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Forecast Report

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Mixed Prospects:

Consumption Leads Fragile Recovery in the CESEE Core — CIS Stumbles

Economic Analysis and Outlook for Central, East and Southeast Europe

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

Mixed Prospects:
Consumption Leads Fragile Recovery in the CESEE Core — CIS Stumbles

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CONTENTS

TABLES AND FIGURES

The statistical data until 2014 presented in this Report are as of 12 October 2015, forecasts as of November 2015. 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

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

BPM5	Balance of Payments Manual Fifth Edition
BPM6	Balance of Payments and International Investment Position Manual Sixth Edition
BOP	balance of payments
CE	Central Europe
CESEE	Central, East and Southeast Europe
CIS	Commonwealth of Independent States
CIS-STAT	Interstate Statistical Committee of the Commonwealth of Independent States
CPI	consumer price index
EA	euro area 19 countries
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
ER	exchange rate
ESA'95	European system of national and regional accounts, ESA 1995
ESA 2010	European system of accounts, ESA 2010
EU	European Union
EU-15	15 original members of the European Union
FDI	Foreign Direct Investment
FISIM	Financial Intermediation Services, Indirectly Measured
GDP	Gross Domestic Product
ICP	International Comparison Project
IMF	International Monetary Fund
LFS	Labour Force Survey
NACE	Nomenclature statistique des activités économiques dans la Communauté européenne (Statistical classification of economic activities in the European Community)
NACE Rev. 1	first revision of the original NACE (1970)
NACE Rev. 2	revised classification, introduced in 2008
NB	National Bank
NC	national currency
NMS	new EU Member States
OECD	Organisation for Economic Co-operation and Development
OICA	Organisation Internationale des Constructeurs d'Automobiles
OMS	old EU Member States
pp	percentage points
PPI	producer price index
PPP	Purchasing Power Parity
SEE	Southeast Europe
SME	small and medium-sized enterprise
SNA	System of National Accounts
SPE	Special Purpose Entity
VAT	value added tax
WBC	Western Balkan countries
WIFO	Austrian Institute of Economic Research
wiiw	The Vienna Institute for International Economic Studies

.	not available (in tables)
2015q1	first quarter of 2015
2015h1	first half of 2015
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

Executive summary

The medium-term macroeconomic outlook for the CESEE region is rather mixed and is characterised by further growth divergence. At the one end of the spectrum, the **Central European** countries are expected to continue robust recovery. At the other – the **CIS** group faces particularly poor prospects, with Russia and Belarus both tumbling into a deep recession in 2015 and Kazakhstan following suit with a deceleration in growth. Whereas economic activity in the **Baltic** countries suffered this year owing to their exposure to Russia, they appear to be resilient and recovery is still on track. **Southeast Europe** displays overall improving, but irregular and unstable growth tendencies, in many cases accompanied by macroeconomic imbalances and deep structural problems. The situation in **Ukraine** remains particularly fragile and serious downside risks persist, although there are signs that the recession, much deeper than originally anticipated, might be bottoming out.

On account of better-than-expected performance to date, the wiiw economic growth forecast for most of the CESEE countries has been revised slightly upwards relative to the Spring 2015 forecast. Notably, all countries, with the exception of the CIS group and Ukraine, are expected to end up in the positive growth zone both this year and over the forecast horizon (2015–2017).

Net exports are providing only a limited, if at all positive, contribution to growth, while household consumption is coming to the fore as the main engine of growth across most of the CESEE region and is expected to remain among the key drivers in the medium term as well, while the support lent by the external environment is still but moderate as the world economy struggles with recovery amid persistent risks.

The observed consumption-led growth is associated with labour market improvements. Complementing the gradually receding unemployment, rising real wages (also reflecting the downward pressures on inflation due to soft commodity prices) emerged as another key pillar that plays a major role in boosting domestic demand. However, unless associated with improvements in labour productivity, increasing real wages may hinder competitiveness and impair the current account balance: a particularly important concern for the CESEE region, comprised as it is of small open economies, many of which do not have an independent monetary policy either.

Private investment remains the much-needed missing link in the mechanism essential to rekindling sustainable output growth in the CESEE region. Weak investor sentiment, reluctance to borrow in the low-inflation environment, non-performing loans and high private debt levels continue to act as a drag, and public investment may prove to be an important complementary factor for countries with fiscal space. In this regard, the EU structural and investment funds are also instrumental in addressing the infrastructural needs, and the 2014–2020 Multiannual Financial Framework is expected to make a significant contribution to investments in CESEE, increasing towards the end of the forecast horizon. Concerted efforts to trigger investment are particularly important for boosting the potential growth rate, as its slowdown risks to be a feature of the 'new normal' for the CESEE region.

Despite rebounding household consumption, inflation remains very weak across the CESEE region, hovering at near-zero levels on account of low commodity prices, with the exception of the CIS countries, Turkey and Ukraine, whose inflation spiked owing to exchange rate pass-through effects that followed sharp currency depreciations in 2014-2015, as well as country-specific factors, such as the food embargo in Russia and the rise in utility tariffs in Ukraine.

While economic conditions are gradually improving, the crisis legacies, elevated public and private debt levels, high unemployment along with low employment rates, macroeconomic imbalances and structural bottlenecks are still a concern rendering growth fragile in some countries, particularly in the Western Balkans. As the multi-speed recovery of the world economy continues in 2015, manifold external risks also arise that could jeopardize the recovery of the CESEE region, including geopolitical tensions associated with the situation in Ukraine and the Middle East, a slowdown in major emerging markets, normalisation of monetary policy in the USA, and low commodity prices (a negative shock for the CIS group). The special sections of the forecast report discuss some of the potential risks to the CESEE region that have been receiving much attention since the beginning of the year:

– Refugee crisis in Europe. The CESEE region has become a prominent transit route for migrants and refugees headed for Western Europe. As only some choose to settle in the CESEE countries *en route*, the direct economic impact appears to be rather limited, amounting to a marginal contribution to consumption, while the fears that the asylum seekers will jeopardise labour markets and fiscal stability appear to be largely unfounded. The main risks stem from the political tensions associated with the rise of anti-migration sentiment throughout Europe.

– Recession and import-substitution in Russia. The decline in trade with Russia has accelerated dramatically in 2015 owing to the combined impact of recession, sanctions and counter-sanctions, and the devaluation of the rouble. The major losses attributable to the foregone exports to Russia over the period 2014-2015 were accrued, unsurprisingly, by Belarus and Ukraine, and, to a lesser extent, the Baltics, while most of the NMS proved to be relatively resilient according to the estimates.

– Volkswagen scandal. Despite the importance of the automotive industry to a number of the CESEE economies (Czech Republic, Hungary and Slovakia) and the significant presence of Volkswagen in these countries, the developments to date indicate that the risks associated with the emissions tests scandal have been contained. However, the potential impact is still unclear, largely conditional on the market response over the coming months, including a decline in demand, imposition of penalties and liabilities for damages.

– Slowdown in China. In connection with the much-debated risk of 'hard landing' in China that took on added impetus over the past summer, possible effects are assessed with the focus on the trade channel. Given the limited direct trade exposures, the slowdown in China is expected to have but a minor impact on the CESEE region. Yet, the indirect spillovers via other countries, such as Germany, and non-trade channels may well prove to be a matter of concern.

– Implications of the Greek crisis. Among the key lessons from the Greek crisis are the weaknesses it has revealed in the capacity of the EU institutions to deal with such events and its implications for the stability of the EU institutional arrangements. The preference for cooperation rather than dissolution should be reinforced in the EU, and risk-sharing along with other newly introduced frameworks are particularly important for the developing economies of Europe, including the CESEE countries.

All in all, diverging growth patterns will continue to be a characteristic trait of the CESEE region in the longer run as well. Overall, in the new EU Member States output growth is expected to average close to 3% both in 2015 and over the forecast horizon, signifying a modest improvement in comparison with the past year. Thus far, the better-performing countries of Central Europe appear to be rather resilient to external shocks and remain on track to sustainable recovery supported by domestic demand, expected to grow in the 2-4% range per annum over the forecast horizon (2015–2017). Constrained as they are by profound structural problems, the countries of Southeast Europe are muddling their way through recovery and are only slowly converging to the rest of Europe. Serbia and Croatia, the worst performers in the group, will enjoy hardly any growth at all in 2015 (0.1% and 0.7%, respectively), while other countries of the group are expected to grow in the 2-4% range. Already in a depressed state (expected growth of Russia and Belarus in 2015: -3.7% and -3.8%, respectively), the CIS region faces still gloomy prospects for the future, unless global commodity prices recover, while it continues to ‘decouple’ from Europe along many fault lines, mostly geopolitical in nature. ‘*A solid core and flaky surrounds*’ would thus seem to come close to describing the present state of affairs in the CESEE region.

COUNTRY SUMMARIES

ALBANIA

A credit market lacking vigour, a contraction of exports and meagre fiscal performance are restraining economic growth. Differently, an outstanding performance in terms of gross fixed capital formation, foreign direct investments and remittances, which are flourishing again, is expected to boost the economy by 2.6% in 2015. Growth above 3% is expected in 2016-2017. The rigorous campaign against the shadow economy and consequently a more efficient tax collection can open up more space for public investments.

BELARUS

Belarus has gone into recession for the first time in more than 15 years as a result of a combination of external shocks and chronic macroeconomic distortions. Further policy adjustments aimed at reducing macroeconomic disequilibria are likely after the October presidential elections. The short- and medium-term prospects remain gloomy; they will depend largely on the eventual recovery of the Russian economy. In all probability, Belarus will only return to a growth scenario in 2017.

BOSNIA AND HERZEGOVINA

This year's recovery of close to 2% growth of GDP could be speeded up to close to 3% beyond the forecasting period on the basis of better investment and continued growth of exports. There are both downside and upside risks depending on the evolution of the political and institutional set-up, including the relations with the EU.

BULGARIA

GDP growth in the first half of 2015 was supported by a robust upturn in exports in the first quarter. The strengthening in the labour market contributed to the unemployment rate dropping to below 10% by mid-year. However, economic performance was uneven across sectors, while progress in key policy reform areas was limited. Overall, the chances are that a moderate recovery will continue in the short term with GDP rising higher than 2% for 2015 as a whole.

CROATIA

After six years of contraction, Croatia's economy has returned to a growth pattern in 2015. The turnaround has been backed by rising external demand and a mild recovery in household consumption and investments. GDP growth is expected to firm up over the years to come, fuelled primarily by EU-funded investments. Fiscal consolidation and deleveraging on the part of enterprises are the major obstacles to sustainable growth.

CZECH REPUBLIC

Given the relatively low level of debt in the private sector and the growth-friendly monetary policy, a further moderate recovery should be forthcoming in 2016-2017 (with growth averaging 2.35%). However, the current expansion of infrastructural investment is not going to extend into the years ahead. Uncertainties also persist where the performance of foreign trade is concerned. Furthermore, growth might be seriously impaired, were the previous fiscal consolidation policy to be reintroduced.

ESTONIA

Dragged down by dwindling external demand in the neighbouring countries to the east and the current decline in investments, the Estonian GDP will grow by 1.9% in 2015. Household consumption remains the strongest driver of economic activity. Over the next two years we expect a recovery in trade with countries to the west, while the decline in exports to Russia should come to a halt. Moreover, an upswing, particularly in public investments, should boost GDP growth to 2.6% and 2.8% in 2016 and 2017, respectively.

HUNGARY

After six quarters featuring GDP growth rates higher than 3%, the second quarter of 2015 brought about a deceleration in the pace of economic expansion to 2.7%. Both that slowdown and the preceding high quarterly growth rates are linked to the cyclical nature of cohesion policy transfers from the European Union. The marked upturn in investment experienced in 2014 will not be repeated this year; the economy appears to be returning to its earlier growth pattern characterised by net exports as the major contributors to economic expansion.

KAZAKHSTAN

Increasing costs of keeping the KZT/USD exchange rate within the given band forced the government to switch to a floating currency regime; as a result the tenge depreciated by about 50%. A substantial weakening in external demand and sluggish domestic private consumption and investment will limit GDP growth to 1.5% in 2015. In 2016-2017, growth is expected to accelerate to 2.5% and 3.5%, respectively, since fiscal stimuli are expected to boost investment, while exports will gradually recover.

KOSOVO

The growth outlook for Kosovo remains stable. GDP growth in 2015, 2016 and 2017 is expected to hover around 4%, mainly on account of strong household consumption fuelled by pre-election public wage increases and a rise in remittances, as well as improved dynamics in gross fixed capital formation over the medium term. The GDP growth figures for 2014 are ambiguous, with the Agency of Statistics and the Central Bank publishing diverging figures. That ambiguity hints at the need for improved statistics.

LATVIA

For 2015, our GDP growth forecast for Latvia remains almost unchanged at 2.4%. As expected, the slump in Russian demand has been offset by growth in exports to the EU and Asian markets. While household consumption is developing at a good pace, investment activity remains stagnant. In both 2016 and 2017 we expect an upswing in GDP growth to 3%, driven by stronger external demand and investment activity in both the public and private sectors.

LITHUANIA

Throughout 2015, growth of the Lithuanian economy has been dampened by a slump in external demand in the CIS countries and the lower demand for oil products. Only part of the shortfall can be offset by exports to the EU and Asian markets or growth in other product categories. Consumer demand has developed apace and investment activity is flourishing. We forecast a reasonable GDP growth rate of 2% for 2015 and an upswing to 3% and 3.4% for 2016 and 2017, respectively.

MACEDONIA

This year's growth may disappoint owing to a slowdown in consumption and in investment. Still, the growth rate should prove to be among the highest in the region. In the medium term, assuming preserved political and social stability, the growth rate should remain at around 3%. Faster growth is possible if there is political stabilisation after the early elections in April next year and a significant economic improvement in the region.

MONTENEGRO

Given that stability is preserved, the adjustment process in Montenegro needs to deal with the external imbalances, which means that consumption will have to grow slowly if at all. So, it all depends on the growth of investment, which is quite sensitive to security and stability risks, and on tourism, which has performed rather well so far. With that in mind, a growth rate of around 3% should be maintained in the medium term.

POLAND

The current moderate and broad-based growth has yet to eliminate the excessive unemployment and put a stop to deflationary tendencies. The recent elections are unlikely to change Poland's economic trajectory over the biennium 2016-2017. Continuing moderate growth (at a rate in excess of 3%) will bring about gradual improvements without giving rise to any major internal or external imbalances.

ROMANIA

In all likelihood, expanding private consumption and a recovery in investments will lead to an acceleration in economic growth in the order of 3.4% in 2015. VAT cuts and wage rises in the public sector may further accelerate consumption growth in 2016, yet trigger an increase in the foreign trade deficit. On average, consumer prices are stable; unemployment is hovering just below 7%, while signs of structural labour shortages are emerging.

RUSSIA

The economy plunged into a full-blown recession in 2015. Both exports and (even more so) imports were slashed, while the current account surplus surged upwards. The recession may have already bottomed out by mid-2015, yet there is no consensus as to future prospects. Depending on the oil price, Russia may face another mild GDP decline in 2016, although stabilisation or even modest growth seems more likely. Nevertheless, growth will remain unimpressive even in the medium term since restructuring will not materialise.

SERBIA

This year will prove stabilising for growth, the risks to the forecast being on the upside owing to last year's bad second half. Growth prospects should be improving at a moderate pace in the medium term. Assuming political stability is preserved and the reforms are sustained, in the medium run the adjustment of main GDP components, with a relatively strong investment performance and continued growth of exports, should allow for real GDP growth of 3% on average for the next five years or so.

SLOVAKIA

In 2015, surging investments will boost Slovak GDP growth, which is expected to reach 3.2%. Better conditions on the labour market will encourage household consumption and imports. At the same time, global uncertainties will restrain export growth, resulting in net exports contributing negatively to economic growth. Over the next two years we expect annual real GDP growth in the order of 3%.

SLOVENIA

Slovenia's economy has continued down its growth path in 2015. The rebound has been driven by rising external demand and a mild recovery in private consumption. GDP growth in 2016 and 2017 will be moderate on account of lower EU-funded investments at the beginning of the new cycle. Exports and the gradual recovery of household consumption will remain the main engines of growth.

TURKEY

Economic growth has accelerated in the first half of 2015, driven by a hike in final consumption expenditures and an increase in private investment, despite the current political uncertainties. However, the parity between dollar and euro and weak global growth led to the contribution of exports to Turkish GDP growth turning slightly negative. Overall, we expect GDP growth of around 3% for 2015 and the years to come.

UKRAINE

After three quarters of deep recession, the recent months suggest a gradual bottoming out of the economy, albeit at a very low level. Fiscal austerity and high inflation continue to weigh heavily on domestic demand, while hitherto exports have been unable to take full advantage of the competitive exchange rate. The recent sovereign debt restructuring might well provide minor budgetary relief, yet will not prevent a further rise in the public debt to GDP ratio.

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

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

Table 1 / OVERVIEW 2013-2014 AND OUTLOOK 2015-2017

	GDP real change in % against prev. year					Consumer prices change in % against prev. year					Unemployment (LFS) rate in %, annual average					Current account in % of GDP				
			Forecast					Forecast					Forecast					Forecast		
	2013	2014	2015	2016	2017	2013	2014	2015	2016	2017	2013	2014	2015	2016	2017	2013	2014	2015	2016	2017
NMS-11																				
Bulgaria	1.3	1.5	2.3	2.6	3.0	0.4	-1.6	0.5	1.0	1.5	13.0	11.4	10.3	9.5	9.0	1.8	1.2	1.8	0.9	0.0
Croatia	-1.1	-0.4	0.7	1.2	1.6	2.3	0.2	-0.3	0.5	1.0	17.3	17.3	17.0	16.5	16.0	1.0	0.8	1.0	0.5	0.3
Czech Republic	-0.5	2.0	3.9	2.4	2.3	1.3	0.4	0.5	1.5	1.7	7.0	6.1	5.5	5.5	5.4	-0.5	0.6	1.0	0.0	-1.0
Estonia	1.6	2.9	1.9	2.6	2.8	3.2	0.5	-0.1	1.8	2.1	8.6	7.4	6.5	6.1	5.8	-0.1	1.0	2.0	-0.2	-1.8
Hungary	1.9	3.7	2.9	2.1	2.0	1.7	0.0	0.3	2.5	3.0	10.2	7.7	6.9	6.9	6.9	4.0	2.3	4.7	4.4	4.1
Latvia	3.0	2.8	2.4	3.0	3.0	0.0	0.7	0.4	1.8	2.1	11.9	10.8	9.9	9.3	8.9	-2.4	-2.0	-2.0	-3.5	-3.7
Lithuania	3.5	3.0	1.6	3.0	3.4	1.2	0.2	-0.6	2.0	2.5	11.8	10.7	9.5	8.5	8.0	1.5	3.6	-4.1	-4.6	-4.9
Poland	1.7	3.4	3.5	3.3	3.3	0.8	0.1	-0.7	1.2	1.8	10.3	9.0	8.8	8.5	8.3	-1.3	-2.0	-0.5	-1.5	-2.0
Romania	3.5	2.8	3.4	3.7	2.7	3.2	1.4	0.0	1.0	2.0	7.1	6.8	6.8	6.7	6.6	-1.1	-0.5	-0.4	-0.7	-1.0
Slovakia	1.4	2.4	3.2	3.0	2.9	1.5	-0.1	0.0	1.4	1.7	14.2	13.2	11.6	10.6	10.0	2.0	0.8	-0.8	-1.2	-1.7
Slovenia	-1.1	3.0	2.7	2.2	2.3	1.9	0.4	-0.4	0.5	1.0	10.1	9.7	9.0	8.5	8.0	5.6	7.0	6.6	5.4	4.7
NMS-11 1)2)	*1.6*	*2.8*	*3.2*	*2.9*	*2.8*	*1.5*	*0.3*	*-0.2*	*1.3*	*1.9*	*10.0*	*9.0*	*8.5*	*8.2*	*7.9*	*0.1*	*-0.1*	*0.5*	*-0.3*	*-0.9*
EA-19	*-0.3*	*0.9*	*1.6*	*1.8*	*1.9*	*1.3*	*0.4*	*0.1*	*1.0*	*1.6*	*12.0*	*11.6*	*11.0*	*10.6*	*10.3*	*2.5*	*3.0*	*3.7*	*3.6*	*3.4*
EU-28	*0.2*	*1.4*	*1.9*	*2.0*	*2.1*	*1.5*	*0.6*	*0.0*	*1.1*	*1.6*	*10.9*	*10.2*	*9.5*	*9.2*	*8.9*	*1.5*	*1.6*	*2.2*	*2.2*	*2.0*
Candidate countries																				
Albania	1.1	2.1	2.6	3.2	3.6	1.9	1.6	2.0	2.3	2.5	15.9	17.5	16.8	16.3	16.0	-10.9	-12.9	-10.0	-10.0	-9.0
Macedonia	2.7	3.8	3.4	2.7	3.1	2.8	-0.3	0.5	1.0	2.0	29.0	28.0	27.0	27.0	26.0	-1.7	-0.8	-4.0	-4.0	-4.0
Montenegro	3.3	1.5	2.4	2.6	2.8	1.8	-0.5	1.0	2.0	2.0	19.5	18.0	18.0	17.5	17.0	-14.6	-15.4	-15.0	-15.0	-15.0
Serbia	2.6	-1.8	0.1	0.9	1.4	7.8	2.9	1.5	2.0	3.0	22.1	18.9	17.0	17.0	17.0	-6.1	-6.0	-6.0	-7.0	-6.0
Turkey	4.2	2.9	3.0	3.1	3.1	7.5	8.9	7.4	6.9	6.2	9.7	9.9	10.6	10.2	9.8	-7.9	-5.9	-5.6	-5.2	-5.0
Potential candidate countries																				
Bosnia and Herzegovina	2.4	1.1	1.8	2.3	2.4	0.2	-0.9	1.0	2.0	2.0	27.5	27.5	27.4	26.5	25.4	-5.7	-7.6	-8.0	-8.0	-8.0
Kosovo	3.4	0.9	4.3	3.5	4.1	1.8	0.4	0.0	1.0	2.0	30.0	35.3	34.0	34.0	33.0	-6.4	-8.0	-8.8	-8.0	-8.1
Belarus 3)	1.0	1.6	-3.8	0.0	1.4	18.3	18.1	18.0	20.0	18.0	0.5	0.5	0.5	0.5	0.5	-10.5	-6.9	-2.4	-3.1	-3.4
Kazakhstan	6.0	4.4	1.5	2.5	3.5	5.8	6.7	7.5	8.0	5.0	5.2	5.0	5.0	5.0	5.0	0.4	2.8	-3.1	-2.9	-2.4
Russia 4)	1.3	0.6	-3.7	1.0	1.4	6.8	7.8	15.0	8.0	6.0	5.5	5.2	5.3	5.3	5.3	1.7	3.1	7.0	5.9	5.0
Ukraine 5)	0.0	-6.8	-11.5	0.0	1.8	-0.3	12.1	49.0	17.0	8.0	7.2	9.3	10.0	11.0	11.0	-8.8	-3.5	-1.4	-0.8	-0.9

Note: LFS: Labour Force Survey. NMS: The New EU Member States. EA: Euro area 19 countries.
1) wiiw estimate. - 2) Current account data include transactions within the region (sum over individual countries). - 3) Unemployment rate by registration. - 4) From 2014 including Crimea. -
5) From 2014 excluding Crimea and parts of Donbas.
Source: wiiw (data until 2014 as of October 2015), Eurostat. Forecasts by wiiw (Nov 2015) and European Commission for EU and euro area (Autumn Report, November 2015).

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BY AMAT ADAROV[1]

GLOBAL ECONOMIC DEVELOPMENTS: SLUGGISH RECOVERY

Throughout 2015 the countries of Central, East and Southeast Europe (CESEE) have continued to evolve in a still challenging global economic environment, characterised by weak recovery and high risks. Apart from country-specific internal conditions that played a key role in the revision of our projections (mostly upwards), the medium-term macroeconomic outlook for the CESEE region has been adjusted in the light of a number of new developments that have altered the global economic landscape since the previous wiiw forecast report released in spring 2015, as well as persistent old risks. In particular, oil prices took yet another dive in the summer and are expected to stay at depressed levels in the future. China's prospects took a turn for the worse and economic performance in other large emerging markets has been poor. Risks are abating in Greece, while geopolitical hazards emanating from the tension between Russia and Ukraine still loom large, compounded by the escalating conflict in the Middle East and the related refugee crisis. An expected, but unclear as regards its timing, normalisation of monetary policy in the United States has also contributed to the sense of uncertainty. Overall, the global economic outlook has deteriorated slightly relative to the somewhat rosier expectations at the start of 2015, while downside risks have increased in Europe.

Multi-speed resurgence of the world economy is progressing, albeit only at a moderate pace, driven primarily by advanced economies and accompanied by poor performance in large emerging market economies. Global growth is still sluggish, estimated at 2.3%[2] in the second quarter of 2015 (2015q2) seasonally adjusted annualised rate (saar[3]). The USA and the UK continued with the robust recovery in 2015q2, accelerating, respectively, to 0.8% and 1%, quarter-on-quarter (qoq) seasonally adjusted (sa). On the other hand, several large emerging market economies continue to experience difficulties: Russia and Brazil slipped into recession (-2% and -1.9% qoq sa, respectively), while South Africa registered negative growth in 2015q2 and China posted a moderate growth of 1.8% (Figure 1).

As the end of 2015 is nigh, global conditions are still characterised by uncertainties emanating from unstable growth of systemically important advanced and developing economies, volatility in commodity markets (particularly, crude oil prices), geopolitical tensions associated with Russia, Ukraine and the Middle East, and migrant flows in Europe. Taken together, the above factors have given rise to a less

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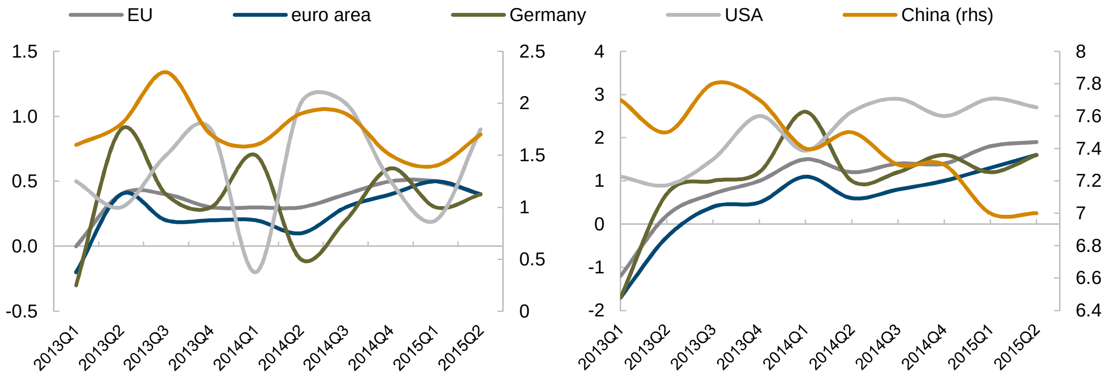
2 According to the World Bank's September estimates.

3 Please refer to the list of abbreviations for other conventions used in the forecast report.

optimistic reappraisal of the global economy, and the world economic prospects depend upon whether the steady recovery of advanced economies will offset the slowdown of emerging market economies. In the light of these risks and the rather modest headway to date, international organisations expect the year to end with global growth figures worse than those of the previous year (as well as being lower than projected earlier). Thus, in the October issue of its World Economic Outlook report the International Monetary Fund (IMF) expects global economic expansion to reach just 3.1% in 2015, while the World Bank in June reported an expected growth of 2.8%[4].

Figure 1 / Real GDP growth of selected economies, %



Note: Left panel: quarter-on-quarter, seasonally adjusted; right panel: year-on-year, seasonally adjusted.
Source: Eurostat.

The economy of Europe is slowly healing. Output in the euro area expanded in 2015q2 by 0.3% and in the European Union (EU) by 0.4% (qoq sa), on account of the support lent by low crude oil prices and broad monetary stimulus efforts by the European Central Bank (ECB). However, recovery in the euro area is losing momentum and actual growth is lower than expected. Despite the ultra-easy monetary policy, inflation has stabilised in a low-positive zone of around 0.2% owing to subdued commodity prices that have complemented the downward pressures from weak demand conditions. Italy and France have acted as major drags on the European economy, while Spain and Greece finally appear to be making some headway in terms of economic growth (although high unemployment, debt legacies and other issues are still a major impediment to recovery and Greece runs high risks of slipping back to recession).

Robust growth of 0.4% (qoq sa) in **Germany** in 2015q2, up from 0.3% in 2015q1, has contributed to regional recovery and offset to some degree the emerging markets' worsening prospects. Steady expansion is assumed to continue throughout the second half of the year. However, we can no longer speak of sure-fire robust growth as Europe's powerhouse faces downside risks associated with the slowdown in China, one of its important export destinations, as well as the repercussions of the Volkswagen emissions scandal.

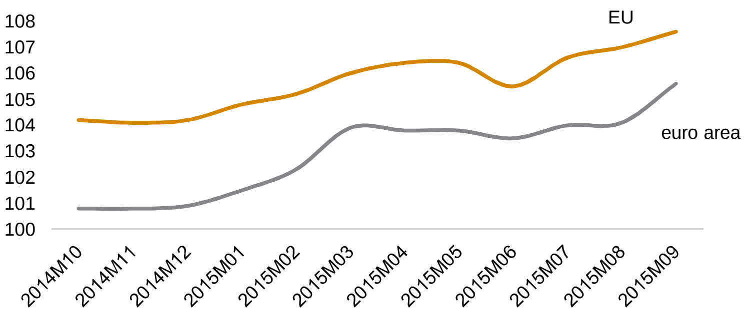
The situation around **Greece** has to some extent calmed down and the related risks for the rest of Europe are more or less contained. The turmoil and uncertainty that beset developments around the Greek crisis and the possibility of a 'Grexit' this year have eased, while the Syriza party's return to power

[4] World Bank Group (2015), 'Global Economic Prospects, June 2015', World Bank Publications, #21999, The World Bank.

after the September elections has also helped to reduce anxieties. Despite improvements in growth reaching the positive zone in first half of 2015, downside risks are still significant.

Owing to the weakening external environment the ECB released a less optimistic assessment of the euro area's prospects in September[5] and slightly revised its projections downwards (from 1.5% to 1.4% for 2015), anticipating that recovery will continue, albeit at a slower pace than previously estimated. In line with this, the ECB is likely to carry on with interest rates at historically low levels, along with quantitative easing measures throughout much of the forecast horizon[6], thus providing important stimulus to domestic demand, while a weaker euro will, it is hoped, support net exports. Altogether, the euro area along with the rest of Europe is still on track in terms of a gradual recovery, further to which business confidence is improving as reflected by economic sentiment indicators (Figure 2), and our forecast assumes the recovery will continue in the medium term.

Figure 2 / Economic sentiment indicator



Note: 100=long term average, thus values above 100 indicate above-average sentiment.[7]
Source: European Commission.

China's economy continues its slowdown and rebalancing act. The country was shaken by financial turmoil in summer 2015 when, after reaching historical highs in June, the Chinese stock market slumped sharply by about 30%, provoking synchronous downturns across global stock market indices. Turbulence in financial markets, an unexpected devaluation of the yuan in August, policy actions centred on fiscal and monetary easing indicate that the actual economic situation might be feebler than appears from the growth figures that China posted — output expansion of 7% yoy in 2015q2 — and the risks of a hard landing in China are still present[8]. The negative developments in China have contributed palpably to the downward pressures on global commodity prices, further worsening the prospects of those countries that rely on commodity exports: notably, Brazil and Russia that are already mired in recession. Regardless whether the landing is 'hard' or 'soft', it is expected that China will continue its rebalancing

5 ECB September 2015 Staff Macroeconomic Projections for the Euro Area.

6 The ECB since March 2015 has been purchasing assets, mostly sovereign bonds, worth EUR 60 billion per month in efforts to boost the economy and anaemic inflation, and is expected to proceed with the quantitative easing until at least September 2016.

7 A composite indicator computed by European Commission (DG ECFIN) based on sectoral confidence indicators (industry, services, consumption, construction, retail trade): http://ec.europa.eu/economy_finance/db_indicators/surveys/index_en.htm

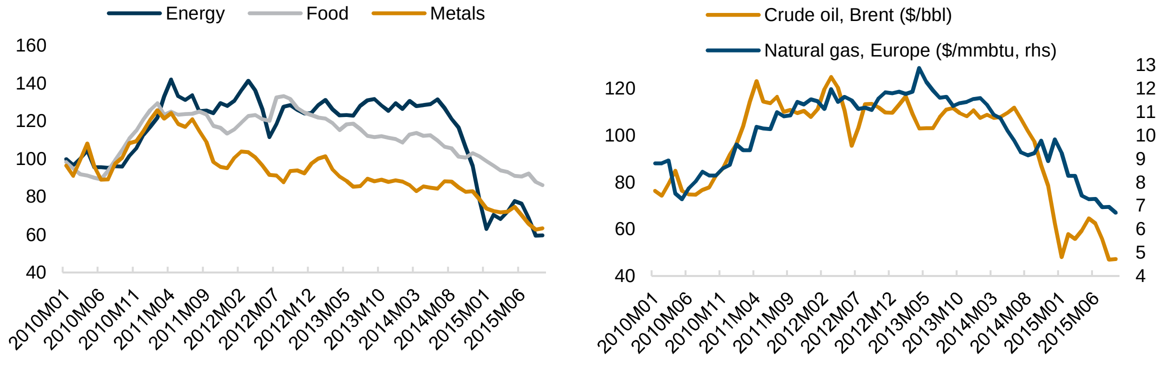
8 In this regard, some commentators argue that China's actual growth rate is already much lower, see, e.g., W. Buiter (2015), 'Is China Leading the World into Recession?', Citi Research, Economics, Global, Global Economics View, 8 September.

act towards a more sustainable development path based on internal demand rather than export-led growth, and will see less ambitious growth rates (compared to the double-digit figures reminiscent of the pre-crisis period).

To date, the United States has been among the top growth performers in 2015. Despite the slowdown in 2015q1, the USA aggregate output growth is accelerating once again. Bolstered by consumption and strengthening investments, the country registered output growth of 3.7% (qoq saar) in 2015q2, which is expected to remain robust over the forecast horizon. Whereas this will provide ample support for global demand, the USA rebound also incurs risks associated with the reversal of its extraordinarily accommodative monetary policy that may potentially spur financial volatility: a risk factor of particular pertinence to emerging and developing countries. The Federal Reserve has already sent repeated signals regarding the forthcoming monetary policy exit that looms large. At the time of writing this report, however, the interest rate hike has been further postponed in the light of the less favourable outlook in emerging markets. All in all, **it is expected that the monetary authorities in the USA (alongside with those in the UK) will proceed with the normalisation of monetary policy relatively soon (at end-2015 or in early 2016), thus setting it at odds with the ECB policy**.

Global commodity markets are characterised by weak prices, which are likely to remain depressed in the medium term. Overall, commodity prices have declined in the course of the current year on the back of China's deteriorating macroeconomic prospects (Figure 3). In particular, food prices in September (as measured by the World Bank's aggregate food price index[9]) declined by 13% relative to January, while the metals/minerals price index fell by 14% over the same period. Given the weak demand from commodity importers and ample supply, it is expected that commodity prices will remain soft over the forecast horizon. The possible upside risks are likely to be contained (in particular, the El Niño episode under way is anticipated to be among the strongest in the recent history, yet it is expected to produce only a limited impact on food prices at the global scale).

Figure 3 / Global commodity prices, 2010-2015



Note: Left panel: World Banks' commodity price indices, 2010=100; Right panel: Crude oil and natural gas prices (USD)
Source: World Bank.

Oil prices are driven largely by supply-side developments. Despite an increase in oil prices in the first half of 2015 (2015h1) up from the historic lows of late-2014, the upturn was short-lived only to be

9 For details on the methodology, please see http://www.worldbank.org/en/research/commodity-markets

followed by another slump as Brent crude oil prices fell to levels below USD 50 per barrel (USD 47.24 per barrel in September). While the demand-side prospects are not very promising as a result of the slowdown suffered by major importers of commodities (notably, China, which consumes over 10% of total global oil production) and the slow recovery of the world economy, the global supply of oil is still lavish as OPEC continues to maintain its production quotas and the supply of shale-oil remains resilient. Notably, by mid-2015 OPEC had increased its production of oil to the record highs over the last three years. With the lifting of sanctions, Iran is expected to restore its oil output capacity soon. Taking all this into account and despite the many uncertainties about the future of the global oil market, the supply of oil is likely to abound at least in the medium term as the major oil exporters will strive to preserve their market shares. Our projections assume that the price of Brent crude will hover around USD 55 per barrel, hence providing additional stimulus to most of the CESEE countries — with the exception of net oil exporting countries, which, on the contrary, will suffer an adverse shock and terms of trade losses.

