Turkey highly exposed to further tightening of monetary policy in the US.

UKRAINE

Economic recovery continues largely unabated, as the negative shock to industrial production and exports from the ban on trade with Donbas has been offset by strengthening private consumption. Also, the government has been able to borrow from international capital markets for the first time since 2015. Barring major negative shocks, growth is expected to reach 2% this year, and to accelerate to 3% in 2018-2019.

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, EU integration indebtedness

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
BG	Bulgaria	3.6	3.9	3.8	3.7	3.5	-1.1	-1.3	1.5	2.0	2.5
CZ	Czech Republic	5.3	2.6	3.7	3.2	3.0	0.3	0.6	2.3	2.1	2.0
EE	Estonia	1.7	2.1	3.8	3.3	2.9	0.1	0.8	3.6	3.2	3.0
HR	Croatia	2.2	3.0	3.0	2.7	3.0	-0.3	-0.6	1.3	1.6	1.6
HU	Hungary	3.4	2.2	4.0	3.9	3.0	0.1	0.4	2.5	2.8	2.9
LT	Lithuania	2.0	2.3	3.8	3.5	2.8	-0.7	0.7	3.5	3.0	2.7
LV	Latvia	2.8	2.2	4.2	3.8	3.2	0.2	0.1	3.3	3.2	3.0
PL	Poland	3.8	2.7	3.8	3.5	3.3	-0.7	-0.2	1.6	1.9	2.0
RO	Romania	3.9	4.8	5.7	4.5	4.6	-0.4	-1.1	1.0	3.0	3.5
SI	Slovenia	2.3	3.1	4.0	3.9	3.7	-0.8	-0.2	1.5	1.8	1.8
SK	Slovakia	3.9	3.3	3.3	3.6	4.0	-0.3	-0.5	1.3	1.8	1.8
	EU-CEE 1)2)	*3.8*	*3.1*	*4.1*	*3.7*	*3.5*	*-0.4*	*-0.2*	*1.8*	*2.3*	*2.4*
	EA-19	*2.1*	*1.8*	*2.2*	*1.8*	*1.7*	*0.0*	*0.2*	*1.9*	*1.8*	*1.7*
	EU-28 3)	*2.3*	*1.9*	*2.4*	*2.0*	*.*	*0.0*	*0.3*	*2.0*	*2.0*	*.*
AL	Albania	2.2	3.4	3.9	4.2	4.1	1.9	1.3	2.3	2.8	3.0
BA	Bosnia and Herzegovina	3.1	3.2	3.0	3.4	3.5	-1.0	-1.1	1.2	1.6	1.9
ME	Montenegro	3.4	2.9	2.7	2.9	3.0	1.4	0.1	1.5	2.0	2.0
MK	Macedonia	3.8	2.4	1.8	3.1	3.4	-0.3	-0.2	1.0	1.5	2.0
RS	Serbia	0.8	2.8	1.9	2.5	2.7	1.4	1.1	3.0	3.0	3.0
XK	Kosovo	4.3	3.4	3.7	3.8	3.8	-0.5	0.3	1.6	1.9	2.3
	WB 1)2)	*2.2*	*3.0*	*2.5*	*3.1*	*3.2*	*0.7*	*0.5*	*2.1*	*2.4*	*2.6*
TR	Turkey	6.1	3.2	5.4	3.9	3.9	7.7	7.7	10.8	7.8	6.8
BY	Belarus 4)	-3.8	-2.6	2.0	2.3	2.6	13.5	11.8	8.5	8.0	7.0
KZ	Kazakhstan	1.2	1.1	3.0	3.0	3.5	6.6	14.6	7.0	6.0	6.0
RU	Russia	-2.8	-0.2	1.7	1.9	1.9	15.5	7.1	4.5	4.0	5.0
UA	Ukraine	-9.8	2.3	2.0	3.0	3.0	48.7	13.9	14.3	8.0	5.0
	CIS + Ukraine 1)2)	*-3.0*	*0.0*	*1.9*	*2.1*	*2.2*	*17.1*	*8.6*	*5.7*	*4.7*	*5.2*
	V-4 1)2)	*4.1*	*2.7*	*3.8*	*3.5*	*3.3*	*-0.3*	*0.0*	*1.8*	*2.1*	*2.1*
	BALT-3 1)2)	*2.2*	*2.2*	*3.9*	*3.5*	*2.9*	*-0.3*	*0.5*	*3.5*	*3.1*	*2.9*
	SEE-9 1)2)	*3.2*	*4.0*	*4.3*	*3.8*	*3.9*	*-0.2*	*-0.7*	*1.4*	*2.6*	*2.9*
	NON-EU-11 1)2)	*-0.2*	*1.1*	*2.9*	*2.7*	*2.7*	*13.8*	*8.0*	*7.1*	*5.5*	*5.6*
	CESEE-22 1)2)	*1.0*	*1.7*	*3.3*	*3.0*	*3.0*	*9.7*	*5.6*	*5.5*	*4.5*	*4.6*

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
BG	Bulgaria	9.2	7.6	6.4	6.0	5.5	0.0	5.3	4.9	4.1	3.0
CZ	Czech Republic	5.1	4.0	3.5	3.3	3.5	0.2	1.1	0.6	0.2	0.1
EE	Estonia	6.2	6.8	6.5	6.0	5.8	2.0	1.9	1.8	1.0	0.4
HR	Croatia	16.2	13.1	13.0	12.0	11.5	4.6	2.5	3.0	2.0	1.9
HU	Hungary	6.8	5.1	4.3	4.3	4.3	3.5	6.1	4.3	4.0	3.2
LT	Lithuania	9.1	7.9	7.2	6.5	6.0	-2.8	-1.1	-1.4	-2.0	-2.4
LV	Latvia	9.9	9.6	9.2	8.8	8.4	-0.5	1.4	-0.4	-1.7	-2.3
PL	Poland	7.5	6.2	5.0	4.5	4.5	-0.6	-0.3	0.2	-0.1	-0.2
RO	Romania	6.8	5.9	5.0	4.8	4.5	-1.2	-2.1	-3.0	-3.3	-3.5
SI	Slovenia	9.0	8.0	7.0	6.5	6.0	4.4	5.2	6.0	4.2	4.1
SK	Slovakia	11.5	9.7	8.3	7.7	7.2	-1.8	-1.5	-1.2	-0.6	0.3
	EU-CEE 1)2)	*7.8*	*6.5*	*5.6*	*5.2*	*5.0*	*0.1*	*0.8*	*0.5*	*0.1*	*0.0*
	EA-19	*10.9*	*10.0*	*9.1*	*8.6*	*8.1*	*3.7*	*3.6*	*2.9*	*2.5*	*2.5*
	EU-28 3)	*9.4*	*8.6*	*7.8*	*7.5*	*.*	*2.0*	*2.0*	*1.8*	*1.6*	*.*
AL	Albania	17.1	15.2	14.0	13.0	12.5	-8.6	-7.6	-8.6	-9.3	-9.4
BA	Bosnia and Herzegovina	27.7	25.4	20.2	19.4	18.8	-5.7	-5.1	-4.6	-4.5	-4.5
ME	Montenegro	17.6	17.4	16.0	15.0	15.0	-13.2	-18.1	-19.8	-19.8	-19.6
MK	Macedonia	26.1	23.7	23.0	23.0	23.0	-2.0	-2.7	-1.0	-0.8	-0.7
RS	Serbia	17.7	15.3	15.0	14.0	14.0	-4.7	-4.0	-4.2	-4.5	-5.0
XK	Kosovo	32.9	27.5	29.5	27.0	25.2	-8.6	-9.2	-10.0	-10.6	-11.1
	WB 1)2)	*21.2*	*18.7*	*17.6*	*16.6*	*16.3*	*-5.8*	*-5.6*	*-5.7*	*-5.9*	*-6.2*
TR	Turkey	10.3	10.9	11.0	10.6	10.4	-3.7	-3.8	-4.1	-3.9	-3.9
BY	Belarus 4)	1.0	0.8	0.9	0.8	0.7	-3.3	-3.6	-2.6	-2.9	-3.0
KZ	Kazakhstan	5.0	5.0	5.0	5.0	5.0	-2.8	-6.5	-2.8	-1.7	-1.8
RU	Russia	5.6	5.5	5.4	5.4	5.2	5.0	2.0	2.9	2.9	1.7
UA	Ukraine	9.1	9.3	9.4	9.0	8.5	-0.2	-3.7	-3.4	-4.0	-3.9
	CIS + Ukraine 1)2)	*5.9*	*5.9*	*5.9*	*5.8*	*5.6*	*3.6*	*0.7*	*1.9*	*2.0*	*1.0*
	V-4 1)2)	*7.3*	*5.9*	*4.9*	*4.5*	*4.5*	*0.1*	*0.8*	*0.7*	*0.5*	*0.4*
	BALT-3 1)2)	*8.7*	*8.2*	*7.7*	*7.1*	*6.7*	*-0.9*	*0.4*	*-0.3*	*-1.2*	*-1.7*
	SEE-9 1)2)	*12.8*	*11.2*	*10.2*	*9.6*	*9.3*	*-1.4*	*-1.2*	*-1.7*	*-2.2*	*-2.5*
	NON-EU-11 1)2)	*7.6*	*7.6*	*7.6*	*7.4*	*7.2*	*0.9*	*-1.0*	*-0.2*	*-0.2*	*-0.9*
	CESEE-22 1)2)	*7.6*	*7.3*	*7.1*	*6.8*	*6.6*	*0.7*	*-0.4*	*0.1*	*-0.1*	*-0.6*

1) wiiw estimates. - 2) Current account data include transactions within the region (sum over individual countries). -
3) Forecasts estimated by wiiw. - 4) Unemployment rate by registration.

Source: wiiw, Eurostat. Forecasts by wiiw (October 2017), ECB for Euro area (September 2017) and European Commission for EU (Spring Report, May 2017).

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TABLES AND FIGURES

The statistical data until 2016 presented in this report are as of 20 October 2017, forecasts as of October 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
V-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
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

CESEE back on track to convergence

BY PETER HAVLIK[1]

FAVOURABLE EXTERNAL ENVIRONMENT – DESPITE HEIGHTENED POLITICAL RISKS

The outlook for the world economy has improved further in the last couple of months. The economic recovery has been gaining strength since mid-2017 in Europe as well – despite persistent geopolitical challenges and related uncertainties. Some of these uncertainties may even have increased recently (Russia, migration, Brexit and the Trump presidency), and new tensions have emerged on the Korean Peninsula, in Syria, Iraq and Iran. Conflicts surrounding the Catalan referendum may potentially undermine the stability not only of Spain, but of the whole EU, since other latently separatist regions may follow. Despite this, global economic growth has accelerated in the course of 2017, to 3.6% according to the International Monetary Fund's (IMF) latest World Economic Outlook (WEO) from October, and the performance of the major world economies – the USA, the European Union (particularly Germany, which is the most important trading partner of Central, East and Southeast Europe (CESEE)), China and India – has been surprisingly resilient. Indeed, after a dip in 2016, GDP growth is expected to accelerate to more than 2% in 2017 in both the USA and the euro area. Growth will remain robust – at nearly 7% in 2017 – in China as well. Despite some modest increase in energy prices and improving labour markets, both wage growth and inflationary pressures are largely being kept in check. Most importantly, inflation in the euro area will accelerate a little in 2017 (after fears of deflation over the past couple of years), but is expected to remain safely below the European Central Bank's (ECB) 2% target in the forecasting period.

With presidential elections in France and parliamentary elections in Germany now over, Brexit could open up a window of opportunity for advancing badly needed reforms at the EU level. Both the EU Commission President Juncker and the recently elected French President Macron have launched initiatives aimed at fostering EU integration. But especially Mr Macron's proposals to establish a common budget for the eurozone and to create an office of EU finance minister are highly controversial: in Germany, the new government coalition fears that such an attempt could lead to the stealthy establishment of a 'transfer union'. Meanwhile the Visegrád states, especially those that are still outside the eurozone (Czech Republic, Hungary and Poland), fear that a separate eurozone budget would lead to the establishment of a 'two-speed Europe' and that they would be left behind. None of these countries is eager to join the eurozone in the foreseeable future, and nor are they willing to accept obligatory quotas for the relocation of migrants from Greece and Italy. Together with illiberal domestic developments (especially in Hungary and Poland), these latent conflicts with the 'core' EU could easily escalate – during negotiations over the next (post-Brexit) EU budget at the latest (EU transfers to the EU-CEE have been quite important in recent years, in the range of 2-5% of GDP). Brexit will have a

[1] The author would like to thank Amat Adarov, Vasily Astrov, Vladimir Gligorov, Richard Grieveson, Mario Holzner, Sándor Richter, Robert Stehrer and Hermine Vidovic for comments on an earlier draft, as well as Clive Liddiard for English-language edits.

number of other previously unanticipated consequences for the rest of the EU, too. For example, a bilaterally agreed sharing of the current EU-wide tariff rate quotas on agricultural imports between the UK and the post-Brexit EU-27 (which would formally conform with the World Trade Organisation) would most likely not be automatically acceptable to the USA, Australia or New Zealand – all three being major EU (and especially UK) sources of food imports. In the CESEE region, Poland and the Baltic States will be particularly affected by Brexit.[2]

The current assessment of global economic prospects is favourable. Both the latest Organisation for Economic Co-operation and Development (OECD) Economic Outlook (from September 2017)[3] and the IMF World Economic Outlook (from October 2017) are now more upbeat than previously. The latest IMF World Economic Outlook not only contains a more optimistic assessment of the global economy than was the case in July 2017, but also provides upward revisions of GDP growth forecasts for both 2017 and 2018 in the USA, the euro area (including Germany, France and Italy), Russia and especially emerging and developing Europe.[4] The IMF currently expects growth in the euro area to exceed 2% in 2017 and to stay close to that (1.9%) in 2018. This represents an upward revision of the previous forecast of 0.2 percentage points (pp) in both years. Importantly, the favourable GDP growth outlook is not endangered by rising inflation. In fact, inflation forecasts have even been revised downwards: consumer prices are now projected to increase by just 1.7% in the advanced economies in both 2017 and 2018. By and large, this is a welcome uptick compared to previous deflation fears, though these fears have not yet been completely allayed – especially in the euro area – according to the IMF assessment. Commodity prices (especially oil) picked up in 2017, but are forecast to remain stable in 2018. There is no imminent danger of demand-pull inflation in most advanced economies, where high economic growth has not (yet) translated into higher wages (this is in contrast to the situation in most of CESEE, where wages have been increasing strongly – see below).

The cyclical recovery is expected to continue in the advanced economies, albeit at a somewhat lower speed owing to (largely) demographic constraints on potential output and only weak total factor productivity growth. In contrast, the IMF expects growth acceleration in emerging economies in the medium term. Risks to the short-term forecast are two-sided and are broadly balanced. But in the medium term, the financial stability risks in China, global financial tightening, rising protectionism and a host of other non-economic factors may adversely affect economic prospects. The IMF latest WEO also sees the current cyclical upturn as an 'ideal window of opportunity for making progress in reforms', especially in labour markets in the advanced economies.

INTERNATIONAL GDP AND TRADE GROWTH ARE HELPING CESEE

GDP growth and import trends for key CESEE trading partners point upwards (Figure 1). Stronger Western GDP growth and rising demand for imports continue to fuel exports from the CESEE region. The major stock markets in the USA, Europe and China, as well as the economic sentiment trends in the EU, Central and Eastern Europe, Western Balkans and Turkey, are all on the rise, seemingly

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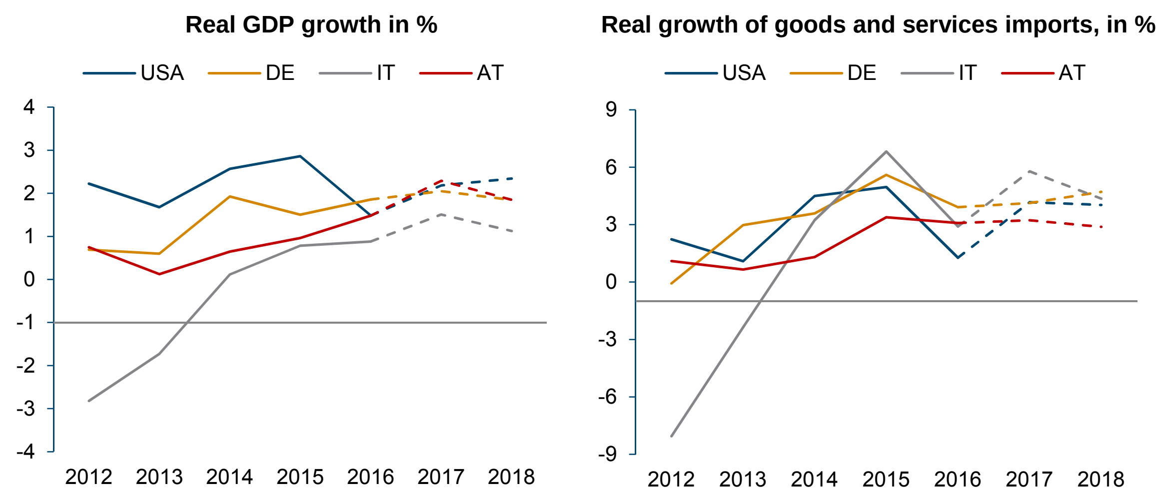
2 For more on Brexit's effects on the EU-CEE, see: https://wiiw.ac.at/five-things-for-eu-cee-to-watch-in-brexit-negotiations-n-229.html

3 See: 'Short-term momentum: will it be sustained?', OECD Economic Outlook presentation, September 2017, www.oecd.org/economy/economicoutlook.htm

4 See: https://www.imf.org/en/Publications/WEO/Issues/2017/09/19/world-economic-outlook-october-2017

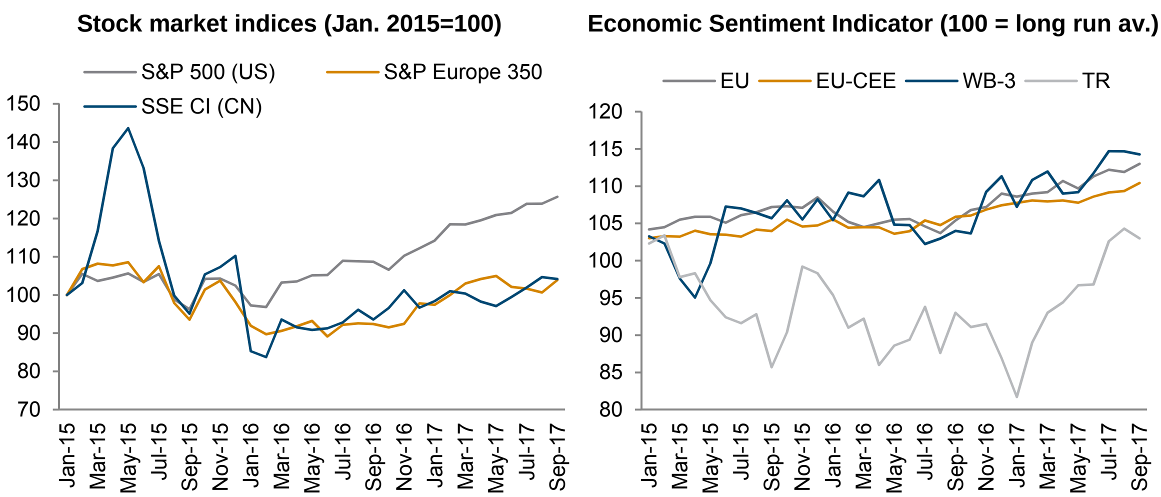
undisturbed by existing political risks (Figure 2). Especially Turkey's market sentiment indicator has risen markedly since January 2017, driven by a very strong fiscal push, higher growth in the EU (especially strong German demand, which is driving Turkish goods export growth) and the revival of Russian tourism. Both economic developments and investors' sentiments are thus apparently decoupled from politics.

Figure 1 / International GDP and import trends



Note: Dashed lines are forecasts.
Source: WEO (IMF), October 2017.

Figure 2 / International stock market and economic sentiment trends



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

Major commodity prices (oil, metals and grain) are expected to stay relatively flat in the short and medium term, without any major fluctuation in either direction, as demand and supply factors will cancel out one another. The Brent oil price, for example, will likely stay within the USD 50-60 per barrel corridor, as the key driving forces (rising global output and demand, new supply factors arising from shale deposits, geopolitical and technological developments) are not expected to shift energy prices decisively in either direction in the near future – although many uncertainties obviously remain.[5] The current oil price of some USD 55 per barrel is acceptable to the Organisation of the Petroleum Exporting Countries (OPEC) and the other major producers (such as Russia and Kazakhstan), which have all enjoyed rising export revenues in 2017, as well as to EU-CEE importers, who have not felt the inflationary pressures too much.

ROBUST GDP GROWTH IN MOST OF THE CESEE REGION

Particularly the Central and East European EU Member States (EU-CEE) have enjoyed robust (and sometimes even accelerating) growth over the past couple of years, and this trend has even strengthened recently (Figure 3). Romania, Hungary, Poland and the Czech Republic have reported near record GDP growth rates in the first half of 2017, at least by post-crisis standards. Estonia, Latvia, Lithuania and Slovenia are growing strongly as well. With annual growth rates close to or even above 4%, their economic convergence with Western Europe has gained momentum. Indeed, in all EU-CEE countries, GDP growth has been higher than in the eurozone: their average growth will exceed 4% in 2017. A similar development can be observed in most of the Western Balkans, with Serbia and Macedonia being important exceptions.

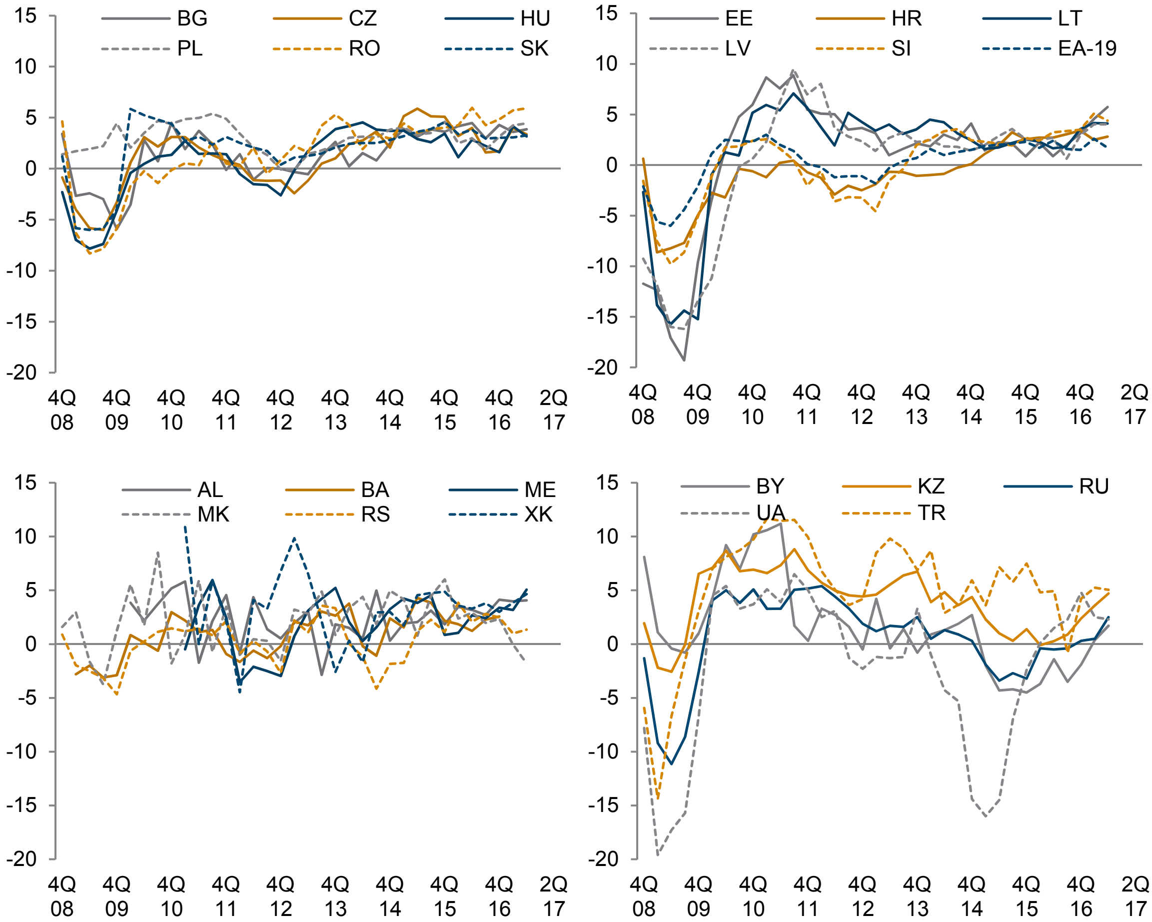
The growth performance of the Western Balkans (2.5% on average in 2017, 0.5 pp less than in 2016) and **Turkey** (more than 5% in 2017, 2.4 pp more than in 2016) has again been uneven, and in the Western Balkans growth is less spectacular than in the EU-CEE, though growth rates of around 3% per year have at least helped to somewhat stabilise the local labour markets (see below).

Russia, Kazakhstan and Ukraine are finally also emerging from recession. Even Belarus, which has been hit hard by the Russian crisis, is struggling to overcome external shocks emanating from the east and has so far failed to address its deep structural distortions, is recovering in 2017. This is largely thanks to the economic revival in Russia and bilateral agreements about preferential oil and gas deliveries. In Belarus, and especially in Kazakhstan and Russia, the current recovery is largely a result of the recent increase in (and subsequent stabilisation of) the price of oil. The upswing in Ukraine is the result of recovery from a very deep recession in 2014-2015; it has also been assisted by less restrictive fiscal policy. However, with growth forecast to be below 2% in 2017, and just fractionally higher later, the whole Commonwealth of Independent States (CIS) region (and probably Ukraine as well) will not follow the EU-CEE's return to a growth convergence path (see also the special section on convergence in this report).

[5] Nevertheless, the Russian authorities operate in their baseline budget and GDP growth scenarios for 2018-2020 with a more conservative projection of oil price developments (slightly above USD 40 per barrel).

Figure 3 / Quarterly real GDP growth of the CESEE countries

change in % against preceding year



Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Overall, across most of the CESEE region, the economic outlook has improved markedly. The current GDP forecast for 2017 was revised upwards in all EU-CEE countries (Table 2). Despite continuing political uncertainties both within and outside the region, economic convergence is here largely back on its pre-crisis track (which it left abruptly a decade ago). Farther east, especially in Russia, but also in the Western Balkans, the post-crisis recovery has been much weaker, with GDP growth lagging behind, forecasts being revised downwards (Macedonia, Montenegro and Serbia) and economic convergence delayed. Given these divergent growth paths in the EU-CEE, the Western Balkans and Russia, it is now important to ascertain the key driving forces behind the present resumption of convergence, and why parts of the region are lagging behind.

Table 2 / Real GDP growth: current forecast and revisions

		Forecast, %			Revisions, pp		
		2017	2018	2019	2017	2018	2019
EU-CEE	BG	3.8	3.7	3.5	0.9	0.6	0.2
	CZ	3.7	3.2	3.0	1.3	0.6	0.7
	EE	3.8	3.3	2.9	1.6	1.0	0.5
	HR	3.0	2.7	3.0	0.2	-0.2	0.0
	HU	4.0	3.9	3.0	0.7	0.5	-0.1
	LT	3.8	3.5	2.8	1.1	0.7	-0.3
	LV	4.2	3.8	3.2	1.7	1.1	0.4
	PL	3.8	3.5	3.3	0.9	0.5	0.2
	RO	5.7	4.5	4.6	1.7	0.5	0.6
	SI	4.0	3.9	3.7	1.1	1.0	0.7
	SK	3.3	3.6	4.0	0.2	0.0	0.1
WB	AL	3.9	4.2	4.1	0.4	0.3	0.1
	BA	3.0	3.4	3.5	0.2	0.4	0.4
	ME	2.7	2.9	3.0	-0.4	0.0	-0.3
	MK	1.8	3.1	3.4	-1.3	-0.2	0.4
	RS	1.9	2.5	2.7	-0.9	-0.5	-0.6
	XK	3.7	3.8	3.8	-0.2	0.0	0.1
Turkey	TR	5.4	3.9	3.9	3.3	1.3	0.8
CIS +UA	BY	2.0	2.3	2.6	1.5	0.7	0.4
	KZ	3.0	3.0	3.5	1.0	0.0	0.5
	RU	1.7	1.9	1.9	0.0	0.2	-0.1
	UA	2.0	3.0	3.0	-0.5	0.0	0.0

Note: Current forecast and revisions relative to the wiiw spring forecast 2017. Colour scale reflects variation from the minimum (red) to the maximum (green) values.
Source: wiiw forecast (Autumn 2017).

LABOUR MARKET IMPROVEMENTS – TOO GOOD TO LAST IN SOME PLACES?

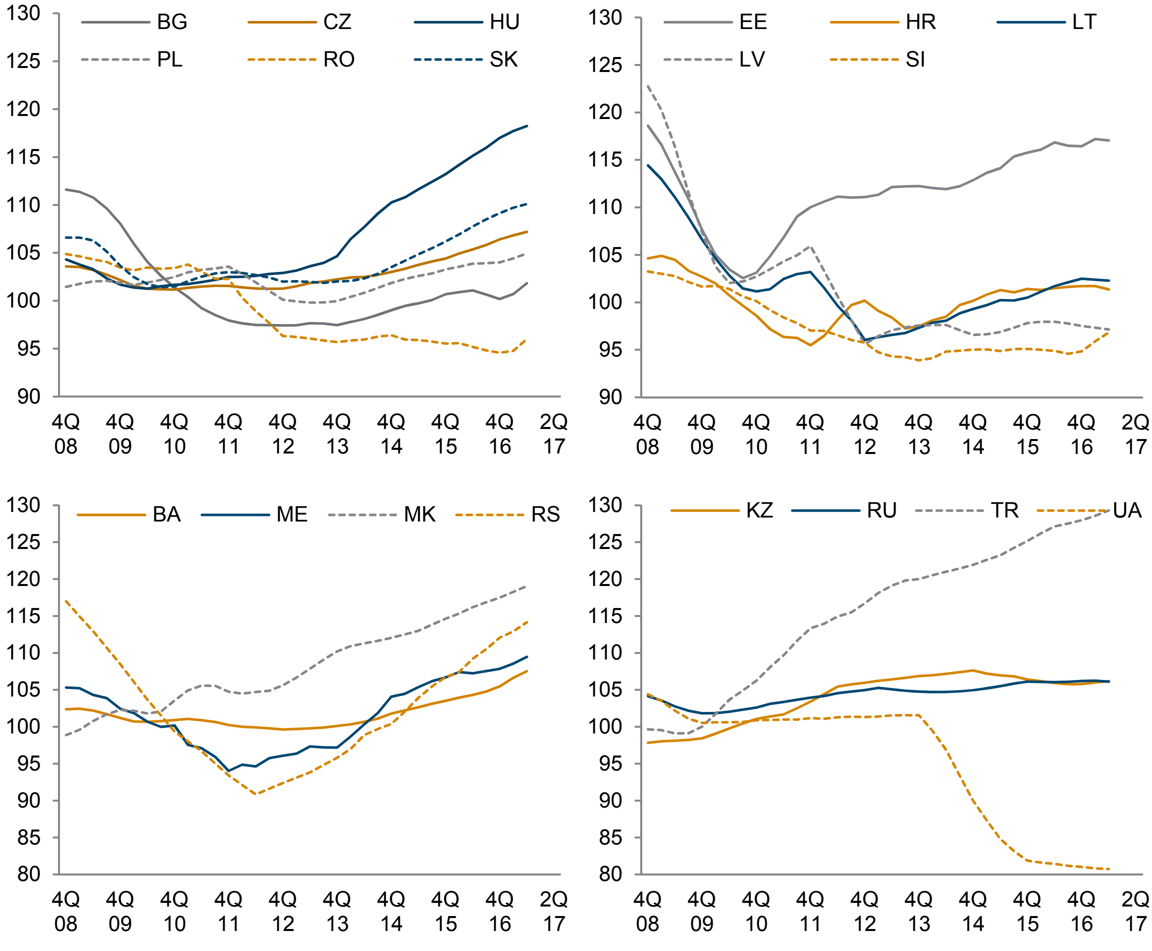
Improvements in CESEE labour markets are spectacular. With few exceptions (such as Bulgaria, Romania, Latvia and Slovenia), the number of employed persons in most CESEE countries now exceeds the pre-crisis level (this contrasts with the aggregate situation in many advanced economies – especially in the United States – where labour force participation levels in 2016 were still below the pre-crisis level).[6] Employment growth has been especially impressive in Hungary, Estonia and Slovakia, in the Western Balkans and in Turkey (Figure 4). In contrast, employment trends have been flat in Kazakhstan and Russia (and sharply negative in Ukraine, owing to the conflict in Donbas) – which corresponds neatly to their weaker output development. In actual fact, the rising employment levels are on average associated with GDP growth rates of at least 3%, which represents an earlier estimated threshold for employment elasticity to GDP growth in the CESEE.[7]

6 IMF WEO, October 2017, p. 9 and Chapter 2.

7 V. Astrov et al. (2013), 'Double-dip recession over, yet no boom in sight', *wiiw Current Analyses and Forecasts*, No. 11, March.

Figure 4 / Labour market trends - employed persons

LFS, thousand, based on 1Q 2010=100, 4 quarters moving averages

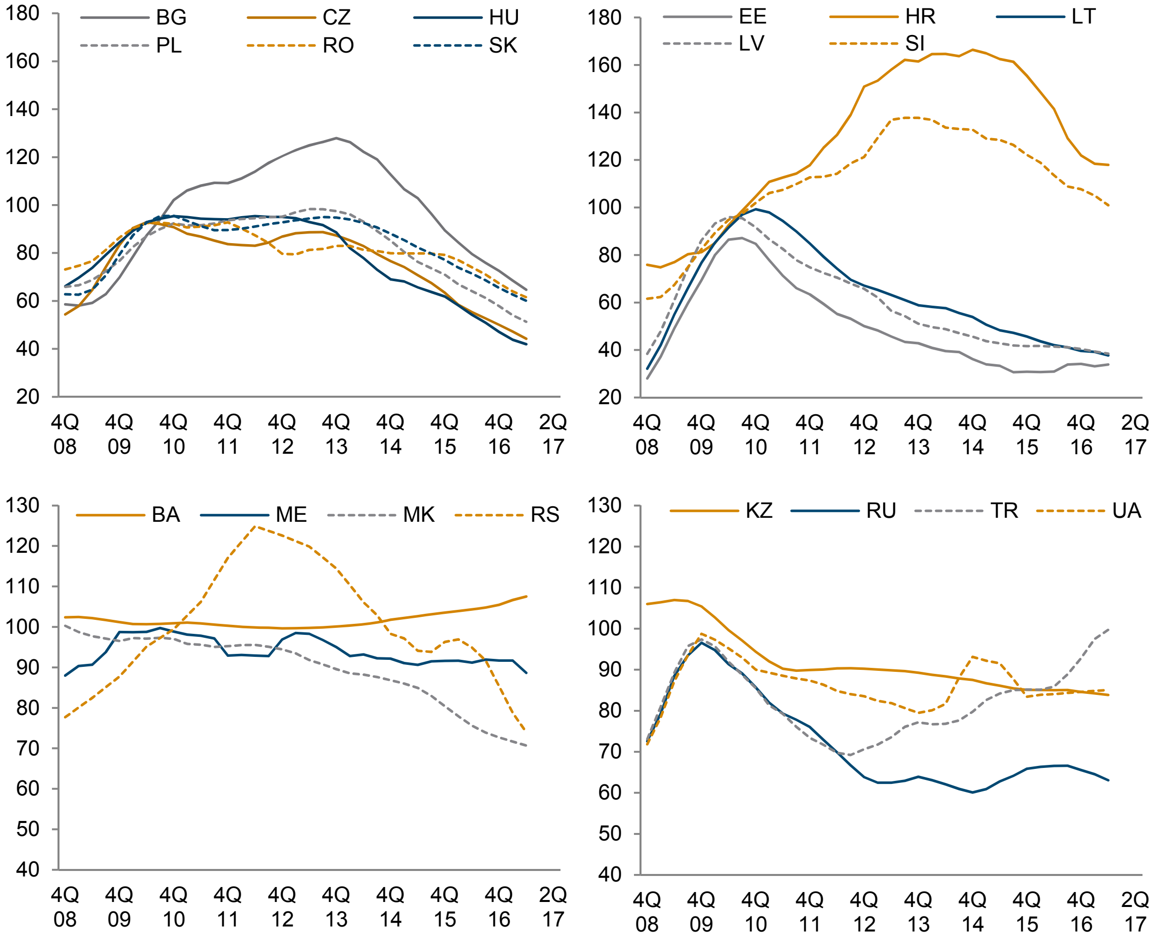


Note: BA: employees registered.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Rising employment levels are mirrored by declining unemployment (Figure 5). Again, with a few exceptions (such as Bosnia and Herzegovina and Turkey) the number of unemployed persons is not only below the post-crisis peak (which differs in the individual CESEE countries), but is frequently even below the pre-crisis level (for example, in the Czech Republic, Hungary and Slovakia, as well as in Macedonia, Serbia and Russia). In Hungary, Estonia and Macedonia (as well as in Turkey), the number of employed persons increased by about 20% during the period 2010-2017. By contrast, the conflict-prone Ukraine has witnessed a drop in employment of about 8% since the outbreak of the conflict in late 2013 (though adjusted for Crimea and parts of Donbas, the drop in employment was lower than the fall in GDP; the unemployment rate remains in single digits). The number of unemployed persons fell by 40-60% in the EU-CEE between 2010 and 2017 (with the exceptions of Croatia and Slovenia). Even in Bosnia and Herzegovina, as well as in Serbia, employment is growing, though the number of (registered) unemployed is also still rising. Apart from higher economic growth, demographic factors such as a shrinking labour force, an ageing society and constant outward migration are key factors behind the falling unemployment rates in several EU-CEE countries.

Figure 5 / Labour market trends - unemployed persons

LFS, thousand, based on 1Q 2010=100, 4 quarters moving averages

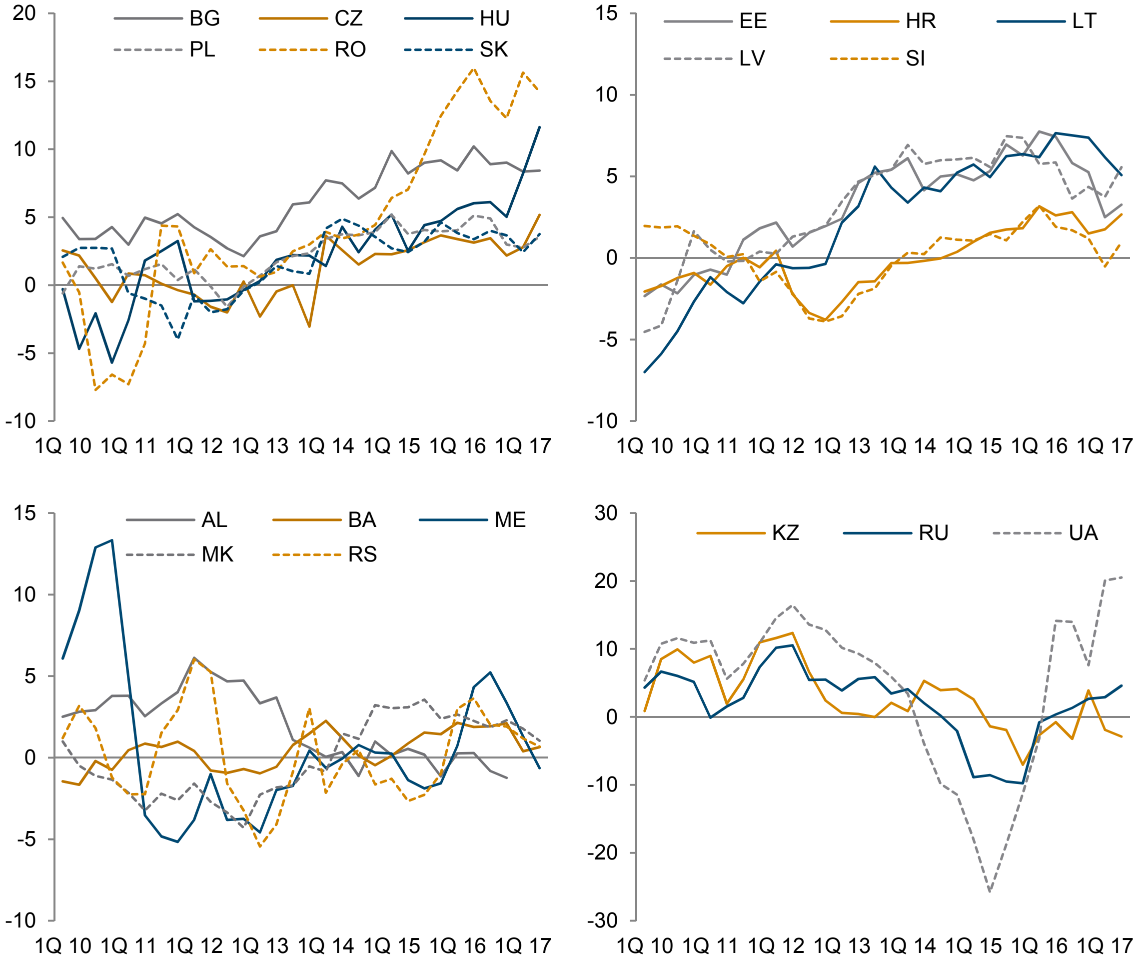


Note: BA: unemployed registered.
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

But it is important to note that the unemployment rates differ widely across countries. In 2017, the average unemployment rates ranged from 3.5% in the Czech Republic and 4.3% in Hungary to double digits in the Western Balkans (and close to 30% in Kosovo!). The situation on CESEE labour markets thus currently varies from de facto full employment (Czech Republic) to low unemployment rates (Hungary – although there some controversial labour market practices of de facto forced labour are being used, similar to measures used by Slovakia and Belarus) to a still considerable degree of slack (Bosnia and Herzegovina, Macedonia and Kosovo). Yet even in countries where the labour market situation is a long way from full employment (the latter judged, for example, by still high unemployment rates), reports about serious labour shortages have become more frequent recently. Apart from the Czech Republic, serious shortages of labour are reported in Hungary, Poland and Slovakia, and even in Bulgaria and Romania. Except Slovakia (where the unemployment rate is above 8%), all these countries have unemployment rates of below 5%. In most of them, labour shortages – especially, but not solely, a shortage of skilled workers – are putting a brake on the expansion of output and are inducing wage pressures (see below). Yet many existing vacancies in the EU-CEE are being filled by migrant workers, who come mainly from Ukraine, but also from Moldova and Serbia. It is reported, for example, that more than 1 million Ukrainians are currently working in Poland, several hundred thousand Ukrainian workers are employed in the Czech Republic. (another several thousand Poles and Slovaks work in the Czech Republic.) Many migrant workers are engaged in the shadow economy, since the number of work permits officially issued is not adequate to fill all the available vacancies (as reported by, for example, the Czech Republic).[8] A large number of migrant workers – mostly from Central Asia, Ukraine and Moldova – are employed in Russia.

Figure 6 / Average monthly real gross wages total

change in % against preceding year



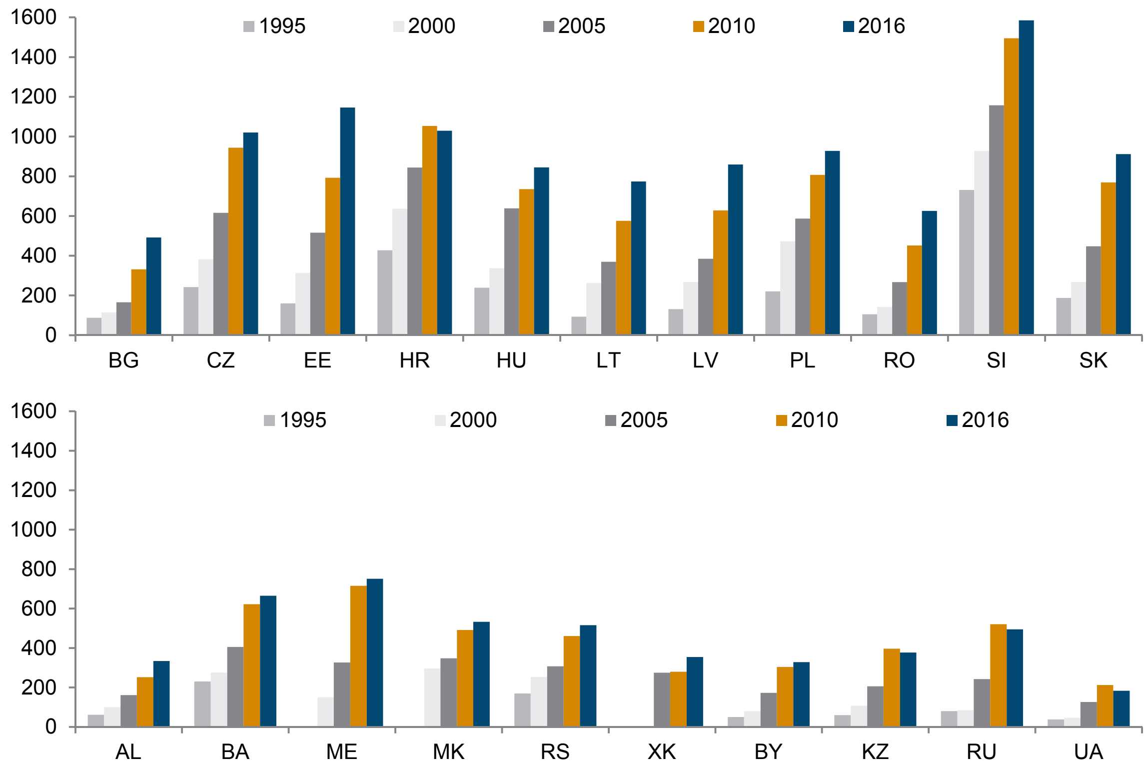
Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Hand in hand with rapidly rising output and emerging labour shortages, we also observe growing wages; in several countries this is quite spectacular (Figure 6). For example, in the Czech Republic average real wages increased by 4% year on year in the first half of 2017; in Hungary by 10%; in Romania by 14.4%; in Slovakia by 3.8%; and in Ukraine by as much as 20%. In some countries, wage increases have been driven by administrative hikes in the minimum wage (as in Romania and Ukraine); elsewhere trade union action has pushed up wages (for example, the recent strike at the Volkswagen

8 According to the Czech Industry and Transport Union, the Czech economy could immediately employ 140,000 additional workers; see: http://ekonom.ihned.cz/c1-65911800-stat-by-mel-firmam-ukazat-i-svou-lepsi-tvar.

plant in Bratislava or similar strike threats in the Czech automotive industry). Indeed, both rising wages and labour shortages are likely to become more widespread in future throughout the CESEE region. Tightened labour markets (rising employment, declining unemployment and widespread labour shortages) are thus mirrored by wage developments. We observe a clearly accelerating growth in real wages, especially in Bulgaria, Hungary and Romania, but also elsewhere in the EU-CEE region. Again, the Western Balkans are different in this respect, as real wages have either stagnated or even declined in 2017. The extraordinary increase in real wages in Ukraine can be attributed largely to a rise in the minimum wage (as, for example, in Romania), as well as to other regulatory measures aimed at combating the shadow economy.

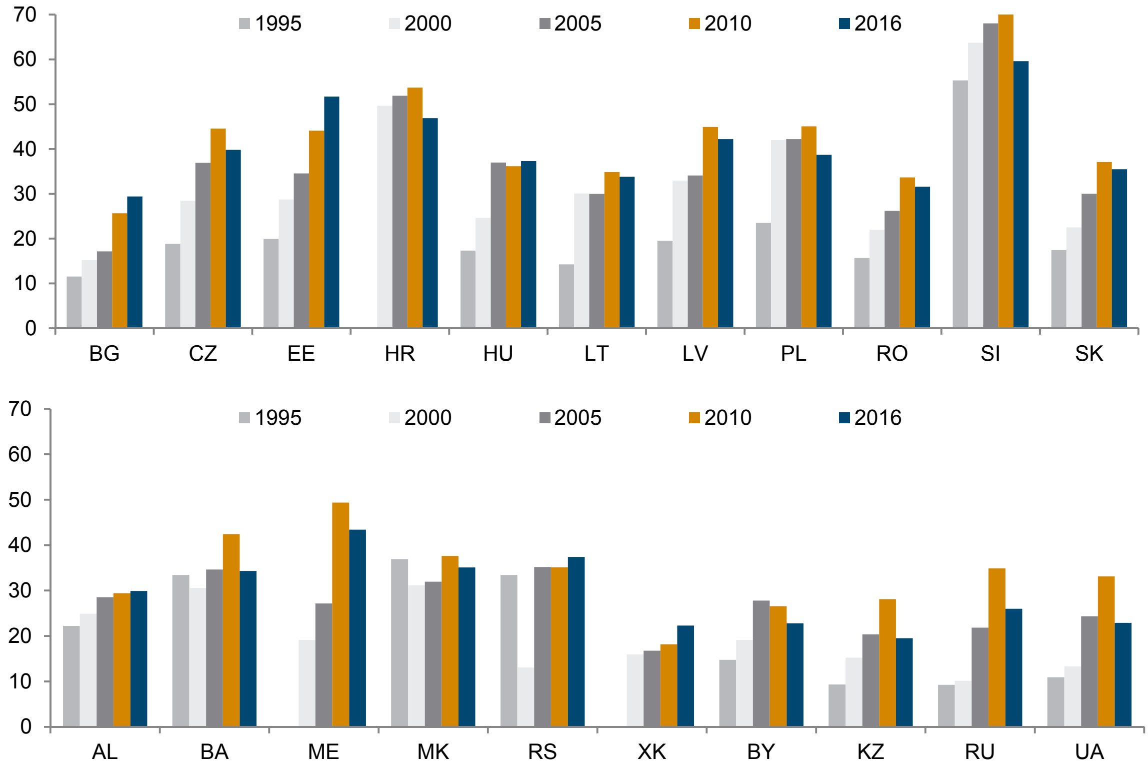
Figure 7 / Average monthly gross wages, EUR (ER)



Note: Data 1995: Bosnia and Herzegovina 1996, Serbia 1999.
Source: wiiw Annual Database incorporating national and Eurostat statistics.

However, CESEE labour cost competitiveness is not yet endangered. It is important to note in this context that although wage growth has sometimes outpaced the growth in productivity, and that unit labour costs have been rising (e.g. in Bulgaria, the Baltic States and Belarus – see Figure 8 and Appendix), the levels of unit labour costs and especially of wages are still far below those in Western Europe (Figure 7). Unit labour costs in the Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia have not been rising too much over the past couple of years, as wages have largely risen in line with productivity, and so labour cost competitiveness has been maintained. On average, the unit labour cost adjusted for productivity and exchange rate levels is below 50% of the Austrian level (except in Slovenia, where it is 60% of that level – Figure 8). Average monthly gross wages in EUR (at the exchange rate) amount to less than one third of the Austrian level in the Czech Republic, Hungary, Poland and Slovakia (and to less than half of the Austrian level in Slovenia – see Figure 7 and Appendix, Indicators of macro-competitiveness).[9]

Figure 8 / Unit labour costs, PPP adjusted, Austria = 100



Note: Data 1995: Romania and Macedonia 1996, Bosnia and Herzegovina and Serbia 1999. Data 2000: Kosovo 2004.
Source: wiiw Annual Database incorporating national and Eurostat statistics.

So far there has not been much wage-cost-induced inflationary pressure, either in the eurozone (where wage growth has been much subdued) or in the CESEE. Consumer prices have risen modestly in 2017 (after two years of deflation), but the inflation has not been excessive – with the possible exception of the Baltic States (Figure 9). Inflation has dropped spectacularly in Ukraine after the devaluation-driven spike in 2015, and is expected to drop to single digits in 2018. Russia managed to reach the central bank's inflation target (4% per year) by mid-2017, and September's inflation was just 3%. For the time being – even in countries where labour shortages are most acute and wage pressures are strong, such as the Czech Republic, Hungary, Poland and Slovakia – inflationary pressures are neither visible nor expected (the Baltic States and Romania may be exceptions). The anticipated tightening of monetary policies in the USA, probably followed with some delay by the ECB, will likely be cautious – though there is a potential danger from prolonged periods of accommodative monetary policies and the resulting reduced inflationary expectation. According to the IMF, 'low inflation and interest rates would reduce central banks' capacity to lower real interest rates to restore full employment in an economic downturn … prolonged below-target inflation deepens the downside risks to advanced economies' medium-term growth prospects'.[10] Nevertheless, we do not see such dangers as imminent –

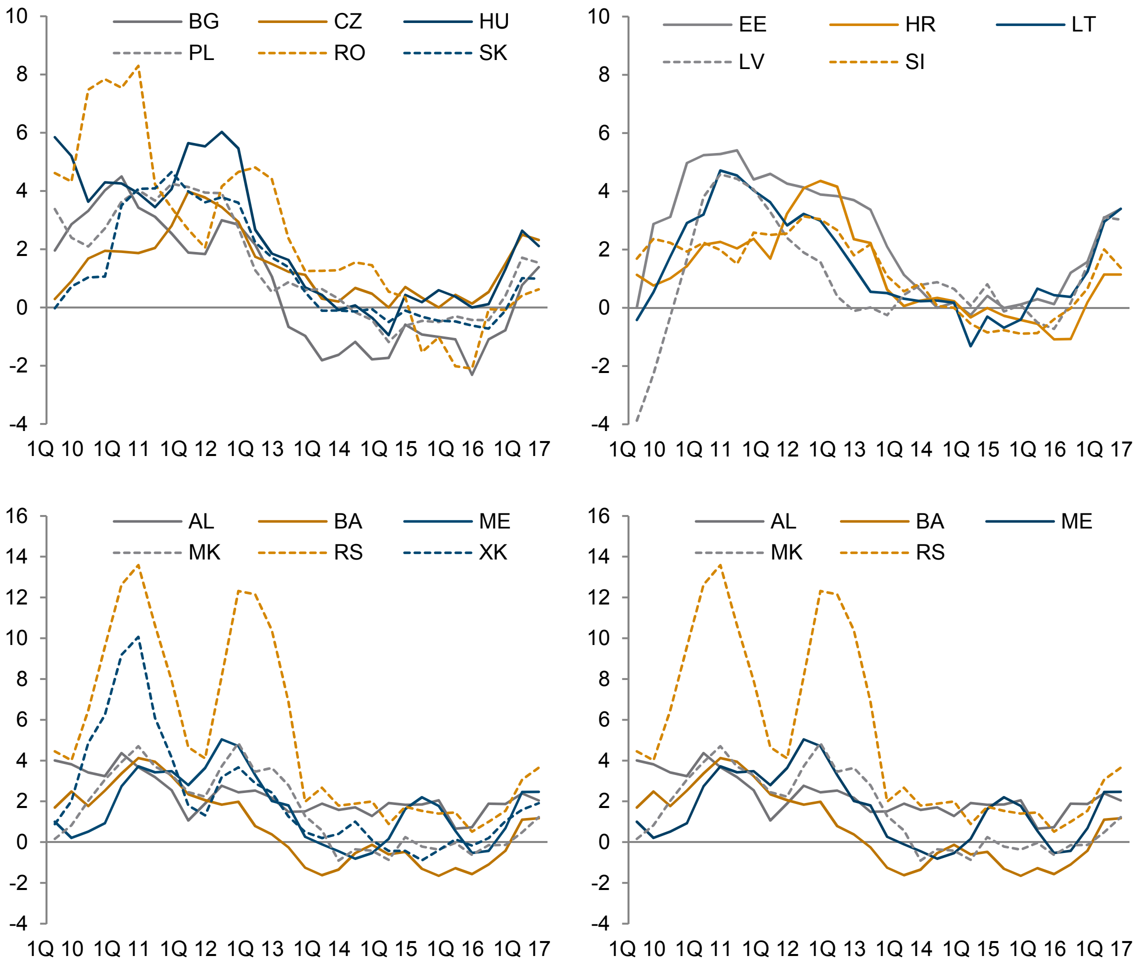
[9] The domestic purchasing power of wages is much higher owing to lower price levels in CESEE – see Appendix, Indicators of macro-competitiveness.

[10] See IMF WEO, October 2017, p. 23.

especially for CESEE, where inflation has already picked up moderately (for example, in the Baltic States). In some countries, a moderation of inflationary pressures has been assisted by appreciating currencies (e.g. in the Czech Republic and Russia) and monetary policy is perceived as excessively restrictive, inhibiting domestic credit growth and investment (this criticism is being especially voiced in Russia).

Figure 9 / Inflation (CPI)

change in % against preceding year



Source: wiiw Monthly Database incorporating national and Eurostat statistics.

BROADER-BASED AND RESILIENT GROWTH IN THE CESEE

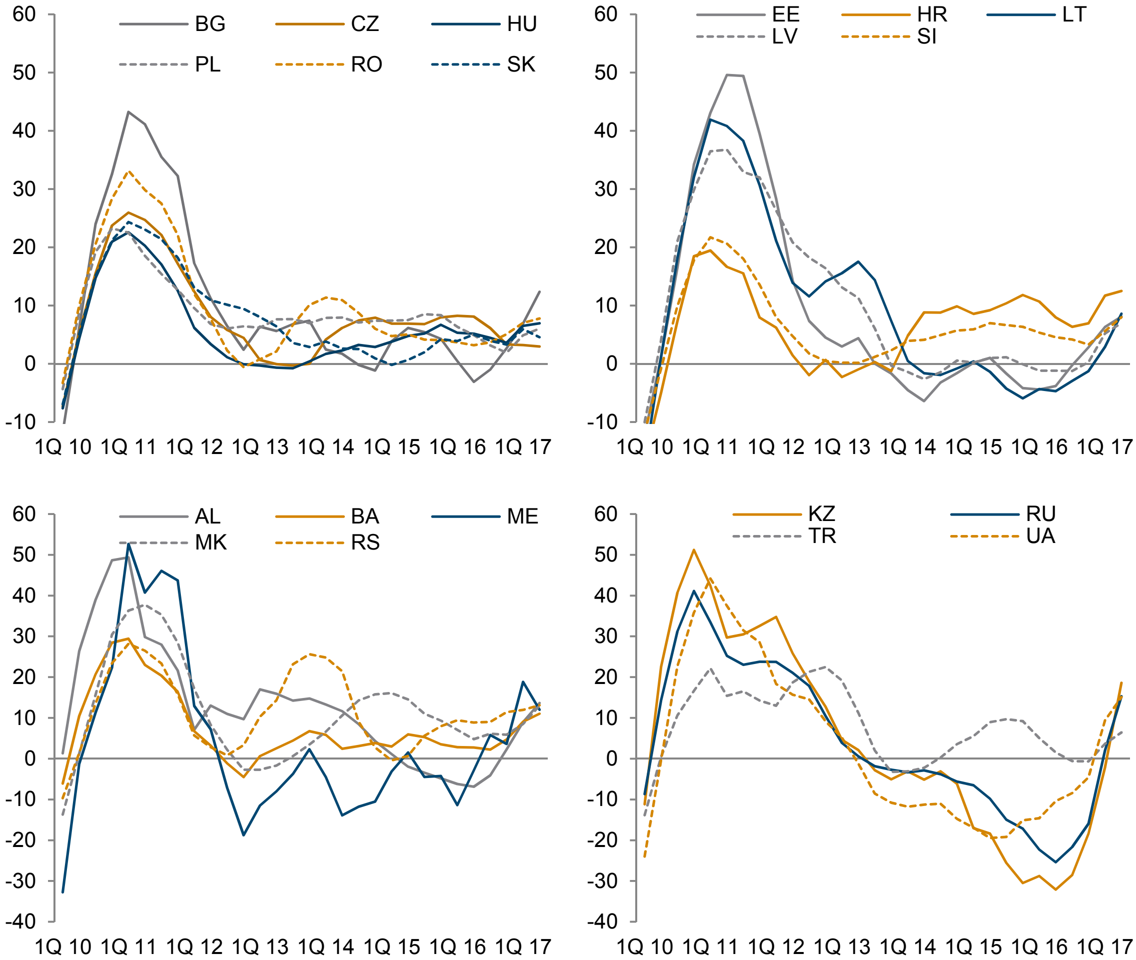
Private consumption is the main growth driver throughout most of the CESEE region, underpinned by rising real wages and household incomes. This was already identified as a key driver in last year's wiiw Autumn Forecast Report.[11] Simultaneously, declining unemployment and emerging labour shortages – both partly associated with outward migration from several countries – have already been acting not only as productivity growth drivers, but also as a potential constraint on future growth. In the wiiw 2017 Spring Forecast, we reckoned on an average GDP growth in EU-CEE of

[11] V. Astrov et al. (2016), 'Labour shortages driving economic growth?', wiiw Autumn Forecast Report, November.

3% in 2017, with a slight upward trend. In the current forecast, we revise the average GDP growth in EU-CEE by 1 pp upwards (to 4% in 2017).

Gradually, along with rising private consumption, investments have also gained strength and have increasingly emerged as a driver of growth. Indeed, a robust growth in investments – supported in most EU-CEE countries by substantial transfers from the EU budget, which (despite Brexit) are expected to pick up over the forecast horizon due to the EU programme cycle, together with its higher absorption rates towards the end of the disbursement period – has been helpful in boosting overall GDP growth (even though these transfers are often accompanied by corruption scandals, e.g. in the Czech Republic, Hungary, Slovakia and Romania). Despite rising unit labour costs in parts of the CESEE region, competitiveness does not seem to be threatened, and trade balances have improved thanks to the positive effects of infrastructure investment, modernisation, restructuring and quality (including skills) improvements (except the CIS and Ukraine).

Figure 10 / Exports of goods (custom statistics) growth, 4 quarters moving averages, in %

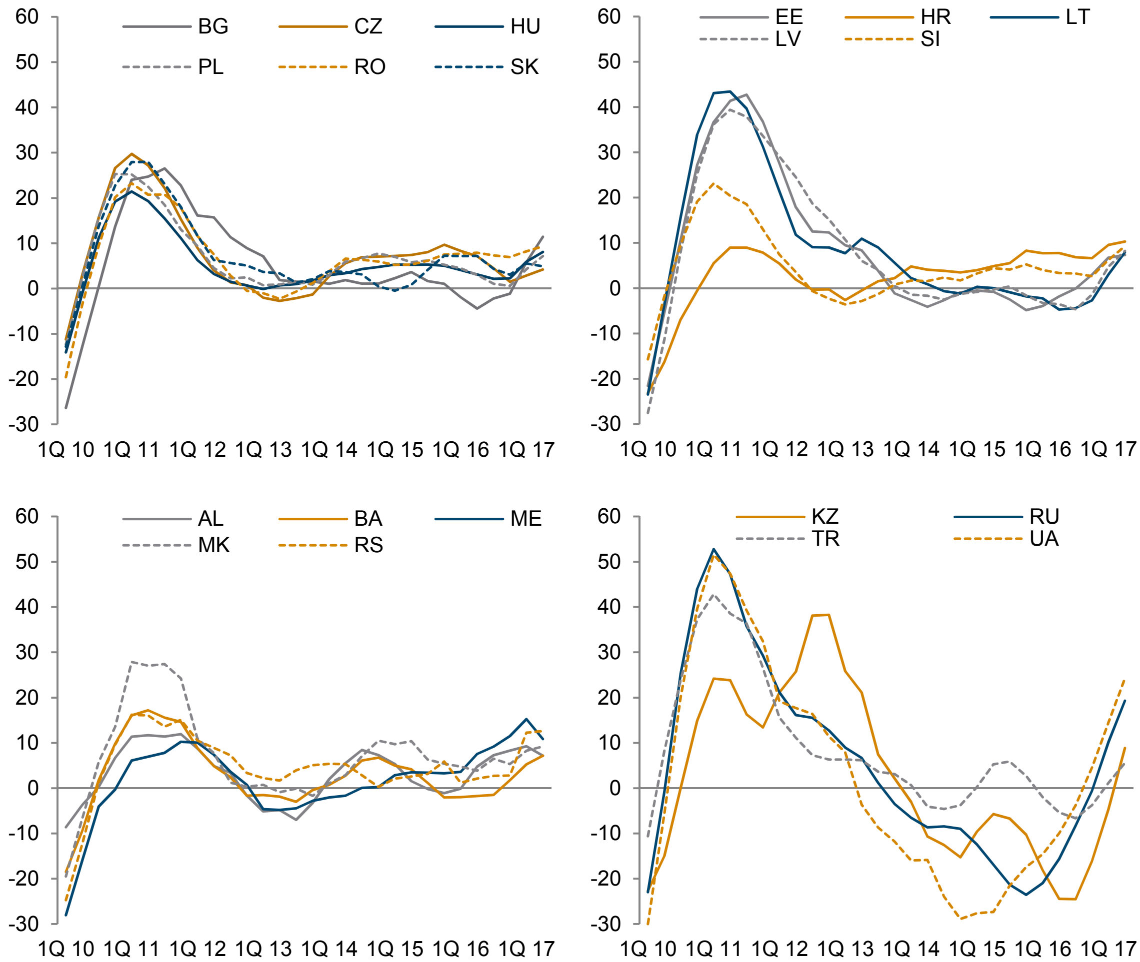


Source: wiiw Monthly Database incorporating national and Eurostat statistics.