A SNAPSHOT OF THE CESEE FORECAST REVISIONS

The medium-term macroeconomic outlook for the CESEE region is rather mixed. The region is characterised by divergent development patterns: robust growth in the Central European (CE) countries, particularly poor prospects in the CIS and Ukraine, and improving, but irregular and unstable, trends in Southeast Europe (SEE). Taking into account the better-than-expected performance in 2015h1 of most of the CESEE countries on account of household consumption and investments, we have revised the projections for the forecast horizon (2015–2017) mainly upwards relative to the wiiw Spring 2015 forecast (Table 2), and, by and large, expect that multi-speed recovery will continue throughout most of the region.

Table 2 / Real GDP growth forecast and revisions

		Forecast, %			Revisions, pp		
		2015	2016	2017	2015	2016	2017
NMS-11	BG	2.3	2.6	3.0	⇧ 0.8	⇧ 0.7	⇧ 0.7
	HR	0.7	1.2	1.6	⇧ 0.4	⇧ 0.1	⇧ 0.1
	CZ	3.9	2.4	2.3	⇧ 1.6	⇨ 0.0	⇩ -0.1
	EE	1.9	2.6	2.8	⇩ -0.1	⇧ 0.1	⇩ -0.3
	HU	2.9	2.1	2.0	⇧ 0.6	⇧ 0.1	⇨ 0.0
	LV	2.4	3.0	3.0	⇧ 0.3	⇧ 0.2	⇧ 0.2
	LT	1.6	3.0	3.4	⇩ -0.4	⇧ 0.1	⇧ 0.2
	PL	3.5	3.3	3.3	⇨ 0.0	⇧ 0.1	⇧ 0.1
	RO	3.4	3.7	2.7	⇧ 0.9	⇧ 0.6	⇩ -0.3
	SK	3.2	3.0	2.9	⇧ 0.7	⇧ 0.3	⇩ -0.1
	SI	2.7	2.2	2.3	⇧ 1.0	⇧ 0.4	⇧ 0.3
Candidate countries	AL	2.6	3.2	3.6	⇧ 0.6	⇧ 1.0	⇧ 1.2
	MK	3.4	2.7	3.1	⇩ -0.1	⇩ -0.2	⇧ 0.5
	ME	2.4	2.6	2.8	⇧ 0.1	⇨ 0.0	⇩ -0.1
	RS	0.1	0.9	1.4	⇧ 0.6	⇩ -0.1	⇨ 0.0
	TR	3.0	3.1	3.1	⇩ -0.3	⇩ -0.4	⇩ -0.4
Potential candidate countries	BA	1.8	2.3	2.4	⇧ 0.2	⇧ 0.2	⇨ 0.0
	XK	4.3	3.5	4.1	⇧ 0.7	⇧ 0.6	⇧ 0.3
CIS+UA	BY	-3.8	0.0	1.4	⇩ -1.8	⇩ -1.3	⇩ -0.6
	KZ	1.5	2.5	3.5	⇩ -0.5	⇩ -1.0	⇩ -1.0
	RU	-3.7	1.0	1.4	⇧ 0.2	⇩ -0.9	⇩ -0.6
	UA	-11.5	0.0	1.8	⇩ -6.5	⇨ 0.0	⇨ 0.0

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

At the one end of the spectrum, the CE countries will continue to enjoy expansion in the 2-4% range in 2015, with a gradual deceleration of growth rates in the medium term as they come closer to bridging negative output gaps. In particular, estimated growth in the Czech Republic for 2015 has been revised by +1.6 pp, in Slovakia and Hungary – by +0.7 and +0.6 pp, respectively. Among the NMS countries, only for Estonia and Lithuania the growth projections have been revised downwards slightly on the account of the recession in Russia reflecting negatively on their exports. Despite these strains, the Baltics are still expected to exhibit modest growth of some 1.5-3% per annum in the medium term. Overall, in the NMS league output growth is expected to average close to 3% both in 2015 and over the forecast horizon, signifying a modest improvement in comparison with the past year.

At the other end of the scale, the prospects of the CIS group have become rather dismal as both Russia and Belarus tumbled into a deep recession in 2015 and Kazakhstan followed suit with a deceleration in growth. Low oil prices adversely affected Russia, adding to its geopolitical complications and deep-rooted structural problems that culminated in recession and prompted negative spillovers to Belarus and Kazakhstan, the latter also being hit by soft commodity prices. Taking these developments into account, our growth forecast for 2015 has been revised downwards for Kazakhstan (1.5%) and Belarus (-3.8%) by -1.8 and -0.5 pp, respectively, and remains negative for Russia: -3.7%. The medium-term prospects in the CIS are murky unless oil prices rebound, and growth projections have thus been adjusted downwards for the years to come as well. The situation in **Ukraine** remains particularly alarming and serious downside risks persist (although there are signs that the recession might be bottoming out). As the downturn to date has been much more profound than anticipated, the economy of Ukraine is expected to drop by 11.5% in 2015 – a major revision since the spring forecast vintage – followed by a year of stagnation.

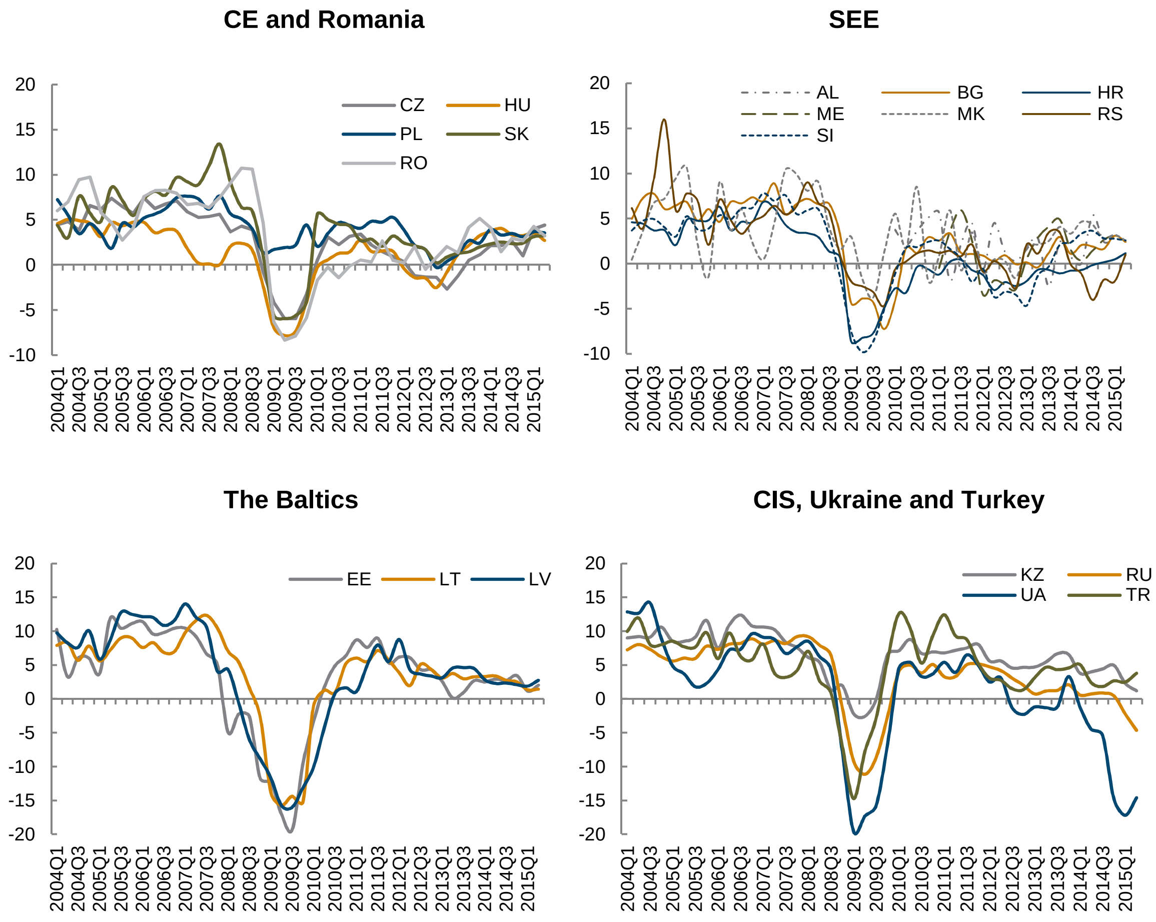
Trends in the SEE countries diverge markedly. Kosovo is expected to accelerate to as much as 4.3% (on account of wage growth in the public sector and remittances from abroad). Serbia and Croatia, the worst performers among the NMS and candidate countries, will enjoy hardly any growth at all in 2015 (0.1% and 0.7%, respectively), although both countries made progress and left the negative growth zone this year, and hence the projections were revised upwards. Output growth rates in the rest of the SEE states will accelerate to 2-3% over the forecast horizon. Growth forecasts for Turkey and Macedonia have been corrected downwards slightly, yet both countries are still expected to grow at rates of about 3% in the medium term.

The external environment is still only moderately supportive as the world economy struggles with recovery and displays divergent trends and high risks, and wiiw expects the CESEE to rely on internal factors as the main engine of growth in the medium term. Net exports are providing only a limited, if positive at all, contribution to growth (although exports are recovering), while household consumption is coming to the fore as the driver of growth across most of the CESEE. In the light of these developments, the section below discusses the forecast with a focus on internal market developments and expectations. Apparently, as there are binding limits to the boost that domestic demand can yield for small open economies, external exposures pose significant risks for the region. External vulnerabilities thus come under closer scrutiny in the section that follows and are featured in the special sections of the forecast report, focusing on the migrant crisis in Europe, spillovers from the slowdown and 'rebalancing' in Russia and China, the Volkswagen scandal and developments in Greece.

MEDIUM-TERM OUTLOOK: HOUSEHOLD CONSUMPTION TAKES THE LEAD

Economic developments in the CESEE region in 2015h1 and future prospects are characterised by divergence, which is not surprising given the vast macroeconomic asymmetries across the countries and disparate exposures to the external environment. The economies still exhibit symptoms of economic slack and pre-crisis growth rates have not been re-attained (Figure 4). Economic recovery is gradually gaining momentum throughout most of the CESEE region – with the exception of the CIS group. The CE countries continue to exhibit robust expansion, while the SEE region has also accelerated, although in the latter case growth is often accompanied by persistent internal and external macroeconomic imbalances. Conversely, the CIS economies slowed down significantly, giving rise to negative spillovers to the Baltics, which, nevertheless, registered moderate growth in 2015h1.

Figure 4 / Quarterly real GDP growth of the CESEE countries, year-on-year



Source: National statistics and Eurostat.

The CE countries and Romania proceeded along a robust growth path in 2015h1. The Czech Republic leads the way as the CESEE champion with a real GDP growth rate of 4.4% in 2015h1 (yoy), while other economies in the CE group expanded by 3% and more; however, the second-quarter dynamics indicate that Poland and Hungary may be losing momentum. Despite the headway gained, growth is still weak and economic slack remains, while the recovery appears to be fragile in the light of the risks stemming from the external environment (for a detailed discussion see the next section).

Domestic demand has emerged as the major growth driver in the CE countries, bolstered besides low commodity prices by improving labour markets and consumer confidence, whereas net exports have lost importance as an engine of growth. Overall, the 'Visegrad Four' is characterised by steady growth at a moderate pace, and is expected to remain the growth 'locomotive' in the CESEE region. In 2015 the economy of the Czech Republic is expected to expand by 3.9%, Poland by 3.5%, Hungary by 2.9% and in Slovakia by 3.2%. The growth rate in Romania, another top performer, reached 3.8% (yoy) in 2015h1 and the economy is projected to expand by 3.4% in 2015.

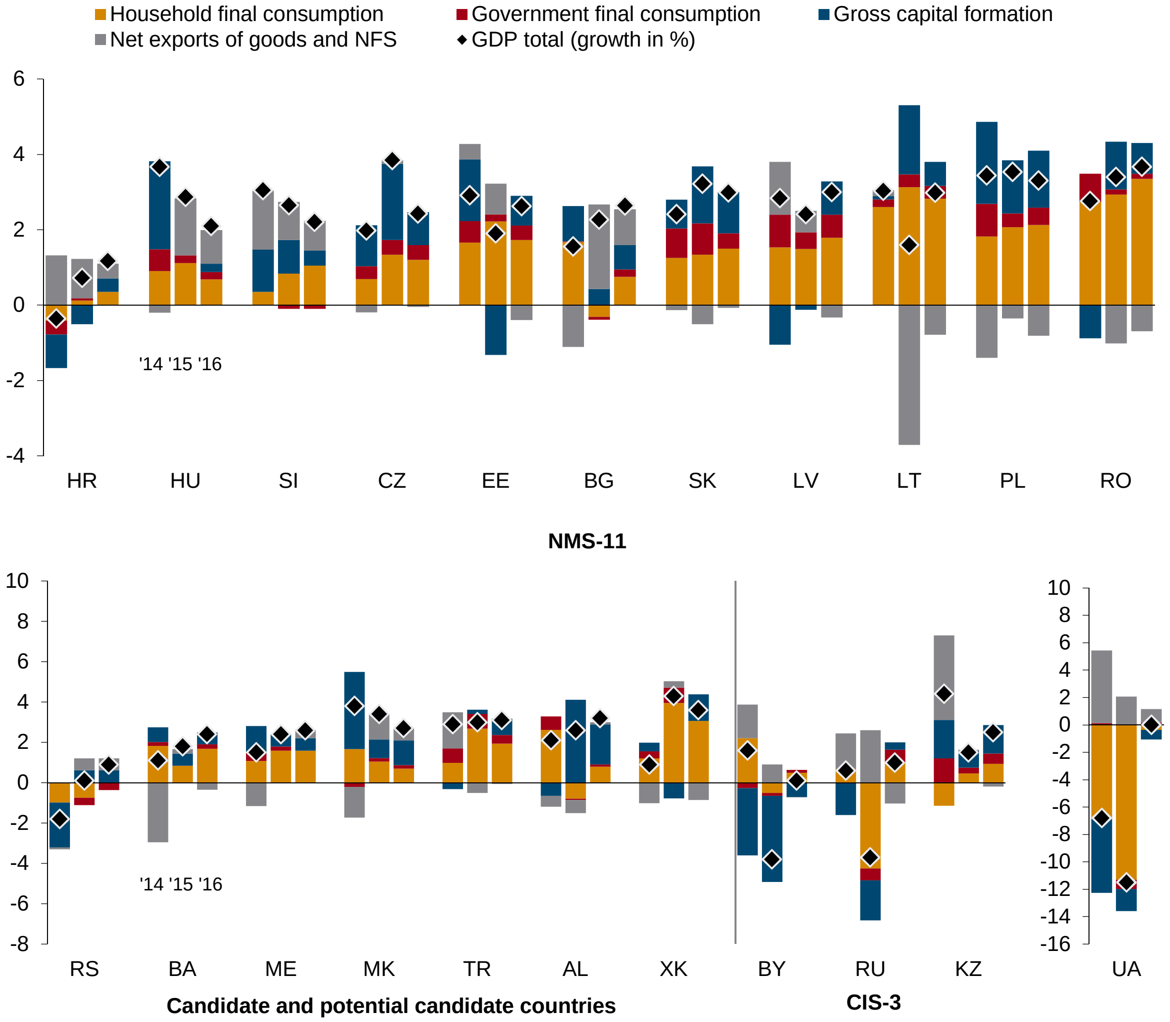
Growth in the CIS economies has plummeted sharply in the course of 2015. The economies of Belarus, Kazakhstan and Russia have been historically moving in tandem due to an interplay of common exposures to global commodity markets, tightening trade and investment linkages owing to Eurasian economic integration, and faced a synchronous downturn in 2015h1, although Kazakhstan managed to stay in the positive growth zone. Russia has plunged into a full-blown recession, recording -3.5% (yoy) in 2015h1 as negative oil price shocks were complemented by sanctions resulting in a further weakening of domestic market confidence. Russia's partners in the newly formed Eurasian Economic Union (in which Russia dominates with over 80% of its aggregate GDP) also suffered as a result. In Belarus, highly exposed to Russia's market (over 40% of total exports), growth dropped reaching -3.5% in 2015h1 (yoy). The growth rate in Kazakhstan declined to a meagre 1.7% as the country suffered a swingeing blow by low commodity prices as well. **The situation in Ukraine is still rather gloomy.** As the country has been struggling with macroeconomic stability issues along with the continued military conflict in Donbas, it has slithered into a recession far deeper than anticipated at the start of the year, growth dropping by to 15.8% in 2015h1. However, more recently the economy has displayed some hopeful signs of bottoming out and is expected to return to growth in as early as 2017 after a year of stagnation. That having been said, the situation in Ukraine is very fragile and much depends on how the conflict in the eastern part of the country evolves, another factor being the progress achieved in terms of debt resolution and other reforms aimed at macroeconomic stabilisation.

Economic activity in the Baltics suffered in 2015h1 owing to exposures to Russia, but recovery is still on track. The Baltic states, which still depend on Russian export markets, particularly, in agriculture and transport, are holding on despite negative spillovers from the economic turbulence in Russia and the counter-sanctions that Russia imposed on selected imports from Europe. Of the Baltics, Lithuania decelerated most and posted a growth rate of only 0.4% in 2015h1 (yoy), while Estonia and Latvia were hit less hard expanding by 1.6% and 2.3%, respectively. Nevertheless, wiiw expects the impact to be transitory and the three economies are forecast to return to a growth rate close to 3% in the medium term, driven by private consumption while they re-route their exports to other destinations.

The countries of Southeast Europe are characterised by generally improving tendencies, although recovery is forecast to continue at a rather different pace and with varied implications for macroeconomic imbalances across the countries of the group. While the economy of Montenegro expanded in 2015h1 by as high as 3.4% (yoy), Serbia with -0.5% growth over the same period was the only non-CIS country of the CESEE region to post negative growth. Nevertheless, that negative growth is an improvement over the decline by -1.8% registered in 2014, and, in fact, Serbia recorded positive growth in 2015q2 on a year-on-year basis, and is expected to further accelerate to 1.4% by 2017. For the other SEE countries, real output growth in 2015h1 remained in the 2-3% range and further gradual expansion is anticipated over the forecast horizon.

Notably, household consumption has become the major catalyst of growth throughout the region with only a few exceptions. Household consumption is estimated to contribute as much as half of the real GDP growth in the NMS and candidate countries in 2015 (Figure 5). The only exceptions are Bulgaria and Serbia, where net exports are the more important drivers, and Albania, where investments are expected to be the main growth factor in the current year – while declining consumption is estimated to be a drag on growth in these countries this year. Investments have been particularly important as a driver of growth in the CE countries (estimated to contribute between 1.4–2 pp to real growth this year), with Hungary as the notable exception. The latter enjoyed a particularly strong double-digit investment spike in 2014, which, however, slowed down to a halt in 2015. In Belarus, Russia and Ukraine the recent unfortunate macroeconomic developments find their harsh reflection in the contraction of private and public consumption as well as investments, whereas net exports contributed positively on account of a marked shrinkage in imports resulting from currency depreciations and a decline in purchasing power attributable to internal factors.

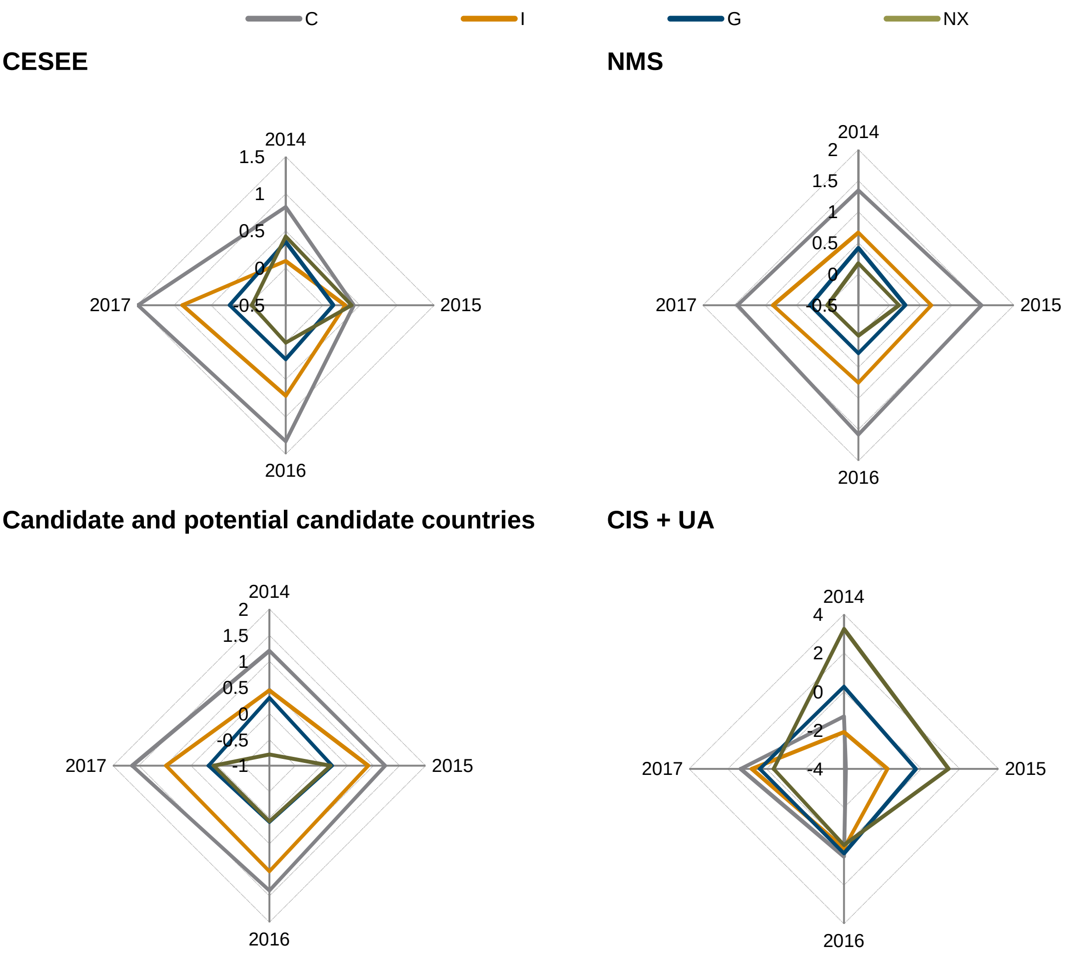
Figure 5 / Real GDP growth in 2014-2016 and contribution of individual demand components in percentage points



Note: 2014 – actual, 2015 and 2016 – wiiw forecast. Sorted by 2016 forecast values in increasing order within groups.
Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Peeking beyond the current year, wiiw expects that domestic demand will remain the principal driver as well (Figure 6). Household consumption growth will be followed by investments towards the end of the forecast horizon as the private sector gains confidence on the back of improving demand conditions, as well as support by the EU funding drawn down by countries eligible under the 2014–2020 Multiannual Financial Framework[10]. Although foreign trade will gradually rebound over the medium term, its net contribution is expected to be smaller (or negative) as imports will continue to offset gains in exports owing to stronger domestic demand.

Figure 6 / Contributions to real GDP growth by CESEE subgroups, 2014-2017, pp



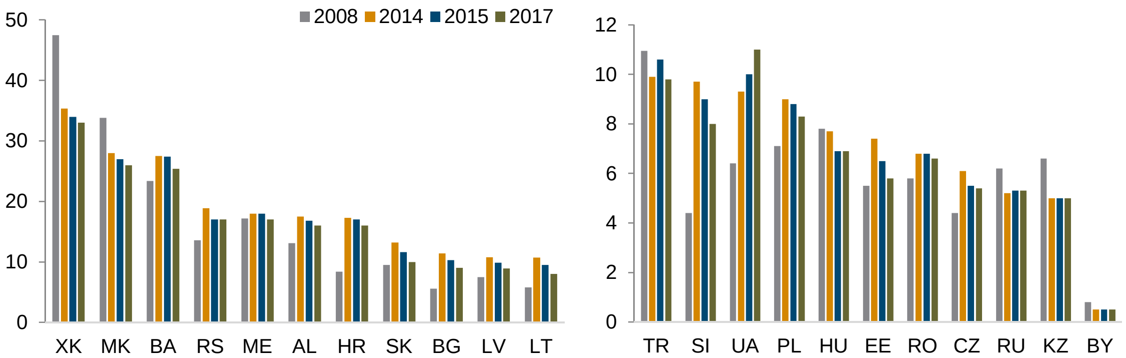
Note: Simple averages by country groups. C – household consumption, I – gross capital formation, G – government consumption, NX – net exports.
Source: wiiw Annual Database and forecast.

The consumption boost observed in the course of the current year has been driven by labour market conditions improving throughout the region in all but the CIS countries and Turkey. In the first half of 2015, the labour markets continued to strengthen in the CESEE, as evidenced by real wage growth and a sustained gradual decline in unemployment rates throughout the region, with the exception of the CIS, Ukraine and Turkey. Most notably, after hovering at double-digit levels for years since the

10 More details are provided in the next section of the report, and further information on the initiative can be found at the dedicated EC web portal: http://ec.europa.eu/budget/mff/index_en.cfm

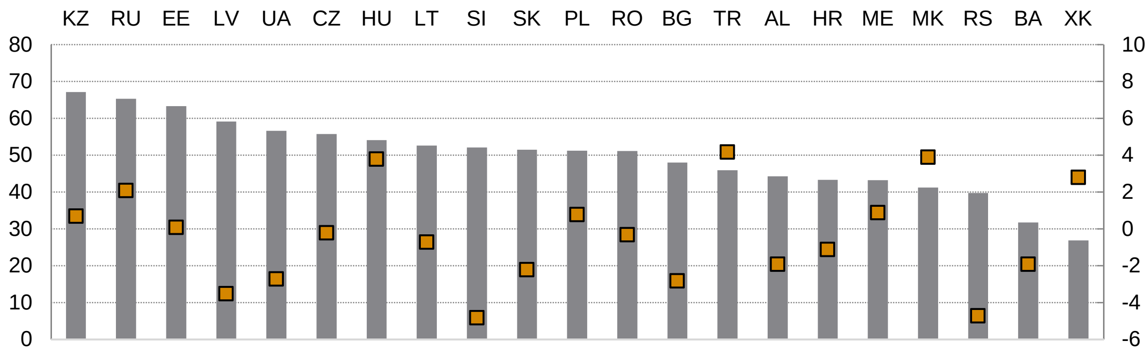
crisis erupted, unemployment rates in Latvia, Lithuania and Bulgaria dropped below the 10% mark in June 2015. Despite these trends, in most countries unemployment rates remain elevated relative to the respective pre-crisis levels and there is surely room for further improvement (Figure 7).

Figure 7 / Unemployment rate in the CESEE region, selected years 2008-2017



Note: Unemployment rates, LFS (except for Belarus, where unemployment is based on registered unemployment).
Left panel: countries with unemployment rates exceeding a 10% threshold in 2014; Right panel: other countries.
Source: wiiw Annual Database and forecast.

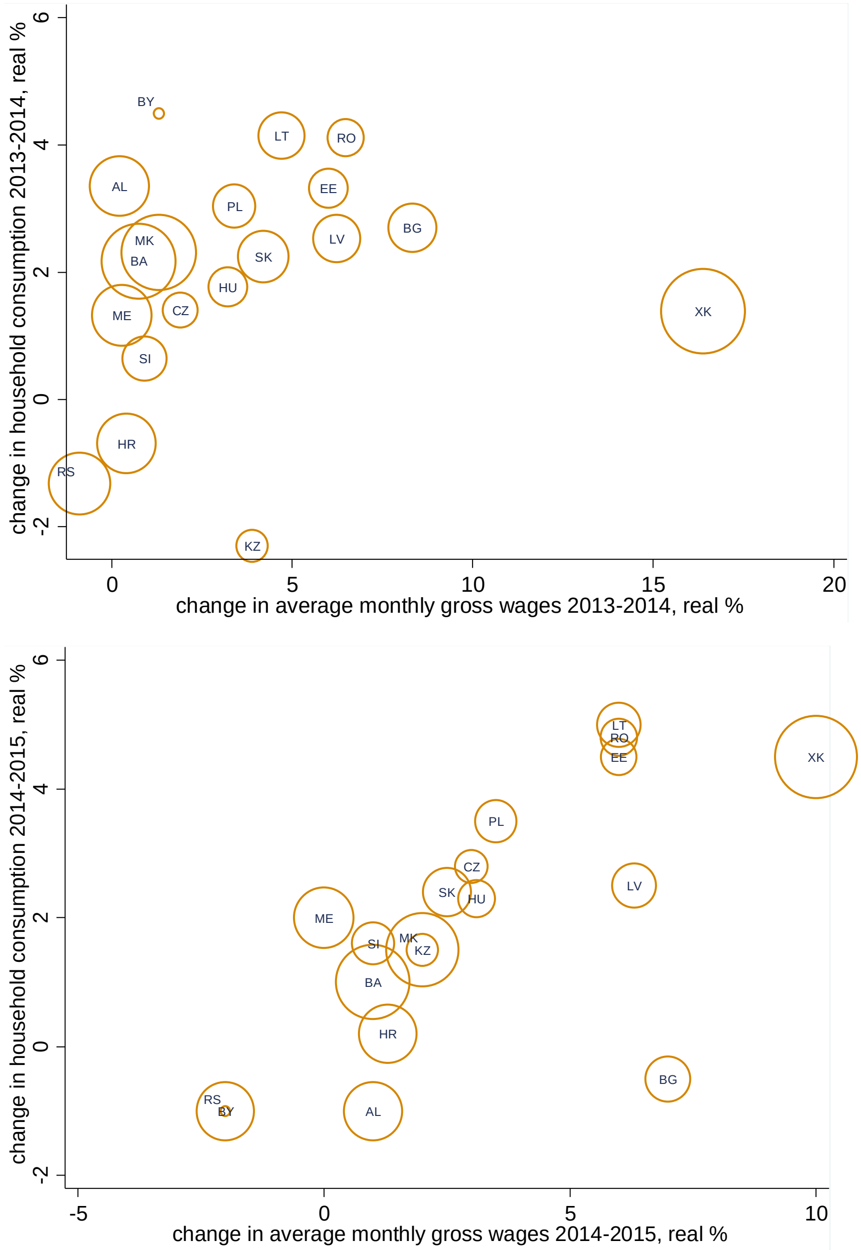
Figure 8 / Employment rate in the CESEE region in 2014, % population



Note: Based on LFS employed persons in % of population 15+. Grey bars (left scale): 2014 employment, % population; Orange dots (right scale): the change of employment rate in 2014 from 2008, in pp. Sorted by 2014 employment rates in decreasing order.
Source: wiiw Annual Database.

In this regard, in the Western Balkans, however, labour market conditions continue to be challenging. The Western Balkans have been notorious throughout the modern history for their extremely high and persistent unemployment rates accompanied by low employment rates (Figures 7 and 8). High youth unemployment, particularly long unemployment spans, difficulties with job creation have been a dismal characteristic of labour market conditions signifying deep structural problems as opposed to the effects of cyclical downturns. While in some countries higher unemployment is complemented by declining labour force (e.g. Serbia: a decline in the employment rate by 4.7 pp over the period 2008-2014 came along with the unemployment rate up by 5.3 pp over the same period), gradual improvement could be observed in others: for instance, in Macedonia and Kosovo receding unemployment (by 5.8 pp and 12.1 pp, respectively over 2008-2014) was associated with labour force improvements (employment rate up by 3.9 and 2.8 pp over the same period), at least as evidenced by the official statistics. As of 2015, the unemployment rates are still, however, unduly high: close to 30% in Macedonia and Bosnia and Herzegovina, and in the 16-20% range in Albania, Montenegro and Serbia, and only moderate improvement is expected over the forecast horizon.

Figure 9 / Household consumption and real wages in the CESEE region, 2013-2015



Note: Dropping Russia and Ukraine. Bubble size corresponds to unemployment rate in 2014 (left panel) and 2015 (right panel), ranging from the highest (XK=34%) to the lowest (BY=0.5%); left panel: change from 2013-2014; right panel: change from 2014-2015 (estimated).
Source: wiiw Annual Database and forecast.

Rising real wages emerged as another key pillar complementing the drop in unemployment that played a major role in boosting domestic demand (Figure 9)[11]. In 2015h1 wages in real terms have increased on average by 3.5% in Central Europe and by about 5% in the Baltics. The situation in the CIS countries, on the other hand, is dim: as a result of high inflation and deteriorating economic activity real wages dropped by 22% in Ukraine, by 8.5% in Russia and by 2.9% in Belarus in 2015h1 (yoy), while stagnating in Kazakhstan at near-zero levels. Over the forecast horizon real wages are forecast to continue growth, increasing by up to 6.5% per annum in the Baltics and Romania, leading the CESEE in this respect, between 2-4% in the CE countries, and up to 2% for the majority of the Western Balkans.

Accelerating real wages may induce growth in imports, rendering negligible the contribution of net exports to growth despite increasing exports, and, unless associated with concurrent improvements in labour productivity, increase unit labour costs thereby eroding competitiveness. These effects should be monitored closely in the countries exhibiting particularly high wage growth with corresponding growth in consumption (Romania, the Baltics, and Kosovo, the latter in a particularly high risk zone with persistently high unemployment and a range of other imbalances).

While household consumption is rebounding, inflation remains very weak across the CESEE region hovering at near-zero levels, with the exception of the CIS countries, Ukraine and Turkey which suffered currency depreciations and related exchange rate pass-through effects to domestic prices. Over the period January-August 2015 consumer inflation in most of the CESEE countries remained negative or stagnant. A decline in oil prices, along with residual weak demand exerted downward pressures on consumer and producer prices. In fact, for the NMS and (potential) candidate countries the risk of deflation has either already materialised (Bulgaria, Poland, Lithuania, Slovenia, Slovakia, Bosnia and Herzegovina) or remains an imminent threat, lingering in the very low positive zone (Figure 10). The effects of weakening global oil prices on domestic prices and its supportive role for consumption and growth (for net oil importers) were anticipated earlier[12]. However, the negative effects of deflation well-discussed in economic literature should not be neglected either, including postponing purchases if deflationary expectations are formed, increasing real costs to producers due to nominal wage rigidities, higher real costs of borrowing, which undermines investment. The accommodative monetary conditions due to the ECB efforts (complemented also by the stimulus measures of the monetary authorities in Czech Republic, Hungary, Poland, Romania) seem to have little effect on offsetting the downward price pressures.

By way of contrast, acceleration of inflation as a result of strong currency depreciations and increases in domestic food prices has become a genuine hazard in both the CIS region, Ukraine and, to some extent, Turkey. Consumer prices in Russia and Belarus increased sharply and are expected to reach as high a level as 18% in Belarus and 15% in Russia this year. Kazakhstan managed to withstand the inflationary pressures and prices are expected to increase by only 7.5% this year. The already-alarming situation with inflation in Russia has been further aggravated by its decision to impose counter-sanctions, banning a range of foods from Europe, leading to price spikes in substitute goods. In Ukraine, the country with the highest inflation in Europe, besides drastic impact of depreciation,

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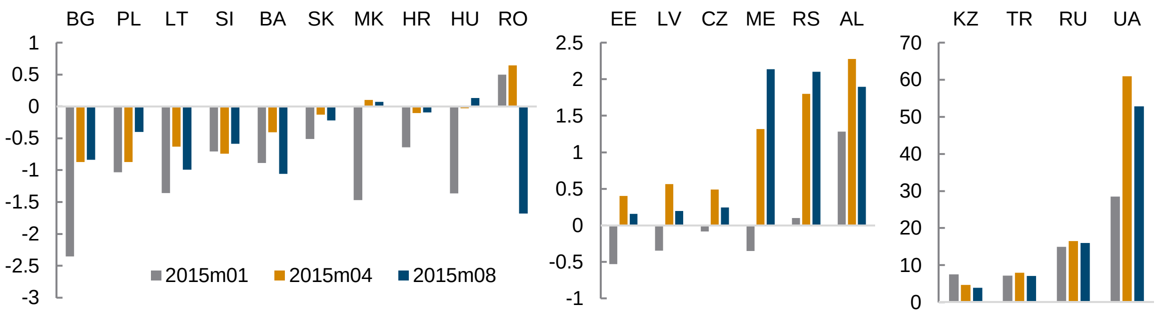
11 It should be noted also that in some countries discretionary fiscal stimulus measures also contributed to purchasing power, e.g. a VAT reduction from 24% to 9% in Romania for food products, minimum wage rises in the Baltics, social packages in Slovakia.

12 See the Special Section 'Energy prices, inflation and growth in the CESEE countries' by A. Adarov, V. Astrov and S. Cicek in the *wiiw Forecast Report* Spring 2015.

significant price pressures were induced by a utility tariff hike (in April inflation soared to 60% yoy) and inflation is projected to remain at extreme levels (49%) in 2015. In order to alleviate intense inflation, the local authorities have resorted to an arsenal of fiscal and monetary measures. Thus, in Belarus, besides price controls practiced regularly, fiscal tightening was introduced along with constraints on money creation channels. Monetary authorities in Turkey, Russia and Kazakhstan hiked their interest rates to resist exchange rate pressures as attempted foreign exchange interventions had limited impact while quickly depleting reserves.

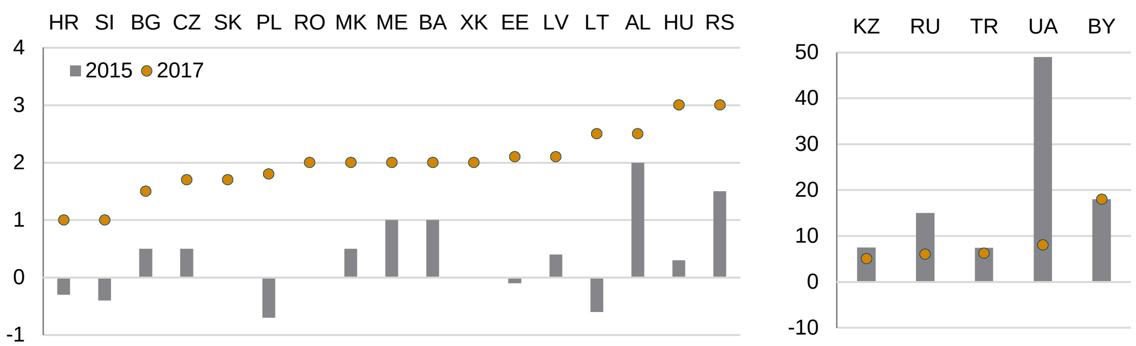
Figure 10 / Consumer inflation in the CESEE region, 2015



Note: Monthly CPI inflation, yoy, January, April and August 2015; sorted by the eight-month average inflation rate from low to high. Countries are grouped as follows: deflation (left panel), low inflation (centre panel), moderate/high inflation (right panel).
Source: wiiw Monthly Database.

Divergent paths of inflation are rather characteristic of external exposures and capacity to withstand external risks varying across countries. As could be seen in Figure 10, the countries that suffered from high inflation are those that are either exposed to commodity price fluctuations and/or have flexible exchange rates with significant pass-through effects to inflation. On the other hand, the economies that have either adopted the euro or opted for variants of a pegging regime are more prone to deflation/disinflation owing to imported inflation from advanced countries in Europe (besides other factors already mentioned).

Figure 11 / CPI inflation forecast for the CESEE region, 2015–2017

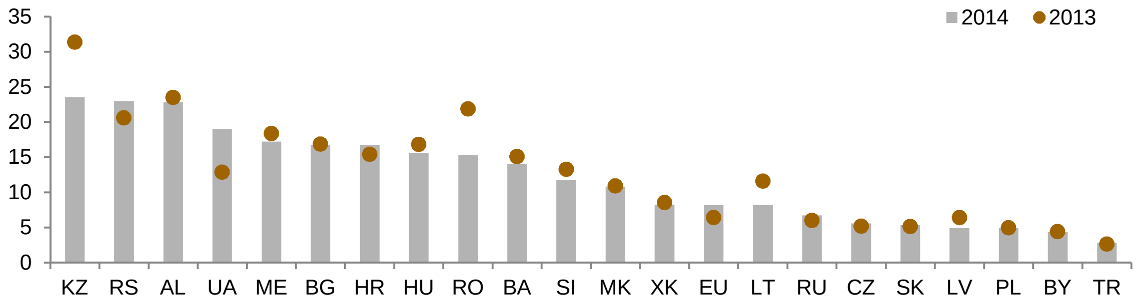


Note: Sorted by 2017 forecast values in increasing order. Grey bars – 2015; Orange dots – 2017.
Source: wiiw forecast.

We expect that inflation across the CESEE region will normalise towards the end of the forecast horizon. In particular, inflation is forecast to pick up speed in the medium term (Figure 11) for low-inflation countries, averaging 2-3% for most of the region by 2017 as internal demand continues to strengthen and commodity prices (presumably) do not continue falling further. Conversely, inflationary pressures will abate in the CIS countries, Ukraine and Turkey achieving the levels of 5-8% by 2017, more or less consistent with their monetary policy objectives. The only exception is Belarus, in which inflation is forecast to stick at double-digit levels 18-20% over the forecast horizon.

Based on the observed macroeconomic dynamics and our judgement as to output gaps, economic slack is still present in the CESEE, although small in most countries and diminishing over the forecast horizon. Macroeconomic developments are still symptomatic of negative, albeit relatively small, output gaps in the region (Western Balkans is a special case in this regard, as, e.g. historically extremely high unemployment rates are associated with deep structural issues rather than cyclical developments, rendering it difficult to evaluate the 'potential' output levels; yet, rough assessment indicates that the economies operate as much as 15-20% below their 'full capacity'). Still elevated unemployment relative to the pre-crisis levels, very weak inflation at times slipping to deflation and weak external demand conditions along with sluggish investment call for additional counter-cyclical stimulus. Importantly, the legacies of the double-dip recession and protracted (and still fragile) recovery in Europe may also have adverse effects on the potential output in the CESEE region via hysteresis effects.

Figure 12 / Bank non-performing loans, % of total loans



Note: Countries sorted in decreasing order based on the 2014 values
Source: World Bank.

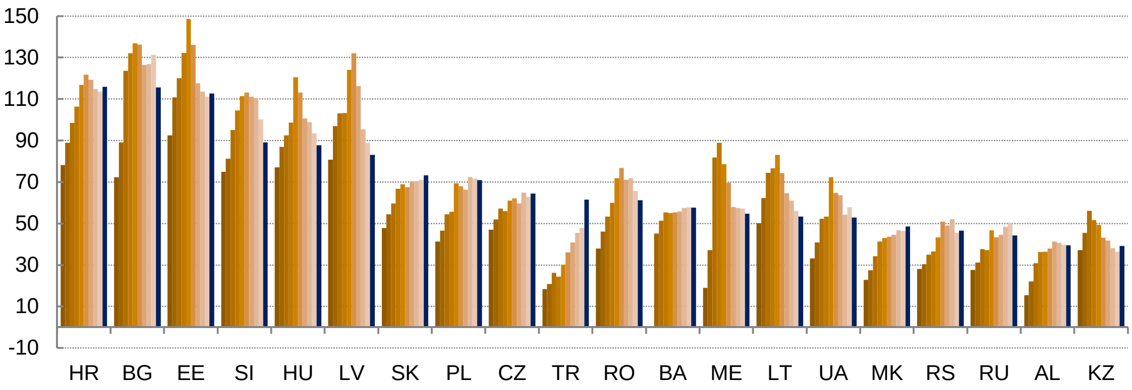
In this regard, investment is the much-needed missing link in the mechanism essential to rekindling sustainable output growth in the CESEE region. As noted earlier, gross fixed capital formation increased markedly in certain countries and contributed to growth, supported by the EU structural and investment funds (NMS), as well as foreign direct investment (e.g. in Albania, Serbia, Montenegro)[13]. The ECB continued with an extraordinarily accommodative monetary policy implementing quantitative easing this March to complement the low interest rates that had reached the zero lower bound. Besides lowering long-term interest rates and contributing to a weakening of the euro, which, in turn, will provide an additional export stimulus, this policy has allowed those nations that, as

13 More on the role of FDI in the CESEE in the wiiw FDI Report, 'Recovery in the NMS, Decline in the CIS' by G. Hunya and M. Schwarzhappel, June 2015.

noted earlier, are pursuing an independent monetary policy to follow suit and ease their monetary conditions.

Despite accommodative conditions throughout most of the region with few exceptions, private investment is feeble, constrained by weak investor sentiment, reluctance to borrow in a low-inflation environment, while non-performing loans (NPLs) and high private debt levels in some countries continue to act as a drag on lending to both households and non-financial corporations. NPLs continue to pose problems standing as they do at double-digit levels (Figure 12). In Croatia, for instance, the NPL share increased reaching to over 17% in June. Besides direct implications for balance sheets of financial intermediaries, inhibit lending and render monetary policy ineffective. High levels of private debt and slow deleveraging constitute additional bottlenecks for reigniting investment-led growth in the CESEE economies (Figure 13). Private debt is at particularly high levels in Croatia, Bulgaria, Estonia, Slovenia, Hungary and Latvia, at or exceeding their respective GDP levels in nominal terms.

Figure 13 / Private debt as a percentage of GDP, 2005-2014

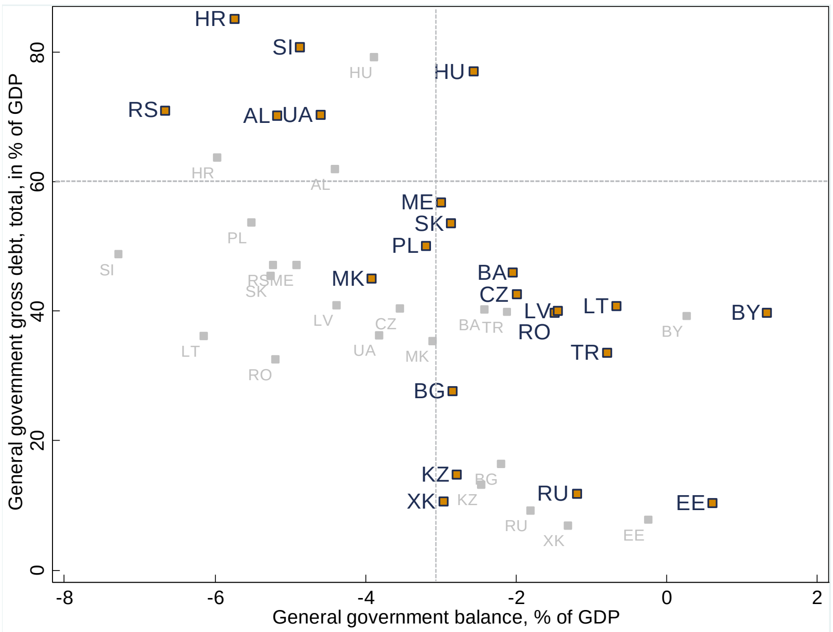


Note: Private debt (loans only) of non-financial organisations, households and non-profit institutions serving households, consolidated, in % of GDP; First bar (per country) – value in 2005; last bar – value in 2014 (wiiw estimate).
Source: Eurostat, IMF, wiiw data and estimates.

As opposed to the core CESEE, in the CIS region in an attempt to curb inflation and address the currency depreciation challenges monetary regulators increased sharply policy interest rates. Thus, in Ukraine the interest rate was raised to 30% in spring 2015 – the world's highest, although in the recent months, price stabilisation and extensive capital controls have permitted the rate to be lowered to 22%. The base interest rate in Kazakhstan was raised by 4 pp to 16% in October, and Russia pushed its interest rate to 17% in December 2014 and only recently started to ease it gradually. Apparently, these moves further squeezed the private sector and households, already battling with the economic downturn. However, given the threat of a further speculative currency slump, monetary authorities are hesitant to relax their tight monetary stance.

As consumption recovery does not seem to have triggered private investment to date, **public investment along with foreign investments and development assistance, in particular the EU structural and investment funds could be instrumental for eliciting private investment** (see also Box 1). However, the capacity to resort to public investment differs across the region owing to varying fiscal constraints. Fiscal policy in general can complement easy monetary policy in providing a counter-cyclical stimulus, whereas for the countries that have adopted the euro or maintain a fixed exchange rate regime, it is the only feasible option. However, many CESEE countries have exhausted their fiscal space having accumulated sizeable public debts. In 2014 all of the countries of the CESEE region were running deficit budgets (Figure 14) with the exception of Belarus and Estonia. For many countries that ran high government deficits in 2014, adjustment efforts have led to increasing public debt ratios as austerity measures came at the cost of constraining economic activity. On the other hand, countries that were running more precarious deficits slipped further down with public debt levels expanding and moving to the danger zone, ultimately standing at more than 60% of GDP. Serbia, Croatia, Slovenia, Albania, and Ukraine are cases in point. As of 2014, with the exception of those five countries, deficits in the CESEE have not exceeded 4% and public debt burden risks are more or less contained, although some countries, such as Slovakia and Macedonia, are approaching the risk zone. Politics has also entered the game in a number of countries as the election cycles were accompanied by additional fiscal loads, e.g. debt write-offs and utility subsidies for the poor in Croatia this year. Conversely, in Bulgaria, the new government is intent upon reforming the healthcare and social security systems, raising the age of retirement and stepping up pension contributions. In the Western Balkans, fiscal sustainability issues also confront the challenge of preserving social and political stability: an onerous task given the political turbulence, soaring levels of unemployment and related social issues.

Figure 14 / Fiscal stance of the CESEE countries.



Note: Orange dots: 2014; Grey dots – average over 2009-2013.
Source: wiiw Annual Database

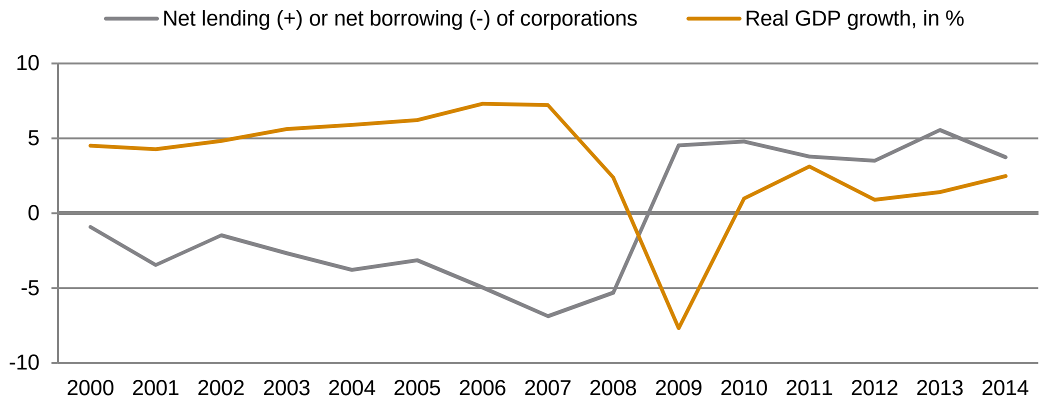
BOX 1 / EXCESSIVE CORPORATE NET SAVINGS IN THE NMS DEPRESS GDP GROWTH

by Mario Holzner

In the early years of the current century, the NMS corporate sector was acting the way economists expect firms to operate; it borrowed funds and invested in the economy. During the peak years of the boom in the mid-noughties, corporations in the NMS massively overshot in terms of their investment and found themselves heavily indebted; in brief, the economy was overheating. However, since the outbreak of the global financial crisis, firms in the region have gone to the other extreme. On aggregate, the NMS corporations have become net lenders. Together with households, the private sector has been accumulating excessive savings over recent years; the upshot is that funds for domestic investment are inadequate. Certainly, part of these savings is attributable to the current practice of deleveraging, especially in the financial sector. However, according to anecdotal evidence many firms prefer to stash away their cash rather than invest in uncertain projects. This reflects the current depressed mood among economic agents throughout Europe. As indicated in Figure 16, the net result is overall sluggish GDP growth.

Governments are reluctant to absorb these excessive savings and invest on a massive scale, for example, in ailing infrastructure, as such a move would simply increase public spending and fiscal deficits. The remaining private savings surplus has to be exported in order to close the gap in the macroeconomic balances. Given that at present the rest of the world is not enjoying an economic boom either, the positive external position in the NMS is partly achieved via consumption and the associated import restraint (owing to wage repression) rather than through marked export expansion. This has resulted in an additional impediment to economic growth. Economic policy-makers should aim for greater balance between internal and external net lending positions with full employment, if they are to avoid long-term macroeconomic imbalances that limit growth. More pronounced public investment programmes capable of triggering private investment would be one such policy measure. The European Commission’s Investment Plan for Europe aka the ‘Juncker Plan’ is only a drop in the bucket. None the less, it is the first sign of a change in attitude.

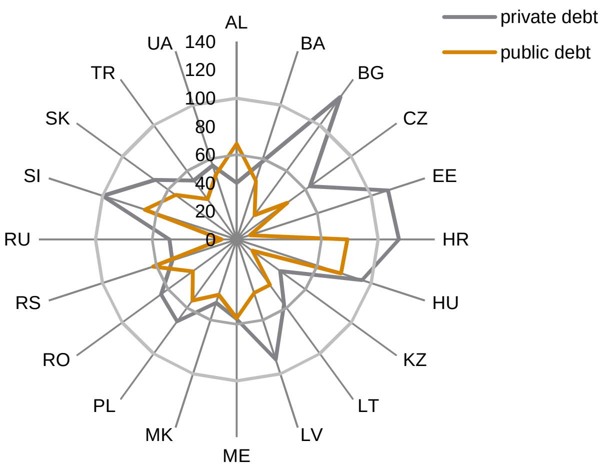
Figure 15 / Saving corporate sector and slow growth in recent years in the NMS



Note: Time series are simple averages of the new EU Member States (NMS), subject to availability.
Source: AMECO, Eurostat, own calculations.

The countries with high public and private debt burdens – Slovenia, Croatia, Hungary – are running particularly high risks associated with the need for simultaneous deleveraging, especially in a weak inflation environment (Figure 15). Deleveraging in such cases may play negatively on aggregate demand and further weaken inflation, thereby increasing the real value of debt relative to GDP and making it all the more problematic an issue.

Figure 16 / Private and public debt, 2014, % GDP



Source: wiiw Annual Database and estimates

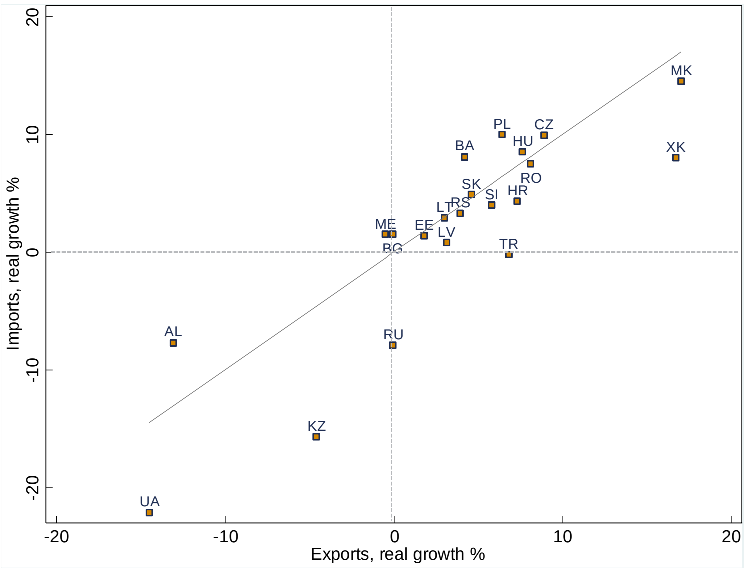
Fiscal stimulus measures via the use of national oil funds provide a major cushion for the net oil exporters, Russia and Kazakhstan, which are facing fiscal challenges attributable to the terms of trade shocks they have suffered. However, should oil prices stay, as expected, at low levels, the oil funds may provide only a temporary solution as the countries are confronted with particularly difficult choices where cutting public spending is concerned.

EXTERNAL FACTORS AND IMBALANCES

At present the external environment offers the CESEE countries more risks rather than opportunities. Significant risks for the entire region emanate from geopolitical pressures in Ukraine and the Middle East. A related matter is the range of sanctions imposed on Russia, as well as the counter-sanctions imposed by Russia, aggravating issues associated with the crisis legacies (for more see special section II). Reliance on the Russian market for exports, as well as Europe's general dependence on Russian energy (gas and oil) that are increasingly used as arguments in the political dialogue certainly weigh negatively on investor sentiment in both Russia and Europe.

As outlined earlier, net exports have lost significance for most of the CESEE countries as an engine of growth in 2015 both because the conditions in external markets are still rather weak and due to imports outpacing export growth as a result of stronger domestic demand. The external environment is gradually improving, so do the export dynamics of most of the CESEE region (Figure 17). Growth of real exports, however, is largely counterbalanced by imports increasing on the back of improving internal demand conditions. Net exports are nevertheless significant in certain countries: for instance, in Bulgaria, registering a spike in exports in 2015h1, net exports are expected to contribute as much as +2.2 pp to real growth — the highest across the CESEE, with the exception of the CIS. To a lesser extent, net exports are expected to contribute to growth in Hungary and Macedonia (+1.5 pp and +1.3 pp), Croatia and Slovenia (+1pp each). For the CIS countries and Ukraine the positive contribution of net exports is rather the result of a sharp contraction of imports.

Figure 17 / Growth of exports and imports in 2014, real % yoy

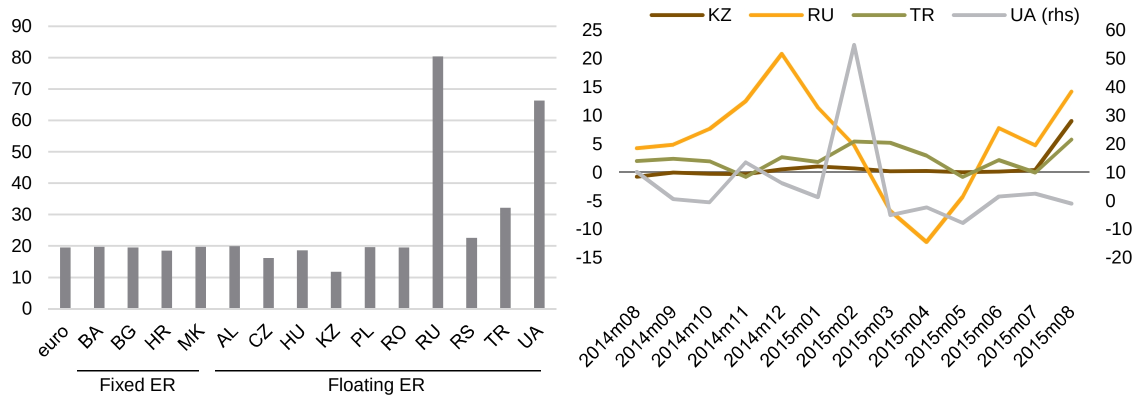


Source: wiiw Annual Database

High dependency on oil exports hit the commodity-based economies of Russia and Kazakhstan hard. As oil prices are expected to remain at subdued levels in the medium term, the growth prospects of the net commodity exporters are rather gloomy in the long-run as well, unless the countries manage to restructure. Rebalancing and moving away from the natural resource curse seems to be an overly challenging agenda for the countries which still score rather low globally in terms of institutional development, quality of infrastructure, and overall capacity to carry out the necessary reforms efficiently. Years spent discussing the apparent need to diversify and modernise failed to trigger much effective action throughout the 'prosperous' 2000s.

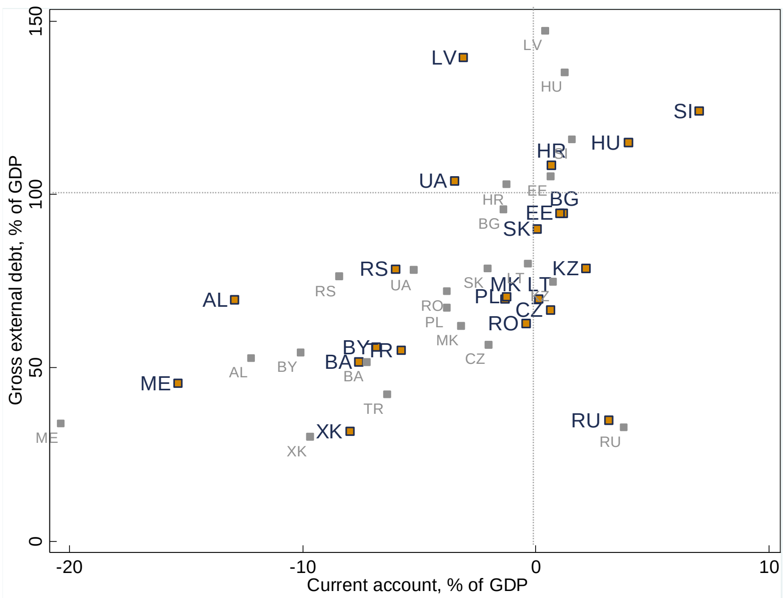
As a result of external pressures, exchange rates fell sharply in Russia, Kazakhstan, Belarus and Turkey. After trying to grapple with overwhelming depreciation pressures and dwindling reserves, the CIS economies, along with Ukraine and Turkey allowed their currencies to fall freely resulting in sharp depreciations (Figure 18). Overall the CIS countries have veered towards flexible exchange rate regimes. Apart from the recognised risks associated with accumulating external imbalances followed by a sharp adjustment, this move was influenced by the openness of trade within the Eurasian Economic Union, in which depreciation of the rouble and associated gains in price competitiveness of Russian exporters were frown on by producers in Belarus and Kazakhstan experiencing pressures as a result even on domestic markets. On the other hand, the monetary authorities in the CIS countries are struggling with the complexities of establishing a credible inflation-targeting regime. This will require strong communication and credible commitment, in addition to effective monetary transmission mechanisms, which are questionable in the countries concerned.

Figure 18 / Nominal exchange rates, NCU/USD



Note: Left panel: change in exchange rate in August 2015 yoy; Right panel: change in NCU/USD exchange rate month-over-month (mom) for selected CESEE economies exhibiting higher exchange rate volatility. 'Fixed ER' denotes countries with fixed/pegged exchange rate arrangements. 'Floating ER' – other countries.
Source: wiiw Monthly Database

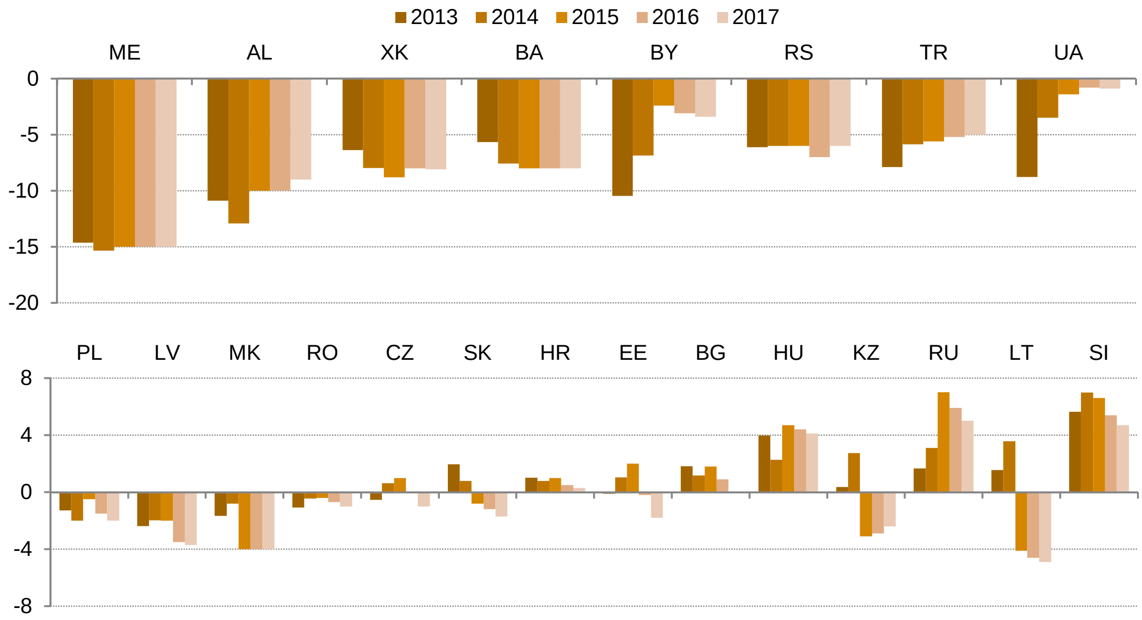
Figure 19 / Current account balance versus external debt



Note: Orange dots: 2014. Grey dots: 2009-2013 average.
Source: wiiw Annual Database

Current account and external debt (Figure 19) display divergent trends. The external debt burden is particularly high in Slovenia, Hungary, Croatia and Latvia, exceeding the levels of their aggregate output. However, particularly arduous challenges associated with external debt are now facing Ukraine, and the deal on sovereign external debt restructuring reached in August 2015 may only partially address the problem (for details see the country report). While there is a risk that rising domestic demand might worsen the current accounts, for most countries of the region current accounts balances are not viewed as a threat over the forecast horizon (Figure 20) as concurrently rising exports will allow for a balanced growth trajectory in this regard. For most countries the current account balance is expected to fluctuate in the ±4% range, with the exception of the Western Balkans that have a history of running into significant and persistent external imbalances.

Figure 20 / Current account balance as a share of GDP, 2013-2017



Note: wiiw projections from 2015 onwards. Top panel: countries exceeding the 6% level of current account deficit as a share of GDP, bottom panel – other countries, sorted in increasing order by average 2013-2014 values
Source: wiiw Annual Database and forecast

EU structural and investment funds have been providing important support to economic growth in the NMS, stimulating aggregate demand and contributing to potential growth, although absorptive capacity and efficiency in utilisation varies across the recipient countries, as well as over time. 2015 is the final year in which EU funds can be absorbed under the 2007-2013 financial framework, as well as being the overlapping year with the next cycle spanning 2014-2020. This has resulted in increased efforts to draw down funds that reflected in investment boost in certain countries. Given the observed ‘cyclicality’ of fund disbursement (see Box 2), it is expected that the new EU funding in line with the 2014-2020 programming will already start contributing to growth 2016 next year and will manifest itself fully towards the end of the forecast horizon should absorption exhibit similar patterns.

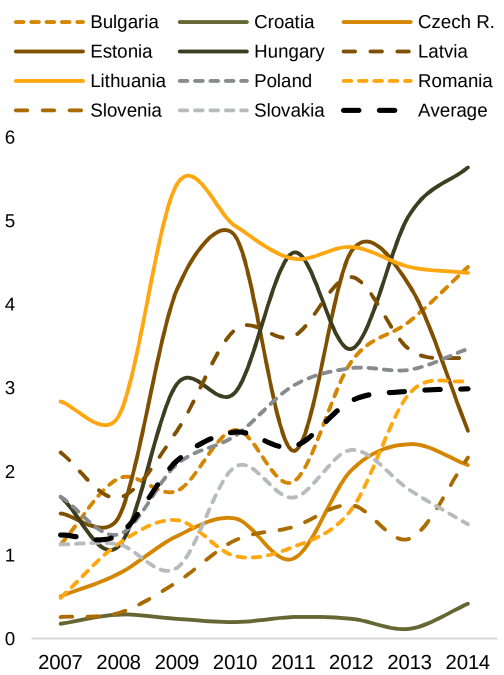
As a result of the recession in Russia a number of economies were adversely affected. A particularly vast negative impact suffered mutual trade within the CIS countries, also members of the Eurasian Economic Union, formed this year on the basis of its predecessor, the Eurasian Customs Union – Single Economic Space. Also hit, albeit to a smaller extent, were other CESEE nations exposed to Russia. This held particularly true for the Baltics (much dependent on the CIS export markets in certain foods and the transit of goods), although they are managing to offset the negative spillovers at least partially by expanding exports to European destinations. Importantly, in the case of Russia the recession per se constitutes only a part of the risks: the geopolitical tensions along with internal political factors have brought about a shift to self-isolationism, also manifesting in economic matters and the declared import substitution agenda may have longer-run implications for Europe if materialised (for more see the special section to the report).

BOX 2 / EU STRUCTURAL AND INVESTMENT FUNDS: AN IMPORTANT SOURCE OF INVESTMENT FOR EUROPE

by Amat Adarov

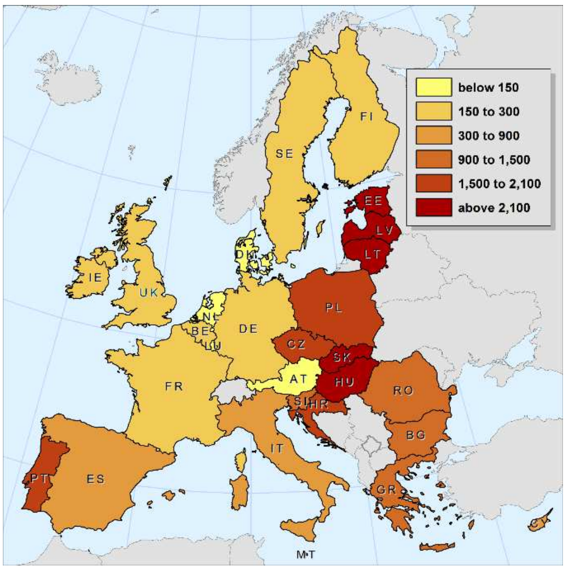
The EU structural and investment funds (European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund) constitute a valuable source of co-funding for the NMS countries. In the light of the sluggish private investment in the region, the funds disbursed under the 2007-2013 Multiannual Financial Framework contributed to the development of infrastructure and played an important role in triggering complementary private investment. As evidenced by the past financing patterns, the funds' absorption tends to peak towards the end of the cycle (Figure 21). The disbursement under the next financial framework spanning 2014-2020 (Figure 22) will put more emphasis on research and development, and is also expected to phase in gradually over the forecast horizon and provide a much-needed development boost. Drawing from the EU 2007-2013 funds will end this year and final efforts are expected to support investment in the countries lagging behind (Figure 23): Slovakia, Romania and Croatia the latter only joined the EU in July 2013 and has an additional year in which to draw resources from the outgoing framework.

Figure 21 / Net financial position against the EU budget, % of GNI



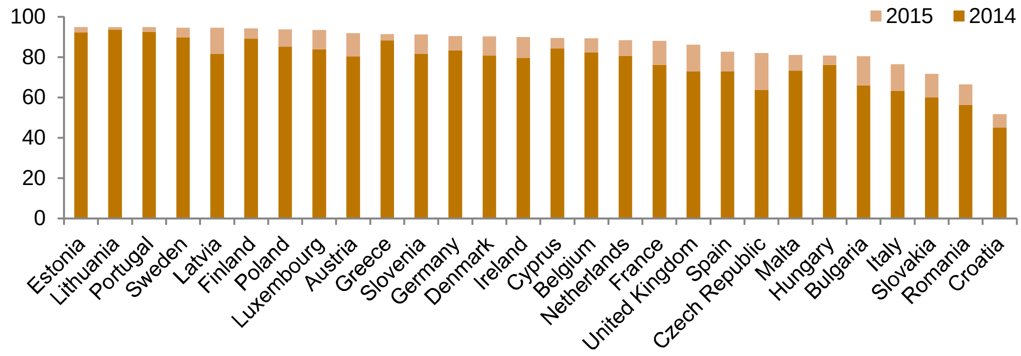
Source: European Commission

Figure 22 / Allocation of the EU funds under the 2014-2020 framework, EUR per capita (2014 population)



Source: wiiw calculations based on the European Commission data

Figure 23 / Absorption rate of the 2007-2013 EU funds, %



Source: European Commission

In general, over the forecast horizon, while exports continue to recover as global markets improve, net exports are expected to contribute to growth moderately and only in some countries in the SEE region and Hungary. The recent unfavourable developments in emerging markets – Brazil and China – in this regard may have both negative direct (for example, via commodity prices for energy and metal exporting CIS countries, Latvia's steel production) and indirect impact (via Germany and other advanced economies) on the economies of the CESEE region. Contributing to the risks of weakening demand from large emerging markets, the industry-specific risks, including the scandal related to the Volkswagen emissions tests, may impair robust recovery in Germany, potentially affecting the CESEE region, particularly on the CE economies that have both sizeable trade exposures to Germany and linkages along value-added chains (see more in special section III).

Normalisation of monetary policy in the USA may trigger yet another round of global financial volatility. In response to improving internal economic conditions, the monetary authorities in the USA and the UK are likely to phase out their extremely accommodative monetary policy soon (either late 2015 or early 2016). The ECB, on the contrary, launched its quantitative easing policy earlier this year in addition to keeping interest rates at historically low levels. As has been evidenced before, even public communication by respective authorities of a possible reversal of monetary policy is enough to spark off volatility in financial markets worldwide, provoking capital flows and related exchange rate pressures, especially in developing markets. Needless to emphasize, financial market turmoil could well jeopardise the very recovery trends that are currently becoming apparent in the CESEE. On the other hand, the resulting weakening of the euro relative to the USD will lend additional support to European producers, and in all likelihood, the net effect of this divergence in monetary policy will yield benefits for the CESEE region (for more see Box 3).