Lasting competitiveness or even new competitive gains are evidenced also by recent foreign trade developments. Driven by vigorous demand in the eurozone, export growth (Figure 10) has generally held up or has even accelerated in the past year (in Hungary, the Baltic States and even in the

Western Balkans). Several CESEE countries (Albania, Croatia, Bulgaria, Romania and Turkey) have also benefited from rising services exports, thanks to expanding tourism at the expense of destinations in North Africa. In Kazakhstan and Russia, the upswing in nominal export growth is mainly associated with a revival of oil prices. Since both domestic consumption and investments are growing robustly, imports have recently picked up quite strongly as well (Figure 11).

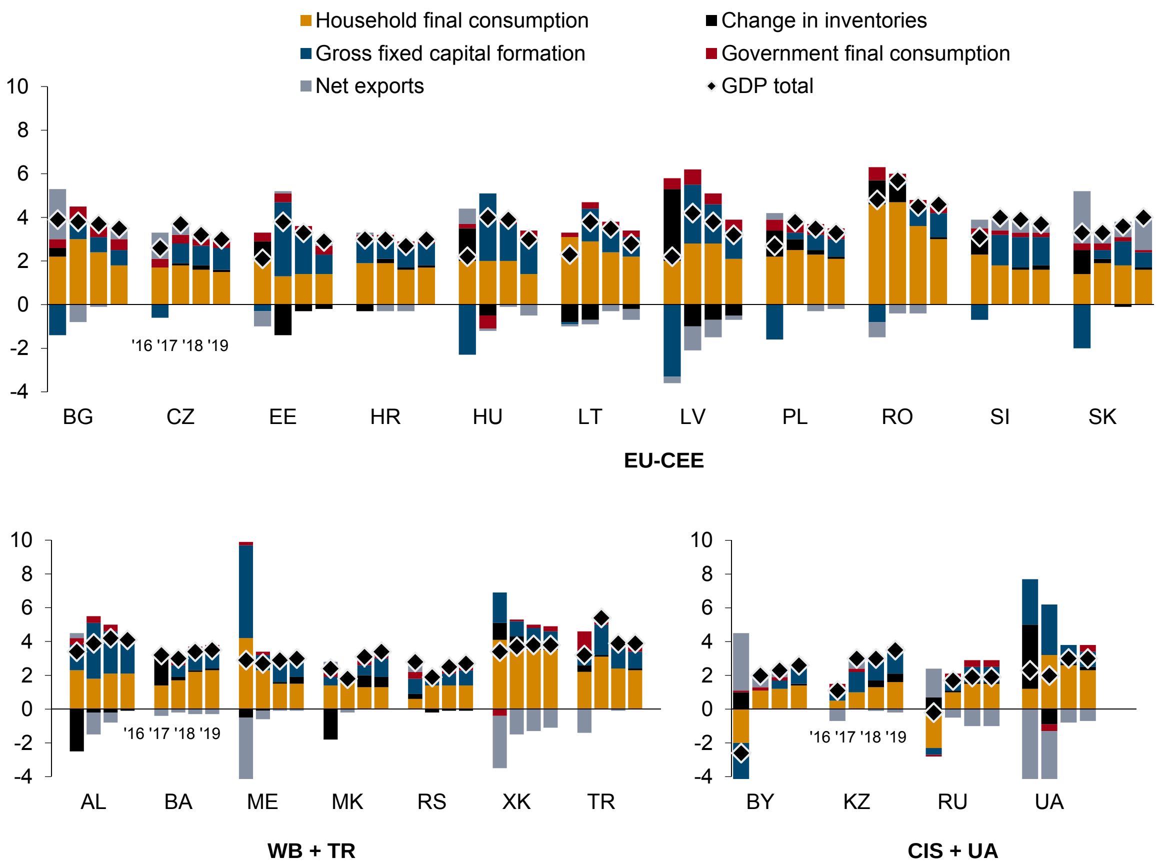
Figure 11 / Imports of goods (custom statistics) growth, 4 quarters moving averages, in %



Source: wiiw Monthly Database incorporating national and Eurostat statistics.

CESEE economic performance, supported by strong growth in the eurozone, is continuing to improve over the forecast horizon. For the most part, GDP growth forecasts have been revised upwards, the upbeat outlook being underpinned by economic recovery in the eurozone, the growth in private consumption fuelled by strongly rising wage incomes, higher transfers from the EU budget and stable (low) oil prices. The economic resilience is persisting, regardless of the continuing elevated geopolitical risks. FDI flows into the region increased in 2016 and early 2017, and business prospects generally improved as well. After household consumption and investments, it is currently also net exports that are contributing to the rapid CESEE growth. Trade balances have improved, and many EU-CEE countries (as well as Russia) also report current account surpluses (especially Bulgaria, Hungary and Slovenia) that indicate their healthy competitive position. The growth is thus becoming broader-based, more robust and probably also more sustainable. Figure 12 illustrates the recent patterns in the main GDP demand components and the wiiw forecasts for the coming two years. Household consumption will continue to be the main growth driver, supported by investments. Almost everywhere in the CESEE region (except Kosovo, Russia and Ukraine), net exports are expected to stimulate GDP growth – though their contribution will be less significant than that of domestic demand components.

Figure 12 / 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.

In terms of current GDP growth and prospects, the CESEE region is split into three sub-regions: the EU-CEE, with average growth close to 4% in the forecasting period; the Western Balkans with GDP growing by around 3%; and finally the CIS and Ukraine, where growth will be around 2% in the medium-term perspective.

As a result of more rapid economic growth, the prospects for the EU-CEE region catching up have again improved and the process of economic convergence has resumed. This catching-up process is expected to continue, according to the wiiw forecast – at least in the medium run and probably for the rest of the decade. Looking back over the longer term, in the past two decades the EU-CEE has caught up rapidly in terms of income: between 1995 and 2016, Bulgaria and the Czech Republic reduced the gap in their real per capita income compared to the EU-28 average by 15 pp, and the Baltic States, Slovakia and Romania by more than 30 pp. Croatia, Hungary and Slovenia have been less successful in this respect (although Slovenia started from an already high level – see Appendix Table A/1 and the Special section on convergence in this report).[12]

Economic growth seems not to be associated with the generally perceived adverse geopolitical tensions and related uncertainties. Importantly, economic convergence is not expected to resume in Russia, where the lack of structural change, lasting investment climate deficiencies and geopolitical conflicts impose a burden on growth. Meagre growth in Russia may well adversely affect the growth prospects of her CIS partners (Belarus in particular). But in several other CESEE countries, recent political developments are not very conducive to growth and European integration in the medium term (e.g. in the Czech Republic, Hungary, Poland, Romania, Slovakia, Turkey and Ukraine). However, for the moment economic growth seems to be unaffected by political instability.

12 It is important to note that the catching-up speed (when measured by real per capita incomes) is affected not only by income growth, but also by demography and outward migration. The latter has been particularly large in Bulgaria, Romania, Latvia, Lithuania and Ukraine, where between 2000 and 2016 the population declined by more than 10% in Bulgaria, Romania and Ukraine, and by more than 17% in Latvia and Lithuania.

Special section I: Convergence: A long-term matter

LEON PODKAMINER[13]

- **In terms of per capita GDP, the CESEE economies have been catching up with the 'old' EU. However, the convergence, which was quite rapid in the past, has been gradually slowing down. This slowdown affects primarily the more developed CESEE countries (e.g. Slovenia and the Czech Republic), which may be caught in a 'medium-income trap'. However, the least affluent CESEE economies continue to grow much faster.**

- **This pattern of convergence is consistent with the so-called 'beta-convergence hypothesis', according to which the higher the level of a country's per capita income, the slower its further growth. After using the data for a number of EU and OECD countries to establish the hypothetical relationship between income level and GDP growth, it is suggested that the EU-CEE countries (as well as Turkey and the Western Balkan countries) will close the income gap with the EU-28 at different speeds.**

- **By 2026, per capita GDP in the Czech Republic will exceed 90% of the EU-28 level, whereas in Poland and Hungary it will not even reach the 80% mark.**

The anticipated acceleration in growth in the 'old' EU in 2017-2018 is also expected to amplify the rates of growth in the CESEE economies. The growth rate differentials are likely to return to 2 percentage points, as was observed in the 2000s.[14] With differentials of that size, the catch-up process in real per capita income could gain momentum.

This optimistic view on the prospects for faster convergence needs to be qualified. First, it is not quite clear whether the current more rapid growth in the West is a sustainable trend, or will prove to be short lived. There are grounds for believing that growth in the 'West' will slacken again relatively soon. Without going too deep into this, it should be observed that the current accelerated Western European growth is actually a recovery, coming after a 'lost decade' of economic stagnation. From 2008 through 2015, per capita GDP in the EU-15 (i.e. the 'old' EU members) hovered at below the 2007 level. The 2016 stabilisation was still very fragile (per capita GDP grew by 0.6%). Should the Western part of the

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13 Thanks are due to Mario Holzner and Peter Havlik for valuable suggestions.

14 Real GDP for the EU-28 rose annually by 2.7% between 1995 and 1999, by 2.2% between 2000 and 2004, by 0.9% between 2005 and 2009 and by 1% between 2010 and 2014. According to a wiiw estimate, the real GDP of the 11 EU-CEE countries combined rose by 3.6%, 4.1%, 3.7% and 2.0%, respectively. The real growth differential between the EU-CEE and the EU-28 was 0.9 percentage points (pp) in the late 1990s, 1.9 pp in the early 2000s, 2.8 pp between 2005 and 2009 and 1.0 pp between 2010 and 2014. It may be important to add that the differences in real growth rates (calculated at constant national prices) do not automatically translate into the changing mutual positions in terms of purchasing power parities. (This may be attributed to the so-called Gerschenkron effect.)

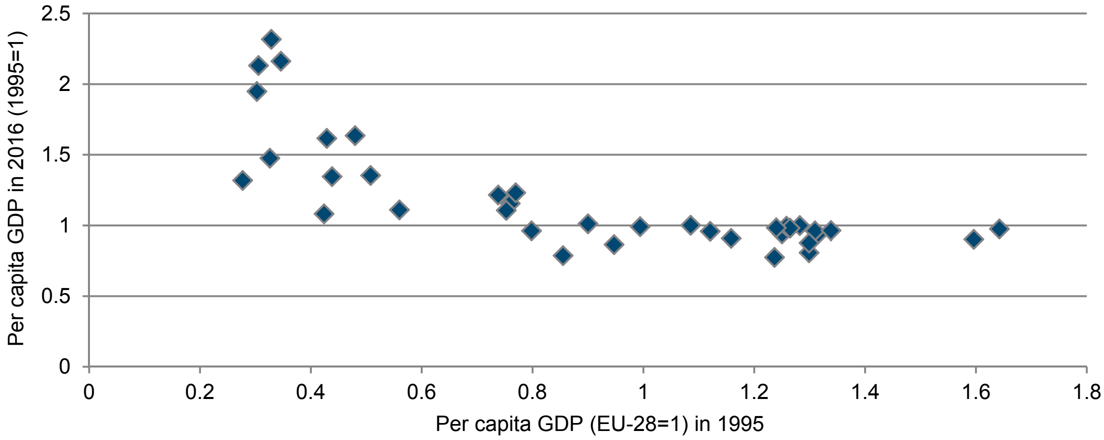
EU return to the 'new normal' of persistent stagnation, growth in the CESEE countries will undoubtedly slow down, too – and the growth rate differentials are likely to contract.

The real convergence process is unlikely to move the CESEE close to Western European income levels anytime soon. Historically, rapid convergence remains the exception rather than the rule. The longer-term growth patterns observed in lower-income countries are generally consistent with the so-called beta-convergence hypothesis. This hypothesis, which is seemingly applicable to the CESEE, envisages a rather protracted convergence process. Beta-convergence is characterised by its progressive slowdown: relatively rapid growth at low income levels and relatively slow growth at medium (and higher) income levels. According to the beta-convergence thesis, it should be relatively easy to leave the club of low-income countries. But breaking out of the club of medium-income countries is a laborious process (hence one often talks of a 'medium-income trap'). Box 1 applies the beta-convergence hypothesis to the long-term data available for a number of countries (including CESEE); its conclusions are not very optimistic for the prospects of rapid catch-up.

BOX 1 / THE LONGER TERM GROWTH PATTERN: EVIDENCE OF BETA CONVERGENCE

There is some evidence that longer-term growth across the EU Member States (including the EU-CEE) has been consistent with the so-called beta-convergence hypothesis. According to this hypothesis (first theoretically derived from Robert Solow's neo-classical growth model), in the longer term a country's growth rate is negatively correlated with its income level. Roughly speaking, the higher the income achieved, the slower its further growth.

Box Figure 1 / The longer-term growth pattern: evidence of beta-convergence



Source: AMECO database, own calculation.

The scatter plot in Box Figure 1 illustrates this for each individual EU and OECD country (excluding Ireland, Norway and Luxembourg, which, for various reasons, sustained high growth, despite relatively high income levels back in 1995). The change in per capita GDP (at current purchasing power parities – PPPs) of individual countries, compared to the average for the EU-28 as a whole, is measured along the vertical axis. The change in question is defined as Y_{2016}/Y_{1995}, where Y_{1995} and Y_{2016} are the per capita levels of PPP GDP in 1995 and 2016, respectively (vs. the average per capita PPP GDP levels for the EU-28). The initial per capita income level (i.e. Y_{1995}) is measured along the horizontal axis[15].

Evidently, the lower-income countries (primarily the EU-CEE and Turkey) performed strongly, compared to the 'average', while medium-income countries (including Slovenia and the Czech Republic) did not. Finally, some high-income countries have lost out compared to the 'average' (which is consistent with Solow's growth model – as well as with common sense).

A regression function fitted to the data from Box Figure 1 has the following logarithmic form:[16]

$$\mathrm{Log}(Y_{2016}/Y_{1995}) = a + c\,\mathrm{Log}(Y_{1995})$$

The estimated regression coefficient c (equal to -0.4465) is properly negative and highly significant statistically (its approximate standard error equals 0.0741, with a t-value of -6.02). The regression's adjusted R-squared is 0.716. The implied average annual speed of convergence (the so-called beta) equals -2.8% (-0.028=[log(1-0.4465)]/21.[17] This estimate indicates that convergence for the set of 37 countries considered has been faster than the 2% often revealed for other regions and/or time periods.

Despite relatively rapid convergence, a halving of the current distance from the average per capita GDP for the EU-28 (assumed to be 1.0) would have to be expected to take over 30 years.

Box Figure 2 below shows the estimates, consistent with the 2.8% speed of convergence, for per capita GDP levels in 16 CESEE countries in 10 and 15 years' time (and shows the GDP levels recorded in 2000, 2008 and 2016). As can be seen, the convergence process was everywhere quite rapid between 2000 and 2008 (even in relatively advanced countries, such as the Czech Republic). Progress was slower between 2008 and 2016. It is expected to slow down further in the highest-income countries (the Czech Republic, Slovenia, Slovakia and the Baltic States), but still to continue rather vigorously in the lowest-income countries (Albania, Serbia, Macedonia and Turkey). The calculations suggest that by 2026, only the Czech Republic could be expected to surpass 90% of the EU-28 level. Poland and Hungary will not even have reached the 80% mark by 2031.

Despite the progressive slowdown in convergence, the average (unweighted) per capita GDP for the CESEE countries (from Box Figure 2) is expected to rise from about 61% in 2016 to 70.7% in 2026 and 74.6% in 2031 (EU-28 = 100). At the same time, the disparities between individual CESEE countries will narrow. The (unweighted) standard deviation in per capita GDP is expected to fall from 18% in 2016 to 13.4% in 2026 and 11.6% in 2031. (In 2000, the average per capita GDP for the CESEE, excluding Albania, Serbia and Montenegro, was about 45% and the standard deviation 16%.)

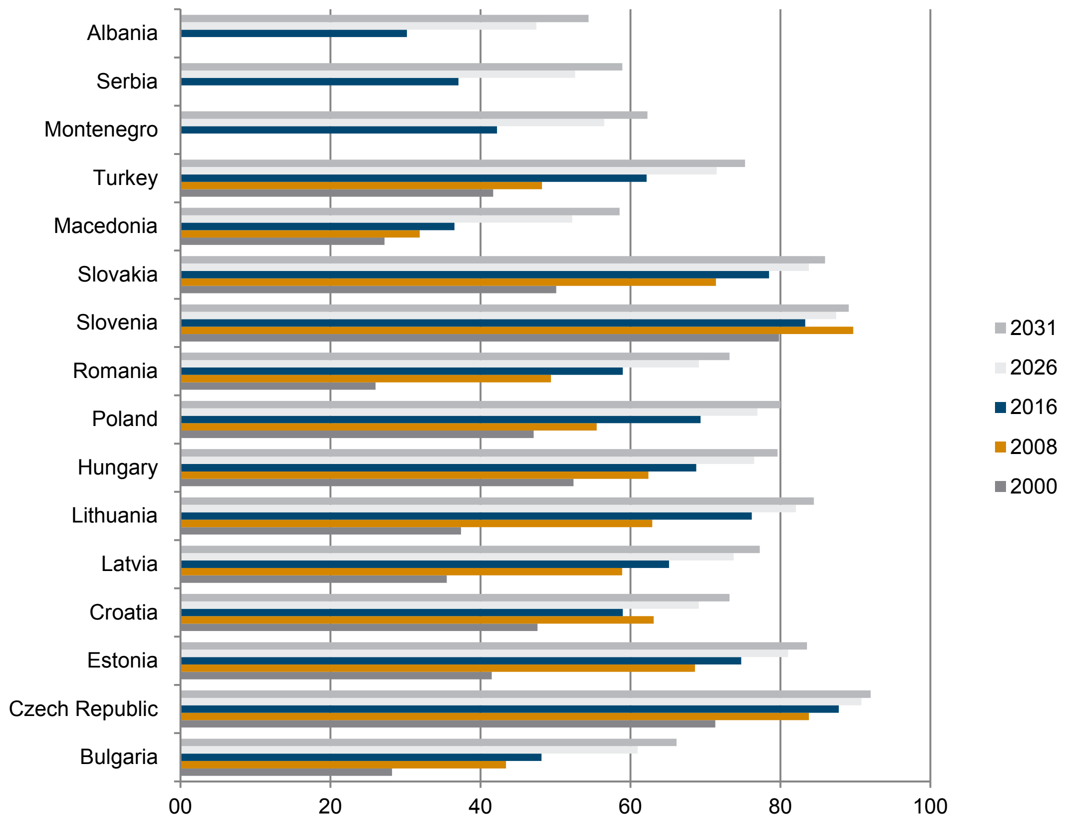
[15] AMECO reports data on per capita GDP for a number of OECD countries located outside the EU. Using the AMECO data (for as much as 37 countries) increases the size of the sample underlying the estimations reported below (and thus the credibility of the estimates derived). On the other hand, it may be worth adding that the AMECO data for some countries may differ (albeit not substantially) from data reported by other sources (e.g. wiiw).

[16] This is the basic form used in innumerable studies on beta-convergence; see, for example, M. Abreu, H. de Groot and R. Florax (2005), 'A meta-analysis of beta convergence: the legendary two-percent', Tinbergen Institute Discussion Paper, 05-0001/3.

[17] The standard error of this 'yearly beta' equals approximately 0.6%. The wiiw Spring 2015 Forecast Report reported beta equal to 2.6%. That value followed the estimation based on data for EU countries only, spanning the period 1995-2014.

A caveat is in order now. It must be remembered that the numbers underlying Box Figure 2 are point estimates only, corresponding to the *average* beta selected econometrically (equal to -2.8%). The true beta remains unknown – it may differ from -2.8%, in which case the numbers for the years 2026 and 2031 would be different, and possibly more 'optimistic'. It goes without saying that if the actual relationship between the GDP level achieved and the likely growth rate is not properly reflected by the logarithmic formula (which is derived from neoclassical growth theory), the calculated GDP positions could be different.

Box Figure 2 / Per capita GDP in 2000, 2008, 2016, 2026 and 2031 (EU-28 = 100)



Source: AMECO database, own calculations.

Needless to say, there are a few countries that have escaped from the medium-income trap, thus 'breaking' the pattern envisaged by the beta-convergence hypothesis. But these successful countries (primarily from East Asia) have persisted with their unconventional and unorthodox economic policies, which are not really compatible with the liberal principles adhered to in Europe (and in the EU in particular). It does not seem likely – or possible – that these successful policies will be followed in the CESEE. Thus the CESEE economies may be doomed to work out their economic advancement through the application of conventional policies. The catch-up achieved that way may take a long time, according to the beta-convergence theory.

ASSESSING THE LEVELS OF CURRENCY OVERVALUATION

Over time, dozens of definitions of the terms 'currency overvaluation' and 'currency undervaluation' have been proposed. As for its proper definition and measurement, the jury is still out.[18] One appealing method (which is relatively easy to implement) hinges on comparison of a country's exchange rate (ER) with its purchasing power parity (PPP). A PPP/ER ratio (otherwise known as the price level) of less than 100% could indicate currency undervaluation. Conversely, a ratio greater than 100% could suggest overvaluation. Of course, this approach neglects the essential intuition – namely that a country's level of overvaluation or undervaluation should be somehow related to its foreign trade performance (and indirectly to overall GDP growth). Empirically, the link between foreign trade performance and price levels (as described above) does not really exist. In the short run, very many countries with price levels far in excess of 100% perform quite well in terms of their foreign trade, while many countries with very low price levels perform poorly in foreign trade. Matters are rather different in the longer term. Sustained overvaluation may provoke trade deficits, while sustained undervaluation is likely to be conducive to trade surpluses. In effect, a strong, firm and quite stable longer-run regularity should be expected, linking a country's price levels to its overall level of development. That (non-linear) regularity is shown to possess some desirable properties.[19] Positions located away from that regularity tend to converge with it over time – by virtue of a combination of changes in price, exchange rate and/or GDP levels. It appears that undervaluation tends to be conducive to faster growth (real convergence in the case of poorer countries), whereas overvaluation tends to retard real growth. The regularity in question can be estimated econometrically and then used to calculate the hypothetical price levels consistent with the long-term regularity and individual countries' relative GDP levels. Figure13 shows the results of applying that approach to 12 selected CESEE countries, Turkey and Germany over the period 2010-2016.[20]

The negative bars in Figure 13 represent undervaluation; the positive bars – overvaluation. Zero represents 'equilibrium' – i.e. an absence of both overvaluation and undervaluation. For example, -15.0% for Romania in 2016 suggests that in that year the Romanian price level (vis-à-vis the EU-28) was 15% too low. Its level actually stood at 50.2%, whereas the calculated 'equilibrium' price level was 57.7%. Achievement of the price level of 57.7% of the EU average would have required (all else being kept constant) a 15% rise in Romanian prices or appreciation of the Romanian nominal exchange rate by (approximately) 15% (from 4.49 RON/EUR to 3.90 RON/EUR) – or some combination of higher domestic prices and nominal appreciation.

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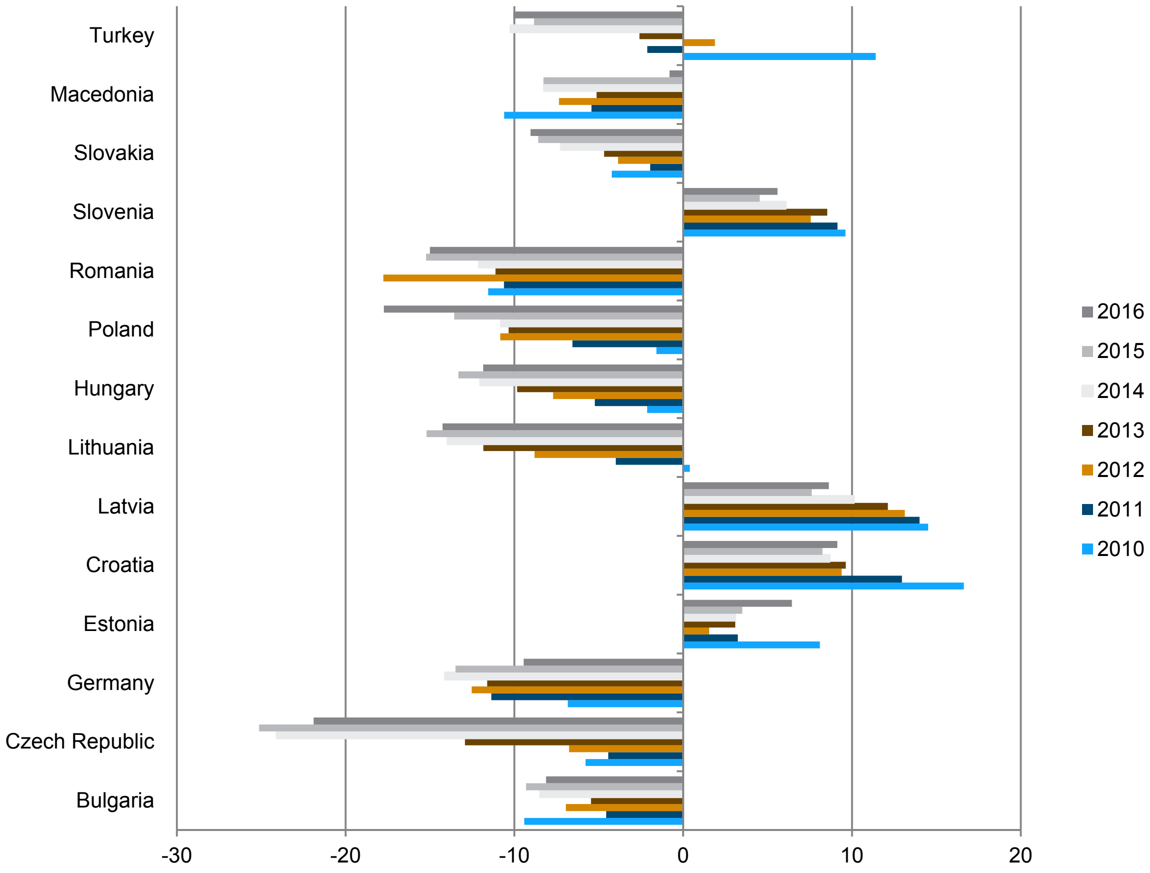
18 See, for example, B. Schnatz (2011), 'Global imbalances and the pretence of knowing fundamental equilibrium exchange rates', *Pacific Economic Review*, Vol. 16, No. 5, pp. 604-615.

19 See L. Podkaminer (2010), 'Real convergence and the price levels: long-term tendencies vs. short-term performance in the enlarged European Union', *Metroeconomica*, Vol. 61, pp. 640-664.

20 The function fitted econometrically is Log(P) = bY+C where Log stands for the natural logarithm, P is the price level, Y is the per capita GDP level and b, C are parameters to estimate. In all, 493 observations were taken into account (pooled data on Y and P for all EU countries except Luxembourg and Ireland, but including Turkey and Macedonia) for the period 2000-2016. The estimates for b and C are 0.010924 and 3.4116, respectively (with standard errors equal to 0.0002 and 0.0157). The equation's adjusted R-squared equals 0.8921. The wiiw Spring 2015 Forecast Report reports the levels of over/undervaluation for the years 2000-2014, based on the same function fitted to the data for the years 1995-2014. The parameter estimates for that function are close to those above (they equalled 0.011047 and 3.382825, respectively).

Figure 13 / Levels of overvaluation (positive) and undervaluation (negative) for selected CESEE economies, Germany and Turkey vs. the EU-28, 2010-2016



Source: AMECO database, own calculations.

It is interesting to observe that the four countries with persistent overvaluation (Latvia, Slovenia, Estonia and Croatia) have had their currencies rigidly linked to the euro (the former three have actually already replaced their own currency with the euro). Except for Estonia, where the overvaluation level slightly increased in 2016, the level of overvaluation is retreating slowly in Latvia, Slovenia and Croatia – primarily due to low inflation rates. The strong deflation observed in recent years across much of the region may have kept undervaluation in place in most of the remaining countries. The policy that was followed for a number of years in the Czech Republic of suppressing the nominal exchange rate using central bank exchange rate interventions contributed to very high undervaluation in the Czech Republic. Discontinuation of that policy (and subsequent strengthening of the nominal exchange rate) will reduce the undervaluation of the Czech currency in 2017.

The levels of undervaluation are likely to drop in 2017-2018 (price levels to increase – see Table 31 in Appendix), partly because deflation seems to have ended in most Central and Eastern European countries, but also because of the real growth acceleration in the region (with growth in the 'old' EU trailing behind).

Special section II: Euro may yet survive and attract new members

VLADIMIR GLIGOROV*

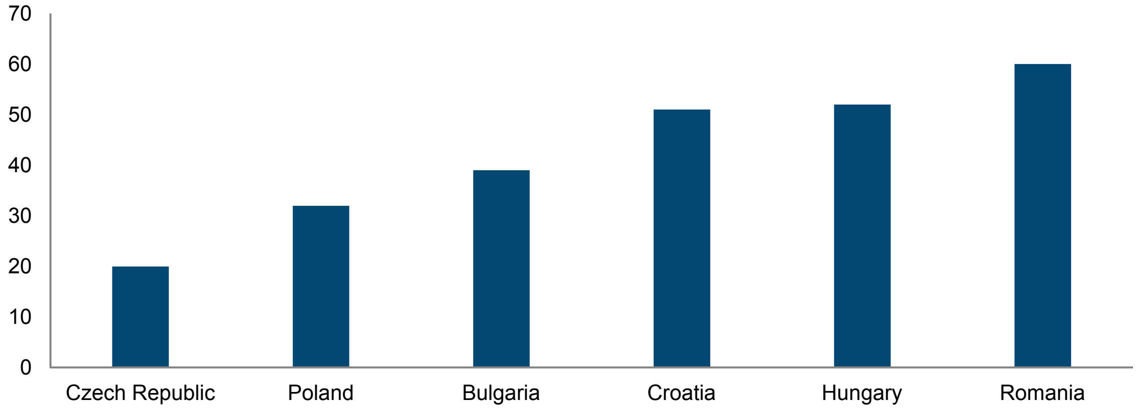
- **The euro has faced sustained criticism since its inception. This has intensified since the 2008-2009 global financial crisis and its aftermath, which saw many peripheral members of the bloc suffer deep and protracted recession, much of which was blamed on the rigidity inherent in being part of a single currency area.**
- **This contributed (along with political factors) to widespread opposition in many parts of the EU's Central and Eastern European area (EU-CEE) to possible membership of the euro. However, the reality is that the problems of Southern Europe and Ireland have had little to do with the euro itself. Many other members of the bloc have done quite well.**
- **We find that some types of country are more suited to euro membership than others. For the EU-CEE, this has important implications. Our conclusion is that it is largely in the interests of Croatia and Bulgaria to join, and potentially advantageous for Hungary and Poland. The case is not so clear cut for the Czech Republic, which is not euroised, and Romania, which may struggle to satisfy the criteria.**
- **In general, we find that membership of the euro is not decisive in determining a country's economic fortunes. Euro accession would not be economically damaging to any country in the EU at the moment.**

Jean-Claude Juncker, the President of the European Commission, recently suggested that EU members who are not currently part of the eurozone should speed up the process of joining the currency union. It also appears likely that post-Brexit, there will be a greater push to integrate the 'core' EU. In order to avoid being left behind, non-euro members may face greater pressure to join. These developments have important implications for the six EU-CEE members – the Czech Republic, Poland, Hungary, Romania, Bulgaria and Croatia – that are not currently members of the single currency area. Having in some cases basically ignored their obligation to join for quite some time, these countries are now under greater pressure to consider accession to the euro area. This is particularly the case for those that are close to meeting the criteria for accession, namely the Czech Republic and Poland.

Broadly, there are two key reasons why some EU-CEE countries do not want to join the euro. First, there are political considerations. Euroscepticism is strong across much of the EU-CEE, in some cases specifically in relation to the euro (Figure 14). Second, many do not believe that it makes economic sense to join. We will deal with the second point in this article.

* The author would like to thank Richard Grieveson, Peter Havlik, Mario Holzner and Michael Landesmann for valuable comments and suggestions.

Figure 14 / Support for eurozone accession, %, 2016



Source: Eurobarometer.

ASSESSING THE ECONOMIC EFFECTS OF THE EURO

We suggest a simple litmus test to assess the performance of the euro. To evaluate the economic effects of eurozone membership, we split a selection of EU Member States and Balkan countries into groups, depending on the area we are analysing. We divide the countries by exchange-rate regime, and look at this in terms of both the real exchange-rate adjustment post-2008 and how open or closed those economies are (Table 3). We then apply three criteria to these groups to assess the performance of Economic and Monetary Union (EMU) and the advantage of membership (if any) of the currency union: (1) adjustment to shocks, especially asymmetric ones, (2) sustainability of external balances, and (3) the contribution of EMU to growth and employment.

Table 3 / Characteristics of European economies, by exchange-rate type

Exchange-rate regime	Real exchange-rate adjustment post-2008	Open versus closed (exports of goods and services/GDP)*
Currency boards (and euro) and fixed exchange rate: Latvia, Lithuania, Estonia, Bulgaria, Croatia	Estonia and Bulgaria: appreciation Lithuania and Latvia: cyclical depreciation Croatia: secular depreciation	Very open: Lithuania, Latvia, Estonia Quite open: Croatia, Bulgaria
Inflation targeting: Czech Republic, Poland, Hungary, Romania	Depreciation; Czech Republic mostly stable	Very open: Czech Republic, Hungary Quite open: Romania, Poland
Core eurozone: Germany, France, Italy, the Netherlands, Austria	Nominal depreciation of euro (e.g. versus dollar)	Very open: Austria, Netherlands Quite open: Germany Quite closed: Italy, France
Peripheral eurozone: Ireland, Spain, Greece, Portugal	Depreciation particularly deep in the case of Greece and Ireland	Very open: Ireland Quite closed: Portugal, Spain, Greece
Eastern eurozone: Slovenia and Slovakia	Appreciation	Very open: Slovakia, Slovenia
Balkan EU candidate countries	Serbian real exchange rate depreciation, others mostly stable, Macedonia some appreciation	Quite open: Serbia, Macedonia, Montenegro Quite closed: Kosovo, Albania, Bosnia and Herzegovina

Note: * Very open: goods and services exports/GDP over 50%; quite open: goods and services exports/GDP 30-50%; quite closed: goods and services exports/GDP under 30%. All data for 2010.
Source: Eurostat, own elaboration.

The post-2008 period has tested EMU rather severely, and therefore the experience should provide answers to all the issues pertinent to the persistence of the euro area and to the possible advantages of its further enlargement. It must also be borne in mind that the crisis in the eurozone has brought significant changes in recent years. EMU has been strengthened visibly in terms of monetary policy capabilities, particularly since European Central Bank (ECB) President Mario Draghi's famous 'whatever it takes' speech. However, work done so far largely represents fire-fighting and crisis management. Reforms aimed at putting the euro on a structurally safer footing by promoting greater financial and fiscal integration remain quite limited (a more positive view is to be found in Buti et al., 2017).

Most discussions of the desirability or not of euro membership (both within and outside the EU-CEE) have been couched within the framework of the theory of optimal currency areas (Mundell, 1961, 1973a, 1973b; Farhi and Werning, 2017). However, this is probably not the best model to rely on in a period of severe and protracted crisis, such as the one after 2008. During such a time of severe economic and financial dislocation, even optimal currency areas are bound to lose their optimality. So, here the issue is about the adjustment to shocks and imbalances in a non-optimal currency area.

THE ADJUSTMENT PROBLEM

Paul Krugman has argued that the euro has performed poorly, because it stands in the way of adjustment to asymmetric shocks or generally of persistent external imbalances (Krugman, 2013; on adjustment problem Krugman 1989). Primarily, the argument goes, this is because it stands in the way of nominal exchange-rate changes that correct for the misalignment of the real exchange rate. The assumption is that euro exchange-rate corrections, e.g. vis-à-vis the dollar, will not be enough to support the adjustment in regions most affected by asymmetric shocks (in short, that EMU is not an optimal currency area). In addition, it is argued that customs and currency unions support specialisation, which may increase the risks of asymmetric shocks. This view is widely shared.

There has therefore been some surprise that the euro has not only survived, but its role as reserve currency in the world has not declined. Moreover, the number of member states has increased since the crisis of 2008. Below, we look at how the adjustment problem has been solved or dealt with over the past decade.

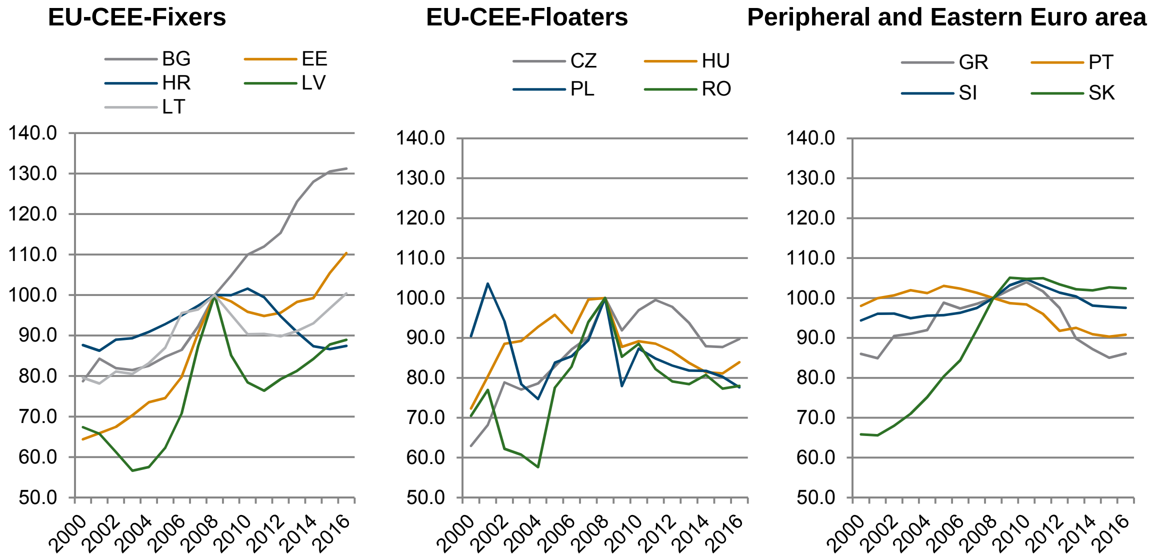
Core eurozone

Some more developed countries in the eurozone have not experienced much real exchange-rate adjustment in within-euro trade. The euro exchange rate itself nominally depreciated, and so they experienced real depreciation towards e.g. the dollar. These countries can be seen as perhaps being the core of the euro area.

Peripheral eurozone

Many other EU countries, irrespective of their exchange-rate regimes, experienced persistent real exchange-rate depreciation against the euro after 2008. Of particular interest are the so-called 'peripheral' eurozone member states, which ran significant trade deficits ahead of the 2008 crisis. Their adjustment since 2008 has been facilitated by real exchange-rate depreciation, though often with delayed improvements in the terms of trade (i.e. the ratio of export prices to import prices).

Figure 15 / Real Effective Exchange Rate (deflator: unit labour costs in the total economy - 19 trading partners - Euro Area), 2000-2016, index 2008=100



Source: Eurostat.

EU-CEE floaters

Within the EU-CEE, there is particular interest regarding adjustment in the countries that rely on inflation targeting, as this group includes those closest to meeting the accession criteria for eurozone entry. These countries' nominal and real exchange rates depreciated after 2008, but they did not experience much of a change in their terms of trade. In addition, the effects on exports have been less pronounced, because their ratios of exports to GDP were high and their external imbalances were minimal ahead of the 2008 crisis.

EU-CEE fixers

Most of the EU-CEE countries with currency boards or largely fixed exchange rates experienced temporary real exchange-rate depreciation after 2008, followed by persistent appreciation. However, their terms of trade improved, though in some cases after first deteriorating.

Western Balkan candidate countries

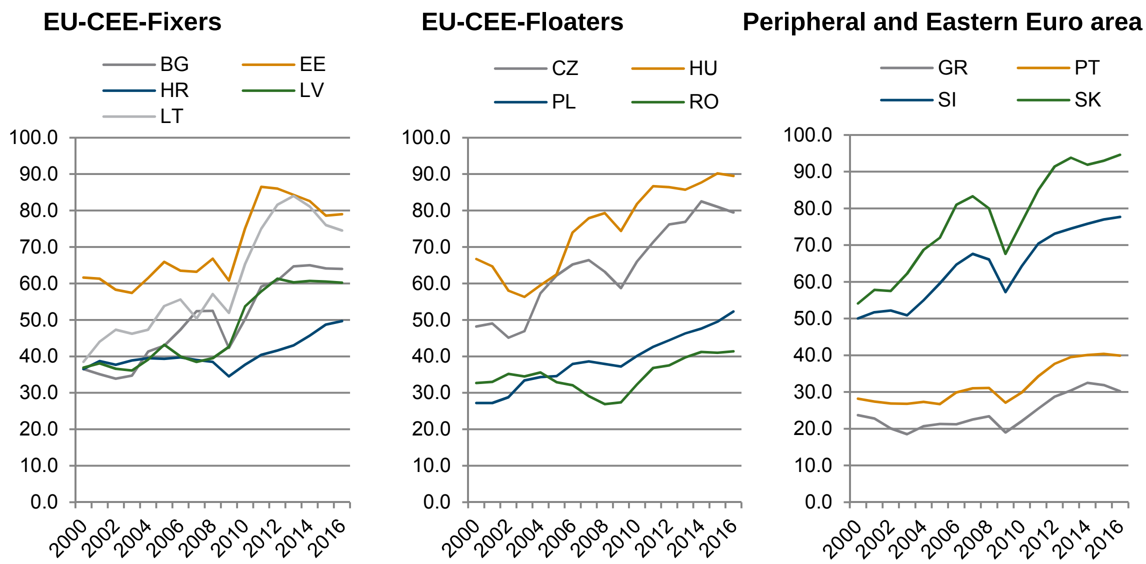
Countries in the Western Balkans are mostly euroised, with mixed monetary regimes (Serbia ostensibly relies on inflation targeting). Most countries in the region have seen real exchange-rate adjustments since 2008, combined with significant export growth, primarily to the EU market. Serbia's quite significant nominal exchange-rate adjustment appears to have been less important for the subsequent sharp growth in exports than the internal devaluation (i.e. nominal cut in public sector wages and pensions) in 2015, which led to expenditure switching, while devaluation did not.

Therefore, based on the examples above, it appears that the main determinant of post-crisis external adjustment was how overvalued or not exchange rates were ahead of the 2008-2009 global financial crisis, not whether or not a country had the option of nominal exchange-rate adjustment afterwards. After 2008, the adjustment problem was dealt with by either real exchange-rate depreciation or by the nominal adjustment of the euro exchange rate. It does not appear that the nominal exchange-rate depreciation of some inflation-targeting countries made much of a difference to adjustment and subsequent export performance, compared to euro member states or the euroised countries in the Balkans.

THE SUSTAINABILITY OF EXTERNAL BALANCES

A second major criticism of the euro has been that it contributed to a build-up of large and unsustainable external deficits in the run-up to the global financial crisis, and also that it has made working off these imbalances more difficult in the post-crisis era. The experience of some peripheral eurozone states has been held up as an example of this. However, we find that large trade and current account imbalances are not necessarily connected with membership of the euro area, nor are they invariably indicative of the need for exchange rate adjustment (Blanchard and Giavazzi, 2002). For example, the Baltics, Bulgaria and a number of Western Balkan countries that peg their currencies to the euro, ran very large current account deficits ahead of the 2008 crisis. However, these then turned relatively quickly into surpluses afterwards, via increased exports and stagnating imports.

Figure 16 / Exports of goods and services, 2000-2016, in % of GDP



Source: Eurostat.

Much more important in determining the sustainability of external imbalances, and whether or not they can be worked off, is whether an economy is relatively open or closed, and whether cross-border investments go into the tradable or non-tradable sectors. Cross-border investments or transfers will benefit the receiving country, depending on the combination of the income and substitution effects. A smaller and more open economy will see its exports increase, while a more closed economy may see an increase in the non-tradable sectors. By contrast, income effects should stimulate export growth in the source country, while substitution effects should lead to deteriorating terms of trade. Before the 2008 crisis, large cross-border investments tended to widen trade and current account deficits in the receiving countries, especially if those that were less open in terms of the exports to GDP ratio and the non-tradable sector experienced a boom.

Irrespective of exchange-rate regimes, therefore, small EU economies will increase their exports if there is a reversal in cross-border financial flows, e.g. through deleveraging. This will happen without the need to depreciate the real exchange rate, if the real exchange rate was not misaligned before the reversal of the financial flows. In the case of less open economies, a reversal of financial flows may require both real exchange-rate and significant income adjustments.

Of the countries considered here, the ones that have faced the biggest problems rebalancing their external trade and financial flows since 2008 are those in the Western Balkans. This is because they are somewhat more closed economies, especially relative to most of the EU-CEE countries. Irrespective of their exchange-rate arrangements, most of these non-euro economies have had to go through real adjustments and structural changes in order to deal with the reversal of financial flows.

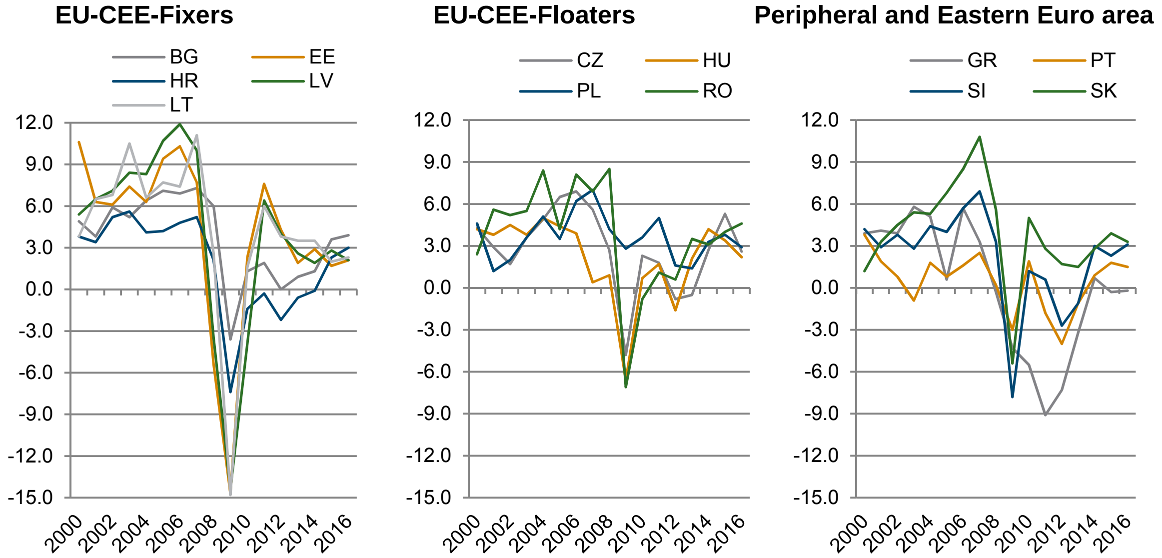
The more closed economies of Southern Europe have also faced some difficulties in tackling external imbalances since 2008. Here, the issue in many cases was that cross-border investments had gone mostly into real estate, tourism and non-tradable goods and services, which is why the reversal of investment and financial flows proved more challenging. Again, the type of exchange-rate regime (in this case eurozone membership) was not a decisive factor.

CONTRIBUTION OF EMU TO GROWTH AND EMPLOYMENT

A third key criticism of euro membership is that it restricts countries' growth prospects. However, in reality, a currency union should support development and convergence, even if it is non-optimal. This is particularly the case if, as in the eurozone, the developed region is significantly bigger than the less developed one. The latter will converge to the former because of downstream investment flows. This process will be supported by the existence of the currency union, because the interest rate will be set closer to what is appropriate for the more developed region, thereby providing an incentive to invest in the less developed region, which will offer higher marginal returns to capital. That, in turn, will support the process of convergence of GDP per capita.

It is normal for EU transfers and cross-border private investments to have led to trade deficits and real exchange-rate appreciation ahead of the 2008 crisis. The deficits that emerged led many analysts to argue not only against the euro, but also against the customs union and membership of the Single Market generally. However, the record is not necessarily supportive of these claims in the case of small, open economies, as already argued. Moreover, these imbalances may actually be sustainable and supportive of growth and development, if there is no unnecessary real exchange-rate misalignment and if the growth differential, i.e. convergence growth, is sustained.

Figure 17 / Real Gross Domestic Product, 2000-2016, percentage change on previous period



Source: Eurostat.

If a non-eurozone country's borrowing costs are linked to the euro interest rate, and if growth is faster than in the more developed euro countries, then that more rapid growth helps to make the widening external, fiscal and financial imbalances sustainable. This was evident in the period before 2008, but it re-emerged after the 2010-2012 eurozone crisis. Evidence of the latter is still somewhat weak, however, because the crisis and the prolonged adjustment led to subdued investments across most of the EU and its candidate countries.

In general, cross-border investments and transfers supported sustainable growth and imbalances in the more open economies, but the effect was lower in the more closed ones. However, as has been shown from the experience of those Western Balkan countries that are euroised but have their own currencies, monetary and exchange-rate policies are probably not the main culprits in unsustainable development. In most cases, euroisation was the choice of the public and businesses, in order to constrain monetary and exchange-rate policies: those are endogenous fixed exchange-rate regimes.

SHOULD THE REST OF THE EU-CEE COUNTRIES JOIN THE EURO?

Based on the above analysis, we conclude that accession to the single currency would not be damaging to any of the six EU-CEE countries yet to join the euro, especially in view of the intended strengthening of the euro macroeconomic and financial framework. The same applies to the Western Balkan EU candidate countries. However, the extent of the positive case for membership varies between countries.

For Croatia and Bulgaria, the case for euro membership is strongly positive. These two countries are in the same position as the Baltic States were before membership. They have high shares of euro debt (public and private) and highly euroised banking sectors. With growing trade integration, the case for these countries to join the euro will become even stronger.

For Poland and Hungary, the case is also quite positive. These economies are quite open, and they trade for the most part within the euro area. As a result, their inflation-targeting regime is not necessarily altogether different from exchange-rate targeting. Indeed, large devaluations in Hungary and Poland after the eruption of the 2008 crisis, and the secular tendency of depreciation afterwards, suggest that these are not typical inflation-targeting regimes.

For Romania and, especially, the Czech Republic, the case is less clear cut. The Czech Republic has a relatively stable exchange rate with the euro, and in many ways belongs to the core of the euro currency union countries. However, while the Czech Republic has not profited all that much from the flexibility of its exchange rate, nor does it have a euroised economy. The literature shows that even small, open economies with significant dependence on exports may benefit from more active monetary policy, if their currency is used domestically and even in international transactions (Woodford, 2010). In the case of Romania, there are still significant inflationary pressures which may make it difficult to satisfy the criteria for membership quickly.

MEETING THE MAASTRICHT CRITERIA

It is generally the case that those countries most able to meet the criteria for membership are those where there is least political support and where the economic case is less decisive (e.g. the Czech Republic). It is possible, however, that given the level of trade and financial integration that these countries have with the eurozone, and considering the apparent push for further integration at the ‘core’, joining the currency union may become less of a political issue in the future.

Meanwhile those countries for which membership makes sense are often the ones facing the most difficulties in meeting the criteria for entry. In the case of Croatia, in particular, meeting the public debt to GDP ratio is still some way off (EC, 2017).

CONCLUSIONS

Based on the analysis above, we draw three key conclusions:

First, the euro contributed to the widening of external imbalances and to the speeding-up of growth in more open economies ahead of the financial crisis of 2008. In more closed economies, the speeding-up of growth and the external imbalances were less pronounced. Closed economies also saw real exchange-rate appreciation.

Second, after 2008 most of the euro area benefited from the nominal depreciation of the euro exchange rate (towards the dollar, in particular), while the other members of the currency union experienced real exchange-rate depreciation in cases where adjustment was needed. Evidence is scant that the EU Member States outside the currency union and those euroised economies in the Western Balkans that could devalue (e.g. Serbia) did any better.

Third, interest rate compression and cross-border investment and other transfers, which are supportive of growth and convergence, work better in open economies than in more closed ones. This is because the terms of trade do not have to experience strong adverse corrections. These cross-border capital flows are supportive of growth and convergence.

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Special section III: Are CESEE sovereigns prepared for higher borrowing rates?

RICHARD GRIEVESON[21]

- **Hard currency sovereign debt markets in Central, East and Southeast Europe (CESEE) have experienced a strong bull run in recent years, reflecting the compression of global interest rates. However, with the US Federal Reserve starting to tighten, and the European Central Bank (ECB) set to begin unwinding stimulus measures by next year, this trend has started to turn.**
- **There are questions about how well prepared the region is for higher global rates. Overall, we find that CESEE is not in a markedly better position to deal with a sharp rise in yields than it was 10 years ago, at the time of the global financial crisis. In some areas, it is in a clearly worse position.**
- **However, differentiation is key: Countries exposed primarily to euro rates are in a much stronger position, with the ECB set to withdraw liquidity but unlikely to raise interest rates in the next few years. Those reliant on dollar funding will face bigger challenges.**
- **CESEE economies face a difficult future, owing to negative population trends, institutional deficiencies and sluggish productivity growth. This creates the risk that countries with heavy debt loads and no apparent prospect of achieving high and sustained growth could face funding difficulties in the coming years.**

Global interest rates have been hugely suppressed in the decade since the global financial crisis, reflecting persistently weak inflation and unprecedented loose monetary policy by major central banks around the world, including the US Fed and the ECB. The combined assets of the Fed, the ECB and the Bank of Japan are now over USD 14 trillion, compared with just over USD 3 trillion in 2007.

Debt markets in CESEE have benefited a lot from this, even in the most risky countries. A particularly striking example was provided in September 2017, when Tajikistan came to the market for its Eurobond debut, selling USD 500 million of 10-year paper at a yield of 7.125%. The auction was reportedly eight times oversubscribed – an extraordinary situation for such an economy, and one that reflects the insatiable demand for yield among bond investors in the context of scant returns on any remotely ‘safe’ asset.

This is a risky investment; Tajikistan is a dictatorship, with a very shaky and opaque economic model. The money is officially for the construction of a hydroelectric dam, although the case of

21 The author would like to thank Peter Havlik and Michael Landesmann for valuable comments and suggestions.

Mozambique's infamous 2013 'tuna' bond is a clear reminder of how much of a chance investors take when giving money to countries with such poor governance. Neighbouring Uzbekistan has repeatedly told Tajikistan not to build the dam because of the impact on a river flowing between the countries.

Moreover, Tajikistan could feasibly have taken a World Bank loan at a much lower rate of interest. At an investor presentation ahead of the bond sale, Tajikistan revealed that it currently pays an average 1.6% on outstanding debt to multilateral organisations and China. In this, the bond sale fits with an interesting trend of frontier markets preferring to pay higher market rates in order to be free from the conditions that multilateral lenders tend to impose. Ukraine is another recent example. The global compression of interest rates has made this a more feasible proposition than in the past.

In less exotic parts of CESEE, such as the EU Member States in the region (EU-CEE), the compression of yields has been even more dramatic. At times in the past few years, Czech debt has traded inside that of Germany and even Switzerland. Ten-year yields in Poland have been as low as 2%. Even in Croatia, long seen as a risk investment because of its large public and external debt loads, wide fiscal deficits and weak growth rates, yields on sovereign debt have tumbled.

ADDICTION TO CHEAP CREDIT CREATES RISKS

Much of the eurozone is currently enjoying a robust cyclical upswing, and in some cases structural reforms to increase potential growth rates have been achieved. However, overall, the bloc continues to face major structural challenges. Even at such a positive point in the business cycle, major slack remains evident in most labour markets (even, despite the strong headline number, in Germany), and there is limited upward pressure on wages. Core inflation is stuck well below the ECB's target of just below 2% almost everywhere, particularly on the 'core' measure (excluding energy and unprocessed food prices), and the strength of the euro will mean more imported deflation in the coming months. As a result, ECB tightening remains some way off. Nevertheless, the spectre of deflation has been banished in the eurozone, at least for now, and an exit from extraordinary stimulus now looks very likely from next year at the latest. Meanwhile in the US, the Federal Reserve has already started to raise interest rates.[22] A change in the bank's board could lead to a more hawkish bias, thereby generating more tightening.

It is reasonable to ask, in this context, how prepared CESEE countries are for a rise in global rates. Below, we examine how various indicators of sovereign risk in CESEE have developed over the decade since the global financial crisis.

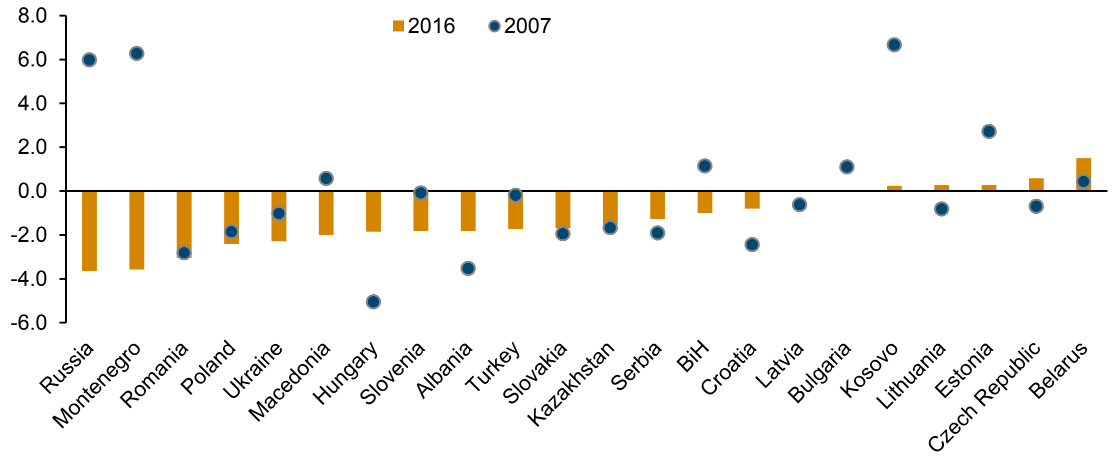
FISCAL POSITIONS HAVE BROADLY DETERIORATED

A key source of sovereign risk is the sustainability of a country's fiscal position. The broad story across CESEE in this area is mixed. In 2016, 10 countries were running stronger fiscal positions than in 2007, while 12 had worse fiscal positions. The biggest improvements were evident in Hungary, Albania, Croatia, the Czech Republic, Lithuania and Belarus. Meanwhile a significant deterioration in the fiscal

[22] Other major central banks are also moving in this direction, but the vast majority of external borrowing by CESEE countries is done either in euros (mostly the EU members and the Western Balkans) or US dollars (Turkey, Ukraine and the Commonwealth of Independent States), meaning that the ECB and the Fed are what really matters for the region.

position was evident in Montenegro, Russia and Kosovo. Macedonia, Estonia and Bosnia and Herzegovina all also experienced significant negative changes.

Figure 18 / Fiscal balances, % of GDP



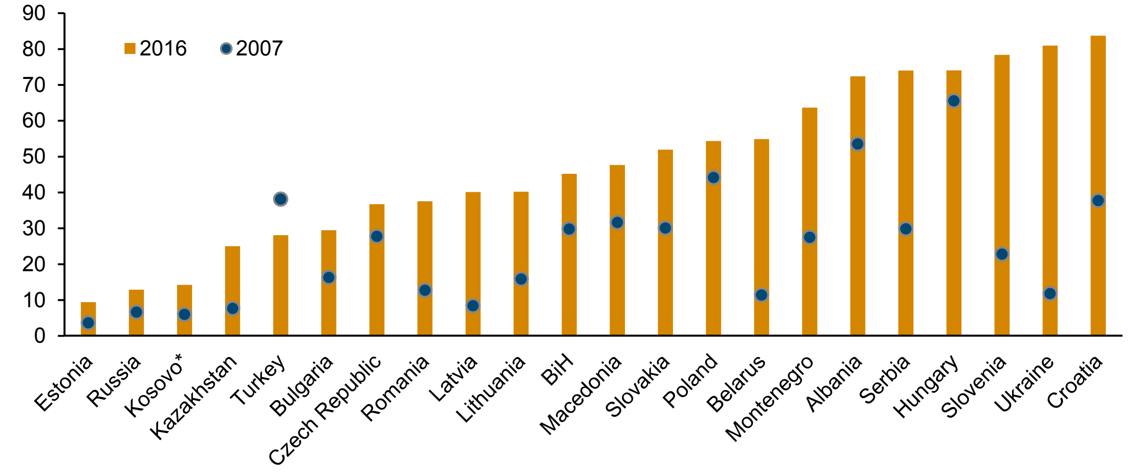
Source: wiiw Annual Database.

However, taking a snapshot of the difference between two particular years risks emphasising the influence of one-off factors, and does not take into account trends in the rest of the economy. One major mistake made by policy makers since the crisis, especially (but certainly not only) in the eurozone, has been to focus on arbitrary deficit targets, which ignore the economic cycle and specific features of the country. This has been reinforced by influential outside actors, including ratings agencies and the International Monetary Fund (IMF) (the latter has in recent years changed its stance somewhat, for the better).

A better impression of fiscal trends over the past decade can be gained from the development of debt/GDP levels. In this case, the picture is negative almost everywhere. In 21 out of 22 CESEE countries, the public debt/GDP level has risen since 2007 (the exception is Turkey, where it has fallen by around 10 percentage points). In 16 of the countries, it has risen by 10 percentage points (pp) or more. The increases in Ukraine (69 pp), Slovenia (56 pp), Croatia (46 pp), Serbia (44 pp) and Belarus (43 pp) are particularly notable. In all five cases, as in many other places where the ratio has risen over the past decades, these increases reflect a combination of persistent fiscal deficits and weak or negative real GDP growth, rather than large-scale borrowing to fund investment and therefore raise the economy's productive potential.

There are two important caveats to this, however. First, in most cases, the level of public debt in CESEE remains relatively low. The EU's Stability and Growth Pact level of 60% of GDP is an arbitrary target, but represents a useful rule of thumb for establishing whether debt levels are dangerously high (for both EU and non-EU countries). Only seven of the 22 CESEE countries that we cover have public debt/GDP ratios over 60%: Montenegro, Albania, Serbia, Hungary, Slovenia, Ukraine and Croatia. Second, some CESEE countries rely heavily on borrowing from multilateral organisations. These loans tend to have interest rates significantly below market rates, and with long maturities. This is particularly the case in some Balkan countries.

Figure 19 / Public debt, % of GDP

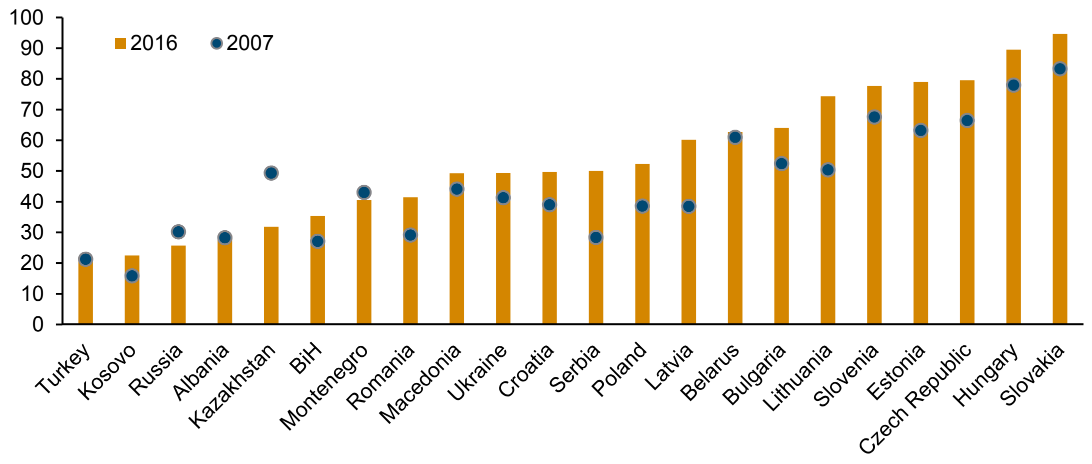


Source: wiiw Annual Database. *Data are for 2009 and 2016.

EXTERNAL RISKS HAVE RISEN

A second major source of sovereign credit risk is a large external deficit (representing flows) and external debt (representing stocks). The reduction of external balances in terms of flows has been material over the past decade. In 2007, the 22 CESEE countries ran an average current account (CA) deficit equivalent to 10.1% of GDP (unweighted). By 2016, this had moved to just 2%. Eight countries ran surpluses last year, including of over 5% of GDP in Bulgaria, Slovenia and Hungary. The sharp compression of external deficits and moves into surplus across much of the region reflects a mixture of improvements in competitiveness, a suppression of domestic demand at a time of still-healthy growth in some export markets, deleveraging by foreign banks, and in many cases strong exports (helped in particular by the recent upswing in Germany and much of the rest of the eurozone). Linked to this, export shares in GDP have increased almost everywhere over the past decade.

Figure 20 / Exports of goods and services, % of GDP



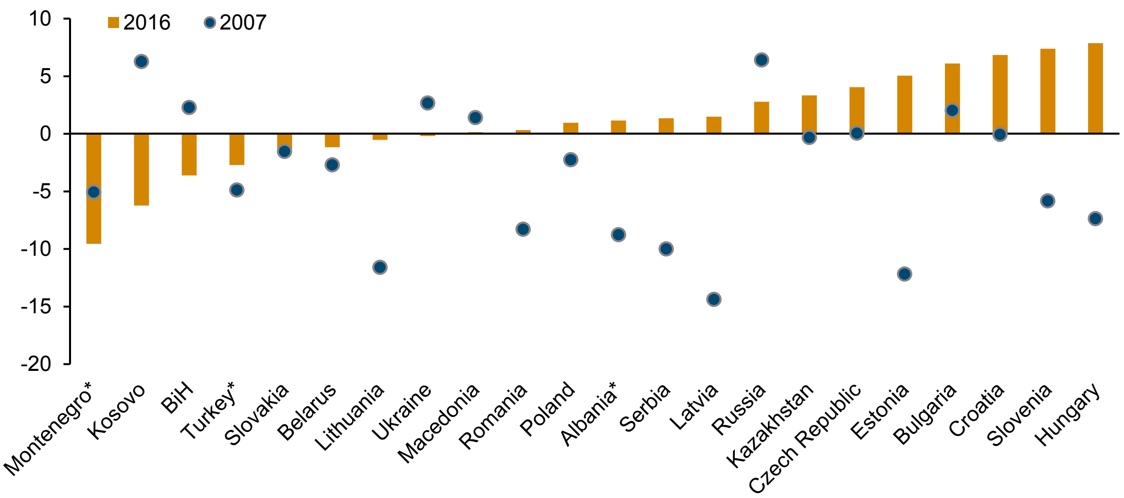
Source: wiiw Annual Database.

Nevertheless, while the general trend is positive, many countries have continued to run big deficits. Overall, these shortfalls reflect an imbalance between savings and investment or, more fundamentally, a lack of external competitiveness. Many of the countries in CESEE with big external deficits are in the Western Balkans. This largely reflects weak export capacity, with most countries in the region struggling to attract large-scale investment into export-oriented manufacturing, and consequently having small tradable sectors. Regional infrastructure deficiencies and several problematic bilateral relationships have also contributed to holding back the development of export sectors in the region. Other notable stories include Turkey and Kazakhstan. In the case of the former, the deficit is driven by large-scale foreign borrowing to finance consumption. The latter reflects the collapse in the oil price, and a lack of success in import substitution (something that has progressed better in Russia, which continues to run a surplus).

However, a focus on simple deficit/surplus dynamics ignores the means of financing, which has a material impact on the sustainability of a country's external position. A reliance on so-called 'hot money' (portfolio and other investment) inflows is risky, given the potential for a rapid reversal. Meanwhile a greater share of foreign direct investment (FDI) in total financial account inflows, which tends to be less volatile, generally indicates greater stability of external financing.

In this context, the overall picture in CESEE is quite encouraging. As the chart below shows, the situation almost everywhere has improved quite dramatically in the past decade. Combining annual current account and FDI flows, only eight CESEE countries – Montenegro, Kosovo, Bosnia and Herzegovina, Turkey, Slovakia, Belarus, Lithuania and Ukraine – ran a deficit in 2016, compared with 15 in 2007 (and in most cases for 2016 this shortfall was negligible). Moreover, in the cases of Kosovo and Bosnia and Herzegovina, much of the balance is made up of concessional loans from multilateral lenders, generally at favourable interest rates and with long-term maturities. On this metric, the country with the most to worry about is probably Turkey, given that it has a particular reliance on US dollar inflows, and with the Fed well ahead of the ECB in the tightening cycle. The position in Russia has also deteriorated over the past decade, although in 2016 it remained firmly in surplus.

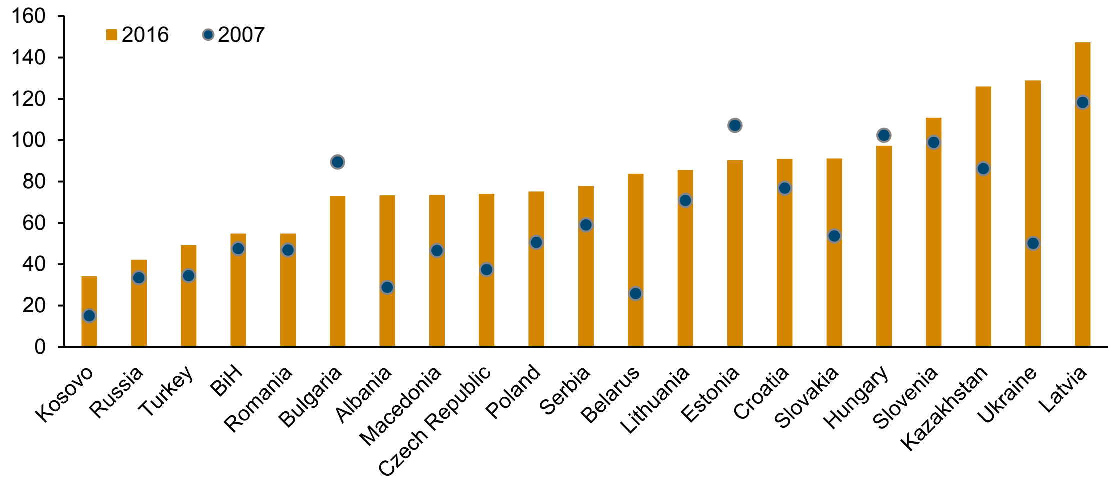
Figure 21 / Current account deficit adjusted for net FDI inflows, % of GDP



Source: wiiw Annual Database. *Montenegro and Turkey data for 2010 and 2016; Albania for 2008 and 2016

While flows generally look better, the situation with external stocks is more of a concern. Over the past decade, external debt loads relative to GDP have risen everywhere, except Bulgaria, Estonia and Hungary, and in some cases – Albania, Belarus and Ukraine – by quite a substantial amount. Breakdowns indicate that this build-up of debt has mostly been undertaken by the private sector, taking advantage of ultra-low borrowing costs. A build-up of potentially unsustainable debt in the private sector is far from irrelevant for sovereign risk.

Figure 22 / External debt, % of GDP



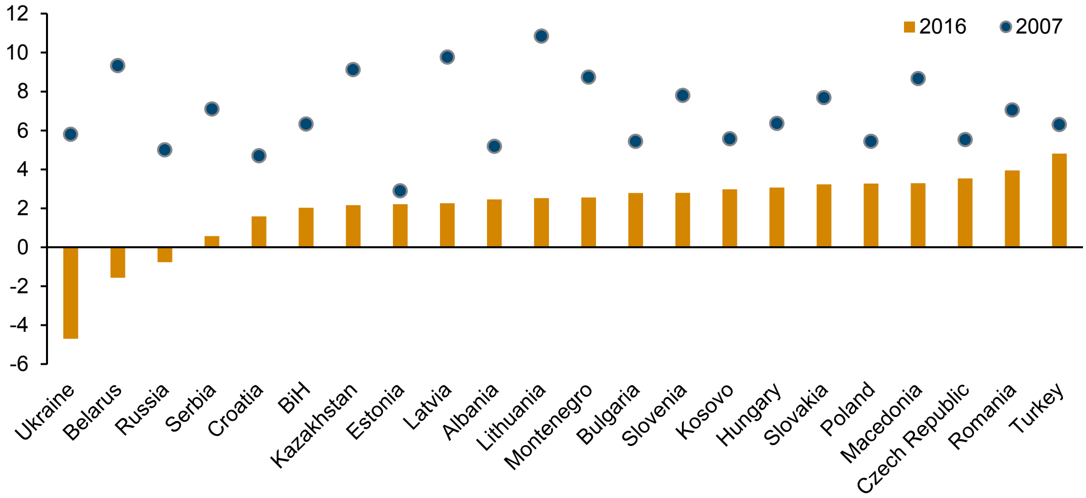
Source: wiiw Annual Database.

GROWTH RATES ARE UNIMPRESSIVE BY PRE-CRISIS STANDARDS, AND WILL MOSTLY FALL FROM HERE

A third key area of potential risk is growth. Put simply, high growth rates give countries a better chance of meeting their debt obligations. This is the area where the most visible deterioration since the global financial crisis is evident. The pre-crisis boom years, which relied so heavily on leverage, are demonstrably over and are highly unlikely to return. Every country in CESEE grew more slowly in the three years to 2016 than in the three years to 2007. In two countries – Ukraine and Belarus – the difference is more than 10 percentage points. In a further eight – Lithuania, Latvia, Kazakhstan, Serbia, Montenegro, Russia, Macedonia and Slovenia – the difference is 5 percentage points or more.

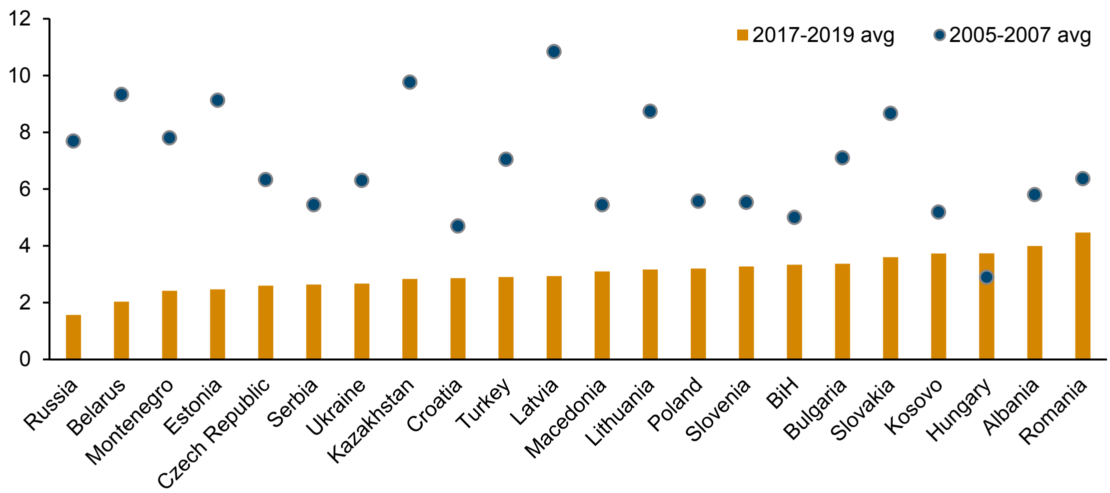
Our forecasts for real GDP growth suggest that this will not change dramatically. Only in countries with negative growth rates in 2016 (Ukraine, Belarus and Russia) do we expect a material increase in growth in 2017-2019 compared with 2016 levels, and none of these countries will reach especially high rates of growth. Across most of the region, we expect some further increases, reflecting a slower recovery from the crisis in large parts of the Western Balkans, and the start of the new EU funds cycle in EU-CEE. However, all these countries (with the interesting exception of Hungary, basically reflecting quite sluggish pre-crisis growth rates) will remain far from pre-crisis rates of expansion.

Figure 23 / Real GDP growth, %, three-year trailing average



Source: wiiw Annual Database.

Figure 24 / Real GDP growth rates, %



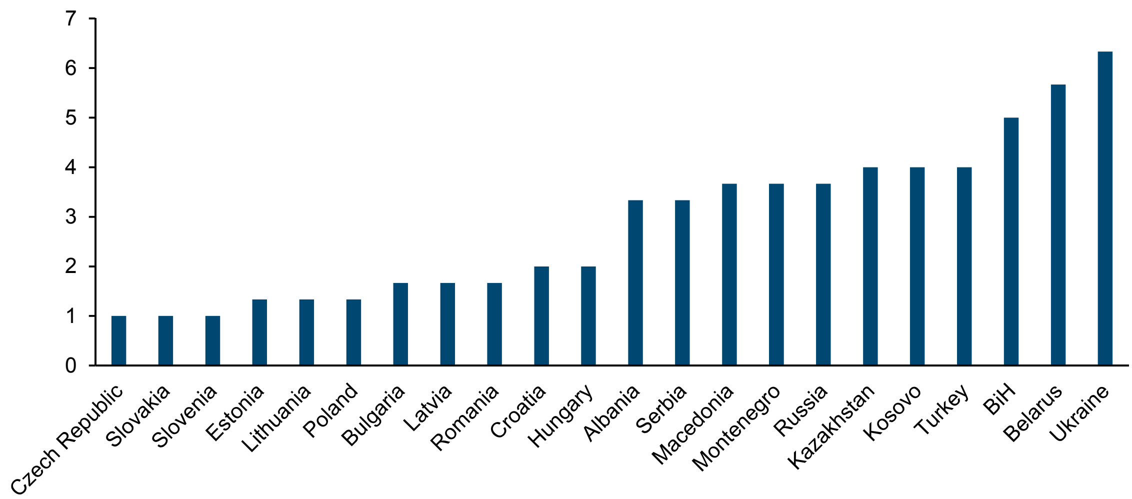
Source: wiiw Annual Database and forecasts.

POLITICAL AND STRUCTURAL RISK

The final major area of potential sovereign credit risk emanates from political and structural factors. These two areas are often the most important determinants of a country's sovereign creditworthiness. Investors tend to tolerate big fiscal and current account deficits in countries that are politically stable, wealthy and have strong institutions.

Political risk is notoriously difficult to quantify. However, it is also necessary when assessing the level of sovereign risk. One attempt has been made by Credendo, a firm that uses insurance rates on trade credits to determine political risk scores. Countries are assessed on a scale of 1 (lowest risk) to 7 (highest risk) on several measures. Below, we average three Credendo scores that we believe are most relevant for sovereign risk – short-term political risk, medium/long-term political risk and political violence risk – to get a score for each country. As the data show, there is sharp differentiation, split largely along the lines of EU members versus non-EU members. Ukraine, Belarus, Bosnia and Herzegovina, Turkey, Kosovo and Kazakhstan appear particularly risky. The Czech Republic, Slovakia and Slovenia are considered the safest.

Figure 25 / Political risk score

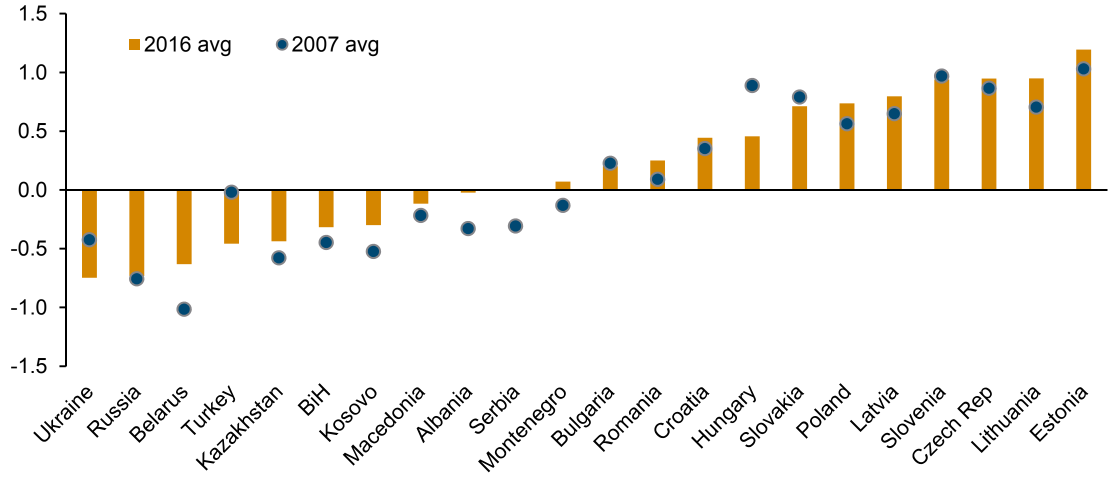


Source: Credendo, own calculations.

Structural factors are easier to quantify, and extremely instructive in assessing sovereign risk. Using structural indicators makes it possible to look through political noise to determine underlying ability to pay. The Czech Republic is a good example of this: in the period since the global financial crisis, it has had several spells of political volatility. However, bond markets have never shown any serious concern, reflecting the assessment that underlying structural factors are strong. Its structural indicators remain close to the best in CESEE.

World Bank governance indicators show that, broadly, countries facing difficult governance challenges have improved over the past decade, while those that already performed well have largely stood still. The two major exceptions to this are Turkey and Hungary, both of which have seen significant falls in governance indicators over the last 10 years. In the case of Hungary, this decline has been fairly broad based. In Turkey, meanwhile, it has been concentrated on voice and accountability, political stability, and the absence of violence. Overall the worst governance conditions are in the Commonwealth of Independent States, Ukraine and Turkey, followed by the Western Balkans. For now, the corrosion of institutional independence in Hungary does not appear to be having much of an impact on the economy and, by extension, sovereign risk. However, in the long run it is hard to see how it will not. Meanwhile, Poland is undergoing a similar process, albeit at a much earlier stage (which is why this is not yet reflected in the World Bank scores). However, if political developments continue as now, Poland's structural risk scores – and by extension sovereign risk perceptions – are likely to follow the Hungarian lead.

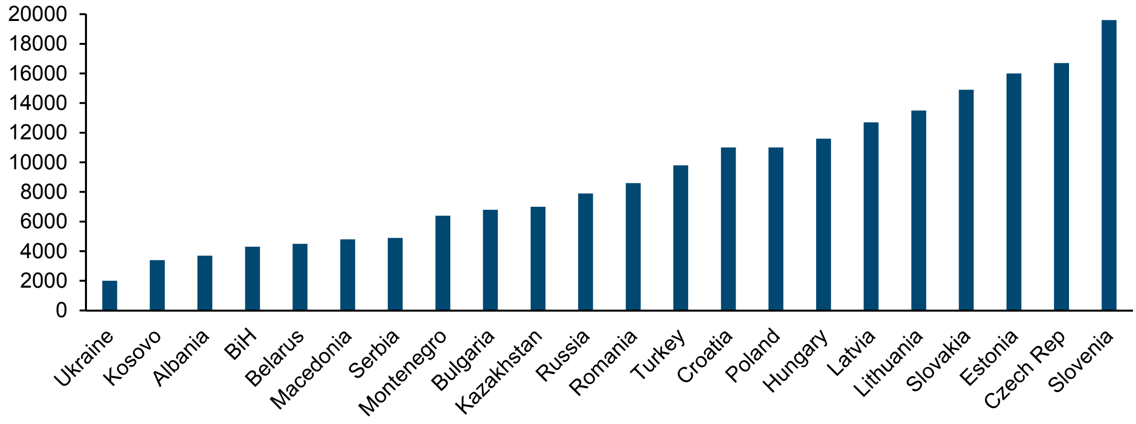
Figure 26 / World Bank Governance indicators, simple average



Source: World Bank.

A further relevant factor is the income level of the country, which is a proxy for how much the government can tax if it needs more funds to service sovereign debt obligations (Canton and Parker, 1996; McCormack and Stringer, 2017; Bhatia, 2002). One way to measure this is simply GDP per capita (at current exchange rates). On this measure, there is very sharp differentiation within the region, with Slovenia's GDP per capita roughly 10 times that of Ukraine.

Figure 27 / GDP per capita, EUR, 2016



Source: wiiw Annual Database.

NEAR-TERM TRIGGERS OF RISK

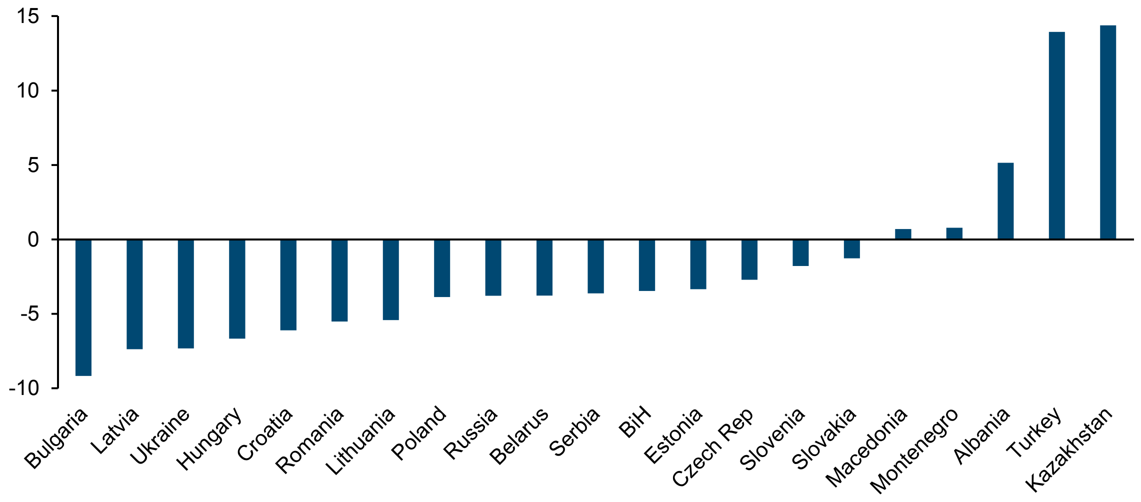
The existence of risks is relatively simple to identify; deciding when they will be triggered is much more difficult. In our view, three potential triggers of the sovereign risk factors we have identified in stand out as particularly serious, in terms of their likelihood and impact. First, a Chinese debt crisis and ensuing global recession. Second, a renewed outbreak of the eurozone crisis, possibly driven by political developments in Spain and especially Italy, a country that is probably too big for the ECB to save if the bond market turns. Third, sharper hikes in US rates than the market currently expects.

Meanwhile, political developments within some countries will also be important. Differentiation here is also key. The strength of populist parties in the Czech Republic, for example, is not especially concerning from a sovereign risk perspective. However, political developments in Ukraine could have material implications for sovereign creditworthiness, given the weakness of institutions. Belarus is a particular case, given that any change of power would be unlikely to be smooth, given the extreme rigidity of power structures and reliance on a single leader.

LONGER-TERM RISKS

It is hard to make a positive case for long-term growth in CESEE. Thinking about growth in terms of its drivers – labour, capital and productivity – the picture is poor in most places. Countries in the region are facing very negative demographic trends, and in general do not have a spectacular record on productivity growth (and do not have the education systems or investment levels to suggest that this will change materially). These factors are likely to keep GDP growth rates subdued in the long run. Without massive immigration or a huge surge in productivity (both highly unlikely), it is difficult to see how many CESEE economies will generate any kind of positive growth in the long run. This will be compounded by similar, if not worse, developments in Western Europe, which will remove the most important source of export demand and remittances for most of CESEE. This is important for sovereign risk in CESEE now, given the extremely long maturities that some countries are borrowing for. The Czech Republic has a 50-year bond, Slovakia and Russia have 20-year bonds, and Hungary has a 15-year bond.

Figure 28 / Change in population between 2015 and 2030, %, zero migration assumption



Source: UN, own calculations.

As a result, beyond the next few years, sovereign risk in CESEE is likely to be quite high. The Japanese scenario – successfully maintaining a very high debt load in the context of little or no growth – is not very feasible for most CESEE countries. Japan can print its own currency, enjoys excellent structural indicators, and has a very wealthy population to tax. If bond markets lose faith in CESEE countries' ability to generate decent and sustained levels of GDP growth, countries with high debt loads and poor long-term growth outlooks may run into trouble. Ukraine, Hungary, Croatia, Serbia and Slovenia all look particularly vulnerable when viewed in this way, although few CESEE states look immune to these risks. Those with strong structural indicators, a relatively high level of wealth, and low levels of private and public leverage (such as the Czech Republic) are in a stronger position. Those which look set to avoid demographic decline in the coming decades, namely Turkey, Albania and Kazakhstan, also have a major advantage, although this on its own is no guarantee of safety.

GROUPING OF COUNTRIES

To conclude, we group countries into four levels of risk. For each indicator of sovereign risk, we split the countries into four, based on the 75th, 50th and 25th percentiles of a defined range (roughly between the highest and lowest regional value on each indicator), and translate this into scores of 1 (lowest) to 4 (highest). We then take a simple average of these scores to get a rating for each country (see table below). We define 4 as very low risk, 3 as generally low risk, 2 as generally higher risk, and 1 as very high risk.

Table 4 / CESEE sovereign risk ranking

Country	Average score
Czech Republic	3.09
Estonia	3.09
Bulgaria	2.91
Lithuania	2.91
Slovakia	2.73
Slovenia	2.73
Turkey	2.73
Poland	2.64
Romania	2.64
Kazakhstan	2.55
Latvia	2.55
Hungary	2.45
Kosovo	2.45
Macedonia	2.45
Croatia	2.36
Russia	2.36
Albania	2.27
Montenegro	2.20
BiH	2.18
Serbia	2.18
Belarus	2.09
Ukraine	1.45

Source: Own calculations.

HEAT MAP OF CESEE SOVEREIGN CREDIT RISKS

Figure 29 / Heat Map of sovereign risk factors in CESEE

Heat map of risks[1)]									
	Fiscal deficit, % of GDP	Public debt, % of GDP	CA + FDI, % of GDP	Gross external debt, % of GDP	Real GDP growth, %	Composite political risk[2)]	World Bank structural indicators[3)]	Population change[4)]	GDP per capita[5)]
Albania	-3.7	71.9	-0.7	73	2.5	3.3	0.0	5.2	3,700
Belarus	1.4	48.6	-2.0	69	-1.6	5.7	-0.6	-3.8	4,500
BiH	-0.8	44.7	-4.0	53	2.0	5.0	-0.3	-3.5	4,300
Bulgaria	-2.4	27.5	4.5	80	2.8	1.7	0.2	-9.2	6,800
Croatia	-3.2	85.6	5.4	101	1.6	2.0	0.4	-6.1	11,000
Czech Republic	-0.7	39.6	1.7	71	3.5	1.0	0.9	-2.7	16,700
Estonia	0.3	10.0	3.3	94	2.2	1.3	1.2	-3.3	16,000
Hungary	-1.8	74.8	5.6	107	3.1	2.0	0.5	-6.7	11,600
Kazakhstan	-2.2	20.8	2.3	96	2.2	4.0	-0.4	14.4	7,000
Kosovo	-0.4	12.5	-4.9	33	3.0	4.0	-0.3	n/a	3,400
Latvia	-0.9	39.2	0.9	144	2.3	1.7	0.8	-7.4	12,700
Lithuania	-0.2	41.1	0.9	77	2.5	1.3	0.9	-5.4	13,500
Macedonia	-3.2	46.7	0.7	71	3.3	3.7	-0.1	0.7	4,800
Montenegro[6)]	-4.9	60.9	-3.6	50	2.6	3.7	0.1	0.8	6,400
Poland	-2.8	51.9	0.9	72	3.3	1.3	0.7	-3.9	11,000
Romania	-1.7	38.3	0.7	58	3.9	1.7	0.2	-5.5	8,600
Russia	-2.7	13.0	2.6	38	-0.8	3.7	-0.7	-3.8	7,900
Serbia	-3.9	73.0	-0.1	78	0.6	3.3	0.0	-3.6	4,900
Slovakia	-2.4	52.7	-0.2	89	3.2	1.0	0.7	-1.3	14,900
Slovenia	-3.3	80.4	7.5	119	2.8	1.0	0.9	-1.8	19,600
Turkey	-1.2	28.1	-3.0	48	4.8	4.0	-0.5	13.9	9,800
Ukraine	-2.8	76.5	-0.1	121	-4.7	6.3	-0.7	-7.3	2,000

1) Unless otherwise stated, average of 2014-16 data.
Source: wiiw annual database.
2) Average of scores for short-term political risk, long-term political risk, and political violence risk. 2017.
Source: Credendo.
3) Average of scores for voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and control of corruption. 2016.
Source: World Bank.
4) Projected percentage change in population, 2015-30.
Source: UN.
5) Nominal euros, 2016.
Source: wiiw annual database.
6) Gross external public debt for Montenegro is only public borrowing.

Source: wiiw annual database, Credendo, World Bank, Eurostat, wiiw annual database, own calculations.

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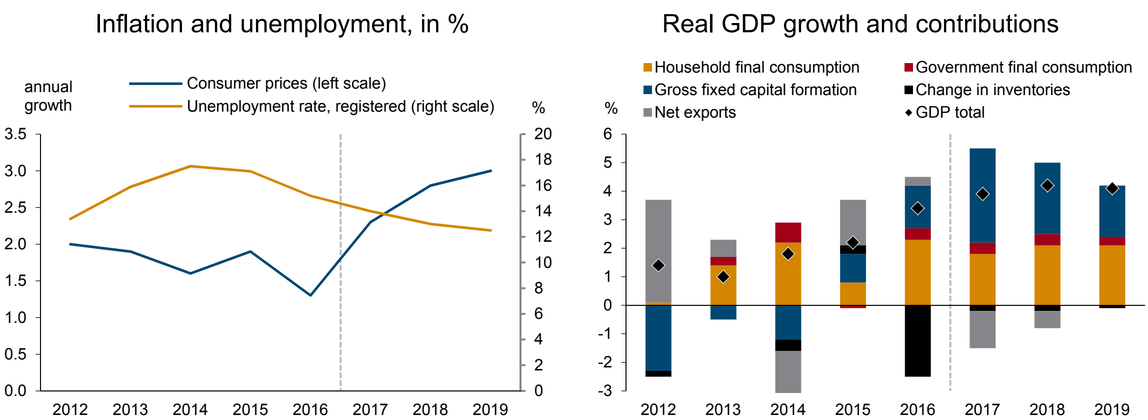
Country reports

ALBANIA: Energy infrastructure construction boom

ISILDA MARA

Strong investment in energy infrastructure will keep real GDP growth at around 4% in 2017 and during the remainder of the forecast period. These investments are mostly privately financed. The budget of the re-elected government of Prime Minister Rama is in surplus. In addition, the tourism sector is doing well, and promises to be an ever more important driver of growth in the coming years.

Figure 30 / Albania: Main macroeconomic indicators



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

The Socialist Party won the parliamentary elections in June 2017 and has a majority of seats in parliament. This is the first time in 16 years that the Socialist Party formed a government without the need for a coalition partner. The continuation of Edi Rama as prime minister might be reassuring for the progress of a number of reforms undertaken during the previous administration. This is particularly important in the context of the continuation and finalisation of the reform of the justice system, which is a crucial criterion for the opening of (lengthy) negotiations for joining the European Union.

Economic growth strengthened to around 4% during the first half of 2017. The first two quarters of the year recorded 3.9% and 4.1% real GDP growth, respectively, compared with the same period in 2016. Almost all sectors of the economy contributed positively. The shooting star was the construction industry, which contributed with 1.8 percentage points to real GDP growth in the second quarter of 2017. Gross fixed investments, as a mirror of the construction sector acceleration, experienced double-digit real growth of 13% in the first half of 2017 year on year – owing to both public and private investments. The construction of the TAP (Trans Adriatic Pipeline) was particularly important in this context; it poured more than EUR 400 million into the economy during the second half of 2016 and the first half of 2017. For 2017-2018 another EUR 800 million is expected to trickle in from the TAP project. Other sectors such as 'extractive industry, energy and water supply' contributed with 0.7 percentage points. The extractive industry benefited in particular from a positive export trend.

Household consumption grew less strongly, by 2.2%, during the first half of 2017. Labour market indicators have improved: overall unemployment dropped, gross earnings grew, and consumer confidence rose in the first half of 2017 as compared with the end of 2016. The fall in the unemployment rate for young people was particularly noteworthy – down from 28.1% to 26.2% – although joblessness rose slightly for those aged 30-64. The number of jobs created was not sufficiently high to generate a stronger recovery in consumption. Moreover, the labour market still suffers from a number of structural problems such as a skill/qualification mismatch. This might create a crowding-out effect of those less educated by those who are highly skilled, and furthermore a continuous outward migration flow. Remittances were slightly higher during the first half of 2017 as compared to the same period a year earlier, but are still – both in absolute terms and with respect to GDP – below the astonishing level reached in the pre-crisis period, at 9% of GDP (in 2016) versus 15% (in 2008).

Although, 2017 was a parliamentary election year, the general government budget posted a surplus of 0.4% of GDP over the first eight months of the year. In January-August 2017, state budget revenues rose by 7% year on year and exceeded expenditures. In October 2016 the government relaunched a campaign against informality, mainly targeting large retailing companies. Nevertheless, tackling tax fraud with a tough approach may prove not to be the best option. A better way to increase tax revenue would be to ensure a better business climate, fair competition, and incentives to invest and expand; at present firms in Albania struggle with high corruption and an unfavourable business climate. The new government has announced changes in the tax system as of January 2018. The proposed changes concern the modification of the property tax (e.g. for houses, dwellings including the primary residence) from fixed to market value based; a cut in the tax on dividends to 6%; and a reduction of tax progressivity for high-income earners – changes which might induce less engagement in tax avoidance but which will have negative distributive effects.

Public debt is likely to fall, but the USD 1 billion public-private partnership programme announced by the new government could obstruct this trend. The new government is targeting up to 6% annual real GDP growth by the end of its current term in office. It aims to achieve this by supporting a number of investment projects in infrastructure, energy, natural resources and public services, funded by financial instruments such as public-private partnerships. Nevertheless, the IMF – which during the government's second term will act only as an advisor – has declared that such a programme might be subject to elevated fiscal risks, especially as concerns public debt. In private finance, signals from the banking sector have been encouraging regarding the drop in non-performing loans to 15.2% in August 2017, down from 21% in August 2016. Less comforting is the demand for credit: the overall stock has almost stagnated whereas the stock of loans of the non-financial private sector shrank by 2% in January-August 2017.

External demand has been strengthening in 2017, as exports of goods have recovered while tourism continued to expand further. However, while the recovery of merchandised goods exports is positive, 44% of these exports consist of garment industry products. This industry is an important source of employment, but the output is concentrated at the low end of the global value chain: more labour intensive and low technology oriented. Despite the long experience in this industry – more than 20 years – little progress has been made towards more capital-intensive chains of production. Consequently, the value added of this industry is still low. The tourism industry has expanded further, and the expectations are that such a trend will continue in the coming year. The new government has classified tourism as a top priority and is committed to invest further in the promotion, diversification and development of this sector.

Merchandise imports also increased, by almost 7% year on year in January-August 2017. In particular, imports of minerals, fuels, electricity grew by 17%, largely reflecting imports of electricity. Domestic production of electricity was sharply reduced because of the extreme drought during the summer. For January-October 2017 electricity imports are estimated to have totalled around EUR 100 million. Albania strongly depends on hydropower as the main source of energy production in the country, and consequently changes in precipitation throughout the year can make a huge difference in satisfying the demand. Given that rainfall is a mean-reverting process in the coming year, Albania is expected to be less dependent on imports of electricity in 2018, which will mean lower imports. The continuous droughts/floods which have been hitting the country in recent years put at risk not only the production of energy and the profitability of hydropower stations but also agricultural production. Investing in the gasification of the country and alternative energy production such as photovoltaic power stations are other options that the new government is aiming to develop further with the purpose of reducing the dependence on hydro resources.

Foreign direct investment in the first half of 2017 dropped by 7% compared with the same period in 2016. It is expected that the Trans Adriatic Pipeline will continue to add to FDI inflows in 2018 and 2019, as will Norvegian Statkraft by completing the Moglica hydropower project in 2018. Otherwise, the evolution of FDI inflows in the coming years is subject to significant uncertainty as long as the structure of FDI attracted by Albania does not change.

In conclusion, growth will continue to accelerate during the forecast period. Domestic demand will be the main driver. The construction boom is back. Tourism and the export industry will benefit from an improvement in external demand. The reforms initiated during the first Rama government have a good chance of being continued during Rama's second tenure. The USD 1 billion programme of public-private investment would certainly be a strong push to the economy, but there is still a long way towards implementation. Thus, our GDP growth forecast remains unchanged for 2017, at 3.9%, has been slightly upgraded to 4.2% for 2018, and has remained at 4.1% for 2019.

Table 5 / Albania: Selected economic indicators

	2013	2014	2015	2016 1)	2016 January-June	2017 January-June	2017 Forecast	2018 Forecast	2019 Forecast
Population, th pers., average	2,895	2,889	2,881	2,876	.	.	2,890	2,890	2,890
Gross domestic product, ALL bn, nom.	1,350	1,395	1,428	1,473	718	767	1,600	1,700	1,800
annual change in % (real)	1.0	1.8	2.2	3.4	3.3	4.0	3.9	4.2	4.1
GDP/capita (EUR at PPP)	7,800	8,300	8,500	8,600	.	.	.	.	.
Consumption of households, ALL bn, nom.	1,074	1,120	1,150	1,201	609	634	.	.	.
annual change in % (real)	1.8	2.8	1.0	2.9	3.7	2.2	2.2	2.6	2.6
Gross fixed capital form., ALL bn, nom.	352	337	352	373	158	179	.	.	.
annual change in % (real)	-2.0	-4.5	4.0	6.0	5.1	12.9	13.0	10.0	7.0
Gross industrial production									
annual change in % (real)	28.2	1.5	-2.1	-16.6	-23.4	4.6	4.0	2.0	2.0
Gross agricultural production 2)									
annual change in % (real)	0.5	0.7	2.9	0.5	.	.	.	.	.
Construction output total									
annual change in % (real)	-13.0	5.0	19.3	5.1	1.6	29.1	.	.	.
Employed persons, LFS, th	1,024	1,037	1,087	1,157	1,139	1,179	1,190	1,230	1,250
annual change in %	-10.2	1.3	4.8	6.5	6.0	3.5	2.8	3.4	1.6
Unemployed persons, LFS, th	194	220	224	208	217	192	190	180	180
Unemployment rate, LFS, in %	15.9	17.5	17.1	15.2	16.0	14.1	14.0	13.0	12.5
Reg. unemployment rate, in %, eop	13.5	13.0	12.9	8.8	10.7	7.8	.	.	.
Average monthly gross wages, ALL 3)	36,332	45,539	46,829	45,845	54,400	58,500	49,200	52,600	56,300
annual change in % (real, gross)	-5.0	-0.7	0.9	-3.4	0.3	5.2	5.0	4.0	4.0
Consumer prices, % p.a.	1.9	1.6	1.9	1.3	0.7	2.2	2.3	2.8	3.0
Producer prices in industry, % p.a.	-0.4	-0.5	-2.1	-1.5	-3.0	3.4	3.0	2.0	2.0
General governm.budget, nat.def., % of GDP									
Revenues	24.2	26.3	26.6	27.6	27.6	27.7	28.0	29.0	29.5
Expenditures	29.2	31.4	30.6	29.4	25.2	27.3	27.8	30.0	31.0
Deficit (-) / surplus (+)	-5.0	-5.2	-4.1	-1.8	2.4	0.4	0.2	-1.0	-1.5
Public debt, nat.def., % of GDP	65.6	70.1	73.1	72.4	69.0	66.7	72.0	69.0	67.0
Stock of loans of non-fin.private sector, % p.a	-1.2	2.4	-2.6	0.2	-3.0	-4.0	.	.	.
Non-performing loans (NPL), in %, eop	23.2	22.8	18.2	18.3	20.0	15.6	.	.	.
Central bank policy rate, % p.a., eop 4)	3.00	2.25	1.75	1.25	1.3	1.3	1.3	1.8	2.5
Current account, EUR mn	-891	-1,076	-884	-812	-485	-383	-1,030	-1,170	-1,250
Current account, % of GDP	-9.3	-10.8	-8.6	-7.6	-9.4	-6.7	-8.6	-9.3	-9.4
Exports of goods, BOP, EUR mn	1,067	932	771	714	320	398	750	790	830
annual change in %	21.9	-12.7	-17.2	-7.4	-24.3	24.3	5.5	5.0	5.0
Imports of goods, BOP, EUR mn	3,030	3,147	3,070	3,317	1,576	1,678	3,700	4,000	4,200
annual change in %	-2.3	3.9	-2.5	8.0	12.6	6.5	11.0	7.5	5.5
Exports of services, BOP, EUR mn	1,715	1,881	2,028	2,396	1,006	1,271	2,700	2,900	3,100
annual change in %	-9.7	9.7	7.8	18.1	14.7	26.3	14.0	8.5	7.0
Imports of services, BOP, EUR mn	1,489	1,558	1,503	1,599	708	785	1,800	1,900	2,000
annual change in %	2.0	4.6	-3.5	6.4	11.9	10.9	13.0	8.0	7.0
FDI liabilities, EUR mn	945	869	890	943	409	380	950.0	.	.
FDI assets, EUR mn	22	58	72	6	31.2	-37.6	50.0	.	.
Gross reserves of NB excl. gold, EUR mn	1,971	2,142	2,831	2,889	2,767	2,760	.	.	.
Gross external debt, EUR mn	6,368	6,927	7,634	7,882	7,828	7,851	8,200	8,600	8,900
Gross external debt, % of GDP	66.2	69.5	74.7	73.5	73.0	66.0	69.0	68.0	67.0
Average exchange rate ALL/EUR	140.26	139.97	139.74	137.36	138.28	135.13	134.5	135.0	135.5

1) Preliminary. - 2) Based on UN-FAO data, from 2015 wiiw estimate. - 3) From 2014 based on data of General Directorate of Taxation, Structural Business Statistics (market producers) used before. - 4) One-week repo rate.

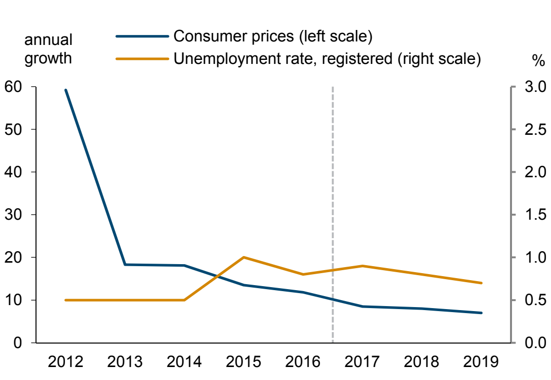
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.

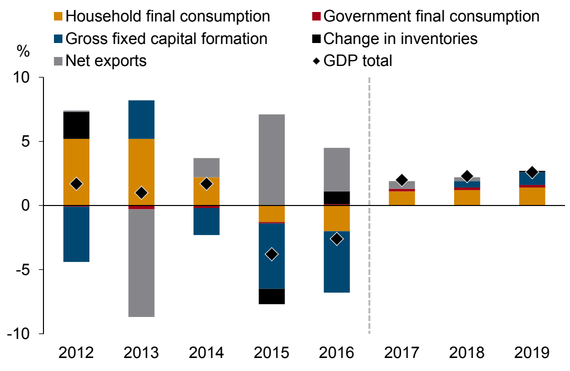
BELARUS: Recovery under way

RUMEN DOBRINSKY

GDP in Belarus grew by 1% in the first half of 2017, thanks to the economic upturn in Russia and the settling of the gas dispute between the two countries. The resumption of normal oil deliveries from Russia enabled a rapid recovery in manufacturing and exports. A tight macroeconomic policy stance contributed to a reduction of inflation in Belarus to single-digit levels. GDP growth could reach 2% for the year as a whole and may strengthen further in 2018 and 2019.

Figure 31 / Belarus: Main macroeconomic indicators





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

After two years of economic decline, GDP in Belarus grew by 1% in the first half of 2017. Preliminary statistics indicate that aggregate output growth was strengthening further in July-August. The recovery in manufacturing was even more pronounced: gross industrial output surged by 6.1% year on year in the first six months. All indications are that the recession is over and that 2017 will be a year of positive economic growth in Belarus.

So far recovery is mostly visible on the supply side. As regards final demand, it was net exports that continued to make (similarly to 2015 and 2016) the most visible contribution to GDP growth in the first half of the year. Given the improving economic environment, domestic demand is probably also on the way to recovery but as of the moment of writing there was still no official statistics reflecting this. An indirect indication of positive shifts in personal consumption was the dynamics of real retail sales: in

January-August 2017 these grew by 1.9% compared to the same period of 2016. Matching this outturn, there was a surge in consumer credit extended by commercial banks which was another indication of improving economic sentiment.

One of the key factors behind this recovery has been the economic upturn in Russia, Belarus' main trading partner, accounting for more than 40% of Belarus' total exports. Thanks to the recovery in Russia's import demand, Belarus' exports of goods to Russia rebounded strongly in 2017, by 24.4% in current USD in the period January-July. Exports of goods to non-CIS countries also bounced back, increasing by 16.1% in the same period.

This, however, would not have happened if it were not for another important development: the settling of the gas dispute between Belarus and Russia in April. In accordance with the settlement, Belarus agreed to pay the full debt for past gas deliveries as requested by Russia but with an extended repayment period. In turn, Russia agreed to price concessions for gas deliveries in 2018 and 2019. After the new accord, oil deliveries from Russia (which were cut by almost a quarter in 2016) recovered to normal levels in 2017.

Thanks to the above two factors and the availability of underutilised capacity, manufacturing production grew by more than 6% year on year in the first half of 2017. It was the recovery in manufacturing production that made the export upturn (both to Russia and to non-CIS countries) possible as a large chunk of it depends on processed oil. The surge in manufacturing output and exports thus gave the main impetus for the overall recovery of the Belarusian economy.

According to anecdotal evidence, businesses (including big industrial firms) in Belarus are re-hiring workers and the job market has also been improving. The absence of reliable labour force statistics prevents an accurate analysis of the situation but even the statistics on registrations indicates a drop in the number of unemployed. However, most likely, employment will not return to its pre-recession levels as some companies, especially the large state-owned firms, will probably use this episode as a pretext to rationalise their staffing by cutting down some slack labour.

Belarus also made notable progress towards macroeconomic stability. The annualised rate of CPI at present stands at single digits, levels that have not been recorded often in recent years; monthly CPI inflation was even negative in July and August. The suppression of inflationary pressures was largely due to tight macroeconomic policies (especially fiscal restraint) during the last couple of years. These policies were matched by a reduction in directed credit (subsidised credit allocated to state-owned firms participating in government programmes), a channel that used to generate considerable monetary leaks. Thus between 2012 and 2017 total (both direct and indirect) public support to the agri-business sector alone was reduced by roughly USD 1 billion (from USD 1.8 billion in 2012 to USD 823 million in 2017). Reflecting these positive outcomes, the National Bank of Belarus reduced in eight consecutive moves its key intervention rate from 18% at end-2016 to 11.0% in October which was also a sign of confidence of the monetary authorities in their policy course.

Tight policies also contributed to the curbing of the current account deficit. From double-digit levels during much of the period 2009-2013 it has now fallen to low single digits, levels that seem to be manageable. The curtailing of final domestic demand, both private consumption and fixed investment (including the slashing of public investment programmes), was the key factor behind the shrinking current account deficit. The lasting strength of services exports, in particular ICT services (which were less affected by the recession), and the steadily positive balance in the services trade also helped to reduce the overall current account deficit.

Weak domestic demand in 2015-2016 by and large offset the effect of the appreciating real exchange rate, the latter being another implication of the macroeconomic restraint. So far there have been no visible negative repercussions of the real exchange rate appreciation but if it continues, policy may need to address the risks associated with it. As another sign of confidence in the external stability, the National Bank of Belarus reduced (effective 1 October 2017) from 20% to 10% the percentage of obligatory sales by local businesses of their foreign currency earnings.

The reduction of the external imbalances alleviated Belarus' foreign borrowing requirements and the authorities raised easily the needed external finance in 2017. Following the settlement of the gas dispute, Belarus concluded a new USD 2 billion funding agreement with the Eurasian Development Bank and negotiated a new credit worth USD 700 million from the Russian government (the latter was largely intended for rolling over matured past debt to Russia). In June, Belarus also placed successfully a Eurobond emission worth USD 1.4 billion in two tranches: USD 800 million bonds with 6-year maturity and a 7.125% coupon rate and USD 600 million of 10-year bonds at 7.625%. Thanks to these cash injections, Belarus repaid fully already in April the USD 726 million debt to Gazprom stemming from the gas dispute which paved the way for the resumption of full-scale oil deliveries. Given the successful borrowing efforts in 2017, Belarus announced that it would not need additional external finance in 2018. At the same time, the 2017 borrowing operations raised the level of external public debt by some USD 2 billion to USD 15.6 billion in August, or almost 40% of the total external debt of Belarus.

At the beginning of 2017, Belarus opened negotiations with the IMF on a new funding agreement. The dialogue was difficult and the IMF insisted on the personal endorsement of the future agreement – and hence personal commitment – by President Lukashenka. Plus the IMF was pushing for a credible schedule of harsh structural reforms, including the reorganisation and restructuring of state-owned firms and the pilot privatisation of a selected few of them. However, as Belarus secured external funding from other sources, its pressing need for a new IMF agreement subsided and negotiations got stuck. Ultimately, in July the IMF pulled out of the negotiations until, in their words, there was 'a clear demonstration of high-level support for the necessary changes'.

The prospects for the Belarus economy have improved over the course of 2017 and the rate of GDP growth could reach some 2% for the year as a whole. Should the external environment remain favourable (in particular, should the Russian economic upturn continue) the recovery in Belarus may strengthen in 2018 and 2019, with GDP growth in the range of 2½-3% p.a. supported by both recuperating domestic demand and a continuing export revival. It is unlikely, however, that GDP growth will return to the levels (high single digits) seen in the past, as these were only achieved thanks to unbalanced and destabilising demand-stimulation policies.

If there is no relaxation of the macroeconomic stance, disinflation should continue with inflation staying in the single-digit range. In case prudent policies are preserved, management of the external public debt in the short run would also not create problems given the external funding already secured in 2017. However, a possible easing of this stance could endanger the fragile external and internal macroeconomic stability. Hence macroeconomic risks associated with the policy course are still in place and require careful monitoring and management.

Table 6 / Belarus: Selected economic indicators

	2013	2014	2015	2016 1)	2016 January-June	2017 January-June	2017 Forecast	2018 Forecast	2019 Forecast
Population, th pers., average	9,466	9,475	9,490	9,502	.	.	9,520	9,540	9,560
Gross domestic product, BYN mn, nom. 2)	67,069	80,579	89,910	94,321	43,737	47,642	104,300	115,200	126,500
annual change in % (real)	1.0	1.7	-3.8	-2.6	-2.5	1.1	2.0	2.3	2.6
GDP/capita (EUR at PPP) 2)	13,400	13,900	13,700	13,200	.	.	.	.	.
Consumption of households, BYN mn, nom. 2)	33,970	42,082	47,006	50,953	24,385	26,607	.	.	.
annual change in % (real)	10.9	4.3	-2.4	-3.9	-1.6	1.2	2.0	2.3	2.5
Gross fixed capital form., BYN mn, nom. 2)	24,941	26,772	25,763	22,585	9,908	10,253	.	.	.
annual change in % (real)	9.0	-5.7	-15.5	-16.7	-18.3	-2.2	0.0	2.0	4.0
Gross industrial production									
annual change in % (real)	-4.9	2.0	-6.6	-0.4	-1.6	6.1	5.0	4.0	4.0
Gross agricultural production									
annual change in % (real)	-4.0	3.1	-2.5	3.3	3.3	-0.8	.	.	.
Construction industry									
annual change in % (real)	4.6	-5.7	-11.3	-18.4	.	.	.	.	.
Reg. employment, th, average	4,578	4,551	4,496	4,406	4,423	4,354	4,380	4,390	4,400
annual change in %	-0.7	-0.6	-1.2	-2.0	-1.7	-1.6	-0.6	0.2	0.2
Reg. unemployed persons, th, eop	21.0	24.2	43.3	35.3	47.2	34.2	40.0	35.0	31.0
Reg. unemployment rate, in %, eop	0.5	0.5	1.0	0.8	1.1	0.8	0.9	0.8	0.7
Average monthly gross wages, BYN	506.1	605.2	671.5	722.7	699.2	767.3	790	860	930
annual change in % (real, gross)	16.4	1.3	-2.3	-3.8	-3.6	2.6	0.5	1.0	1.5
Consumer prices, % p.a.	18.3	18.1	13.5	11.8	12.4	7.0	8.5	8.0	7.0
Producer prices in industry, % p.a. 3)	13.6	12.8	16.8	12.0	14.0	9.2	10.5	9.0	8.0
General governm.budget, nat. def., % of GDP									
Revenues	39.0	37.3	41.3	41.2	42.6	42.2	39.0	39.0	39.0
Expenditures	38.8	36.1	39.9	39.7	40.9	39.0	38.0	38.0	38.0
Deficit (-) / surplus (+)	0.2	1.3	1.4	1.5	1.6	3.2	1.0	1.0	1.0
Public debt, EU-def., % of GDP	34.5	37.3	53.7	54.9	.	.	53.0	52.0	50.0
Stock of loans of non-fin.private sector, % p.a	28.8	21.1	19.4	-6.2	7.2	-11.9	.	.	.
Non-performing loans (NPL), in %, eop	4.4	4.4	6.8	12.8	13.4	13.7	.	.	.
Central bank policy rate, % p.a., eop 4)	23.5	20.0	25.0	18.0	22.0	13.0	11.0	10.0	9.0
Current account, EUR mn 5)	-5,737	-4,057	-1,669	-1,523	-1,248	-571	-1,200	-1,400	-1,500
Current account, % of GDP 5)	-10.1	-6.7	-3.3	-3.6	-6.3	-2.4	-2.6	-2.9	-3.0
Exports of goods, BOP, EUR mn 5)	27,701	27,492	23,854	20,988	9,920	12,319	23,700	25,400	26,900
annual change in %	-21.7	-0.8	-13.2	-12.0	-17.8	24.2	12.9	7.2	5.9
Imports of goods, BOP, EUR mn 5)	31,183	29,537	25,807	23,270	10,957	13,260	25,300	27,100	28,600
annual change in %	-10.8	-5.3	-12.6	-9.8	-11.8	21.0	8.7	7.1	5.5
Exports of services, BOP, EUR mn 5)	5,690	6,115	6,048	6,194	2,785	3,253	6,300	6,500	6,800
annual change in %	16.1	7.5	-1.1	2.4	-2.7	16.8	1.7	3.2	4.6
Imports of services, BOP, EUR mn 5)	3,983	4,449	4,003	3,983	1,871	1,929	3,800	3,900	4,200
annual change in %	26.8	11.7	-10.0	-0.5	1.6	3.1	-4.6	2.6	7.7
FDI liabilities, EUR mn 5)	1,703	1,445	1,506	1,133	835	802	1,000	.	.
FDI assets, EUR mn 5)	199	57	97	112	41	12	100	.	.
Gross reserves of NB excl. gold, EUR mn 5)	3,589	2,820	2,510	3,071	2,343	4,233	.	.	.
Gross external debt, EUR mn 5)	28,807	32,982	34,996	35,930	34,504	34,119	33,400	32,600	33,400
Gross external debt, % of GDP 5)	50.8	54.1	69.4	83.8	80.5	73.6	72.0	68.0	66.0
Average exchange rate BYN/EUR	1.1834	1.3220	1.7828	2.2010	2.2210	2.0393	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. - 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.

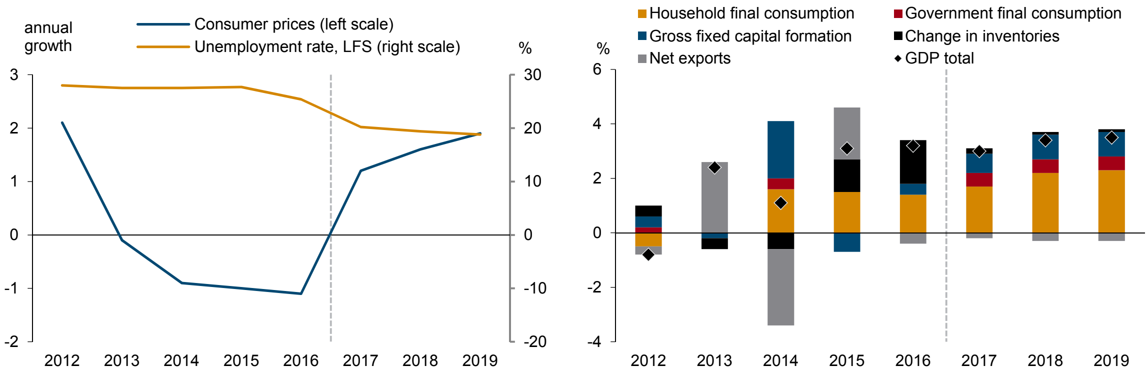
BOSNIA AND HERZEGOVINA: Political stalemate could cause further delays in investment

RICHARD GRIEVESON

The economy lost momentum in the second quarter, although overall it is likely to post growth of around 3% this year. Growth should pick up even further in the rest of the forecast period, driven by remittances, a gradual improvement in the labour market, tourism and exports. Political risk will remain elevated ahead of the 2018 election, which is having an impact on investment spending, although it is unlikely significantly to derail medium-term growth.

Figure 32 / 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 next general election is now only a year away, and tensions in the run-up to polling could create challenges for the economy. However, political noise in BiH is nothing new, and the usual verbal sparring is unlikely to have a material impact on growth. Investors and economic agents in Bosnia are well aware of the high risk of political instability in the country.

Many key actors appear already to be in pre-election mode, meaning that there is even less impetus for reform than usual. Moreover, there is no longer a clear parliamentary majority to pass laws, meaning an effective stalemate. The government has still not returned a questionnaire from the European Commission that it received last December as part of its accession process (other candidate countries had already completed the process by this point). In July, Bosnia was the only one of the Berlin Process partner countries not to sign the Transport Community Treaty (this was finally done in

September). The treaty aims to create an integrated transport network in the region in order to support economic integration with the EU.

The IMF Extended Fund Facility (EFF) is subject to the usual delays, and meeting the conditions will remain challenging. The government failed to adopt new, higher tariffs on gasoline and laws on banking deposit insurance required under the IMF agreement, meaning that the latest IMF disbursement – earmarked for funding improvements in transport infrastructure, and due to be released in May – has been delayed. It is likely that a compromise will eventually be found, although with the election approaching, the room for an agreement on the issues required for the release of IMF funding that all sides can accept could be limited in the next year. Meanwhile, regional tensions continue to rumble on. BiH is currently engaged in a heated spat with Croatia, which plans to build the Pelješac Bridge to connect two parts of its territory – the Pelješac peninsula and the rest of the country – and thereby bypass Bosnia's Neum corridor. Bosnia has argued that this will block the access of large ships from the Neum harbour to the sea. However, in June the European Commission approved the project, and Croatia has received EU funds for construction.

Growth slowed in the second quarter, but we expect this to be temporary. The economy expanded by 1.7% year on year in real terms in Q2, down from 2.8% in the first three months of the year. We still think that full-year growth will come in at around 3% this year, with high frequency indicators suggesting a pick-up in momentum during the third quarter. Merchandise exports rose by an average 23% year on year in July-August, compared with 15.5% in the first half of the year. Working-day adjusted industrial output increased by 6.3% in July-August, compared with 2.3% in January-June. Retail trade also continued to expand robustly (4.9% average growth in July-August), albeit a slight slowdown from the first half of the year (6%).

Private consumption is by far the biggest section of the economy, and remains the key to overall growth. Total employment rose by an average 3.5% year on year in January-July, a material improvement on recent years. Nominal net earnings growth has also increased, rising by 1.7% year on year on average in January-July. Having risen to 2.2% year on year in May, consumer price inflation has since fallen back, rising by 1% in August, thereby providing some support to real income growth. As in much of the rest of Europe, the phasing out of positive base effects from low energy prices in early 2016, plus continued slack in the labour market, is likely to keep inflation at historically low levels during the forecast period.

Construction activity is weak, reflecting delays to the disbursement of financing. Real construction output fell by 2.2% year on year in January-June. Construction relies heavily on external financing, meaning that the weakness is likely to persist as long as IMF disbursements are delayed.

The export base is still small and narrow, which will continue to limit the contribution of the external sector to growth. However, it is gradually growing and diversifying, and will become slowly more important. Merchandise exports were equivalent to 32% of GDP in 2016, double the level of 2003, and up from 28% in 2010. Moreover, data show that the reliance on commodity exports is declining; mineral products were 8% of exports in 2016 and base metals 17%, down from 17% and 23%, respectively, in 2010. Over the same period, the share of total exports made up of chemicals, plastics and rubber, textiles, footwear and headwear, machinery and mechanical appliances, and transport equipment all increased.

Nevertheless, the external deficit is large, and will remain so during the forecast period. The current account shortfall was equivalent to 5.1% of GDP in 2016, although it should be a bit narrower this year and in 2018-19. The current account deficit narrowed by over 6% year on year in Q1, driven by improvements in the services and secondary incomes surpluses. Services benefited from growth in goods processing, tourism and transport, while secondary income rose as a result of higher remittances, linked to better growth in key remittance sources in Western Europe. Bosnia's tourism industry is growing quickly; tourist nights rose by 11% year on year on average in H1. Merchandise exports also rose strongly in Q1, increasing by 19.7% year on year. However, imports – which remain much bigger – increased by 12.8%, meaning that the goods deficit still widened year on year. According to the central bank, a large part of the rise in nominal imports reflected higher prices for oil and oil products. Stronger domestic demand also likely contributed.

The Stabilisation and Association Agreement (SAA) with the EU, signed in 2015, should have a positive effect on the external accounts over the medium term, although is unlikely to be a game changer on its own. Foreign direct investment (FDI) inflows could rise somewhat in line with trends seen previously in other CESEE countries on the way to EU membership. However, this effect will be limited by Bosnia's particularly tortuous EU accession process, as well as clear accession fatigue in Brussels and other EU capitals. The primary means of financing the current account deficit will probably remain 'other' investment, chiefly loans on concessional terms, which means that Bosnia's current account deficit is not as risky as for other countries. Net foreign exchange reserves have generally remained in the range of 6-7 months of import cover, providing reasonable cover for the currency board arrangement.

The fiscal position has strengthened, helped by higher value-added tax revenue on the back of stronger consumption. 2017 started positively, with revenue up by 6.6% year on year in Q1. The delay in IMF financing is an issue from the fiscal perspective, although the budget has been bolstered by a repayment of debt from the USSR (honoured by Russia). However, it is not clear that positive fiscal trends will continue, particularly if IMF disbursements continue to be delayed. Moreover, ahead of the 2018 election there is some risk of fiscal slippage.

Credit growth is picking up, driven by stronger private sector demand, from both non-financial corporations and households. Although the banking sector is still not in perfect shape, asset quality and stability indicators are improving, which should mean that the sector can further support growth during the forecast period. Non-performing loans (NPLs) fell to 11.5% of the total in Q1 2017, their lowest level since 2010. The ratio of tier 1 capital to risk-weighted assets reached 14.8% in Q1.

Although political noise and delays to the IMF programme could generate some volatility in quarterly growth rates, overall we expect real GDP to expand at a reasonably strong rate – above 3% – during the forecast period. Growth will be driven primarily by private consumption, underpinned by positive momentum in the labour market and earnings. The traditional factors that stand behind growth in Bosnia – remittances and multilateral loans – will remain important. However, positive trends in other areas such as tourism and manufacturing exports should also continue, and these sectors will gradually increase their share of overall growth. Assuming that compromises between local actors can be found, infrastructure projects currently held up by political arguments related to IMF-mandated legislation will also contribute positively to growth during the forecast period.