The geopolitical risks are still elevated in the CESEE region. The risks associated with the conflict in Eastern Ukraine still run high, although they have abated somewhat recently**.** While the Minsk-2 agreement holds so far, the situation can be deemed highly fragile and a 'frozen conflict' scenario is still the best we can realistically hope for. The ability to carry out the reforms in Ukraine in a situation marked by the risk of military conflict and deep recession is highly questionable and will take years to resolve, even after the conflict abates[14]. The risks around the Ukraine crisis were matched by an escalation of

[14] For an in-depth analysis of the situation in Ukraine see the wiiw report 'How to Stabilise the Economy of Ukraine', background study 15/04/2015

the conflict in the Middle East over which tension between the West and Russia may also intensify. As a related matter, the refugee crisis has also been high on the agenda recently as it may lend additional impetus to the sentiment of Euroscepticism that is already on the rise in Europe (for more see special section I of the report).

BOX 3 / MONETARY POLICY DIVERGENCE

by Vladimir Gligorov

The Federal Reserve System (FED) is not intent on simply fine-tuning the interest rate, e.g. by hiking it some 25 basis points one time and thus changing its monetary policy. It is set on changing the monetary regime, proceeding step by step to a policy rate level of about 3 percent over the next two to three years. The FED needs to determine the best moment to start this process. It has no desire to be caught up in uncertainties about the sustainability of the regime change.

The regime change, when it starts, will set the ECB at odds with the FED (Table 3). This may not necessarily be due to the different positions of their respective economies in their business cycles, but rather because of the persistently stagnant economy, in terms of growth and prices, that ECB on its own has been unable to stimulate with its low interest rate and the on-going policy of quantitative easing. This divergence being the case, normalizing FED policy should have a positive effect on the euro area economies on three counts. It will: (i) weaken the euro´s dollar exchange rate (possible all the way to 1 dollar for one euro; ECB's most recent forecast is in Table 3); (ii) improve the efficacy of the quantitative easing policy; and (iii) keep oil and commodity prices low (partly on account of the strong dollar) even with the weaker euro. The impact of the first two influences should help the ECB to boost inflation, while the third should continue to support both investment and consumption

The impact on the CESEE depends on the degree of their connectivity with either the euro or the dollar. Continuing lax ECB monetary policy will help euro area member states from CE and the Baltics: this is already reflected in part in their improved prospects of recovery. The same holds true for the countries of CE (and possibly Romania), which pursue a policy of targeting inflation and maintaining low interest rates, but it does not apply to stagnant economies in the Balkans. There, 'euroisation' does not necessarily translate into low interest rates. They, however, may well be shielded from the negative fallout of the dollar hike on account of the euro being their reserve currency. Negative effects are to be expected both in the dollarized countries in Eastern Europe and in Turkey, given the possibility of capital flight and the need to tighten monetary policy in an attempt to offset the moves adopted by the FED.

Table 3 / FED versus ECB

	2015	2016	2017	2018
FED's policy rate	0.4	1.4	2.6	3.4
ECB's policy rate	0.0	0.0	0.1	
Expected rate of inflation				
- FED	0.4	1.7	1.9	2.0
- ECB	0.1	1.1	1.7	
Forecasted exchange rate (€/$)	1.1	1.1	1.1	

Sources: FED and ECB

TOWARDS THE 'NEW NORMAL'

The CESEE region is characterised by rather divergent sub-regional dynamics, and not only do the current macroeconomic circumstances vary, but so do the region's medium- and long-term prospects. Of particular significance is the divide between the CIS group, which has embarked on the Eurasian integration vector headed by Russia, and the rest of the CESEE region, which is gravitating towards European integration. That gap is rapidly widening, driven as it is by strained geopolitical relations between the EU and Russia. Ukraine, caught between the two integration vectors, is a particularly striking example of the potentially far-reaching consequences that such a split can have. The related geopolitical tensions may loom in the years to come adversely affecting the overall business sentiment in Europe, especially in the countries that are more exposed to Russia. Furthermore, the prospects of pan-European-Eurasian integration spanning the EU and the Eurasian Economic Union is on the wane as geopolitical concerns intensify along the numerous fault lines. Both sides will have to take decisive steps to find common ground.

The economic growth model of Russia and Kazakhstan is largely based on the exploitation of natural resources, and adjustment to an alternative growth paradigm under the 'new normal' with lower global commodity prices is likely to be painful for them, as well as for Belarus, highly exposed to Russia. On top of the recent significant slowdown, the CIS countries face gloomy medium-term prospects, unless oil prices return to the rapid growth observed in the 2000s, which is not seen as a likely scenario. The present economic difficulties caused by the cyclical downturn are aggravating the internal structural constraints in the CIS countries and hinder their ability to bring about the institutional reforms and infrastructural improvements essential to shifting to a more diverse industrial structure and modernising the weak technological base that currently renders many of their industries largely uncompetitive in a global setting. Rather than attempting to integrate with Europe, Russia, on the contrary, appears to be making a decisive turn to isolationism, inducing Belarus and Kazakhstan to follow suit given their close historical ties underpinned by the intensification of Eurasian integration and similar political and institutional setup. For all the discussion on the need to diversify and modernise economic structures, little headway was in fact made during the 2000s and today the capacity for reform is severely constrained by macroeconomic difficulties the countries have encountered and is even less likely.

Apparently, prospects in the remaining CESEE countries will be largely determined by developments in advanced Europe, as well as the pace of integration and convergence of individual economies. While most of the CESEE countries exhibit signs of gradual recovery, there is little doubt that the recovery process is still fragile as external risks abound. After enduring a double-dip recession, the CESEE countries are now far weaker and more susceptible to macroeconomic shocks, while the policy tools they have at their disposal to withstand another possible downturn are far more limited than before. As discussed in the sections above, in this respect the CE countries are relatively more resilient (although Hungary has encountered certain sustainability issues), while the Western Balkans are characterised by particularly vast macroeconomic imbalances, in addition to the long-term structural challenges they face.

The anaemic growth is the outcome of the interplay between cyclical and structural factors. Aggregate demand is still weak both in the CESEE countries and across the globe, although market conditions are gradually improving as evidenced by consumption having picked up. The cyclical downturn, however, is only part of the growth shortfall, as potential output growth, characterised by structural supply-side factors, is also expected to decline in the CESEE over the medium term as a result of multiple factors: demographic issues associated with ageing populations and labour migration, limits to catch-up technology-driven growth, anticipated potential growth slowdown in the advanced economies. Prolonged periods of recession have also contributed to the slowdown in potential output growth: a phenomenon known as the hysteresis effect of recessions[15]. While the expected potential output slowdown is a widely discussed feature of the hypothesised 'new normal', some economists also point to the possibility of long-term depressed aggregate demand (demand-side 'secular stagnation'[16]). In any case, slower economic growth relative to the pre-crisis trends seems to be a realistic fate awaiting the CESEE countries, given that they are small open economies directed towards large EU markets.

Amid these challenges, the economic growth model of the core CESEE region is expected to shift to more sustainable practices. Pre-crisis growth throughout the region was catalysed by excessive credit that ultimately forced debt to rise to precarious levels and accelerated consumption leading to ever-widening current account deficits, funded in many cases by portfolio and FDI inflows that were not always channelled to the tradable sectors. In general, the CE countries and Slovenia displayed relatively balanced growth paths, while growth in the SEE countries and the Baltics provoked an accumulation of major macroeconomic imbalances[17]. Correction of those imbalances proved painful, adding to the severity of the recession and prolonging it for most countries as private sector deleveraging and fiscal consolidation downplayed gains in recovery growth. Having learnt a hard lesson, Europe is now seeking ways to secure a more resilient and sustainable growth model for the post-crisis world and has launched a range of multi-dimensional initiatives focusing on improving the architecture of the EU.

The need to search for a more sustainable development paradigm taking into account the observed and projected relative importance (as regards contribution to growth) of household consumption for most of the CESEE countries provokes the well-worn debate on the relative merits of export-led growth versus growth based on internal demand. Across the globe, the fragilities associated with external trade, financial and other exposures are recognised in the light of the recent financial crisis and recession that countries have suffered. Export-based investment-fuelled growth hinges on continuous efforts to maintain external competitiveness of domestic producers that can be achieved by restraining real labour costs (wages) and domestic consumption, weakening the real exchange rate and boosting productivity. Countries pursuing this practice are also bound to run up current account surpluses and fund consumption in the deficit countries: an inherently unsustainable practice if allowed to persist in the long run.

Consumption-led growth also faces its own constraints and challenges. In the case of the CESEE economies, the recently observed recovery of consumption, while expected to persist throughout the forecast horizon, is rather different in nature in comparison with the pre-crisis developments: induced by

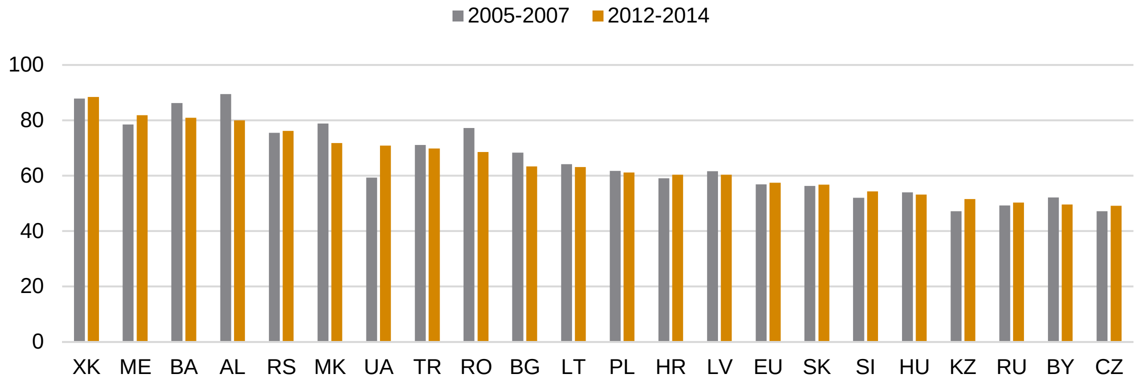
[15] For additional discussion, see, for instance, Ball, Laurence (2014), 'Long-Term Damage from the Great Recession in OECD Countries', NBER Working Paper 20185, May.

[16] See, e.g. Lawrence H. Summers, 2015. 'Demand Side Secular Stagnation,' American Economic Review, American Economic Association, vol. 105(5), pages 60-65, May.

[17] For a detailed assessment of the pre-crisis developments and future scenarios, see also Pisani-Ferry et al. (2010) 'Whither growth in Central and Eastern Europe? Policy lessons for an integrated Europe,' Blueprints, Bruegel, number 453, June 2010.

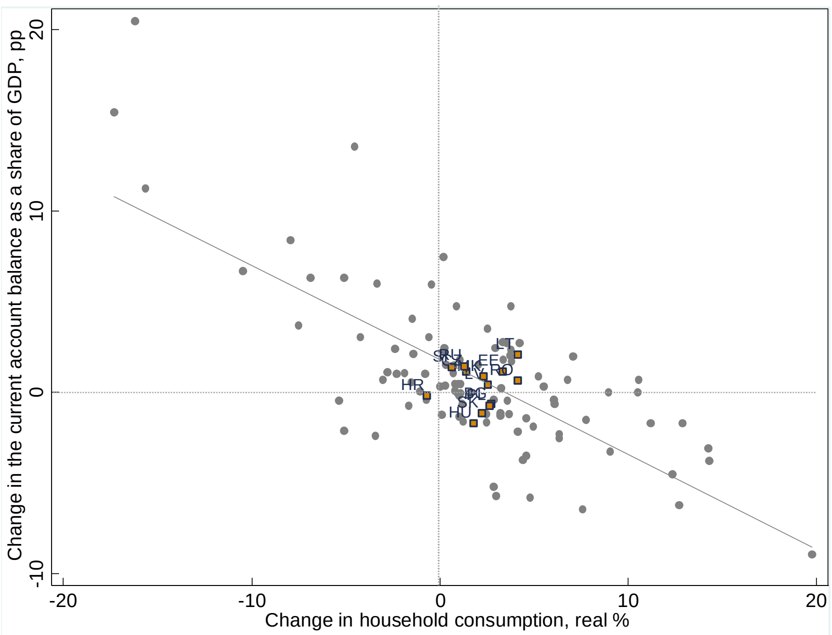
labour market recovery, low inflation and hence higher real wages, as distinct from credit-fuelled growth. It is unlikely that consumption *per se* can provide a sustainable engine of growth for most of the CESEE region in the future as consumption as a share of GDP is already high, above the EU average for most countries, and little wriggle room is left in this regard (Figure 24).

Figure 24 / Household consumption as a percentage of GDP in the CESEE, 2005-2014



Note: Simple average of the years 2005-2007 and 2012-2014. Countries are sorted in descending order by the 2012-2014 average values.
Source: World Bank

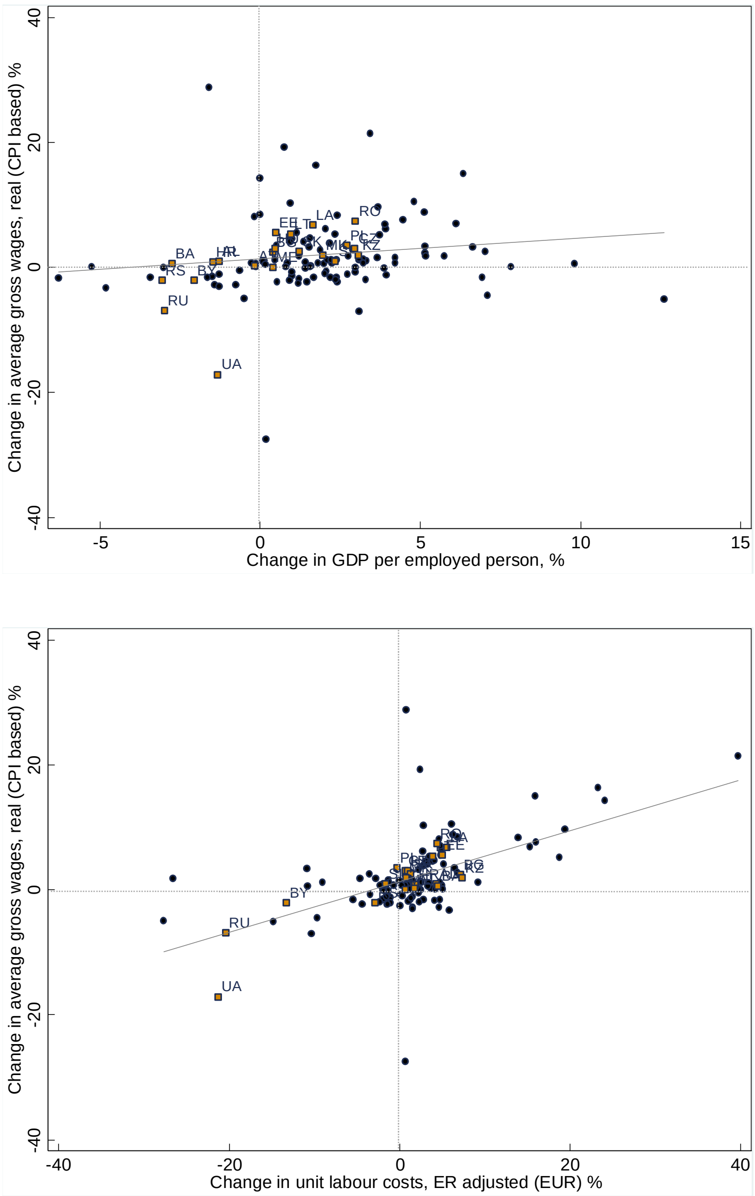
Figure 25 / Household consumption versus current account balance in the CESEE, annual percent change, 2005-2014



Note: Each dot represents a country. Orange dots – 2014. Grey dots – 2005-2013.
Source: wiiw Annual Database and forecast.

Marked increases in household consumption have historically led to deterioration of the current account balance in the CESEE countries (Figure 25), yet, over the forecast horizon, as discussed earlier, it is not expected to be an imminent threat as exports will also recover counterbalancing the trade account. However, peeking to the factors behind the expected consumption growth, all other things equal, real wage growth that outpaces labour productivity gains leads to higher unit labour costs and thus deterioration of external competitiveness – a characteristic feature of many CESEE economies in the past (Figure 26).

Figure 26 / Real wages, unit labour costs and labour productivity in the CESEE, 2010-2015

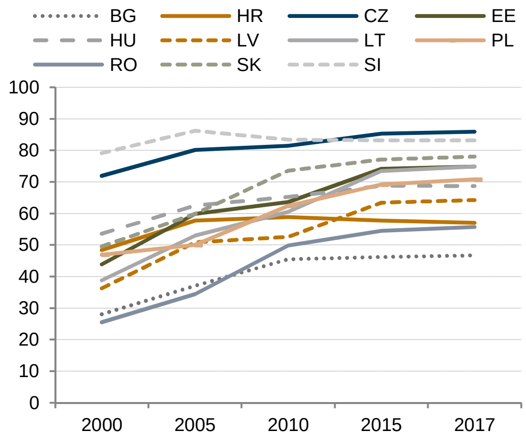


Note: Annual changes in percent. Each dot represents a country. Orange dots – 2015 values (wiiw estimates); Grey dots – 2010-2014 values.
Real change in average gross wages, CPI based versus real change in GDP per employed person, NCU (left panel) and real change in unit labour costs, exchange-rate adjusted (right panel).
Source: wiiw Annual Database and forecast

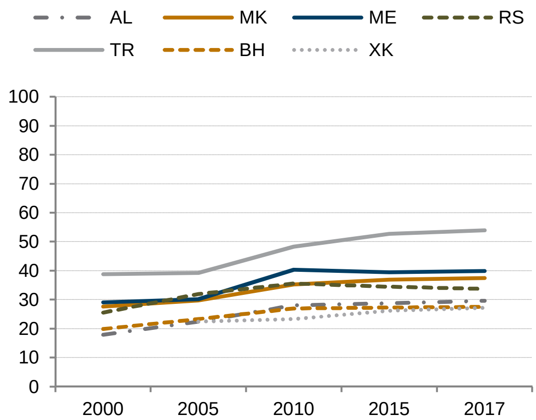
Furthermore, the economic growth agenda for many CESEE countries in the pre-crisis era was based on the explicit or implicit objectives of achieving faster and closer integration with the advanced EU countries. That called for decisive actions by their authorities in order to meet the convergence criteria and led to important institutional and other reforms that resulted in improving competitiveness of the transition economies (in addition to improving market sentiment on account of optimistic expectations as to EU integration that markets harboured). This has also manifested in the rapid income convergence (Figure 27) to the level enjoyed by advanced nations via labour productivity gains. As income levels come closer to those of the advanced countries, competitiveness based on the low wage-costs of the relatively qualified workforce that much of the region enjoyed in the past also phases out. Today, however, the thrust behind income convergence has stalled and is not expected to resume over the forecast horizon. In this regard, the Western Balkans have been stuck in transition at the levels of per capita income 40% and below the EU average.

Figure 27 / GDP per capita at current PPPs (EUR)

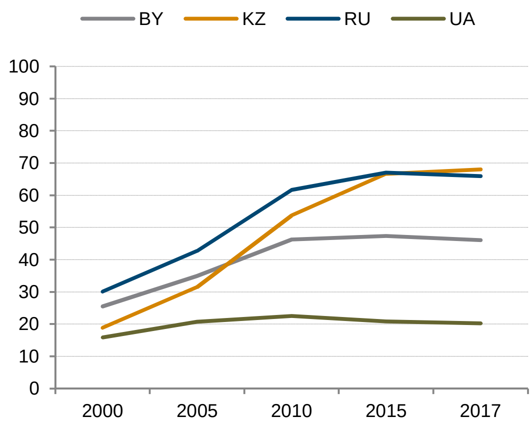
NMS



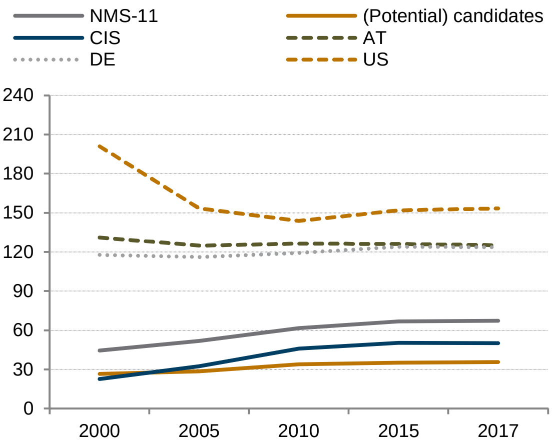
Candidate and potential candidate countries



CIS+UA



CESEE subgroups and selected advanced economies



Note: EU average = 100; from 2015 onwards – wiiw estimates at constant PPPs and population.
Source: wiiw Annual Database incorporating national and Eurostat statistics, wiiw estimates, Eurostat, EC - Autumn Report 2014.

Given that the CESEE countries are small open economies and face natural limits to growth driven by domestic demand, the key to sustainable development that does not lead to widening internal and external imbalances, as well as limits the risks associated with cross-country exposures, is to diversify export markets and steer towards a more balanced structure of growth drivers. This is certainly not only an issue to be faced by the CESEE region, but also a part of the broader agenda for many countries across the globe. The constraints that EU integration imposes and will impose, such as limits to independent monetary and fiscal policy, as well as coordination issues, are an additional challenge for some countries. Yet, most importantly, the EU countries have managed to stay united and act coherently in the face of the recent recession, withstanding a host of economic and political challenges that have emerged in recent years, despite their revealing a broad spectrum of weaknesses in EU institutional arrangements and their functionality. However, those same challenges have triggered a round of essential improvements in the economic architecture of Europe: initiatives that will engender more sustainable and equitable practices throughout wider Europe[18].

All in all, as it stands now, the CESEE region exhibits much divergence both in terms of the observed dynamics and tendencies expected over the medium term. The output growth of the NMS group is expected to average close to 3% both in 2015 and over the forecast horizon, signifying a modest improvement in comparison with the past year. The better-performing countries of Central Europe appear to be rather resilient to external shocks and remain on track to sustainable recovery supported by domestic demand, expected to grow in the 2-4% range per annum over the forecast horizon. At the other end of the spectrum, the CIS group faces particularly poor prospects unless global commodity prices recover, with Russia and Belarus both already tumbling into a deep recession (expected growth in 2015: -3.7% and -3.8%, respectively) and Kazakhstan following suit with a deceleration in growth (1.5% in 2015). Constrained as they are by profound structural problems, the countries of Southeast Europe are muddling their way through recovery, and are only slowly converging to the rest of Europe, as the region displays overall improvement, but irregular growth tendencies, in many cases accompanied by macroeconomic imbalances and deep structural problems. Serbia and Croatia, the worst performers among in the group, will enjoy hardly any growth at all in 2015 (0.1% and 0.7%, respectively), other countries will growth in the 2-4% range. Whereas economic activity in the Baltics suffered this year owing to their exposure to Russia, the region appears to be resilient and its recovery is still on track with growth in the medium term expected to be in a 1.5-3% range. The situation in Ukraine remains particularly fragile and serious downside risks persist, although there are signs that the recession, much deeper than originally anticipated (output estimated to drop by -11.5% this year), might be bottoming out, and the country is expected to return to modest growth only in 2017.

[18] See, e.g. the 'Five Presidents' Report' available at http://ec.europa.eu/priorities/economic-monetary-union/docs/5-presidents-report_en.pdf

Special section I: The recent human turmoil: migration and the implications for Balkan countries and the NMS

ISILDA MARA

Throughout the period this special topic was being prepared, the conditions facing the refugees on reaching Greece and moving on up through the Balkans worsened dramatically by the day. The fear that borders would soon be closed and unfavourable weather conditions would impede crossing the Aegean Sea gave rise to a massive influx of desperate refugees. Tension is running high not only in Greece, but also in the countries in the Western Balkans (WBCs). In particular along the Serbian-Croatian and Croatian-Slovenian borders, with the number of refugees claiming entry each day running into the thousands persons, conditions beggared description.

With the escalation of the humanitarian and migration crisis that has its origins in the Middle East, more particularly Syria, the WBCs and the New EU Member States (NMS) are becoming deeply involved not only as a transitory route, but also as a destination country for the refugees. The reallocation system proposed by the EU requires that most of the NMS share a greater burden in terms of providing shelter for asylum seekers. The quotas allocated to the NMS are not exorbitantly high, yet given the political challenges and the upsurge in anti-immigration populism, fuelled by a number of governments in the region, resistance to complying with the commitments agreed with the European Union is palpable. The WBCs are facing an enormous challenge as they strive to deal with the massive inflow of migrants and their attitude is less oppressive than in the NMS. It is difficult to assess the potential economic impact of the refugee crisis on the region on account of the dynamics involved. However, given that more than two thirds of the refugees heading for Western Europe simply pass through the NMS and WBCs, whereas only one fifth ultimately settles there, it is to be expected that local communities will experience a certain boost in consumption, while host organisations and auxiliary facilities will find themselves overstretched.

The Western Balkan region has turned out to be a very important transit route not only for migrants from the region but also for refugees from the Middle East who have crossed over from Turkey and are now passing via Greece through Macedonia and Serbia as they head for the Hungarian border, hence they can move on to Austria and Germany. Over the past three months in particular, it is estimated that some 210,000 illegal border crossings have occurred along this route (Frontex, 2015)[19]. More specifically over the same time period, 116,000 people entered Macedonia illegally, 123,000 entered Serbia in the same manner, as did a further 44,000 in Croatia. At the same time, the so-called ‘Eastern Mediterranean route’ (via Turkey, Greece, southern Bulgaria or Cyprus to the EU) [20] has been another conduit for more than

[19] http://frontex.europa.eu/

[20] According to Frontex, ‘*The Western Balkan route describes two main migratory flows: from the Western Balkan countries themselves, and the secondary movements of migrants who originally entered the European Union through the Bulgarian-Turkish or Greek-Turkish land or sea borders and then proceed, through the Western Balkans, into*

360,000 refugees from Syria, Afghanistan and Iraq on route to the EU. These figures suggest that for more than 75% of all asylum seekers from the Middle East, the NMS and WBCs have been a safe haven as the refugees pass on their way from Turkey to the EU.

The most recent data from the United Nations High Commissioner for Refugees (UNHCR) [21] show that in the period January - August 2015, the number of first-time asylum applications in the EU-28, WB-6 and EFTA-4 reached a level of 763,000. 35% of new asylum applications were filed in the NMS and WBCs. 21% of applications were filed in one of the NMS (87% of which in were Hungary), 14% were submitted in the Western Balkan countries (95% of which were in Serbia). Most of the new asylum seekers come from Syria (44%), Afghanistan (22%), Iraq (6%) and the rest from other countries (see Box 4). The peculiarity of the WBCs is that apart from providing a transit route and offering refuge as destination countries, as countries of origin they have also contributed more than 20% to the number of refugees recently entering the EU-28 (see Figure 28). For the most part, they came from Kosovo (46%), Albania (33%) and Serbia (11%).

BOX 4 / THE PROFILE OF SYRIAN ASYLUM SEEKERS [22]

Characteristics: male (83%) and relatively young (18-35 years in 71% of the cases). 45.7% have completed secondary education and 39.7% have attended university. 48.7% are single and 44.6% married. 44.3% had children. 19.1% reported that some members of their family were missing as a result of the war. 58.36 % spent time in Turkey prior to arriving in Greece. 61.5% declared that they had private accommodation while staying in the transit country. 32.8% gave no response when asked about the duration of their stay in the transit country. 27% stated that they had stayed in the transit country for a duration of 1-3 months. 46 persons (6.9%) declared that they had spent 2 or more years there. 286 persons attributed unemployment as their reason for leaving the transit country, with 222 persons leaving for want of financial assistance. 82.1% stated that they entered Greece on their first attempt, whereas 113 persons (16.9%) said that it took more than one attempt to enter the country. 89.4% of the participants stated that they planned to apply for asylum in a EU country other than Greece. 3.4% stated they would apply for asylum in Greece. 52% declared that they wanted to move to Germany, 18% to Sweden, 6% to Denmark, 4% to Austria while no one said that they preferred to move to one of the NMS.

Despite the large number of refugees entering the Western Balkan region (e.g. Serbia and Macedonia), only a small number of them decide to stay and file an application for asylum rights. Similarly, although the NMS (e.g. Hungary, Slovenia or the Czech Republic) have recorded larger numbers of refugees seeking asylum, they still serve mainly as a transit route to other EU countries.

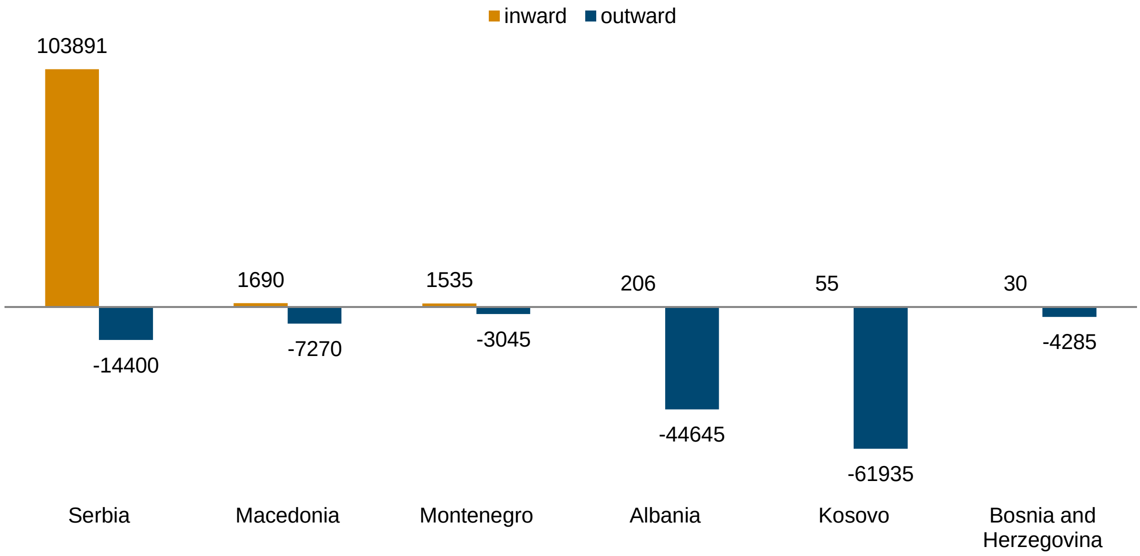
Hungary. The Eastern Mediterranean route is defined as the passage used by migrants crossing through Turkey to the European Union via Greece, southern Bulgaria or Cyprus'.

21 http://www.unhcr.org/cgi-bin/texis/vtx/home

22 Source: Interim Survey results on the profile of persons from Syria arriving at the Greek borders. Survey conducted in Greece with 700 asylum seekers between April and May 2015 (https://data.unhcr.org/syrianrefugees/download.php?id=9528).

The recent flow of refugees has given rise to dispute and dissent among EU members. A large number of old EU Member States are responding to the refugee crisis with a stronger sense of solidarity than the NMS; this has happened for a number of reasons. The old EU Member States can look back on a long history as immigration countries, whereas the opposite holds true for the NMS, which continue to have negative net migration. As a consequence the former countries are much more experienced, having developed well-managed hospitality centres, introduced immigration and integration policies and set up networks and organisations that facilitate matters under such circumstances. On the other hand, immigration has never been a priority issue in the NMS as long as emigration was the predominant issue. All the propaganda about distinct identities, anti-immigrant sentiments and claims to nationalist and homogenous cultures provide the principal arguments against aliens, particularly in the case of Muslims who are portrayed as a threat to Christianity. The Hungarian government has been particularly hostile in its dealings with the humanitarian crisis. For its part, the Slovak government expressed solidarity solely with Christian refugees.

Figure 28 / New applications for asylum to and from the Western Balkans, January-August 2015



Source: Own calculations using UNHCR Statistics.

In early September, the Czech government stirred up the Visegrad group (Hungary, Poland, Slovakia and the Czech Republic) that is opposed to mandatory EU quotas. The Visegrad group, together with Romania, voted against the quota system. The previous Polish government broke ranks over the agreement. However, the freshly elections in Poland that brought in power the Law and Justice Party might divert again the position of Polish government , being governed by a right-wing party that is not kindly disposed to receiving refugees and being in the condition to rule alone - by winning 39% of the seats. Furthermore, Poland has had to deal with an ever-increasing influx of asylum seekers from Ukraine[23]. Of the Baltic States, the Latvian and Lithuanian government opposed the mandatory quotas,

[23] According to the UNHCR the number of Ukrainians applying for asylum in EU neighbouring countries, including Russia amounted to around 172,000. Over the period January-August 2015, Poland recorded an increase in the number of asylum seekers from Ukraine by 25%: up from 1,050 to 1,300 year-on-year (http://www.unhcr.org/pages/49e48d4d6.html).

while Estonia was in favour. However, the agreement on the quotas is binding on EU members and failure to observe the same will incur a penalty equivalent to 0.002% of GDP.[24] Especially in Hungary, the government response has not been limited solely to objecting to quotas, but concrete steps were taken to disrupt the flow of refugees, first by erecting a razor-wire fence along the 175 km border with Serbia followed by a second fence along the border with Croatia. [25]

In direct opposition to this anti-immigrant attitude, civil society organisations and volunteers lent extensive support to refugees by providing them with food and other basic needs. Public opinion polls conducted in spring 2015 suggested that 13% of all Hungarians considered immigration to be one of the two main concerns that the country is facing at the moment. The case is similar in the Czech Republic where18% of all Czechs are deeply concerned about immigration, whereas only 9% of all Poles, 4% of all Slovaks and 1% of all Slovenes harbour such sentiments. The public response has been mixed, with protests in favour of, but also against, immigrants. An intensive political debate has engaged intellectuals and artists, as well as politicians who disagree with government policy on this score.

Euroscepticism, weakening of the nation state, trust in the EU and politics are other arguments that might split apart old and new EU countries and their attitude towards immigrants. The lack of trust in national governments and political parties is more manifest among the NMS than other EU members (three fourths as against two thirds). Almost half of the citizens in Europe tend to distrust the EU, whereas only one third of the citizens in the NMS are of the same opinion. EU citizens from both the old and new EU are in favour (four fifths) of additional measures against the illegal migration of people from outside the EU. Nonetheless, old Europe (three fourths) is more in favour of having a Common European Policy on Migration than new Europe (two thirds). NMS citizens are also less optimistic about the contribution that immigrants might make to the country. Two thirds of them disagree with the suggestion that immigration might yield major benefits as against half of the population in old Europe. Furthermore, the immigration of people from outside the EU evokes a negative response among two thirds of the population in the NMS (particularly so among the Czechs (81%), the Slovaks (77%) and the Poles (53%)) as against half of all other Europeans (see Table 4). The resistance displayed by this group of countries relates to the issue of unemployment, which is the topmost concern for 59% of all Slovenes, 57% of all Slovaks, 53% of all Poles, 45% of all Hungarians and 29% of all Czechs (Eurobarometer, 2015). [26]

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[24] According to the European Commission, '*The legal basis or the emergency relocation proposal is article 78(3) of the Treaty on the Functioning of the European Union (TFEU) which states that: "In the event of one or more Member States being confronted by an emergency situation characterised by a sudden inflow of nationals of third countries, the Council, on a proposal from the Commission, may adopt provisional measures for the benefit of the Member State(s) concerned. It shall act after consulting the European Parliament". The criteria for triggering Article 78(3) TFEU are defined in the Treaty: one or more Member State(s) must be confronted with an emergency situation, characterised by a sudden inflow of third country nationals. The mechanism is to be triggered in exceptional circumstances when, based on clear and measurable indications, the functioning of the asylum system of a Member State(s) can be endangered by a consistently high of refugees arriving on its territory, and in particular of those in clear need of international protection. A high threshold of urgency and severity of the problem are therefore pre-conditions for the triggering of the mechanism.*' http://europa.eu/rapid/press-release_MEMO-15-5698_en.htm

[25] Hungary closed the border to Serbia on 14 September 2015 and to Croatia on 16 October 2015.