Table 7 / Bosnia and Herzegovina: Selected economic indicators

	2013	2014	2015	2016 1)	2016 January-June	2017 January-June	2017 Forecast	2018 Forecast	2019 Forecast
Population, th pers., mid-year 2)	3,531	3,526	3,518	3,515	.	.	3,515	3,510	3,510
Gross domestic product, BAM mn, nom. 3)	26,779	27,359	28,586	29,899	14,205	14,849	31,200	32,800	34,600
annual change in % (real)	2.4	1.1	3.1	3.2	2.7	2.2	3.0	3.4	3.5
GDP/capita (EUR at PPP) 3)	8,100	8,300	8,800	9,000	.	.	.	.	.
Consumption of households, BAM mn, nom. 3)	22,521	22,830	23,157	23,538	.	.	.	.	.
annual change in % (real)	0.0	1.9	1.8	1.7	.	.	2.2	2.8	2.9
Gross fixed capital form., BAM mn, nom. 3)	4,808	5,330	5,097	5,189	.	.	.	.	.
annual change in % (real)	-1.2	11.5	-3.5	2.5	.	.	4.0	5.0	5.0
Gross industrial production									
annual change in % (real)	5.2	0.2	3.1	4.4	4.7	2.1	3.0	4.5	5.1
Gross agricultural production 4)									
annual change in % (real)	15.2	-14.2	5.0	2.0	.	.	.	.	.
Construction output total									
annual change in % (real)	-2.4	6.8	-3.2	-1.0	-1.7	-3.0	.	.	.
Employed persons, LFS, th, April	821.6	812.0	822.0	801.0	801	816	820	830	840
annual change in %	1.0	-1.2	1.2	-2.6	-2.6	1.8	1.8	1.1	1.1
Unemployed persons, LFS, th, April	311.5	308.0	315.0	273.0	273	211	208	200	195
Unemployment rate, LFS, in %, April	27.5	27.5	27.7	25.4	25.4	20.5	20.2	19.4	18.8
Reg. unemployment rate, in %, eop	44.5	43.6	42.9	40.9	41.6	39.4	.	.	.
Average monthly gross wages, BAM	1,291	1,290	1,289	1,301	1,295	1,316	1,330	1,370	1,410
annual change in % (real, gross)	0.2	0.8	1.0	2.0	2.0	0.5	0.8	1.1	1.1
Average monthly net wages, BAM	827	831	830	838	834	848	850	870	900
annual change in % (real, net)	0.2	1.3	1.0	2.0	2.0	0.5	0.8	1.0	1.0
Consumer prices, % p.a.	-0.1	-0.9	-1.0	-1.1	-1.4	1.1	1.2	1.6	1.9
Producer prices in industry, % p.a.	-1.8	-0.5	0.6	-2.1	-2.7	2.6	2.2	1.8	2.1
General governm.budget, nat.def., % of GDP									
Revenues	42.6	43.7	43.2	42.7	.	.	45.2	45.4	45.4
Expenditures	44.8	45.8	42.5	41.5	.	.	46.0	46.2	46.3
Deficit (-) / surplus (+)	-2.2	-2.0	0.7	1.2	.	.	-0.8	-0.8	-0.9
Public debt, nat.def., % of GDP 5)	43.5	44.0	45.0	45.2	.	.	44.9	44.7	44.5
Stock of loans of non-fin.private sector, % p.a.	2.9	1.7	2.0	3.5	2.2	6.2	.	.	.
Non-performing loans (NPL), in %, eop	15.1	14.2	13.7	11.8	12.1	11.1	.	.	.
Central bank policy rate, % p.a., eop 6)	.	.	.	.	.	.	.	.	.
Current account, EUR mn 7)	-728	-1,033	-826	-776	-434	-406	-730	-750	-790
Current account, % of GDP 7)	-5.3	-7.4	-5.7	-5.1	-6.0	-5.3	-4.6	-4.5	-4.5
Exports of goods, BOP, EUR mn 7)	3,397	3,501	3,678	3,935	1,844	2,175	4,220	4,450	4,720
annual change in %	9.5	3.0	5.1	7.0	4.0	17.9	7.2	5.5	6.1
Imports of goods, BOP, EUR mn 7)	7,027	7,527	7,355	7,535	3,580	3,997	7,840	8,220	8,650
annual change in %	-0.7	7.1	-2.3	2.4	1.3	11.6	4.1	4.8	5.2
Exports of services, BOP, EUR mn 7)	1,223	1,253	1,378	1,436	635	681	1,480	1,570	1,660
annual change in %	-1.0	2.5	9.9	4.3	1.5	7.2	3.0	6.1	5.9
Imports of services, BOP, EUR mn 7)	392	401	445	457	187	192	480	510	540
annual change in %	-2.2	2.1	11.2	2.7	0.0	2.4	5.0	6.0	6.0
FDI liabilities, EUR mn 7)	239	408	334	247	119	198	230	.	.
FDI assets, EUR mn 7)	64	7	85	6	7	10	50	.	.
Gross reserves of NB excl. gold, EUR mn	3,530	3,908	4,307	4,768	4,371	4,735	.	.	.
Gross external debt, EUR mn 5)	7,138	7,245	7,787	8,204	.	.	8,250	8,400	8,550
Gross external debt, % of GDP 5)	52.1	51.8	53.3	53.7	.	.	51.7	50.1	48.3
Average exchange rate BAM/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.96	1.96	1.96

1) Preliminary. - 2) According to census October 2013. - 3) According to ESA'10 (FISIM not yet reallocated to industries). - 4) Based on UN-FAO data, from 2015 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.

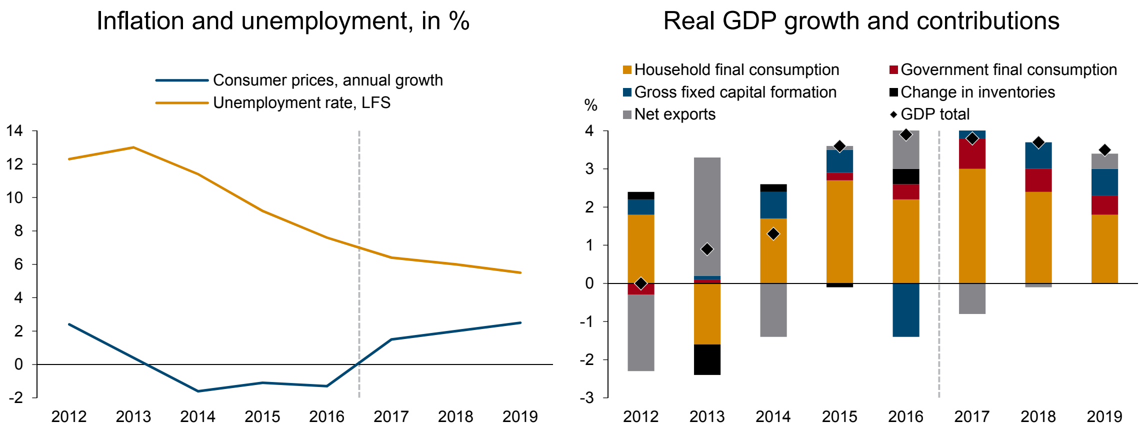
Source: wiiw Databases incorporating national statistics and IMF. Forecasts by wiiw.

BULGARIA: Economy in good shape

RUMEN DOBRINSKY

Bulgaria's broad-based economic upturn has continued, with positive output growth across all sectors of economic activity. The pattern of growth has switched from the export-led model of 2016 to a demand-driven type. However, labour shortages are causing supply constraints. The short-term prospects have improved and GDP growth for 2017 as a whole could come close to 4% and will remain in this range in the foreseeable future. Growth is balanced, with no imminent threats to macroeconomic stability.

Figure 33 / Bulgaria: Main macroeconomic indicators



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

Bulgaria's GDP grew by 3.7% year on year in the first half of 2017 which was above what the government and most analysts had expected. Revised national accounts data also indicate that GDP growth in 2016 was 0.5 percentage points higher than it was reported earlier. Importantly, the current economic upturn is broad-based and growth has not been accompanied by visible macroeconomic and/or external imbalances. In the first half of 2017, output growth was positive in all sectors of economic activity: export-led expansion strengthened both in manufacturing and high value-added services like ICT; the tourism boom continued for a second consecutive year and revenues reached a new record high; even the construction sector, which had been in a deep recession for about two years, started to recover in the second quarter.

The pattern of growth switched from the predominantly export-led model of 2016 to a demand-driven type. Private consumption has taken the lead as the main growth driver, supported by the ongoing surge in real wages and improving consumer confidence. In addition, household credit rebounded strongly in 2017 thanks to the combined effect of several factors including the households' positive expectations about their personal economic prospects and financial situation, the historically low interest rates and also the growing confidence by the banking sector in the borrowers' solvency. The new financial flows to the household sector are giving a boost to both personal consumption and to investments in the housing market, which is also recovering strongly in 2017.

After the contraction recorded in 2016, gross fixed capital formation started to recover in 2017 and made a positive contribution to GDP growth. The key factor behind this was the upturn in public investment, which reflects the phasing in of long-delayed public investment projects co-funded from EU sources. Robust final domestic demand boosted the imports of goods, which grew in the first half of 2017 by an impressive 20.6% year on year in current euro terms. While exports also continued growing strongly in this period, the strong upturn in imports resulted in a negative contribution of net exports to GDP growth in the first half of the year.

Matching the positive economic environment and improving expectations, hiring by businesses intensified. In consequence, the rate of unemployment fell to 6.6%, levels not seen since 2008. The net job creation has been associated with an overall expansion of the workforce: in the second quarter of 2017, the employment rate in Bulgaria reached 67.2%. This was 3.5 percentage points higher than a year earlier and the highest employment rate recorded after the end of central planning. At the same time, the labour market is becoming increasingly tight, which creates supply bottlenecks; more and more industries point to labour shortages as the main constraint to their possible future expansion. The biggest shortages concern professions such as electrical and mechanical engineers in manufacturing businesses as well as various machine operators. There are many vacancies also in the medical professions.

However, regional disparities in the labour market remain large. 70% of the 138,000 new jobs created during the 12 months to June 2017 were only generated in three fast growing regions: Sofia, Plovdiv and Stara Zagora. At the same time, despite the increasing internal labour migration to the regions in growth where labour shortages deepen, regional unemployment remains quite high in the North-Western and Southern parts of the country.

The growing demand for labour has been pushing wages up which, in turn, has translated into inflationary pressure. As a result, the deflationary trends which prevailed during the previous three years have been reversed and the rate of growth of consumer prices is expected to be positive in 2017 as a whole. The same is true for producer prices, which rebounded in 2017, reflecting both the conditions in international markets but also the cost push from rising wages.

Outmigration from Bulgaria has been declining in recent years. At present it mostly involves students leaving to study abroad and some high-skill occupations (such as the medical professions). Moreover, there has been some reversal in flows, in particular, young professionals returning to pursue career or business development in Bulgaria after graduating abroad.

Against this backdrop, **Bulgaria joined other Central and Eastern European economies in seeking to attract additional labour from abroad**, especially in seasonal jobs such as those in agriculture and tourism. Thus in 2017, the Employment Agency issued more than 3,000 work permits to non-EU citizens applying for seasonal work in Bulgaria. The majority of the applicants were from Ukraine, followed by Moldova, Macedonia and Albania; most of the seasonal foreign workers were employed in the tourism industry. The business sector has been actively lobbying for simplifying the administrative procedures for hiring seasonal workers from abroad. On top of that, some high value industries (such as ICT, other business services but also some manufacturing firms) seek to import skilled workers, in the first place from other EU countries (mostly from Central Europe). To do that, such businesses have to offer internationally competitive salaries, which is an additional upward push on wage levels and also leads to further differentiation in labour pay within the economy.

The economic upturn contributed to a notable cyclical improvement in Bulgaria's fiscal position. In cash terms, the consolidated general government balance at the end of August reported a surplus of BGN 2.2 billion (more than 2% of annual GDP). There has been no formal revision of the 2017 budget so far but the government already started drafting hasty plans for the possible apportioning of the windfall. The first related – populist – decision refers to a significant (by 15% on average) rise of teachers' wages as of 1 September. It is very likely that demands for pay rises from other professions will mushroom after this move.

Despite the acceleration of import growth, the current account balance remained in positive territory thanks to the strong services exports. Notably, given the lasting export expansion (both in goods and services) and the current account surplus, the ongoing appreciation of the price-based real effective exchange rate and the continuing rise in real wages so far have not had a perceptible negative effect on Bulgaria's international competitiveness. One of the explanations is that the unit labour cost based real effective exchange rate has not appreciated, meaning that the productivity rises offset wage growth.

The policy front in Bulgaria is in a standstill. Since coming to office in March the third GERB-dominated[23] government led by Boyko Borisov has not come up with a noteworthy policy initiative. The governance programme agreed by the coalition of three parties in April looks more like a wish list of vaguely formulated priority policy areas and contains almost no concrete objectives or targets. The one area where there has been some progress is the initiative to reduce some administrative hurdles to businesses and citizens. It is difficult to trace policy-induced effects in the current economic upturn which in the first place reflects improvements in the external economic environment and the fruits of the slow but steady growth of the indigenous private sector of the economy over the years.

In any case, the short-term prospects for the Bulgarian economy have improved. GDP growth for 2017 as a whole may come close to 4% on the strength of private consumption and recovering gross fixed capital formation. Domestic demand is likely to continue to act as the main growth driver in the following years as well. However, the limited labour supply poses certain constraints on Bulgaria's future growth potential. The pool of the workforce at present is still some 7.5% below the level achieved in 2008. Taking into account the shrinking population of the country and unfavourable age structure, while there is still some room for mobilising new job seekers from within the economically inactive part of the

[23] The acronym for the name of the party 'Citizens for European Development in Bulgaria'.

population, these reserves are limited. Thus even if the external environment remains favourable, GDP growth will probably stay below 4% also in the following years 2018-2019. An extra push could only be expected in the case of large foreign capital inflows; however, at present there are no signs of this happening.

There do not seem to be imminent threats to macroeconomic stability. Maintaining a positive or balanced current account has contributed to deleveraging and reduction of Bulgaria’s external debt. The fiscal balance also seems to be under control, which should contribute to further shrinking of public debt, which is not large anyway. The persistent tightness of the labour market will continue feeding inflationary pressure but this could be taken as an attribute of an ongoing catch-up process, with no negative macroeconomic implications.

Table 8 / Bulgaria: Selected economic indicators

	2013	2014	2015	2016 1)	2016 January-June	2017 January-June	2017 Forecast	2018 Forecast	2019 Forecast
Population, th pers., average	7,265	7,224	7,178	7,128	.	.	7,100	7,050	7,000
Gross domestic product, BGN mn, nom.	82,166	83,634	88,571	94,130	42,168	44,215	99,200	104,900	111,300
annual change in % (real)	0.9	1.3	3.6	3.9	4.3	3.7	3.8	3.7	3.5
GDP/capita (EUR at PPP)	12,200	12,800	13,600	14,200	.	.	.	.	.
Consumption of households, BGN mn, nom.	50,660	51,963	54,831	56,715	26,334	27,569	.	.	.
annual change in % (real)	-2.5	2.7	4.3	3.5	4.5	4.7	5.0	4.0	3.0
Gross fixed capital form., BGN mn, nom.	17,365	17,653	18,612	17,484	7,796	8,477	.	.	.
annual change in % (real)	0.3	3.4	2.7	-6.6	-2.4	3.4	4.0	4.0	4.0
Gross industrial production 2)									
annual change in % (real)	-0.2	1.8	2.9	2.6	1.8	4.4	4.5	4.0	4.0
Gross agricultural production									
annual change in % (real)	14.2	-0.6	-8.2	-1.2	.	.	.	.	.
Construction industry 3)									
annual change in % (real)	-3.7	7.0	11.2	-16.8	-16.6	3.3	.	.	.
Employed persons, LFS, th, average	2,935	2,981	3,032	3,017	3,004	3,104	3,110	3,160	3,190
annual change in %	0.0	1.6	1.7	-0.5	0.8	3.3	3.0	1.5	1.0
Unemployed persons, LFS, th, average	436	385	305	247	273	219	210	200	190
Unemployment rate, LFS, in %, average	13.0	11.4	9.2	7.6	8.4	6.6	6.4	6.0	5.5
Reg. unemployment rate, in %, eop	11.8	10.7	10.0	8.0	8.4	6.8	.	.	.
Average monthly gross wages, BGN	775.1	821.7	877.9	961.6	934.0	1023.3	1,050	1,150	1,250
annual change in % (real, gross)	5.1	7.5	7.0	10.4	8.8	7.5	8.0	7.0	6.0
Consumer prices (HICP), % p.a.	0.4	-1.6	-1.1	-1.3	-1.7	1.1	1.5	2.0	2.5
Producer prices in industry, % p.a.	-1.5	-1.2	-1.9	-3.1	-4.9	4.5	3.0	3.0	3.0
General governm.budget, EU-def., % of GDP									
Revenues	37.2	36.6	39.0	34.9	.	.	38.5	38.0	38.0
Expenditures	37.6	42.1	40.7	34.9	.	.	38.0	38.0	38.0
Net lending (+) / net borrowing (-)	-0.4	-5.5	-1.6	0.0	.	.	0.5	0.0	0.0
Public debt, EU-def., % of GDP	17.0	27.0	26.0	29.0	.	.	27.4	25.9	24.5
Stock of loans of non-fin.private sector, % p.a	0.0	-8.2	-1.6	1.0	-1.5	2.1	.	.	.
Non-performing loans (NPL), in %, eop	16.9	16.7	20.4	18.3	19.7	17.0	.	.	.
Central bank policy rate, % p.a., eop 4)	0.02	0.02	0.01	0.00	0.00	0.00	0.0	0.0	0.0
Current account, EUR mn	536	35	-17	2,561	977	428	2,500	2,200	1,700
Current account in % of GDP	1.3	0.1	0.0	5.3	4.5	0.8	4.9	4.1	3.0
Exports of goods, BOP, EUR mn	21,218	21,027	21,920	23,104	10,728	12,376	25,500	26,700	27,800
annual change in %	7.8	-0.9	4.2	5.4	-2.1	15.4	10.4	4.7	4.1
Imports of goods, BOP, EUR mn	24,151	23,803	24,542	24,088	11,288	13,611	27,000	28,500	30,000
annual change in %	2.0	-1.4	3.1	-1.8	-6.7	20.6	12.1	5.6	5.3
Exports of services, BOP, EUR mn	5,889	6,738	6,967	7,591	3,181	3,076	7,800	8,200	8,500
annual change in %	1.2	14.4	3.4	8.9	12.7	-3.3	2.8	5.1	3.7
Imports of services, BOP, EUR mn	3,235	4,224	3,964	4,498	2,225	1,936	4,250	4,500	4,700
annual change in %	0.2	30.6	-6.2	13.5	18.5	-13.0	-5.5	5.9	4.4
FDI liabilities, EUR mn	1,509	1,539	2,430	1,042	975	495	700	.	.
FDI assets, EUR mn	266	657	101	702	240	140	400	.	.
Gross reserves of NB excl. gold, EUR mn	13,303	15,276	19,022	22,475	20,910	22,555	.	.	.
Gross external debt, EUR mn 5)	36,936	39,338	33,317	34,046	34,063	33,671	33,500	33,000	32,500
Gross external debt, % of GDP 5)	87.9	92.0	73.6	70.7	70.8	66.4	66.0	62.0	57.0
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558

1) Preliminary. - 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.

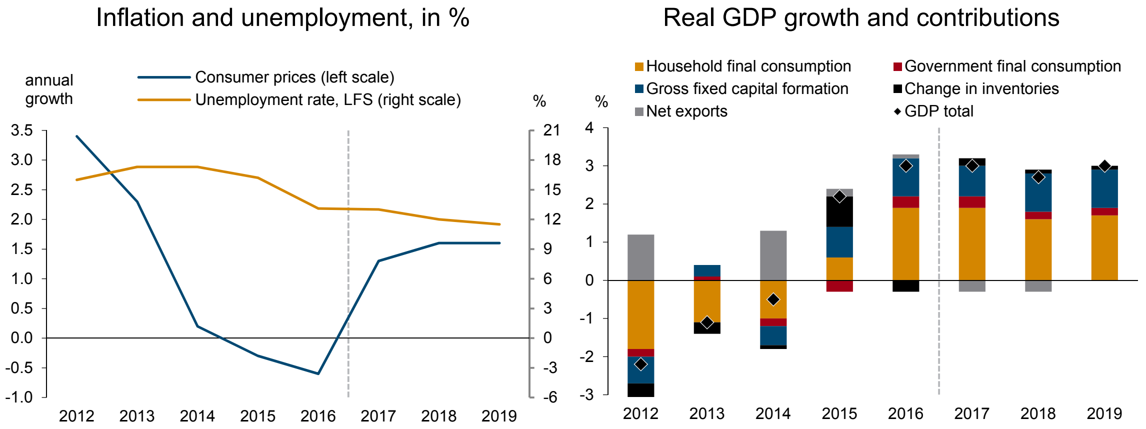
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

CROATIA: Reasonable growth prospects

HERMINE VIDOVIC

Croatia's economy continues on its path of recovery, with annual GDP growth of up to 3% in the period 2017-2019. Household consumption will remain the main driver, but investments, fuelled by EU funding, will play an important role as well. Demographic changes, coupled with continued emigration, will become a major challenge in the future.

Figure 34 / Croatia: Main macroeconomic indicators



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

Croatia's real GDP grew by 2.7% year on year in the first half of 2017, more than one might have expected after the failure of Agrokor, the country's largest company. Growth was backed by domestic demand: both private consumption and investments expanded. Private consumption growth was at its highest level since the onset of the global financial crisis, gaining momentum thanks to real wage increases. Gross fixed capital formation continued growing modestly. The contribution of net exports was negative due to rising imports. Industrial production grew less dynamically than in 2016, and was up by a meagre 2.3% during the first eight months of 2017 year on year.

The labour market situation has improved, but challenges remain. According to Pension Insurance data employment increased by 1.8% during the first half of the year, while based on the Labour Force Survey employment was up by less than 1% and the unemployment rate fell to 12.6% in the first half of 2017. Despite these improvements the unemployment rate is still among the highest in the EU. The reduction in unemployment is only partly a result of rising domestic employment; one of the major factors behind the decline is continued outward migration – despite improving economic conditions in the country. In Germany alone, the number of Croatian workers increased by 75,800 between July 2013, when Croatia joined the EU, and July 2017; the stock of Croatian employees in Austria rose by about 9,700 persons in the same period. In addition, there is also some labour emigration of Croatian citizens to Ireland, Sweden and Norway. On the other hand, Croatian employers complain about labour and skills shortages in certain branches, such as shipbuilding, construction, tourism, transport and IT, but also in agriculture. Real net wages increased by almost 4% during the first half of 2017 due to income tax changes, but also as a result of public sector wage increases (2%) as of January. Further wage increases in the public sector took effect in August and November 2017.

External trade in goods performed well, with exports and imports growing by 12-13% in euro terms during the first half of the year. The trade deficit was about EUR 430 million higher than in 2016, while the surplus in the services trade rose, thanks to another record-breaking tourist season, and that partly offset the rise in the trade deficit. Earnings from tourism reached a record high in 2017, benefiting from political uncertainties in competitor countries in Northern Africa and Turkey. In addition, the income outflow of the (mostly foreign-owned) banking sector due to the loan loss provisioning for exposure to Agrokor is lower than a year earlier. Hence, the current account will remain in surplus in 2017, at an estimated 3% of GDP. The inflow of FDI remained at almost the same level as in 2016, at slightly over EUR 600 million.

Fiscal consolidation continues. In the first half of 2017 the general government budget closed even with a small surplus, mostly on account of higher than expected revenues from taxes (VAT in particular) and social security contributions. Spending on public sector wages, increases of which were gradually introduced during 2017, is likely to be offset by higher revenues than anticipated. For the whole year the government expects a lower than the originally planned 1.3% deficit-to-GDP ratio. The reduction in the deficit will also translate into a reduction in public debt to about 81% of GDP. Recent announcements by the Croatian government to raise benefit payments for war veterans and to purchase 12 military jets as well as to cover health sector arrears give rise to concerns that the deficit may increase again in the coming years.

The introduction of the euro remains an important goal in Croatia. According to Boris Vujčić, governor of the Croatian National Bank, a public discussion on the costs and benefits of euro introduction will start in autumn 2017. The central bank itself has been in favour of euro adoption for years, as the Croatian economy has been heavily euroised; about three quarters of savings deposits in Croatian banks are in euro, also loans are mainly in euro or indexed to the euro. Hence, there is little room for using the exchange rate as a policy instrument. With respect to the convergence criteria, Croatia currently satisfies the criteria on price stability and long-term interest rates but it does not fulfil the criterion on sustainable public finances (the debt-to-GDP ratio is above 60%). Results of a Eurobarometer survey carried out in April 2017 suggest that about 47% of Croatian citizens believed that the euro will be introduced within five years and that the personal consequences of the euro introduction would be rather positive than negative.

At the beginning of October Ante Ramljak, the state manager of Agrokor, Croatia's biggest retailer and food producer, presented the audit report on the financial situation of the company which fell into trouble in March this year. Accordingly, in 2016 total liabilities amounted to EUR 7.6 billion, exceeding total assets by about EUR 2 billion; in addition, financial irregularities were reported for 2015 and 2016. Mr Ramljak said that he had filed a criminal charge against the responsible persons in the former management. Also, the Croatian parliament will set up a committee of inquiry to shed light on the matter. The total amount of debt claims against the company is not known yet. Creditors include suppliers, bondholders and banks, with the biggest share, about EUR 1.1 billion, owed to Russian Sberbank. Along with the adoption of an emergency law (Lex Agrokor), which is to prevent the company from starting bankruptcy procedures, the management of the company was handed over to a government-appointed manager in April 2017. So far new loans have been provided to pay out old debt of small suppliers and to ensure the continuation of regular business operations. Subsidiaries of Agrokor will have to be sold, but further details are yet unknown.

wiiw has revised its GDP growth for 2017 slightly upwards from 2.7% to 3%. Driven by household consumption and a continued recovery in investments, GDP growth may come close to 3% p.a. also in the coming two years. Private consumption will continue to rise at comparatively high rates, thanks to growing employment along with rising wages and pensions. Credit to households will play only a minor role in boosting consumption as households are still deleveraging. The expected rise in investments will be spurred by transfers from the EU budget, provided that absorption capacity increases. The strengthening of domestic demand will lead to rising imports and consequently result in higher trade deficits. The services trade surplus, by contrast, may remain at high levels due to high earnings from tourism, since tourism in the main competitor markets will recover only slowly. As a result, the current account surplus is expected to gradually decrease from an estimated 3% in 2017 to 1.9% in 2019. Assuming further reductions in the general government deficit or even a slight surplus, public debt is expected to continue its downward path in the coming two years, but downside risks are related to rising expenses on war veterans and spending on the health sector. Demographic issues – ageing of the population, coupled with a shrinking working-age population and continued emigration – are becoming increasing challenges for the future. The potential impact of the Agrokor crisis and political uncertainty – the current government has only a thin majority in the parliament – constitute additional downside risks.

Table 9 / Croatia: Selected economic indicators

	2013	2014	2015	2016 1)	2016	2017	2017	2018	2019
					January-June			Forecast	
Population, th pers., average	4,254	4,236	4,208	4,172	.	.	4,100	4,050	4,000
Gross domestic product, HRK mn, nom.	329,571	328,109	335,521	345,166	163,272	168,776	360,000	375,500	393,000
annual change in % (real)	-1.1	-0.5	2.2	3.0	2.7	2.7	3.0	2.7	3.0
GDP/capita (EUR at PPP)	15,900	16,100	16,900	17,300	.	.	.	.	.
Consumption of households, HRK mn, nom.	195,623	191,407	192,250	196,105	96,246	100,717	.	.	.
annual change in % (real)	-1.9	-1.6	1.0	3.3	3.0	3.6	3.4	2.8	3.0
Gross fixed capital form., HRK mn, nom.	65,257	63,797	66,401	69,317	34,212	35,654	.	.	.
annual change in % (real)	1.4	-2.8	3.9	5.1	6.5	4.2	4.0	5.0	5.0
Gross industrial production 2)									
annual change in % (real)	-1.8	1.2	2.7	5.3	6.4	1.8	2.3	2.5	3.5
Gross agricultural production									
annual change in % (real)	4.2	-7.0	2.9	-2.7	.	.	.	.	.
Construction output 2)									
annual change in % (real)	-4.6	-7.3	-0.6	2.6	3.9	1.7	.	.	.
Employed persons, LFS, th, average	1,524	1,566	1,585	1,590	1,576	1,589	1,590	1,610	1,630
annual change in %	-2.7	2.7	1.3	0.3	0.2	0.8	0.0	1.0	1.0
Unemployed persons, LFS, th, average	318	327	306	240	258	227	240	220	210
Unemployment rate, LFS, in %, average	17.3	17.3	16.2	13.1	14.1	12.6	13.0	12.0	11.5
Reg. unemployment rate, in %, eop	21.5	19.4	17.6	14.7	13.4	10.8	.	.	.
Average monthly gross wages, HRK 3)	7,939	7,953	8,055	7,753	7,751	8,014	8,000	8,300	8,600
annual change in % (real, gross)	-1.4	0.4	1.8	3.0	3.5	2.3	2.0	2.0	2.0
Average monthly net wages, HRK 3)	5,515	5,533	5,711	5,685	5,674	5,959	6,000	6,300	6,600
annual change in % (real, net)	-1.5	0.5	3.7	2.7	3.1	3.9	3.5	3.0	3.0
Consumer prices (HICP), % p.a.	2.3	0.2	-0.3	-0.6	-0.8	1.1	1.3	1.6	1.6
Producer prices in industry, % p.a.	-0.4	-2.7	-3.9	-4.3	-5.4	2.0	2.0	2.0	2.0
General governm.budget, EU-def., % of GDP									
Revenues	42.6	43.1	45.0	47.3	.	.	45.6	43.3	43.3
Expenditures	48.0	48.5	48.4	48.1	.	.	46.6	44.3	44.3
Net lending (+) / net borrowing (-)	-5.3	-5.4	-3.4	-0.8	.	.	-1.0	-1.0	-1.0
Public debt, EU-def., % of GDP	82.2	86.6	86.3	83.7	.	.	82.5	81.0	80.0
Stock of loans of non-fin.private sector, % p.a.	-1.5	-2.0	-3.1	-4.3	-6.2	-1.3	.	.	.
Non-performing loans (NPL), in %, eop	15.7	17.1	16.7	13.8	15.0	13.2	.	.	.
Central bank policy rate, % p.a., eop 4)	7.0	7.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Current account, EUR mn	415	861	2,019	1,158	-1,477	-1,398	1,420	1,000	980
Current account, % of GDP	1.0	2.0	4.6	2.5	-6.8	-6.2	3.0	2.0	1.9
Exports of goods, BOP, EUR mn	8,924	9,440	10,193	10,511	4,965	5,605	11,500	12,200	12,900
annual change in %	2.9	5.8	8.0	3.1	3.0	12.9	9.0	6.0	6.0
Imports of goods, BOP, EUR mn	15,511	15,952	17,168	17,848	8,810	9,879	19,100	20,400	21,700
annual change in %	3.6	2.8	7.6	4.0	4.1	12.1	7.0	7.0	6.5
Exports of services, BOP, EUR mn	9,844	10,238	11,279	12,264	4,047	4,354	12,800	13,500	14,200
annual change in %	2.1	4.0	10.2	8.7	5.9	7.6	4.0	5.5	5.5
Imports of services, BOP, EUR mn	3,088	2,897	3,271	3,581	1,606	1,723	3,800	4,000	4,200
annual change in %	-2.2	-6.2	12.9	9.5	5.6	7.3	6.0	5.8	5.0
FDI liabilities, EUR mn	737	2,297	196	1,694	663	617	1,500	.	.
FDI assets, EUR mn	-111	1,600	-54	-249	-102	254	500	.	.
Gross reserves of NB excl. gold, EUR mn	12,908	12,688	13,707	13,514	12,937	14,028	.	.	.
Gross external debt, EUR mn	45,803	46,416	45,384	41,668	43,440	40,383	41,600	42,600	43,000
Gross external debt, % of GDP	105.3	108.0	103.0	90.9	94.8	84.1	86.7	85.2	82.0
Average exchange rate HRK/EUR	7.5786	7.6344	7.6137	7.5333	7.5610	7.4488	7.50	7.50	7.50

1) Preliminary. - 2) Enterprises with 20 and more employees. - 3) From 2016 based on new data sources. - 4) Discount rate of NB.

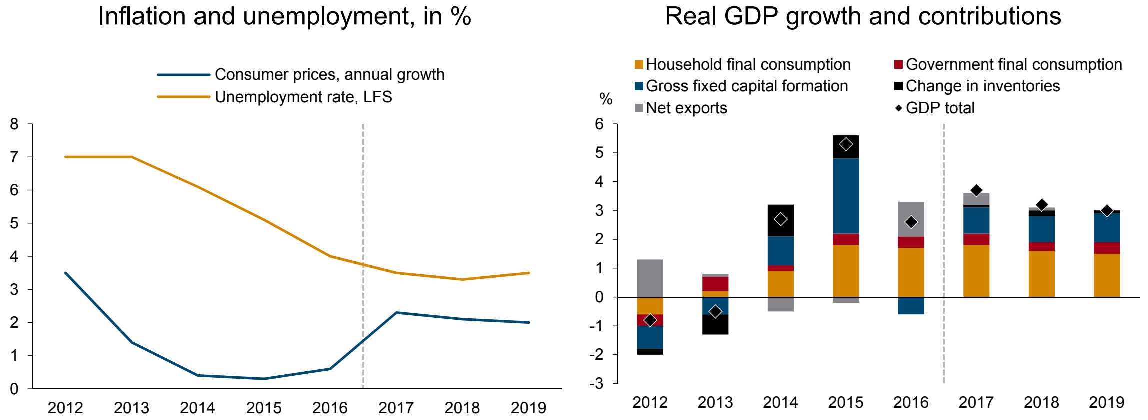
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

CZECH REPUBLIC: Broad-based growth

LEON PODKAMINER

Demand, profitability and indebtedness conditions are conducive to rapid, broad-based growth. The emerging labour shortages support a faster rise in wages, yet without eroding profits in industry. Monetary policy faces no serious dilemmas. The fiscal policy orientation of the new government will remain essentially unchanged.

Figure 35 / Czech Republic: Main macroeconomic indicators



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

After very strong performance in the first quarter of 2017, growth slowed down somewhat in the second quarter, with GDP growth rates (year on year, seasonally unadjusted) falling from 4.0% to 3.4%. Growth of household consumption remained steady (at about 3.8%) while gross fixed capital formation was expanding at an accelerated pace (with the rates of growth rising from 2.4% in the first quarter to 5.2% in the second). Inventories were reduced strongly throughout the first half of 2017 which may augur the emergence of some supply bottlenecks. Foreign trade in goods and services performed very well in the first quarter, with volumes of exports and imports rising by 7.4% and 3.9% respectively. In the second quarter the volumes grew at much lower rates (and not so different from each other, 3.9% and 2.9% respectively). Consequentially the unusually large trade surplus recorded in the first quarter (10.2% of GDP) fell to a surplus of 8.3% of GDP in the second quarter. The contribution of foreign trade to GDP growth was reduced from about 2 percentage points (pp) in the first quarter to about 1 pp in the second.

Unemployment has been very low and is expected to fall further. This development has much to do with the unfavourable demography (but not so much with outward migration as is the case in other

CESEE countries). The size of the working-age population has been contracting since at least 2010 (on average by close to 1% annually). This tendency will continue in the foreseeable future. The strong output growth currently observed has also been important in raising the number of employees (as well as the lengthening of working hours) and thus reducing the size of unemployment.

Emerging labour shortages are felt throughout the economy (including the foreign-owned firms) and may already be reducing the levels of output that could be produced. In an attempt to alleviate the staffing difficulties, firms tend to hire foreign workers (primarily recruited in Slovakia and Poland or coming from Ukraine). A longer-term option possibly already implemented (by e.g. foreign direct investors) would require the introduction of more labour-saving and efficiency-augmenting technologies and production modes. This option would include moving parts of the particularly labour-intensive (and low value added) production abroad.

Under the impact of tightening labour markets the wage rate is rising quite strongly, **though not exorbitantly.** The Czech labour market has been characterised by the coexistence of low unemployment with a good deal of wage moderation. (To some extent this may reflect the age structure of the Czech labour force.) It is rather unlikely that the wage movements would fuel strong inflation or seriously erode profitability of the corporate sector. In actual fact, despite the strong rise in wages, unit labour costs in industry have been falling recently.

The rising wage bill underlies continuing growth in private consumption and will also be vital for the expansion of households' housing investment. All conditions are in place for an acceleration of firms' productive investments as well. The firms' financial position is very strong (their operating surpluses increased at close to 15% in the first quarter of 2017), the interest rates on loans are low and the portfolios of orders (including export orders) are full. Public investments (co-financed out of EU structural funds) into infrastructure projects are also expected to gain momentum starting in 2018.

The Czech currency has been strengthening moderately. In the first quarter of 2017 the upcoming discontinuation of the policy of keeping the exchange rate stable (at a level not lower than 27 CZK/EUR) was generally anticipated – as was the prospect of immediate nominal appreciation of the Czech currency. In fact, the re-floating of the Czech currency (on 6 April) was momentarily followed by its nominal (as well as real) appreciation. It is yet too early to see a new equilibrium level of the exchange rate emerging under the absence of the National Bank's active participation in the foreign exchange market. The huge CZK positions taken before April 2017 (primarily by speculative investors who had rightly expected the imminent CZK nominal appreciation) do not seem to have been liquidated. After rising turbulently in the first quarter of 2017, foreign exchange reserves of the Czech National Bank (CNB) have remained unchanged thereafter. This may be due to high demand for Czech government securities, which prove attractive despite the relatively low yields offered. The attractiveness of the Czech governmental securities is understandable given the country's low public debt, 'sound fiscal policy' and the overall economic and social stability.

Imports rising faster than exports are a real possibility. The extraordinary foreign trade developments in the first quarter of 2017 may have come about under rather exceptional circumstances that need not repeat themselves over the rest of 2017. The expectation of currency appreciation may have provided incentives to sign export contracts in advance (that is already in the first quarter of 2017) – and to suppress or delay imports accordingly. It is natural to expect that under a strong CZK exports will be less dynamic over the rest of 2017, but imports more so – especially in the environment of strong growth of consumption and investment. Another reason to anticipate exports to lose momentum and imports to gain more of it is that the Czech economy could be already close to exhausting its spare production capacities as shortages of labour (and possibly intermediate inputs) are becoming widespread. However, even if imports rise faster than exports in the near future so that foreign trade will be reducing GDP growth, the trade surplus is highly unlikely to turn into deficit any time soon.

Inflation is 'back to normal'. One of the (declared) reasons for giving up control over the exchange rate was the prospect of inflation returning to 'normal' (after running at close to nil since the beginning of 2014). The return of inflation is a fairly natural consequence of the tight labour markets and very low levels of unemployment – and, consequently, rising wages and costs (e.g. embodied in the prices of raw materials and components which temporarily could be in short supply).

The National Bank is unlikely to be opposing inflation very actively, by high interest rates hikes – as this would do some harm to the investment activities and possibly also additionally strengthen the Czech currency. In August 2017 the policy rate was increased (for the first time since February 2008) from a symbolic 0.05% to (almost equally symbolic) 0.25%. The policy interest rate hikes may be expected to passively follow inflation rather than pre-empt it. Also the CNB may rely on the currency strengthening on its own, which also stabilises inflation. The 'hike' in the policy interest rates has not affected the market interest rates on loans. The latter remain unchanged nominally (and fall in real terms) encouraging a strong rise in the demand for loans (both by firms and households).

Fiscal policy has been successfully targeting a balanced budget of the general government. Actually the Finance Ministry plans slight fiscal surpluses (of around 1% of GDP) in 2017-2019, implying a decline in the public debt/GDP ratio to about 30% in 2019. Very low cost of servicing public debt is one component of the successful fiscal consolidation. Fast growth and disappearing unemployment (as well as spending on unemployment benefits) facilitate the fiscal consolidation as well.

The overall orientation of the economic policy will be unchanged. The parliamentary elections held on 21-22 October 2017 were decidedly won by the ANO party, the junior partner in the outgoing coalition government (in power since 2013). The Social Democrats (ČSSD), formerly the senior coalition partner, suffered heavy losses. Nine parties will sit in the new parliament – including clearly exotic ones ('Pirates', Communists, etc). The liberal-conservative ODS, the traditional political force ruling the country throughout much of the past 28 years, has come second. Quite possibly ODS will join ANO in the next coalition government to be led by Andrej Babiš, the leader of ANO. (From 2013 through May 2017 he was the deputy PM and finance minister in the ČSSD-led government. He was then forced to step down over corruption allegations.) The new government's economic policy agenda is likely to remain essentially unchanged. Given ANO's (and Mr Babiš' personal)[24] background one could perhaps expect a slightly more pro (domestic) business emphasis in matters of taxation and administrative regulation. Neither the CNB nor the new government are likely to change their sceptical stance on the issue of euro accession. Also on other important European matters (e.g. on the readiness to accept large-scale quotas of migrants) the new government will remain uncooperative.

Summing up, a virtuous cycle of rising incomes, consumption (and investment) demand and output is in place. Despite the emergence of labour shortages (and supply bottlenecks) inflation will be contained while the growth rate may well exceed 3% in the period 2017-2019.

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[24] Mr Babiš is a successful businessman, active primarily in the food processing and distribution industry. He is considered the second-richest Czech citizen ('worth' some USD 4 billion).

Table 10 / Czech Republic: Selected economic indicators

	2013	2014	2015	2016 1)	2016 January-June	2017 January-June	2017 Forecast	2018 Forecast	2019 Forecast
Population, th pers., average	10,514	10,525	10,546	10,566	10,559	10,581	10,580	10,590	10,600
Gross domestic product, CZK bn, nom.	4,098	4,314	4,596	4,773	2,323	2,427	5,100	5,400	5,700
annual change in % (real)	-0.5	2.7	5.3	2.6	3.6	3.7	3.7	3.2	3.0
GDP/capita (EUR at PPP)	22,400	23,800	25,400	25,700	.	.	.	.	.
Consumption of households, CZK bn, nom.	1,997	2,044	2,125	2,214	1,073	1,138	.	.	.
annual change in % (real)	0.5	1.8	3.8	3.6	4.0	3.7	3.8	3.5	3.2
Gross fixed capital form., CZK bn, nom.	1,027	1,084	1,216	1,192	553	584	.	.	.
annual change in % (real)	-2.5	3.9	10.2	-2.3	-1.1	3.8	3.8	3.5	4.0
Gross industrial production									
annual change in % (real)	-0.1	5.0	4.6	3.5	4.9	5.3	5.0	4.5	4.0
Gross agricultural production									
annual change in % (real)	6.0	10.1	-6.1	4.8	.	.	.	.	.
Construction industry									
annual change in % (real)	-6.7	4.3	7.0	-5.9	-8.1	3.3	.	.	.
Employed persons, LFS, th, average	4,937	4,974	5,042	5,139	5,108	5,183	5,190	5,200	5,200
annual change in %	1.0	0.8	1.4	1.9	1.8	1.5	1.0	0.1	0.0
Unemployed persons, LFS, th, average	369	324	268	211	220	172	190	180	190
Unemployment rate, LFS, in %, average	7.0	6.1	5.1	4.0	4.2	3.3	3.5	3.3	3.5
Reg. unemployment rate, in %, eop	8.2	7.5	6.2	5.2	5.2	4.0	.	.	.
Average monthly gross wages, CZK	25,035	25,768	26,591	27,575	26,874	28,619	29,500	31,300	33,000
annual change in % (real, gross)	-1.5	2.5	2.9	3.0	3.3	4.0	4.5	4.0	3.5
Consumer prices (HICP), % p.a.	1.4	0.4	0.3	0.6	0.3	2.4	2.3	2.1	2.0
Producer prices in industry, % p.a.	0.7	0.9	-2.4	-3.2	-4.2	2.2	-1.0	1.0	1.5
General governm. budget, EU-def., % of GDP									
Revenues	41.4	40.3	41.1	40.0	.	.	40.7	41.0	41.0
Expenditures	42.6	42.2	41.7	39.4	.	.	40.3	40.6	41.0
Net lending (+) / net borrowing (-)	-1.2	-1.9	-0.6	0.6	.	.	0.4	0.4	0.0
Public debt, EU-def., % of GDP	44.9	42.2	40.0	36.8	.	.	35.5	34.4	33.0
Stock of loans of non-fin.private sector, % p.a	4.1	2.7	6.6	6.7	6.7	5.8	.	.	.
Non-performing loans (NPL), in %, eop	5.9	6.1	5.8	4.8	5.3	4.3	.	.	.
Central bank policy rate, % p.a., eop 2)	0.05	0.05	0.05	0.05	0.05	0.05	0.25	1.0	1.25
Current account, EUR mn	-829	296	368	1,946	3,635	3,326	1,160	410	220
Current account, % of GDP	-0.5	0.2	0.2	1.1	4.2	3.7	0.6	0.2	0.1
Exports of goods, BOP, EUR mn	103,184	110,401	115,573	118,494	60,550	65,023	124,000	129,000	135,000
annual change in %	-1.1	7.0	4.7	2.5	4.9	7.4	4.5	4.0	5.0
Imports of goods, BOP, EUR mn	96,735	102,406	108,701	109,224	54,438	58,847	115,000	121,000	127,000
annual change in %	-2.7	5.9	6.1	0.5	2.0	8.1	5.5	5.0	5.0
Exports of services, BOP, EUR mn	18,059	18,915	20,603	21,618	10,379	11,377	22,000	23,000	24,000
annual change in %	-4.3	4.7	8.9	4.9	6.2	9.6	3.5	4.0	4.5
Imports of services, BOP, EUR mn	15,346	16,892	17,742	17,880	8,554	9,249	19,000	20,000	21,000
annual change in %	-2.7	10.1	5.0	0.8	2.2	8.1	3.5	4.5	4.5
FDI liabilities, EUR mn	5,544	6,101	1,521	5,875	2,198	4,428	5,500	.	.
FDI assets, EUR mn	5,831	3,175	3,357	661	-558	1,012	3,500	.	.
Gross reserves of NB excl. gold, EUR mn	40,460	44,528	58,903	80,999	67,055	124,403	.	.	.
Gross external debt, EUR mn	99,652	109,067	118,252	130,573	122,363	171,064	150.700	174.100	193.700
Gross external debt, % of GDP	63.2	69.6	70.2	74.0	69.3	88.6	78.0	84.0	88.0
Average exchange rate CZK/EUR	25.98	27.54	27.28	27.03	27.04	26.79	26.40	26.05	25.90

1) Preliminary. - 2) Two-week repo rate.

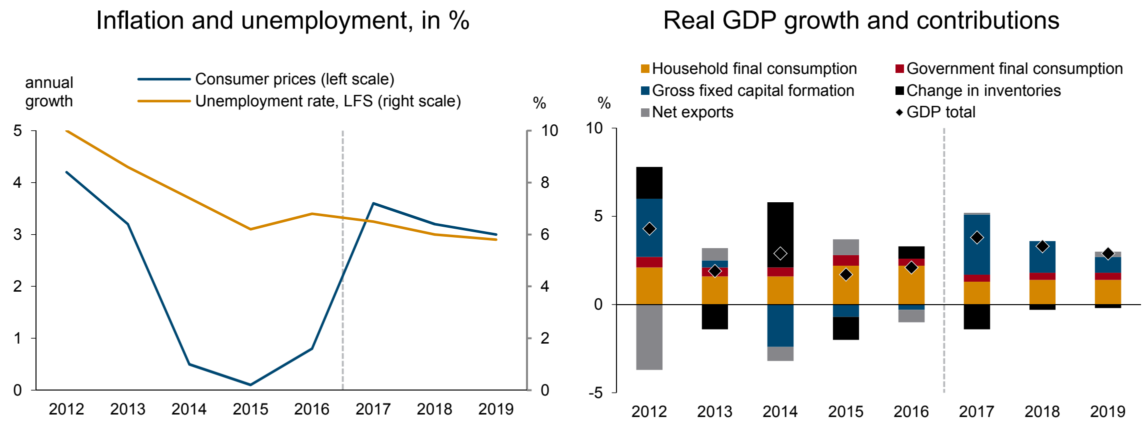
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

ESTONIA: Investment and revived exports drive growth

SEBASTIAN LEITNER

Investment activity in both the private and the public sector picked up more strongly than expected, pushing GDP growth upwards in both 2017 and 2018. Meanwhile exports have also gained momentum and recovered, particularly towards Russia. Household consumption, backed by a still considerable rise in real wages, continues to be a strong driver of economic activity. A speed-up in economic activity in the short run is projected to result in a GDP growth rate of 3.8% in 2017 and 3.3% in 2018, declining somewhat to 2.9% in 2019.

Figure 36 / Estonia: Main macroeconomic indicators



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

The export activity throughout 2017 has evolved much more dynamically than expected. In particular, goods exports to Russia gained strongly in momentum, increasing by almost 30% nominally in the first half of 2017. This also fosters growth in services exports, since transit trade with Russia has revived as well. Moreover, also activity in the tourism industry has regained momentum. The economy of neighbouring Sweden is expected to expand at about 3% per annum in 2017, while that of Finland is expected to grow by about 2.5% this year and close to 2% in 2018. Export activity with neighbouring Latvia, Estonia's third most important trading partner after Sweden and Finland, still remains stagnant. However, it is anticipated to strengthen on account of the revival of investment in that country as was already the case with Lithuania. Last year's slump in the production of shale oil, Estonia's second most important export product after assembled mobile phones, caused by low oil prices, was counterbalanced in 2017. As a result, shale oil-based electricity production has regained momentum and electricity imports from Finland have declined again. Overall, we expect growth in goods exports to increase at a stronger pace in 2017 and 2018, while levelling off in 2019. From 2018 onwards, however, imports should increase even more strongly than exports.

Investment activity of the public and private sectors became even more pronounced than expected. In 2017, external demand and industrial production have started to strengthen; furthermore, activity in the construction sector has gained momentum as well. In the residential construction sector we see a strong growth in new floor space being built, but also prices and wages growing. Data on building permits and mortgage loans suggest that dwelling construction will continue to expand not only in 2017, but also in 2018. Economic sentiments of employers rose substantially this year and are back at levels as before the crisis in 2008. As forecasted, public investment has started to increase markedly in 2017, driven by inflows of fresh EU funds. In total, the government anticipates that EU funds for public and private investment will amount to 2-3% of GDP this year. In its 2018 budget plan, the government foresees a low budget deficit of 0.5% for 2017 and 0.3% for 2018, easily achievable given the good economic growth prospects. A further reduction in the public debt to close to 8% of GDP is envisaged towards 2019. A larger part of the rising public expenditure in 2017 will be devoted to defence (2.1% of GDP) and the health sector.

The unemployment rate has remained stable at a rather low level, whereas the employment rate almost attains the level of the Scandinavian economies. While employment in the services sectors has continued to rise, it is stagnant in agriculture and industry. Due to the work ability reform, introduced in July 2016, more people have entered the labour market in search of work. People having received work incapacity pensions in the past now have to look more actively for jobs and take part in public work activation measures. Thus, the unemployment rate increased in 2016 and refrains from declining in 2017 irrespective of the decent growth in jobs. Moreover, the employment rate of those aged 15 to 64 years increased to more than 73% of the population; in that indicator Estonia ranks 7th in the list of EU countries.

The increase in real net wages went down to 3.5% in the first half of 2017 year on year, still pushing household consumption upwards. Nevertheless, we expect somewhat lower growth than recently: 2.5% in real terms in 2017 and a slight acceleration in 2018. Consumer prices have started to rise somewhat in recent months. However, the upward price movement is mostly caused by an increase in excise taxes and, most recently, by rising energy prices. In 2018 consumer prices will continue to rise more swiftly, pushed up by rising import prices. Forward-looking consumer confidence indicators show an improvement in 2017, and the most recent retail trade and credit statistics indicate a good spending mood. Monthly incomes will continue to grow considerably in both 2017 and 2018, not least thanks to another increase in the minimum wage that is planned for 2018. Moreover, the government's 2018 budget plan comprises additional measures to lower the income tax burden, in particular an increase of the non-taxable basic exemption from EUR 180 to EUR 500, which will substantially increase the net incomes of low- and middle-income earners.

Overall, strong GDP growth has returned to Estonia. The 2016 GDP growth of 2.1% in real terms was somewhat lower than forecasted, due to the unexpectedly poor performance of investment. But the remarkable revival of external demand particularly from Russia has continued, and private investment activity is thriving much more than expected. An ongoing 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 have revised our forecast for real GDP growth substantially upwards, to 3.8% and 3.3%, respectively, while for 2019 we expect economic activity to develop at a pace of 2.9%.

Table 11 / Estonia: Selected economic indicators

	2013	2014	2015	2016 1)	2016 January-June	2017 January-June	2017 Forecast	2018 Forecast	2019 Forecast
Population, th pers., average	1,318	1,315	1,315	1,316	.	.	1,315	1,315	1,315
Gross domestic product, EUR mn, nom.	18,932	19,766	20,348	21,098	10,133	11,078	22,700	24,200	25,600
annual change in % (real)	1.9	2.9	1.7	2.1	1.5	5.2	3.8	3.3	2.9
GDP/capita (EUR at PPP)	20,200	20,900	21,700	21,700	.	.	.	.	.
Consumption of households, EUR mn, nom.	9,457	9,813	10,232	10,771	5,351	5,625	.	.	.
annual change in % (real)	3.3	3.2	4.4	4.3	4.3	1.5	2.5	2.8	2.9
Gross fixed capital form., EUR mn, nom.	5,253	4,829	4,807	4,712	2,219	2,686	.	.	.
annual change in % (real)	1.5	-8.7	-2.9	-1.2	3.8	17.4	15.0	8.0	4.0
Gross industrial production									
annual change in % (real)	4.1	3.9	0.3	2.4	-1.0	11.7	9.0	7.0	5.0
Gross agricultural production									
annual change in % (real)	4.7	4.6	8.7	-16.7	.	.	.	.	.
Construction industry									
annual change in % (real)	-0.1	-2.1	-3.4	2.6	3.9	18.7	.	.	.
Employed persons, LFS, th, average	621.3	624.8	640.9	644.6	643.5	650.2	655	660	665
annual change in %	1.0	0.6	2.6	0.6	1.9	1.0	1.6	0.8	0.8
Unemployed persons, LFS, th, average	58.7	49.6	42.3	46.7	44.5	43.7	46	42	41
Unemployment rate, LFS, in %, average	8.6	7.4	6.2	6.8	6.5	6.3	6.5	6.0	5.8
Reg. unemployment rate, in %, eop 2)	5.3	4.4	4.7	4.4	4.2	4.6	.	.	.
Average monthly gross wages, EUR	949	1,005	1,065	1,146	1,127	1,198	1,230	1,320	1,430
annual change in % (real, gross)	4.1	6.0	6.5	7.4	8.4	3.1	3.5	4.0	5.0
Average monthly net wages, EUR	757	799	859	924	910	967	980	1,040	1,110
annual change in % (real, net)	4.3	5.7	8.0	7.4	8.5	3.1	2.5	3.0	4.0
Consumer prices (HICP), % p.a.	3.2	0.5	0.1	0.8	0.2	3.2	3.6	3.2	3.0
Producer prices in industry, % p.a.	7.2	-2.7	-3.0	-1.3	-2.2	2.5	3.0	3.2	3.0
General governm. budget, EU-def., % of GDP									
Revenues	38.3	39.1	40.3	40.3	.	.	38.5	38.6	38.6
Expenditures	38.4	38.4	40.2	40.1	.	.	39.0	39.0	39.0
Net lending (+) / net borrowing (-)	-0.2	0.7	0.1	0.3	.	.	-0.5	-0.4	-0.4
Public debt, EU-def., % of GDP	10.2	10.7	10.0	9.4	.	.	9.0	8.5	8.0
Stock of loans of non-fin.private sector, % p.a	0.7	2.6	4.8	6.6	8.6	5.3	.	.	.
Non-performing loans (NPL), in %, eop	1.7	1.5	1.1	1.0	1.1	0.8	.	.	.
Central bank policy rate, % p.a., eop 3)	0.25	0.05	0.05	0.00	0.00	0.00	.	.	.
Current account, EUR mn	99	51	398	400	29	179	400	250	100
Current account, % of GDP	0.5	0.3	2.0	1.9	0.3	1.6	1.8	1.0	0.4
Exports of goods, BOP, EUR mn	10,968	10,998	10,757	11,168	5,483	5,839	12,100	13,100	13,800
annual change in %	2.0	0.3	-2.2	3.8	1.8	6.5	8.0	8.0	5.0
Imports of goods, BOP, EUR mn	11,893	12,089	11,612	11,958	5,920	6,323	12,900	13,900	14,900
annual change in %	-1.1	1.6	-3.9	3.0	3.0	6.8	7.5	8.0	7.0
Exports of services, BOP, EUR mn	4,992	5,323	5,237	5,496	2,562	2,864	5,900	6,400	6,800
annual change in %	6.8	6.6	-1.6	4.9	3.2	11.8	8.0	8.0	6.0
Imports of services, BOP, EUR mn	3,535	3,673	3,568	3,892	1,876	2,022	4,200	4,500	4,800
annual change in %	13.5	3.9	-2.9	9.1	8.7	7.8	7.5	8.0	7.0
FDI liabilities, EUR mn	834	1,308	-661	665	350	382	750	.	.
FDI assets, EUR mn	641	847	-532	156	207	219	300	.	.
Gross reserves of NB excl. gold, EUR mn	222	352	373	325	418	282	.	.	.
Gross external debt, EUR mn	17,618	19,062	19,178	19,072	19,443	18,943	19,300	20,100	20,500
Gross external debt, % of GDP	93.06	96.43	94.25	90.40	92.16	83.45	85.0	83.0	80.0

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

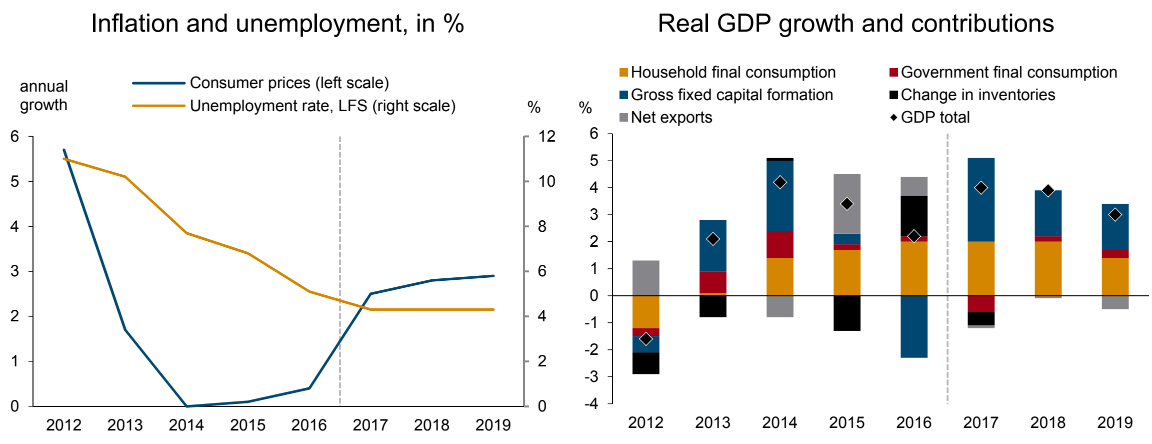
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

HUNGARY: Euro introduction is far far away

SÁNDOR RICHTER

Economic growth has accelerated compared to the previous year. The main drivers are investment and household consumption. The foreign trade balance started to deteriorate, but the trade surplus is still significant and will remain so over the forecast horizon. The sharp increase in wages will stimulate domestic demand, but productivity growth is lagging and may increasingly become a problem for firms, primarily for small and medium-sized enterprises. According to the Hungarian Central Bank, introduction of the euro will only be feasible if Hungary's per capita GDP and wages attain 90% of the EU average; this rules out euro adoption, even in the medium term.

Figure 37 / Hungary: Main macroeconomic indicators



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

Economic growth in the first half of 2017 has been substantially stronger than in the previous year, driven both by investment and consumption. Gross fixed capital formation shot up by 24.1%. This is primarily due to the boost in EU co-financed projects, more exactly the disbursement of advance payments from the central government budget for such projects. While this practice helped to revive investments from the 2016 depression caused by the cyclicality of the 2014-2020 financial framework of EU cohesion policy transfers, it may become a double-edged weapon. In the remaining part of the current seven-year financial framework, the 'cold turkey' effect may turn out to be much more severe than it was in 2016, diminishing aggregate demand in 2020-2022. Good news, however, is that not only

EU co-financed, mainly infrastructure projects thrive; investment in manufacturing increased by 16.6%, mainly in the computer and automobile clusters but also in nearly all sub-branches. New facilities for border protection and defence contributed to the investment boom as well. Despite the very strong expansion of gross fixed capital formation the investment rate (share in GDP) has just surpassed 20%, and is far below the 25% share which ensures sustainable longer-term economic growth. Due to a drop in inventories, gross capital formation expanded at a much slower pace than investments. Though the expansion of household consumption was also impressive, 4.1% in the first half of the year, it remained far below the growth rate of average real wages (10%). Government consumption declined, thus moderating the contribution of final consumption to growth.

The strong growth of investment and household consumption has been reflected in the foreign trade data. The gap between export and import growth rates (the latter being higher) increased to about two percentage points. That means that the trade surplus has begun to shrink; in January-July it was about one billion euro smaller than a year earlier (according to customs statistics). Even so it amounted to over EUR 5 billion. The current account surplus has diminished to a considerable extent as well. All in all, the contribution of net exports to growth was slightly negative.

After years of silence on the subject, the introduction of the euro has finally been addressed by the central bank. The Maastricht criteria are considered to be obsolete by the central bank, which elaborated its own system of criteria. According to this the Hungarian per capita GDP should first reach 90% of the EU level; the same applies to the level of wages. Currently per capita GDP is at 70% of the average EU level, according to wiiw, and the lag is even larger in the case of wages. Further, total liabilities & equity of the financial sector should approach 250% of the GDP, far beyond the current 90% level. Real-economy and financial cycles should move in a harmonised way with that of the eurozone. The efficiency of the SME sector, now at one third of the level of large enterprises, should improve to 50%. The participation rate should reach 65%, the unemployment rate should be around 4%. (This latter has already been achieved.) Concerning the fiscal stance, the structural balance should be around zero and the public debt to GDP proportion below 50%. Here there is still room for improvement. Thus, while some of the mentioned preconditions are not far from being met, the first two targets – per capita GDP and wages at 90% of the EU average – are set so high that euro introduction will be impossible even in the medium and long run, even if the pace of convergence to the core EU were to speed up to some extent. Meanwhile Slovakia, a country being a comparable regional peer to Hungary, performed spectacularly better than Hungary in terms of convergence despite having introduced the euro already in 2009 and not fulfilling many of Hungary's self-imposed conditions either currently or in the year of the euro introduction. These economic arguments, together with the political conflicts of the Hungarian government with the EU concerning its policy towards refugees and the rule of law, make it probable that Hungary will not join the group of the core EU Member States which endeavour a qualitatively closer cooperation following a series of recently proposed reforms.

Economic developments in this and the next year will be determined by the forthcoming elections and the accelerated investment activity financed to a large extent by EU transfers. The government will do everything possible to mobilise its potential voters and may go to the limits in government-financed projects, yet remaining within the 3% fiscal deficit/GDP threshold. That means that long-neglected areas like health and education may receive additional resources, beyond pointless prestige investments. A recovery of lending activity, both to households and the business sector, helps maintain the growth momentum.

The increasingly acute shortage of labour will drive the expansion of wages ways beyond the pace of GDP or productivity growth. This will maintain the dynamic increase of household consumption, but may increase inflationary pressure and adversely affect competitiveness. Investment, bouncing back in 2017 after a deep fall in the previous year, will level out at a relatively high level. In the medium term, beginning in 2019, the limits of the current growth path will be felt. Extremely rapid wage growth, which is partly driven by labour shortage, will prevail; however, profitability of the business sector will deteriorate as productivity cannot keep pace with that rate of wage growth, at least not in the SME sector and in most of the services sector. Labour shortages will continue to be a major obstacle to growth. According to official data there are 65,000 vacancies currently; according to expert estimations this number may be substantially higher. One of the solutions – to rely on imported labour – is no longer viable, at least in the short run, following the poisonous political campaign of the government against migrants. Programmes launched to encourage the return of recent Hungarian emigrants have had limited results as yet. In the medium term investments will be negatively affected by the artificially reinforced cyclicality described above. Uncertainties related to Brexit and consequently a possible reduction of cohesion policy related transfers add a new dimension to the existing problems. Last but not least, the growing isolation of Hungary (together with that of Poland) following from PM Orbán's unstoppable inclination to provoke the EU delivers an additional element of risk related to the longer-term availability of EU support.

Table 12 / Hungary: Selected economic indicators

	2013	2014	2015	2016 [1]	2016 January-June	2017 January-June	2017 Forecast	2018 Forecast	2019 Forecast
Population, th pers., average	9,893	9,866	9,843	9,814	.	.	9,780	9,750	9,720
Gross domestic product, HUF bn, nom. [2]	30,247	32,592	34,324	35,420	16,405	17,600	37,900	40,700	43,300
annual change in % (real)	2.1	4.2	3.4	2.2	2.0	3.6	4.0	3.9	3.0
GDP/capita (EUR at PPP)	18,000	18,800	19,900	19,800	.	.	.	.	.
Consumption of households, HUF bn, nom. [2]	15,311	15,874	16,377	17,020	8,316	8,856	.	.	.
annual change in % (real)	0.2	2.8	3.6	4.2	5.0	4.1	4.2	4.2	3.0
Gross fixed capital form., HUF bn, nom. [2]	6,308	7,223	7,525	6,812	2,541	3,273	.	.	.
annual change in % (real)	9.8	12.3	1.9	-10.6	-15.8	24.1	16.0	9.0	8.7
Gross industrial production									
annual change in % (real)	1.1	7.7	7.4	1.0	2.0	5.6	6.0	7.0	6.0
Gross agricultural production									
annual change in % (real)	12.5	11.4	-2.3	8.7	.	.	.	.	.
Construction industry									
annual change in % (real)	8.4	13.5	3.0	-18.8	-25.4	26.9	.	.	.
Employed persons, LFS, th, average	3,893	4,101	4,211	4,352	4,302	4,394	4,440	4,460	4,460
annual change in %	1.7	5.3	2.7	3.4	3.5	2.1	2.0	0.5	0.0
Unemployed persons, LFS, th, average	441	343	308	235	253	202	200	200	200
Unemployment rate, LFS, in %, average	10.2	7.7	6.8	5.1	5.6	4.4	4.3	4.3	4.3
Reg. unemployment rate, in %, eop	9.3	8.9	7.6	6.1	6.5	6.1	.	.	.
Average monthly gross wages, HUF [3]	230,714	237,695	247,924	263,171	258,003	290,344	288,600	314,500	333,300
annual change in % (real, gross)	1.7	3.2	4.4	5.7	5.7	7.4	7.0	6.0	3.0
Average monthly net wages, HUF [3]	151,118	155,690	162,391	175,009	171,573	193,078	195,500	217,100	232,300
annual change in % (real, net)	3.1	3.2	4.4	7.4	7.5	10.0	9.0	8.0	4.0
Consumer prices (HICP), % p.a.	1.7	0.0	0.1	0.4	0.2	2.4	2.5	2.8	2.9
Producer prices in industry, % p.a.	0.6	-0.4	-0.9	-1.7	-1.8	3.1	3.0	3.0	3.0
General governm.budget, EU-def., % of GDP									
Revenues	46.6	46.7	48.0	45.1	.	.	47.9	47.5	47.7
Expenditures	49.1	48.7	49.6	46.9	.	.	50.4	50.4	50.4
Net lending (+) / net borrowing (-)	-2.5	-2.1	-1.5	-1.8	.	.	-2.5	-2.9	-2.7
Public debt, EU-def., % of GDP	76.3	75.2	74.0	73.2	.	.	72.9	71.9	70.9
Stock of loans of non-fin.private sector, % p.a.	-4.4	-0.3	-12.3	-1.3	-5.8	2.3	.	.	.
Non-performing loans (NPL), in %, eop	18.1	17.4	13.6	8.9	.	.	.	.	.
Central bank policy rate, % p.a., eop [4]	3.00	2.10	1.35	0.90	0.90	0.90	0.90	1.30	1.50
Current account, EUR mn [5]	3,892	1,587	3,838	6,967	4,039	2,703	5,300	5,200	4,400
Current account, % of GDP [5]	3.8	1.5	3.5	6.1	7.7	4.8	4.3	4.0	3.2
Exports of goods, BOP, EUR mn [5]	70,243	73,826	79,638	80,188	40,002	44,696	88,200	97,000	104,800
annual change in %	0.4	5.1	7.9	0.7	1.9	11.7	10.0	10.0	8.0
Imports of goods, BOP, EUR mn [5]	66,912	71,701	75,236	75,482	37,060	42,503	84,500	94,600	104,100
annual change in %	-0.2	7.2	4.9	0.3	0.0	14.7	12.0	12.0	10.0
Exports of services, BOP, EUR mn [5]	16,993	18,727	20,289	21,659	10,242	10,741	23,300	25,000	26,500
annual change in %	5.8	10.2	8.3	6.8	7.2	4.9	7.5	7.5	6.0
Imports of services, BOP, EUR mn [5]	13,232	14,120	14,885	14,892	7,076	7,564	15,600	16,400	17,100
annual change in %	7.9	6.7	5.4	0.0	3.2	6.9	5.0	5.0	4.0
FDI liabilities, EUR mn [5]	4,986	7,134	6,667	-7,140	-8,622	3,168	5,000	.	.
FDI assets, EUR mn [5]	3,848	4,186	5,574	-9,052	-8,175	3,509	5,000	.	.
Gross reserves of NB excl. gold, EUR mn	33,696	34,481	30,226	24,384	24,668	23,353	.	.	.
Gross external debt, EUR mn [5]	119,963	121,129	118,613	109,411	116,536	109,435	107,000	105,000	103,000
Gross external debt, % of GDP [5]	117.7	114.7	107.1	96.2	102.5	89.2	87.2	80.7	75.4
Average exchange rate HUF/EUR	296.87	308.71	310.00	311.44	312.70	309.47	309	313	317

1) Preliminary. - 2) Half-year GDP data unrevised. - 3) Enterprises with 5 and more employees. - 4) Base rate (two-week NB bill). - 5) Excluding SPE.

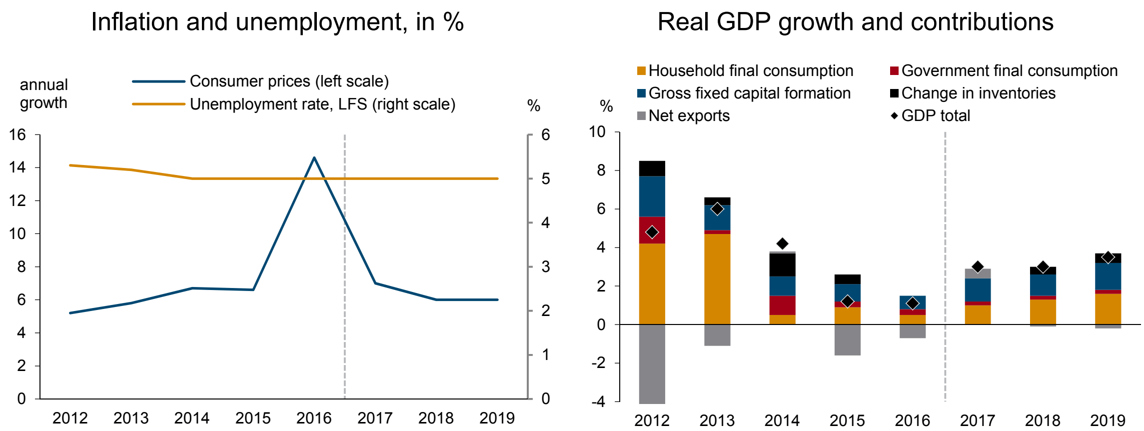
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

KAZAKHSTAN: Economy accelerates on the back of booming oil sector

OLGA PINDYUK

Strong industry performance accounts for a speeding-up of economic growth in 2017. The oil sector is benefiting from output expansion, higher prices and increased external demand. Real household income has been in decline, and private consumption growth is financed primarily through bank loans. The government is adopting measures to achieve fiscal consolidation and revive the banking sector.

Figure 38 / Kazakhstan: Main macroeconomic indicators



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

Kazakhstan's economy is gathering speed. According to preliminary data, GDP increased by 4.3% year on year in the first half of 2017, with goods production contributing more than 60% to growth. In particular, oil production has been on the rise after the start of operation of the Kashagan oil field last year. In January-August 2017, oil extraction increased by 12.2% year on year. Increased supply together with more favourable external demand conditions and higher prices have allowed revenues from export of oil to rise considerably – by more than 40% in USD terms during January-July 2017 as compared with the same period last year. Production in manufacturing also picked up (by 6.1% year on year), mainly on the back of metallurgy, which contributed to more than half of total manufacturing growth during that period. The industry is benefiting from increased external demand for metals, which allowed boosting metals exports by 47% in USD terms during January-July 2017 as compared with the same period last year. Other industries that are experiencing a revival are oil processing, machinery and equipment, and textiles and clothing.

The services sectors have been lagging behind industry. In the first half of 2017, value added in services increased only by 2.4% year on year. The financial services sector was one of the most anaemic with a mere 0.8% growth, reflecting the ongoing issues in the banking system. The transport sector benefited from the export surge and demonstrated the highest growth in value added among the services sectors – 3.9% year on year. The share of services in GDP has been in decline since the previous year and was at 56.5% in the first half of 2017, 1.3 p.p. lower than in 2016; the share of the mining industry was on the rise instead. Given the government's significant efforts to revamp the banking system and to stimulate the restructuring of the economy, in particular to decrease its dependency on the oil sector, these developments are likely to be a temporary setback.

In terms of expenditures, growth continues to be driven by investment and net exports. Investment is on the rise owing to the supportive fiscal policy, in particular the 'Nurly Zhol' programme, which has provided funding to infrastructure projects, SMEs support, and construction. Government funds accounted for 15.4% of total sources of investment financing in June-August 2017, up by 1.9 p.p. relative to the same period of 2016. The trade surplus has been increasing, as import growth is slower than that of exports due to still lasting effects of the sharp depreciation of the national currency at the end of 2015-beginning of 2016. Though the Kazakh tenge has regained some of its value with respect to the US dollar recently, consumers' ability to buy imports remains subdued – the average wage in the first half of 2017 was still 20% lower in USD terms than in 2015.

Household income has been declining in real terms for the second year in a row regardless of the overall positive economic dynamics. In January-June 2017, real household income was 1.3% lower than during the same period of 2016. Still, private consumption has been experiencing some growth, which is primarily financed by bank loans. Newly issued consumer loans increased during January-June 2017 by 57% relative to the same period of the previous year and accounted for about 15% of total nominal household income. This is a worrying sign, pointing to risks to sustainability of consumption growth as well as to the quality of the banks' loan portfolios.

The ability to support wage growth through fiscal expenditures will be limited as the government is pursuing fiscal consolidation in an effort to decrease the non-oil budget deficit and cut down on the use of the National Oil Fund resources. Unwinding of the fiscal stimulus is expected to be gradual to minimise its impact on growth. The guaranteed transfer from the National Fund (currently at KZT 2.9 trillion or about USD 8.8 billion) will decline to KZT 2 trillion (about USD 6 billion) by 2020 to reduce oil revenue dependence. The non-oil budget deficit should decrease from 8.3% of GDP in 2016 to 7% of GDP by 2020 and 6% of GDP by 2025. The government is working on new Customs and Tax Codes in order to reduce costs of doing business and expand the taxation base, which should help to increase non-oil revenues.

The government is determined to provide substantial support to the ailing banking sector. The sector still has not recovered from the consequences of the 2008 crisis, and non-cleansed balance sheets have been a bottleneck to credit expansion. In January-August 2017, regardless of the positive consumer loans dynamics, newly issued loans to corporate clients decreased by 8% year on year; the total stock of loans in August 2017 was only 2.9% higher than a year before. The National Bank of

Kazakhstan announced to allocate KZT 500 billion (about USD 1.5 billion) to help banks recapitalise starting from August 2017. According to the conditions of the programme, the bank shareholders will have to add their own capital to the funds loaned by the National Bank (at least one third of additional capital should be from own sources) and provide a detailed plan of actions to improve banks' sustainability. It appears that in anticipation of the programme banks have already started to reveal non-performing loans hidden in their balance sheets – on 1 August, the share of NPLs in total loans was at 12.8%, 6 p.p. higher than at the beginning of the year.

Stronger industry performance makes us revise upward the forecast of GDP growth in 2017 – to 3%. The oil sector will continue to be a major determinant of economic developments as the impact of the economic restructuring programmes is likely to take effect only in the medium to longer run. As oil prices are expected to remain stable over the forecasting period, GDP growth will remain at 3-3.5% in 2018-2019. Consumption of households will continue to grow at a slower pace than investment during the forecast period. Imports will be gradually gaining momentum as consumers' purchasing power will be increasing and investment projects will require increased imports of machinery and equipment.

Table 13 / Kazakhstan: Selected economic indicators

	2013	2014	2015	2016 1)	2016 January-June	2017 January-June	2017 Forecast	2018 Forecast	2019 Forecast
Population, th pers., average	17,035	17,289	17,544	17,794	17,733	17,976	18,100	18,350	18,600
Gross domestic product, KZT bn, nom.	35,999	39,676	40,884	46,971	19,357	20,936	52,700	57,500	62,500
annual change in % (real)	6.0	4.2	1.2	1.1	0.1	4.2	3.0	3.0	3.5
GDP/capita (EUR at PPP)	17,500	18,200	18,700	18,900	.	.	.	.	.
Consumption of households, KZT bn, nom.	17,617	18,806	21,492	24,550	.	.	.	.	.
annual change in % (real)	10.6	1.1	1.8	1.0	.	.	2.0	2.5	3.0
Gross fixed capital form., KZT bn, nom.	7,877	8,552	9,355	10,333	.	.	.	.	.
annual change in % (real)	5.5	4.4	4.2	3.0	.	.	5.5	5.0	6.5
Gross industrial production									
annual change in % (real)	2.5	0.3	-1.6	-1.1	-1.6	7.8	4.0	5.0	5.0
Gross agricultural production									
annual change in % (real)	9.7	1.0	3.4	5.4	3.0	3.1	.	.	.
Construction industry									
annual change in % (real)	3.5	4.6	5.8	7.4	6.6	5.9	.	.	.
Employed persons, LFS, th, average	8,571	8,510	8,624	8,553	8,437	8,498	8,600	8,640	8,680
annual change in %	0.7	-0.7	1.3	-0.8	-0.9	0.7	0.5	0.5	0.5
Unemployed persons, LFS, th, average	471	452	451	446	447	439	450	450	460
Unemployment rate, LFS, in %, average	5.2	5.0	5.0	5.0	5.1	4.9	5.0	5.0	5.0
Reg. unemployment rate, in %, eop	0.3	0.4	0.4	0.4	0.8	1.1	.	.	.
Average monthly gross wages, KZT 2)	109,141	121,021	126,021	142,898	138,185	145,108	156,000	170,300	185,900
annual change in % (real, gross)	1.9	3.9	-2.3	-1.1	-1.7	-2.4	2.0	3.0	3.0
Consumer prices (HICP), % p.a.	5.8	6.7	6.6	14.6	15.8	7.6	7.0	6.0	6.0
Producer prices in industry, % p.a.	-0.3	9.5	-20.5	16.8	11.9	20.9	12.0	5.0	2.0
General governm.budget, nat.def., % of GDP									
Revenues	17.7	18.5	18.7	19.8	21.4	23.9	19.0	19.0	18.5
Expenditures	19.7	21.2	20.9	21.4	23.7	24.4	20.7	20.4	19.7
Deficit (-) / surplus (+)	-1.9	-2.7	-2.2	-1.6	-2.4	-0.4	-1.7	-1.4	-1.2
Public debt, nat.def., % of GDP	12.6	14.6	22.7	25.0	23.2	23.0	24.0	23.0	22.0
Stock of loans of non-fin.private sector, % p.a.	13.4	7.2	4.7	0.3	26.1	0.3	.	.	.
Non-performing loans (NPL), in %, eop	31.2	23.5	8.0	6.7	7.9	10.7	.	.	.
Central bank policy rate, % p.a., eop 3)	5.5	5.5	16.0	12.0	15.0	10.5	10.25	9.75	9.00
Current account, EUR mn 4)	894	4,621	-4,632	-8,066	-3,557	-2,720	-3,700	-2,400	-2,800
Current account in % of GDP 4)	0.5	2.8	-2.8	-6.5	-7.1	-4.5	-2.8	-1.7	-1.8
Exports of goods, BOP, EUR mn 4)	64,435	60,440	41,961	33,673	15,322	21,627	38,800	42,700	45,700
annual change in %	-4.7	-6.2	-30.6	-19.8	-31.2	41.2	15.0	10.0	7.0
Imports of goods, BOP, EUR mn 4)	38,244	33,162	30,530	25,366	11,360	13,732	26,200	28,000	30,000
annual change in %	0.8	-13.3	-7.9	-16.9	-26.7	20.9	3.0	7.0	7.0
Exports of services, BOP, EUR mn 4)	3,988	4,981	5,842	5,699	2,779	2,858	5,400	5,700	6,100
annual change in %	6.2	24.9	17.3	-2.4	0.3	2.9	-5.0	6.0	7.0
Imports of services, BOP, EUR mn 4)	9,379	9,721	10,448	9,997	4,476	4,774	9,600	10,100	10,900
annual change in %	-5.5	3.6	7.5	-4.3	-2.7	6.6	-4.0	5.0	8.0
FDI liabilities, EUR mn 4)	7,536	5,437	5,568	15,340	6,914	4,171	8,300	.	.
FDI assets, EUR mn 4)	1,488	1,982	2,990	3,130	2,125	1,243	1,900	.	.
Gross reserves of NB excl. gold, EUR mn 4)	13,940	17,920	18,555	19,019	18,297	16,527	.	.	.
Gross external debt, EUR mn 4)	109,137	129,438	140,232	156,368	144,469	147,141	139,200	140,500	142,000
Gross external debt, % of GDP 4)	61.3	77.7	84.3	126.0	116.5	110.6	104.6	96.8	89.9
Average exchange rate KZT/EUR	202.09	238.10	245.80	378.63	385.76	344.64	396	396	396

1) Preliminary. - 2) Excluding small enterprises, engaged in entrepreneurial activity. - 3) From 2015 one day (overnight) repo rate, refinancing rate of NB before. - 4) Converted from USD.

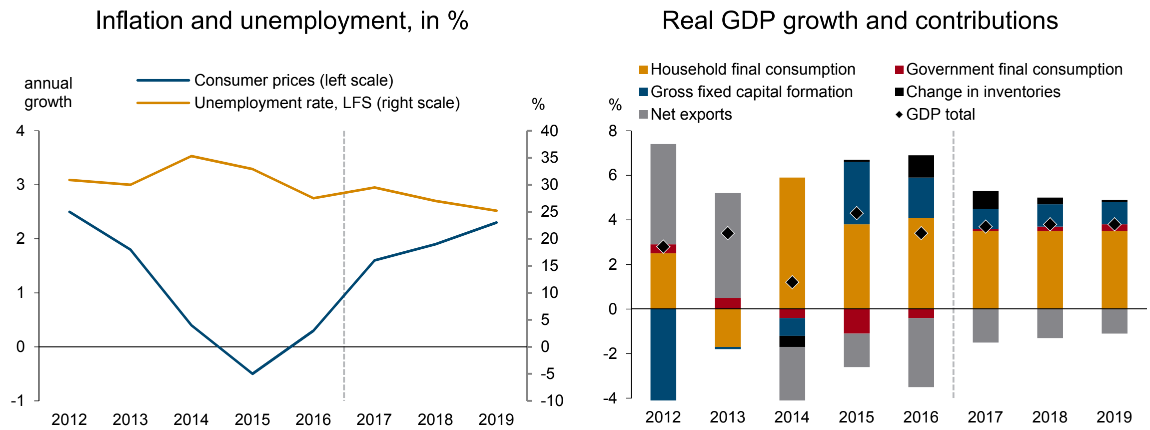
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

KOSOVO: New government facing challenges, but growth will remain strong

RICHARD GRIEVESON

The new government has a tiny majority and is made up of a diverse set of parties, meaning that significant reform will be difficult. However, the economy is growing strongly, driven in particular by supportive external factors, and this is likely to remain the case over the forecast period. Exports are growing rapidly, but from a very low base, and a significant change in Kosovo's remittance-dependent growth model is unlikely in the medium term.

Figure 39 / Kosovo: Main macroeconomic indicators



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

A new government was approved by parliament in September 2017, with Ramush Haradinaj of the Alliance for the Future of Kosovo (AAK) as prime minister. Mr Haradinaj heads the PAN coalition, which received 61 votes in parliament out of 120, meaning that his majority is wafer thin. Important support came from Srpska Lista, the main Serbian party in Kosovo, which in return will have three ministries in the administration. The Bosnian and Turkish minorities are also represented in the government. The tiny majority and large number of parties in the coalition create particularly significant risks to political stability and policy formation.

Mr Haradinaj has stated that he intends to focus on continued dialogue with Serbia, and tackling corruption. Broadly, we expect few radical changes compared with the previous government's policy stance. The challenges facing the government remain daunting. Aside from those emphasised by

Mr Haradinaj, they include EU visa liberalisation, a border demarcation agreement with Montenegro, and changing the Kosovo Security Force into a regular army.

In the near term, a government led by Mr Haradinaj is probably positive for regional stability. Albin Kurti, the Vetevendosje candidate for PM, would likely have taken a much more antagonistic approach towards Serbia. Vetevendosje is a relatively new party which opposes continued dialogue with Serbia on the current terms and came second in the recent election. Mr Kurti previously said that EU-mediated Serbia-Kosovo talks have 'failed' and should not continue. However, whoever is in power, relations with Serbia will remain difficult. This will continue to be a major structural impediment to Kosovo's economy, and particularly the development of the external sector.

Kosovo's public debt is low, and the fiscal deficit is not a source of risk at present. However, fiscal reforms initiated by the ex-finance minister Avdullah Hoti could now be abandoned. The new government is also pushing forward with a plan to increase wages in the public sector. Pressure from social groups for increased transfers could create fiscal pressures over the medium term.

The economy is currently growing strongly, driven in particular by supportive external developments. Real GDP rose by 3.7% year on year in Q1, and growth strengthened to 4.4% in Q2. Growth in Q2 was driven primarily by gross capital formation and exports, which rose by 8.4% and 20.7%, respectively. Household consumption fell by 3.1% and imports by 1.7%. On the production side, the fastest growth in Q2 came from mining and quarrying (+23.5%), electricity (+6%), construction (+18.8%), transportation and storage (+9.8%) and accommodation and food services (+8%).

We expect growth to remain robust during the forecast period, with Kosovo set to be among the fastest growing economies in the Western Balkans in 2018-19. Growth is forecast to average 3.8% in the next two years, driven primarily by private consumption and investment. The latter should benefit from a continued steady increase in net foreign direct investment (FDI) inflows. Remittance inflows will also remain strong, with growth in key source countries such as Switzerland and Germany likely to remain robust.

The labour market remains a major source of weakness for the economy, and this will remain the case during the forecast period. Remittances from much wealthier countries such as Switzerland and Germany are partly behind this; domestic wages are at a level where many locals are unwilling to work. Remittances accounted for 11.5% of GDP in 2016. However, a bigger reason is the lack of productive capacity in the economy. As of 2016, Kosovo had the lowest employment rate and the highest unemployment rate of the CESEE countries for which we provide data. Youth unemployment is also particularly high.

Monetary conditions have continued to loosen, tracking developments in the eurozone. The effective interest rate on new loans has continued to fall, for both corporates and households. Inflation has tailed off from its April peak of 2.2% year on year (as the very low oil prices of early 2016 dropped out of the base for year-on-year comparison) but is still relatively high (at 1.7% in both July and August). Nevertheless, it appears that Kosovo's brief flirtation with deflation is over. Credit growth will provide some support for growth during the forecast period.

The external deficit is large, and will remain so during the forecast period. Kosovo posted a current account deficit equivalent to 9.2% of GDP in 2016, and the shortfall widened by 13% year on year in January-July 2017. We expect a full-year deficit equivalent to 10% of GDP this year, and further widening thereafter. The expansion of the deficit is being driven by a wider goods shortfall; this widened by 7% year on year in January-July. The merchandise trade deficit was offset partly by higher surpluses on the services, primary income and secondary income accounts. The latter remains by far the most significant of the three, and largely reflects inflows of remittances from Kosovans abroad. Net secondary income inflows covered 46% of the goods deficit in January-July, a slight decrease from 49% in the same period of 2016. Separate quarterly data for remittances showed year-on-year growth of 13.2% in Q1 and 10.6% in Q2.

Merchandise exports are growing rapidly, albeit from a very low base. Nominal merchandise exports grew by an average 30.9% year on year on average in March-August. Imports were up by 9.6% over the same period, but with exports only equivalent to a little more than 10% of imports, the trade deficit still widened. Exports primarily go to other members of the Central European Free Trade Agreement (CEFTA); 47% went to other CEFTA countries in 2016, with a further 23% going to the EU. Manufactured goods (including machinery and transport equipment) accounted for 48% of total exports in 2016, with crude materials excluding fuels responsible for a further 22%. However, Kosovo has a very long way to go; merchandise exports represented just 5% of nominal GDP in 2016, well below regional peers such as Croatia (27%), Bosnia (31%), Serbia (39%) and Macedonia (44%).

External debt is rising quite quickly, although remains the lowest in the region relative to GDP. Gross external debt increased by 8.9% year on year in H1, driven by increases in both public and private credit. Banks are deleveraging on a net basis, while non-bank private sector borrowing is growing rapidly, in part because of a ramping up of short-term debt. Over one third of external debt is still made up of inter-company lending, although the share has fallen as non-bank private debt has increased (26.5% of the total in Q2).

In summary, we expect the economy to grow by 3.7% this year, and 3.8% in 2018-19. Growth will primarily be driven by external factors, particularly (but not only) remittances. This growth rate will ensure continued convergence with wealthier states, albeit from a low base. Inflation developments will largely track those of the eurozone, meaning that price growth will remain relatively subdued in the historical context. Significant reform is highly unlikely, given the broad coalition and its tiny majority. Further strong export growth is likely, although the export base will remain small, and major structural challenges – particularly tensions with Serbia – will keep Kosovo’s export sector among the smallest in the region during the forecast period. As a result, the merchandise trade deficit will remain huge, although inflows of remittances, loans and other investment will help to offset this.

Table 14 / Kosovo: Selected economic indicators

	2013	2014	2015	2016 1)	2016	2017	2017	2018	2019
					January-June			Forecast	
Population, th pers., average	1,818	1,813	1,788	1,778	.	.	1,770	1,760	1,750
Gross domestic product, EUR mn, nom.	5,327	5,568	5,807	5,985	2,729	2,831	6,300	6,700	7,100
annual change in % (real)	3.4	1.2	4.3	3.4	3.4	4.3	3.7	3.8	3.8
GDP/capita (EUR at PPP)	6500	6700	7400	7800	.	.	.	.	.
Consumption of households, EUR mn, nom. 2)	4,468	4,821	4,964	5,176	2,492	2,529	.	.	.
annual change in % (real)	-1.9	7.0	4.3	4.8	0.9	1.8	4.0	4.1	4.0
Gross fixed capital form., EUR mn, nom.	1,323	1,294	1,499	1,545	.	.	.	.	.
annual change in % (real)	-0.2	-3.3	12.1	7.1	.	.	3.5	4.0	4.0
Gross industrial production 3)									
annual change in % (real)	6.5	-1.3	5.0	-1.1	.	.	4.0	5.0	5.0
Gross agricultural production 3)									
annual change in % (real)	1.4	0.8	-3.0	7.6	.	.	.	.	.
Construction output 3)									
annual change in % (real)	2.6	-6.1	4.0	1.2	.	.	.	.	.
Employed persons, LFS, th, average 4)	338.4	323.5	296.9	331.8	314.7	353.0	370	390	400
annual change in %	11.7	-4.4	-8.2	11.7	.	12.2	12.0	4.3	3.1
Unemployed persons, LFS, th, average 4)	144.8	176.7	145.8	126.1	116.0	155.0	150	140	130
Unemployment rate, LFS, in %, average 4)	30.0	35.3	32.9	27.5	27.0	30.6	29.5	27.0	25.2
Reg. unemployment rate, in %, end of period	.	.	.	.	.	.	.	.	.
Average monthly net wages, EUR 5)	364	429	458	453	.	.	450	470	490
annual change in % (real, net)	-3.9	17.4	7.3	-1.4	.	.	-1.5	1.5	1.5
Consumer prices, % p.a.	1.8	0.4	-0.5	0.3	-0.02	1.7	1.6	1.9	2.3
Producer prices, % p.a.	2.3	1.6	2.7	-0.1	-0.1	0.2	1.9	2.2	2.5
General governm.budget, nat.def., % of GDP									
Revenues	25.5	24.2	29.4	29.7	.	.	28.9	29.8	29.8
Expenditures	28.0	27.2	27.8	29.5	.	.	31.0	32.0	32.0
Deficit (-) / surplus (+)	-2.5	-2.9	1.6	0.2	.	.	-2.1	-2.2	-2.2
Public debt, nat.def., % of GDP	8.9	10.5	12.9	14.2	13.8	14.5	15.6	16.9	18.1
Stock of loans of non-fin.private sector, % p.a	2.6	6.2	7.2	10.5	.	.	.	.	.
Non-performing loans (NPL), in %, eop	8.7	8.3	6.2	4.9	.	.	.	.	.
Central bank policy rate, % p.a., eop 6)	10.90	9.29	7.69	7.22	7.2	6.8	6.80	7.00	7.30
Current account, EUR mn	-179	-385	-497	-549	-382	-366	-633	-709	-790
Current account, % of GDP	-3.4	-6.9	-8.6	-9.2	-14.0	-12.9	-10.0	-10.6	-11.1
Exports of goods, BOP, EUR mn	291	324	322	308	150	179	340	364	389
annual change in %	3.4	11.3	-0.6	-4.5	-5.4	19.4	10.4	7.1	6.9
Imports of goods, BOP, EUR mn	2,287	2,383	2,432	2,599	1,210	1,303	2,790	2,970	3,175
annual change in %	-1.9	4.2	2.1	6.9	10.1	7.6	7.4	6.5	6.9
Exports of services, BOP, EUR mn	875	929	952	1,038	325	351	1,070	1,133	1,209
annual change in %	-2.2	6.1	2.5	9.1	8.3	8.0	3.0	5.9	6.7
Imports of services, BOP, EUR mn	355	469	494	473	205	186	465	485	500
annual change in %	-10.1	32.0	5.5	-4.3	-13.5	-9.3	-1.8	4.3	3.1
FDI liabilities, EUR mn	280	151	309	216	85	139	450	.	.
FDI assets, EUR mn	30	27	37	40	1	9	40	.	.
Gross reserves of NB excl. gold, EUR mn	694	645	734	830	.	.	.	.	.
Gross external debt, EUR mn	1,608	1,737	1,932	2,045	2,003	2,174	2,200	2,300	2,500
Gross external debt, % of GDP	30.19	31.20	33.26	34.17	33.47	34.50	35.0	35.0	35.0

1) Preliminary. – 2) Including expenditures of NPISHs. - 3) According to gross value added (manufacturing industry for industrial production). - 4) Population 15-64. - 5) Net wages in state administration. - 6) Average weighted effective lending interest rate (Kosovo uses the euro as national currency).

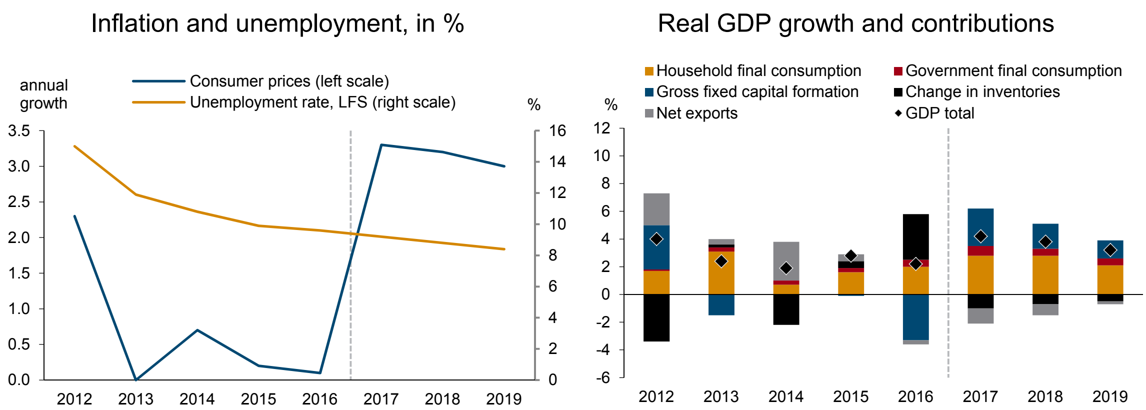
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

LATVIA: Public investment and minimum wages to lift growth

SEBASTIAN LEITNER

Our GDP growth forecast for 2017 has been increased to 4.2%. Private and (particularly) public investment activity is expanding faster than expected. The inflow of EU funds is likely to amount to 2.6% of GDP this year. As anticipated, exports to Russia have revived following the upswing in that country. Household consumption is developing rapidly, and this will continue in the coming years thanks to rising minimum wages and the 2018 income tax reform. In both 2018 and 2019, we expect continuously robust GDP growth of 3.8% and 3.2%, respectively.

Figure 40 / Latvia: Main macroeconomic indicators



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

After a slump in 2016, gross fixed capital investment is growing strongly. Following an interim year that caused a halt in public capital expenditure, fresh EU funds have become available again in 2017. Thus, public investment in infrastructure rallies again; the inflow from Brussels is expected to amount to 2.6% of GDP in 2017. Apart from the public sector, the increase in capital expenditure however has so far occurred only in transport and trade, but is expected to broaden next year as capacity utilisation has reached relatively high levels in industry. Private residential construction output, however, has remained rather anaemic this year. The development of the number of building permits, for residential and non-residential buildings alike, does not show a stronger upwind for prospects in the sector for 2018. Overall, we forecast total gross fixed investment to increase more strongly than expected previously, by 15% in 2017 and another 10% in real terms in 2018.

The rather difficult years for the export sector are over, the development of foreign demand in 2017 and 2018 is positive. In the past years direct exports and transit trade to Russia were under pressure due to Russian sanctions and the downturn of economic activity in the Eastern neighbourhood. In 2017 Latvian goods exports have started to grow again more strongly, to Russia by even about 35% in the first half of 2017 in nominal year-on-year terms. But also trade with Western Europe, the Scandinavian countries and the rest of the world has gradually gained momentum. Wood and food producers report an upswing of export growth figures, but the strongest increases are observed in the re-exporting wholesale sector. In general, we expect both goods and services exports to revive again this year, and to remain lively in the years to come. With strongly increasing capital investments but also household consumption, however, imports are expected to grow faster and the goods trade balance is likely to become more negative again.

As expected, the rising level of prices for imported goods in 2017, compared to the previous year, resulted in an increase in consumer inflation. Strong wage growth has started to raise core inflation. As the effect of slightly reviving energy prices abates, rising prices in the services sector and an upswing in those of imported goods will raise consumer inflation to about 3.3% this year and 3.2% in 2018.

Declining activity in construction has led to lower employment there, while job growth has been recorded in the services sectors. Overall employment will again decline slightly in 2017 as in the year before. Demographic developments – including continuing net emigration – will result in a further decline in the working-age population and also in employment in the coming years. However, employment rates are likely to increase gradually at the same time. In the first half of 2017, the unemployment rate receded to 9.2%. Up to the end of the forecast period in 2019, we expect it to decline gradually to 8.4%.

Gross real wages will continue to rise, by 4.5% in 2017 and by about 3.5% in the two years ahead. Inspired by the forthcoming parliamentary elections in October next year, the government approved a strong increase in the minimum wage from EUR 380 to EUR 430 in January 2018. Thus, we expect growth in household consumption to increase by more than 4.5% in real terms this and the next year and still by 3.5% in 2019.

Starting with January 2018, Latvia will introduce a progressive personal income tax rate, after having pursued a flat tax system for more than 20 years. The aim is to reduce income inequality, which is one of the highest in the EU, while providing additional resources for the health and pension system. The government lowered the rate for annual income up to EUR 20,000 to 20%, kept it at 23% for higher earnings, but increased it to 31.4% for income above EUR 55,000. Moreover, apart from other measures, the tax reform foresees an increase in the payroll tax of 1 percentage point and the abolition of the taxation of retained profits for enterprises. The government budget for 2018 foresees expenditure growth – particularly in the field of health and defence, but also in education and EU-funded infrastructure. The budget deficit is expected to amount to 0.8% of GDP in 2017. The effect of the tax reform and election-biased expenditure increases will be a one-year increase in the budget deficit to 1.2% of GDP in 2018.

Broader-based stable economic growth is expected in the years to come. In 2017, external demand has started to grow again at a vivid pace, not only in nominal but also in real terms. After a sharper than anticipated investment hike in 2017, we expect a further – also election-induced – upswing in 2018. Also household demand is continuing to evolve at a remarkable pace, thus our GDP growth forecast for 2017 has been raised to 4.2%. Due to the anticipated speed-up in demand in the EU, and domestic investment activity driven by the inflow of EU funds, we expect GDP growth to remain high at 3.8% in 2018 before declining slightly to 3.2% in 2019.

Table 15 / Latvia: Selected economic indicators

	2013	2014	2015	2016 1)	2016	2017	2017	2018	2019
					January-June			Forecast	
Population, th pers., average	2,013	1,994	1,978	1,960	1,964	1,944	1,950	1,945	1,940
Gross domestic product, EUR mn, nom.	22,787	23,618	24,271	24,866	11,675	12,472	26,800	28,700	30,500
annual change in % (real)	2.4	1.9	2.8	2.2	2.6	4.0	4.2	3.8	3.2
GDP/capita (EUR at PPP)	16,700	17,500	18,500	18,900	.	.	.	.	.
Consumption of households, EUR mn, nom.	13,780	14,178	14,393	15,040	7,250	7,848	.	.	.
annual change in % (real)	5.3	1.2	2.7	3.4	3.4	4.5	4.6	4.7	3.5
Gross fixed capital form., EUR mn, nom.	5,291	5,337	5,385	4,538	1,837	2,180	.	.	.
annual change in % (real)	-6.0	0.1	-0.5	-15.0	-17.8	17.5	15.0	10.0	7.0
Gross industrial production 2)									
annual change in % (real)	-0.9	-1.0	3.6	5.4	4.7	9.6	9.5	7.0	5.0
Gross agricultural production									
annual change in % (real)	2.3	4.5	14.2	-1.9	.	.	.	.	.
Construction industry									
annual change in % (real)	8.1	7.9	-1.2	-17.9	-19.0	13.1	.	.	.
Employed persons, LFS, th, average	893.9	884.6	896.1	893.3	893.9	887.1	890	888	885
annual change in %	2.1	-1.0	1.3	-0.3	0.3	-0.8	-0.4	-0.2	-0.3
Unemployed persons, LFS, th, average	120.4	107.6	98.2	95.3	98.1	89.0	90	90	80
Unemployment rate, LFS, in %, average	11.9	10.8	9.9	9.6	9.9	9.2	9.2	8.8	8.4
Reg. unemployment rate, in %, eop 3)	9.5	8.5	8.7	8.4	8.3	7.2	.	.	
Average monthly gross wages, EUR	715.7	765.0	818.0	859.0	839.7	905.8	930	1,000	1,070
annual change in % (real, gross)	4.6	6.2	6.7	3.8	5.8	4.6	4.5	4.0	4.0
Average monthly net wages, EUR	515.4	560.0	603.0	631.0	618.8	662.5	680	730	780
annual change in % (real, net)	5.6	8.0	7.4	4.3	5.5	3.8	3.8	3.5	3.5
Consumer prices (HICP), % p.a.	0.0	0.7	0.2	0.1	-0.6	3.1	3.3	3.2	3.0
Producer prices in industry, % p.a.	1.6	0.4	-1.0	-3.0	-3.5	1.4	2.0	2.5	2.0
General governm.budget, EU-def., % of GDP									
Revenues	35.9	35.9	35.9	36.6	.	.	36.0	35.3	35.7
Expenditures	36.9	37.5	37.2	36.6	.	.	36.8	36.5	36.4
Net lending (+) / net borrowing (-)	-1.0	-1.6	-1.3	0.0	.	.	-0.8	-1.2	-0.7
Public debt, EU-def., % of GDP	39.0	40.9	36.7	40.4	.	.	38.0	37.0	35.0
Stock of loans of non-fin.private sector, % p.a	-7.0	-8.8	-3.4	0.5	-0.3	1.0	.	.	.
Non-performing loans (NPL), in %, eop	8.3	6.9	6.0	4.4	5.1	4.4	.	.	.
Central bank policy rate, % p.a., eop 4)	0.25	0.05	0.05	0.00	0.00	0.00	.	.	.
Current account, EUR mn	-621	-411	-116	342	202	-17	-100	-500	-700
Current account, % of GDP	-2.7	-1.7	-0.5	1.4	1.7	-0.1	-0.4	-1.7	-2.3
Exports of goods, BOP, EUR mn	9,810	10,242	10,336	10,391	4,888	5,366	11,300	11,900	12,400
annual change in %	1.7	4.4	0.9	0.5	-1.6	9.8	8.5	5.5	4.5
Imports of goods, BOP, EUR mn	12,431	12,621	12,538	12,310	5,848	6,631	14,100	15,300	16,200
annual change in %	1.2	1.5	-0.7	-1.8	-4.4	13.4	14.5	8.5	6.0
Exports of services, BOP, EUR mn	3,900	4,105	4,355	4,575	2,222	2,335	4,900	5,200	5,500
annual change in %	3.5	5.3	6.1	5.1	7.6	5.1	6.5	6.0	5.0
Imports of services, BOP, EUR mn	2,127	2,066	2,276	2,433	1,151	1,233	2,600	2,800	3,000
annual change in %	-0.8	-2.9	10.2	6.9	9.6	7.1	7.3	6.5	5.5
FDI liabilities, EUR mn	743	704	752	222	-129	361	500	.	.
FDI assets, EUR mn	373	409	126	217	149	170	300	.	.
Gross reserves of NB excl. gold, EUR mn 5)	5,565	2,448	2,957	3,100	2,912	3,113	.	.	.
Gross external debt, EUR mn	30,501	34,035	34,921	37,079	37,923	37,424	37,500	38,700	39,700
Gross external debt, % of GDP	133.6	144.1	143.9	149.1	152.5	139.6	140.0	135.0	130.0
Average exchange rate EUR-LVL/EUR	0.9981	1.0000	1.0000	1.0000	1.0000	1.0000	1	1	1

1) Preliminary. - 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.

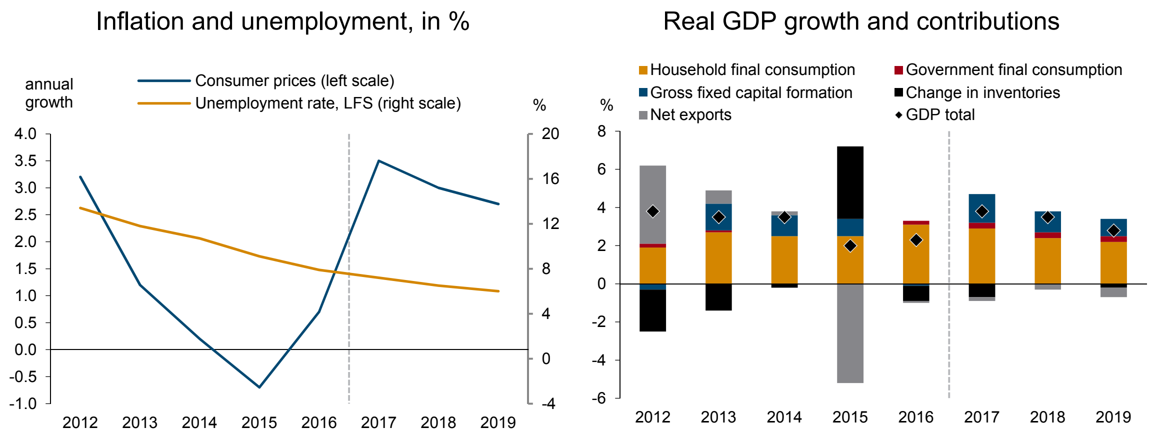
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

LITHUANIA: Upswing in the investment cycle and foreign demand

SEBASTIAN LEITNER

In 2017, economic growth in Lithuania is being driven by a resurgence in external demand, particularly from the CIS, and also for oil products. Moreover, strong growth in investment is underpinned by fresh funds from the EU and by private housing construction. The ongoing decline in unemployment and rapid wage increases have resulted in steady, strong growth in consumer demand. For 2017, we forecast a greater upswing in the GDP growth rate to 3.8%, followed by 3.4% in 2018 and 2.8% in 2019.

Figure 41 / Lithuania: Main macroeconomic indicators



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

After stagnation in goods exports in 2016, a strong revival is underway to all destinations this year. Exports to the CIS region increased by almost 30% nominally year on year in the first half of 2017. The recovery of the economy of Russia, Lithuania's most important individual trading partner, will back the upswing in exports further on. Moreover, external demand from the EU partners in general and from the Baltic states in particular is boosted by an upswing in the European investment and trade cycle. In addition, services exports have been growing more strongly this year, and will continue to do so in the coming years, particularly due to increasing transit trade to Russia. Tourism exports are also growing at a good pace in 2017: quarterly figures show that an increase of about 10% in overnight stays is likely. Since household demand keeps on flourishing and investment activity is strongly reviving this year, imports in 2017 are increasing at a high rate in line with exports. Nevertheless, we expect the current account deficit to remain again below 1% of GDP and increase only gradually in the medium term.

Gross fixed capital investment is reviving, growing by 6.9% in real terms year on year in the first half of 2017. The inflow of fresh EU funds from the 2014-2020 programming period allows the government to increase capital spending. Investment is particularly foreseen in energy, as well as in the road and railway infrastructure – an ongoing major EU-funded project is Rail Baltica, connecting the Baltics with the European rail network. The construction of new dwellings but also refurbishment co-financed by public sources has started to increase as swiftly as expected this year, and the rising number of building permits indicates that the upswing will continue in 2018. In addition, the stock of mortgage loans granted to households is growing again at a faster pace, by 10% from August 2016 to August 2017.

Following deflationary developments in 2016, rising prices for imports, particularly of oil and gas, resulted in consumer prices to increase gradually during 2017. Apart from energy, also prices for food started to grow more swiftly. In addition, inflation is fuelled by higher excise duties, and the ongoing strong increase in wages pushes up core inflation. In nominal terms, gross wages grew by more than 8% on average and still by 5.6% in real terms in the first half of 2017 year on year. The economic stimulus in the rest of the EU and higher investment activity will lead to consumer inflation of about 3% in both 2018 and 2019.

Employment is expected to decrease this year by about 0.5%, although the employment rate is rising. Demographic developments, particularly still high net outward migration, result in a continuously shrinking working-age population in Lithuania, in 2017 again by about 1%. About half of the emigrants having left the country in the period following the economic crisis went to the UK. In contrast to Polish citizens, for Lithuanians we can so far observe no migration-reducing Brexit effect. Based on British registration statistics for national insurance numbers, migration of Lithuanians to the UK remained nearly constant in the period July 2016 to June 2017 compared to the same term one year before. In Lithuania, the employment rate among those aged 15-64 already climbed above 70% in the second quarter of this year, almost the level of Austria, and the unemployment rate is likely to drop to close to 7% of the labour force in 2017.

The government plans to attain a budget surplus also in 2018. Buoyant state revenues will allow the government to increase social spending more considerably next year. However, a large part of the rising government outlays will be devoted to defence spending, increasing to 2% of GDP in 2018. The EU Commission and the OECD have recently emphasised that income inequality in Lithuania is not only one of the highest in the EU but has also been rising continuously since 2012. The reason for that is a tax and benefit system not redistributing enough between high- and low-income earners. Apart from Ireland, the level of public expenditures is the lowest in Lithuania compared to other EU countries. -----Moreover, the Lithuanian welfare system cannot prevent its citizens from getting poor in the case of major life risks, like disability. The policy recommendation is thus to build up a proper welfare state that can offer its citizens a more decent living, in order to reduce large scale emigration.

Given the swift upswing in the EU funds driven public capital expenditures, investment but also foreign demand are the most important drivers of growth for the Lithuanian economy in 2017. However, also the improving situation in the labour market and rising incomes keep the household consumption flourishing this year and thereafter. Adjusting our forecast upwards, we expect GDP to expand by 3.8% in 2017, followed by a minor attenuation to 3.4% in 2018 and 2.8% in 2019. The assumed drivers of that growth are the economic upswing in Russia and growth gaining momentum in the euro area. Moreover, public investment activity should be facilitated by inflows of EU funds. The general government budget deficit will most probably not exceed 0.3% in 2017 due to revenues above expectation. In the years to follow the government plans a budget surplus, resulting in a continuously falling public debt to GDP ratio, which at present amounts to about 40% of GDP.

Table 16 / Lithuania: Selected economic indicators

	2013	2014	2015	2016 1)	2016	2017	2017	2018	2019
					January-June		Forecast		
Population, th pers., average	2,958	2,932	2,905	2,868	2,870	2,822	2,860	2,840	2,820
Gross domestic product, EUR mn, nom.	34,960	36,568	37,427	38,668	18,171	19,694	41,500	44,200	46,700
annual change in % (real)	3.5	3.5	2.0	2.3	2.0	4.1	3.8	3.5	2.8
GDP/capita (EUR at PPP)	19,600	20,700	21,600	21,900	.	.	.	.	.
Consumption of households, EUR mn, nom.	21,792	22,686	23,375	24,771	11,833	12,800	.	.	.
annual change in % (real)	4.3	4.0	4.0	5.0	5.1	4.8	4.5	3.8	3.5
Gross fixed capital form., EUR mn, nom.	6,455	6,906	7,325	7,314	3,308	3,502	.	.	.
annual change in % (real)	8.3	5.8	4.8	-0.5	-2.6	5.7	8.0	6.0	5.0
Gross industrial production (sales)									
annual change in % (real)	3.2	0.1	4.9	2.8	2.8	7.0	7.0	6.0	4.5
Gross agricultural production									
annual change in % (real)	-1.8	8.4	8.6	-4.4	.	.	.	.	.
Construction industry									
annual change in % (real)	11.3	17.0	-3.5	-9.4	-16.3	6.7	.	.	.
Employed persons, LFS, th, average	1,293	1,319	1,335	1,361	1,359	1,354	1,358	1,360	1,365
annual change in %	1.3	2.0	1.2	2.0	2.4	-0.4	-0.2	0.1	0.4
Unemployed persons, LFS, th, average	173	158	134	116	121	110	105	95	87
Unemployment rate, LFS, in %, average	11.8	10.7	9.1	7.9	8.2	7.6	7.2	6.5	6.0
Reg. unemployment rate, in %, eop 2)	11.1	9.3	9.0	8.5	7.4	7.3	.	.	.
Average monthly gross wages, EUR 3)	646.3	677.4	714.1	774.0	760.0	828.2	850	920	990
annual change in % (real, gross)	4.0	4.7	6.4	7.4	6.6	5.6	6.0	5.5	5.0
Average monthly net wages, EUR 3)	501.1	527.2	553.9	602.3	592.4	651.8	660	720	780
annual change in % (real, net)	3.8	5.1	6.1	7.7	7.0	6.7	6.0	5.2	5.3
Consumer prices (HICP), % p.a.	1.2	0.2	-0.7	0.7	0.5	3.2	3.5	3.0	2.7
Producer prices in industry, % p.a.	-2.4	-4.9	-9.7	-4.3	-8.1	6.2	5.0	3.5	3.5
General goverm.budget, EU-def., % of GDP									
Revenues	33.0	34.1	34.8	34.4	.	.	34.0	33.5	33.3
Expenditures	35.6	34.8	35.0	34.2	.	.	33.8	33.2	33.1
Net lending (+) / net borrowing (-)	-2.6	-0.7	-0.2	0.3	.	.	0.2	0.3	0.2
Public debt, EU-def., % of GDP	38.8	40.5	42.6	40.2	.	.	41.0	38.0	36.0
Stock of loans of non-fin.private sector, % p.a	-2.3	-0.9	4.1	7.1	8.9	2.7	.	.	.
Non-performing loans (NPL), in %, eop	11.0	6.5	5.5	3.8	4.7	3.5	.	.	.
Central bank policy rate, % p.a., eop 4)	0.27	0.12	0.05	0.00	0.00	0.00	.	.	.
Current account, EUR mn	292	1,158	-1,050	-433	-531	-386	-600	-900	-1,100
Current account, % of GDP	0.8	3.2	-2.8	-1.1	-2.9	-2.0	-1.4	-2.0	-2.4
Exports of goods, BOP, EUR mn	23,998	23,750	22,309	21,922	10,407	12,282	25,900	28,500	30,200
annual change in %	7.0	-1.0	-6.1	-1.7	-2.6	18.0	18.0	10.0	6.0
Imports of goods, BOP, EUR mn	24,918	24,686	24,296	23,690	11,435	13,510	27,700	30,700	33,200
annual change in %	5.9	-0.9	-1.6	-2.5	-4.5	18.1	17.0	11.0	8.0
Exports of services, BOP, EUR mn	5,390	5,850	6,011	6,845	3,239	3,894	8,100	9,100	9,700
annual change in %	12.5	8.5	2.7	13.9	14.2	20.2	18.0	12.0	7.0
Imports of services, BOP, EUR mn	4,033	4,212	4,266	4,599	2,182	2,503	5,400	6,100	6,600
annual change in %	18.5	4.4	1.3	7.8	6.4	14.7	17.0	13.0	8.5
FDI liabilities, EUR mn	531	387	873	870	109	52	600	.	.
FDI assets, EUR mn	322	382	164	732	557	-265	0	.	.
Gross reserves of NB excl. gold, EUR mn 5)	5,705	6,991	1,376	2,263	2,043	1,093	.	.	.
Gross external debt, EUR mn	24,596	25,551	28,332	33,091	31,418	33,132	35,300	38,500	42,000
Gross external debt, % of GDP	70.36	69.87	75.70	85.58	81.25	79.84	85.0	87.0	90.0

1) Preliminary. - 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.

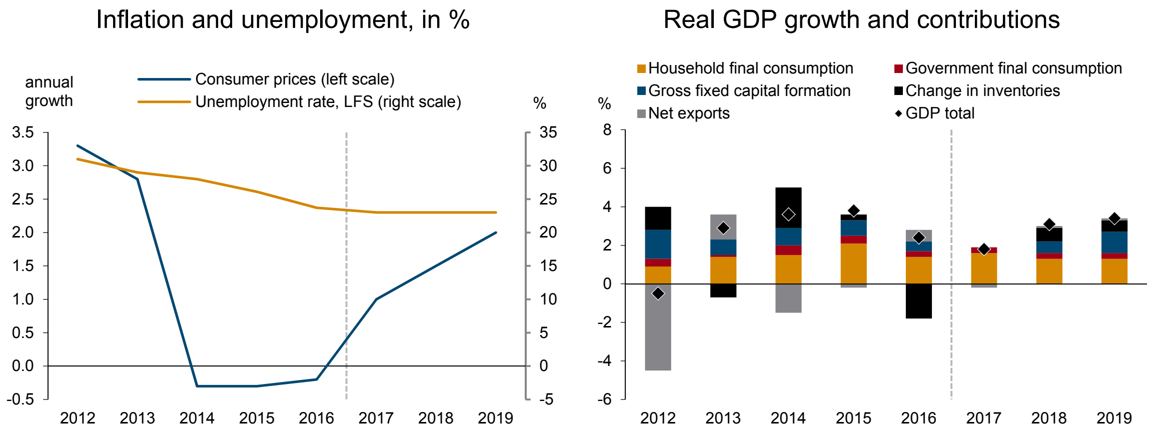
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

MACEDONIA: Democratisation is not costless

VLADIMIR GLIGOROV

This year's disappointing growth of at most 2% is due to the prolonged political crisis. Medium-term prospects have improved, though they are dependent on the political ability of the new government. Assuming that stability is preserved, next year should see growth of 3%, which should edge up towards 3.5% in the medium run, driven mostly by investment, both private and public.

Figure 42 / Macedonia: Main macroeconomic indicators



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

Growth slows down sharply, recovery is expected. Over the last few years, growth was headed towards 4%, which is probably the potential growth rate given the unemployment rate and the potential of development policies to speed it up. This year, however, growth has all but disappeared due to prolonged political crisis, which has now been resolved at least for the moment. The country democratised once again, but the uncertainty took a toll especially when it comes to investments. Indeed, initially, i.e. at the height of the crisis, there was some outflow of money and some growth of consumption, the latter boosting imports more than domestic sales. Thus, growth was flat in the first quarter and probably for the first half of the year. It is expected to recover in the second half, but it is hard to expect that overall growth for the year will reach 2%. And that would be a significant decline over the expected 3% or so before the crisis. Next year should see a recovery and in the medium term, the economy is well placed to reach its potential growth rate.

There is no authoritarian alternative for Macedonia. There are lessons to be learned from the recent Macedonian experience. One is that a country with a sizeable minority is hard to run in an authoritarian manner. In the recent crisis, the president of the Republic, who does not have executive power, tried to influence the coalition-making process in the parliament by refusing to appoint the prime minister from the majority coalition on the ground that their programme threatens the very existence of the state. This is usually enough to introduce a state of emergency. As it turned out, that was impossible. The possible pretext would have been ethnic clash, which however did not materialise – for the reason that both key ethnic groups, the Macedonians and the Albanians, have pluralistic polities. There is political competition, a multiparty system, within both dominant ethnic groups. So, neither ethnic group had much to gain from a conflict because that would lead to the collapse of the party system to which the country seems well attuned to. So, the attempt to disrupt the democratic decision-making went nowhere.

Recovery will take time, though the macroeconomic set-up and trade policy should be supportive. The political crisis lasted for almost half a year, and uncertainty prevailed during that period. It does not seem that macroeconomic balances and the institutional set-up have suffered too much. Monetary policy needed to be tightened somewhat in order to stop the outflow of money. Also, the trade deficit widened rather strongly, which suggests precautionary consumption due to uncertainty. However, macro balances are sustainable and overall the macro set-up has been in place for almost two decades now so the economy is well adjusted to the fixed exchange rate and the relatively low fiscal deficit. In addition, the financial sector is in better shape than in most Balkan countries, e.g. in terms of nonperforming loans. Finally, the open trade regime has also been functional since at least the beginning of the century and Macedonian external balances have proved sustainable in that entire period. Indeed, the growth strategy is one of export-led growth, which has proved supportive of relatively better post-crisis performance than in most other countries in the region.

The new government aims to boost wages and investments. The economic programme of the new government, a coalition of Macedonian Social-Democrats and three Albanian parties, is to increase minimum wages and possibly wages in the public sector as well as to support investment and exports. There is no doubt that investments in infrastructure would be helpful. Other development policies, e.g. centred on education and innovation, would help too. There is clearly a lot of opportunity for the new government to make a difference especially in the labour market, which is still characterised by an unemployment rate of above 20%. The programme, which initially relies on increased consumption, may not be without merit because the share of final consumption has declined in the last several years and is probably in part behind the dissatisfaction with the previous government.

International support is important in the medium term and in the long term too. The key barrier and the main source of uncertainty is the stalled EU accession process. The chances for improved relations with Greece and the EU are there, but it is not clear that those will be realised. The EU is concentrated on moving Serbia along, while Greece does not seem interested in new initiatives to resolve the dispute over the name of Macedonia. Clearly, the investment and export strategy would benefit from the boost of greater certainty when it comes to EU negotiations and integration.

Medium-term prospects have improved, though dependent on the political ability of the new government. Democratisation offers chances in the short run, and there is the effect of the recovery due to improved risks and expectations. Assuming that stability is preserved, e.g. after the upcoming local elections, next year should see growth of 3%, which should edge up towards 3.5% in the medium run, driven mostly by investment, both private and public.

Table 17 / Macedonia: Selected economic indicators

	2013	2014	2015	2016 1)	2016 January-June	2017 January-June	2017 Forecast	2018 Forecast	2019 Forecast
Population, th pers., mid-year	2,064	2,067	2,070	2,072	.	.	2,090	2,095	2,100
Gross domestic product, MKD mn, nom.	501,891	527,631	558,240	607,452	290,674	299,384	624,000	653,000	689,000
annual change in % (real)	2.9	3.6	3.8	2.4	2.7	-0.9	1.8	3.1	3.4
GDP/capita (EUR at PPP)	9,300	10,000	10,500	11,100	.	.	.	.	.
Consumption of households, MKD mn, nom.	355,959	363,629	377,258	391,479	193,414	202,352	.	.	.
annual change in % (real)	1.9	2.1	3.1	2.1	2.9	3.4	2.5	2.0	2.0
Gross fixed capital form., MKD mn, nom.	119,003	123,549	129,095	128,517	.	.			
annual change in % (real)	3.5	4.0	3.6	2.0	.	.	0.0	3.0	5.0
Gross industrial production 2)									
annual change in % (real)	3.2	4.8	4.9	3.4	5.6	1.2	3.0	5.0	4.0
Gross agricultural production									
annual change in % (real)	6.4	1.7	5.2	6.0	.	.	.	.	.
Construction industry									
annual change in % (real)	43.1	-3.4	40.8	8.0	41.8	-26.1	.	.	.
Employed persons, LFS, th, average	678.8	690.2	706.0	723.6	717.6	737.0	730	740	750
annual change in %	4.3	1.7	2.3	2.5	2.7	2.7	1.0	1.0	2.0
Unemployed persons, LFS, th, average	277.2	268.8	248.9	225.1	229.6	217.2	220	200	220
Unemployment rate, LFS, in %, average	29.0	28.0	26.1	23.7	24.3	22.8	23.0	23.0	23.0
Reg. unemployment rate, in %, eop	22.8	23.4	22.1	21.2	21.3	20.5	.	.	.
Average monthly gross wages, MKD	31,025	31,325	32,171	32,821	32,553	33,292	33,500	34,300	35,300
annual change in % (real, gross)	-1.6	1.3	3.0	2.2	2.5	1.4	1.0	1.0	1.0
Average monthly net wages, MKD	21,145	21,394	21,904	22,342	22,165	22,652	22,800	23,400	24,100
annual change in % (real, net)	-1.6	1.5	2.7	2.2	2.5	1.3	1.0	1.0	1.0
Consumer prices, % p.a.	2.8	-0.3	-0.3	-0.2	-0.3	0.9	1.0	1.5	2.0
Producer prices in industry, % p.a.	-1.4	-1.9	-3.9	-2.4	-4.1	3.9	0.0	2.0	2.0
General governm. budget, nat.def., % of GDP									
Revenues	30.1	29.7	31.0	29.9	.	.	31.0	31.0	31.0
Expenditures	34.1	33.9	34.4	32.5	.	.	33.0	33.0	33.0
Deficit (-) / surplus (+)	-4.0	-4.2	-3.4	-2.6	.	.	-2.0	-2.0	-2.0
Public debt, nat.def., % of GDP	40.2	45.7	46.6	47.7	45.4	46.1	48.0	48.0	47.0
Stock of loans of non-fin.private sector, % p.a	6.4	9.9	9.5	0.9	-0.5	0.0	.	.	.
Non-performing loans (NPL), in %, eop 3)	11.3	11.1	10.7	6.5	7.5	6.7	.	.	.
Central bank policy rate, %, p.a., eop 4)	3.25	3.25	3.25	3.75	4.00	3.25	3.25	3.25	3.50
Current account, EUR mn	-134	-43	-177	-265	-258	-218	-100	-90	-80
Current account, % of GDP	-1.6	-0.5	-2.0	-2.7	-5.5	-2.2	-1.0	-0.8	-0.7
Exports of goods, BOP, EUR mn	2,375	2,784	3,047	3,471	1,617	1,882	3,870	4,300	4,770
annual change in %	2.9	17.2	9.4	13.9	11.6	16.4	11.5	11.0	11.0
Imports of goods, BOP, EUR mn	4,238	4,640	4,870	5,279	2,529	2,783	5,780	6,240	6,740
annual change in %	-1.8	9.5	5.0	8.4	9.1	10.0	9.5	8.0	8.0
Exports of services, BOP, EUR mn	1,155	1,304	1,378	1,395	648	690	1,490	1,590	1,720
annual change in %	8.2	12.9	5.7	1.3	1.9	6.5	7.0	7.0	8.0
Imports of services, BOP, EUR mn	780	920	1,029	1,048	470	505	1,130	1,190	1,290
annual change in %	2.9	18.0	11.8	1.8	-0.5	7.5	8.0	5.0	8.0
FDI liabilities, EUR mn	302	37	262	495	341	271	300	.	.
FDI assets, EUR mn	73	-160	59	179	170	174	90	.	.
Gross reserves of NB excl. gold, EUR mn	1,803	2,221	2,049	2,370	1,899	2,159	.	.	.
Gross external debt, EUR mn	5,220	5,992	6,291	7,217	6,861	7,781	7,900	8,100	8,500
Gross external debt, % of GDP	64.0	70.0	69.4	73.2	69.7	76.8	78.0	76.0	76.0
Average exchange rate MKD/EUR	61.58	61.62	61.61	61.60	61.68	61.60	61.5	61.5	61.5

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

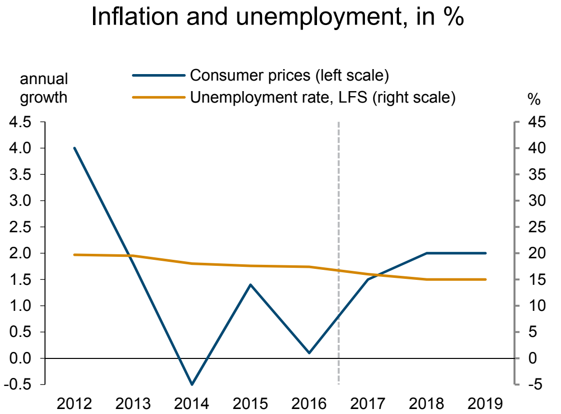
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

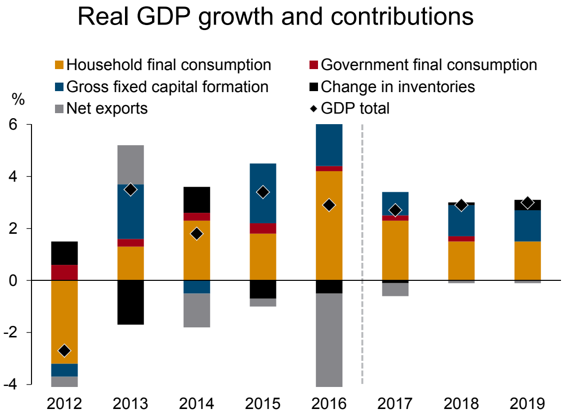
MONTENEGRO: Better than expected

VLADIMIR GLIGOROV

In the medium term, growth should return to somewhere above 3%. Improved prospects in the EU and in Russia are supportive of the growth of tourism, which should compensate for the necessary macroeconomic adjustments. If the region as a whole does better – which is likely e.g. in the case of Croatia, if not Serbia – that will also help. So overall, Montenegro could see its growth rate fulfil its potential, which is about 4%.