[26] Eurobarometer (2015). http://ec.europa.eu/COMMFrontOffice/PublicOpinion/index.cfm/Survey/getSurveyDetail/instruments/STANDARD/surveyKy/2099

Table 4 / European citizenship and attitude towards immigration

	Trust in political parties	Trust in government	Trust in the EU	Feeling evoked by immigration of people from outside the EU	Additional measures to be taken to combat illegal immigration of people from outside the EU?	In favour of a common European policy on migration?	Immigrants contribute a lot to the country?
	tend not to trust, in % of total	tend not to trust, in % of total	tend not to trust, in % of total	negative feeling, in % of total	yes, agree, in % of total	yes, agree, in % of total	Disagree, in % of total
Austria	67	52	59	60	89	58	52
Bulgaria	80	67	27	59	89	78	63
Czech Republic	86	66	45	81	93	52	84
Estonia	70	49	19	73	92	53	74
Hungary	77	62	34	70	91	71	67
Latvia	88	67	31	70	87	62	58
Lithuania	84	58	17	78	82	82	76
Poland	79	71	33	53	81	66	51
Romania	84	69	24	34	72	78	30
Slovakia	90	67	38	57	86	65	73
Slovenia	80	78	51	77	77	69	61
Croatia	83	75	38	43	68	71	57
NMS average	82	66	32	63	83	68	63
EU-28 Average	72	56.00	46.00	56	85	73	44

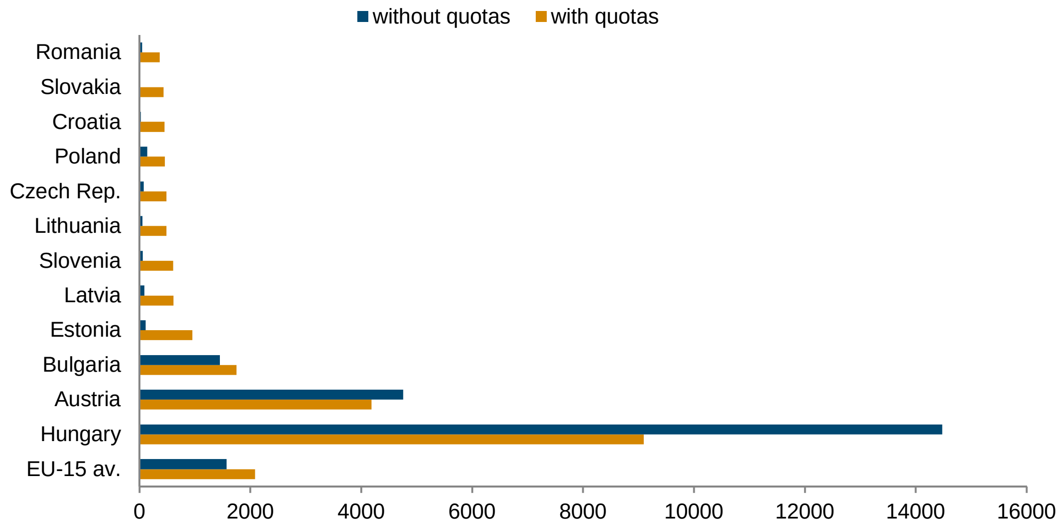
Source: Collected from Eurobarometer 83, spring 2015.

The opposition of a number of NMS to supporting mandatory quotas is to some extent overstated and unjustified. The fears that the asylum seekers will jeopardise the labour market and social security system are exaggerated because the mandatory quota scheme observes strict criteria: size of population (40% weighting) which reflects the absorption capacity of a country; total GDP (40% weighting) which captures the absorption and integration capacity of a country; the average number of asylum seekers per one million inhabitants over the period 2010-2014 (10% weighting) which captures the current refugee burden; and finally the rate of unemployment (10% weighting) which reflects the integration capacity. Accordingly, the newly agreed EU quota scheme foresees that 35,000 migrants that have settled in Italy and Greece have to be reallocated to NMS (see Figure 29). An additional contingent of 10,700 asylum seekers is to be transferred from Hungary to other NMS (out of a total of 54,000 that will be distributed to other EU countries).[27] As a consequence, the number of asylum seekers in the NMS is expected to rise by 21% to around 200,000, a figure which represents 0.16% of the total population of the NMS. Exceptionally, for Hungary that has been receiving 14,000 applications per one million inhabitants, introduction of the mandatory quota will reduce that figure to less than 10,000 asylum seekers per one million inhabitants, thus relieving the burden on the country by a third. Furthermore, of the 67,000 refugees who filed applications for asylum in Hungary during the first half of 2015, only 19% were granted refugee status. The remaining 81% were scrubbed suggesting that the overwhelming

[27] See Figure 29 for more details about individual NMS.

number of asylum seekers in Hungary had already left the country and most likely had moved on to other countries in Western Europe. [28]

Figure 29 / Asylum seekers, January-August 2015, per million inhabitants



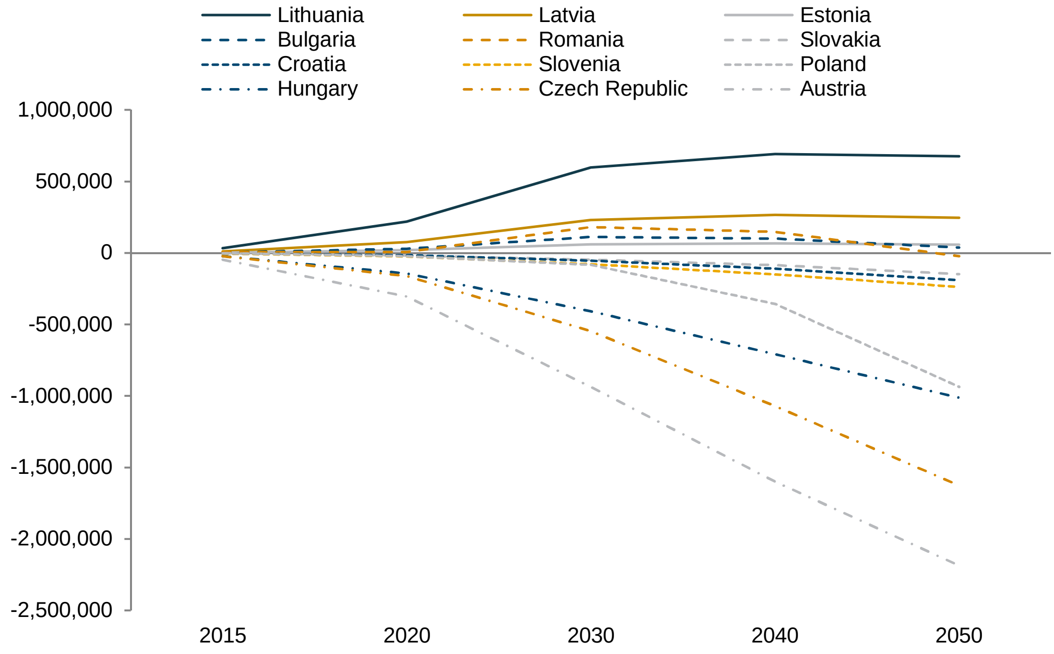
Source: UNHCR Statistics as of 29/09/2015 , EC, Eurostat, own calculations.

In economic terms, the impact is difficult to assess owing to the dynamics of the refugee crisis. The large inflow of refugees, estimated at around 5.000 new arrivals each day, is likely to increase the demand for local products and services. At the same time, however, some fiscal pressure might build up relating to the provision of adequate refugee reception centres, health care, education or other facilities. The fiscal burden might increase as new camps are built or accommodation and shelter provided for new arrivals, but the number of asylum seekers will not be so high as to endanger the fiscal sustainability of the NMS and WBCs. However, under the framework of the Asylum, Migration and Integration Fund and Internal Security Fund, the European Commission will allocate funds amounting to more than EUR 4 billion during the period 2014-2020. More than 23% of that funding will go to the NMS, while for the Western Balkan countries it was announced that EUR 17 million would be allocated to Serbia and Macedonia.

Population projections with and without immigration suggest that by 2050 countries such as the Czech Republic, Hungary and Poland are expected to shrink by about 1.6, 1 and 0.97 million respectively: figures which represent 15, 11 and 3 % of their populations (see Figure 30). The shrinkage and ageing of the population is not a problem that pertains only to old EU-Member States: it also applies to the NMS. This is a demographic constraint that the NMS should address; in the ultimate analysis, migration might well prove to be part of the solution to the problem.

[28] Source: Hungarian office of Immigration and Nationality Statistics, http://www.bmbah.hu/index.php?option=com_k2&view=item&layout=item&id=492&Itemid=1259&lang=en#

Figure 30 / Population shrinkage, 2015-2050



Source: UNHCR Statistics as of 29/09/2015 , EC, Eurostat, own calculations.[29].

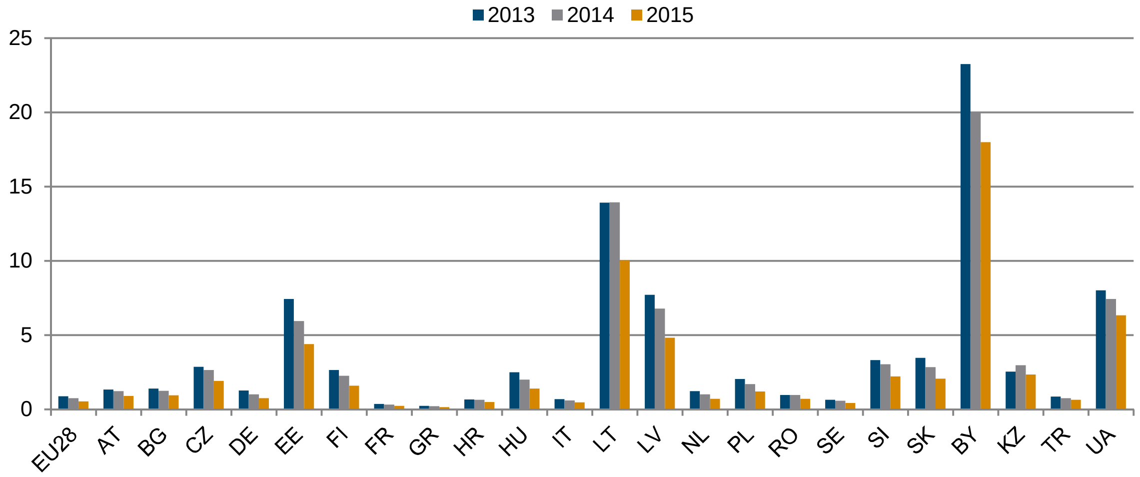
[29] Own calculations using Eurostat population projections, main scenario [proj_13npms] (International net migration included) and no migration scenario [proj_13npzms] (international net migration assumed to be zero). Population shrinkage is calculated as the difference between the 'no migration' and 'main' population projection scenarios.

Special section II: Russian crisis and European growth: resilient NMS, infected CIS and the Baltics

PETER HAVLIK

The Russian economy plunged into recession in 2015. The combined effect of the prolonged stalemate in terms of reforms, the imposition of extensive sanctions, the collapse in oil prices and the subsequent devaluation of the rouble have resulted in an unprecedented drop in Russian exports and – even more so – in imports.[30] As of 2013, Russian external trade started to falter; in 2014 Russian goods exports dropped by another 5% and imports by nearly 10% compared to the previous year. Trade with the EU was hit particularly hard: EU exports to Russia declined by 14% in 2014 (German exports fell by 18%: all in current EUR terms). In parallel, FDI flows declined sharply as well: according to CBR data, Russian inward FDI stocks fell by more than USD 200 billion during 2014 (outward FDI stocks by USD 90 billion), mostly on account of Cyprus. The process of disinvestment accelerated dramatically in the first half of 2015 (inward FDI flows: -80% year on year; outward flows: -64%).

Figure 31 / Exports of goods to Russia (selected countries, in % of GDP)



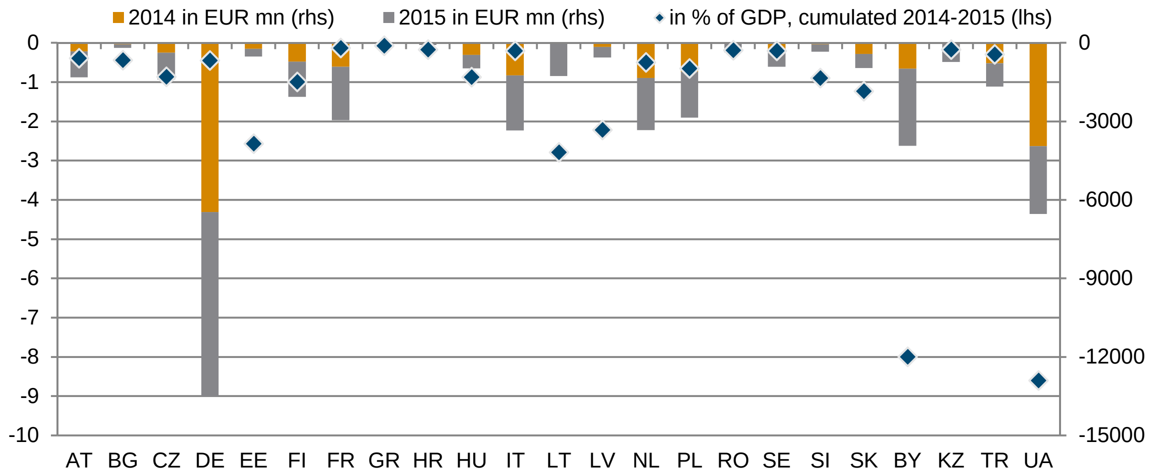
Note: 2015 exports estimated on the basis of the Russian Customs Statistics for the IH2015.
Sources: Eurostat, national statistics; wiiw and European Commission forecasts.

The decline in trade has dramatically accelerated in 2015 as the impact of oil prices, sanctions and the devaluation of the rouble struck home: data for the first half of 2015 indicate a huge drop not only in

[30] See the corresponding country report in this issue. For more details on Russian economic performance and prospects see P. Havlik (2015), 'Russian Federation 2015: From Stagnation to Recession and Back', *wiiw Research Reports*, No. 406; on trade restructuring see P. Havlik (2015), 'Russian grand trade collapse', *wiiw Monthly Report*, No. 12 (forthcoming). Comments by Amat Adarov, Vasily Astrov and Mario Holzner (all wiiw) are gratefully acknowledged.

Russian exports (-12%), but also – and especially so – in imports (-25%) compared to the previous year period (in EUR terms).[31] Once again, trade with the EU suffered more than average, whereas trade with China and the USA proved relatively resilient. Trade with Ukraine was decimated (both exports and imports were cut by another 35% in the first half of 2015). Perhaps surprisingly, some of Russia's partners in the Eurasian Economic Union (EAEU), Armenia, Belarus and Kazakhstan, were severely hit by Russian import cuts and a number of new import barriers emerged. In cumulative terms, over the period 2013-2015 Russian imports were reduced overall by some 30%. Imports from the EU fell by 35%, while those from Germany, Estonia, Finland, France, Hungary, the Netherlands and Slovakia dropped by close to 40%. Russian imports from Ukraine slumped by close to 60% on a cumulative basis![32]

Figure 32 / Estimated losses due to reduced exports to Russia, 2014-2015



Note: Year 2015 estimated on the basis of the Russian Customs Statistics for the IH2015.
Sources: Eurostat, national statistics; wiiw estimates.

The above export losses suffered by many EU countries are already close to the 'extreme' scenario elaborated in November 2014 (which reckoned with a 50% export drop).[33] Drawing on newly available data for 2014, we can now update those estimates and revise the previously estimated effects on GDP growth. In general, the Russian market has steadily declined in importance. In 2013, 2.6% of EU exports overall went to Russia. In 2014 they accounted for a mere 2.2%, dropping in 2015 to below 2%.[34] Figure 31 shows the varying – and generally rapidly declining – importance of Russia as an export market. On average, just 0.5% of the EU GDP was exported to Russia in 2015 (compared to 0.9% of GDP in 2013 and 0.7% in 2014). Needless to say, a number of new member states (NMS) – especially the Baltic States – remain more exposed than others to the Russian market. Dependence on exports to Russia is still extremely high in Belarus (18% of GDP), Lithuania (10%) and Ukraine (6%). In absolute terms, the EU-28 suffered an estimated cumulative loss of EUR 42 billion (less than 0.3% of EU-28 GDP in 2015) on account of the exports of goods to Russia they forwent over the period 2013-2015. The loss accruing to Estonia, Latvia and Lithuania attributable to exports to Russia forgone mounts to more than

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

[32] Projections for 2015 are based on the Russian Customs Statistics for the first half of the year.

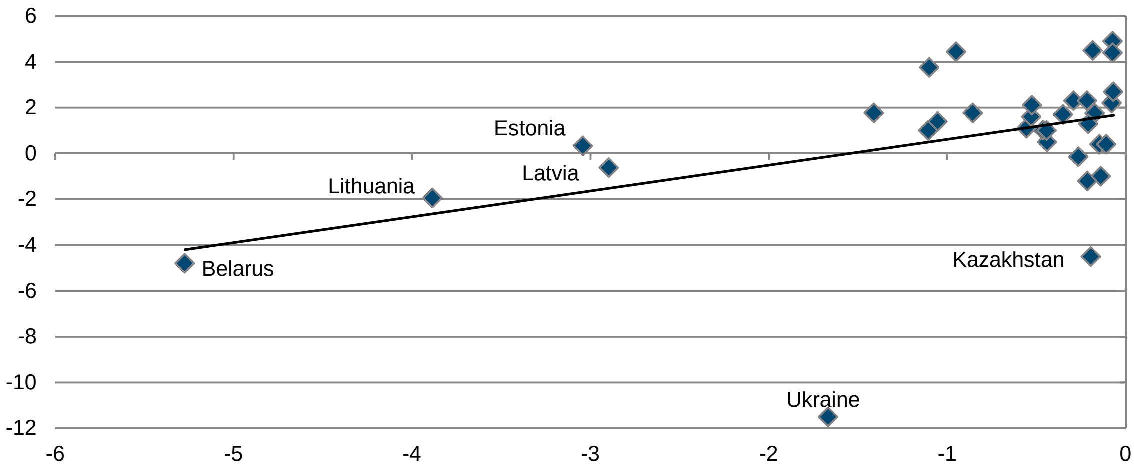
[33] P. Havlik (2014), 'Economic Consequences of the Ukraine Conflict', *wiiw Policy Notes and Reports*, No. 14.

[34] Note the huge asymmetry: in 2015 nearly 38% of Russian imports still came from the EU (see Havlik, 2015, 'Russian grand trade collapse, op. cit.).

2% of their respective GDP in 2015; in Belarus and Ukraine they amount to more than 8% of GDP (Figure 32).[35]

A comparison of export losses suffered with actual GDP growth performance shows a surprising resilience in the majority of NMS. In actual fact, average GDP growth in the NMS has accelerated throughout the period 2013-2015 as those countries entered new export markets, absorbed EU transfer funds, enjoyed gains in terms of trade and generally reduced their exposure to Russia. However, this has not been the case everywhere. In the Baltics, especially in Estonia and Lithuania, GDP growth in 2015 is expected to fall below 2% – even lower than in 2013. Overall, there seems to be a link between declining export shares to Russia (in terms of GDP) and acceleration in GDP growth that suggests a reorientation away from the Russian market (Figure 33). Needless to say, both Belarus and Ukraine are the outliers that have been affected most by the Russian crisis. Even apart from Ukraine, it will be difficult for the EU to recapture the Russian market shares it has lost (on account of continuing sanctions, a shift towards China, weak domestic demand, import substitution, etc.).[36]

Figure 33 / Exports to Russia as shares in GDP (dX: 2013-2015) and changing GDP growth (dY: 2013-2015), in pp



Note: Exports in 2015 extrapolated on the basis of the Russian Customs Statistics for the IH2015.
Sources: Eurostat, national statistics; wiiw and EU Commission forecasts.

[35] From a sectoral perspective, Russia de facto stopped importing meat, fish, milk, fruits and vegetables from the EU in 2015, although some of those items were reportedly re-directed via third-party countries such as Belarus or Serbia. EU fruits and vegetables were partly replaced by imports from third countries (mostly CIS), but there was little import substitution via domestic production. Imports of transport equipment (automobiles, aircraft and trams) were cut back severely (see Havlik, 2015, 'Russian grand trade collapse', op. cit.).

[36] For more details see Havlik (2015), 'Russian Federation 2015', op. cit.

Special section III: The Volkswagen emission scandal and its impact on Central and Eastern Europe

DORIS HANZL-WEISS

The impact of the scandal is still an unknown factor, yet fears abound of it spreading to the Czech Republic, Slovakia and Hungary, as well as, to a lesser degree, to Poland. The automotive industry is the main manufacturing sector in many countries in Central and Eastern European (CEECs). In fact, in terms of manufacturing output, it is the largest sector in the Czech Republic (24.5%), Hungary (25%), and Slovakia (31.3%). It ranks second in Romania (13.5%) behind the food industry and in Slovenia (11.5%) behind basic metals and fabricated metal products. In Poland, the automotive industry is also an important sector (10.1%), but ranks lower, whereas in Bulgaria it scarcely registers (a mere 2.6%)[37]. The recent scandal surrounding Volkswagen has thus given rise to concern over the knock-on effects on those countries' economies. Questions are being raised about the countries that might be affected, the extent of Volkswagen's engagement in the region and the looming overall impact.

After the collapse of communism, Volkswagen was one of the first automotive companies to enter the former centrally planned economies in Central and Eastern Europe. As far back as 1991, Volkswagen was already actively engaged in the Czech and Slovak Republics (or Czechoslovakia as it was still known). It set up joint ventures with local automotive companies operating at that time. Those joint ventures ultimately emerged as Škoda Auto and VW Bratislava (motor car production). Audi arrived in Hungary in 1993 and built a green-field investment plant manufacturing engines. Volkswagen has also been active in Poland since the beginning of the 1990s and its plant, Volkswagen Poznan, produces light commercial vehicles. Volkswagen has continuously invested in the region over the past 25 years, enlarging existing facilities or building new plants, also for component production. For example, it is currently constructing a new plant for commercial vehicles in Poland.

Other car manufacturers have also set up plants in the region such as Renault (Slovenia and Romania), Daewoo (Poland and Romania) and Fiat (Poland). Over the period 2000-2010, enlargement of the EU also sparked investment by companies from further afield: Toyota-Peugeot-Citroën and Hyundai in the Czech Republic; PSA Peugeot-Citroën and Kia in Slovakia, as well as Mercedes-Benz in Hungary. Thus, Volkswagen alone does not dominate the region as a whole nor is it possible to assess the extent to which the countries in the region have been affected by the scandal.

That notwithstanding, the regional significance of Volkswagen becomes apparent on reading a list of major companies (Coface, 2015)[38]. Today, in terms of turnover Škoda Auto and VW Bratislava are the largest companies in both the Czech Republic and Slovakia; they are also major employers (25,889 and

[37] Data based on Eurostat National Accounts for 2014, Bulgaria and Romania 2013, Poland 2012.

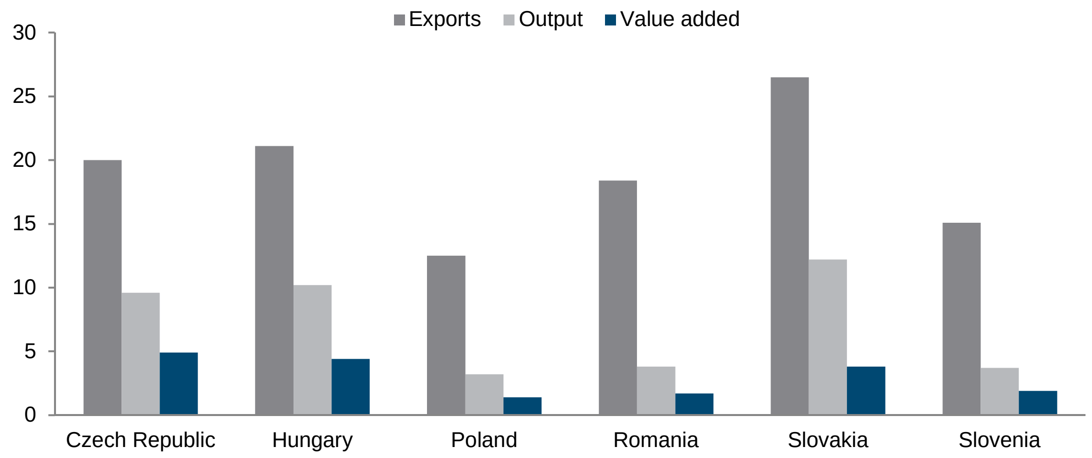
[38] Coface (2015), Coface CEE Top 500 companies, August.

8,938 employees, respectively) and exporters. Audi Hungary Motor Kft is the second largest Hungarian company (after the MOL) in terms of turnover and has 11,274 employees; Volkswagen Poznan also ranks among the largest companies in Poland and has a workforce of 7,554 employees.

The impact of the recent Volkswagen scandal is still obscure in terms of both size (a drop in demand feared, imposition of penalties and liabilities for damages) and scope (the number of countries affected). In addition to the possible direct effects on the CEECs, a slowdown of the German automotive industry would also have a negative impact on the region via linkages along the value chain.

In attempting to assess the impact of the scandal on the countries' GDP, we have looked at the automotive industry's share in total gross value-added as a rough proxy (on the one hand and their importance notwithstanding, linkages to other industries, such as rubber, were thus ignored, while on the other hand it was recognised that Volkswagen does not make up the whole automotive industry). As can be seen in Figure 34, the automotive sector is smaller when measured in terms of value-added rather than in terms of output on account of the large share of intermediates that are also imported. In those countries where Volkswagen is present, the sector accounts for roughly 5% of gross value-added in the Czech Republic, 4.4% in Hungary, about 4% in Slovakia and only 1.4% in Poland. Against that backdrop, the impact on growth is expected to be only minor. Furthermore, initial reactions in the CEECs hint at only a limited impact. In the Czech Republic, the finance minister is not concerned about the outcome in Škoda Auto, but rather about the impact on suppliers. Hungarian politicians are also fearful of the impact however small, whereas the attitude of Slovak economists is rather relaxed. Overall, it is still unclear how customers will respond. Possibly, were they to switch to other brands, it would help other car manufacturers with plants in the region.

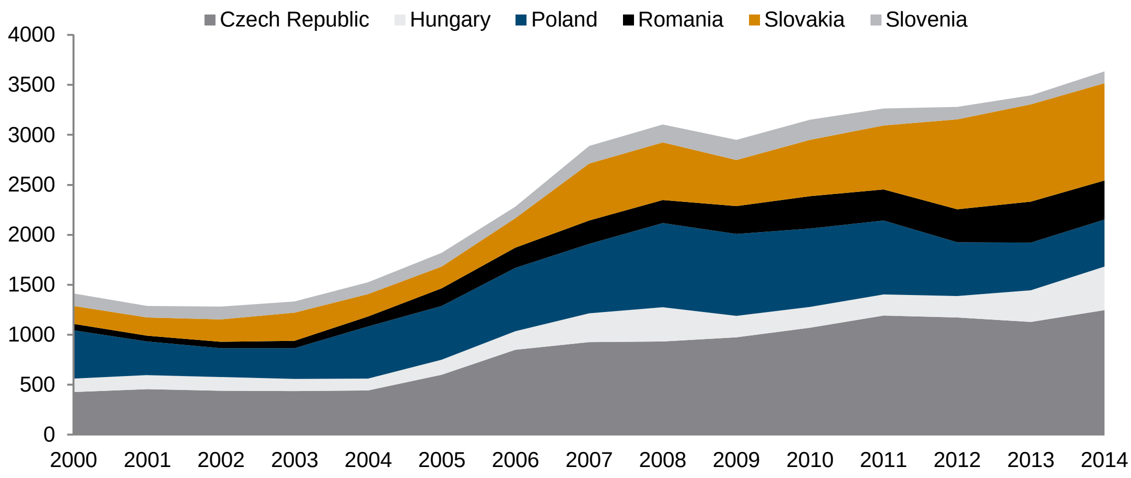
Figure 34 / Automotive industry overview (NACE rev. 2, 29), 2014, in % of total



Notes: 1) Poland 2012, Romania and Germany 2013.
NACE 29 'Manufacture of motor vehicles, trailers and semi-trailers' including: 291 'Manufacture of motor vehicles' 292 'Manufacture of bodies (coachwork) for motor vehicles; manufacture of trailers and semi-trailers 293 'Manufacture of parts and accessories for motor vehicles'.
Source: Eurostat National Accounts Database.

On the whole, whatever the ultimate impact, it will only become apparent in the months to come; they thus fall into the following year. For the current year, figures for car production in the first six months paint a positive picture and show an increase of about 6% for the region as a whole. In the Czech Republic car production increased by 6%, in Hungary by 7%, in Poland by 14% and in Slovenia even by 51%.[39] The figures for Romania show only a minor increase (+1%), while those for Slovakia even show a decrease (-1.7%), the reason being that both countries export a larger share of their output to countries outside Europe, whose economies are not doing well at present.

Figure 35 / Passenger car production, in thousands



Source: OICA - International Organization of Motor Vehicle Manufacturers, www.oica.net.

[39] Data from OICA.

Special section IV: Slowdown in China: only a modest impact on the CESEE region

DORIS HANZL-WEISS AND ROBERT STEHRER

Introduction

As already elaborated in the report, recent forecasts speak of world growth as being slower than expected: 3.5 percent in 2015 and 3.8 in 2016 (cf. IMF, 2015)[40]. Furthermore, growth developments across world regions are expected to be more uneven. Growth in emerging markets in particular is expected to lessen. Growth in China in 2014 was 7.4 percent; it is expected to decline further to 6.8 percent in 2015 (IMF, 2015), i.e. lower than projected. It is therefore interesting to investigate the implications that slowdown bears for the economic performance of the countries in the CESEE region. This section therefore looks first at the share of China in each country's exports and imports and goes on to describe how important exports to China are with respect to GDP. Given the recent debate on gross export flows becoming increasingly less important as the role of international integration of production and hence international supply and value chains take on increasingly more importance, the section briefly discusses bilateral trade relations between China and the NMS in terms of value-added trade.

The importance of trade with China

Just how important is China for the export performance of the CESEE countries? Furthermore, just how dependent are those countries on imports from China? The shares of goods exports to China in total exports have been generally increasing over time, albeit from low initial levels in some cases. In 2014, the shares of exports to China in total exports ranged from less than or only slightly above 1% for most CESEE countries to more than 12% for Kazakhstan and Kosovo. China also takes on relative important for Russia with a 7.6% share in that country's exports, the comparative figures for Ukraine and Albania being 5% and 3.4%, respectively. As for imports, the share of China in total imports is higher in all countries in the region - on average 7% across all countries. Up until 2007 those shares were on the increase; thereafter, however, they have remained relatively stable with a slight increase in average terms (and a rapid increase in Russia). China is amongst the top 10 export destinations for Albania (ranking seventh), Kazakhstan (ranking second), Kosovo (ranking third), Macedonia (ranking eighth), Russia (ranking second) and Ukraine (ranking fourth)[41]. Compared to other European countries, those export shares are at the lower end of the scale: for example, the share of China in Austrian exports is about 2.2% and that of Germany about 6.6%. As for imports, the shares tend to be closer to those of

40 IMF (2015), World Economic Outlook: Adjusting to Lower Commodity Prices, Washington, October.

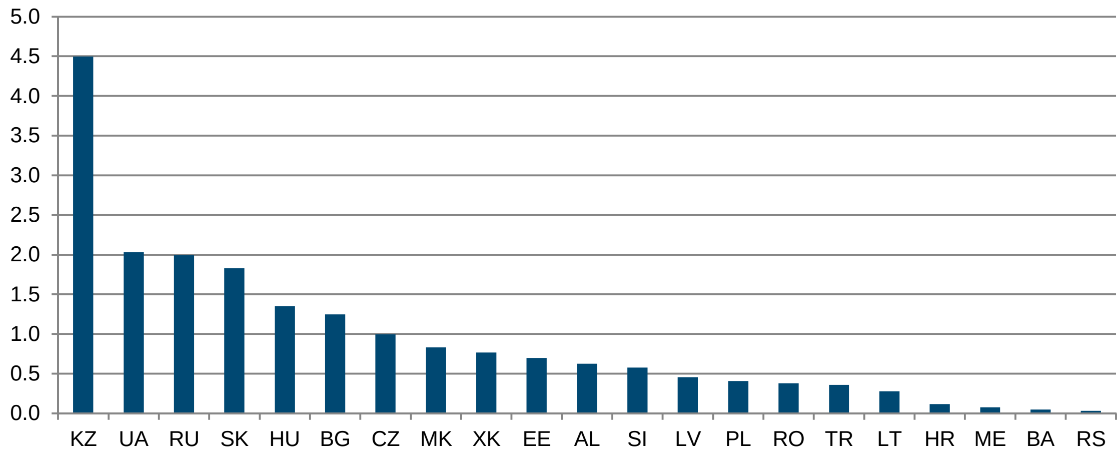
41 Ranks refer to year 2014.

other European countries: for example, the share of China in total imports is 3.6% and that of Germany about 6.7%).

Implications for economic growth

How important are exports to China in terms of GDP? Figure 36 presents the share of exports to China in percent of GDP for each country. Exports to China were most pronounced in Kazakhstan, accounting for 4.5% of GDP in 2014 (mostly on account of oil exports). In Ukraine, Russia and Slovakia the shares of exports to China in terms of GDP reached about 2%. In Hungary, Bulgaria and the Czech Republic the shares ranged between 1.5% and 1%. In all other countries - encompassing the Baltic countries and two large countries, Poland and Turkey - exports to China accounted for about 0.5% of GDP or even less. The shares were smallest in the Western Balkan countries (WBCs).

Figure 36 / Goods exports to China in % of GDP, 2014



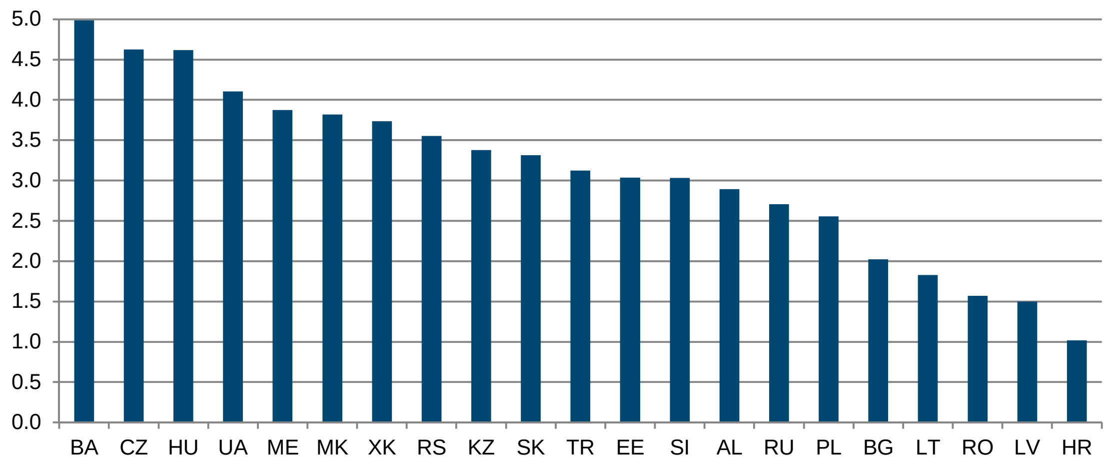
Source: wiiw Annual Database; own calculations.

If we consider trends over the period 2000 -2014, we can see that most of the countries in the region have experienced an increase in their share of exports to China in GDP terms. Such was the case in the CE-5 (the Czech Republic, Hungary, Poland, Slovakia, and Slovenia), the Baltics and Bulgaria. In Slovakia and Bulgaria, the shares literally leapt upwards in both 2010 and 2012 - owing to car exports from Slovakia and copper exports from Bulgaria. In Romania, Russia and Ukraine the pattern was different. In all three countries the share declined up until 2008 and only thereafter did it start to grow. In the WBCs, exports to China have been of relatively little importance, fluctuating heavily over time. Kazakhstan's share of exports to China in GDP terms (mostly in oil and petroleum products, metals and metal ore) increased initially and peaked in 2011 at 8%, only to drop again on account of fluctuations in oil prices.

If we consider imports, we can observe that with the exception of Kazakhstan, Chinese imports take on greater importance than exports and account for 1 - 5 percentage points in GDP terms. In 2014, at the upper end of the scale, the share of imports in percent of GDP reached 5% in Bosnia & Herzegovina, 4.5% in the Czech Republic and Hungary, about 4% in the Ukraine and four WBCs (Montenegro, Macedonia, Kosovo and Serbia). At the lower end of the scale, Bulgaria and Romania, Lithuania and

Latvia as well as Croatia recorded the lowest shares, ranging between 2% and 1%. Considering developments over time, most of the countries, except Estonia, registered a short-lived increase in their shares from 2000 onwards up until the crisis. The crisis brought about a slump in imports and a pattern change thereafter. In the majority of countries in the region, shares have remained mainly constant over the past four years; they have even declined in Hungary and Croatia.