Figure 43 / Montenegro: Main macroeconomic indicators





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

The new government seems to be enjoying a post-crisis recovery with growth being faster than it projected. It planned fiscal consolidation with significant costs in terms of growth with perhaps even higher adjustment costs in 2018, with a speed-up to start in 2019. This still looks as the likely scenario, though growth this year may be higher than forecasted at about 2.7%. The tourist season seems to have gone well and consumption has recovered strongly. The latter is in all probability due to the public relief that a potential political crisis with far-reaching consequences over NATO accession has been averted. Better economic performance will also make fiscal consolidation easier.

Democratisation is advancing, though slowly. The next political challenge is the upcoming presidential election. The ruling party of the Democratic Socialists favours another run for the enduring leader of the country Milo Đjukanović, but it is not clear that he stands to win against the next generation politician Aleksa Bečić. This in any case would be a test of the theory of democratisation in a polarised society, which would certainly be interesting.

The conflict of two nationalisms has stood in the way of democratisation so far. The opposition in Montenegro was criticising the authoritarianism of Mr Đjukanović, but it in fact was opposed to the independence of the state, which was the outcome of the 2006 referendum. So, basically, this was Serbian opposition to the main Montenegrin party. That led to the persistent division of majority and minority with enduring deficiency in the functioning of the democratic process. Clearly, pluralisation of both sides is needed in order for democratisation to advance. That seems to be happening with the emergence of new political forces, which aim to look beyond the ethnic and national divisions. And, the upcoming presidential elections are another chance for this trend to strengthen.

Montenegro is not enthusiastic about the regional economic area or the single market. In the wake of the Berlin Process, the European Commission and the Serbian government argued for increased regional cooperation and integration. Ideas of the creation of the single market and customs union were tossed around, with which Montenegro went along but without really supporting them. In part, the reason is that these ideas were not well thought out. A customs union of candidate countries does not make sense primarily because there is no way to harmonise trade regimes with third countries. In the case of Montenegro, that would not matter much, but it would in the case of Serbia for instance. More important is the risk that Montenegro would have to accede to the EU together with Serbia at least, which is certainly later than it could manage on its own. The EU, however, has signalled that it plans for Montenegro and Serbia to join the EU by 2025, which has to worry the more advanced Montenegro absent further clarification. The reason is Serbia's reluctance to normalise its relations with Kosovo, which is the condition for an advance in the EU accession process. If in fact Serbia is going to join the EU together with Kosovo, on fears that it would otherwise use its EU membership to block Kosovo's advancement, much like Greece in the case of Macedonia, that may postpone Montenegro's membership if it does not make it quite uncertain.

Macroeconomic balances are worrisome, but sustainable. Foreign debt and other foreign financial obligations are high as are public debts, which of course are in euro, the official currency of the country. Employment is increasing, but the unemployment rate is still quite high as it has been close to 20% for quite some time. Financial stability was the major worry in the post-2008 period and it is still not altogether clear how sound the one bank, Prva Banka, which had to be bailed out, in fact is. Finally, the current account deficit continues to be in double digits due to foreign investments and a complementary high trade deficit. This seems to be sustainable because of the country specialising in tourist and other services. In addition, infrastructure investments are seen as in fact investments in tourism and transportation, and partly also in the production of energy. So, the expectation is that they will pay for themselves.

With such specialisation in production, EU membership would help a lot. Infrastructure investments that are needed are sizeable and EU transfers and investments would certainly prove helpful. In fact, Montenegro's accession would have a hardly noticeable impact on the EU budget, while Montenegro would experience a significant boost in all respects, economic and political.

In the medium term, growth should return to somewhere above 3%. Improved prospects in the EU and in Russia are supportive of the growth of tourism, which should compensate for the necessary macroeconomic adjustments. Gradual democratisation should prove stabilising and supportive of EU integration. If the region also does better, which is likely e.g. in the case of Croatia if not Serbia, that will also help. So, overall, Montenegro could see its growth rate climbing to its potential, which is about 4%.

Table 18 / Montenegro: Selected economic indicators

	2013	2014	2015	2016 1)	2016	2017	2017	2018	2019
					January-June			Forecast	
Population, th pers., mid-year	621	622	622	622	.	.	625	625	625
Gross domestic product, EUR mn, nom. 2)	3,362	3,458	3,655	3,954	1,586	1,694	4,100	4,300	4,500
annual change in % (real)	3.5	1.8	3.4	2.9	2.0	4.2	2.7	2.9	3.0
GDP/capita (EUR at PPP)	10,900	11,300	12,200	12,900	.	.	.	.	.
Consumption of households, EUR mn, nom. 2)3)	2,724	2,775	2,893	3,035	1,389	1,488	.	.	.
annual change in % (real)	1.6	2.9	2.2	5.4	1.7	5.7	3.0	2.0	2.0
Gross fixed capital form., EUR mn, nom. 2)	678	657	736	917	464.3	478.0	.	.	.
annual change in % (real)	10.7	-2.5	11.9	27.5	27.7	4.2	4.0	5.0	5.0
Gross industrial production 4)									
annual change in % (real)	10.6	-11.4	7.9	-3.7	-4.5	-9.5	0.0	5.0	4.0
Net agricultural production									
annual change in % (real)	5.0	3.0	3.0	5.0	.	.	.	.	.
Construction output 4)									
annual change in % (real)	41.6	34.1	20.3	47.4	40.1	44.0	.	.	.
Employed persons, LFS, th, average	201.9	216.3	221.7	224.2	220.9	227.6	229	231	233
annual change in %	1.0	7.1	2.5	1.1	1.1	3.1	2.0	1.0	1.0
Unemployed persons, LFS, th, average	48.9	47.5	47.2	48.3	47.3	44.1	50	40	40
Unemployment rate, LFS, in %, average	19.5	18.0	17.6	17.4	18.3	16.3	16.0	15.0	15.0
Reg. unemployment rate, %, average	15.8	16.1	16.5	21.9	18.8	21.3	.	.	.
Average monthly gross wages, EUR	726	723	725	751	745	766	770	790	810
annual change in % (real, gross)	-1.9	0.1	-1.1	3.1	2.5	0.3	1.0	1.0	1.0
Average monthly net wages, EUR	479	477	480	499	495	509	510	530	550
annual change in % (real, net)	-3.4	0.1	-0.8	3.9	3.1	0.4	1.0	1.0	1.0
Consumer prices, % p.a.	1.8	-0.5	1.4	0.1	0.0	2.5	1.5	2.0	2.0
Producer prices in industry, % p.a. 5)	1.6	0.1	0.3	-0.1	-0.5	0.8	1.0	2.0	2.0
General governm.budget, nat.def., % of GDP									
Revenues	37.0	39.1	36.3	37.6	39.9	40.2	39.0	40.0	40.0
Expenditures	43.0	42.1	44.3	41.0	45.9	44.0	42.0	42.0	42.0
Deficit (-) / surplus (+)	-6.0	-3.0	-8.0	-3.4	-6.0	-3.8	-3.0	-2.0	-2.0
Public debt, nat.def., % of GDP	55.7	56.2	62.3	60.8	60.6	62.8	60.0	60.0	60.0
Stock of loans of non-fin.private sector, % p.a	5.0	-1.5	2.9	6.3	4.3	5.9	.	.	.
Non-performing loans (NPL), in %, eop	18.4	16.8	13.4	11.1	12.6	9.5	.	.	.
Central bank policy rate, % p.a., eop 6)	8.68	8.41	8.53	7.45	8.0	7.1	7.00	8.00	8.00
Current account, EUR mn	-487	-526	-483	-715	-665	-631	-810	-850	-880
Current account, % of GDP	-14.5	-15.2	-13.2	-18.1	-42.0	-37.3	-19.8	-19.8	-19.6
Exports of goods, BOP, EUR mn	396	357	325	345	153	164	370	400	440
annual change in %	2.1	-9.7	-9.0	6.2	2.5	7.0	7.0	9.0	9.0
Imports of goods, BOP, EUR mn	1,724	1,734	1,789	2,003	950	1,030	2,160	2,350	2,560
annual change in %	-2.7	0.6	3.2	12.0	13.6	8.4	8.0	9.0	9.0
Exports of services, BOP, EUR mn	994	1,031	1,214	1,255	311	371	1,380	1,530	1,700
annual change in %	4.6	3.6	17.8	3.3	5.2	19.3	10.0	11.0	11.0
Imports of services, BOP, EUR mn	341	340	425	486	224	237	500	530	560
annual change in %	1.0	-0.3	24.8	14.3	28.8	5.6	4.0	5.0	5.0
FDI liabilities, EUR mn	337	375	630	205	-22	230	600	.	.
FDI assets, EUR mn	13	21	11	-167	-177	10	-100	.	.
Gross reserves of NB excl. gold, EUR mn 7)	424	545	674	803	666	702	.	.	.
Gross external public debt, EUR mn	1,433	1,562	1,956	2,003	2,034	2,009	2,260	2,450	2,660
Gross external public debt, % of GDP	42.62	45.16	53.53	50.65	51.43	49.00	55.0	57.0	59.0

1) Preliminary. - 2) Half-year GDP data unrevised. - 3) Including expenditures of NPISHs. - 4) Enterprises with 5 and more employees. - 5) Domestic output prices. - 6) Average weighted lending interest rate of commercial banks (Montenegro uses the euro as national currency). - 7) Data refer to reserve requirements of Central Bank.

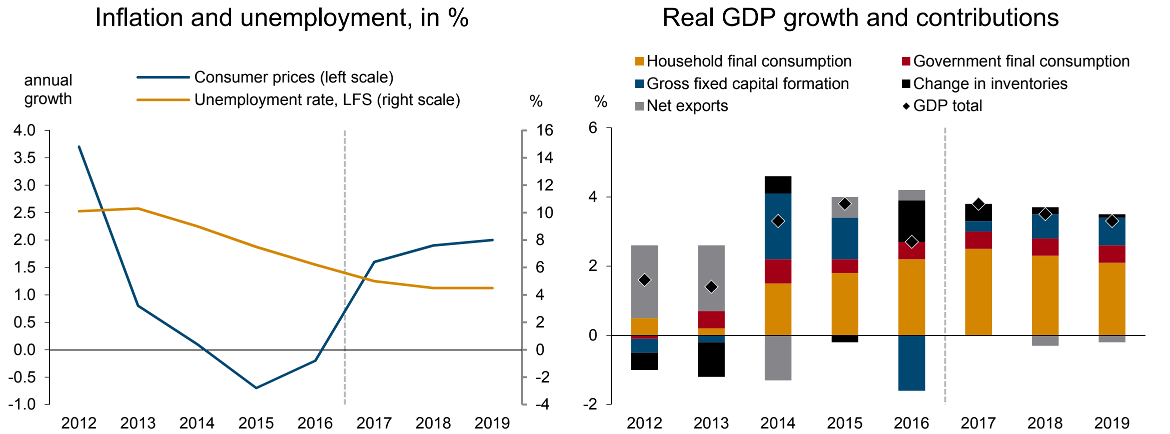
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

POLAND: Consumption-driven expansion

LEON PODKAMINER

Strong consumption-driven growth has been propelled by rising wages and employment. Economic conditions are conducive to a recovery in investment activities, which has yet to materialise. The positive growth prospects may be endangered by the unwelcome effects of the ongoing evolution of the political system – including the country's progressive alienation from its EU partners.

Figure 44 / Poland: Main macroeconomic indicators



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

GDP growth in the first quarter of 2017 turned out to be stronger than generally expected: 4% year on year. At 3.9% the GDP growth was steady in the second quarter. Growth of household consumption remained strong throughout the first half of the year and growth of public consumption accelerated. Consumption has been the main factor behind GDP growth, contributing 3.3 percentage points to the 4% growth in the first half of 2017.

Gross fixed capital formation (GFCF), which virtually stagnated in the first quarter of 2017, was reported to have increased, rather symbolically, in the second quarter (by 0.8%, year on year). The contribution of GFCF to GDP growth in the first half of 2017 remains negligible. However, the contributions of changes in inventories were large and rising (0.7 percentage points in the first quarter of 2017 and 1.9 percentage points in the second). It seems rather improbable that inventories could expand strongly much longer (as they already had expanded rather strongly throughout 2016). On the other hand, the strong increase in output of the construction sector observed so far in 2017 may suggest a part of rising inventories represents construction works in progress.

The performance of foreign trade has been robust, yet weakening throughout 2017. Foreign trade developments did not affect the GDP growth rate in the first quarter of 2017 (both exports and imports of goods and non-factor services rose, by 8.3% and 8.7% respectively in real terms). But in the second quarter of the year imports rose over 6% while exports by only 2.8%. Consequently, in the second quarter foreign trade contributed negatively to the GDP growth rate (by -1.5 percentage points).

Household consumption is set to continue to grow quite strongly in the rest of 2017 (as well as in 2018-2019). Primarily this is due to a relatively strong rise in employment which has been leading to a rising wage bill. Government policy measures supporting household incomes and growing private consumption include quite generous transfers to families with children, increasing official minimum wage rates and higher tax-free personal income thresholds. On the other hand, the government tries to 'economise' on retirement expenditure (growth of average pensions of retirees lag behind average wages and inflation).

Rising demand for (primarily skilled) labour is one aspect of the labour market situation, which is gradually shifting in favour of the employees. Average wages are growing under the impact of tightening labour markets. The wage hikes are still quite moderate though, roughly in line with rising productivity. The presence of a large 'shadow labour army' consisting of potentially employable migrants (primarily from Ukraine) seems to be restricting the wage pressures. Also, the introduction of sizeable social transfers may have reduced, at least temporarily, the wage-earners income aspirations. Labour costs are not expected to activate stronger cost-push inflation anytime soon, although they may prevent further growth in the corporate sector's profitability indicators.

Wage developments have also much to do with the demography-related weakening of the labour supply. The lowering of the retirement age (from 67 years for both sexes to 65 for men and 60 for women), effective as of October 2017, will be reducing the labour supply additionally – and as such should be conducive to further growth in wages.

The financial standing of the non-financial corporate sector has been quite strong. Net profits of the sector rose again, by 8.8% in the first half of 2017, reaching an equivalent of about EUR 15.7 billion (over 7% of the period's GDP). Profitability of the sector is high and its financial standing very strong – though firms generally expect some deterioration of these indicators in the future (on account of possibly rising costs and more intense competition). Financial sector corporations have also been faring relatively well. Although commercial banks' net profits declined by 17% (on account of higher personal costs, much higher obligatory contributions to the (centralised) banking system reserve fund and a higher tax burden) they reached an equivalent of over EUR 1.6 billion in the first half of 2017.

Indebtedness of the non-financial private sector remains relatively low. Borrowing by firms and households is not expensive and the interest rates on loans are quite stable. Despite this, loans to the non-financial corporate and household sectors have grown rather moderately (the stocks of such loans rose within one year by less than 6% and 3% respectively). Stronger growth in loans is observed in the segment of small and medium-sized enterprises, the larger firms 'sit' on cash reserves. The borrowing by households predominantly supports the satisfaction of housing needs. Overall, the levels of private sector indebtedness are comparatively low and the shares of non-performing loans are low and falling.

Purely economic factors would suggest that fixed investment by the private sector could be expanding strongly. The basic reason why corporate investment remains sluggish seems to have much to do with the political climate that set in after the electoral victory of the Law and Justice (PiS) party. The PiS government, in power since late 2015, blatantly disrespects the constitution. Actually it is now subordinating the judiciary system to its own will. That cannot but evoke anxieties among the private (domestic) businessmen who rightly fear the advent of legally unrestrained arbitrary administrative harassment and interference into their activities. These fears have been strengthened as the government has legislated draconian penalties for breaches (or apparent breaches) of tax obligations. It may be added that the prospect of such penalties (but also newly introduced administrative measures aimed at closing some VAT tax loopholes) are proving effective. The indirect tax (including VAT) revenue to be collected in 2017 will exceed all earlier expectations.

Faster growth of public investment (co-financed out of EU funds) expected in the second half of 2017 is likely to add more vigour to private sector investment. Eventually the stagnation of GFCF may be overcome in 2017 – though faster growth may only be expected in 2018-2019 when larger-scale infrastructure project are started.

The macroeconomic policies continue to be relaxed. Although the deflationary tendencies observed since 2013 are being overcome now, the National Bank of Poland (NBP) is very likely to leave its policy rates unchanged. This is not a bad position because, despite a vigorous rise in wages and consumer demand, the risk of any disquieting inflationary acceleration seems still rather remote. Nor is there any need to pre-empt a build-up of investment bubbles. But in the first place the NBP policy follows from the fact that it is now dominated by 'doves' unconditionally loyal to the ruling party. Their priority is to avoid decisions that could slow down real growth. The Finance Ministry seems to share much the same orientation. In effect, despite relatively high growth the financial deficit of the general government must be expected to exceed 3% of GDP. That is not necessarily a bad development – at least as long as the public debt is low, inflation is insignificant and the foreign trade balances remain positive.

The failure to respect the 3% budget deficit limit is still a relatively minor offence against the EU rules (especially given the fact that the authorities do not intend to access the eurozone anytime soon). Domestic political developments have been more disquieting. The ruling party, enjoying a parliamentary (though not constitutional) majority, violates the constitution. It is bent on subjugating all public institutions, including the ones in charge of controlling and balancing the powers of the government. The political system currently developing in Poland is unlikely to do any good to the country in the longer run.

The sustained assault on the basic principles and institutions of a law-abiding democratic system, conducted by the PiS authorities, constitutes a truly grave problem – both to the Polish society and the rest of the EU. For the time being it is difficult to see how that assault could be contained. On the other hand, it may be also hard to square Poland's continued EU membership with its becoming another 'sovereign democracy' of an Central European rather than Western persuasion.

Summing up, at present Poland's economy is in a good shape. Driven primarily by consumption, its GDP is likely to rise by over (or close to) 3.5% in 2017-2019. Investment is likely to add to growth also due to higher financing of infrastructure projects while trade is likely to gradually become a drag on growth. However, the positive growth prospects may be endangered by the unwelcome effects of the ongoing evolution of the political system – including the country's alienation from its major EU partners.

Table 19 / Poland: Selected economic indicators

	2013	2014	2015	2016 1)	2016 January-June	2017 January-June	2017 Forecast	2018 Forecast	2019 Forecast
Population, th pers., average	38,514	38,487	38,458	38,435	38,427	38,422	38,400	38,400	38,400
Gross domestic product, PLN bn, nom.	1,657	1,720	1,799	1,851	877	928	1,940	2,050	2,170
annual change in % (real)	1.4	3.3	3.8	2.7	2.7	4.3	3.8	3.5	3.3
GDP/capita (EUR at PPP)	17,900	18,600	19,800	20,100	.	.	.	.	.
Consumption of households, PLN bn, nom.	995	1,019	1,038	1,072	539	577	.	.	.
annual change in % (real)	0.3	2.6	3.0	3.8	3.0	4.9	4.3	4.0	3.6
Gross fixed capital form., PLN bn, nom.	312	339	361	334	128	130			
annual change in % (real)	-1.1	10.0	6.1	-7.9	-6.9	0.4	1.5	4.0	4.5
Gross industrial production (sales) 2)									
annual change in % (real)	2.3	3.4	4.8	2.8	4.0	5.7	6.0	5.5	4.5
Gross agricultural production									
annual change in % (real)	0.5	6.9	-2.6	7.2	.	.	.	.	.
Construction industry 2)									
annual change in % (real)	-10.2	4.3	0.3	-14.5	-13.2	7.2	.	.	.
Employed persons, LFS, th, average	15,568	15,862	16,084	16,197	16,097	16,388	16,360	16,440	16,440
annual change in %	-0.1	1.9	1.4	0.7	1.2	1.8	1.0	0.5	0.0
Unemployed persons, LFS, th, average	1,793	1,567	1,304	1,063	1,134	895	860	770	770
Unemployment rate, LFS, in %, average	10.3	9.0	7.5	6.2	6.6	5.2	5.0	4.5	4.5
Reg. unemployment rate, in %, eop	13.4	11.4	9.7	8.3	8.7	7.1	.	.	.
Average monthly gross wages, PLN 3)	3,659	3,777	3,908	4,047	4,224	4,434	4,240	4,440	4,680
annual change in % (real, gross)	2.8	3.2	4.5	4.2	5.1	3.0	3.2	2.7	3.3
Consumer prices (HICP), % p.a.	0.8	0.1	-0.7	-0.2	-0.4	1.6	1.6	1.9	2.0
Producer prices in industry, % p.a.	-1.3	-1.3	-2.0	-0.3	-1.3	3.4	1.0	0.8	1.3
General governm.budget, EU-def., % of GDP									
Revenues	38.5	38.8	39.0	38.8	.	.	39.0	39.0	39.5
Expenditures	42.6	42.3	41.6	41.3	.	.	42.0	42.0	42.5
Net lending (+) / net borrowing (-)	-4.1	-3.5	-2.6	-2.4	.	.	-3.0	-3.0	-3.0
Public debt, EU-def., % of GDP	55.7	50.2	51.1	54.4	.	.	55.4	55.2	55.3
Stock of loans of non-fin.private sector, % p.a	3.3	5.8	7.1	5.3	6.7	6.1	.	.	.
Non-performing loans (NPL), in %, eop	8.5	8.1	7.5	7.0	7.3	6.9	.	.	.
Central bank policy rate, % p.a., eop 4)	2.5	2.0	1.5	1.5	1.50	1.50	1.75	2.0	2.5
Current account, EUR mn 5)	-5,028	-8,529	-2,409	-1,250	1,575	712	900	-420	-1,010
Current account, % of GDP 5)	-1.3	-2.1	-0.6	-0.3	0.8	0.3	0.2	-0.1	-0.2
Exports of goods, BOP, EUR mn 5)	149,113	158,656	172,150	177,412	87,944	98,011	189,800	201,200	214,300
annual change in %	5.7	6.4	8.5	3.1	2.9	11.4	7.0	6.0	6.5
Imports of goods, BOP, EUR mn 5)	149,448	161,911	169,937	174,479	85,050	96,959	188,400	201,600	217,700
annual change in %	0.2	8.3	5.0	2.7	1.7	14.0	8.0	7.0	8.0
Exports of services, BOP, EUR mn 5)	33,592	36,743	40,663	45,018	21,147	23,605	49,100	52,000	55,100
annual change in %	5.1	9.4	10.7	10.7	9.2	11.6	9.0	6.0	6.0
Imports of services, BOP, EUR mn 5)	25,948	27,679	29,749	30,941	14,222	15,310	33,300	35,000	36,800
annual change in %	0.0	6.7	7.5	4.0	3.3	7.7	7.5	5.0	5.0
FDI liabilities, EUR mn 5)	658	14,824	13,534	15,213	8,421	-373	6000	.	.
FDI assets, EUR mn 5)	-2,524	5,096	4,385	10,233	2,636	981	4000	.	.
Gross reserves of NB excl. gold, EUR mn	74,257	79,379	83,676	104,439	95,254	94,360	.	.	.
Gross external debt, EUR mn 5)	278,948	293,510	303,120	318,956	311,437	318,891	346,900	369,000	393,200
Gross external debt, % of GDP 5)	70.7	71.4	70.5	75.2	73.4	69.9	76.0	76.5	77.0
Average exchange rate PLN/EUR	4.1975	4.1843	4.1841	4.3632	4.3686	4.2685	4.25	4.25	4.25

1) Preliminary. - 2) Enterprises with 10 and more employees. - 3) Half-year data refer to enterprises with 10 and more employees. - 4) Reference rate (7-day open market operation rate). - 5) Including SPE.

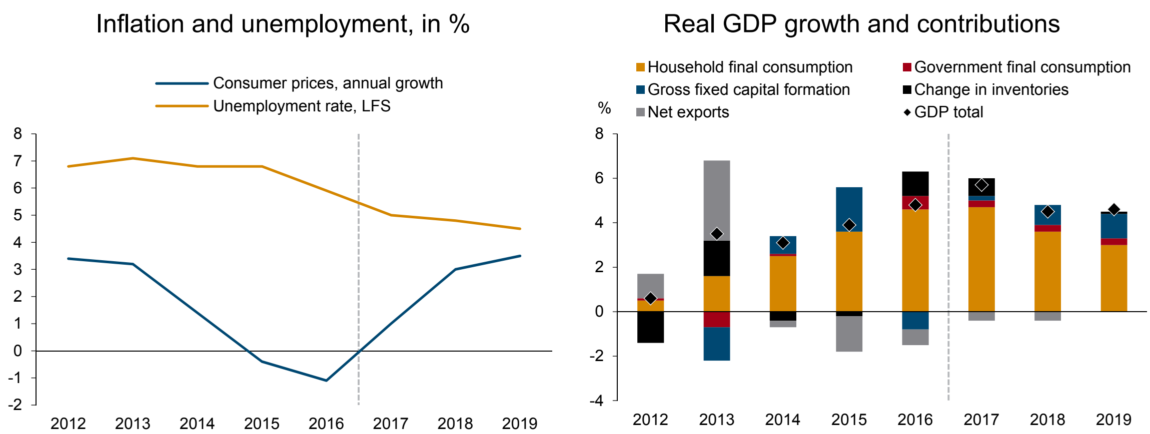
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

ROMANIA: Economic deceleration to follow the current boom

GÁBOR HUNYA

Economic growth in Romania is expected to climb to 5.7% in 2017 and to subside to 4.5% in the following two years. Household demand has boomed and investments have stagnated this year. The most recent measures aim to keep the fiscal deficit below 3% of GDP. Inflation has returned to positive figures and is bound to accelerate, putting the National Bank under pressure to hike the prime rate.

Figure 45 / Romania: Main macroeconomic indicators



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

Economic growth accelerated to 5.9% in the first half of 2017 and a similar rate is expected for the year as a whole. Pro-cyclical fiscal measures have stimulated a boom in household consumption, while investments have been essentially stagnant. A deterioration of the external balance occurred in the wake of surging imports of consumer goods and despite rapidly rising exports. In the real sector both industry and agriculture registered high rates of output growth, while construction contracted. Infrastructure investments suffered delays waiting for the resumption of projects co-financed from EU funds.

Household consumption has carried most of the economic boom, stimulated both by tax and income measures of the government. VAT cuts in mid-2016 and early 2017 brought down the prices of consumer goods and have stimulated retail sales. People also spent more on services and vacations. Gross and net real wages are expected to rise by 14% in 2017 driven by wage rises and a new wage scheme in the public sector. The private sector, competing for manpower, had to follow even if wage increases are not covered by productivity increases.

As decided by the government, 2018 will bring additional wage hikes in the public sector focusing on education and health care. In addition, a restructuring of the social security contributions from the employer to the employee will take place across the whole economy, giving a one-time boost to gross wages but having no impact on net wages. Up to 2017 the contribution was split between employee and employer while the latter often forgot to pay his part. Under the new system, the employee is expected to gain information about the total contribution due to his social security budget, while its rate will be reduced from 39% to 35% of the gross wage.

Fiscal expansion was on the agenda until August 2017, but lately the government seems determined to keep the deficit below 3% of GDP. Putting a brake on public expenditures means cutting investments, first of all. On the revenue side, state-owned companies have been requested to transfer their retained profits to the treasury, depriving them of the means to finance investments in the rest of the year. Higher excise duties on fuel and gas have been implemented for the fourth quarter of the year, bringing additional revenues.

The impact of VAT cuts is phasing out and consumer prices have started to rise also as a consequence of the demand surge. Administered prices of electricity and fuel increased as well as of 1 October. While inflation will be only about 1% on the annual average in 2017, it may climb close to 2% by the end of the year and above 3% in 2018. These are sober rates, but they come abruptly after two years of negative inflation. The money market has reacted to the recent change in inflationary expectations by hiking the cost of borrowing on the interbank market (ROBOR). The National Bank tightened the band between the lending and deposit facility from +/- 1.5% to 1.25% around the policy rate on 4 October. The policy rate, which is currently at 1.75%, may be hiked in December.

The current account deficit expanded sharply in the first half of the year. Exports of goods expanded by 10% in the first semester but imports surged by more than 12%. A new development can be observed in the trade of services where imports grew more rapidly than exports for the first time after many years, especially on the transport and travel accounts. Increasing domestic demand will trigger further high current account deficits in the years to come.

The economic upturn has had positive labour market effects. The number of employed persons grew for the first time after two years of decline and the activity rate increased to above 66% of the working-age population. The unemployment rate fell to close to 5%. Labour shortage is widely present which, combined with higher wages, may have reduced the push to emigrate.

Political life has hardly calmed down after the tug-of-war in the first half of the year. The conflict related to the fight against corruption, which led to street protests in early 2017, contributed to the replacement of the Sorin Grindeanu cabinet after just six months in office. On 26 June 2017, Mihai Tudose became the prime minister of the new cabinet led by the Social Democratic Party (PSD) while the real power still lies in the hands of party leader Liviu Dragnea. The conflict between the National Anti-corruption Directorate (DNA) and the government escalated in September when the DNA started the prosecution of three ministers in a case that may ultimately target Mr Dragnea. He accepted to replace the three cabinet members in October. Meanwhile, DNA chief prosecutor Laura Codruta Kovesi, enjoying the support of President Iohannis and Western embassies, is being investigated by the Judicial Inspection for possible misconduct.

All in all, the current upturn is narrowly based and unsustainable. The economy will have a lower but still robust growth rate of about 4.5% in the next two years. (The Romanian government forecasts sustainable growth of at least 5.5% annually in the next four years.) External and fiscal imbalances will persist but will not be excessive so as to become a serious danger to stability. The recovery of investments hinges on the risk perception of companies and banks whose expectations are improving. The inflow of EU funds will be moderate and will involve larger amounts only towards the end of the forecasting horizon.

Table 20 / Romania: Selected economic indicators

	2013	2014	2015	2016 1)	2016	2017	2017	2018	2019
					January-June			Forecast	
Population, th pers., average	19,984	19,909	19,815	19,699	.	.	19,600	19,500	19,500
Gross domestic product, RON bn, nom.	637.5	668.1	711.1	761.5	325.2	360.9	850	910	980
annual change in % (real)	3.5	3.1	3.9	4.8	5.2	5.8	5.7	4.5	4.6
GDP/capita (EUR at PPP)	14,600	15,300	16,500	17,200	.	.	.	.	.
Consumption of households, RON bn, nom.	385.5	406.4	433.1	463.1	210.1	228.9	.	.	.
annual change in % (real)	2.6	4.2	5.9	7.6	9.8	7.7	7.7	6.0	5.0
Gross fixed capital form., RON bn, nom.	157.5	162.4	176.1	172.6	68.1	71.7	.	.	.
annual change in % (real)	-5.4	3.2	8.3	-3.3	4.0	1.1	1.0	4.0	5.0
Gross industrial production 2)									
annual change in % (real)	7.8	6.1	2.8	1.7	1.3	8.1	8.0	5.0	5.0
Gross agricultural production									
annual change in % (real)	24.5	2.9	-6.8	0.6	.	.	.	.	.
Construction industry 2)									
annual change in % (real)	-0.6	-6.7	10.3	-4.8	4.6	-7.2	.	.	.
Employed persons, LFS, th, average	8,549	8,614	8,535	8,449	8,388	8,645	8,620	8,710	8,800
annual change in %	-0.7	0.8	-0.9	-1.0	-0.7	3.1	2.0	1.0	1.0
Unemployed persons, LFS, th, average	653	629	624	530	558	466	450	440	410
Unemployment rate, LFS, in %, average	7.1	6.8	6.8	5.9	6.3	5.2	5.0	4.8	4.5
Reg. unemployment rate, in %, eop	5.7	5.4	5.0	4.8	4.7	4.2	.	.	.
Average monthly gross wages, RON 3)	2,163	2,328	2,555	2,809	2,803	3,237	3,200	4,400	4,900
annual change in % (real, gross)	0.8	6.5	10.4	11.7	15.7	15.0	14.0	32.0	7.0
Average monthly net wages, RON	1,579	1,697	1,859	2,046	2,029	2,331	2,400	2,600	2,900
annual change in % (real, net)	0.8	6.4	10.1	11.8	15.8	14.4	14.5	6.0	6.0
Consumer prices (HICP), % p.a.	3.2	1.4	-0.4	-1.1	-2.1	0.5	1.0	3.0	3.5
Producer prices in industry, % p.a.	2.0	-0.2	-2.4	-1.9	-2.8	3.3	4.0	3.0	3.0
General governm.budget, EU-def., % of GDP									
Revenues	33.3	33.5	35.0	31.7	.	.	33.0	33.0	34.0
Expenditures	35.4	34.9	35.8	34.7	.	.	36.0	36.0	37.0
Net lending (+) / net borrowing (-)	-2.1	-1.4	-0.8	-3.0	.	.	-3.0	-3.0	-3.0
Public debt, EU-def., % of GDP	37.8	39.4	38.0	37.6	.	.	39.0	40.0	41.0
Stock of loans of non-fin.private sector, % p.a.	-3.4	-3.7	2.5	0.9	0.6	3.8	.	.	.
Non-performing loans (NPL), in %, eop	21.9	13.9	13.5	9.6	11.3	8.3	.	.	.
Central bank policy rate, % p.a., eop 4)	4.00	2.75	1.75	1.75	1.75	1.75	2.00	3.00	3.50
Current account, EUR mn	-1,542	-1,004	-1,977	-3,496	-2,197	-3,004	-5,540	-6,600	-7,350
Current account, % of GDP	-1.1	-0.7	-1.2	-2.1	-3.0	-3.8	-3.0	-3.3	-3.5
Exports of goods, BOP, EUR mn	43,893	46,839	49,111	52,164	25,489	28,125	57,400	60,800	65,100
annual change in %	10.1	6.7	4.8	6.2	4.6	10.3	10.0	6.0	7.0
Imports of goods, BOP, EUR mn	49,709	53,375	56,896	61,412	29,648	33,340	68,800	73,600	78,800
annual change in %	1.2	7.4	6.6	7.9	8.6	12.5	12.0	7.0	7.0
Exports of services, BOP, EUR mn	13,434	15,104	16,640	18,006	8,608	9,979	20,710	22,370	24,160
annual change in %	36.1	12.4	10.2	8.2	8.1	15.9	15.0	8.0	8.0
Imports of services, BOP, EUR mn	8,733	9,236	9,849	10,284	4,804	5,961	12,550	13,550	14,630
annual change in %	18.1	5.8	6.6	4.4	1.2	24.1	22.0	8.0	8.0
FDI liabilities, EUR mn	2,894	2,931	3,885	5,656	2,477	1,920	4,000	.	.
FDI assets, EUR mn	-24	227	930	1,143	402	231	600	.	.
Gross reserves of NB excl. gold, EUR mn	32,525	32,216	32,238	34,242	31,729	35,208	.	.	.
Gross external debt, EUR mn	98,069	94,744	92,069	92,910	91,799	94,057	96,000	100,000	105,000
Gross external debt, % of GDP	68.0	63.0	57.6	54.8	54.1	50.3	51.4	50.5	50.4
Average exchange rate RON/EUR	4.4190	4.4437	4.4454	4.4904	4.4956	4.5364	4.55	4.60	4.70

1) Preliminary. - 2) Enterprises with 4 and more employees. - 3) In 2018 the social security contribution paid by employers will be added to gross wages increasing the latter by 25%. - 4) One-week repo rate.

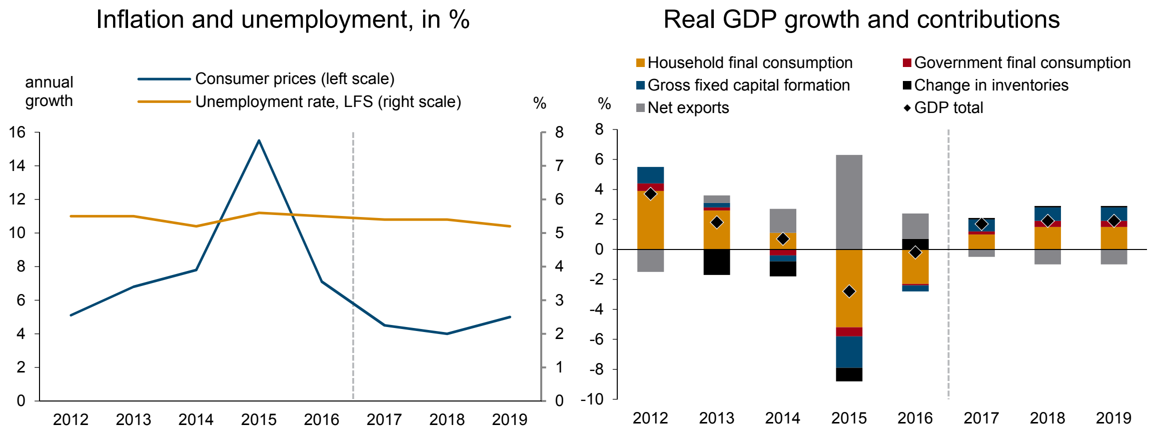
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

RUSSIAN FEDERATION: Growth without convergence

PETER HAVLIK

The Russian economy is growing again. The inflation target of 4% has been met and the rouble is appreciating. Yet the expected GDP growth will remain below 2% even in the medium run, and will lag behind most of the country's CESEE peers. No changes in economic policies are expected before next year's presidential elections. Sanctions and the poor investment climate are there to stay.

Figure 46 / Russian Federation: Main macroeconomic indicators



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

The Russian economy finally emerged from recession. GDP increased by 1.5% in the first half of the year, largely on account of modestly rising consumption and somewhat faster growth of investment. Along with the recovery of domestic demand, the contribution of real net exports to GDP growth is expected to become slightly negative as import volumes are growing faster than those of exports. On the supply side, industrial production (particularly the extraction industry) is growing again while agriculture, construction, trade and other services stagnate. Aggregate output of five basic industries (agriculture, industry, construction, transport and services) expanded by 3%; strong growth was recorded in the first half of 2017 in goods transport in particular.

Inflation slowed down and the envisaged inflation target (4% per year) was almost reached by mid-2017. In fact, annual CPI inflation in August was just 3.3% (producer price inflation is much higher) and the key interest rate of the Central Bank of Russia (CBR) was reduced to 8.5% p.a. in September.

Unemployment remains stable (and low) and sectoral/regional labour shortages occur, especially in higher skill segments.

Thanks to higher oil prices in the first half of 2017 (+20% compared to a year earlier), export revenues grew by one third (EUR based) and the rouble appreciated in both nominal and real terms by around 20% in January-August 2017 compared to the pre-year period with respect to both the US dollar and the euro. As a consequence, imports recovered strongly as well. Yet the growth of exports and imports will slow down as oil prices and the exchange rate will stabilise. The growth contribution of net exports will remain negative in the coming years while the current account surplus will be close to 3% of GDP in 2017.

A draft federal budget for the 2018-2020 period was submitted to the Duma in September 2017. It reckons with annual inflation of 4% and is based on a conservative forecast of the oil price (below USD 44 per barrel). The federal budget deficit for 2018 is projected at 1.3% of GDP, with subsequent further reductions below 1% of GDP in the rest of the decade – despite planned cuts in revenues related to rather conservative expectations regarding the oil price developments.

No major reforms are on the horizon, at least before the presidential elections which are scheduled for March 2018. Vladimir Putin has not officially announced his candidacy yet, but his next-term presidency is taken for granted and no change in tandem similar to that in 2000 is expected (in fact, Prime Minister Dmitry Medvedev may lose his job after the elections). The Russian economy has seemingly adjusted to the 'new normal' of sanctions and to mediocre growth. After the recent bankruptcies of several major companies and banks (Bank Otkrytie, Binbank, airline VIM Avia, etc.), the government stepped in to rescue them and took the remaining assets under its control. Competition is being restricted and the conditions for doing business, especially for SMEs, remain poor. The huge FDI flows officially reported in 2016 and the first half of 2017 (both inflows and outflows) reflect to a large degree transactions with offshore destinations resulting either from a few big deals or portfolio investments. The shares of Cyprus and other offshore tax havens in total FDI stocks remain extremely high (around 50% of the total). This is a reflection, inter alia, of the poor domestic investment climate, including sanctions. The positive dynamics of FDI inflows continued in the first quarter of 2017. The reported increase in FDI inflows is again connected with several huge transactions such as the sale of a 10% stake in the Russian petrochemical holding Sibur to the Chinese Silk Road Fund, or the launch of the construction of a Mercedes-Benz passenger car plant by the German company Daimler (this project is so far the largest Western investment in Russia after the introduction of sanctions). Moreover, the Russian import substitution strategy may partly contribute to an increase in FDI inflows, particularly in the food processing industry.

The overall assessment of Russian economic prospects has not changed very much in the last couple of years, although the current growth forecast was revised slightly upwards owing to the higher than previously expected oil price. GDP growth will remain sluggish (below 2%) also in the medium term, constrained by shortages of labour, capital and especially reforms. Owing to the lack of investments, both domestic and foreign, the structure of the economy is not expected to change. The CBR will proceed with a prudent monetary policy and the cleaning of the banking sector. Official CBR baseline forecasts of GDP growth range between 1.5% and 2% in the medium-term horizon (2018-2020). Alternatively, an oil price above USD 55/bbl would stimulate somewhat higher GDP growth and a faster expansion of credits while the annual CPI inflation is projected to remain at 4%. wiiw's GDP growth forecast was revised slightly upwards, largely on account of higher oil price expectations, but it will remain below 2% in the forecasting period. With this growth rate the Russian economy will not catch up with its more advanced EU-CEE peers.

Without marked productivity improvements, Russia is facing a prolonged period of near stagnation in economic, political and societal developments alike (the latter may even deteriorate). However, productivity will not improve without structural reforms aiming at the improvement of the business climate and stimulating investment, restructuring and modernisation (this mantra has been repeated for years without any visible effect). Sanctions are expected to stay, but the Russian economy has already largely accommodated to the sanction regime. Financial restrictions hurt, but innovative ways how to avoid some of the pain, for example via offshore financing vehicles, seem to help (e.g. Rosneft). Still the expected GDP growth will remain below 2% per year in the medium term and the process of economic convergence will stall. This is a disappointing performance for an emerging economy – especially given the fairly robust growth in the EU, China and elsewhere.

A resuscitation of a dialogue with the EU could happen after a new coalition government has been formed in Germany, yet a normalisation of Russian relations with neighbours (Ukraine, Baltics) will be difficult and the damage incurred so far will last. A reset of the Minsk process and an agreement on more OSCE involvement in Ukraine would be helpful. Whether Putin's next presidency will bring any change in domestic economic policies remains to be seen. With respect to external policies, no major turnaround is expected and many uncertainties (relations with the EU and US, Donbas, future of the Eurasian Economic Union, etc.) will persist.

Table 21 / Russia: Selected economic indicators

	2013	2014	2015	2016 [1]	2016 January-June	2017 January-June	2017 Forecast	2018 Forecast	2019 Forecast
Population, th pers., average	143,507	146,091	146,406	146,675	146,600	146,789	146,500	146,400	146,300
Gross domestic product, RUB bn, nom.	73,134	79,200	83,233	86,044	39,246	41,782	91,900	97,400	104,200
annual change in % (real)	1.8	0.7	-2.8	-0.2	-0.5	1.5	1.7	1.9	1.9
GDP/capita (EUR at PPP)	19,300	18,700	17,700	16,900	.	.	.	.	.
Consumption of households, RUB bn, nom.	38,465	42,016	43,243	43,941	20,912	22,276	.	.	.
annual change in % (real)	5.2	2.0	-9.8	-4.5	-5.1	3.5	2.0	3.0	3.0
Gross fixed capital form., RUB bn, nom.	15,926	16,828	17,266	18,112	6,820	7,358	.	.	.
annual change in % (real)	1.3	-1.8	-9.9	-1.8	-3.8	4.6	4.0	4.0	4.0
Gross industrial production [2]									
annual change in % (real)	0.4	1.7	-0.8	1.3	1.3	2.0	2.0	3.0	4.0
Gross agricultural production									
annual change in % (real)	5.8	3.5	2.6	4.8	3.4	0.2	.	.	.
Construction output									
annual change in % (real)	0.1	-2.3	-4.8	-4.3	-6.8	0.2	.	.	.
Employed persons, LFS, th, average	71,392	71,539	72,324	72,393	71,850	71,722	72,300	72,300	72,200
annual change in %	-0.2	0.2	-0.4	0.1	-0.1	-0.2	-0.1	0.0	-0.1
Unemployed persons, LFS, th, average	4,137	3,889	4,264	4,243	4,404	4,077	4,100	4,100	4,000
Unemployment rate, LFS, in %, average	5.5	5.2	5.6	5.5	5.8	5.4	5.4	5.4	5.2
Reg. unemployment rate, in %, eop [3]	1.2	1.2	1.3	1.2	1.3	1.1	.	.	.
Average monthly gross wages, RUB	29,792	32,495	34,030	36,746	35,708	38,635	39,600	42,800	47,200
annual change in % (real, gross)	4.8	1.2	-9.3	0.7	-0.2	3.8	3.0	4.0	5.0
Consumer prices, % p.a.	6.8	7.8	15.5	7.1	7.9	4.3	4.5	4.0	5.0
Producer prices in industry, % p.a. [4]	3.3	6.4	13.5	4.2	4.1	9.2	6.0	5.0	4.0
General governm.budget, nat.def., % of GDP									
Revenues	33.4	33.8	32.3	32.8	31.9	34.7	35.0	35.0	35.0
Expenditures	34.6	34.9	35.7	36.4	34.6	34.6	37.5	38.0	38.0
Deficit (-) / surplus (+)	-1.2	-1.1	-3.4	-3.7	-2.7	0.2	-2.5	-3.0	-3.0
Public debt, nat.def., % of GDP	10.3	13.0	13.2	12.9	12.4	12.5	13.0	14.0	15.0
Stock of loans of non-fin.private sector, % p.a.	17.1	25.9	7.6	-6.9	6.3	-3.9	.	.	.
Non-performing loans (NPL), in %, eop [5]	3.5	3.8	5.3	5.2	5.7	5.4	.	.	.
Central bank policy rate, % p.a., eop [6]	5.50	17.00	11.00	10.00	10.50	9.00	8.0	6.0	6.0
Current account, EUR mn [7]	25,164	43,477	61,898	23,064	13,344	23,513	39,000	41,100	25,100
Current account, % of GDP [7]	1.5	2.8	5.0	2.0	2.7	3.5	2.9	2.9	1.7
Exports of goods, BOP, EUR mn [7]	392,827	375,561	307,040	254,498	115,047	153,585	300,600	330,700	353,900
annual change in %	-4.3	-4.4	-18.2	-17.1	-29.0	33.5	18.1	10.0	7.0
Imports of goods, BOP, EUR mn [7]	256,901	232,739	173,585	172,996	75,022	98,472	210,700	236,000	266,700
annual change in %	-1.6	-9.4	-25.4	-0.3	-8.9	31.3	21.8	12.0	13.0
Exports of services, BOP, EUR mn [7]	52,787	49,700	46,491	45,648	20,664	25,221	51,800	54,400	57,100
annual change in %	8.8	-5.8	-6.5	-1.8	-6.6	22.1	13.5	5.0	5.0
Imports of services, BOP, EUR mn [7]	96,643	91,487	79,694	67,163	30,296	36,943	74,400	78,100	82,000
annual change in %	14.1	-5.3	-12.9	-15.7	-20.4	21.9	10.8	5.0	5.0
FDI liabilities, EUR mn [7]	52,107	16,655	6,163	29,381	6,752	16,085	17,000	.	.
FDI assets, EUR mn [7]	65,120	43,151	19,861	20,149	13,550	14,807	20,000	.	.
Gross reserves of NB excl. gold, EUR mn [7][8]	341,787	279,383	292,467	301,871	297,124	300,675	.	.	.
Gross external debt, EUR mn [7]	530,481	493,861	474,681	488,752	473,355	466,457	446,000	423,500	446,600
Gross external debt, % of GDP [7]	30.7	31.7	38.6	42.2	40.9	34.5	33.0	30.0	30.0
Average exchange rate RUB/EUR	42.27	50.77	67.76	74.26	78.39	62.70	68.0	69.0	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. - 2) Excluding small enterprises. Until 2014 according to NACE Rev.1. - 3) In % of labour force (LFS). - 4) Domestic output prices, in 2013 according to NACE Rev.1. - 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) One-week repo rate. - 7) Converted from USD. - 8) Including part of resources of the Reserve Fund and the National Wealth Fund of the Russian Federation.

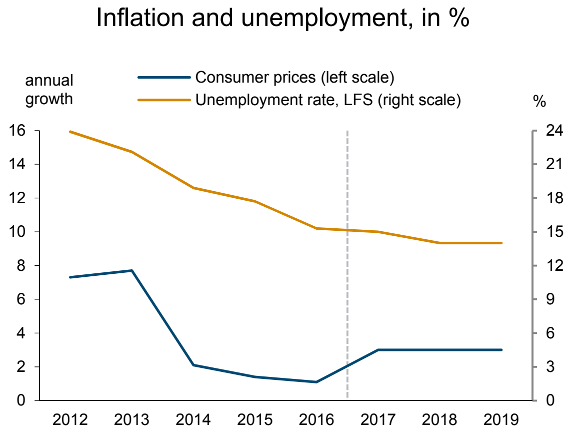
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

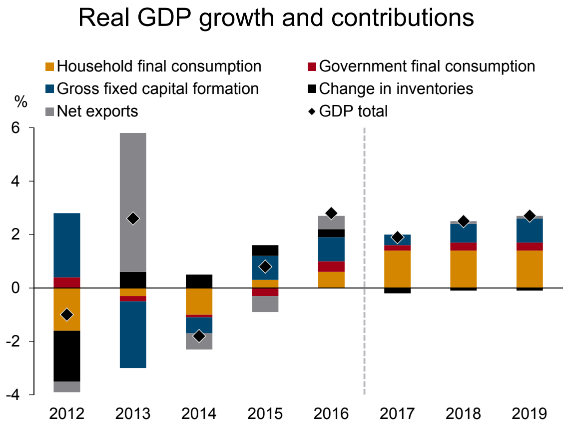
SERBIA: Slowdown and confusion

VLADIMIR GLIGOROV

If there is no sustained recovery of investments, which stand at just around 18% of GDP now, growth cannot speed up too much in the medium term. It should rise to around 2.5% in 2018, and probably some more in 2019. But growth rates above 3%, which are certainly within the economy's potential, can be contemplated only beyond that period.

Figure 47 / Serbia: Main macroeconomic indicators





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

This year's growth will disappoint. The first half came in with just over 1% growth of GDP over the previous year. It is expected to speed up in the second half, but probably not as much as to push the growth rate higher than 2%. With continuing growth of manufacturing and exports and with the recovery of consumption, both private and public, it is the slowdown of investment together with falling energy and agricultural production which are slowing the growth. The unemployment rate continues to decline, heading to 12% or even 10% in the medium run, which is the consequence of the rise of informal employment, outward migration, and expansion of jobs with low productivity. The three-year agreement with the IMF is expiring, so the government is contemplating some increases in wages of public sector employees and in pensions.

Fiscal consolidation has proved costly in terms of growth. There is not much new to be said about current and even medium-term developments. Perhaps the key issue, given the economic history of the country, is the strength or lack of policy commitment. In the last few years, the challenge has been fiscal consolidation, pursued rather single-mindedly since early 2014. Within three years, the high fiscal deficit has been slashed to close to balance with public debt declining from more than 70% of GDP to somewhere above 60%. Some of it is due to the exchange rate changes, as more than 50% of the debt is in foreign currency (euro and dollar). However, the average real growth rate in the last three years is going to be below 2%. Given the potential growth rate being somewhere around 4%, this policy adjustment has proved costly.

Some macroeconomic rebalancing has been achieved. Like most Balkan economies, Serbia features a rather high share of consumption in GDP. Before the current fiscal policy adjustment, final consumption tended to be 90% to 95% of GDP. In the last three years, it has declined by as much as 10 percentage points (depending on the base year or period). Exports have increased to compensate for that in part, and investments increased, after declining quite strongly since 2008. Still, the overall growth performance disappointed. In 2017, the central government is running a primary surplus of between 2% and 3% of GDP (it is hard to say before the end of the year), which it seems had no idea what to do with. As a consequence, it is contemplating a stimulus package to boost consumption and perhaps some easy-to-implement investments. So, the macroeconomic balances seem to be tending towards a long-term structure with high consumption and reliance on foreign investments.

Optimism of the government and the IMF proved unfounded. As has been the case in a number of other instances of fiscal adjustments, there were unrealistic expectations. There is no doubt that rebalancing was needed, however, one that was sustainable. The IMF was optimistic that growth would speed up after the initial slowdown. Indeed, as late as the end of June 2017, it projected growth of 3% for this year. It also expects recovery next year and in the medium term. Eventually, that will happen, though probably due to a change of policy rather than because of enduring policy commitment.

Political pressure is mounting. The current government dates from 2012. However, in order to get ahead of a possible increase in instability, it called for three early elections in five years. It also changed the nature of the system of governance with the last presidential elections in 2017. It is now de facto a presidential rather than parliamentary system of government, the latter being the constitutional one. With that, political responsibility is weaker and authoritarianism is easier to practise. There are rumours in the public of possible early elections together with the upcoming election for the city government in the capital of Belgrade. Because there is growing dissatisfaction, chances are the opposition may have a strong showing and perhaps even win. In that context, plans for increases in wages and pensions ahead of the elections together with an early general poll may seem attractive to the government. However, such manoeuvres are increasingly risky given the declining prospects for economic recovery.

Medium-term prospects are rather less than optimistic. After five years, the government does not have much to show for itself. Also, its international and regional policies are not without problems. There is still strong support in the EU and in Berlin in particular, but doubts about the ability of President Vučić to deliver are increasing. Also, fiscal consolidation is increasingly seen as a failure, not in terms of the fiscal deficit or the current level of public debt, but because of lack of improvement in the real economy and slow growth. Thus, if it proves unsustainable, and consumption-driven growth is the alternative strategy with the aim of shoring up political support, instability both domestic and international is possible. In addition, the system has advanced enough on the path to authoritarianism to be able to accept a division of power if the opposition were to make inroads in the capital city especially and preserve stability.

Investments are the key. Investments stand at around 18% of GDP. They recovered from as low as 16% in the period after 2008. Their growth has slowed down however. If there is no sustained recovery, growth cannot speed up too much in the medium term. It should amount to around 2.5% in 2018 and probably some more in 2019. But growth rates above 3%, which are certainly within the economy's potential, can be contemplated only beyond that period.

Table 22 / Serbia: Selected economic indicators

	2013	2014	2015	2016 1)	2016 January-June	2017 January-June	2017 Forecast	2018 Forecast	2019 Forecast
Population, th. pers., mid-year	7,167	7,132	7,095	7,058	.	.	7,000	7,000	7,000
Gross domestic product, RSD bn, nom. 2)	3,876	3,908	4,043	4,262	1,969	2,048	4,500	4,800	5,100
annual change in % (real)	2.6	-1.8	0.8	2.8	2.9	1.2	1.9	2.5	2.7
GDP/capita (EUR at PPP)	10,100	10,100	10,500	10,700	.	.	.	.	.
Consumption of households, RSD bn, nom. 2)	2,886	2,922	2,982	3,041	1,472	1,533	.	.	.
annual change in % (real)	-0.4	-1.3	0.4	0.8	0.9	1.8	2.0	2.0	2.0
Gross fixed capital form., RSD bn, nom. 2)	668	652	715	756	347	365	.	.	.
annual change in % (real)	-12.0	-3.6	5.6	5.1	5.5	2.0	2.0	4.0	5.0
Gross industrial production 3)									
annual change in % (real)	5.4	-6.4	8.3	4.7	6.7	0.4	2.0	4.0	5.0
Gross agricultural production									
annual change in % (real)	21.8	2.4	-8.4	8.1	.	.	.	.	.
Construction output									
annual change in % (real)	-20.0	2.4	20.9	7.1	12.9	-2.5	.	.	.
Employed persons, LFS, th, average 4)	2,311	2,421	2,574	2,719	2,666	2,767	2,790	2,850	2,910
annual change in %	3.7	4.8	0.6	5.6	4.7	3.8	2.5	2.0	2.0
Unemployed persons, LFS, th, average 4)	656	563	552	489	549	418	490	460	470
Unemployment rate, LFS, in %, average 4)	22.1	18.9	17.7	15.3	17.1	13.2	15.0	14.0	14.0
Reg. unemployment rate, in %, eop 5)	29.1	28.4	26.8	25.9	26.0	23.8	.	.	.
Average monthly gross wages, RSD	60,708	61,426	61,145	63,474	62,012	64,694	66,700	70,100	73,600
annual change in % (real, gross)	-1.9	-1.7	-2.4	2.6	3.3	0.9	2.0	2.0	2.0
Average monthly net wages, RSD	43,932	44,530	44,432	46,097	45,069	47,029	48,400	50,800	53,400
annual change in % (real, net)	-1.5	-1.5	-2.1	2.5	3.3	1.0	2.0	2.0	2.0
Consumer prices, % p.a.	7.7	2.1	1.4	1.1	1.0	3.4	3.0	3.0	3.0
Producer prices in industry, % p.a.	2.7	1.3	1.0	0.0	-0.8	3.0	1.0	1.2	2.0
General governm.budget, nat.def., % of GDP									
Revenues	39.7	41.5	41.9	43.2	44.5	46.6	44.0	44.0	44.0
Expenditures	45.1	48.1	45.6	44.5	45.4	44.4	45.0	45.0	46.0
Deficit (-) / surplus (+)	-5.5	-6.6	-3.7	-1.3	-0.9	2.2	-1.0	-1.0	-2.0
Public debt, nat.def., % of GDP	59.6	70.4	74.7	71.9	.	.	68.0	68.0	68.0
Stock of loans of non-fin.private sector, % p.a	-4.9	4.5	3.0	2.3	4.7	2.2	.	.	.
Non-performing loans (NPL), in %, eop	21.4	21.5	21.5	17.0	.	.	.	.	.
Central bank policy rate, % p.a., eop 6)	9.50	8.00	4.50	4.00	4.3	4.0	3.75	3.75	4.00
Current account, EUR mn	-2,098	-1,985	-1,577	-1,370	-689	-1,113	-1,540	-1,770	-2,050
Current account, % of GDP	-6.1	-6.0	-4.7	-4.0	-4.3	-6.7	-4.2	-4.5	-5.0
Exports of goods, BOP, EUR mn	10,515	10,641	11,357	12,732	6,250	6,968	14,300	15,300	16,400
annual change in %	25.5	1.2	6.7	12.1	11.6	11.5	12.0	7.0	7.0
Imports of goods, BOP, EUR mn	14,674	14,752	15,350	16,209	7,931	8,949	18,000	19,300	20,700
annual change in %	4.7	0.5	4.1	5.6	5.5	12.8	11.0	7.0	7.0
Exports of services, BOP, EUR mn	3,422	3,810	4,273	4,581	2,061	2,346	4,800	5,100	5,500
annual change in %	10.6	11.3	12.2	7.2	6.7	13.8	5.0	6.0	7.0
Imports of services, BOP, EUR mn	3,109	3,344	3,548	3,686	1,691	1,962	4,000	4,400	4,800
annual change in %	4.3	7.6	6.1	3.9	0.6	16.0	9.0	9.0	8.0
FDI liabilities, EUR mn	1,548	1,500	2,114	2,080	1,010	1,129	2,000	.	.
FDI assets, EUR mn	250	264	310	219	128.0	38.0	100	.	.
Gross reserves of NB, excl. gold, EUR mn	10,734	9,351	9,812	9,543	8,585	9,006	.	.	.
Gross external debt, EUR mn 7)	25,644	25,679	26,234	26,549	25,667	25,425	28,000	29,000	30,000
Gross external debt, % of GDP 7)	74.8	77.1	78.3	76.7	74.0	69.0	76.0	74.0	73.0
Average exchange rate RSD/EUR	113.14	117.31	120.76	123.10	122.93	123.39	122	123	124

1) Preliminary. - 2) Half-year GDP data unrevised. - 3) Excluding arms industry. - 4) In 2013 survey of April and October, quarterly thereafter. From 2015 adjustments according to ILO, Eurostat and EU-LFS. - 5) From 2015 new source for labour force potential. - 6) Two week repo rate. - 7) BOP 5th Edition.

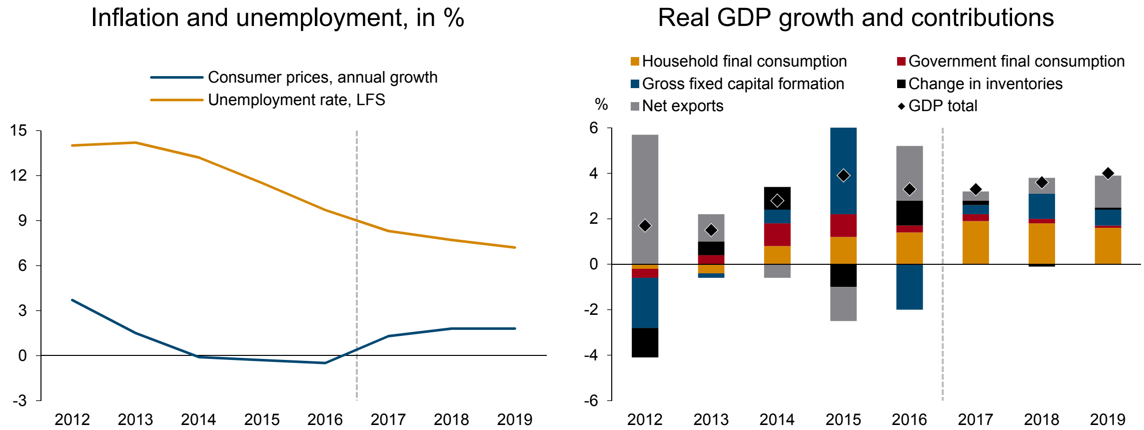
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

SLOVAKIA: Solid growth

DORIS HANZL-WEISS

Slovakia experienced solid growth of 3.2% in the first half of 2017, backed by accelerating household consumption. While investment was still down, it is expected to recover in the second half of 2017. Capacity increases in the automotive industry are going to take off at the end of 2018/2019 and will allow for growth rates of close to 4%.