Figure 37 / Goods imports from China in % of GDP, 2014



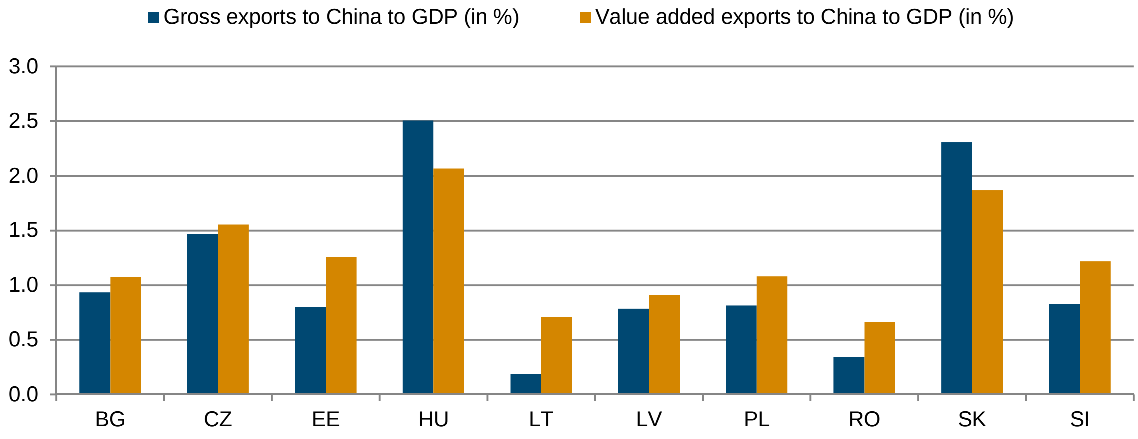
Source: wiiw Annual Database; own calculations.

Taken together, all countries in the region, with the exception of Kazakhstan, were running a trade deficit with China ranging from less than 1% in the case of Russia, Bulgaria and Croatia to almost 5% in Belarus in 2014 (see Figure 38).

If taken as a share of GDP, the bilateral gross exports considered above might prove a somewhat misleading indicator for two reasons. On the one hand, gross exports can to a large extent be produced using imported intermediate inputs, which do not add to a country's GDP. Thus, accounting for that factor could appreciably reduce the impact of exports on GDP. On the other hand, countries might export to other countries intermediate products that are subsequently re-exported and finally absorbed in the (direct) partner country being considered. If account is taken of these 'indirect' exports, the impact in GDP terms increases, even though those inputs do not constitute part of the bilateral gross exports.[42] These are two countervailing forces, the magnitudes of which depend on the structural involvement of a country or industry in global value chains and a country's export structure. In essence, it remains an empirical question on the extent to which bilateral gross trade differs from bilateral value-added trade in GDP terms. Using global input-output tables allows us to investigate the impact of exports on GDP, while taking into account the issues mentioned above. Figure 38 presents the gross exports and value-added exports to China in percent of GDP for the CEE-10 based on the world input-output database (WIOD).

[42] Theoretically a country A, which does not maintain any export relations with country C, could nonetheless be a value-added exporter via its exports of intermediate products to country B where they are processed further prior to being shipped to country C.

Figure 38 / Gross and value-added exports to China in % of GDP, 2011



Source: WIOD; own calculations.

Given these two countervailing forces, both ratios differ from 0.4 percentage points in Hungary and the Slovak Republic to -0.5 percentage points in Estonia and Lithuania. Thus, in the case of the first two countries gross exports outstrip value-added exports owing to the large volume of imported intermediate inputs used in the production of their exports. Estonia and Lithuania, as well as Romania, Slovenia and Poland, export more to China in value-added terms than in gross export terms; this shows that those five countries supply intermediate inputs that China ultimately absorbs via third countries.

Impact of the Chinese slowdown

In most countries in the region, the share of exports to China is modest, ranging from 2 percent in the Ukraine and Russia to less than 0.5 percent in more than 10 of the CESEE countries considered. Of the remaining countries, nine report shares ranging between 2% and 0.5%; only Kazakhstan features prominently with a share of 4.5%. Given this modest share of exports to China, a slowdown in Chinese growth might have only a relatively modest impact on overall GDP growth rates of the countries considered here. For example, assuming a GDP growth rate for 2015 of 2%, the growth contribution of exports to China for a country with an export to GDP ratio of 0.015 is 0.03 percentage points. However, two caveats should be heeded. First, if the Chinese slowdown triggers further slowdowns in other countries and in the world economy as a whole, the impact on the CESEE countries would, of course, increase not only via direct exports, but also via indirect trade effects given the importance of supply and value chains for certain countries as discussed above. Secondly, despite the relatively small contribution to growth that exports to China make, they nonetheless contribute positively to growth, particularly when indirect effects are taken into account. Thus, a growth slowdown might ultimately have a negative impact on the already sluggish growth rates. Finally, assuming that imports from China respond more slowly than exports to China in the course of a growth slowdown, the trade balance with China might deteriorate slightly (depending on the structure of imports from China). However, efforts are being made to intensify trade between the countries in the region and China in an initiative called 16+1 with ongoing or planned Chinese investments; plans are being mooted to revive the Silk Road. That initiative is expected to lead to a further increase in the volume of trade between the CESEE region and China.

Special section V:
Greece and the EMU: crisis and stability

VLADIMIR GLIGOROV

What can the Greek crisis teach us about the stability of the European Union (EU) and its Member States? Stability or lack thereof is also the main conduit via which the Greek crisis can influence developments in the countries of Central, Eastern, and South-East Europe (CESEE). Even in the Balkan countries with their extreme exposure to Greek banks either direct or indirect effects of that country's bankruptcy are negligible.

The first lesson we learn relates to the nature of the game that the EU and its Member States play, given the specific institutional structure of the EU and even more the manner in which the European Monetary Union (EMU) functions. The obligations incumbent on the membership are contractual; this means that in principle Member States can reclaim their sovereignty, should they so decide. However, in terms of the distribution of interests, cooperative solutions, or shared sovereignty, are preferred even in cases of asymmetric or general crises. This outcome is attributable to the advantages of the common market as well as, perhaps surprisingly given the widespread criticism, to the preference for a common currency over national currencies.[43]

The latter point has proven crucial in the current Greek crisis because, however defined, be it businesses, households, voters or opinion-makers, the Greek public has not been prepared to substitute the drachma for the euro. Hence, despite all the criticism levelled at the EMU and, in particular, at the policy framework of the European Central Bank (ECB), people tend to see the EMU as being preferable to returning to a system of national currencies. The reasons for this need to be explored.

One reason is that unlike any other fixed exchange regime, monetary union means complete indexation of prices and incomes in the common currency. In other fixed exchange rate regimes, all the way to strict currency boards, some prices and some incomes, for example some or most wages, are quoted in domestic currencies and undergo staggered adjustment to inflation or labour market conditions, so monetary and exchange policies, however constrained, can have real consequences. Furthermore, the residual risk is that national economic authorities, the central bank and the government, may opt for monetisation of the budget, possibly through devaluation and more rapid inflation, which, in turn has a bearing on real wages. In the case of a monetary union, indexation is complete and the risk of devaluation quite low, because the costs is high. The former makes leaving the EMU undesirable, whereas the latter increases the cost of devaluation because the risk is equivalent to a collapse of the monetary union and is thus priced in as a relatively negligible factor. Indeed, when the crisis spiked in 2012, with euro collapse starting to look probable, it transpired that the expected devaluations in countries like Greece, as revealed in the increase in the spread of yields, was considerable, thus reducing the appeal of abandoning the euro.

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[43] Detailed account in V. Gligorov, 'Greek Negotiations: No Payoff, No Game', http://wiiw.ac.at/greek-negotiations-no-payoff-no-game-n-74.html.

Given the preference for a cooperative solution or shared sovereignty, the range of political options in the democratic game is rather limited at the domestic level. That is the second lesson that the Greek crisis can teach us, but it clearly applies generally. As long as the public is not ready to contemplate secession from the EU and the EMU, domestic political competition stabilises and is restricted to alternatives that even far left or far right parties can offer as workable policies within the context of the common market and the currency union. Clearly, this occurs not for the want of sovereignty, as a Member State is free to choose to leave both the EU and the currency union; it is, however, the predictable outcome of the democratic decision-making process in a Member State, given the popular support for membership in both the EU and the EMU.

This does not only hold true for a country such as Greece, although clearly the level of commitment to membership in the EU and the EMU varies across countries – partly in keeping with the varying costs of secession. However, since the beginning of the crisis and, in particular, since the currency union crisis in 2012, it has become clear that in most Member States the public is not ready to forgo either the common market or the currency union, as long as the cost of integrating markets and currencies does not increase dramatically. By the same logic, the policy options in practically all Member States are based on a preference for cooperation over dissolution. This stabilises the political competition in all Member States and, thus, in the EU as a whole.

The major implication of this is that the crisis needs to be overcome in a cooperative manner. This means that the risks and costs of adverse developments have to be shared. The sharing takes on three forms.

The one form is that of debt mutualisation, increasing the ways in which risks to financial, fiscal, and foreign debt stability are shared. Specifically, the elements of public debt mutualisation have their roots in the manner in which bankruptcy has been handled in the case of Greece. The country's massive public debt, currently standing at more than 200% of the GDP, has been financed mostly via the European Stability Mechanism (ESM) or its precursor, the European Financial Stability Facility (EFSF), which borrows on behalf of Greece. This explains why the interest rate on that debt is so low (ESM bonds have first-class ratings). The implication of all this is that the default risk is shared by the members of the ESM, who, mostly but not exclusively, are EMU member states. This is, thus, a form of fiscal union, which, however, has not been accompanied by the transfer of at least some taxing powers to the EU or EMU authorities.

This element of the fiscal union changes somewhat the approach to the sustainability of the public debts of EMU member states. The major sticking point in the Greek crisis has been that of the pace of adjustment to debt sustainability. The Greek voters elected a new government that argued that Greece was insolvent and requested that its debt be written off or at least fiscal austerity be eased. The latter request led ultimately to a new programme with the EMU that relaxed the schedule of primary surpluses, which the Greek consolidated budget needs to produce in order to service the debt. If the lower budget surpluses are to be squared with the debt repayment schedule, while default is avoided, the maturity of the debts needs to be extended, for example, to more than 30 years and probably to more than 40 years.

Taken together, lowering the interest rate on ESM loans to close to 1% and extending maturity to 40 years imply a significant debt write-off. Depending on the discount rate assumed, current debts in terms of their future value fall to between 80% and 120% of current GDP: down from over 200% in face value. That, in turn, means that sustainability does not require unpopularly high primary surpluses: a factor that should also be reflected in the severity of the fiscal adjustment to be negotiated.

The remaining issue is whether that adjustment will be enough to allow Greece to start borrowing on its own on sustainable terms. Whereas the International Monetary Fund (IMF) argues that this requires an outright debt write-off, the EU and the EMU member states argue that it is more of a question of greater trust in the ability of Greece to improve its economic performance thorough structural reforms: in other words by changing the manner in which most markets are regulated. The list of reforms is such that it implies a wholesale institutional transformation of the country.

The end is an adjustment of the Greek supply structure from one that is characteristic of a rather closed economy to one where exports of goods and service account for a much larger share in GDP (in Greece the volume of exports of goods is particularly small). Traditionally, exports of goods and services account for about 20% of GDP and have risen to 30% on account of lower GDP in recent years. The latter share would probably have to be twice as large for a country the size of Greece.[44] This clearly is a project for the longer term. It is, however, a necessary undertaking as the current foreign debt of Greece, both public and private, is equivalent to more than 300% of the country's GDP. That puts a cap on the volume of additional foreign investment and funding that the country can count on, especially if the exposure of the domestic banks to the same does not have the requisite fiscal backing.

The latter point has led to a realisation that a banking union is needed within both the EU and EMU, if the link between the financial and fiscal crises is to be severed. That is the final lesson that the Greek crisis has taught us.

Table 5 / Greece and the EMU

Greece: public debt (rounded figures) - Of that - Average maturity	EUR 320 billion 180% of GDP EUR 200 billion, and growing, to EFSF and ESM and EMU member states 15 years (possible extension to 30 to 40 years)
Greece: implicit interest rate	2% with possible lowering to close to 1%
Greece: real growth rate (forecast)	around 3% in the medium term
Greece: primary surplus (programme)	from close to minus 1% in 2015 to 3% in 2018
Write-off in future value terms	from the expected peak at 200% of GDP to at most 120% if ESM and EMU part is extended to 40 years with the interest rate at around 1%
The extent of fiscal mutualisation	at least the Greek debt, at most the ESM credit limit, around EUR 700 billion, or approximately 7% of euro area GDP

In summary, it has transpired that the EMU is more of an integrating rather than a disintegrating instrument – at least for member states and for highly 'euroised' states (such as certain Baltic states that joined the EMU during the crisis). If, however, its sustainability is to go forward, further improvements in the fiscal and banking unions are required. The key test for the sustainability of the EMU and EU also hinges on the calculation of the political costs and benefits of a full-blown, i.e. with the power to tax, though initially limited, fiscal union. All these institutional and policy innovations, not all of which were prompted, yet certainly dramatised by the Greek crisis, bear far-reaching implications for the stability of the EU and the EMU – and thus for all the CESEE countries.

[44] Detailed account in V. Gligorov, 'Greece's Adjustment Problem', http://wiiw.ac.at/greece-s-adjustment-problem-n-96.html.

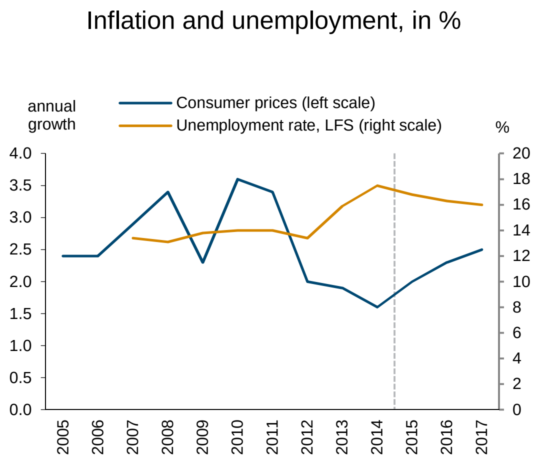
Country reports

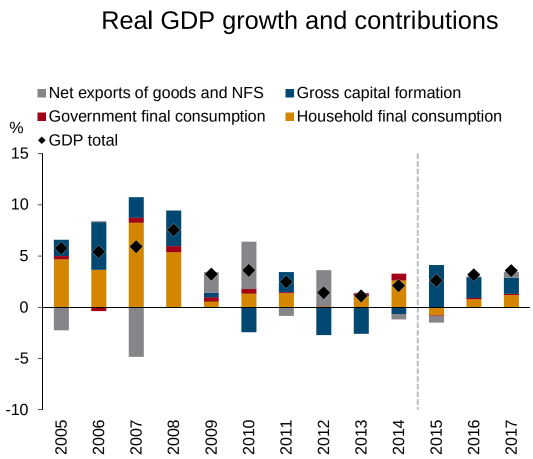
ALBANIA: The challenge of stepping out of the shadow

ISILDA MARA

A credit market lacking vigour, a contraction of exports and meagre fiscal performance are restraining economic growth. Differently, an outstanding performance in terms of gross fixed capital formation, foreign direct investments and remittances, which are flourishing again, is expected to boost the economy by 2.6% in 2015. Growth above 3% is expected in 2016-2017. The rigorous campaign against the shadow economy and consequently a more efficient tax collection can open up more space for public investments.

Figure 39 / Albania: Main macroeconomic indicators





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

The local elections in June induced a shift of power from the right- to the left-wing coalition, which guarantees to the latter exercising its power at the local and the central levels. Leaking of confidential information of a report produced for internal use from the OSCE (Organisation for Security and Co-operation in Europe) classifying a number of parliament members suspected of criminal activities in their past has heated the political debate. Nonetheless, putting the finger on the problem has pushed the government to take further steps towards a reform of the justice system and decriminalisation law. The new decriminalisation law will define the procedures and certain requirements (e.g. prohibition to become a civil servant if in the past the person has been condemned by a local or international court) to be adopted for regulating employment in the public sector.

The Albanian economy has been running below its potential. In the first half of 2015, growth accelerated by 2.53%, on a year-on-year basis. Household consumption contracted by 2.3% compared with the first half of 2014. In spite of the decline, the dynamics of household consumption indicate that in nominal terms its level stays above the average of the last two years by 1.6%. A strong increase of 16% was recorded for gross fixed capital formation. Accordingly, construction output expanded by 20%, but industrial production was cut by 4.3%. The stock of public debt increased by 3% but with respect to GDP stagnated at 70% of GDP. Until August 2015, public revenues increased by 5.1% nominally in lek terms. By contrast, expenditures went down by 1.1% year-on-year. Revenues collected from VAT represent the highest source, but still the performance was 1.7% lower on a year-on-year basis. Capital expenditures rose by 6.4% whereas expenditures on wages and social insurance contributions hardly changed, increasing only by 0.6% year-on-year. The weak performance of tax collection and the customs office has prompted the Albanian government to undertake an intensive campaign against the underground economy.

Starting from 1 September 2015, the key milestone of the governmental programme for the coming 300 days is to reduce the shadow economy, which according to an EBRD and World Bank survey in 2013 is estimated at around 36% of GDP during 1996-2012.[45] So far the strategy adopted by the government is focusing on the use of punitive measures, such as high lump sums of fines to be applied in case of non-conformity (e.g. in case of exercising an unregistered activity, lack of possession of fiscal devices, non-provision of fiscal statements, non-maintenance of inventories, etc.). By the end of 2014, the number of enterprises active in Albania was 112,537. 90% of them are small businesses with one to four employees (69% have only 1 employee). The EBRD and WB survey in 2013 revealed that 40% of the companies claim to compete with businesses that operate informally. According to the Ministry of Finance, some first tangible results of the campaign during August and September have been the registration of more than 19,000 new businesses (but no official figures are reported on the number of closed activities/businesses) and the inclusion of 60,000 new employees in the social security system. Especially for small businesses avoiding their bankruptcy (due to high penalties) and the shift into unemployment (particularly of those self-employed), the application of deterrence measures in complementary with diverse incentive tools – the so-called carrot and stick approach – would be required. Such an approach would not only motivate voluntary tax compliance but would further strengthen the fiscal consolidation in the medium and long run. Furthermore, more efficient tax collection can create more room for raising public expenditures and consequently contribute to public investments.

The signals from the credit market are mixed. Until August 2015, total loans shrank by 1.2% year-on-year. Loans to businesses dropped by 2.7% whereas loans to households rose by 2.9%. In the same period, total new loans went down by 1.1%. In particular, new loans to businesses fell by 12% while loans to households picked up by 15%. As a consequence, the contribution by households to the loan portfolio rose by 8 pp, from 11% to 19% year-on-year, whereas the share of loans to businesses contracted from 89% to 81%. According to the Bank Lending Survey of the Albanian Central Bank, expectations are pessimistic as concerns the demand for credit by businesses but optimistic as concerns households.

Non-performing loans (NPLs), in particular, continue to be a drag on credit growth; these are relatively high, at 20%, in spite of a 3.34 pp decline in the first half of 2015, year-on-year. The cut was achieved

45 http://ebrd-beeps.com/countries/albania/

mainly through loan restructuring, abatement from the balance sheet and other new measures introduced by the Albanian Central Bank. The Annual Supervision Report 2014 of the Albanian Central Bank indicated that by the end of 2014, NPLs amounted to ALL 25 billion for households and ALL 110 billion for businesses, totalling approximately EUR 970 million or 10% of GDP. The Central Bank in collaboration with the government has been preparing a number of new measures, including bailouts (e.g. involvement of the government in buying part of the debt of a company facing difficulties in liquidity). The target is to reduce the share of NPLs to 16% by 2017. The key interest rate was slightly lowered to 1.75% recently, while inflation moved up from 1.3% in January to 2.2% in September 2015 (still below the target of 3%). The economic sentiment indicator for the second quarter of 2015 improved by 5.1 pp, standing above the long-term average by 4.8 pp. That increase is attributed to improvements in the industrial, services and consumer confidence indicators, as opposed to retail trade and construction, which lost confidence.

In the first eight months of 2015, the trade deficit expanded further, by 2.2%, on account of exports falling more strongly than imports, by 3.7% and 0.7% year-on-year, respectively. Disaggregating by commodity groups, not only exports of ‘Minerals, fuels and electricity’ – which used to have the largest share in exports – declined by 7 pp (from a share of 36% to 29%) but also imports of the same group fell by 6 pp (down from a 17% to a 11% share), a reflection of the oil price reductions in international markets and a higher demand for energy that is domestically satisfied. The expectations of the international oil price staying at the current level might contribute to a stable level of exports for this group. Particularly, owing to an increase in net domestic production of electricity by almost 60%, Albania turned from a net importer into a net exporter with gross exports six times higher and gross imports halved. The commodity group ‘Machinery, equipment and spare parts’ has a share in exports of only 5% but registered the highest increase in exports, by 42%. Similarly, imports of this category rose by 14% and reached a share of 20%, suggesting a further increase in private investments and gross fixed capital formation. The EU continues to remain the main trading partner; half of exports are directed to Italy, and two thirds of exports to this country are related to the garment industry. This is a sector constantly on the rise, already overtaking the role of ‘Minerals, fuels and electricity’ in foreign trade and showing the highest share in exports at 35.4%. The current account reflects a further expansion of export services, characterised by an increase in services exports by 7.4% and a decline in imports by 11.5%. Exports in services performed particularly well in tourism, which registering an increase of 9% in the first half of 2015, year-on-year. Foreign direct investment returned to moving upwards, recording an astonishing increase of 32% in the first half of 2015, year-on-year. This increasing trend is expected to be preserved for the rest of the year since the Trans Adriatic Pipeline project has been launched in June and the construction of hydropower plants at the Devoll river by the Norwegian company Statkraft is duly progressing. Other sources of secondary income such as remittances experienced an upswing, growing again by 18% in the first half of 2015, compared to a 1% increase in 2014, on a year-on-year basis. The reasons for that renewed increase may have been the uncertainties that characterised Greece in the first half of 2015 – the country that hosts the majority of Albanian migrants – and the related risk of the Greek drachma returning into circulation. The picking-up of remittances might not slow down considering that the two main destination countries of Albanian migrants, Italy and Greece, have returned to positive growth (according to the European Commission’s Economic Forecasts, expectations are for growth rates of 0.6% and 0.5% in 2015 and 1.4% and 2.9% in 2016, respectively).

In the second quarter of 2015, labour market indicators announced positive outcomes as concerns overall employment but negative ones with respect to the youth unemployment rate. The employment rate went up to 45.8%, 1.4 pp higher than in the second quarter of 2014, while the unemployment rate fell to 17%, 0.2 pp lower than in the same period a year earlier. Nonetheless, youth unemployment remains a stumbling block for the Albanian labour market, signing a further increase to 34.2%, 0.7 pp more than a year earlier. The new migration wave of Albanians in the form of asylum seekers, at a record level of 44,600 during January-August 2015, may have contributed to bringing down the level of unemployment. But still it is a signal of malfunctioning of the labour market and a lack of working opportunities, especially among the youth. The inclusion of Albania in the list of safe countries has reduced the chances of recent asylum seekers to gain this status. Germany, which hosts more than 84% of the 44,600 new asylum seekers, has committed to returning them to Albania, thus there is the risk of the pool of unemployed rising again.

In view of shrinking exports, a weak credit market and meagre fiscal performance, economic growth is expected to be spurred by gross fixed capital formation, foreign direct investment and the restructuring of exports from energy-oriented towards services and other goods. The improvement in consumer sentiment, the increase in household credit for consumption and the recovering of remittances hint at a further expected boost to household consumption against the decline in the first half of 2015. Further fiscal consolidation can be achieved if deterrence measures are applied in complementary with incentives that motivate tax compliance. In the medium term, the economy is expected to move to growth rates of above 3%; for the coming years our forecasts have been adjusted upwards to 2.6% in 2015, 3.2% in 2016 and 3.6% in 2017.

Table 6 / Albania: Selected economic indicators

	2011	2012	2013	2014 1)	2014 January-June	2015 January-June	2015 Forecast	2016 Forecast	2017 Forecast
Population, th pers., average 2)	2,905	2,900	2,897	2,894	.	.	2,896	2,898	2,900
Gross domestic product, ALL bn, nom. 3)	1,301	1,333	1,351	1,394	681	699	1,460	1,540	1,640
annual change in % (real)	2.5	1.4	1.1	2.2	0.4	2.6	2.6	3.2	3.6
GDP/capita (EUR at exchange rate) 3)	3,200	3,300	3,300	3,400	.	.	3,600	3,800	4,000
GDP/capita (EUR at PPP) 3)	7,300	7,300	7,400	7,800	.	.	.	.	.
Consumption of households, ALL bn, nom. 3)	1,012	1,032	1,052	1,104	566.9	558.5	.	.	.
annual change in % (real)	1.8	0.1	1.4	3.4	4.5	-2.3	-1.0	1.0	1.5
Gross fixed capital form., ALL bn, nom. 3)	382	353	350	347	142.9	168.9	.	.	.
annual change in % (real)	5.9	-7.9	-2.1	-2.2	-13.8	15.9	14.5	7.0	5.5
Gross industrial production									
annual change in % (real)	19.0	15.7	28.3	1.6	1.8	-4.3	-5.0	2.0	3.0
Gross agricultural production									
annual change in % (real)	4.8	5.7	-3.4	2.0	.	.	.	.	.
Construction output total									
annual change in % (real)	-1.1	-11.4	-13.0	5.0	-8.2	20.1	.	.	.
Employed persons, LFS, th 4)	1,160	1,140	1,024	1,037	1,004	1,075	1,078	1,090	1,100
annual change in %	.	-1.8	-10.2	1.3	-5.1	7.0	3.9	1.1	0.9
Unemployed persons, LFS, th 4)	189	176	194	220	216	219	218	212	208
Unemployment rate, LFS, in % 4)	14.0	13.4	15.9	17.5	17.7	17.0	16.8	16.3	16.0
Reg. unemployment rate, in %, end of period 2)	13.1	12.8	13.5	13.0	13.5	13.8	13.5	13.0	12.0
Average monthly gross wages, ALL	36,482	37,534	36,332	36,997	.	.	38,100	39,500	41,100
annual change in % (real, gross)	1.5	0.8	-5.0	0.2	.	.	1.0	1.3	1.5
Consumer prices, % p.a.	3.4	2.0	1.9	1.6	1.8	2.2	2.0	2.3	2.5
Producer prices in industry, % p.a.	2.6	1.1	-0.4	-0.5	-0.4	-1.5	-1.2	-0.4	-0.2
General governm.budget, nat.def., % of GDP									
Revenues	25.4	24.8	24.2	26.3	25.7	26.2	26.4	26.5	27.0
Expenditures	28.9	28.2	29.2	31.5	29.0	28.0	29.0	29.0	29.0
Deficit (-) / surplus (+)	-3.5	-3.4	-5.0	-5.2	-3.3	-1.8	-2.6	-2.5	-2.0
Public debt, nat.def., % of GDP	59.4	62.1	70.9	70.2	71.0	70.0	70.0	69.0	67.0
Central bank policy rate, % p.a., end of period 5)	4.75	4.00	3.00	2.25	2.50	2.00	1.8	1.8	1.8
Current account, EUR mn 6)	-1,225	-978	-1,049	-1,287	-609	-423	-1,000	-1,100	-1,000
Current account, % of GDP 6)	-13.2	-10.2	-10.9	-12.9	-12.5	-8.5	-10.0	-10.0	-9.0
Exports of goods, BOP, EUR mn 6)	1,406	1,526	1,051	932	481	422	900	920	950
annual change in %	20.0	8.5	.	-11.3	-2.8	-12.2	-3.4	2.2	3.3
Imports of goods, BOP, EUR mn 6)	3,647	3,525	3,030	3,147	1,456	1,399	3,100	3,150	3,200
annual change in %	12.1	-3.4	.	3.9	7.2	-3.9	-1.5	1.6	1.6
Exports of services, BOP, EUR mn 6)	1,747	1,673	1,715	1,881	809	869	1,900	1,930	2,000
annual change in %	-0.2	-4.2	.	9.7	21.9	7.4	1.0	1.6	3.6
Imports of services, BOP, EUR mn 6)	1,612	1,460	1,489	1,558	715	633	1,500	1,520	1,550
annual change in %	6.2	-9.5	.	4.6	11.8	-11.5	-3.7	1.3	2.0
FDI liabilities (inflow), EUR mn 6)	630	666	945	869	367	483	950	.	.
FDI assets (outflow), EUR mn 6)	21	18	22	58	21	15	90	.	.
Gross reserves of NB excl. gold, EUR mn	1,851	1,909	1,971	2,142	1,964	2,335	.	.	.
Gross external debt, EUR mn 6)	4,958	5,513	6,368	6,927	6,652	7,257	7140	7500	7800
Gross external debt, % of GDP 6)	53.5	57.5	66.1	69.6	66.8	69.6	68.0	69.0	67.0
Average exchange rate ALL/EUR	140.33	139.04	140.26	139.97	140.21	140.43	140	141	141
Purchasing power parity ALL/EUR	61.56	62.65	62.85	61.86	.	.	.	.	.

1) Preliminary. - 2) According to census October 2011. - 3) According to ESA'10 (FISIM reallocated to industries etc). - 4) In 2011 survey done once a year, quarterly thereafter. According to census October 2011. - 5) One-week repo rate. - 6) From 2013 based on BOP 6th edition, 5th edition before.

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

BELARUS: Economy sinks further down

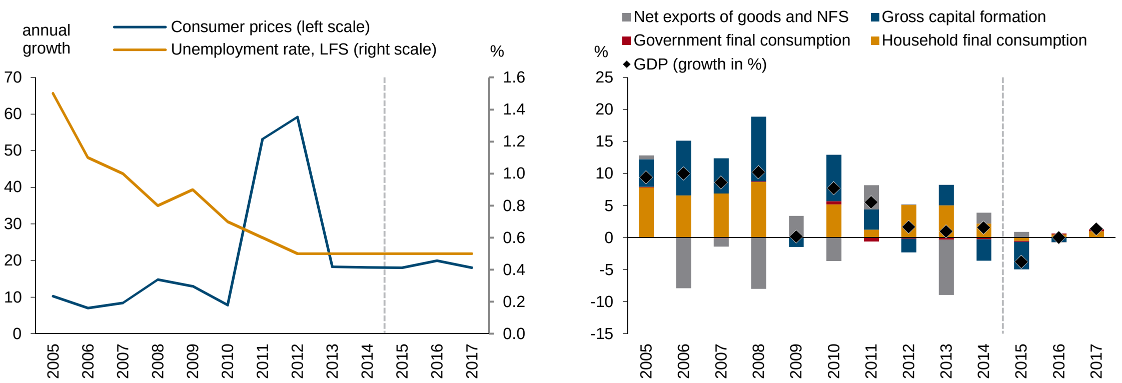
RUMEN DOBRINSKY

Belarus has gone into recession for the first time in more than 15 years as a result of a combination of external shocks and chronic macroeconomic distortions. Further policy adjustments aimed at reducing macroeconomic disequilibria are likely after the October presidential elections. The short- and medium-term prospects remain gloomy; they will depend largely on the eventual recovery of the Russian economy. In all probability, Belarus will only return to a growth scenario in 2017.

Figure 40 / Belarus: 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 economy of Belarus has kept losing steam in the course of 2015, slipping further into recession. Following a drop by 2.3% in the first quarter of 2015, GDP registered a further 4.5% year-on-year decline in the second quarter, resulting in a 3.5% year-on-year drop in the first half. The continuing recession in Russia – Belarus' main export market – contributed to the further slump in Belarus' economic activity. Similarly, the deepening economic turmoil in Ukraine, another key export market for Belarus, added to the depth of the external shock. Exports, and hence the manufacturing industry, suffered the most from the contraction in export demand. In the first half of 2015, Belarus' total trade turnover fell by a quarter compared to the same period of 2014 while real industrial output dropped by 7.4%.

On the demand side, apart from exports, gross fixed capital formation also took a serious hit and its contraction deepened: a drop by 3.1% in the first quarter was followed by a much more pronounced (by 23.1%) fall in the second quarter, resulting in an average decline by 14.2% in the first half of 2015. Private consumption was not so affected but still registered a small drop in this period. At the same time, there was a slight upturn in real retail trade in 2015. One of the factors supporting retail sales was probably the introduction of wide-ranging price controls on a number of consumer goods which likely contributed to distortions and shifts in the structure of prices, making some goods more attractive. Some precautionary purchases were probably also taking place in the anticipation of future price increases.

As suggested by anecdotal evidence, the economic downturn in Belarus hit harshly the labour market as well, producing massive layoffs. However, in the absence of reliable LFS statistics, the official statistics on employment and registered unemployment fails to reflect the magnitude of this shock.

Flash estimates of economic activity in July and August suggest that aggregate economic output and real industrial output continued to shrink and there are no clear signals yet that the economy is on the way to bottom out.

The recession in Belarus has been accompanied by dynamic changes in the macroeconomic sphere as well as by an activist macroeconomic policy stance. The government announced early on its willingness to prevent inflationary spillovers from the exchange rate crisis and took a range of policy measures – both fiscal and monetary – to this effect. On the fiscal side this amounted to a considerable tightening of the fiscal stance, sometimes involving very rigid controls and even cuts in public expenditure.

In 2015 there was also a radical shift in the policy instruments used by the monetary authorities: while before the recent currency crisis they mainly used exchange rate targeting as a key policy instrument, at the beginning of the year this was abandoned and the Belarusian National Bank turned to targeting the money supply. In line with this policy course, the National Bank raised in August the reserve requirements for commercial banks. The exchange rate remains as an indicative target based on a basket of three currencies: the US dollar, the euro and the Russian rouble.

However, what is peculiar in the case of Belarus is that the quantitative management of the money supply is mostly effectuated through direct controls on money creation, including by setting caps on the refinancing of commercial banks and reducing the direct channelling of public funds through the banking system. These channels of directed credit were both sources of inflationary pressure and of implicit subsidies to ailing SOEs. Hence such a monetary tightening, if sustained, may contribute to the start of a process of restructuring of the outdated industry. On the other hand, it adds to the woes of the big industry which suffered losses in export markets.

These macroeconomic policy efforts have been coupled with administrative controls on the retail prices of a number of consumer goods. The price controls were announced as temporary and subsequently the government started removing some of them.

Up to now this set of measures has managed to put some brakes on the price dynamics. Notably, the rate of inflation in 2015 has been lagging considerably behind the pace of depreciation: thus, while the index of the basket of currencies increased by some 27% between December 2014 and August 2015, CPI in the same period grew by 11.8%. Weakening domestic demand also contributed to the relatively modest inflation.

At the same time, the abortion of massive direct interventions on the foreign exchange market in 2015 highlighted even more the very high dependence of Belarus on the Russian economy and the strength of contagion effects: in the absence of such interventions, volatility in the Russian foreign exchange market is directly transmitted to the Belarusian currency markets with the Belarusian rouble also following closely the fluctuations of the Russian rouble.

The loss of export revenue has put even more strain on the balance of payments. In the past several years, Belarus has been facing chronic balance of payments constraints. Rather than adopting corrective policy measures towards a more stable macroeconomic equilibrium, policy efforts have been mostly directed towards attracting additional external financial resources to mitigate the effect of the balance of payments constraints. In the same vein, considerable efforts are made in 2015 to mobilise additional foreign borrowing in support of the balance of payments, mostly for the repayment of maturing old debt.

Russia has been a main source of such lending. In July, the Russian government extended a USD 760 million loan to the Belarusian government as balance of payments support. Russia also pledged to restructure USD 1.3 billion of past loans to Belarus maturing in 2015. On top of that, the Russian Sberbank extended a USD 500 million commercial loan to the Belarusian industrial giant Belaruskalii, one of the largest producers of potassium fertilisers in the world. Belarus also officially requested in March up to USD 3 billion loans from the Stabilisation and Development Fund of the Eurasian Development Bank. In the course of the year, the Eurasian Development Bank has been discussing with the Belarusian authorities the framework conditions of such a loan and while a final deal has not been sealed yet, Belarus is expected to receive a first tranche by the end of the year.

Belarus also started negotiations with the IMF for a new balance of payments support loan. The IMF has voiced its readiness to negotiate such funding on the basis of a medium-term reform programme jointly agreed with the World Bank. Preparatory work on such a programme has started but there is no public information on progress in this area.

Overall it appears that the authorities have been able to prevent a balance of payments crisis in 2015. However, apart from cementing in-built macroeconomic distortions, the current policy course has led to a fast accumulation of considerable external debt. While still remaining in a manageable range, the mounting debt indicates that the policy of the past is no longer sustainable. The authorities were aiming to prevent any macroeconomic destabilisation in the run-up to the presidential elections held in October; however, after the elections, one can expect more significant changes in the policy course.

The short-term prospects for the Belarusian economy continued to deteriorate in the course of the year. The recession has deepened and GDP is expected to drop by some 3-4% for the year 2015 as a whole. The chances for a recovery largely hinge on the prospects of the Russian economy which are not rosy anyway. It can be expected that the authorities will continue to maintain a tighter than usual macroeconomic stance with the ambition to prevent an inflationary outburst. However, given the significant depreciation of the exchange rate, an upward adjustment in the level of prices seems unavoidable, if not in 2015 then in the following years. The 2016 forecast is based on the assumption of a gradual modest recovery in exports and may therefore be on the high side. Coupled with a similarly modest growth in private consumption this could contribute to arresting the economic decline but will hardly leave scope for a substantial recovery. A modest upturn, even in this optimistic scenario, is only expected in 2017.

Table 7 / Belarus: Selected economic indicators

	2011	2012	2013	2014 1)	2014 January-June	2015 January-June	2015 Forecast	2016 Forecast	2017 Forecast
Population, th pers., average 2)	9,473	9,465	9,466	9,475	.	.	9,490	9,510	9,530
Gross domestic product, BYR bn, nom.	297,158	530,356	649,111	778,456	345,111	399,109	883,700	1,060,400	1,268,800
annual change in % (real)	5.5	1.7	1.0	1.6	1.3	-3.5	-3.8	0.0	1.4
GDP/capita (EUR at exchange rate)	3,900	5,200	5,800	6,200	.	.	5,200	5,100	5,500
GDP/capita (EUR at PPP)	12,500	13,100	13,300	13,700	.	.	.	.	.
Consumption of households, BYR bn, nom.	139,955	244,863	318,332	393,956	177,527	202,254	.	.	.
annual change in % (real)	2.3	10.8	10.9	4.5	5.6	-1.8	-1.0	1.0	2.0
Gross fixed capital form., BYR bn, nom.	113,230	178,455	244,296	249,623	105,532	105,977	.	.	.
annual change in % (real)	13.9	-11.3	9.6	-8.9	-7.4	-14.2	-12.0	-2.0	0.0
Gross industrial production									
annual change in % (real)	9.1	5.8	-4.9	2.0	-1.1	-7.4	-6.0	0.0	3.0
Gross agricultural production									
annual change in % (real)	6.6	6.6	-4.2	2.9	-4.3	2.7	.	.	.
Construction industry									
annual change in % (real)	6.7	-8.6	4.6	-5.7	.	.	.	.	.
Reg. employment, th, average	4,691	4,612	4,578	4,551	4,561	4,495	4,470	4,450	4,430
annual change in %	-0.3	-1.7	-0.7	-0.6	-0.7	-1.4	-1.8	-0.4	-0.4
Reg. unemployment rate, in %, end of period	0.6	0.5	0.5	0.5	0.5	1.0	0.5	0.5	0.5
Average monthly gross wages, ths BYR	1,900	3,676	5,061	6,052	5,763	6,457	7,000	8,400	10,000
annual change in % (real, gross)	1.9	21.5	16.4	1.3	3.2	-2.9	-2.0	0.0	1.0
Consumer prices, % p.a.	53.2	59.2	18.3	18.1	17.1	15.3	18.0	20.0	18.0
Producer prices in industry, % p.a. 3)	71.4	76.0	13.6	12.8	11.3	17.7	20.0	20.0	18.0
General governm.budget, nat. def., % of GDP 4)									
Revenues	38.7	38.5	40.3	38.6	40.6	43.2	41.0	40.0	39.0
Expenditures	35.9	37.7	40.1	37.3	40.5	39.3	39.0	39.0	38.0
Net lending (+) / net borrowing (-)	2.8	0.8	0.2	1.3	0.1	3.9	2.0	1.0	1.0
Public debt, EU-def., % of GDP	45.9	38.5	37.6	39.8	.	.	40.0	39.0	39.0
Central bank policy rate, % p.a., end of period 5)	45.0	30.0	23.5	20.0	21.5	25.0	25.0	24.0	22.0
Current account, EUR mn 6)	-3,518	-1,446	-5,737	-4,034	-1,840	-467	-1,200	-1,500	-1,800
Current account, % of GDP 6)	-9.5	-2.9	-10.5	-6.9	-7.1	-1.9	-2.4	-3.1	-3.4
Exports of goods, BOP, EUR mn 6)	28,499	35,391	27,701	27,492	13,637	12,115	26,800	27,400	28,000
annual change in %	55.6	24.2	-21.7	-0.8	-4.5	-11.2	-2.5	2.2	2.2
Imports of goods, BOP, EUR mn 6)	30,913	34,952	31,183	29,537	13,870	12,131	28,500	29,000	29,500
annual change in %	22.4	13.1	-10.8	-5.3	-9.1	-12.5	-3.5	1.8	1.7
Exports of services, BOP, EUR mn 6)	3,906	4,901	5,690	6,113	2,797	2,869	5,800	5,900	6,000
annual change in %	9.0	25.5	16.1	7.4	3.7	2.6	-5.1	1.7	1.7
Imports of services, BOP, EUR mn 6)	2,334	3,140	3,983	4,424	2,111	1,812	4,100	4,200	4,300
annual change in %	3.9	34.5	26.8	11.1	18.9	-14.2	-7.3	2.4	2.4
FDI liabilities (inflow), EUR mn 6)	2,787	1,137	1,703	1,445	983	1,198	1,400	.	.
FDI assets (outflow), EUR mn 6)	87	121	199	57	16	70	100	.	.
Gross reserves of NB, excl. gold, EUR mn	4,648	4,390	3,589	2,820	3,432	3,254	.	.	.
Gross external debt, EUR mn 6)	26,305	25,518	28,807	32,982	29,962	41,959	42,700	43,400	43,900
Gross external debt, % of GDP 6)	71.3	51.9	52.5	56.0	50.9	85.5	87.0	90.0	83.0
Average exchange rate BYR/EUR	8,051	10,778	11,834	13,220	13,296	16,474	18,000	22,000	24,000
Purchasing power parity BYR/EUR	2,504	4,283	5,145	5,985	.	.	.	.	.

1) Preliminary. - 2) According to census October 2009. - 3) Domestic output prices. - 4) Quarterly data refer to first estimates on a monthly basis. - 5) Refinancing rate of NB. - 6) Converted from USD and based on BOP 6th edition.

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

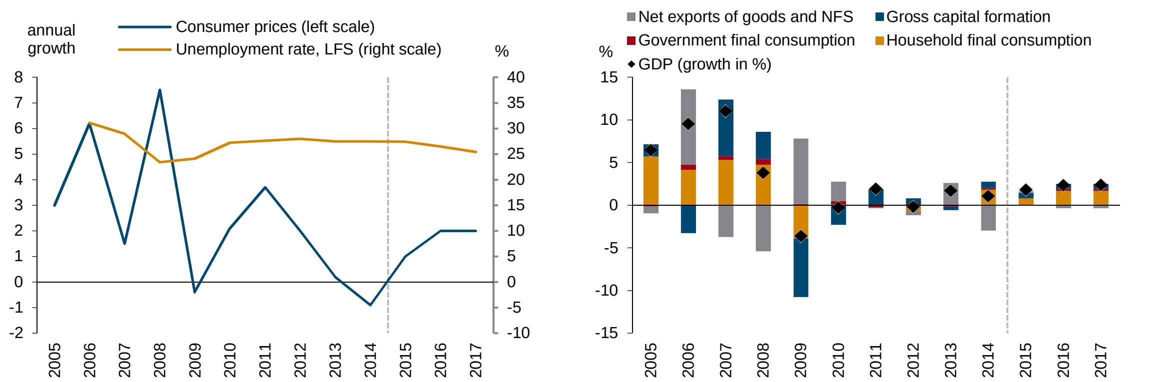
BOSNIA AND HERZEGOVINA: Change in slow motion

VLADIMIR GLIGOROV

On the basis of better investment and continued export growth, the recovery of close to 2% growth in GDP terms estimated for 2015 could accelerate and come close to 3% in the forecasting period and beyond. The country faces both downside and upside risks depending on the evolution of its political and institutional structures, including relations with the EU.

Figure 41 / 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.

Recovery from last year's floods has been faster in Bosnia and Herzegovina than in Serbia though the former was arguably a more affected country. Growth was positive last year and is accelerating this year. In the medium term, it could conceivably surpass 3% after the expected growth rate of around 2% this year. On the demand side, this is due to export growth, while on the supply side it comes from growth of industrial production. Also, government and private consumption are traditionally holding up – in principle due to private and public transfers from abroad and also to continuing foreign investment mainly in the Federation part of this sharply divided country.

As in most other Balkan countries, the labour market is persistently depressed with the unemployment rate hovering around 27%. Other macro balances are mostly sustainable. Public debt is constantly being brought up in local discussions and by the IMF, but this is mostly due to the fear that the institutional setup is such that it is bound to produce unsustainable public finances, but that is not borne out by the data (about which there is some doubt however). In fact, Bosnia and Herzegovina is a country with high public spending which is covered by high public revenues. So, it certainly could benefit from some fiscal restructuring, but that is hard to do given the generally sluggish economic activity. The fiscal situation in the Serbian Republic is worse than in the Federation (which are the two political entities that form the country) and may become problematic at some point of time in the future. Again, this often comes as a surprise to many because the Serbian Republic is centralised, while the Federation is true to its name as it is indeed quite decentralised (it consists of ten quite autonomous cantons). There is also the district of Brčko, which is run again quite differently from the rest of the country. Still, though there are the makings of a failed country, especially in terms of fiscal responsibility, that is not the case due in large part to the system and the authority of collecting and distributing indirect taxes (VAT and tariffs) which work fairly well.

Perhaps the greater risk comes from the external imbalances, as the current account deficit has been large for two decades now. However, it has not led to the development of an unsustainable foreign debt exposure due to it being financed from foreign investments and public transfers. But, more importantly, the country has been able to spur its exporting activities, though those are still smaller than in most countries in the region. However, exports have proved resilient in the crisis and have managed to grow. Clearly the external balances will have to be adjusted at some point in the future, but that is not an immanent problem.

The country was constructed on two premises: One was that economic development will drive political evolution, and the other — that the economic policy framework, with the currency board and balanced budgets, will provide for export-led growth based in large part on foreign investments. Both of these premises have proved to be overly optimistic, to say the least.

In any case, progress has proved to be quite slow. The political adjustment that is slowly taking place is more the consequence of strong social pressures and of the improved regional setup. The political system is constructed in the way that isolates politics from social accountability. In the last couple of years there has been a slow erosion of this isolation, but the final outcome is uncertain. At the moment, there is a last ditch attempt in the Serbian Republic to thwart it by putting the nationalist issues on the agenda and bring back the prospect of secession. In the Federation, in turn, that puts obstacles to democratisation as it becomes harder to find partners so as to create a country-wide movement. That frustrates the more limited change in the Federation itself. Again, this is changing slowly with the creation of a pro-EU coalition in the country’s parliament, which however has to overcome the resistance in the Serbian Republic primarily.

When it comes to the sources of economic development, it will take some time to be driven by exports and investments. However, the framework has proved stabilising and is not questioned by most. For Bosnia and Herzegovina it is crucially important to be integrated regionally and with the EU. The former is more of a reality with the success of CEFTA, the regional free trade agreement, while the latter could see a breakthrough once the EU gets around to putting more effort into that project. This, the start of the slow process of EU integration, is likely to happen in the medium terms and coincide with the slow process of state building.

Assuming these prospects are not frustrated, this year’s recovery of close to 2% growth of GDP could be speeded up to close to up to 3% beyond the forecasting period on the basis of better investment and continued growth of exports.

Table 8 / Bosnia and Herzegovina: Selected economic indicators

	2011	2012	2013	2014 1)	2014 January-June	2015 January-June	2015 Forecast	2016 Forecast	2017 Forecast
Population, th pers., mid-year	3,840	3,836	3,832	3,826	3,826	3,832	3,832	3,832	3,832
Gross domestic product, BAM mn, nom. 2)	26,210	26,193	26,743	27,259	.	.	28,000	29,200	30,500
annual change in % (real)	0.9	-0.9	2.4	1.1	0.9	2.1	1.8	2.3	2.4
GDP/capita (EUR at exchange rate) 2)	3,500	3,500	3,600	3,600	.	.	3,700	3,900	4,100
GDP/capita (EUR at PPP) 2)	7,100	7,200	7,300	7,500	.	.	.	.	.
Consumption of households, BAM mn, nom. 2)	21,927	22,337	22,515	22,886	.	.	.	.	.
annual change in % (real)	0.0	-0.8	0.0	2.2	.	.	1.0	2.0	2.0
Gross fixed capital form., BAM mn, nom. 2)	4,750	4,783	4,714	5,159	.	.	.	.	.
annual change in % (real)	6.2	2.2	-1.0	10.1	.	.	4.0	5.0	5.0
Gross industrial production									
annual change in % (real)	2.4	-3.9	5.2	0.2	0.2	2.7	5.0	5.0	5.0
Gross agricultural production 3)									
annual change in % (real)	1.8	-10.0	15.3	0.0	.	.	5.0	5.0	3.0
Construction output total									
annual change in % (real)	-5.6	-3.1	-2.3	6.8	10.9	1.4	3.0	5.0	5.0
Employed persons, LFS, th, April	816.0	813.7	821.6	812.0	812.0	822.0	820	830	850
annual change in %	-3.2	-0.3	1.0	-1.2	-1.2	1.2	1.0	1.0	2.0
Unemployed persons, LFS, th, April	310.9	316.6	311.5	308.0	308.0	315.0	310	300	290
Unemployment rate, LFS, in %, April	27.6	28.0	27.5	27.5	27.5	27.7	27.4	26.5	25.4
Reg. unemployment rate, in %, end of period	43.9	44.6	44.5	43.6	43.7	43.0	43.0	43.0	42.0
Average monthly gross wages, BAM	1,271	1,290	1,291	1,289	1,288	1,288	1,310	1,350	1,390
annual change in % (real, gross)	0.7	-0.5	-0.1	0.7	1.7	0.5	1.0	1.0	1.0
Average monthly net wages, BAM	816	826	827	830	830	830	850	880	920
annual change in % (real, net)	-1.4	-0.7	-0.1	1.3	2.3	0.5	1.0	1.0	1.0
Consumer prices, % p.a.	3.7	2.0	0.2	-0.9	-1.5	-0.5	1.0	2.0	2.0
Producer prices in industry, % p.a.	5.5	0.3	-1.8	-0.5	-1.4	1.4	1.0	2.0	2.0
General governm.budget, nat.def., % of GDP									
Revenues	43.3	43.8	42.6	43.9	.	.	44.0	44.0	44.0
Expenditures	44.6	45.8	44.8	45.9	.	.	46.0	46.0	46.0
Deficit (-) / surplus (+)	-1.2	-2.0	-2.1	-2.0	.	.	-2.0	-2.0	-2.0
Public debt, nat.def., % of GDP 4)	40.8	42.7	42.6	45.9	.	.	46.0	46.0	46.0
Central bank policy rate, % p.a., end of period 5)	.	.	.	.	.	.	.	.	.
Current account, EUR mn 6)	-1,270	-1,168	-773	-1,057	-515	-468	-1,100	-1,150	-1,200
Current account, % of GDP 6)	-9.5	-8.7	-5.7	-7.6	.	.	-8.0	-8.0	-8.0
Exports of goods, BOP, EUR mn 6)	2,953	2,988	3,286	3,386	1,599	1,692	3,700	4,000	4,300
annual change in %	21.0	1.2	10.0	3.0	-1.8	5.8	8.0	8.0	8.0
Imports of goods, BOP, EUR mn 6)	7,085	7,079	7,027	7,528	3,523	3,527	7,800	8,200	8,600
annual change in %	13.6	-0.1	-0.7	7.1	5.6	0.1	3.0	5.0	5.0
Exports of services, BOP, EUR mn 6)	1,343	1,324	1,311	1,347	613	632	1,400	1,500	1,600
annual change in %	-4.7	-1.4	-1.0	2.8	0.5	3.1	4.0	5.0	5.0
Imports of services, BOP, EUR mn 6)	399	404	388	416	172	185	400	400	400
annual change in %	-2.9	1.1	-4.0	7.3	4.4	7.0	5.0	5.0	5.0
FDI liabilities (inflow), EUR mn 6)	340	261	241	419	260	248	400	.	.
FDI assets (outflow), EUR mn 6)	-4	1	16	-3	-13	29	0	.	.
Gross reserves of NB excl. gold, EUR mn	3,207	3,246	3,530	3,908	.	.	.	.	.
Gross external debt, EUR mn 4)	6,553	6,991	6,973	7,206	.	.	7,500	7,650	7,800
Gross external debt, % of GDP 4)	48.9	52.2	51.0	51.7	.	.	52.4	51.2	50.0
Average exchange rate BAM/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.96	1.96	1.96
Purchasing power parity BAM/EUR	0.9620	0.9436	0.9537	0.9452	.	.	.	.	.

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

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

BULGARIA: Modest recovery continues

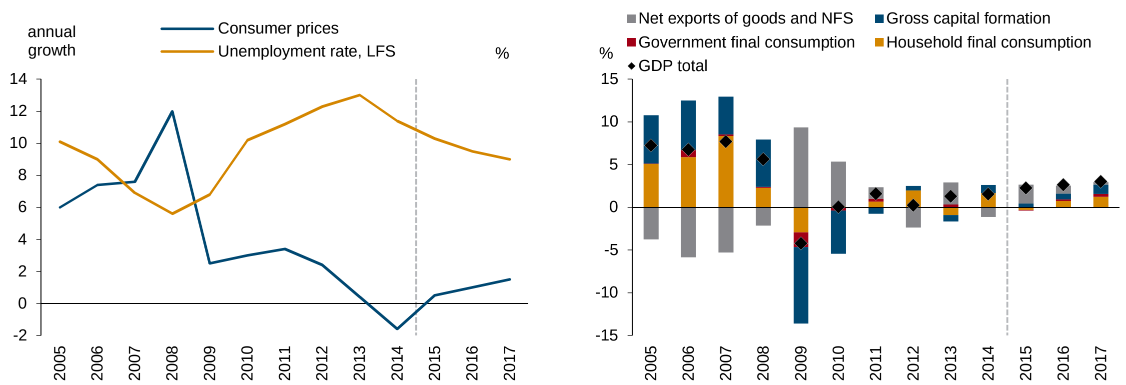
RUMEN DOBRINSKY

GDP growth in the first half of 2015 was supported by a robust upturn in exports in the first quarter. The strengthening in the labour market contributed to the unemployment dropping to below 10% by mid-year. However, economic performance was uneven across sectors, while progress in key policy reform areas was limited. Overall, the chances are that a moderate recovery will continue in the short term with GDP rising higher than 2% for 2015 as a whole.

Figure 42 / Bulgaria: 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 recent major revisions of Bulgaria's national accounts going back to 2005, published recently by the National Statistical Institute, suggest a different picture of the macroeconomic dynamics both during the past decade and in 2015 as compared to that depicted by the previous NSI estimates. While the revised rate of GDP growth in the first half of 2015 was lower than that published earlier, it was still almost 1 percentage point higher than the average annual GDP growth for 2015 expected at the beginning of the year. On the supply side, all main sectors of economic activity apart from construction registered positive growth in this period. On the demand side, growth in the first half was exclusively propelled by a surge in exports in the first quarter; both private consumption and gross fixed capital formation made a negative contribution to GDP growth.

The export boom during the first months of the year was probably the most important factor for the overall economic upturn. In particular, total merchandise exports to the EU in current euros grew at double-digit rates both in the first and in the second quarter of the year. Exports to non-EU countries rose at similar rates in the first quarter but in the later months their growth decelerated while still remaining positive. Such dynamics of the trade flows contributed to an even higher current account surplus.

The manufacturing industry both contributed to and benefited from the recovery in export markets: real manufacturing output continued to recover steadily while at the same time the industry was absorbing increasing numbers of employees. The high-tech service sector has been another source of recent growth: between 2008 and 2014, the export of IT services from Bulgaria quadrupled. The IT sector at present contributes around 2% of Bulgaria's GDP; this share increased threefold during the past decade making it the fastest growing sector of the economy. The ICT sector, the manufacturing industry and other business services have also been the main sources of net job creation during the last couple of years (some 70 ths. between mid-2013 and mid-2015).

The situation in the labour market has improved notably in the course of 2015: by mid-year, the rate of unemployment (both registered and LFS) fell below 10% for the first time since 2009. In turn, the growing labour demand, especially for skilled labour, has been pushing wages up: average real gross wages grew by 7.7% year-on-year in the first half of 2015, giving a boost to consumer sentiment. The ICT sector is a clear leader both in the absolute level and in the growth of wages. Albeit slowly, these labour market developments have started to generate an upward pressure on prices as well: after two deflationary years, the cumulative monthly CPI change in 2015 was marginally positive (0.2%) at the time of writing this report.

The recovery in economic activity contributed to a better than expected cash fiscal outturn in 2015: cash fiscal revenue of the consolidated government in the first seven months of 2015 was 5.8% higher than a year earlier (driven by higher tax revenue and better tax collection) while cash expenditure grew by 4.5%. The consolidated government cash balance reversed to the positive territory in 2015 and, unless there is a revision of the budget, is expected to remain there for the year as a whole. However, in ESA95 terms, the fiscal situation is much less clear due to the fiscal implications of the Corporate Commercial Bank (CCB) failure in 2014. As a part of the bankruptcy procedure, the Deposit Insurance Fund was to reimburse households who own CCB deposits eligible for repayment a total of some BGN 3.6 billion (about 4.4% of GDP in 2014), and most of these have already been paid. This liability was fixed in the amendment of the 2014 budget law but, apparently, the resulting fiscal commitments is so far not reflected in the official 2014 ESA95 fiscal deficit (-2.8%). Therefore either the 2014 number will have to be revised subsequently, or these extraordinary fiscal commitments will be reflected in the 2015 ESA95 fiscal balance.

Up to now the refugee influx to Europe has largely bypassed Bulgaria. After an initial inflow in 2014 which met with a very unwelcome reception in the country, refugees have sought to avoid this transit route. However, with the gradual tightening of internal EU borders along the traditional refugee routes, it is not excluded that a larger flow of migrants may try again to penetrate into Europe through Bulgaria.

Despite the relatively good economic outcome, there was rather limited progress on the policy front. The GERB government that came to power in 2014 with an ambitious reform agenda addressing most aspects of economic and social life (including the business environment, the public administration, the pension system, the health care system and the judiciary). So far, some progress has only been made with the reforms in the pension and healthcare systems. Just before the summer break, the National Assembly adopted changes in the social security legislation that introduced a modest reform in the pension system, envisaging a further gradual increase in the retirement age which is now due to reach 65 years both for men and women by the year 2037. The reform also envisages a gradual increase in the mandatory payroll pension contributions to the National Social Security Institute (the first pillar of the pension system). A modest step was undertaken in reforming the healthcare system with the introduction of elements of competition among hospitals for the funding from the National Health Insurance Fund.

Within the set of planned reforms, the energy sector remains the biggest pain for the government. In the course of the past decade, several governments have been taking a range of commitments to support the development of renewable energy sources which in effect were equivalent to the undertaking of contingent fiscal liabilities under the assumptions that these would be gradually passed to consumers and businesses through price increases. However, up to now all such attempts have faced fierce social opposition and actually led to the fall of the first GERB government in 2013. In the meantime, deficits related to various public sector commitments kept accumulating in the state-owned National Electricity Company, reaching BGN 3.7 billion (some 4.4% of GDP) in September 2015. So far the government has not come up with any practically workable policy solution to these problems.

While the aggregate economic outturn in the first half of the year was generally positive, there were also drags on economic activity and the sustainability of the recovery is far from certain. The tourist industry was badly hit by the shrinking numbers of tourists from Russia by some 25% compared to the previous year. The upturn in business services exports could not offset these losses and the exports of services as a whole dropped year-on-year in the summer months. There was also a downturn in housing construction in 2015 which led to a generally anaemic performance of the construction industry. Exports of goods, the main growth driver in the first months of the year, also started losing steam after the first quarter, mostly due to lower EU import demand.

Given the limited progress in policy reforms and the lack of clearly declared focus on growth in the policy agenda, it is difficult to expect visible policy-induced growth impetus in the short to medium run. Hence the current forecast assumes that Bulgaria’s growth will mostly depend on the small but dynamic new economic sectors and the intensity of export demand. Notwithstanding the existing uncertainties, the short-term prospects of the Bulgarian economy have improved somewhat compared to the beginning of the year.

The current wiiw forecast assumes that exports of goods will continue to provide moderate positive impulses to economic activity while improving consumer and investor expectations will support a modest recovery in domestic demand. Under these assumptions, modest aggregate growth will continue in the second half of the year as well. The average annual GDP growth in 2015 could thus be above 2%. The strengthening in the labour market should also continue while the price dynamics will gradually turn to the positive territory. The forecast for 2016-2017 assumes that the current growth factors will be combined with a strengthening of private consumption and fixed investment, leading to a gradual shift towards a domestically demand-driven type of growth. Under these favourable assumptions, the rate of GDP growth could be expected to be in the range of 2.5% to 3% over the forecast horizon.

Table 9 / Bulgaria: Selected economic indicators

	2011	2012	2013	2014 1)	2014 January-June	2015 January-June	2015 Forecast	2016 Forecast	2017 Forecast
Population, th pers., average 2)	7,348	7,306	7,265	7,224	.	.	7,250	7,230	7,200
Gross domestic product, BGN mn, nom. 3)	80,100	81,544	81,971	83,612	37,022	38,931	85,900	89,000	93,100
annual change in % (real)	1.6	0.2	1.3	1.5	1.5	2.2	2.3	2.6	3.0
GDP/capita (EUR at exchange rate) 3)	5,600	5,700	5,800	5,900	.	.	6,100	6,300	6,600
GDP/capita (EUR at PPP) 3)	11,800	12,100	12,100	12,500	.	.	.	.	.
Consumption of households, BGN mn, nom. 3)	49,582	53,022	50,906	52,207	24,476	24,453	.	.	.
annual change in % (real)	1.1	3.2	-1.4	2.7	3.1	-1.8	-0.5	1.2	2.0
Gross fixed capital form., BGN mn, nom. 3)	16,896	17,443	17,365	17,653	7,674	7,627	.	.	.
annual change in % (real)	-4.4	1.8	0.3	3.4	5.7	-3.0	2.0	3.0	5.0
Gross industrial production 4)									
annual change in % (real)	5.8	-0.4	-0.1	1.8	3.9	3.2	3.0	4.0	5.0
Gross agricultural production									
annual change in % (real)	-2.5	-10.0	14.2	-5.0	.	.	.	.	.
Construction industry 5)									
annual change in % (real)	-12.8	-0.8	-3.7	1.8	3.1	1.7	.	.	.
Employed persons, LFS, th, average 6)	2,950	2,934	2,935	2,981	2,937	2,981	3,030	3,080	3,130
annual change in %	-3.4	-1.1	0.0	1.6	1.4	1.5	1.7	1.5	1.5
Unemployed persons, LFS, th, average 6)	372	410	436	385	407	340	350	320	310
Unemployment rate, LFS, in %, average 6)	11.2	12.3	13.0	11.4	12.2	10.3	10.3	9.5	9.0
Reg. unemployment rate, in %, end of period	10.4	11.4	11.8	10.7	10.7	9.6	.	.	.
Average monthly gross wages, BGN	685.8	731.1	775.1	827.7	806.5	869.2	890	930	970
annual change in % (real, gross)	1.5	3.5	5.1	8.3	4.5	7.7	7.0	4.0	3.0
Consumer prices (HICP), % p.a.	3.4	2.4	0.4	-1.6	-1.7	-1.2	0.5	1.0	1.5
Producer prices in industry, % p.a.	9.2	4.4	-1.5	-1.2	-2.0	-0.6	0.0	1.0	2.0
General governm.budget, EU-def., % of GDP									
Revenues	31.9	33.9	36.6	35.8	.	.	37.0	37.0	37.0
Expenditures	33.9	34.5	37.5	38.6	.	.	41.0	38.0	38.0
Net lending (+) / net borrowing (-)	-2.0	-0.6	-0.8	-2.8	.	.	-4.0	-1.0	-1.0
Public debt, EU-def., % of GDP	15.3	17.6	18.0	27.1	.	.	30.4	30.4	30.0
Central bank policy rate, % p.a., end of period 7)	0.22	0.03	0.02	0.02	0.05	0.02	.	.	.
Current account, EUR mn 8)	375	-108	765	495	-83	332	700	400	0
Current account in % of GDP 8)	0.9	-0.3	1.8	1.2	-0.4	1.7	1.6	0.9	0.0
Exports of goods, BOP, EUR mn 8)	19,056	19,668	21,208	21,017	9,775	10,903	22,000	22,800	23,500
annual growth rate in %	34.4	3.2	7.8	-0.9	-3.3	11.5	4.7	3.6	3.1
Imports of goods, BOP, EUR mn 8)	21,704	23,615	24,099	23,752	11,265	11,820	24,800	26,000	27,000
annual growth rate in %	22.5	8.8	2.0	-1.4	-2.8	4.9	4.4	4.8	3.8
Exports of services, BOP, EUR mn 8)	6,471	6,845	6,860	6,749	2,644	2,904	7,300	7,600	7,800
annual growth rate in %	6.0	5.8	0.2	-1.6	-5.2	9.8	8.2	4.1	2.6
Imports of services, BOP, EUR mn 8)	3,571	4,114	4,124	4,219	1,915	2,117	4,500	4,700	5,000
annual growth rate in %	3.5	15.2	0.3	2.3	-2.3	10.5	6.7	4.4	6.4
FDI liabilities (inflow), EUR mn 8)	1,537	1,383	1,509	1,486	900	799	1,500	.	.
FDI assets (outflow), EUR mn 8)	348	315	266	650	445	44	200	.	.
Gross reserves of NB excl. gold, EUR mn	11,788	13,935	13,303	15,276	13,085	17,866	.	.	.
Gross external debt, EUR mn	36,295	37,714	36,936	39,356	37,396	35,889	38000	37000	36000
Gross external debt, % of GDP	88.6	90.5	88.1	92.1	87.5	81.7	87.0	81.0	76.0
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
Purchasing power parity BGN/EUR	0.9259	0.9195	0.9302	0.9222	.	.	.	.	.

1) Preliminary. - 2) According to census February 2011. - 3) According to ESA 2010. - 4) Enterprises with 10 and more employees. - 5) All enterprises in public sector, private enterprises with 5 and more employees. - 6) From 2012 according to census February 2011. - 7) Base interest rate. This is a reference rate based on the average interbank LEONIA rate of previous month (Bulgaria has a currency board). - 8) BOP 6th edition

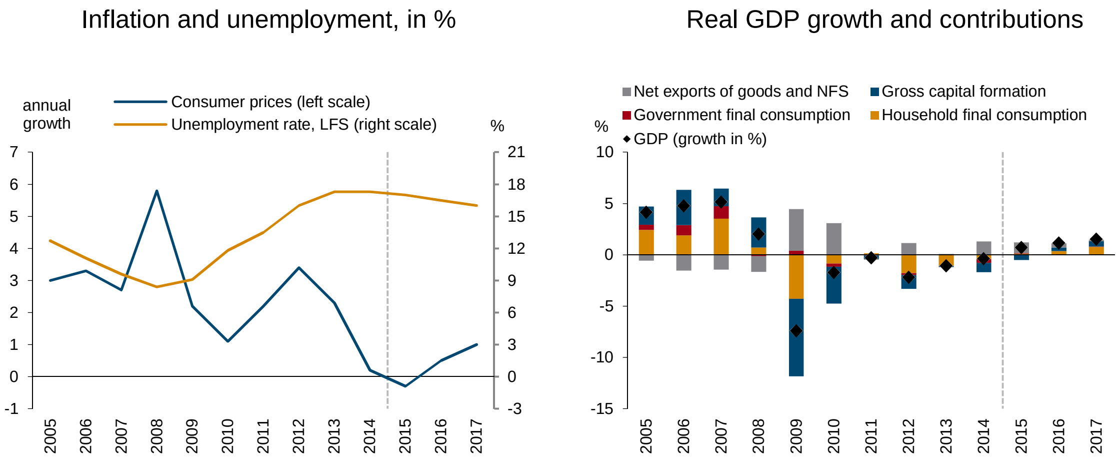
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

CROATIA: Mild recovery

HERMINE VIDOVIC

After six years of contraction, Croatia's economy has returned to a growth pattern. The turnaround has been backed by rising external demand and a mild recovery in household consumption and investments. GDP growth is expected to firm up over the years to come, fuelled primarily by EU-funded investments. Fiscal consolidation and deleveraging on the part of enterprises are the major obstacles to sustainable growth.

Figure 43 / Croatia: Main macroeconomic indicators



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

GDP growth, having resumed in the last quarter of 2014 after six years of recession, continued during the first half of 2015. Foreign demand was the main driver behind the 0.8% rise in GDP in the first half of the year as compared with the corresponding 2014 period; also domestic demand contributed slightly positively to the expansion. Private consumption rose for the first time since 2011 owing to a mild recovery in the labour market, real wage increases and a reduction of personal income tax introduced at the beginning of the year. With the exception of a temporary increase in 2013, gross fixed capital formation grew for the first time since 2009 thanks to an improved absorption of EU funding. Construction output continued to shrink for the seventh consecutive year, although at a slower pace than in the years before. Industrial production growth took off in the second quarter of 2015, increasing by 1.5% during the first seven months as against the same 2014 period, with the highest growth rates reported for the manufacture of leather, the manufacture of rubber and plastics and in shipbuilding (after years of contraction related to restructuring). Labour productivity has further increased due to continued layoffs. The situation in the labour market has been slightly improving in 2015: according to Pension Insurance data, employment rose by 0.4% during the first half of the year; Labour Force Survey data report an increase by even 2.2% along with the unemployment rate declining to 16.8%. The latter however, is still one of the highest among EU Member States, ranging third after Greece and Spain. Both real gross and net wages increased, by 1.3% and 3.4% respectively, in the first half of 2015.

External trade performed dynamically: during the first half of 2015, goods exports (up 10.3%) rose ahead of imports (up 6.1%, both in nominal euro terms). The trade deficit remained stagnant against the same period a year earlier. In trade with the EU, exports rose above average by 17%, while deliveries to CEFTA countries have slightly decreased, primarily due to a strong export decline in trade with Bosnia and Herzegovina, Croatia's main trading partner in the region. Trade with Russia shrank significantly both in terms of exports (-30%) and imports (-35%). Taking into account a somewhat lower trade deficit than in 2014 and assuming a rise in the services trade surplus due to record earnings from tourism, the 2015 current account will show an even more pronounced surplus than in 2014.

At the end of June 2015 the ratio of non-performing loans to total loans was 17.3% (up from 16.6% in June 2014). Out of the loans provided to the corporate sector, 30.9% were categorised as non-performing; the ratio of non-performing loans in total household loans was 12.1% (of which mortgage loans 34.8%). During the first seven months of 2015 bank lending both to the non-financial corporate sector and to private households was falling, in the latter case reflecting a long-lasting deleveraging process and tight labour market situation.

Ahead of the upcoming parliamentary elections in autumn this year, the Croatian government (parliament) has approved a series of (popular) measures. Already in February, a programme was launched following a government deal with the country's largest banks, telecommunications operators and public utility companies to write off debts of the country's poorest citizens. Another measure, which came into force at the beginning of October, is envisaged to fight energy poverty. Accordingly 60,000 to 70,000 poor households will receive vouchers worth HRK 200 or EUR 26 per month which can be used exclusively to pay electricity bills.

Finally, in September the Croatian parliament passed legislation allowing to convert Swiss franc loans into euro-denominated loans. Altogether there are 55,000 loans outstanding, amounting to HRK 23 billion (EUR 3.1 billion). The amended law envisages the conversion of the loans according to the exchange rate applicable on the date of loan disbursement, while the initial interest rate in Swiss francs will be replaced by the interest rate on euro loans. The conversion will be conducted on a voluntary basis. In return the banks will receive tax benefits. The entire cost of the conversion should be borne by banks and could reach, according to Croatian National Bank estimates, HRK 8 billion, reducing banks' capital adequacy from 23.5% to 19.7%. Already at the beginning of the year the government passed a bill freezing the exchange rate for those loans at HRK 6.39 per franc. In response to the law, five international banks active in Croatia stated that this move violates European law and bilateral investment treaties and announced to sue Croatia at the International Centre for Settlement of Investment Disputes in Washington. The ECB, too, has released an opinion[46] on the new law, stating, among other things, that the conversion of the loans may result in a decline of Croatia's foreign currency

[46] https://www.ecb.europa.eu/ecb/legal/pdf/en_con_2015_32_f_sign.pdf

reserves and consequently affect the country's economic stability. It might also have negative effects on investors' sentiment 'due to a perceived increase of legal uncertainty' and 'financial costs for the banking sector may have a negative impact on the profitability, capitalisation and future credit potential of the affected credit institutions'.