Figure 48 / Slovakia: Main macroeconomic indicators



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

Growth in the first half of 2017 was driven by household consumption while investment was still down. In the first half of 2017, Slovak GDP experienced steady growth of 3.2%, about the same as last year when GDP increased by 3.3%. The main growth driver has been household consumption. Finally the favourable situation in the labour market translated into higher and accelerating household demand (+3.5% in the first half of 2017 compared to the same period of last year). The number of employed persons, rising by nearly 3% in both 2015 and 2016, has decreased somewhat recently (only +1.4% in the second quarter of 2017). The unemployment rate is going down as well; it reached 8.1% in the second quarter, a historically low level in Slovakia. In 2008, when the unemployment rate had been the lowest so far, it stood at 9.5%. However, labour shortages of skilled workers are on the rise, and wages are going up. In the first half of the year the real wage increase was still rather moderate, at 3.1%. But recent events such as the strike at the Volkswagen Bratislava plant or the steady increase in the minimum wage signal a stronger wage rise in the future. After three years of deflation, inflation is back but prices are rising only slowly (by 1% in the first half of 2017). Government consumption slightly decreased in the first half of the year (by -0.4%). Investment was down by -3.4%, while stockbuilding resulted in an increase in gross capital formation by 1.5%. The construction sector was still performing poorly (-2.6%), also due to the delay of major infrastructure projects (e.g. Bratislava ring road delayed due to problems with land acquisition).

The weak performance of the automotive sector was compensated by other industries. Looking at sectoral trends, industrial production increased by a robust 4.5% in the first half of 2017. The main industrial sectors showing an overall good performance were basic metals & fabricated metal products, rubber & plastic & other non-metallic mineral products, the food industry and electric equipment. However, the automotive industry, the main industrial sector in Slovak manufacturing, did not contribute to growth. It had a sluggish start into this year and in June Volkswagen Bratislava faced a six-day strike. For the three car companies in Slovakia (VW Bratislava, KIA Motors and PSA Peugeot-Citroën) this year's car production should be around the same number as last year (1.04 million cars were produced in 2016). Jaguar Land Rover, which currently builds a new plant near Nitra, is mulling an extension of its previous plans. Going into operations at the end of 2018, overall capacity will increase by an initial production of 150,000 cars. The major Slovak steel plant U.S. Steel Košice might still change its owner, with Chinese HeSteel being the potential buyer. While negations were said to have stopped in July, they seem to be still ongoing.

The external sector contributed slightly to growth. Net exports had a small positive effect on growth in the first half of 2017. While goods imports rose faster than goods exports (7.2% compared to 6.2%), services exports increased dynamically (+10%, fostered by transport services and telecommunication, computer & information services). Goods exports to Slovakia's main trading partner Germany declined by 3.8%, while exports to its second main trading partner, the Czech Republic, increased by 4.3%. With primary and secondary income the same size as trade balances, the current account is mostly balanced, with a tiny surplus at the end of June 2017.

Efforts were made to change the Fiscal Responsibility Law; at the same timer there is continued strong household loan growth. The most recent figures for 2016 show a general government budget deficit of -1.7% of GDP and a public debt level of 51.9% of GDP. For the years to come, official deficit targets (according to the Slovak Stability Programme 2017-2020) are set at -1.3% for 2017 and -0.5% for 2018, while balanced budgets are envisioned for 2019 and 2020. However, further efforts would be needed to reach these targets. As the thresholds incorporated in the Fiscal Responsibility Law will decline from the fiscal year 2018 onwards (the 50-60% debt to GDP thresholds will continuously decline by 1 percentage point to 40% by 2027), attempts at easing the debt brake law have been made. The draft state budget for 2018 includes social measures such as supplementary payment for work during nights and weekends, an increase in the minimum wage and the introduction of a (voluntary) 13th and 14th salary. These measures have not changed after the recent coalition crisis in August 2017. Loans to households still show continuing high growth rates of 13% although new regulations to curb loan growth came into effect in March. Loans to corporations accelerated in the second quarter of 2017 (from 8% in the first quarter to 10% in the second). The share of non-performing loans remains at a very low level (5% in 2016).

The government experienced a political crisis in August 2017. At the beginning of August, the three-party coalition government headed by Robert Fico (elected in March 2016) faced a crisis when the junior coalition partner, the Slovak National Party (SNS), withdrew from the coalition agreement. This was related to a corruption scandal at the Education Ministry (headed by a minister from SNS), where the distribution of EU funds for research and innovation were said to have been manipulated. Finally, a new collation agreement was signed by the same parties in September. On 4 November, regional elections are going to take place under new rules (only one round).

The growth forecast is favourable as capacity increases in the automobile industry are to take off at the end of 2018. The wiiw forecast for the next three years has not changed as compared to the summer forecast. For the year 2017, GDP growth will reach about 3.3%. The main growth driver will be accelerating household consumption, which benefits from favourable developments in the labour market. Gross fixed capital formation (i.e. investment) is expected to revive in the second half of 2017 (base effect). Net exports will be broadly balanced. On the one hand, investment in new plants will generate import needs; on the other hand, growing household consumption will spur imports as well. For the years 2018 and 2019, export growth will further accelerate thanks to a capacity increase in the automotive industry. With the new Jaguar Land Rover plant going into operation at the end of 2018, exports will surge and provide a strong growth impetus. Thus, growth will be around 4% annually in 2018 and 2019 (3.6% and 3.9%). Internal risks include the shortage of qualified labour, which might constitute an obstacle to higher future growth. External risks remain (uncertainties around Brexit, Trump), but seem to have moved into the background for the moment.

On 1 January 2018, Slovakia is going to celebrate its 25th anniversary. During this quarter century of independence, Slovakia has shown an exceptionally strong growth performance – contrary to some initial expectations and enjoyed a higher growth than the Czech Republic. Slovakia has increased its GDP per capita level (in % of the EU-28 average) by 40 percentage points, starting from 37% of the average EU-28 GDP per capita in 1993 and skyrocketing to 77% in 2016 (compared to 89% in the Czech Republic and 70% in Hungary and Poland).

Table 23 / Slovakia: Selected economic indicators

	2013	2014	2015	2016 1)	2016	2017	2017	2018	2019
					January-June			Forecast	
Population, th pers., average	5,413	5,419	5,424	5,431	.	.	5,430	5,440	5,440
Gross domestic product, EUR mn, nom. 2)	74,170	76,088	78,896	81,154	38,766	40,342	84,900	89,500	94,800
annual change in % (real)	1.5	2.8	3.9	3.3	3.6	3.2	3.3	3.6	4.0
GDP/capita (EUR at PPP)	20,500	21,300	22,400	22,500	.	.	.	.	.
Consumption of households, EUR mn, nom. 2)	41,084	41,605	42,496	43,473	21,392	22,399	.	.	.
annual change in % (real)	-0.8	1.4	2.3	2.6	2.9	3.5	3.5	3.3	3.0
Gross fixed capital form., EUR mn, nom. 2)	15,374	15,772	18,890	17,196	7,521	7,317	.	.	.
annual change in % (real)	-0.9	3.0	19.8	-8.3	0.1	-3.4	2.1	5.0	3.5
Gross industrial production									
annual change in % (real)	3.8	3.6	7.3	4.8	6.2	4.7	3.0	5.0	6.0
Gross agricultural production									
annual change in % (real)	6.7	7.4	-3.2	7.7	.	.	.	.	.
Construction industry									
annual change in % (real)	-5.3	-4.1	17.9	-10.7	-0.9	-2.6	.	.	.
Employed persons, LFS, th, average	2,329	2,363	2,424	2,492	2,476	2,520	2520	2540	2550
annual change in %	0.0	1.5	2.6	2.8	3.0	1.8	1.0	0.7	0.5
Unemployed persons, LFS, th, average	386	359	314	267	276	231	230	210	200
Unemployment rate, LFS, in %, average	14.2	13.2	11.5	9.7	10.0	8.4	8.3	7.7	7.2
Reg. unemployment rate, in %, eop	13.5	12.3	10.6	8.8	9.5	6.9	.	.	.
Average monthly gross wages, EUR	824	858	883	912	884	921	960	1020	1080
annual change in % (real, gross)	1.0	4.2	3.2	3.8	3.6	3.1	3.8	4.4	4.0
Consumer prices (HICP), % p.a.	1.5	-0.1	-0.3	-0.5	-0.5	1.0	1.3	1.8	1.8
Producer prices in industry, % p.a.	-1.0	-3.5	-2.9	-4.1	-4.7	2.8	3.2	2.5	2.5
General governm.budget, EU-def., % of GDP									
Revenues	38.7	39.2	42.7	39.9	.	.	39.8	39.8	39.5
Expenditures	41.4	41.9	45.4	41.5	.	.	41.4	40.9	40.1
Net lending (+) / net borrowing (-)	-2.7	-2.7	-2.7	-1.7	.	.	-1.6	-1.1	-0.6
Public debt, EU-def., % of GDP	54.7	53.5	52.3	51.8	.	.	51.8	50.8	49.7
Stock of loans of non-fin.private sector, % p.a.	5.4	6.7	9.7	9.3	.	.	.	.	.
Non-performing loans (NPL), in %, eop	5.8	6.0	5.2	4.7	.	.	.	.	.
Central bank policy rate, % p.a., eop 3)	0.25	0.05	0.05	0.00	0.00	0.00	.	.	.
Current account, EUR mn	1,379	871	-1,391	-1,205	-88	-326	-1,000	-530	250
Current account, % of GDP	1.9	1.1	-1.8	-1.5	-0.2	-0.8	-1.2	-0.6	0.3
Exports of goods, BOP, EUR mn	62,410	62,581	64,650	67,206	33,451	35,670	70,200	74,800	81,200
annual change in %	3.7	0.3	3.3	4.0	4.9	6.6	4.5	6.5	8.5
Imports of goods, BOP, EUR mn	59,503	59,823	63,601	65,542	32,120	34,805	68,800	72,900	78,400
annual change in %	3.2	0.5	6.3	3.1	4.3	8.4	5.0	6.0	7.6
Exports of services, BOP, EUR mn	6,965	6,889	7,301	7,588	3,589	4,021	8,300	8,700	9,000
annual change in %	15.1	-1.1	6.0	3.9	4.6	12.1	9.0	5.0	3.0
Imports of services, BOP, EUR mn	6,481	6,713	7,144	7,180	3,374	3,612	7,400	7,800	8,200
annual change in %	15.2	3.6	6.4	0.5	2.3	7.1	3.0	5.0	5.0
FDI liabilities, EUR mn	757	-324	1,357	3,234	1,375	3,195	3,000	.	.
FDI assets, EUR mn	976	94	1,266	3,725	2,510	2,181	2,500	.	.
Gross reserves of NB excl. gold, EUR mn	670	1,165	1,648	1,624	1,606	1,613	.	.	.
Gross external debt, EUR mn	60,444	67,776	67,225	73,750	70,200	78,792	80,000	82,500	84,000
Gross external debt, % of GDP	81.49	89.08	85.21	90.88	86.50	92.81	94.2	92.2	88.6

1) Preliminary. - 2) Half-year GDP data unrevised. - 3) Official refinancing operation rates for euro area (ECB).

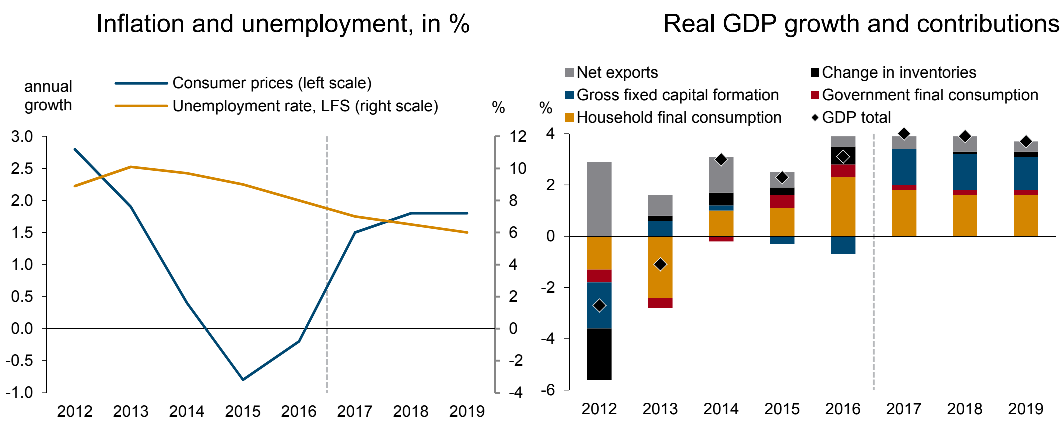
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

SLOVENIA: Growth far above expectations

HERMINE VIDOVIC

Annual GDP growth will reach close to 4% during the period 2017-2019. Exports, the recovery of investments spurred by EU funding and steady consumption growth will remain the main drivers of GDP growth. Household consumption is expected to be boosted by rising disposable income and a further improvement in the labour market. Demographic changes and labour shortages will become one of the major challenges in the future.

Figure 49 / Slovenia: Main macroeconomic indicators



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

Slovenia's GDP increased by 4.7% year on year in the first half of 2017, which was far above wiiw expectations. Private consumption has been the main driver of growth, supported by strong consumer confidence, improvements in the labour market and growing disposable income (increases in both pensions and wages). Also gross fixed capital formation – thanks to EU co-financing – contributed positively to GDP growth. After a strong contraction in 2016, the revival of investment growth translated into an increase of construction activities, particularly in non-residential building. Investments in machinery and equipment continued to grow as well. Industrial production expanded by 6.8%, with the strongest output increases reported for manufacturing of cars, leather, machinery and equipment, furniture, and electrical equipment industries.

High GDP growth translated into a marked improvement in the labour market. Labour Force Survey data indicate an employment increase of 4.2% in the first half of 2017 and a fall of the unemployment rate to 7.1%, which is, however, still higher than in the pre-crisis period. Employment via personnel leasing and employment of foreigners is increasing again. Similar to other Central and Eastern European EU countries, Slovenia is facing labour shortages and future employment creation will be constrained by the demographic change, including ageing of the population and declining labour force. Average real net wages rose only modestly, by about 0.6% in 2017. Wage increases, particularly in the private sector, will likely follow a moderate growth pattern due to competitiveness reasons as in recent years, while wage growth in the public sector will pick up this year and the next following wage agreements between the government and the public sector trade unions on the abolition of certain austerity measures in 2017 and 2018, as well as an agreement with the doctors' union. In the medium term, labour shortages may cause an upward pressure on wages.

Both trade in goods and services expanded significantly. Goods exports and imports rose by 12.5% and 14% respectively year on year in the first half of 2017. Thus, the trade surplus was somewhat lower than a year earlier. Services trade, too, reported two-digit growth rates, with the surplus widening owing to exports – travel, transport and construction services in particular – rising ahead of lower import growth. The deficit in the primary income balance has been narrowing and the deficit in the secondary income balance has remained almost unchanged. Hence, the current account surplus increased compared with 2016 and amounted to an estimated 6% of GDP. Foreign direct investment inflows in 2017 were only half those recorded in 2016.

Fiscal consolidation continues thanks to strong GDP growth in 2017. The general government deficit narrowed to an estimated 0.7% of GDP in the first half of the year and the share of the public debt to GDP decreased to 79.8%. The deficit reduction was primarily made possible through a marked increase in revenues (6.2%) mainly from taxes, but also from government revenues from profits and dividends of financial corporations. Expenditures rose by 3%, in particular on account of higher compensation of employees, intermediate consumption and social benefits. Also government spending on gross fixed capital formation increased for the first time since 2014. Given the favourable forecast, the deficit should decline further in the coming years. Thus, public debt is expected to continue its downward path to below 80% of GDP.

Slovenian banks' pre-tax profits fell by 10% to EUR 253 million in the first half of the year. Lending activities to the corporate sector started to increase, thanks to new investment loans rather than to refinancing of existing liabilities. Lending to the household sector strengthened further, both with respect to consumer loans and housing loans. Non-performing loans have been steadily on the decline, accounting for 5% of total loans by the end of June 2017, down from 8% a year earlier. Currently the Slovenian government is negotiating with the European Commission on the further postponement of the privatisation of NLB, aiming to sell the bank at a higher price due to its favourable performance. Already in May the Commission accepted Slovenia's request to sell 50% of NLB by the end of 2017, rather than 75% as originally committed in the restructuring plan agreed upon in 2013. The 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 used for the bank's bailout.

In September Moody's upgraded Slovenia's government bond ratings from Baa3 to Baa1 and the outlook on the ratings has been changed from stable to positive to stable. The main reasons behind this decision are fiscal consolidation and robust economic growth as well as progress with respect to the banking sector, judiciary (faster court procedures) and the state administration.

Fairly robust economic growth is expected in the forecasting period. wiiw expects GDP to grow close to 4% annually in the period 2017 to 2019, driven by rising domestic demand and exports. Investments are expected to expand, co-funded by EU transfers under the current (2014-2020) financial perspective. Household consumption will also remain an important driver, boosted by rising wages and pensions in particular. 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 further. Earnings from services exports – travel, transport – will remain high. In the longer run, demographic changes, similar to other EU countries, will become a key challenge.

Table 24 / Slovenia: Selected economic indicators

	2013	2014	2015	2016 1)	2016 January-June	2017	2017 Forecast	2018	2019
Population, th pers., average	2,060	2,062	2,064	2,065	.	.	2,064	2,064	2,064
Gross domestic product, EUR mn, nom.	36,239	37,615	38,837	40,418	19,632	20,918	42,700	45,200	47,700
annual change in % (real)	-1.1	3.0	2.3	3.1	2.8	4.7	4.0	3.9	3.7
GDP/capita (EUR at PPP)	21,900	22,900	24,000	24,400	.	.	.	.	.
Consumption of households, EUR mn, nom.	19,785	20,141	20,437	21,250	10,027	10,647	.	.	.
annual change in % (real)	-4.2	1.9	2.1	4.3	3.1	3.7	3.4	3.0	3.0
Gross fixed capital form., EUR mn, nom.	7,175	7,292	7,322	7,105	3,441	3,868	.	.	.
annual change in % (real)	3.1	1.1	-1.7	-3.6	-6.4	10.2	8.0	8.0	7.5
Gross industrial production									
annual change in % (real)	-1.0	2.2	5.6	7.1	7.6	6.8	6.5	5.0	4.5
Gross agricultural production									
annual change in % (real)	-1.9	12.5	4.7	-2.7	.	.	.	.	.
Construction industry 2)									
annual change in % (real)	-2.6	19.5	-8.1	-17.8	-25.6	18.2	.	.	.
Employed persons, LFS, th, average	905.9	916.7	917.4	915.0	906.8	945.2	950	970	990
annual change in %	-1.9	1.2	0.1	-0.3	-0.4	4.2	4.0	2.0	2.0
Unemployed persons, LFS, th, average	101.8	98.1	90.3	79.6	82.3	72.3	72	67	63
Unemployment rate, LFS, in %, average	10.1	9.7	9.0	8.0	8.4	7.1	7.0	6.5	6.0
Reg. unemployment rate, in %, eop	13.5	13.0	12.3	10.8	10.8	9.1	.	.	.
Average monthly gross wages, EUR 3)	1,523	1,540	1,556	1,585	1,571	1,601	1,600	1,650	1,700
annual change in % (real, gross)	-2.0	0.9	1.2	1.9	2.4	0.3	0.5	1.5	1.5
Average monthly net wages, EUR 3)	997	1,005	1,013	1,030	1,021	1,044	1,050	1,080	1,110
annual change in % (real, net)	-1.2	0.6	0.9	1.8	2.2	0.6	0.6	1.0	1.0
Consumer prices (HICP), % p.a.	1.9	0.4	-0.8	-0.2	-0.6	1.7	1.5	1.8	1.8
Producer prices in industry, % p.a.	0.0	-0.7	-0.3	-1.3	-2.1	2.0	2.0	2.0	1.9
General governm.budget, EU-def., % of GDP									
Revenues	44.8	44.4	44.9	42.9	.	.	43.0	42.9	42.8
Expenditures	59.8	49.7	47.8	44.7	.	.	43.9	43.9	43.3
Net lending (+) / net borrowing (-)	-15.0	-5.3	-2.9	-1.8	.	.	-0.9	-1.0	-0.5
Public debt, EU-def., % of GDP	70.4	80.3	82.6	78.4	.	.	77.0	76.5	76.0
Stock of loans of non-fin.private sector, % p.a.	-16.1	-13.7	-6.4	-4.0	-8.5	1.9	.	.	.
Non-performing loans (NPL), in %, eop	13.4	11.9	9.9	5.5	8.0	5.0	.	.	.
Central bank policy rate, % p.a., eop 4)	0.25	0.05	0.05	0.00	0.00	0.00	0.0	0.0	0.0
Current account, EUR mn	1,594	2,179	1,698	2,108	1,207	1,339	2,560	1,890	1,960
Current account, % of GDP	4.4	5.8	4.4	5.2	6.1	6.4	6.0	4.2	4.1
Exports of goods, BOP, EUR mn	21,692	22,961	24,039	24,991	12,465	14,003	28,100	29,900	31,700
annual change in %	2.1	5.9	4.7	4.0	4.4	12.3	12.5	6.5	6.0
Imports of goods, BOP, EUR mn	20,984	21,780	22,563	23,454	11,531	13,167	26,900	29,100	31,000
annual change in %	-1.7	3.8	3.6	3.9	2.7	14.2	14.5	8.0	6.5
Exports of services, BOP, EUR mn	5,318	5,558	5,866	6,410	2,899	3,264	6,800	7,200	7,600
annual change in %	4.1	4.5	5.5	9.3	8.4	12.6	6.0	5.5	5.5
Imports of services, BOP, EUR mn	3,586	3,862	4,007	4,236	1,906	2,106	4,400	4,600	4,800
annual change in %	-0.3	7.7	3.8	5.7	2.9	10.5	5.0	5.0	5.0
FDI liabilities, EUR mn	71	739	1,560	1,312	910	452	600	.	.
FDI assets, EUR mn	24	155	292	432	235	367	450	.	.
Gross reserves of NB excl. gold, EUR mn	580	736	687	593	649	639	.	.	.
Gross external debt, EUR mn	41,644	47,287	46,627	44,805	46,145	44,528	44,800	46,600	47,700
Gross external debt, % of GDP	114.91	125.71	120.06	110.85	114.17	104.28	105.0	103.0	100.0

1) Preliminary. - 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).

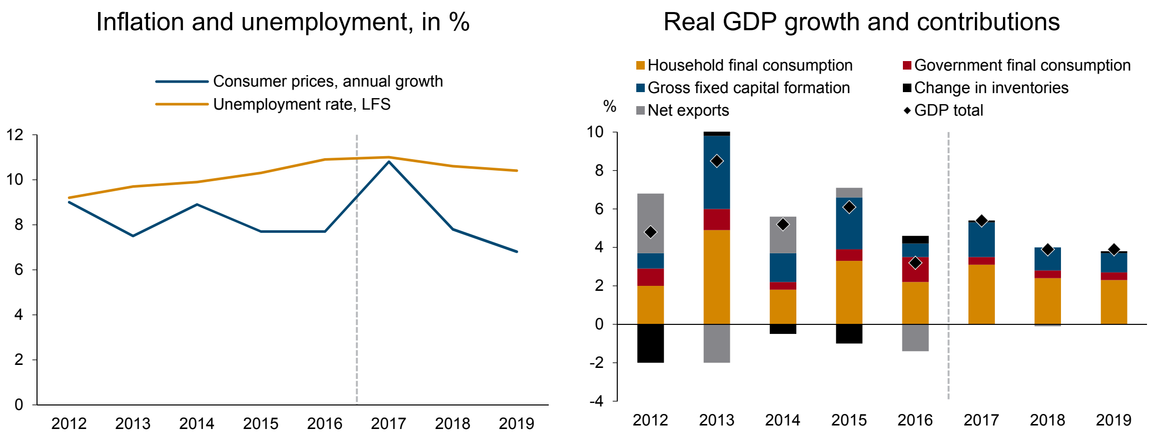
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

TURKEY: Economy shrugging off political noise with help of external demand

RICHARD GRIEVESON

The economy is growing strongly, thanks to both government-driven stimulus and robust foreign demand. However, continued political noise – both at home and abroad – risks knocking the recovery off course. Rapid private credit growth is also a source of concern, although the main risk remains the large external financing requirement, which leaves Turkey highly exposed to further tightening of monetary policy in the US.

Figure 50 / Turkey: Main macroeconomic indicators



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

The political situation has calmed down a bit over the past six months, but political risk remains high and a potential impediment to growth. There is an awareness in the government that the crackdown after the coup attempt had worried domestic and foreign investors, and risked really knocking the economy off track. In addition, the government was rattled by how close the referendum result was ('yes' took just 51.4% of the vote), and the loss of all the big cities.

The next elections (both parliamentary and presidential) are due to take place in 2019. These will be the first under the recently amended constitution, which creates a powerful president. Prime Minister Recep Tayyip Erdoğan will stand for president and probably win, but is keen to secure a strong mandate, something that looks more challenging in light of the referendum result. Mr Erdoğan has demanded a 'renewal' in the party and called for 'radical' change. He will also keep pushing the economy hard (see below), aware that much of the popularity of the AKP party is due to its record in delivering sustained growth and increases in living standards since 2002. If the economy is still growing quickly in 2018, a snap election is very possible.

Foreign policy, and its impacts on domestic policy, represent a challenge to overall political stability and the economy. There are concerns about the approaching defeat of the Islamic State and what will come next in Syria. The recent Kurdish independence referendum has also provoked significant unease in Turkey, which firmly opposes the creation of a separate Kurdish state. Turkey has been expanding its role abroad, including its military presence in Qatar (in defiance of demands from Saudi Arabia to wind down its presence there). In September, Turkey opened a military base in Somalia, its biggest military base abroad.

Tensions with some Western countries are elevated, and are likely to remain so. Turkey has agreed to buy the S-400 missile defence system from Russia, which should mean US sanctions (these are required for any foreign entity that has significant transactions with Russia's defence and intelligence sectors). Tensions between the US and Turkey have increased, particularly following the arrest of a US embassy employee in Turkey. Relations with some EU countries, including (but not limited to) Germany and Austria, are even worse. On 3 September Angela Merkel, the German Chancellor, said that Turkey should not become an EU member. This was met by strong criticism on the Turkish side. 12 German citizens were under arrest in Turkey at the time of Ms Merkel's announcement. The recent German election result, which saw Ms Merkel's CDU lose votes and the far-right Alternative für Deutschland enter parliament for the first time, are likely to produce a more hawkish foreign policy, which is unlikely to calm German-Turkish tensions in the next few years. However, the refugee deal should hold, given strong incentives on both sides. Moreover, the economic impact of these tensions is likely to be limited.

Despite continued political noise, the economy is doing well, and the near-term outlook is very positive. Working-day adjusted real GDP rose by 4.9% year on year in Q1, and 6.5% in Q2, indicating a sharp bounce-back from the slowdown at the end of 2016. Household consumption (+8.2%) and gross fixed capital formation (+9.5%) rose particularly strongly in Q2. We have revised up our forecasts accordingly. Q3 GDP is also likely to be strong in the year-on-year comparison, given the contraction in the same period of 2016. However, there are growing suggestions that official data are being manipulated, and that the economy is not growing as fast as the published numbers suggest. A detailed report released by one foreign bank research team in early September argued that Turkey's GDP data were 'more than questionable' and could be 'politically influenced'.

There are two broad reasons for the strength of the economy. First, domestically the government is using various levers to increase momentum, including tax breaks on white goods (which are due to run until October), and fiscal stimulus (including via higher infrastructure spending). 80% of the TRY 250 billion (USD 70 billion) Credit Guarantee Fund (CGF) is reported to have been drawn down, and so far the government has said that it will not be extended. This has supported a significant increase in credit expansion to non-financial companies. Credit growth has risen back above 20% year on year since March. This has had a positive impact on economic confidence, especially that of businesses. Economic confidence reached a five-year high in August. Confidence is also benefiting from the (relatively) calmer political situation. Moreover, positive momentum in the labour market is increasingly visible. Employment growth has improved gradually since the start of the year, and reached 3.8% year on year in June. Working-day adjusted retail trade rose by an average 1.8% year on year in May-August (after being consistently negative between October 2016 and April 2017), while industrial output was up by an average 6.7% on the same basis in April-August.

The second factor driving growth, which should continue in the near term, is the strength of external demand, including from the EU, Turkey's main export market. Nominal merchandise exports increased by an average 12.1% year on year in March-September. The real effective exchange rate (REER) is back to 2003 levels, implying better external competitiveness, although this appears to be much less important than the strength of demand in driving exports. The central bank has noted that Turkish exporters are again nimbly switching between markets depending on demand (this is a historic strength of the export sector). Better external conditions are also contributing to tourism growth, and here the weaker REER may be more important, particularly in terms of arrivals from Russia, which have recovered very strongly this year after a political rapprochement between the two countries. Foreign tourist arrivals rose by an average 34% year on year in April-August.

The lira has broadly stabilised, although is prone to bouts of volatility. Moreover, it is still significantly weaker on the year-on-year comparison, which is continuing to push up inflation. Having fallen somewhat over the summer, inflation rose back to 11.2% year on year in September, the highest level since May. In combination with strong economic growth, this means that the case for cutting rates is weak, although there is a certain amount of political pressure in this direction. We expect inflation to remain high during the forecast period. Foreign exchange deposits have continued to rise in 2017, suggesting a lack of domestic confidence in the lira.

The domestic credit boom is a potential source of risk. The CGF only covers banks with non-performing loans (NPLs) ratios below 7% of total assets; above that level lenders have a significant incentive to be prudent. NPLs for the sector as a whole are currently in the 4.5-5% range, a low level by regional standards. However, overall private credit is booming. The volume of new lending rose by over 20% year on year in January-September. Moreover, with the CGF mostly run down, and banks reporting huge profits in the first part of the year, there will be more pressure on lenders to cut interest rates on new loans. Mr Erdoğan has already demanded more support from banks for the economy. There is a danger that as a result of this pressure, credit conditions are loosened, which would create problems further down the line.

We continue to see the risks emanating from the large external financing need as much more significant. Higher oil prices on the year-on-year comparison saw the current account deficit widen by 9% year on year in the first half of 2017. A wider goods deficit (+10.5% year on year) was partly offset by a higher services surplus (+24% year on year), the latter partly reflecting a recovery in tourism. Net FDI inflows have remained quite steady, despite political noise, but are nowhere near enough to cover the shortfall (and remain among the lowest, relative to GDP, of all the CESEE countries that we cover). 'Hot money' inflows remain the primary source of external financing, which creates clear risks in the case of changes in global (and particularly US dollar) interest rates and investor sentiment. The loans/deposits ratio in the banking sector is already high, creating a need to borrow more money from abroad to finance domestic lending. Istanbul's ISE30 stock index was the worst performing major emerging market exchange in September, suggesting some investor jitters. Persistent external deficits have increased the stock of debt owed to foreigners. In Q1 2017 (latest data available), gross external debt stood at 59% of GDP, its highest level since 2001. 37% of this was held by banks, while 25% of all external debt was short term. Turkish firms’ ability to continue to roll over external debt will depend a lot on what happens in the US.

In summary, after real expansion of 5.4% this year, we expect full-year economic growth to slow to 3.9% in both 2018 and 2019. Although the government will remain committed to supporting the economy ahead of the next election, at least some of the stimulus measures will be unwound by the end of the year. Sticky inflation and downside risks to the lira will prevent significant monetary loosening by the central bank. The current account deficit will remain at around 4% of GDP, and continue to be financed largely by ‘hot money’ inflows. This will keep Turkey highly exposed to US monetary tightening.

Table 25 / Turkey: Selected economic indicators

	2013	2014	2015	2016 1)	2016	2017	2017	2018	2019
					January-June			Forecast	
Population, th pers., average	76,148	77,182	78,218	79,278	.	.	80,100	80,900	81,700
Gross domestic product, TRY bn, nom. 2)	1,810	2,044	2,339	2,609	1,195	1,384	3,000	3,400	3,800
annual change in % (real)	8.5	5.2	6.1	3.2	4.9	5.1	5.4	3.9	3.9
GDP/capita (EUR at PPP) 2)	16,300	16,900	18,000	17,900	.	.	.	.	.
Consumption of households, TRY bn, nom. 2)	1,120	1,242	1,412	1,561	723	826	.	.	.
annual change in % (real)	7.9	3.0	5.4	3.7	3.9	3.3	5.2	4.0	3.8
Gross fixed capital form., TRY bn, nom. 2)	516	591	695	765	353	418	.	.	.
annual change in % (real)	13.8	5.1	9.3	2.2	3.9	6.5	6.0	4.0	3.5
Gross industrial production									
annual change in % (real)	3.0	3.6	3.2	1.9	4.2	1.9	5.2	3.5	3.0
Gross agricultural production 3)									
annual change in % (real)	3.2	-4.3	2.0	2.0	.	.	.	.	.
Construction industry									
annual change in % (real)	7.7	3.0	1.7	3.1	.	.	.	.	.
Employed persons, LFS, th, average	25,520	25,931	26,619	27,216	27,161	27,722	27,800	28,400	29,000
annual change in %	2.8	1.6	2.7	2.2	3.2	2.1	2.0	2.0	2.0
Unemployed persons, LFS, th, average	2,750	2,854	3,050	3,332	3,048	3,539	3,440	3,370	3,370
Unemployment rate, LFS, in %, average	9.7	9.9	10.3	10.9	10.2	11.4	11.0	10.6	10.4
Reg. unemployment rate, in %, eop	.	.	.	.	.	.	.	.	.
Average monthly gross wages, TRY	.	.	.	.	.	.	.	.	.
annual change in % (real, gross)	.	.	.	.	.	.	.	.	.
Consumer prices (HICP), % p.a.	7.5	8.9	7.7	7.7	7.6	10.8	10.8	7.8	6.8
Producer prices in industry, % p.a. 4)	5.7	10.1	5.3	4.3	4.0	15.2	12.0	7.6	6.0
General governm. budget, nat.def., % of GDP									
Revenues	32.7	31.9	31.9	33.0	.	.	37.8	37.5	37.4
Expenditures	34.0	32.7	32.9	34.7	.	.	40.0	39.7	39.5
Deficit (-) / surplus (+)	-1.3	-0.8	-1.0	-1.7	.	.	-2.2	-2.2	-2.1
Public debt, nat.def., % of GDP 5)	31.3	28.6	27.5	28.1	.	.	28.0	27.9	27.7
Stock of loans of non-fin.private sector, % p.a.	33.6	19.4	19.4	15.2	13.9	24.7	.	.	.
Non-performing loans (NPL), in %, eop	2.8	2.8	3.1	3.2	3.3	3.1	.	.	.
Central bank policy rate, % p.a., eop 6)	4.50	8.25	7.50	8.00	7.50	8.00	8.00	8.00	8.00
Current account, EUR mn	-47,989	-33,011	-28,926	-29,441	-17,017	-19,147	-31,000	-33,000	-36,000
Current account, % of GDP	-6.7	-4.7	-3.7	-3.8	-4.6	-5.4	-4.1	-3.9	-3.9
Exports of goods, BOP, EUR mn	121,819	127,237	136,978	135,795	67,521	75,435	132,000	144,000	155,000
annual change in %	-3.4	4.4	7.7	-0.9	-2.6	11.7	-3.0	9.2	7.8
Imports of goods, BOP, EUR mn	182,057	175,312	180,341	172,671	85,687	96,081	165,000	180,000	195,000
annual change in %	2.8	-3.7	2.9	-4.3	-7.0	12.1	-4.4	9.2	8.4
Exports of services, BOP, EUR mn	36,306	39,105	42,279	34,012	14,682	15,625	34,000	36,000	39,000
annual change in %	6.5	7.7	8.1	-19.6	-18.0	6.4	-1.0	7.0	9.0
Imports of services, BOP, EUR mn	18,457	18,915	20,445	20,096	10,315	10,091	20,000	21,000	23,000
annual change in %	12.9	2.5	8.1	-1.7	1.0	-2.2	0.0	6.0	8.5
FDI liabilities, EUR mn	9,682	9,637	15,811	11,147	4,780	4,538	7,900	.	.
FDI assets, EUR mn	2,716	5,379	4,594	2,845	1,435	1,568	2,500	.	.
Gross reserves of NB excl. gold, EUR mn	80,435	88,058	85,355	87,331	91,591	79,033	.	.	.
Gross external debt, EUR mn 7)	282,625	330,955	363,813	383,698	377,990	378,857	369,300	419,800	477,300
Gross external debt, % of GDP 7)	39.6	47.0	47.1	49.2	48.4	50.3	49.0	50.0	51.5
Average exchange rate TRY/EUR	2.5335	2.9065	3.0255	3.3433	3.2587	3.9379	3.98	4.05	4.10

1) Preliminary. - 2) According to SNA 2010. - 3) Based on UN-FAO data, from 2015 wiiw estimate. - 4) Domestic output prices. - 5) Defined according to EU standards. - 6) One-week repo rate. - 7) BOP 5th Edition.

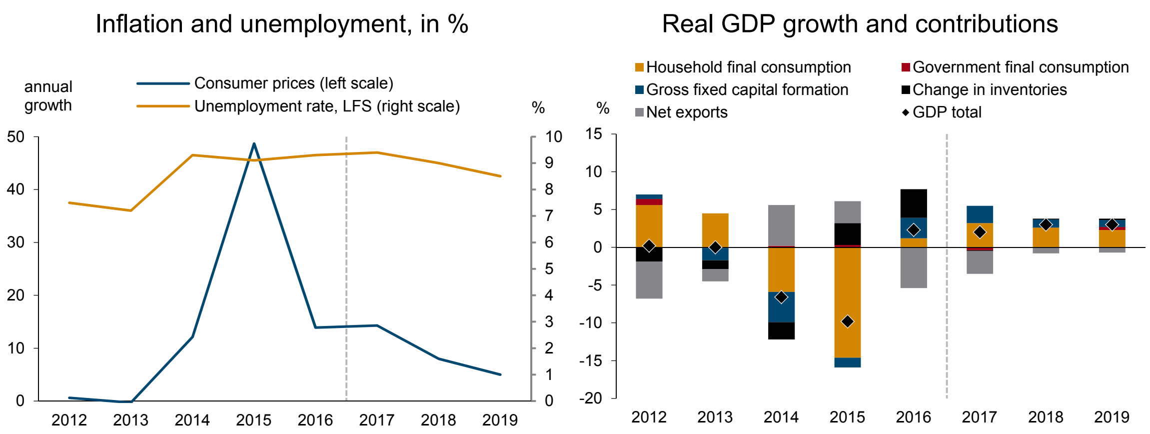
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

UKRAINE: Jobless recovery

VASILY ASTROV

Economic recovery continues largely unabated, as the negative shock to industrial production and exports from the ban on trade with Donbas has been offset by strengthening private consumption. Also, the government has been able to borrow from international capital markets for the first time since 2015. Barring major negative shocks, growth is expected to reach 2% this year, and to accelerate to 3% in 2018-2019.

Figure 51 / Ukraine: Main macroeconomic indicators



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

The recent months have been characterised by relative economic stability, at least viewed against the country's historically highly volatile standards. Economic recovery continues at largely unabated pace, although it is accompanied by persistently high inflation. In September 2017, CPI climbed to 16.4% year on year (y-o-y), partly due to the poor harvest, but also reflecting the implemented tariff hikes for utilities and the growing demand-side pressures. Although high inflation prevents further cuts in the policy rate, bank lending is primarily constrained by other factors than tight monetary policy and does not constitute a bottleneck to recovery, at least so far.[25] The exchange rate, too, has been generally stable, only weakening somewhat by the end of September. This allowed the National Bank to continue withdrawing capital controls which it had imposed in spring 2015, at the peak of the currency crisis. The recent improvement in the global economy has benefited Ukraine as well. The yield on government

25 One such factor is the high share of non-performing loans: 57%, according to the new methodology.

bonds has declined markedly, allowing the government to return to international capital markets (for the first time since 2015) and to place USD 3 billion of 15-year Eurobonds in September (at 7.375% interest rate). **After 2.3% GDP growth recorded last year, the economy continued expanding at about the same pace in the first half of 2017**. However, the aggregate figure masks a pronounced shift in the drivers of growth from quarter to quarter. The contribution of real net exports became much more negative in the second quarter, as real exports (of goods and services) declined by 2.1% y-o-y, after near stagnation in the first quarter. Partly, the export decline was due to the enacted ban on trade with the separatist-controlled areas of Donbas, as stalled shipments of coke from these areas undermined Ukraine's steel production and exports. By contrast, real imports picked up pace in the second quarter: from a growth rate of 2.9% to 4.6% y-o-y, respectively, partly reflecting the increased imports of coal from elsewhere. The marked deterioration in net exports was accompanied by strengthening domestic demand, particularly private consumption; the latter accelerated from 2.8% to 6.9% in the second quarter, y-o-y, partly financed from household savings. Recent data suggest that the strong upturn in private consumption has kept momentum during the recent months: In January-August 2017, the retail trade turnover was up by 8.7% in real terms y-o-y, with an accelerating trend. The expansion of fixed capital investments picked up as well in the second quarter, albeit marginally, whereas public consumption contracted strongly.

Similarly to last year, the main driver of household consumption continues to be strong wage growth (+19% in January-August in real terms y-o-y). However, the factors behind are different this time around. In 2016, the growth in real wages was primarily due to the rapid disinflation and the drastic reduction in social security contributions (from an average of 41% to 22%), which helped release enterprise funds for wage purposes. In contrast, this year it has been fuelled above all by the doubling of the official minimum wage as of January (to UAH 3,200, or USD 115 per month). The hike implied an automatic pay-rise for the vast majority of wage earners, around 40% of whom officially earned less than UAH 3,200 per month prior to January, as well as public sector employees whose salaries are indexed by law to the official minimum wage. In addition, business surveys suggest that the move effectively benefited much broader segments of the population than just the two above-mentioned categories.[26] All in all, this suggests that the hike in the minimum wage has had more of an effect on de facto wages rather than on 'de-shadowing' of the economy (a higher share of 'official' wages in the overall wage bill) which was the stated government motivation for the hike.

The recovery has not led to an improvement in the labour market, at least so far. LFS data suggest that in the first half of 2017 employment actually *declined* (by 0.7% y-o-y) and the unemployment rate picked up marginally, to 9.6% – despite the shrinking labour force. To some extent, it is natural to expect that after a severe economic crisis (GDP contracted by 16% in 2014-2015) which was not accompanied by a corresponding reduction in employment, recovery will initially not lead to increased labour demand but will rather rely on better utilisation of the labour force already employed, translating into labour productivity improvements. In addition, even the increased labour demand recorded in several sectors does not necessarily translate into higher employment, suggesting persistent mismatches in the labour market. For these reasons, employment may well continue to stagnate or even shrink further in the years to come. At the same time, increased labour migration to the EU (particularly to Poland, the Czech Republic and Hungary) following the introduction of a visa-free regime for Ukrainian citizens in June

26 According to a business survey conducted in the first half of 2017, 43% of medium-sized and large enterprises reported wage increases to *all* employees irrespective of their wage level.

2017 will likely accelerate the decline of the labour force, thereby improving the labour market even without gains in domestic employment.

Fiscal performance has markedly improved, albeit partly due to one-off factors. The recent doubling of the minimum wage has led to an increased wage bill of public sector employees. As a result, expenditures of the general government soared by 26% y-o-y (in nominal terms) in the first eight months of 2017. However, this increase was outpaced by the better collection of taxes and non-tax budget revenues (+43%), resulting in a remarkable fiscal surplus, which reached some 3.5% of the period GDP according to our estimates. Even accounting for the one-off factor of the UAH 30 billion received from property seized under the anti-corruption law (from former president Yanukovych officials), the underlying fiscal surplus probably still reached nearly 2% of the period GDP. Given this, the general government deficit in 2017 as a whole will likely not exceed 2% of GDP – despite higher pension spending starting from October as part of the newly adopted pension reform (for more on that, see below). At the same time, more funds (recorded off-budget) are needed for purposes of bank recapitalisation. The recapitalisation of Ukraine's biggest bank Privatbank, which was nationalised in December 2016 and required 4.9% of GDP in public funds at that time, was followed by an injection of another UAH 38.5 billion (1.4% of estimated GDP) in July 2017. In sum, the government reckons with 3.5% of GDP in bank recapitalisation needs this year.

Given the recent trends, it is not obvious that Ukraine still needs IMF credits as an anchor for macroeconomic stability. Indeed, the recent delays in IMF funds (following the allocation of USD 1 billion in April 2017) do not appear to have triggered any turbulence in the foreign exchange market. All in all, because of the delays, Ukraine has so far received only half of the USD 17 billion loan package agreed with the IMF in spring 2015. On the other hand, the country's liberal economic elites continue citing the alleged necessity of cooperation with the IMF as an argument for fostering domestic – generally unpopular – economic reforms.

The most pressing IMF requirement at the current stage is a comprehensive pension reform, the progress on which has been a condition for the allocation of the next (fifth) IMF tranche till the end of the year.[27] The final version of the pension reform adopted in October 2017 abandoned the initial IMF demands for a higher statutory retirement age but envisages a gradual increase in the *effective* retirement age by (i) tightening the number of years in service requirement, and (ii) abolishing early retirement schemes for a wide range of occupations. The idea behind is to reduce the deficit of the Pension Fund, which reached 6.5% of GDP last year due to the above-mentioned cuts in social security contributions.[28] wiiw argues however that the need for a higher retirement age in Ukraine may be exaggerated. In other countries, pension fund deficits tend to be a norm rather than an exception (and are in some cases much higher than in Ukraine); the share of pension expenditures in Ukraine in relation to GDP is not particularly high in an international comparison either, while the impact of the low effective retirement age (61 years) on pension spending is offset by the low life expectancy. The real problem, if any, with the pension system lies on the revenue rather than on the expenditure side; and its solution would realistically require a partial reversal of last year's cuts in social security contributions.

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27 Other IMF conditions reportedly include progress in privatisation and fighting corruption, including setting up an 'anti-corruption court'.

28 For more on that, see Astrov, V. and L. Podkaminer, 'Ukraine: Selected Economic Issues', *wiiw Policy Notes and Reports*, No. 19 (forthcoming).

The 2.4% GDP growth rate observed in the first half of 2017 is unlikely to be sustained throughout the remainder of the year. Particularly in the fourth quarter growth should decelerate on account of a very high statistical base, as the record-high harvest recorded last year will not be repeated. Taking this into account, we expect growth of around 2% this year. For 2018-2019, GDP growth should accelerate to around 3%, barring major shocks. The main factor behind growth acceleration should be the recovery of exports, reflecting their gradual adjustment to the negative shock from the Donbas trade ban, and provided global commodity prices at least do not decline. Also, the recent decision by the European Commission to grant Ukraine autonomous trade preferences starting from October 2017[29] should give a marginal boost to the country's exports going forward. The hryvnia may weaken somewhat, as capital controls are being gradually lifted and it may become more vulnerable to the volatility of capital flows and the recently allowed repatriation of dividends. However, this should not seriously jeopardise macroeconomic stability and disinflation.

The above scenario hinges on the preservation of domestic political stability, which has been shaken by the recent events surrounding the former governor of the Odessa region (and former President of Georgia) Mikhail Saakashvili. After a public row with President Poroshenko and resignation from the post of Odessa governor, Mr Saakashvili was stripped of his Ukrainian citizenship. However, he managed to enter Ukraine (illegally) nonetheless and co-organised (together with other leaders of the right-wing opposition) mass demonstrations in the second half of October, which were aimed against Mr Poroshenko and capitalised on public dissatisfaction with the government reforms and corruption. At the time of finalising this report (23 October), the baseline scenario is still a continuation of the political status quo, but for that it is crucial for Mr Poroshenko not to repeat the mistakes made by former President Yanukovych under similar circumstances: that is, not to overestimate his own power position and not to resort to excessive force in suppressing the public protests.

The preservation of (at least) the semi-frozen status of the conflict in Donbas is far from certain as well, especially taking into account the law on the 'Reintegration of Donbas', which was approved by the parliament in the first reading on 6 October 2017 and envisages a restoration of Kyiv's full authority over the separatist-controlled areas of Donbas. Against this background, any implementation of the Minsk-II agreements, which were agreed back in 2015 and required important concessions by both sides, appears to be utterly unrealistic. Indeed, any move towards recognising the 'special status' of Donbas and granting amnesty to the rebels by President Poroshenko would be tantamount to political suicide in the country's current political climate – all the more so as the next presidential elections are due to be held rather soon (in 2019 at the latest), and Mr Poroshenko's approval ratings are at 17% rather low. However, 'freezing' the conflict is still a realistic option, especially if the two sides agree on the format of UN peace-keeping troops to be deployed in the region. Contrary to its previous stance, Russia has suggested recently that such troops could be deployed along the conflict line (not least to ensure the safety of the unarmed OSCE personnel). Although the Russian proposal has so far met with only a lukewarm response from Ukraine and the West, who advocate the presence of UN peace-keeping troops across the *entire* separatist-controlled area, it potentially signals that a compromise on this issue may be reached sometime soon.

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[29] The new EU regulations envisage higher tariff rate quotas for some agricultural products (such as cereals, processed tomatoes, honey and grape juice), with further import liberalisation for cereals scheduled for January 2018, as well as the elimination of import duties for selected industrial products (such as fertilisers and aluminium) originating from Ukraine.

Table 26 / Ukraine: Selected economic indicators

	2013	2014	2015	2016 1)	2016 January-June	2017 January-June	2017 Forecast	2018 Forecast	2019 Forecast
Population, th pers., average	45,490	43,001	42,845	42,673	42,709	42,526	42,500	42,400	42,350
Gross domestic product, UAH bn, nom.	1,523	1,587	1,989	2,383	991	1,241	2,800	3,100	3,400
annual change in % (real)	0.0	-6.6	-9.8	2.3	0.9	2.4	2.0	3.0	3.0
GDP/capita (EUR at PPP)	6,600	6,400	5,900	6,000	.	.	.	.	.
Consumption of households, UAH bn, nom.	1,099	1,121	1,317	1,538	698	841	.	.	.
annual change in % (real)	6.5	-8.3	-20.7	1.8	0.8	4.9	5.0	4.0	3.5
Gross fixed capital form., UAH bn, nom.	264	224	269	361	133	178	.	.	.
annual change in % (real)	-8.0	-24.0	-9.2	20.1	11.8	22.2	15.0	7.0	6.0
Gross industrial production									
annual change in % (real)	-4.3	-10.1	-13.0	2.8	2.6	-0.3	0.0	4.0	4.0
Gross agricultural production									
annual change in % (real)	13.3	2.2	-4.8	6.3	-0.3	-2.1	.	.	.
Construction output									
annual change in % (real)	-11.0	-20.4	-12.3	17.4	13.0	24.6	.	.	.
Employed persons, LFS, th, average	20,404	18,073	16,443	16,277	16,239	16,121	16,170	16,150	16,150
annual change in %	0.2	-6.4	-0.4	-1.0	-1.0	-0.7	-0.7	-0.1	0.0
Unemployed persons, LFS, th, average	1,577	1,848	1,655	1,678	1,692	1,710	1,680	1,600	1,500
Unemployment rate, LFS, in %, average	7.2	9.3	9.1	9.3	9.5	9.6	9.4	9.0	8.5
Reg. unemployment rate, in %, eop 2)	1.8	1.7	1.6	1.5	1.5	1.3	.	.	.
Average monthly gross wages, UAH 3)	3,265	3,480	4,195	5,183	4,847	6,638	7,000	7,900	8,500
annual change in % (real, gross)	8.2	-5.4	-18.9	8.5	5.7	20.3	19.0	4.0	3.0
annual change in % (real, net)	8.2	-6.5	-20.2	9.0	6.1	19.7	18.5	4.0	3.0
Consumer prices, % p.a.	-0.3	12.1	48.7	13.9	18.1	13.8	14.3	8.0	5.0
Producer prices in industry, % p.a. 4)	-0.1	17.1	36.0	20.5	15.2	33.7	25.0	10.0	7.0
General governm.budget, nat.def., % of GDP						.			
Revenues	29.1	28.7	32.8	32.8	34.3	40.0	33.9	33.0	32.5
Expenditures	33.3	33.3	34.3	35.1	35.4	35.8	35.7	35.5	35.0
Deficit (-) / surplus (+) 5)	-4.2	-4.5	-1.6	-2.3	-1.1	4.2	-1.8	-2.5	-2.5
Public debt, nat.def., % of GDP	38.4	69.4	79.1	81.0	70.0	69.9	78.5	78.5	80.0
Stock of loans of non-fin.private sector, % p.a.	11.6	11.8	-2.8	2.4	-6.9	-0.2	.	.	.
Non-performing loans (NPL), in %, eop 6)	12.9	19.0	28.0	30.5	30.4	57.7	.	.	.
Central bank policy rate, % p.a., eop 7)	6.50	14.00	22.00	14.00	16.50	12.50	12.5	9.0	7.0
Current account, EUR mn 8)	-12,441	-3,476	-170	-3,116	-760	-1,165	-3,100	-3,500	-3,700
Current account, % of GDP 8)	-8.7	-3.4	-0.2	-3.7	-2.2	-2.7	-3.4	-4.0	-3.9
Exports of goods, BOP, EUR mn 8)	44,518	38,235	31,935	30,309	13,647	17,568	33,600	35,600	37,000
annual change in %	-11.2	-14.1	-16.5	-5.1	-12.0	28.7	10.9	6.0	3.9
Imports of goods, BOP, EUR mn 8)	61,185	43,626	35,050	36,579	15,966	20,528	40,500	42,500	44,200
annual change in %	-8.8	-28.7	-19.7	4.4	-5.9	28.6	10.7	4.9	4.0
Exports of services, BOP, EUR mn 8)	17,032	11,257	11,218	11,242	5,212	6,049	11,600	12,200	12,800
annual change in %	-0.9	-33.9	-0.4	0.2	-4.5	16.1	3.2	5.2	4.9
Imports of services, BOP, EUR mn 8)	12,141	9,350	9,639	9,913	4,625	5,083	9,600	10,100	10,600
annual change in %	7.0	-23.0	3.1	2.8	1.9	9.9	-3.2	5.2	5.0
FDI liabilities, EUR mn 8)	3,396	641	2,750	3,108	1,915	1,208	2,000	.	.
FDI assets, EUR mn 8)	324	414	34	156	11	-176	0.0	.	.
Gross reserves of NB excl. gold, EUR mn 8)	13,592	5,429	11,320	13,965	11,645	14,855	.	.	
Gross external debt, EUR mn 8)	102,852	103,557	108,666	108,599	103,696	100,619	104,000	106,000	108,000
Gross external debt, % of GDP 8)	71.7	102.6	132.4	128.9	123.1	111.4	115.1	119.7	114.4
Average exchange rate UAH/EUR	10.61	15.72	24.23	28.29	28.43	28.94	31.0	35.0	36.0

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. - 2) In % of working age population. - 3) Enterprises with 10 and more employees. - 4) Domestic output prices. - 5) Without transfers to Naftohaz and other bail-out costs, in 2014 including VAT refund via issued government bonds. - 6) From 2017 including NPLs of the nationalized Privatbank and changes in rules of credit risk assessment. - 7) Discount rate of NB. - 8) Converted from USD.

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

Appendix

Table 27 / European Union-Central and Eastern Europe (EU-CEE): an overview of economic fundamentals, 2016

	BG	CZ	EE	HR	HU	LT	LV	PL	RO	SI	SK	*EU-CEE 1)*	*EU-28 2)*
Gross domestic product													
EUR bn, at ER	48.1	176.6	21.1	45.8	113.7	38.7	24.9	424.3	169.6	40.4	81.2	*1,184*	*14,903*
EUR bn, at PPP	101.3	271.5	28.5	72.1	193.9	62.8	37.0	771.9	339.3	50.5	121.9	*2,051*	*14,903*
EU-28=100, at PPP	0.7	1.8	0.2	0.5	1.3	0.4	0.2	5.2	2.3	0.3	0.8	*13.8*	*100.0*
Per capita, EUR, at PPP	14,200	25,700	21,700	17,300	19,800	21,900	18,900	20,100	17,200	24,400	22,500	*19,800*	*29,100*
Per capita, EU-28=100, at PPP	49	88	75	59	68	75	65	69	59	84	77	*68*	*100*
1990=100	151.9	158.6	157.5	110.5	141.1	137.3	121.9	223.1 3)	160.1	163.6	194.0	*184.3*	*156.4*
2007=100	116.1	111.5	100.7	94.0	106.6	109.5	96.2	132.3	118.2	101.4	122.7	*119.0*	*106.5*
Price level													
EU-28=100 (PPP/ER)	47	65	74	64	59	62	67	55	50	80	67	*58*	*100*
Industrial production													
2007=100 4)	95.0	109.8	119.9	90.8	111.4	118.1	112.7	135.2	134.7	104.1	143.8	*124.3*	*97.5*
Population													
in thousand, average	7,128	10,566	1,316	4,172	9,814	2,868	1,960	38,435	19,699	2,065	5,431	*103,454*	*511,300*
Employed persons, LFS													
in thousand, average	3,017	5,139	645	1,590	4,352	1,361	893	16,197	8,449	915	2,492	*45,049*	*224,173*
Unemployment rate, LFS													
in %	7.6	4.0	6.8	13.1	5.1	7.9	9.6	6.2	5.9	8.0	9.7	*6.5*	*8.6*
Compensation per employee, monthly 5)													
EUR	635	1,329	1,535	1,306	1,011	1,166	1,243	1,028	763	2,145	1,319	*1,058*	*2,987*
EU-28=100	21.3	44.5	51.4	43.7	33.9	39.0	41.6	34.4	25.6	71.8	44.2	*35.4*	*100.0*
General government budget, EU-def., % of GDP													
Revenues	34.9	40.0	40.3	47.3	45.1	34.4	36.6	38.8	31.7	42.9	39.9	*38.8*	*44.9*
Expenditures	34.9	39.4	40.1	48.1	46.9	34.2	36.6	41.3	34.7	44.7	41.5	*40.4*	*46.6*
Balance	0.0	0.6	0.3	-0.8	-1.8	0.3	0.0	-2.4	-3.0	-1.8	-1.7	*-1.6*	*-1.7*
Public debt, EU def., % of GDP	29.0	36.8	9.4	83.7	73.2	40.2	40.4	54.4	37.6	78.4	51.8	*50.3*	*83.5*
BOP items, % of GDP													
Current account	5.3	1.1	1.9	2.5	6.1	-1.1	1.4	-0.3	-2.1	5.2	-1.5	*0.8 6)*	*2.0 6)*
Exports of goods	48.0	67.1	52.9	22.9	70.5	56.7	41.8	41.8	30.8	61.8	82.8	*50.5 6)*	*31.4 6)*
Imports of goods	50.1	61.9	56.7	39.0	66.4	61.3	49.5	41.1	36.2	58.0	80.8	*50.6 6)*	*29.4 6)*
Exports of services	15.8	12.2	26.0	26.8	19.0	17.7	18.4	10.6	10.6	15.9	9.3	*13.3 6)*	*12.5 6)*
Imports of services	9.3	10.1	18.4	7.8	13.1	11.9	9.8	7.3	6.1	10.5	8.8	*8.8 6)*	*11.0 6)*
FDI stock per capita													
EUR 7)	5,606	10,333	13,966	6,304	7,705	4,890	6,900	4,580	3,570	6,268	7,263	*5,760*	*12,402*

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. EU-28: year 2015.

Source: wiiw Annual Database, Eurostat.

Table 28 / Western Balkans and Turkey, selected CIS countries and Ukraine: an overview of economic fundamentals, 2016

	AL	BA	ME	MK	RS	XK	TR	BY	KZ	RU [1]	UA [2]	*EU-CEE [3]*	*EU-28 [4]*
Gross domestic product													
EUR bn, at ER	10.7	15.3	4.0	9.9	34.6	6.0	780.2	42.9	124.1	1,158.7	84.2	*1,184*	*14,903*
EUR bn, at PPP	24.9	31.6	8.0	22.9	75.7	13.3	1,419.8	125.1	336.6	2,476.0	257.3	*2,051*	*14,903*
EU-28=100, at PPP	0.2	0.2	0.1	0.2	0.5	0.1	9.5	0.8	2.3	16.6	1.7	*13.8*	*100.0*
Per capita, EUR, at PPP	8,600	9,000	12,900	11,100	10,700	7,500	17,900	13,200	18,900	16,900	6,000	*19,800*	*29,100*
Per capita, EU-28=100, at PPP	30	31	44	38	37	26	62	45	65	58	21	*68*	*100*
1990=100	223.0	.	.	141.2	.	.	308.4	186.5	195.5	115.7	59.8	*184.3*	*156.4*
2007=100	130.2	113.8	116.9	125.5	107.5	139.1	151.6	122.8	142.7	108.9	82.2	*119.0*	*106.5*
Price level													
EU-28=100 (PPP/ER)	43	48	49	43	46	45	55	34	37	47	33	*58*	*100*
Industrial production													
2007=100 [5]	249.3	120.1	66.1	111.3	100.4	194.3	128.0	125.5	120.8	106.0	67.9	*124.3*	*97.5*
Population													
in thousand, average	2,876	3,515	622	2,072	7,058	1,778	79,278	9,502	17,794	146,675	42,673	*103,454*	*511,300*
Employed persons, LFS													
in thousand, average	1,157	801	224	724	2,703	332	27,216	4,406	8,553	72,393	16,277	*45,049*	*224,173*
Unemployment rate, LFS													
in %	15.2	25.4	17.4	23.7	15.3	27.5	10.9	0.8 [6]	5.0	5.5	9.3	*6.5*	*8.6*
Average gross monthly wages													
EUR at ER	334	665	751	533	516	453 [7]	1,204 [8]	328	377	495	183	*1,058 [8]*	*2,987 [8]*
EU-28=100	11.2	22.3	25.1	17.8	17.3	15.2	40.3 [8]	11.0	12.6	16.6	6.1	*35.4 [8]*	*100.0 [8]*
General government budget, nat. def., % of GDP													
Revenues	27.6	42.7	37.6	29.9	43.2	29.7	33.0	41.2	19.8	32.8	32.8	*38.8 [9]*	*44.9 [9]*
Expenditures	29.4	41.5	41.0	32.5	44.5	29.5	34.7	39.7	21.4	36.4	35.1	*40.4 [9]*	*46.6 [9]*
Balance	-1.8	1.2	-3.4	-2.6	-1.3	0.2	-1.7	1.5	-1.6	-3.7	-2.3	*-1.6 [9]*	*-1.7 [9]*
Public debt, nat. def., % of GDP	72.4	45.2	60.8	47.7	74.0	14.2	28.1	54.9	25.0	12.9	81.0	*50.3 [9]*	*83.5 [9]*
BOP items, % of GDP													
Current account	-7.6	-5.1	-18.1	-2.7	-4.0	-9.2	-3.8	-3.6	-6.5	2.0	-3.7	*0.8 [10]*	*2.0 [10]*
Exports of goods	6.7	25.7	8.7	35.2	36.8	5.1	17.4	49.0	27.1	22.0	36.0	*50.5 [10]*	*31.4 [10]*
Imports of goods	30.9	49.3	50.6	53.5	46.8	43.4	22.1	54.3	20.4	14.9	43.4	*50.6 [10]*	*29.4 [10]*
Exports of services	22.3	9.4	31.7	14.1	13.2	17.4	4.4	14.5	4.6	3.9	13.3	*13.3 [10]*	*12.5 [10]*
Imports of services	14.9	3.0	12.3	10.6	10.6	7.9	2.6	9.3	8.1	5.8	11.8	*8.8 [10]*	*11.0 [10]*
FDI stock per capita													
EUR [11]	1,732	1,812	6,746	2,124	3,777	1,837	1,825	1,731	6,924	1,640	1,007	*5,760*	*12,402*

Note: PPP: Purchasing power parity, 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. EU28: year 2015.

Source: wiiw Annual Database, Eurostat, AMECO.

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

		1991	1995	2000	2005	2010	2013	2014	2015	2016	2017	2018	2019
												Forecast	
BG	Bulgaria	4,300	5,000	5,600	8,700	11,400	12,200	12,800	13,600	14,200	14,700	15,200	15,700
CZ	Czech Republic	8,800	11,600	14,200	18,600	21,100	22,400	23,800	25,400	25,700	26,700	27,600	28,200
EE	Estonia	5,400	5,300	8,200	14,000	16,500	20,200	20,900	21,700	21,700	22,500	23,200	23,900
HR	Croatia	6,600	6,700	9,400	13,000	15,100	15,900	16,100	16,900	17,300	17,800	18,300	18,800
HU	Hungary	6,800	7,700	10,400	14,500	16,500	18,000	18,800	19,900	19,800	20,600	21,400	22,000
LT	Lithuania	6,900	5,000	7,400	12,300	15,400	19,600	20,700	21,600	21,900	22,700	23,500	24,200
LV	Latvia	6,000	4,600	7,000	11,800	13,400	16,700	17,500	18,500	18,900	19,700	20,400	21,100
PL	Poland	4,600	6,500	9,300	11,800	15,900	17,900	18,600	19,800	20,100	20,900	21,600	22,300
RO	Romania	3,900	4,600	5,200	8,300	13,100	14,600	15,300	16,500	17,200	18,200	19,000	19,900
SI	Slovenia	8,800	11,400	15,800	20,300	21,200	21,900	22,900	24,000	24,400	25,400	26,400	27,400
SK	Slovakia	6,000	7,300	9,900	14,100	19,000	20,500	21,300	22,400	22,500	23,200	24,000	25,000
	EU-CEE	5,400	6,600	8,800	12,200	15,900	17,500	18,300	19,500	19,800	20,600	21,400	22,100
AL	Albania	1,500	2,000	3,400	5,000	7,400	7,800	8,300	8,500	8,600	8,900	9,300	9,700
BA	Bosnia & Herzeg.	.	.	4,000	5,400	6,900	8,100	8,300	8,800	9,000	9,300	9,600	9,900
ME	Montenegro	.	.	5,300	7,100	10,400	10,900	11,300	12,200	12,900	13,200	13,600	14,000
MK	Macedonia	4,300	4,000	5,400	6,700	8,700	9,300	10,000	10,500	11,100	11,300	11,700	12,100
RS	Serbia	.	3,100	5,000	7,400	9,200	10,100	10,100	10,500	10,700	10,900	11,200	11,500
XK	Kosovo	.	.	4,100	5,300	5,900	6,500	6,700	7,300	7,500	7,800	8,100	8,400
TR	Turkey	5,200	6,000	8,100	10,000	13,200	16,300	16,900	18,000	17,900	18,900	19,600	20,400
BY	Belarus	4,900	3,400	5,300	8,500	12,100	13,400	13,900	13,700	13,200	13,500	13,800	14,200
KZ	Kazakhstan	7,100	5,100	6,900	12,100	15,000	17,500	18,200	18,700	18,900	19,500	20,100	20,800
RU	Russia	6,800	4,700	6,000	10,000	15,700	19,300	18,700	17,700	16,900	17,200	17,500	17,800
UA	Ukraine	5,500	3,100	3,300	5,700	6,100	6,600	6,400	5,900	6,000	6,100	6,300	6,500
AT	Austria	18,900	20,000	25,700	29,800	32,100	35,200	36,000	37,400	37,100	37,700	38,300	39,100
DE	Germany	19,300	20,000	24,100	27,500	30,500	33,200	34,700	36,000	35,800	36,400	37,100	37,800
EL	Greece	12,900	13,000	17,100	21,700	21,500	19,200	19,400	19,700	19,500	19,900	20,400	20,800
IE	Ireland	13,300	16,000	26,400	34,400	33,100	35,500	37,900	52,400	53,200	55,300	57,300	58,400
IT	Italy	17,900	18,800	23,700	25,400	26,500	26,400	26,600	27,900	28,000	28,300	28,600	29,200
PT	Portugal	11,500	12,100	16,500	19,300	20,900	20,500	21,200	22,200	22,400	22,800	23,200	23,700
ES	Spain	13,300	13,700	18,900	23,500	24,400	24,000	24,700	26,000	26,700	27,400	28,100	28,700
US	United States	21,000	24,300	31,900	37,600	36,900	38,700	40,000	41,900	41,800	42,700	43,700	44,600
	EU-28 average	14,200	15,200	19,800	23,400	25,500	26,800	27,600	29,000	29,100	29,800	30,400	31,000

European Union (28) average = 100

		1991	1995	2000	2005	2010	2013	2014	2015	2016	2017	2018	2019
BG	Bulgaria	30	33	28	37	45	46	46	47	49	49	50	51
CZ	Czech Republic	62	76	72	79	83	84	86	88	88	90	91	91
EE	Estonia	38	35	41	60	65	75	76	75	75	76	76	77
HR	Croatia	46	44	47	56	59	59	58	58	59	60	60	61
HU	Hungary	48	51	53	62	65	67	68	69	68	69	70	71
LT	Lithuania	49	33	37	53	60	73	75	74	75	76	77	78
LV	Latvia	42	30	35	50	53	62	63	64	65	66	67	68
PL	Poland	32	43	47	50	62	67	67	68	69	70	71	72
RO	Romania	27	30	26	35	51	54	55	57	59	61	63	64
SI	Slovenia	62	75	80	87	83	82	83	83	84	85	87	88
SK	Slovakia	42	48	50	60	75	76	77	77	77	78	79	81
	EU-CEE	38	43	44	52	62	65	66	67	68	69	70	71
AL	Albania	11	13	17	21	29	29	30	29	30	30	31	31
BA	Bosnia & Herzeg.	.	.	20	23	27	30	30	30	31	31	32	32
ME	Montenegro	.	.	27	30	41	41	41	42	44	44	45	45
MK	Macedonia	30	26	27	29	34	35	36	36	38	38	38	39
RS	Serbia	.	20	25	32	36	38	37	36	37	37	37	37
XK	Kosovo	.	.	21	23	23	24	24	25	26	26	27	27
TR	Turkey	37	39	41	43	52	61	61	62	62	63	64	66
BY	Belarus	35	22	27	36	47	50	50	47	45	45	45	46
KZ	Kazakhstan	50	34	35	52	59	65	66	64	65	65	66	67
RU	Russia	48	31	30	43	62	72	68	61	58	58	58	57
UA	Ukraine	39	20	17	24	24	25	23	20	21	20	21	21
AT	Austria	133	132	130	127	126	131	130	129	127	127	126	126
DE	Germany	136	132	122	118	120	124	126	124	123	122	122	122
EL	Greece	91	86	86	93	84	72	70	68	67	67	67	67
IE	Ireland	94	105	133	147	130	132	137	181	183	186	188	188
IT	Italy	126	124	120	109	104	99	96	96	96	95	94	94
PT	Portugal	81	80	83	82	82	76	77	77	77	77	76	76
ES	Spain	94	90	95	100	96	90	89	90	92	92	92	93
US	United States	148	160	161	161	145	144	145	144	144	143	144	144
	EU-28 average	100	100	100	100	100	100	100	100	100	100	100	100

Sources: wiiw Annual Database incorporating national and Eurostat statistics; forecasts by wiiw and EC - Spring Report 2017.

Table 30 / Indicators of macro-competitiveness, 2012-2019, EUR based, annual averages

	2012	2013	2014	2015	2016	2017	2018 Forecast	2019
Bulgaria								
Producer price index, 2010=100	114.0	112.3	110.9	108.8	105.4	108.6	111.8	115.2
Consumer price index, 2010=100	105.9	106.3	104.6	103.5	102.1	103.6	105.7	108.4
GDP deflator, 2010=100	107.7	106.9	107.4	109.8	112.2	113.9	116.2	119.1
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	94.1	94.3	94.8
Real ER (PPI-based), 2010=100	105.3	103.8	104.5	105.1	103.5	105.8	107.2	108.3
PPP, NC/EUR	0.9170	0.9259	0.9067	0.9064	0.9288	0.94	0.94	0.94
Price level, EU28 = 100	47	47	46	46	47	48	48	48
Average monthly gross wages, EUR (ER)	374	396	420	449	492	540	590	640
Average monthly gross wages, EUR (PPP)	797	837	906	969	1,035	1,120	1,220	1,320
GDP per employed person, 2010=100	106.0	106.9	106.6	108.7	113.5	114.3	116.8	119.6
Unit labour costs, ER adj., 2010=100	106.4	111.8	118.9	124.7	130.7	141.7	152.0	161.2
Unit labour costs, PPP adj., Austria=100	26.4	27.0	28.2	28.9	29.4	31.8	33.3	35.0
Czech Republic								
Producer price index, 2010=100	106.2	106.9	107.9	105.3	101.9	100.9	101.9	103.4
Consumer price index, 2010=100	105.8	107.3	107.7	108.0	108.7	111.2	113.5	115.8
GDP deflator, 2010=100	101.5	102.9	105.5	106.7	108.0	111.3	114.2	117.0
Exchange rate (ER), NC/EUR	25.15	25.98	27.54	27.28	27.03	26.40	26.05	25.90
ER nominal, 2010=100	99.5	102.8	108.9	107.9	106.9	104.4	103.0	102.4
Real ER (CPI-based), 2010=100	100.5	97.2	91.6	92.8	93.9	96.6	98.3	98.9
Real ER (PPI-based), 2010=100	98.6	96.2	93.4	94.3	93.5	94.1	94.8	94.9
PPP, NC/EUR	17.60	17.41	17.25	17.14	17.58	18.0	18.2	18.2
Price level, EU28 = 100	70	67	63	63	65	68	70	70
Average monthly gross wages, EUR (ER)	997	964	936	975	1,020	1,120	1,200	1,270
Average monthly gross wages, EUR (PPP)	1,424	1,438	1,494	1,551	1,568	1,640	1,720	1,810
GDP per employed person, 2010=100	100.9	99.4	101.4	105.3	106.0	109.7	113.0	116.4
Unit labour costs, ER adj., 2010=100	104.7	102.7	97.8	98.1	102.0	107.9	112.7	116.0
Unit labour costs, PPP adj., Austria=100	45.1	43.1	40.3	39.5	39.8	41.9	42.7	43.6
Estonia								
Producer price index, 2010=100	107.0	114.7	111.6	108.3	106.9	110.1	113.6	117.0
Consumer price index, 2010=100	109.5	113.0	113.6	113.7	114.6	118.7	122.5	126.2
GDP deflator, 2010=100	108.6	112.4	114.1	115.5	117.4	121.7	125.6	129.1
Real ER (CPI-based), 2010=100	103.5	105.3	105.3	105.4	105.9	107.8	109.4	110.4
Real ER (PPI-based), 2010=100	98.8	106.1	105.2	104.6	104.9	107.3	109.0	110.0
PPP, NC/EUR	0.6897	0.7113	0.7172	0.7124	0.7397	0.76	0.77	0.78
Price level, EU28 = 100	69	71	72	71	74	76	77	78
Average monthly gross wages, EUR (ER)	887	949	1,005	1,065	1,146	1,230	1,320	1,430
Average monthly gross wages, EUR (PPP)	1,286	1,334	1,401	1,495	1,549	1,620	1,710	1,840
GDP per employed person, 2010=100	104.2	105.1	107.6	106.6	108.2	110.6	113.3	115.6
Unit labour costs, ER adj., 2010=100	107.4	113.9	117.9	126.1	133.7	140.4	147.1	156.1
Unit labour costs, PPP adj., Austria=100	45.8	47.3	48.0	50.2	51.7	53.8	55.3	58.2
Croatia								
Producer price index, 2010=100	112.4	111.9	108.9	104.7	100.2	102.2	104.2	106.3
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	104.2	104.1	105.4	107.0	108.7
Exchange rate (ER), NC/EUR	7.522	7.579	7.634	7.614	7.533	7.50	7.50	7.50
ER, nominal, 2010=100	103.2	104.0	104.7	104.5	103.4	102.9	102.9	102.9
Real ER (CPI-based), 2010=100	96.8	96.8	95.8	95.8	96.0	95.9	95.8	95.5
Real ER (PPI-based), 2010=100	100.6	99.5	98.0	96.8	95.2	96.8	97.1	97.1
PPP, NC/EUR	4.850	4.868	4.801	4.734	4.785	4.81	4.81	4.79
Price level, EU28 = 100	64	64	63	62	64	64	64	64
Average monthly gross wages, EUR (ER) [1]	1,047	1,048	1,042	1,058	1,029	1,070	1,110	1,150
Average monthly gross wages, EUR (PPP) [1]	1,624	1,631	1,657	1,702	1,620	1,660	1,730	1,800
GDP per employed person, 2010=100	96.0	97.6	94.5	95.5	98.0	101.0	102.4	104.2
Unit labour costs, ER adj., 2010=100	103.5	101.9	104.6	105.2	99.7	100.3	102.6	104.5
Unit labour costs, PPP adj., Austria=100	53.7	51.5	51.9	51.0	46.9	46.9	47.1	47.6

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

(Table 30 ctd.)

Table 30 / (ctd.)

	2012	2013	2014	2015	2016	2017	2018	2019
							Forecast	
Hungary								
Producer price index, 2010=100	108.5	109.1	108.7	107.7	105.9	109.1	112.3	115.7
Consumer price index, 2010=100	109.8	111.7	111.7	111.8	112.2	115.1	118.3	121.7
GDP deflator, 2010=100	105.7	108.8	112.5	114.6	115.7	119.1	123.1	127.1
Exchange rate (ER), NC/EUR	289.3	296.9	308.7	310.0	311.4	309	313	317
ER, nominal 2010=100	105.0	107.8	112.1	112.5	113.1	112.2	113.6	115.1
Real ER (CPI-based), 2010=100	98.9	96.5	92.4	92.1	91.7	93.1	92.9	92.5
Real ER (PPI-based), 2010=100	95.5	93.6	91.4	92.4	91.9	94.8	94.8	94.5
PPP, NC/EUR	166.3	170.2	175.4	175.0	182.7	186.6	189.8	192.2
Price level, EU28 = 100	57	57	57	56	59	60	61	61
Average monthly gross wages, EUR (ER)	771	777	770	800	845	930	1,000	1,050
Average monthly gross wages, EUR (PPP)	1,342	1,356	1,355	1,417	1,440	1,550	1,660	1,730
GDP per employed person, 2010=100	98.8	99.2	98.1	98.8	97.7	99.6	103.0	106.1
Unit labour costs, ER adj., 2010=100	106.2	106.6	106.7	110.1	117.7	127.6	132.7	134.8
Unit labour costs, PPP adj., Austria=100	37.1	36.3	35.7	36.0	37.3	39.9	40.7	41.2
Lithuania								
Producer price index, 2010=100	119.6	116.7	111.0	100.2	95.9	100.7	104.2	107.9
Consumer price index, 2010=100	107.4	108.7	108.9	108.2	108.9	112.7	116.1	119.3
GDP deflator, 2010=100	108.1	109.5	110.6	110.9	112.0	117.0	121.2	124.2
Real ER (CPI-based), 2010=100	101.6	101.3	101.0	100.3	100.7	102.3	103.6	104.4
Real ER (PPI-based), 2010=100	110.5	107.9	104.6	96.8	94.1	98.1	99.9	101.4
PPP, NC/EUR	0.5991	0.6037	0.6036	0.5953	0.6159	0.64	0.65	0.65
Price level, EU28 = 100	60	60	60	60	62	64	65	65
Average monthly gross wages, EUR (ER)	615	646	677	714	774	850	920	990
Average monthly gross wages, EUR (PPP)	1,027	1,071	1,122	1,199	1,257	1,330	1,410	1,510
GDP per employed person, 2010=100	116.0	118.4	120.2	121.2	121.6	125.1	128.5	131.8
Unit labour costs, ER adj., 2010=100	92.1	94.8	97.9	102.3	110.5	118.0	124.4	130.4
Unit labour costs, PPP adj., Austria=100	31.0	31.1	31.5	32.2	33.8	35.7	36.9	38.4
Latvia								
Producer price index, 2010=100	112.2	114.0	114.5	113.3	109.9	112.1	114.9	117.2
Consumer price index, 2010=100	106.6	106.6	107.3	107.6	107.7	111.2	114.8	118.2
GDP deflator, 2010=100	110.2	112.1	114.0	114.0	114.3	118.3	122.0	125.6
Real ER (CPI-based), 2010=100	102.4	100.3	100.3	100.5	100.3	101.8	103.3	104.3
Real ER (PPI-based), 2010=100	105.3	106.5	108.8	110.3	108.8	110.2	111.1	111.1
PPP, NC/EUR	0.6700	0.6798	0.6758	0.6629	0.6728	0.69	0.70	0.71
Price level, EU28 = 100	68	68	68	66	67	69	70	71
Average monthly gross wages, EUR (ER)	690	717	765	818	859	930	1,000	1,070
Average monthly gross wages, EUR (PPP)	1,022	1,053	1,132	1,234	1,277	1,350	1,430	1,510
GDP per employed person, 2010=100	118.9	119.3	122.8	124.6	127.7	133.8	139.0	144.2
Unit labour costs, ER adj., 2010=100	92.4	95.7	99.2	104.6	107.1	110.7	114.6	118.1
Unit labour costs, PPP adj., Austria=100	40.1	40.5	41.2	42.4	42.2	43.2	43.9	44.9
Poland								
Producer price index, 2010=100	110.8	109.4	108.0	105.8	105.5	106.6	107.4	108.8
Consumer price index, 2010=100	107.7	108.6	108.7	108.0	107.7	109.5	111.5	113.8
GDP deflator, 2010=100	105.7	106.0	106.5	107.3	107.5	108.5	110.8	113.5
Exchange rate (ER), NC/EUR	4.185	4.198	4.184	4.184	4.363	4.25	4.25	4.25
ER, nominal, 2010=100	104.8	105.1	104.7	104.7	109.2	106.4	106.4	106.4
Real ER (CPI-based), 2010=100	97.2	96.3	96.2	95.5	91.1	93.4	93.6	93.6
Real ER (PPI-based), 2010=100	97.7	96.3	97.2	97.6	94.8	97.6	96.8	96.1
PPP, PLN/EUR	2.377	2.399	2.397	2.362	2.398	2.40	2.41	2.43
Price level, EU28 = 100	57	57	57	56	55	57	57	57
Average monthly gross wages, EUR (ER)	844	872	903	934	928	1,000	1,040	1,100
Average monthly gross wages, EUR (PPP)	1,485	1,525	1,576	1,654	1,688	1,760	1,840	1,930
GDP per employed person, 2010=100	109.2	110.9	112.4	115.1	117.4	120.7	124.2	128.4
Unit labour costs, ER adj., 2010=100	95.7	97.4	99.5	100.5	97.9	102.4	104.2	106.2
Unit labour costs, PPP adj., Austria=100	41.7	41.3	41.4	40.9	38.7	40.2	39.8	40.4

(Table 30 ctd.)

Table 30 / (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	114.4	117.8	121.4
Consumer price index, 2010=100	109.4	112.9	114.5	114.0	112.8	113.9	117.3	121.4
GDP deflator, 2010=100	109.6	113.4	115.3	118.1	120.6	127.4	130.5	134.4
Exchange rate (ER), NC/EUR	4.459	4.419	4.444	4.445	4.490	4.55	4.60	4.70
ER, nominal, 2010=100	105.9	104.9	105.5	105.5	106.6	108.0	109.2	111.6
Real ER (CPI-based), 2010=100	97.7	100.2	100.6	100.1	97.7	95.7	95.9	95.2
Real ER (PPI-based), 2010=100	98.3	101.4	102.6	102.6	101.3	103.2	103.5	102.3
PPP, NC/EUR	2.070	2.187	2.200	2.180	2.244	2.35	2.37	2.39
Price level, EU28 = 100	46	49	50	49	50	52	52	51
Average monthly gross wages, EUR (ER) [2)]	463	489	524	575	626	700	960	1,040
Average monthly gross wages, EUR (PPP) [2)]	997	989	1,058	1,172	1,252	1,360	1,850	2,050
GDP per employed person, 2010=100	109.2	113.8	116.4	122.1	129.3	133.9	138.6	143.5
Unit labour costs, ER adj., 2010=100	93.8	95.3	99.7	104.2	107.1	116.3	152.8	160.9
Unit labour costs, PPP adj., Austria=100	30.5	30.2	31.0	31.7	31.6	33.8	44.0	45.7
Slovenia								
Producer price index, 2010=100	105.5	105.5	104.8	104.5	103.1	105.2	107.3	109.3
Consumer price index, 2010=100	105.0	107.0	107.4	106.5	106.3	107.9	109.8	111.8
GDP deflator, 2010=100	101.6	103.2	104.0	105.0	106.0	107.7	109.7	111.6
Real ER (CPI-based), 2010=100	99.2	99.6	99.5	98.7	98.2	97.9	98.0	97.8
Real ER (PPI-based), 2010=100	97.5	97.6	98.8	100.9	101.2	102.5	102.9	102.8
PPP, NC/EUR	0.8031	0.8039	0.7956	0.7832	0.8007	0.81	0.81	0.81
Price level, EU28 = 100	80	80	80	78	80	81	81	81
Average monthly gross wages, EUR (ER)	1,525	1,523	1,540	1,556	1,585	1,600	1,650	1,700
Average monthly gross wages, EUR (PPP)	1,899	1,895	1,936	1,987	1,979	1,980	2,040	2,100
GDP per employed person, 2010=100	102.4	103.3	105.1	107.4	111.1	111.1	113.2	115.1
Unit labour costs, ER adj., 2010=100	99.6	98.7	98.0	96.9	95.4	96.3	97.5	98.8
Unit labour costs, PPP adj., Austria=100	68.5	66.1	64.5	62.3	59.6	59.5	59.1	59.5
Slovakia								
Producer price index, 2010=100	106.5	105.4	101.7	98.7	94.7	97.7	100.2	102.7
Consumer price index, 2010=100	108.0	109.6	109.5	109.1	108.6	110.0	112.0	114.0
GDP deflator, 2010=100	102.9	103.5	103.3	103.1	102.7	104.0	105.8	107.8
Real ER (CPI-based), 2010=100	102.1	102.1	101.4	101.1	100.3	99.8	99.9	99.7
Real ER (PPI-based), 2010=100	98.4	97.5	95.9	95.3	92.9	95.2	96.1	96.5
PPP NC/ EUR	0.6678	0.6687	0.6578	0.6497	0.6656	0.67	0.67	0.67
Price level, EU28 = 100	67	67	66	65	67	67	67	67
Average monthly gross wages, EUR (ER)	805	824	858	883	912	960	1,020	1,080
Average monthly gross wages, EUR (PPP)	1,205	1,232	1,304	1,359	1,370	1,430	1,520	1,610
GDP per employed person, 2010=100	104.0	105.5	106.9	108.2	108.8	111.1	114.2	118.3
Unit labour costs, ER adj., 2010=100	100.6	101.5	104.4	106.1	109.0	112.4	116.1	118.7
Unit labour costs, PPP adj., Austria=100	36.1	35.4	35.8	35.5	35.5	36.2	36.7	37.2
Albania								
Producer price index, 2010=100	103.8	103.3	102.9	100.7	99.2	102.2	104.2	106.3
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	105.3	105.4	105.2	110.0	112.1	114.0
Exchange rate (ER), NC/EUR	139.0	140.3	140.0	139.7	137.4	134.5	135.0	135.5
ER, nominal, 2010=100	100.9	101.8	101.6	101.4	99.7	97.6	98.0	98.3
Real ER (CPI-based), 2010=100	98.8	98.3	99.6	101.7	104.5	107.2	108.0	108.6
Real ER (PPI-based), 2010=100	95.0	93.9	95.5	95.9	97.6	102.0	102.0	101.6
PPP, NC/EUR	57.78	60.07	58.09	58.03	59.22	61.5	61.7	61.5
Price level, EU28 = 100	42	43	42	42	43	46	46	45
Average monthly gross wages, EUR (ER) [3)]	270	259	325	335	334	370	390	420
Average monthly gross wages, EUR (PPP) [3)]	650	605	784	807	774	800	850	920
GDP per employed person, 2010=100	106.5	119.8	120.3	117.4	114.0	115.1	116.1	118.9
Unit labour costs, ER adj., 2010=100	100.5	85.7	107.1	113.1	116.1	125.9	133.0	138.5
Unit labour costs, PPP adj., Austria=100	28.6	23.7	29.1	30.0	29.9	32.5	33.4	34.8

2) In 2018 the employers' social security contribution will be added to gross wages increasing the latter by 25%. -
3) From 2014 higher wages due to new data sources.

(Table 30 ctd.)

Table 30 / (ctd.)

	2012	2013	2014	2015	2016	2017	2018	2019
							Forecast	
Bosnia and Herzegovina								
Producer price index, 2010=100	105.9	104.1	103.5	104.1	101.9	104.2	106.0	108.3
Consumer price index, 2010=100	105.9	105.8	104.8	103.8	102.6	103.9	105.5	107.5
GDP deflator, 2010=100	103.3	103.0	104.1	105.5	106.9	108.3	110.1	112.2
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	94.3	94.2	94.1
Real ER (PPI-based), 2010=100	97.8	96.2	97.6	100.5	100.0	101.5	101.7	101.8
PPP, NC/EUR	0.9344	0.9343	0.9310	0.9252	0.9461	0.95	0.95	0.95
Price level, EU28 = 100	48	48	48	47	48	49	49	49
Average monthly gross wages, EUR (ER)	660	660	659	659	665	680	700	720
Average monthly gross wages, EUR (PPP)	1,381	1,382	1,385	1,393	1,375	1,400	1,440	1,480
GDP per employed person, 2010=100	103.7	105.1	107.6	109.5	116.0	116.6	119.3	121.9
Unit labour costs, ER adj., 2010=100	102.3	101.0	98.5	96.7	92.1	93.7	94.4	95.0
Unit labour costs, PPP adj., Austria=100	41.9	40.3	38.6	37.0	34.3	34.5	34.1	34.0
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	106.9	112.3	113.4	115.6	117.4
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	108.6	108.6	108.2
PPP, NC/EUR	0.4894	0.4956	0.4919	0.4826	0.4932	0.49	0.50	0.49
Price level, EU28 = 100	49	50	49	48	49	49	50	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	1,523	1,560	1,590	1,640
GDP per employed person, 2010=100	104.5	107.2	101.8	102.7	104.7	106.6	109.2	111.2
Unit labour costs, ER adj., 2010=100	97.3	94.7	99.3	98.7	100.3	101.1	101.1	101.8
Unit labour costs, PPP adj., Austria=100	46.4	44.0	45.3	44.0	43.4	43.3	42.5	42.5
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	120.2	121.3	123.1	125.6
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	100.2	100.6	100.6
PPP, NC/EUR	25.15	26.01	25.61	25.66	26.48	26.5	26.5	26.5
Price level, EU28 = 100	41	42	42	42	43	43	43	43
Average monthly gross wages, EUR (ER)	498	504	508	522	533	540	560	570
Average monthly gross wages, EUR (PPP)	1,219	1,193	1,223	1,254	1,239	1,260	1,290	1,330
GDP per employed person, 2010=100	99.9	98.5	100.4	101.9	101.9	102.8	104.5	106.7
Unit labour costs, ER adj., 2010=100	101.6	104.1	103.0	104.2	106.5	107.9	108.6	109.5
Unit labour costs, PPP adj., Austria=100	36.9	36.8	35.8	35.4	35.1	34.9	34.9	34.6
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	119.2	128.4	131.1	132.9	134.4	138.4	142.6	146.8
GDP deflator, 2010=100	116.4	122.8	126.1	129.5	132.7	137.5	143.1	148.1
Exchange rate (ER), NC/EUR	113.13	113.14	117.31	120.76	123.10	122	123	124
ER, nominal, 2010=100	109.8	109.8	113.8	117.2	119.5	118.4	119.4	120.3
Real ER (CPI-based), 2010=100	102.6	108.9	106.7	105.1	103.9	106.1	106.6	106.8
Real ER (PPI-based), 2010=100	101.3	104.1	103.7	104.3	103.9	105.2	103.9	103.0
PPP, NC/EUR	50.27	53.54	54.12	54.13	56.27	57.9	59.3	60.1
Price level, EU28 = 100	44	47	46	45	46	47	48	48
Average monthly gross wages, EUR (ER)	508	537	524	506	516	550	570	590
Average monthly gross wages, EUR (PPP)	1,142	1,134	1,135	1,130	1,128	1,150	1,180	1,220
GDP per employed person, 2010=100	107.9	106.8	100.0	94.8	92.2	92.3	92.6	93.1
Unit labour costs, ER adj., 2010=100	102.1	109.1	113.7	116.0	121.4	128.7	133.7	138.4
Unit labour costs, PPP adj., Austria=100	34.6	36.1	36.9	36.8	37.4	39.5	40.0	40.8

(Table 30 ctd.)

Table 30 / (ctd.)

	2012	2013	2014	2015	2016	2017	2018	2019
							Forecast	
Kosovo								
Producer price index, 2010=100	106.6	109.1	110.9	113.9	113.8	116.0	118.5	121.5
Consumer price index, 2010=100	110.0	112.0	112.4	111.8	112.2	114.0	116.1	118.8
GDP deflator, 2010=100	107.1	109.0	112.6	112.6	112.2	113.9	116.7	119.1
Real ER (CPI-based), 2010=100	104.0	104.3	104.2	103.7	103.7	103.5	103.7	104.0
Real ER (PPI-based), 2010=100	98.5	100.9	104.5	110.0	111.7	113.0	113.6	114.2
PPP, NC/EUR	0.4353	0.4504	0.4571	0.4457	0.4492	0.45	0.46	0.46
Price level, EU28 = 100	44	45	46	45	45	45	46	46
Average monthly gross wages, EUR (ER) 4)	372	364	429	458	453	450	470	490
Average monthly gross wages, EUR (PPP) 4)	855	808	939	1,028	1,009	990	1,030	1,070
GDP per employed person, 2010=100	101.4	93.9	99.4	113.0	104.5	96.9	95.6	96.9
Unit labour costs, ER adj., 2010=100	118.3	125.0	139.2	130.8	139.8	149.8	158.6	163.2
Unit labour costs, PPP adj., Austria=100	20.8	21.4	23.4	21.5	22.3	23.6	24.6	25.1
Belarus								
Producer price index, 2010=100	301.7	342.7	386.6	451.5	505.7	558.8	609.1	657.8
Consumer price index, 2010=100	243.9	288.5	340.8	386.8	432.4	469.1	506.7	542.1
GDP deflator, 2010=100	299.4	363.1	428.9	497.5	535.9	580.9	627.2	671.3
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	74.2	75.5	76.0
Real ER (PPI-based), 2010=100	101.9	105.6	108.3	96.4	88.9	94.9	97.5	99.1
PPP, NC/EUR	0.430	0.528	0.613	0.692	0.754	0.81	0.86	0.90
Price level, EU28 = 100	40	45	46	39	34	35	36	36
Average monthly gross wages, EUR (ER)	341	428	458	377	328	340	360	370
Average monthly gross wages, EUR (PPP)	855	959	988	971	959	970	1,000	1,030
GDP per employed person, 2010=100	109.4	111.3	113.9	110.9	110.2	113.1	115.9	118.6
Unit labour costs, ER adj., 2010=100	102.6	126.5	132.3	111.8	98.0	99.9	101.8	103.2
Unit labour costs, PPP adj., Austria=100	26.3	31.6	32.5	26.8	22.8	22.8	23.1	23.1
Kazakhstan								
Producer price index, 2010=100	131.7	131.3	143.7	114.3	133.5	149.5	157.0	160.1
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	169.5	184.6	195.6	205.4
Exchange rate (ER), NC/EUR	191.7	202.1	238.1	245.8	378.6	396	396	396
ER, nominal, 2010=100	98.0	103.3	121.7	125.6	193.5	202.4	202.4	202.4
Real ER (CPI-based), 2010=100	110.0	108.7	98.0	101.1	75.0	75.4	78.6	81.7
Real ER (PPI-based), 2010=100	124.2	117.5	111.3	87.9	67.7	72.0	74.4	74.4
PPP, NC/EUR	109.2	121.0	125.8	124.6	139.6	150.9	157.3	162.0
Price level, EU28 = 100	57	60	53	51	37	38	40	41
Average monthly gross wages, EUR (ER)	528	540	508	513	377	390	430	470
Average monthly gross wages, EUR (PPP)	928	902	962	1,011	1,024	1,030	1,080	1,150
GDP per employed person, 2010=100	107.3	112.9	118.4	118.2	120.5	123.5	126.6	130.4
Unit labour costs, ER adj., 2010=100	124.1	120.6	108.2	109.4	79.0	80.4	85.7	90.8
Unit labour costs, PPP adj., Austria=100	33.7	31.9	28.1	27.8	19.5	19.4	20.5	21.6
Russia 5)								
Producer price index, 2010=100	125.7	129.9	137.8	154.9	161.1	170.7	179.2	186.4
Consumer price index, 2010=100	113.9	121.7	131.2	151.5	162.3	169.6	176.3	185.2
GDP deflator, 2010=100	126.5	133.3	143.3	155.0	160.6	168.7	175.4	184.2
Exchange rate (ER), NC/EUR	39.94	42.27	50.77	67.76	74.26	68	69	70
ER, nominal, 2010=100	99.2	105.0	126.1	168.3	184.4	168.9	171.3	173.8
Real ER (CPI-based), 2010=100	108.6	108.0	96.4	83.4	81.3	91.1	91.8	93.2
Real ER (PPI-based), 2010=100	117.1	114.4	103.3	90.0	87.0	98.5	100.3	100.8
PPP, NC/EUR	24.43	26.44	28.98	32.13	34.75	36.2	37.1	38.2
Price level, EU28 = 100	61	63	57	47	47	53	54	55
Average monthly gross wages, EUR (ER)	667	705	640	502	495	580	620	670
Average monthly gross wages, EUR (PPP)	1,090	1,127	1,121	1,059	1,057	1,090	1,150	1,240
GDP per employed person, 2010=100	113.8	116.1	116.7	112.1	111.8	113.8	116.0	118.3
Unit labour costs, ER adj., 2010=100	112.6	116.7	105.4	86.1	85.1	98.4	102.8	109.5
Unit labour costs, PPP adj., Austria=100	37.9	38.3	34.0	27.1	26.0	29.7	30.5	32.1

4) Net wages in state administration. - 5) From 2014 including Crimean Federal District (for LFS employment and wages from 2015).

(Table 30 ctd.)

Table 30 / (ctd.)

	2012	2013	2014	2015	2016	2017	2018	2019
							Forecast	
Ukraine 6)								
Producer price index, 2010=100	123.4	123.3	144.4	196.3	236.6	295.7	325.3	348.1
Consumer price index, 2010=100	108.6	108.3	121.4	180.6	205.7	235.1	253.9	266.6
GDP deflator, 2010=100	123.3	128.6	149.1	207.1	242.5	279.3	300.2	319.7
Exchange rate (ER), NC/EUR	10.27	10.61	15.72	24.23	28.29	31.0	35.0	36.0
ER, nominal, 2010=100	97.5	100.8	149.2	230.0	268.6	294.3	332.3	341.8
Real ER (CPI-based), 2010=100	105.3	100.1	75.4	72.7	70.7	72.5	68.2	68.2
Real ER (PPI-based), 2010=100	116.9	113.1	91.2	82.4	86.4	97.9	93.9	95.7
PPP, NC/EUR	4.811	5.082	5.788	7.822	9.264	10.59	11.21	11.70
Price level, EU28 = 100	47	48	37	32	33	34	32	32
Average monthly gross wages, EUR (ER)	295	308	221	173	183	230	230	240
Average monthly gross wages, EUR (PPP)	629	642	601	536	559	660	710	730
GDP per employed person, 2010=100	105.1	104.9	106.5	105.6	109.2	112.1	115.6	119.0
Unit labour costs, ER adj., 2010=100	131.9	137.9	97.8	77.1	78.9	94.7	91.9	93.3
Unit labour costs, PPP adj., Austria=100	42.2	43.0	29.9	23.1	22.9	27.8	26.4	26.6
Austria								
Producer price index, 2010=100	104.9	104.0	102.9	101.4	99.5	101.0	102.6	104.7
Consumer price index, 2010=100	105.8	107.9	109.7	110.7	111.7	113.7	115.7	118.0
GDP deflator, 2010=100	103.9	105.6	107.7	110.2	111.4	113.0	114.9	117.2
Real ER (CPI-based), 2010=100	100.0	100.5	101.7	102.6	103.2	103.2	103.2	103.2
Real ER (PPI-based), 2010=100	96.9	96.2	97.0	97.9	97.7	98.4	98.4	98.4
PPP, NC/EUR	1.077	1.085	1.084	1.067	1.090	1.098	1.099	1.098
Price level, EU28 = 100	108	109	108	107	109	110	110	110
Average monthly gross wages, EUR	3,293	3,364	3,449	3,537	3,630	3,690	3,780	3,850
Average monthly gross wages, EUR (PPP)	3,058	3,100	3,183	3,315	3,330	3,360	3,440	3,510
GDP per employed person, 2010=100	101.9	101.4	102.1	102.3	101.9	102.6	103.2	104.3
Unit labour costs, ER adj., 2010=100	103.5	106.2	108.2	110.8	113.9	115.2	117.4	118.3
Unit labour costs, PPP 2010 adjusted	0.58	0.59	0.61	0.62	0.64	0.64	0.66	0.66

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

Notes:
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 productivitiy (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. Belarus, Kazakhstan, Kosovo, Russia and Ukraine are converted from the USD parity provided by IMF (WDI).

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; IMF (WDI - World Develoment Indicators). wiiw estimates and forecasts.

Table 31 / Indicators of macro-competitiveness, 2012-2019, annual changes in %

	2012	2013	2014	2015	2016	2017	2018 Forecast	2019	2012-16 average
Bulgaria									
GDP deflator	1.6	-0.7	0.5	2.2	2.2	1.5	2.0	2.5	1.2
Real ER (CPI-based)	-0.2	-1.1	-2.1	-1.1	-1.6	-0.3	0.3	0.5	-1.2
Real ER (PPI-based)	1.6	-1.4	0.7	0.5	-1.5	2.3	1.4	1.0	0.0
Average gross wages, real (PPI based)	2.1	7.6	7.4	8.9	13.1	6.0	6.3	5.5	7.8
Average gross wages, real (CPI based)	4.1	5.6	7.7	8.0	11.0	7.6	7.4	6.0	7.3
Average gross wages, EUR (ER)	6.6	6.0	6.0	6.8	9.5	9.8	9.3	8.5	7.0
Employed persons (LFS)	-1.1	0.0	1.6	1.7	-0.5	3.1	1.6	0.9	0.3
GDP per empl. person, NC at 2010 ref. pr.	1.1	0.9	-0.3	1.9	4.5	0.7	2.1	2.4	1.6
Unit labour costs, ER (EUR) adjusted	5.4	5.1	6.3	4.9	4.9	8.4	7.2	6.1	5.3
Czech Republic									
GDP deflator	1.5	1.4	2.5	1.2	1.2	3.0	2.6	2.5	1.6
Exchange rate (ER), EUR/NC	-2.2	-3.2	-5.7	0.9	0.9	2.4	1.3	0.6	-1.9
Real ER (CPI-based)	-1.4	-3.3	-5.7	1.2	1.2	2.9	1.7	0.6	-1.6
Real ER (PPI-based)	-2.6	-2.5	-2.9	0.9	-0.8	0.6	0.7	0.1	-1.6
Average gross wages, real (PPI based)	0.1	-0.8	2.0	5.7	7.2	8.1	5.1	3.9	2.8
Average gross wages, real (CPI based)	-1.0	-1.5	2.5	2.9	3.1	4.6	3.9	3.4	1.2
Average gross wages, EUR (ER)	0.2	-3.3	-2.9	4.2	4.6	9.8	7.1	5.8	0.5
Employed persons (LFS)	0.4	1.0	0.8	1.4	1.9	0.2	0.2	0.0	1.1
GDP per empl. person, NC at 2010 ref. pr.	-1.2	-1.4	1.9	3.9	0.7	3.5	3.0	3.0	0.8
Unit labour costs, ER (EUR) adjusted	1.4	-1.9	-4.7	0.3	4.0	5.9	4.4	3.0	-0.2
Estonia									
GDP deflator	3.2	3.6	1.5	1.2	1.6	3.7	3.2	2.8	2.2
Real ER (CPI-based)	1.6	1.7	0.0	0.1	0.5	1.8	1.5	1.0	0.8
Real ER (PPI-based)	-0.1	7.3	-0.8	-0.6	0.3	2.3	1.5	1.0	1.2
Average gross wages, real (PPI based)	3.0	-0.2	8.8	9.2	9.0	4.2	4.0	5.2	5.9
Average gross wages, real (CPI based)	1.5	3.7	5.4	5.9	6.8	3.6	4.0	5.2	4.6
Average gross wages, EUR (ER)	5.7	7.0	5.9	6.0	7.6	7.3	7.3	8.3	6.4
Employed persons (LFS)	1.9	1.0	0.6	2.6	0.6	1.6	0.8	0.8	1.3
GDP per empl. person, NC at 2010 ref. pr.	2.4	0.9	2.3	-0.9	1.5	2.2	2.5	2.1	1.2
Unit labour costs, ER (EUR) adjusted	3.3	6.0	3.5	6.9	6.0	5.0	4.7	6.2	5.1
Croatia									
GDP deflator	1.6	0.8	0.0	0.0	-0.1	1.3	1.6	1.6	0.5
Exchange rate (ER), EUR/NC	-1.1	-0.8	-0.7	0.3	1.1	0.4	0.0	0.0	-0.3
Real ER (CPI-based)	-0.3	0.0	-1.0	0.0	0.2	0.0	-0.1	-0.4	-0.2
Real ER (PPI-based)	1.1	-1.1	-1.5	-1.2	-1.7	1.7	0.4	0.0	-0.9
Average gross wages, real (PPI based) 1)	-3.8	1.3	2.9	5.3	6.5	1.2	1.7	1.6	2.4
Average gross wages, real (CPI based) 1)	-2.3	-1.5	0.0	1.6	2.5	1.9	2.1	2.0	0.0
Average gross wages, EUR (ER) 1)	-0.1	0.1	-0.6	1.6	3.0	4.0	3.7	3.6	0.8
Employed persons (LFS)	-3.6	-2.7	2.7	1.3	0.3	0.0	1.3	1.2	-0.4
GDP per empl. person, NC at 2010 ref. pr.	1.5	1.7	-3.1	1.0	2.7	3.0	1.4	1.7	0.7
Unit labour costs, ER (EUR) adjusted	-1.5	-1.6	2.7	0.6	0.3	0.6	2.3	1.8	0.1
Hungary									
GDP deflator	3.4	2.9	3.4	1.9	1.0	2.9	3.4	3.3	2.5
Exchange rate (ER), EUR/NC	-3.4	-2.6	-3.8	-0.4	-0.5	0.8	-1.3	-1.3	-2.1
Real ER (CPI-based)	-0.5	-2.4	-4.3	-0.3	-0.4	1.5	-0.2	-0.4	-1.6
Real ER (PPI-based)	-2.2	-1.9	-2.3	1.1	-0.5	3.1	0.1	-0.3	-1.2
Average gross wages, real (PPI based)	0.5	2.9	3.4	5.3	8.0	6.5	5.8	2.9	4.0
Average gross wages, real (CPI based)	-1.0	1.7	3.0	4.2	5.7	7.0	6.0	3.0	2.7
Average gross wages, EUR (ER)	1.1	0.8	-0.9	3.9	5.7	10.1	7.5	5.0	2.1
Employed persons (LFS)	1.8	1.7	5.3	2.7	3.4	2.0	0.5	0.0	3.0
GDP per empl. person, NC at 2010 ref. pr.	-3.4	0.4	-1.1	0.7	-1.1	1.9	3.4	3.0	-0.9
Unit labour costs, ER (EUR) adjusted	4.6	0.4	0.1	3.2	6.8	8.4	4.0	1.6	3.0
Lithuania									
GDP deflator	2.7	1.3	1.0	0.3	1.0	4.5	3.6	2.5	1.3
Real ER (CPI-based)	0.6	-0.3	-0.3	-0.7	0.4	1.7	1.3	0.7	-0.1
Real ER (PPI-based)	2.1	-2.3	-3.0	-7.5	-2.7	4.2	1.8	1.5	-2.7
Average gross wages, real (PPI based)	-1.1	7.7	10.2	16.8	13.2	4.6	4.6	4.0	9.2
Average gross wages, real (CPI based)	0.6	3.8	4.6	6.2	7.6	6.1	5.1	4.8	4.5
Average gross wages, EUR (ER)	3.8	5.1	4.8	5.4	8.4	9.8	8.2	7.6	5.5
Employed persons (LFS)	1.8	1.3	2.0	1.2	2.0	-0.2	0.1	0.4	1.7
GDP per empl. person, NC at 2010 ref. pr.	2.0	2.1	1.5	0.8	0.4	2.9	2.7	2.6	1.4
Unit labour costs, ER (EUR) adjusted	1.8	2.9	3.3	4.6	8.0	6.7	5.4	4.9	4.1

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

(Table 31 ctd.)

Table 31 / (ctd.)

	2012	2013	2014	2015	2016	2017	2018 Forecast	2019	2012-16 average
Latvia									
GDP deflator	3.6	1.6	1.8	0.0	0.3	3.4	3.2	3.0	1.4
Real ER (CPI-based)	1.0	-2.1	0.0	0.2	-0.2	1.5	1.5	1.0	-0.2
Real ER (PPI-based)	2.6	1.1	2.2	1.4	-1.4	1.3	0.9	0.0	1.2
Average gross wages, real (PPI based)	-0.5	2.9	6.4	8.1	8.3	6.1	4.9	4.9	5.0
Average gross wages, real (CPI based)	1.3	4.6	6.1	6.7	4.9	4.8	4.2	3.9	4.7
Average gross wages, EUR (ER)	5.0	3.9	6.7	6.9	5.0	8.3	7.5	7.0	5.5
Employed persons (LFS)	1.6	2.1	-1.0	1.3	-0.3	-0.4	-0.2	-0.3	0.7
GDP per empl. person, NC at 2010 ref. pr.	2.4	0.3	2.9	1.4	2.5	4.7	3.9	3.8	1.9
Unit labour costs, ER (EUR) adjusted	2.5	3.6	3.7	5.4	2.5	3.4	3.5	3.1	3.5
Poland									
GDP deflator	2.3	0.3	0.5	0.8	0.2	1.0	2.1	2.5	0.8
Exchange rate (ER), EUR/NC	-1.5	-0.3	0.3	0.0	-4.1	2.7	0.0	0.0	-1.1
Real ER (CPI-based)	-0.5	-1.0	-0.1	-0.7	-4.6	2.5	0.2	0.0	-1.4
Real ER (PPI-based)	-1.1	-1.5	0.9	0.4	-2.8	2.9	-0.8	-0.7	-0.8
Average gross wages, real (PPI based)	0.5	5.0	4.6	5.6	3.9	3.7	3.9	4.1	3.9
Average gross wages, real (CPI based)	0.0	2.8	3.1	4.2	3.8	3.1	2.8	3.3	2.8
Average gross wages, EUR (ER)	2.1	3.3	3.5	3.5	-0.7	7.8	4.0	5.8	2.3
Employed persons (LFS)	0.2	-0.1	1.9	1.4	0.7	1.0	0.5	0.0	0.8
GDP per empl. person, NC at 2010 ref. pr.	1.4	1.5	1.4	2.4	2.0	2.8	2.9	3.4	1.7
Unit labour costs, ER (EUR) adjusted	0.7	1.8	2.1	1.0	-2.6	4.6	1.7	2.0	0.6
Romania									
GDP deflator	4.7	3.4	1.7	2.4	2.2	5.6	2.4	3.0	2.9
Exchange rate (ER), EUR/NC	-4.9	0.9	-0.6	0.0	-1.0	-1.3	-1.1	-2.1	-1.1
Real ER (CPI-based)	-4.2	2.6	0.3	-0.4	-2.4	-2.1	0.2	-0.7	-0.8
Real ER (PPI-based)	-2.7	3.1	1.2	0.0	-1.3	1.9	0.3	-1.2	0.0
Average gross wages, real (PPI based) 2)	-1.0	2.8	7.8	12.4	12.0	9.5	33.5	8.1	6.7
Average gross wages, real (CPI based) 2)	0.8	1.6	6.1	10.2	11.2	12.8	33.5	7.6	5.9
Average gross wages, EUR (ER) 2)	-1.0	5.8	7.0	9.7	8.8	11.9	37.1	8.3	6.0
Employed persons (LFS)	0.9	-0.7	0.8	-0.9	-1.0	2.0	1.0	1.0	-0.2
GDP per empl. person, NC at 2010 ref. pr.	-0.3	4.2	2.3	4.9	5.9	3.6	3.5	3.5	3.4
Unit labour costs, ER (EUR) adjusted	-0.7	1.5	4.6	4.6	2.8	8.5	31.4	5.3	2.5
Slovenia									
GDP deflator	0.5	1.6	0.8	1.0	0.9	1.6	1.9	1.8	0.9
Real ER (CPI-based)	0.2	0.4	-0.1	-0.8	-0.5	-0.3	0.1	-0.2	-0.2
Real ER (PPI-based)	-1.9	0.1	1.3	2.2	0.3	1.3	0.4	-0.1	0.4
Average gross wages, real (PPI based)	-0.8	-0.2	1.8	1.0	3.2	-1.0	1.1	1.1	1.0
Average gross wages, real (CPI based)	-2.7	-2.0	0.7	1.5	2.1	-0.5	1.3	1.2	-0.1
Average gross wages, EUR (ER)	0.1	-0.2	1.1	0.7	1.8	1.0	3.1	3.0	0.7
Employed persons (LFS)	-1.3	-1.9	1.2	0.1	-0.3	3.8	2.1	2.1	-0.5
GDP per empl. person, NC at 2010 ref. pr.	-1.4	0.8	1.8	2.2	3.4	0.0	1.9	1.6	1.3
Unit labour costs, ER (EUR) adjusted	1.5	-1.0	-0.6	-1.4	-1.5	0.9	1.2	1.4	-0.6
Slovakia									
GDP deflator	1.3	0.5	-0.2	-0.2	-0.4	1.3	1.8	1.8	0.2
Real ER (CPI-based)	1.1	0.0	-0.6	-0.3	-0.8	-0.5	0.1	-0.2	-0.1
Real ER (PPI-based)	-0.9	-0.9	-1.6	-0.6	-2.5	2.5	0.9	0.5	-1.3
Average gross wages, real (PPI based)	0.5	3.4	7.9	6.0	7.6	2.0	3.7	3.3	5.1
Average gross wages, real (CPI based)	-1.2	0.8	4.2	3.2	3.8	3.9	4.4	4.0	2.2
Average gross wages, EUR (ER)	2.4	2.4	4.1	2.9	3.3	5.3	6.3	5.9	3.0
Employed persons (LFS)	0.6	0.0	1.5	2.6	2.8	1.1	0.8	0.4	1.5
GDP per empl. person, NC at 2010 ref. pr.	1.1	1.5	1.3	1.2	0.5	2.2	2.8	3.6	1.1
Unit labour costs, ER (EUR) adjusted	1.4	0.9	2.8	1.7	2.8	3.0	3.4	2.2	1.9
Albania									
GDP deflator	1.0	0.3	1.5	0.1	-0.2	4.6	2.0	1.7	0.6
Exchange rate (ER), EUR/NC	0.9	-0.9	0.2	0.2	1.7	2.1	-0.4	-0.4	0.4
Real ER (CPI-based)	0.3	-0.5	1.3	2.1	2.7	2.6	0.7	0.6	1.2
Real ER (PPI-based)	-0.7	-1.2	1.7	0.5	1.8	4.4	0.0	-0.4	0.4
Average gross wages, real (PPI based) 3)	1.8	-2.8	1.4	5.0	-0.6	4.2	4.8	4.9	0.9
Average gross wages, real (CPI based) 3)	0.9	-5.0	-0.7	0.9	-3.4	4.9	4.0	3.9	-1.5
Average gross wages, EUR (ER) 3)	3.8	-4.0	1.1	3.0	-0.4	10.9	5.4	7.7	0.7
Employed persons (LFS)	-1.8	-10.2	1.3	4.8	6.5	2.8	3.4	1.6	-0.1
GDP per empl. person, NC at 2010 ref. pr.	3.2	12.5	0.5	-2.4	-2.9	1.0	0.8	2.4	2.0
Unit labour costs, ER (EUR) adjusted	0.6	-14.7	0.6	5.6	2.6	8.5	5.7	4.1	-1.3

2) In 2018 the employers' social security contribution will be added to gross wages increasing the latter by 25% in NC (23.6% in EUR terms). - 3) From 2014 new data sources, growth rates comparable.

(Table 31 ctd.)

Table 31 / (ctd.)

	2012	2013	2014	2015	2016	2017	2018 Forecast	2019	2012-16 average
Bosnia and Herzegovina									
GDP deflator	0.8	-0.2	1.0	1.4	1.3	1.3	1.7	1.9	0.9
Real ER (CPI-based)	-0.5	-1.6	-1.4	-1.0	-1.4	-0.6	-0.1	-0.1	-1.2
Real ER (PPI-based)	-2.3	-1.7	1.4	3.1	-0.5	1.5	0.2	0.1	0.0
Average gross wages, real (PPI based)	1.1	1.9	0.4	-0.6	3.1	0.1	1.2	0.8	1.2
Average gross wages, real (CPI based)	-0.5	0.2	0.8	1.0	2.0	1.0	1.4	1.0	0.7
Average gross wages, EUR (ER)	1.5	0.1	-0.1	0.0	0.9	2.2	2.9	2.9	0.5
Employed persons (LFS)	-0.3	1.0	-1.2	1.2	-2.6	2.4	1.2	1.2	-0.4
GDP per empl. person, NC at 2010 ref. pr.	-0.5	1.4	2.3	1.8	5.9	0.5	2.3	2.2	2.2
Unit labour costs, ER (EUR) adjusted	2.1	-1.3	-2.4	-1.8	-4.7	1.7	0.7	0.7	-1.7
Montenegro									
GDP deflator	0.2	2.1	1.0	2.2	5.1	1.0	1.9	1.6	2.1
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	3.3	0.0	-0.4	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	1.9	1.8	2.5	1.8	-1.0
Unit labour costs, ER (EUR) adjusted	6.0	-2.6	4.8	-0.6	1.7	0.7	0.1	0.7	1.8
Macedonia									
GDP deflator	1.0	4.5	1.4	1.9	6.3	0.9	1.5	2.0	3.0
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	-0.6	0.4	0.0	-1.0
Average gross wages, real (PPI based)	-1.1	2.6	3.0	6.9	4.5	2.1	0.4	0.9	3.1
Average gross wages, real (CPI based)	-3.0	-1.6	1.3	3.0	2.2	1.1	0.9	0.9	0.4
Average gross wages, EUR (ER)	0.2	1.1	0.9	2.7	2.0	1.3	3.7	1.8	1.4
Employed persons (LFS)	0.8	4.3	1.7	2.3	2.5	0.9	1.4	1.4	2.3
GDP per empl. person, NC at 2010 ref. pr.	-1.3	-1.4	1.9	1.5	-0.1	0.9	1.7	2.0	0.1
Unit labour costs, ER (EUR) adjusted	1.5	2.5	-1.0	1.2	2.1	1.3	0.7	0.9	1.3
Serbia									
GDP deflator	6.3	5.4	2.7	2.7	2.5	3.6	4.1	3.5	3.9
Exchange rate (ER), EUR/NC	-9.9	0.0	-3.6	-2.9	-1.9	0.9	-0.8	-0.8	-3.7
Real ER (CPI-based)	-5.8	6.1	-2.0	-1.5	-1.1	2.1	0.5	0.2	-0.9
Real ER (PPI-based)	-6.4	2.8	-0.4	0.6	-0.3	1.2	-1.2	-0.8	-0.8
Average gross wages, real (PPI based)	2.0	2.9	-0.1	-1.5	3.8	4.0	3.9	2.9	1.4
Average gross wages, real (CPI based)	1.5	-1.8	-0.9	-1.8	2.7	2.0	2.0	1.9	-0.1
Average gross wages, EUR (ER)	-1.9	5.7	-2.4	-3.3	1.8	6.7	3.6	3.5	-0.1
Employed persons (LFS)	-1.1	3.7	4.8	0.6	5.6	1.9	2.2	2.1	2.7
GDP per empl. person, NC at 2010 ref. pr.	0.1	-1.1	-6.3	0.2	-2.7	0.0	0.3	0.6	-2.0
Unit labour costs, ER (EUR) adjusted	-1.9	6.9	4.2	-3.5	4.6	6.0	3.9	3.6	2.0
Kosovo									
GDP deflator	2.2	1.8	3.3	0.0	-0.3	1.5	2.5	2.1	1.4
Real ER (CPI-based)	-0.1	0.3	-0.1	-0.5	0.0	-0.2	0.2	0.3	-0.1
Real ER (PPI-based)	-0.9	2.4	3.6	5.2	1.5	1.2	0.6	0.5	2.4
Average net wages, real (PPI based) 4)	-0.8	-4.4	15.9	3.9	-1.0	-2.5	2.2	1.7	2.5
Average net wages, real (CPI based) 4)	-1.4	-3.9	17.4	7.3	-1.4	-2.2	2.5	1.9	3.3
Average net wages, EUR (ER) 4)	1.1	-2.2	17.9	6.8	-1.1	-0.7	4.4	4.3	4.2
Employed persons (LFS) 5)	1.4	11.7	-4.4	-8.2	11.7	11.5	5.4	2.6	2.1
GDP per empl. person, NC at 2010 ref. pr.	1.4	-7.4	5.9	13.6	-7.5	-7.3	-1.3	1.4	0.9
Unit labour costs, ER (EUR) adjusted	-0.3	5.7	11.3	-6.0	6.9	7.2	5.9	2.9	3.3
Belarus									
GDP deflator	75.3	21.3	18.1	16.0	7.7	8.4	8.0	7.0	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	2.0	1.8	0.7	-0.3
Real ER (PPI-based)	26.6	3.7	2.6	-11.0	-7.8	6.7	2.8	1.6	2.0
Average gross wages, real (PPI based)	9.9	21.2	6.0	-5.0	-3.9	-1.1	-0.1	0.1	5.2
Average gross wages, real (CPI based)	21.5	16.4	1.3	-2.2	-3.7	0.7	0.8	1.1	6.2
Average gross wages, EUR (ER)	44.5	25.4	7.0	-17.7	-12.8	3.5	5.9	2.8	6.8
Employment registered	-1.7	-0.7	-0.6	-1.2	-2.0	-0.6	0.2	0.2	-1.2
GDP per empl. person, NC at 2010 ref. pr.	3.4	1.7	2.3	-2.6	-0.6	2.6	2.4	2.4	0.8
Unit labour costs, ER (EUR) adjusted	39.7	23.3	4.6	-15.5	-12.3	1.9	1.8	1.4	6.0

4) Net wages in state administration. - 5) wiiw estimate in 2012 due to improved LFS survey based on EU guidelines.

(Table 31 ctd.)

Table 31 / (ctd.)

	2012	2013	2014	2015	2016	2017	2018 Forecast	2019	2012-16 average
Kazakhstan									
GDP deflator	4.8	9.5	5.8	1.9	13.6	8.9	5.9	5.0	7.0
Exchange rate (ER), EUR/NC	6.5	-5.2	-15.1	-3.1	-35.1	-4.4	0.0	0.0	-11.6
Real ER (CPI-based)	9.2	-1.1	-9.9	3.3	-25.8	0.5	4.2	3.9	-5.7
Real ER (PPI-based)	7.2	-5.3	-5.3	-21.1	-22.9	6.3	3.3	0.0	-10.2
Average gross wages, real (PPI based)	8.7	8.1	1.3	31.0	-2.9	-2.5	4.0	7.0	8.6
Average gross wages, real (CPI based)	6.9	1.9	3.9	-2.3	-1.1	2.0	3.0	3.0	1.8
Average gross wages, EUR (ER)	19.8	2.2	-5.9	0.9	-26.4	3.3	10.3	9.3	-3.1
Employed persons (LFS)	1.0	0.7	-0.7	1.3	-0.8	0.5	0.5	0.5	0.3
GDP per empl. person, NC at 2010 ref. pr.	3.7	5.2	4.9	-0.2	2.0	2.4	2.5	3.0	3.1
Unit labour costs, ER (EUR) adjusted	15.5	-2.8	-10.3	1.1	-27.8	1.9	6.5	6.0	-6.0
Russia 6)									
GDP deflator	9.1	5.4	7.5	8.2	3.6	5.0	4.0	5.0	6.7
Exchange rate (ER), EUR/NC	2.3	-5.5	-16.7	-25.1	-8.8	9.2	-1.4	-1.4	-11.3
Real ER (CPI-based)	4.8	-0.6	-10.7	-13.5	-2.6	12.1	0.8	1.5	-4.7
Real ER (PPI-based)	6.3	-2.3	-9.7	-12.9	-3.3	13.3	1.8	0.5	-4.6
Average gross wages, real (PPI based)	6.7	8.3	2.8	-6.8	3.8	1.7	2.9	6.0	2.8
Average gross wages, real (CPI based)	8.4	4.8	1.2	-9.3	0.8	3.1	3.9	5.0	1.0
Average gross wages, EUR (ER)	16.6	5.7	-9.2	-21.5	-1.5	17.2	6.9	8.1	-2.9
Employed persons (LFS)	1.0	-0.2	0.2	-0.4	0.1	-0.1	0.0	-0.1	0.1
GDP per empl. person, NC at 2010 ref. pr.	2.7	2.0	0.5	-2.5	-0.3	1.8	1.9	2.0	0.5
Unit labour costs, ER (EUR) adjusted	13.6	3.6	-9.7	-19.5	-1.2	15.6	4.5	6.5	-3.3
Ukraine 7)									
GDP deflator	8.0	4.3	15.9	38.9	17.1	15.2	7.5	6.5	16.3
Exchange rate (ER), EUR/NC	8.0	-3.2	-32.5	-35.1	-14.4	-8.7	-11.4	-2.8	-17.1
Real ER (CPI-based)	5.9	-4.9	-24.7	-3.5	-2.7	2.5	-5.9	0.1	-6.6
Real ER (PPI-based)	8.9	-3.2	-19.4	-9.6	4.9	13.3	-4.1	2.0	-4.2
Average gross wages, real (PPI based)	10.8	8.0	-9.5	-11.4	2.5	8.0	2.6	0.6	-0.3
Average gross wages, real (CPI based)	14.2	8.2	-5.4	-18.9	8.5	18.2	4.5	2.5	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	-1.0	-0.7	-0.1	0.0	-1.5
GDP per empl. person, NC at 2010 ref. pr.	0.0	-0.2	-0.2	-9.4	3.4	2.7	3.1	3.0	-1.4
Unit labour costs, ER (EUR) adjusted	24.1	4.6	-28.3	-13.7	2.3	20.0	-3.0	1.6	-3.8
Austria									
GDP deflator	2.1	1.6	2.0	2.3	1.1	1.5	1.7	2.0	1.8
Real ER (CPI-based)	-0.2	0.5	1.2	0.9	0.6	0.0	0.0	0.0	0.6
Real ER (PPI-based)	-1.9	-0.8	0.9	1.0	-0.3	0.7	0.0	0.0	-0.2
Average gross wages, real (PPI based)	2.3	3.0	3.6	4.1	4.5	0.3	0.8	-0.1	3.5
Average gross wages, real (CPI based)	0.7	0.1	0.8	1.6	1.6	0.0	0.7	-0.1	1.0
Average gross wages, EUR (ER)	3.1	2.2	2.5	2.5	2.6	1.7	2.4	1.9	2.6
Employed persons (LFS)	0.8	0.5	0.2	0.9	1.7	1.9	1.4	0.9	0.8
GDP per empl. person, NC at 2010 ref. pr.	-0.1	-0.5	0.6	0.2	-0.3	0.7	0.5	1.1	0.0
Unit labour costs, ER (EUR) adjusted	3.3	2.6	1.9	2.3	2.9	1.1	1.9	0.8	2.6

6) From 2014 including Crimean Federal District (for LFS employment and wages from 2015), growth rates comparable. - 7) 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 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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WIRTSCHAFTLICHE KONVERGENZ TROTZ POLITISCHER UNSICHERHEIT
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wiiw-Forschungsberichte / wiiw Research Reports in German language, No. 7, June 2017
85 pages including 103 Tables and 17 Figures
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IMPRESSUM

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

ZVR-Zahl: 329995655

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

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

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ISBN-978-3-85209-058-0