Parliamentary elections will be held on 8 November 2015. The most recent opinion polls show a neck-and-neck race between the ruling coalition led by the Social Democratic Party under Prime Minister Milanovic and the conservative coalition led by HDZ, Croatia's main opposition party. Still, none of the main parties will reach a majority in the future parliament and will have to rely on coalition partners. Regarding the election programmes, HDZ, seeking advice from the IFO Institute Munich, calls – among other things – for a reduction of the budget deficit, more efficient administration, improvement of public procurement procedures, a reform of the health sector and the reduction of the grey economy. The Social Democrats want to focus on strengthening Croatia's competitiveness, improving the standard of living and social security, and increasing efficiency of the public sector. The creation of new jobs will have top priority. EU funding should play a major role in order to achieve these goals. Overall, it seems that economic policy will not change dramatically if HDZ wins the elections because, whatever government will be in power, it will have to comply with the recommendations under the excessive deficit procedure.

wiiw expects the Croatian GDP to grow by 0.7% in 2015, which is slightly higher than the forecast made in spring. The upward revision is mainly due to rising foreign demand (exports plus tourism) and the earlier than expected revival of household consumption. The country will continue to experience growth over the entire forecasting period; that growth will become more robust (up to 1.6%) driven, apart from external demand, also by a further recovery of domestic demand, particularly investments supported by EU funds. Private consumption will remain suppressed due to continued household deleveraging and still high unemployment. Downside risks to the outlook are: long-lasting fiscal consolidation coupled with growing public debt and corporate deleveraging.

Table 10 / Croatia: Selected economic indicators

	2011	2012	2013	2014 [1]	2014 January-June	2015 January-June	2015 Forecast	2016 Forecast	2017 Forecast
Population, th pers., average [2]	4,283	4,269	4,254	4,236	4,236	.	4,250	4,250	4,250
Gross domestic product, HRK mn, nom. [3]	332,587	330,456	329,571	328,431	156,769	158,580	329,700	335,300	344,100
annual change in % (real)	-0.3	-2.2	-1.1	-0.4	-0.7	0.8	0.7	1.2	1.6
GDP/capita (EUR at exchange rate) [3]	10,400	10,300	10,200	10,200	.	.	10,100	10,300	10,500
GDP/capita (EUR at PPP) [3]	15,500	16,000	16,100	16,000	.	.	.	.	.
Consumption of households, HRK mn, nom. [3]	195,325	195,623	195,623	193,524	96,070	96,321	.	.	.
annual change in % (real)	0.3	-3.0	-1.9	-0.7	-0.6	0.5	0.2	0.6	1.3
Gross fixed capital form., HRK mn, nom. [3]	67,471	64,820	65,257	62,639	30,985	31,231	.	.	.
annual change in % (real)	-2.7	-3.3	1.4	-3.6	-3.4	0.2	0.3	2.0	4.0
Gross industrial production [4]									
annual change in % (real)	-1.2	-5.5	-1.8	1.2	0.1	1.2	2.0	2.5	2.5
Gross agricultural production									
annual change in % (real)	-4.7	-9.4	4.2	-1.8	.	.	.	.	.
Construction output [4]									
annual change in % (real)	-11.3	-12.7	-4.7	-7.2	-8.5	-0.7	.	.	.
Employed persons, LFS, th, average [5]	1,493	1,566	1,524	1,566	1,538	1,573	1,600	1,630	1,660
annual change in %	-3.2	-3.6	-2.7	2.7	2.1	2.2	2.0	2.0	2.0
Unemployed persons, LFS, th, average [5]	232	297	318	327	329	318	330	320	320
Unemployment rate, LFS, in %, average [5]	13.5	16.0	17.3	17.3	17.7	16.9	17.0	16.5	16.0
Reg. unemployment rate, in %, end of period	18.7	21.1	21.6	19.6	18.3	16.1	.	.	.
Average monthly gross wages, HRK	7,796	7,875	7,939	7,953	7,939	8,026	8,000	8,200	8,400
annual change in % (real, gross)	-0.8	-2.3	-1.4	0.4	-0.2	1.3	1.3	1.8	2.0
Average monthly net wages, HRK	5,441	5,478	5,515	5,533	5,506	5,685	5,700	5,900	6,100
annual change in % (real, net)	-0.4	-2.6	-1.5	0.5	-0.2	3.4	3.0	2.5	2.5
Consumer prices (HICP), % p.a.	2.2	3.4	2.3	0.2	0.2	-0.2	-0.3	0.5	1.0
Producer prices in industry, % p.a.	7.0	5.4	-0.2	-2.6	-2.7	-3.5	0.0	1.0	1.0
General governm.budget, EU-def., % of GDP									
Revenues	41.0	41.7	42.5	42.3	.	.	42.7	42.9	42.5
Expenditures	48.5	47.0	47.8	48.1	.	.	48.2	47.9	46.5
Net lending (+) / net borrowing (-)	-7.5	-5.3	-5.4	-5.7	.	.	-5.5	-5.0	-4.0
Public debt, EU-def., % of GDP	63.7	69.2	80.8	85.1	.	.	90.0	93.0	95.0
Central bank policy rate, % p.a., end of period [6]	7.0	7.0	7.0	7.0	7.0	7.0	.	.	.
Current account, EUR mn [7]	-318	-22	438	340	-1,863	-1,280	450	240	150
Current account, % of GDP [7]	-0.7	-0.1	1.0	0.8	-9.1	-6.2	1.0	0.6	0.3
Exports of goods, BOP, EUR mn [7]	8,742	8,673	8,919	9,760	4,599	5,071	10,700	11,600	12,500
annual change in %	8.5	-0.8	2.8	9.4	14.2	10.3	10.0	8.0	8.0
Imports of goods, BOP, EUR mn [7]	15,126	14,970	15,498	16,116	8,023	8,511	17,100	18,100	19,000
annual change in %	8.2	-1.0	3.5	4.0	5.5	6.1	6.0	6.0	5.0
Exports of services, BOP, EUR mn [7]	9,367	9,641	9,838	10,265	3,391	3,763	11,300	12,100	12,900
annual change in %	4.7	2.9	2.0	4.3	2.3	11.0	10.0	7.0	7.0
Imports of services, BOP, EUR mn [7]	3,168	3,122	3,049	3,025	1,423	1,566	3,300	3,500	3,700
annual change in %	-0.2	-1.5	-2.3	-0.8	-1.3	10.0	9.0	6.0	6.0
FDI liabilities (inflow), EUR mn [7]	1,015	1,133	703	2,893	2,385	498	1,000	.	.
FDI assets (outflow), EUR mn [7]	-169	-64	-118	1,586	1,758	136	270	.	.
Gross reserves of NB excl. gold, EUR mn	11,195	11,236	12,908	12,688	12,335	13,734	.	.	.
Gross external debt, EUR mn [7]	46,397	45,297	45,958	46,664	46,390	48,913	49,100	48,400	48,000
Gross external debt, % of GDP [7]	103.7	103.0	105.6	108.4	107.8	113.5	114	111	108
Average exchange rate HRK/EUR	7.4342	7.5173	7.5735	7.6300	7.62	7.63	7.65	7.69	7.74
Purchasing power parity HRK/EUR	5.0056	4.8239	4.8114	4.8372	.	.	.	.	.

1) Preliminary. - 2) According to census April 2011. - 3) According to ESA'10. - 4) Enterprises with 20 and more employees. - 5) From 2012 according to census April 2011. - 6) Discount rate of NB. - 7) BOP 6th edition.

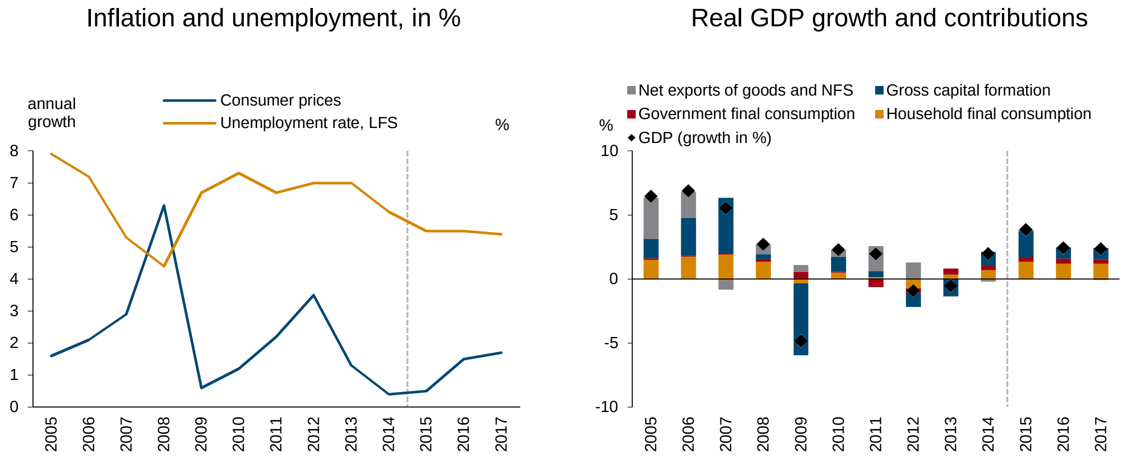
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

THE CZECH REPUBLIC: Benefiting from a positive demand shock

LEON PODKAMINER

Given the relatively low level of debt in the private sector and the growth-friendly monetary policy, a further moderate recovery should be forthcoming in 2016-2017 (with growth averaging 2.35%). However, the current expansion of infrastructural investment is not going to extend into the years ahead. Uncertainties also persist where the performance of foreign trade is concerned. Furthermore, growth might be seriously impaired, were the previous fiscal consolidation policy to be reintroduced.

Figure 44 / Czech Republic: Main macroeconomic indicators



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

GDP grew by 4.2% (seasonally adjusted, year-on-year) in the first half of 2015. Last time growth that strong was recorded in the first half of 2008. The rates of growth of household and government consumption also approached pre-crisis magnitudes (the former rose by about 3%, the latter by 2.5%). The dynamics of exports and imports was less impressive (by Czech standards). Volumes of exports and imports (of goods and non-factor services combined) rose by 7% and 7.7% respectively (year-on-year). Nominally, the (positive) trade balance was almost unchanged – but its real-term contraction had quite a significant impact on the GDP growth rate: foreign trade contributed to the GDP growth negatively (by close to -0.3 percentage points). Gross fixed capital formation rose unusually strongly, by about 4.5%, contributing some 1.2 percentage points to the overall GDP growth of 4.2%. Expanding inventories (primarily representing work in progress and also the acquisition of valuables) appear to have been important contributors to GDP growth (adding another 1.3 percentage points to overall growth).

In the first half of 2015 investment in ICT, machinery, equipment, etc. – constituting about one third of the entire gross fixed capital formation (GFCF) – increased rather weakly, by about 1.3% in real terms. Also residential investment (about 13% of total GFCF) rose moderately, by about 3.4%. The strongest growth (by 12.5%) was recorded for transport equipment (representing about 12% of total GFCF).

However, the greatest impact has had the 7.8% growth in investments assuming the form of ‘other buildings and structures” (whose GFCF share is 30%). The infrastructural investments, broadly understood, included in this category had been declining since 2007, by 22% cumulatively. The current sharp rebound – actually not expected even by the Czech authorities – seems to represent a ‘last-moment” attempt to tap the EU funds earmarked under the financial perspective for 2007-2013.

The past years’ failure to draw available funds from the EU resources need not be attributed to the Czech side’s ‘technical’ unpreparedness. During the four-years fiscal consolidation period (2000-2013) public spending – including the co-financing of EU-financed infrastructural projects – was suppressed. The fiscal relaxation that started in 2014 allows more meaningful government investment spending now. This spending is to rise from approximately 3.9% of GDP in 2014 to 4.8% in 2015 (before being allowed to fall back to about 3.8% later on).

The fiscal relaxation in 2015 (with the general government deficit close to 2% of GDP) is to reduce the public debt/GDP ratio in 2015 to about 40.9%. This is to be achieved largely on account of faster output growth. The ongoing reduction in the debt/GDP ratio, achieved quite ‘painlessly’, would indicate that supportive fiscal policy could continue to be fairly relaxed also in the future. However, the current (April 2015) governmental Convergence Programme envisages renewed fiscal consolidation in 2016-2018, with progressively falling public sector expenditures and fiscal deficits. According to the Programme, the fiscal deficit is to fall to 0.6% of GDP in 2018, with a primary surplus of about 0.5% of GDP and the public debt/GDP ratio falling to 40.2%. It is perhaps not surprising that – consistent with its vision of fiscal policy – the Programme does not promise too much as far as growth prospects are concerned. Actually, for the coming years it envisages steady growth *slowdown* to little over 2% in 2018. Of course, if the ambitious consolidation plans are put into action, the eventual GDP growth may well fall short of the magnitude expected.[47] In other words, the intentions expressed by the government could pose a little appreciated threat to the near-future economic prospects.

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[47] In 2013 a major fiscal consolidation effort took place, with the general government balance/GDP ratio being reduced from -3.9% (in 2012) to -1.2%. This happened to coincide with GDP *contracting* by 0.5% (against *growth* ‘planned’ to be 1.6%). It is well beyond the scope of this report to analyse, extensively, the reasons for the Czech authorities’ revealed predilection for fiscal consolidation. One possible reason may be fairly ‘technical’. The Convergence Programme shows large and growing positive ‘output gaps’ *estimated* for 2016-2018. Accordingly, these estimates (whose derivation is subject to legitimate doubts on conceptual and practical grounds) suggest that real (if anaemic) growth forecasted will soon exceed some hypothetical ‘potential’ GDP growth. From this it has been concluded that the ‘cyclically adjusted budget deficits’ (again hypothetical) are much larger than the actual (statistically measurable) budget deficits and – as such – will necessitate renewed consolidation efforts.

The output recovery (most pronounced in the manufacturing and construction sectors) has supported labour market improvements. The average real wage increased by more than 2.7% in the second quarter of 2015, employment rose by over 2%, the hours worked by over 2% and the unemployment rate (LFS) fell, within a year, by close to 1 percentage point, to 5.2% (as of end-August)[48]. Despite the marked labour market improvements, consumer price inflation is very low (while producer prices continue to fall rather strongly). The revealed insensitivity of inflation to the apparent tightening of the labour market conditions seems to suggest that consumer demand continues to be depressed – possibly on account of a rather low GDP share of wages and the Czech households' saving habits. Of course, some supply-side factors such as falling prices of energy carriers may have also moderated inflation.

The extremely relaxed monetary policy, which prevented the consolidation-driven recession from assuming devastating dimensions in 2012-2013, is very likely to remain unchanged for the time being. The very low policy interest rate (two-week repo rate) of 0.05% in force since early November 2012 has had no perceptible impact on inflation. The devaluation of the Czech currency enforced by the National Bank in November 2013 has also proved unable to activate inflationary tendencies. Right now the National Bank seems to believe that inflation will be gradually recovering in 2016. By that time the Bank may also give up its resolution to keep the CZK/EUR exchange rate above 27. Whether the floating Czech koruna will resume its earlier appreciation tendency is hard to predict now. Very likely it will not: the koruna has remained weak with very little visible effort on the part of the National Bank.

Interest rates on loans to private households have remained moderate (though falling somewhat recently). Loans to corporate clients appear to be rather inexpensive. The shares of non-performing loans extended to households and firms are quite low and falling. However, lending to both households and business has been expanding rather slowly so far. The private sector's bank deposits still exceed the volume of loans extended. Probably the improving consumer and business sentiments can spur a stronger demand for loans in the coming quarters.

The unexpected acceleration of investment in 2015 is unlikely to have significant demand- or supply-side consequences, at least in the medium term. The economy is expected to grow rather moderately in 2016-2017. No major imbalances could be identified even if growth of aggregate demand were to be stronger than could be realistically expected. As in the past, the monetary policy is likely to support stable growth while the fiscal policy's declared intentions suggest the possibility of the return of unnecessary fiscal austerity.

[48] The current unemployment rate is as low as in 2007 – and yet higher than in 2008 (5.3% and 4.4% respectively). The registered unemployment rates are about 1 percentage point higher than those based on LFS.

Table 11 / Czech Republic: Selected economic indicators

	2011	2012	2013	2014 [1]	2014	2015	2015	2016	2017
					January-June		Forecast		
Population, th pers., average [2]	10,496	10,511	10,514	10,525	10,519	10,538	10,525	10,530	10,545
Gross domestic product, CZK bn, nom. [3]	4,023	4,042	4,077	4,261	2,050	2,161	4,450	4,630	4,820
annual change in % (real)	2.0	-0.9	-0.5	2.0	2.2	4.4	3.9	2.4	2.3
GDP/capita (EUR at exchange rate) [3]	15,600	15,300	14,900	14,700	.	.	15,300	16,100	16,900
GDP/capita (EUR at PPP) [3]	21,600	21,800	21,900	22,900	.	.	.	.	.
Consumption of households, CZK bn, nom. [3]	1,957	1,971	2,001	2,042	986	1,018	.	.	.
annual change in % (real) [3]	0.3	-1.5	0.7	1.4	1.2	2.9	2.8	2.5	2.5
Gross fixed capital form., CZK bn, nom. [3]	1,069	1,052	1,025	1,065	490	523	.	.	.
annual change in % (real) [3]	1.1	-3.3	-2.7	2.0	2.0	5.2	6.0	3.0	3.0
Gross industrial production									
annual change in % (real)	5.9	-0.8	-0.1	5.0	6.5	5.0	4.5	5.0	4.5
Gross agricultural production									
annual change in % (real)	8.6	-5.8	6.9	7.3	.	.	.	.	.
Construction industry									
annual change in % (real)	-3.6	-7.6	-6.7	4.3	8.5	9.1	.	.	.
Employed persons, LFS, th, average [4]	4,904	4,890	4,937	4,974	4,943	5,016	5,020	5,030	5,040
annual change in %	0.4	0.4	1.0	0.8	0.5	1.5	1.0	0.2	0.2
Unemployed persons, LFS, th, average [4]	354	367	369	324	338	289	300	290	290
Unemployment rate, LFS, in %, average [4]	6.7	7.0	7.0	6.1	6.4	5.4	5.5	5.5	5.4
Reg. unemployment rate, in %, end of period [5]	8.6	9.4	8.2	7.7	7.4	6.2	6.6	6.0	6.0
Average monthly gross wages, CZK	24,455	25,067	25,035	25,607	25,083	25,807	26,500	27,600	28,800
annual change in % (real, gross)	0.6	-0.8	-1.5	1.9	2.7	2.9	3.0	2.5	2.5
Consumer prices (HICP), % p.a.	2.2	3.5	1.3	0.4	0.3	0.3	0.5	1.5	1.7
Producer prices in industry, % p.a.	3.7	2.4	0.7	1.0	1.2	-1.8	1.0	1.3	1.5
General governm. budget, EU-def., % of GDP									
Revenues	39.7	39.9	40.9	40.1	.	.	40.3	39.5	39.5
Expenditures	42.4	43.8	42.0	42.1	.	.	42.3	41.5	41.0
Net lending (+) / net borrowing (-)	-2.7	-3.9	-1.2	-2.0	.	.	-2.0	-2.0	-1.5
Public debt, EU-def., % of GDP	39.9	44.6	45.1	42.6	.	.	41.0	41.5	41.0
Central bank policy rate, % p.a., end of period [6]	0.75	0.05	0.05	0.05	0.05	0.05	0.05	0.5	1.5
Current account, EUR mn [7]	-3,466	-2,518	-829	958	1,980	3,469	1,620	0	-1,790
Current account, % of GDP [7]	-2.1	-1.6	-0.5	0.6	2.7	4.4	1.0	0.0	-1.0
Exports of goods, BOP, EUR mn [7]	99,123	104,336	103,184	110,524	55,202	58,830	118,000	124,000	130,000
annual change in %	14.1	5.3	-1.1	7.1	8.6	6.6	7.0	5.0	4.5
Imports of goods, BOP, EUR mn [7]	96,048	99,413	96,735	101,841	49,896	53,661	109,000	116,000	122,000
annual change in %	12.6	3.5	-2.7	5.3	7.1	7.5	7.0	6.0	5.5
Exports of services, BOP, EUR mn [7]	17,923	18,863	18,059	18,956	8,958	9,835	20,000	21,000	21,000
annual change in %	8.1	5.2	-4.3	5.0	1.8	9.8	8.0	4.0	2.0
Imports of services, BOP, EUR mn [7]	14,614	15,776	15,346	16,925	7,662	8,387	18,000	19,000	20,000
annual change in %	8.4	8.0	-2.7	10.3	5.7	9.5	8.0	3.5	3.0
FDI liabilities (inflow), EUR mn [7]	3,025	7,348	5,544	3,679	1,272	564	2,800	.	.
FDI assets (outflow), EUR mn [7]	1,161	2,531	5,831	-1,181	-2,289	627	2,000	.	.
Gross reserves of NB excl. gold, EUR mn	30,675	33,550	40,459	44,547	42,942	50,659	.	.	.
Gross external debt, EUR mn [7]	89,627	96,826	99,652	103,035	100,673	106,458	106,600	110,000	113,800
Gross external debt, % of GDP [7]	54.8	60.3	63.5	66.6	65.1	65.8	66.0	65.0	64.0
Average exchange rate CZK/EUR	24.59	25.15	25.98	27.54	27.44	27.50	27.50	27.25	27.00
Purchasing power parity CZK/EUR	17.76	17.66	17.74	17.65	.	.	.	.	.

1) Preliminary. - 2) According to census March 2011. - 3) According to ESA 2010. - 4) From 2012 according to census March 2011. -
5) From 2013 available job applicants 15-64 in % of working age population 15-64, all available job applicants in % of labour force before. -
6) Two-week repo rate. - 7) BOP 6th edition.

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

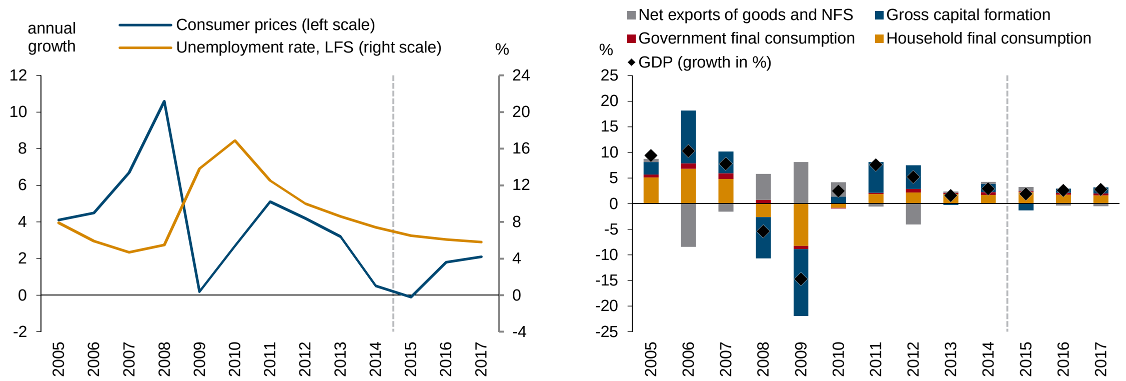
ESTONIA: Consumption growth remains robust

SEBASTIAN LEITNER

Dragged down by dwindling external demand in the neighbouring countries to the east and the current decline in investments, the Estonian GDP will grow by 1.9% in 2015. Household consumption remains the strongest driver of economic activity. Over the next two years we expect a recovery in trade with countries to the west, while the decline in exports to Russia should come to a halt. Moreover, an upswing, particularly in public investments, should boost GDP growth to 2.6% and 2.8% in 2016 and 2017, respectively.

Figure 45 / Estonia: 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.

In the first half of this year sentiment indicators of households and the services sectors showed declining confidence in the prospects of the Estonian economy. However, in the past four months the fear that the Russian economic turmoil could slash growth also in Estonia has gradually vanished. This comes with no surprise when looking at the current situation of the Estonian labour market. The unemployment rate came down to 6.5% in the second quarter of 2015, while net wages increased by more than 7% on average in the first half of this year. As a result, household consumption has remained a stable driver of GDP growth.

The number of unemployed is reduced by a decline in the working-age population, but the statistics also show a strong increase in employment, by 2.3% year-on-year in the first half of 2015. In part, however, this is the effect of the new employment register, introduced in July 2014. Enterprises now have to register their workers before their employment starts. This regulation reduces the size of the shadow economy in Estonia, estimated at about 10% of GDP, particularly in the construction and the restaurants and accommodation sectors, and results in higher tax income for the government. Nevertheless, envelope payment of a part of the wages of employees is still possible and evident, since the figures of the employment register show that an overly high share of the newly registered persons declared to receive only the national minimum income.

The vacancy statistics show that in effect employment demand is actually declining, particularly in the manufacturing subsectors, which are hit by shrinking exports. In the coming years, demographic factors will further reduce labour supply and thus also the unemployment rate, although more gradually compared to the past years of recovery. The upward pressure on gross wages will remain and net incomes will grow even more owing to the planned reductions in the labour tax burden.

The downturn of the Russian economy in the first half of 2015 by 3.4% year- on- year resulted in Estonian exports to plummet by about 40% to the eastern neighbour in the same period. The still persistent stagnation in Finland and relatively low economic growth in Latvia and Lithuania, the three main trading partners, further dampen the export activity of Estonian entrepreneurs. Not only manufacturing, but also the transport sector is hit hard by dwindling external demand. However, exports to the rest of the European Union are on the upswing. A strong increase in foreign demand is recorded for Sweden, which is expected to attain a GDP growth rate of about 3% in 2015. Overall, while we expect exports to decline slightly this year, imports are going to shrink even more owing to low investment activity, and net exports will contribute positively to GDP growth in 2015. This will change in 2016 and thereafter, when stronger GDP growth will be supported by increases in exports, but an even swifter revival of imports due to an upswing in investment is assumed.

On account of overall sluggish external demand and stagnating industrial production, investment activity of the enterprise sector will decline once again throughout 2015 – there is ample idle capacity in the manufacturing sector. Also, construction output will shrink in real terms since public investments will gain momentum only in 2016 when EU funds will ease those investments' financing. Households still refrain from taking up new mortgages to invest in housing.

The decline in import prices, particularly of oil and gas as well as home-produced food (caused inter alia by the Russian embargo), has led to consumer price stagnation throughout 2015. The strong growth in wages has not raised core inflation to more than 1% in the first seven months of this year. From 2016 onwards consumer prices will rise again, also driven by announced hikes in excise taxes.

The budget proposal for 2016 presented by the Estonian government foresees an increase in the personal income tax-exempt threshold, a rise in pensions by 5.5% on average and higher child benefits. Apart from somewhat higher excise taxes, the reduced VAT rate on accommodation will be raised from 9% to 14%. The budget of the government should be more or less balanced in the subsequent two years after attaining a deficit of not more than 0.5% of GDP in 2015.

Our forecast for GDP growth in 2015 has been slightly revised downwards, to 1.9% in real terms. For 2016 and 2017 we forecast an upswing to 2.6% and 2.8%, respectively. We expect a recovery of external demand mostly from Western trading partners, while the decline in exports to Russia should come to a halt. An upswing in investments will be facilitated by public investments co-financed by EU funds.

Table 12 / Estonia: Selected economic indicators

	2011	2012	2013	2014 1)	2014	2015	2015	2016	2017
					January-June			Forecast	
Population, th pers., average 2)	1,327	1,323	1,318	1,315	.	.	1,305	1,300	1,295
Gross domestic product, EUR mn, nom. 3)	16,668	18,006	19,015	19,963	9,673	9,949	20,300	21,200	22,200
annual change in % (real)	7.6	5.2	1.6	2.9	2.7	1.6	1.9	2.6	2.8
GDP/capita (EUR at exchange rate) 3)	12,500	13,600	14,400	15,200	.	.	15,600	16,300	17,100
GDP/capita (EUR at PPP) 3)	18,000	19,200	19,800	20,300	.	.	.	.	.
Consumption of households, EUR mn, nom. 3)	8,195	8,850	9,463	9,861	4,871	5,117	.	.	.
annual change in % (real)	3.6	4.4	3.8	3.3	2.5	5.3	4.5	3.5	3.3
Gross fixed capital form., EUR mn, nom. 3)	4,367	4,761	5,153	5,033	2,326	2,205	.	.	.
annual change in % (real)	34.4	6.7	3.2	-3.1	7.2	-8.8	-5.0	3.0	4.5
Gross industrial production									
annual change in % (real)	19.9	1.1	4.1	1.9	-0.3	0.4	0.0	3.0	4.0
Gross agricultural production									
annual change in % (real)	9.7	5.6	4.7	3.6	.	.	.	.	.
Construction industry									
annual change in % (real)	27.3	16.6	-0.1	-2.6	-3.8	-4.6	.	.	.
Employed persons, LFS, th, average 4)	609.1	614.9	621.3	624.8	617.7	631.6	635	630	625
annual change in %	6.7	1.9	1.0	0.6	-0.6	2.3	1.6	-0.8	-0.8
Unemployed persons, LFS, th, average 4)	86.8	68.5	58.7	49.6	52.2	44.3	44	41	39
Unemployment rate, LFS, in %, average 4)	12.5	10.0	8.6	7.4	7.8	6.6	6.5	6.1	5.8
Reg. unemployment rate, in %, end of period 5)	7.4	6.2	5.3	4.4	4.4	4.1	.	.	.
Average monthly gross wages, EUR	839	887	949	1,005	994	1,046	1,060	1,150	1,240
annual change in % (real, gross)	0.9	1.7	4.1	6.0	5.7	5.6	6.0	6.5	6.0
Average monthly net wages, EUR	672	706	757	799	791	844	850	910	970
annual change in % (real, net)	0.5	1.1	4.3	5.7	5.2	7.2	6.5	5.0	4.5
Consumer prices (HICP), % p.a.	5.1	4.2	3.2	0.5	0.9	0.1	-0.1	1.8	2.1
Producer prices in industry, % p.a.	4.2	2.6	7.3	-2.7	-3.2	-2.2	-2.0	0.0	1.0
General governm. budget, EU-def., % of GDP									
Revenues	38.6	38.8	38.0	38.5	.	.	38.5	38.2	38.0
Expenditures	37.4	39.0	38.2	37.9	.	.	39.0	38.5	38.3
Net lending (+) / net borrowing (-)	1.2	-0.2	-0.2	0.6	.	.	-0.5	-0.3	-0.3
Public debt, EU-def., % of GDP	5.9	9.5	9.9	10.4	.	.	10.1	10.0	6.5
Central bank policy rate, % p.a., end of period 6)	1.00	0.75	0.25	0.05	0.15	0.05	0.05	0.05	0.20
Current account, EUR mn 7)	223	-438	-20	205	-39	296	400	-50	-400
Current account, % of GDP 7)	1.3	-2.4	-0.1	1.0	-0.4	3.0	2.0	-0.2	-1.8
Exports of goods, BOP, EUR mn 7)	10,384	11,104	11,624	11,430	5,594	5,500	11,200	11,650	12,330
annual change in %	38.8	6.9	4.7	-1.7	-4.1	-1.7	-2.0	4.0	5.8
Imports of goods, BOP, EUR mn 7)	10,735	12,283	12,522	12,429	6,108	5,849	11,870	12,230	12,970
annual change in %	36.1	14.4	1.9	-0.7	-2.5	-4.2	-4.5	3.0	6.1
Exports of services, BOP, EUR mn 7)	4,040	4,486	4,876	5,320	2,506	2,500	5,270	5,480	5,770
annual change in %	13.3	11.0	8.7	9.1	9.3	-0.3	-0.9	4.0	5.3
Imports of services, BOP, EUR mn 7)	2,734	3,131	3,556	3,639	1,747	1,719	3,580	3,690	3,840
annual change in %	22.9	14.5	13.6	2.3	4.0	-1.6	-1.6	3.1	4.1
FDI liabilities (inflow), EUR mn 7)	818	1,394	664	1,172	511	-445	-300	.	.
FDI assets (outflow), EUR mn 7)	-951	996	578	617	257	-200	-150	.	.
Gross reserves of NB excl. gold, EUR mn	150	218	222	352	309	336	.	.	.
Gross external debt, EUR mn 7)	16,721	17,957	17,455	18,902	18,906	20,185	18,900	18,700	18,900
Gross external debt, % of GDP 7)	100.3	99.7	91.8	94.7	94.7	99.4	93.0	88.0	85.0
Purchasing power parity EUR/EUR	0.6947	0.7092	0.7291	0.7467	.	.	.	.	.

1) Preliminary. - 2) According to census March 2011. - 3) According to ESA 2010. - 4) From 2012 according to census March 2011. -
5) In % of labour force (LFS) and according to census March 2011. - 6) Official refinancing operation rate for euro area (ECB). -
7) BOP 6th edition.

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

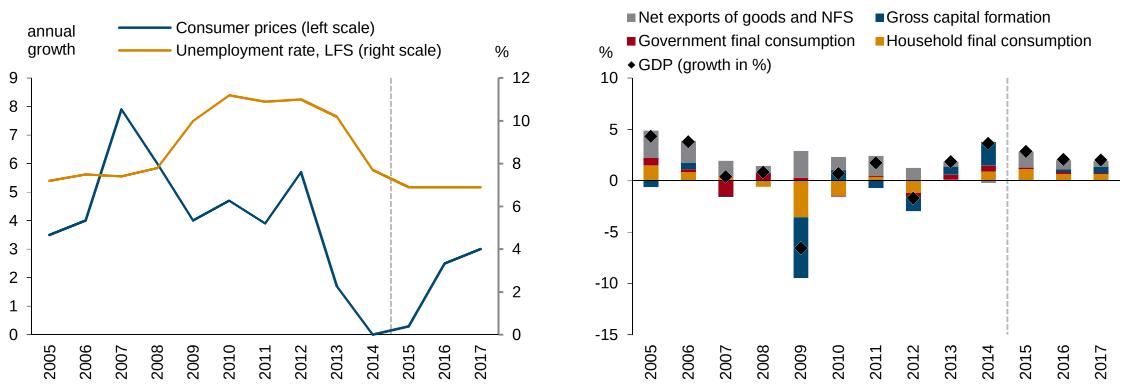
HUNGARY: Losing momentum

SÁNDOR RICHTER

After six quarters featuring GDP growth rates higher than 3%, the second quarter of 2015 brought about a deceleration in the pace of economic expansion to 2.7% (all data here and later, if not otherwise indicated, are year-on-year). Both that slowdown and the preceding high quarterly growth rates are linked to the cyclical nature of cohesion policy transfers from the European Union. The marked upturn in investment experienced in 2014 will not be repeated this year; the economy appears to be returning to its earlier growth pattern characterised by net exports as the major contributors to economic expansion.

Figure 46 / Hungary: 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 Hungarian economy expanded by 3.1% in the first half of the year. The second-quarter growth rate was, however, 0.8 percentage points lower than that of the first quarter. Industry has been the main contributor to growth, though its increase has also become slower than it was in the first half of the previous year. Within manufacturing the automotive sector, dominated by foreign-owned enterprises, achieved an outstanding expansion of 15.7%. Growth performance of construction suffered a serious setback, dropping from well over 20% in the first half of 2014 to 8% in the first half of 2015. Agricultural output has shrunk substantially. In the services sector, gross value added increased by over 2% in the first six months of the year, with a higher than average expansion in retail trade, accommodation and food service activities, transportation and storage, computer programming and consultation. Below-average performance was recorded in financial and insurance activities, public administration, education and health services.

Household consumption continued to increase, approaching the GDP's expansion, while government consumption declined by about 3%. Gross fixed capital formation increased by a disappointing 0.4% in the first six months, a radical drop from the 19.2% growth rate recorded in the first half of the previous year. The near-stagnation of investments is the combined effect of still dynamically expanding outlays in various fields of environmental protection, storage, transport, public administration, and defence, i.e. mostly areas which are typical targets of EU co-financed projects. Simultaneously, investment in manufacturing, wholesale and retail trade, real estate activities and agriculture declined. The good news comes from foreign trade where the expansion of exports surpassed that of imports to a considerable extent, even if the large gap recorded in the first quarter narrowed somewhat in the second quarter. Nevertheless, net exports figured as the major driver of economic growth in the first half of 2015.

Employment kept increasing substantially, even if the pace dropped to half of that characterising the previous year. In the second quarter of 2015, 54% of the increment in employment was explained by domestic primary employment growth, 36% by an increase in public work employment, and 10% by growth of employed working abroad. In the first half of 2015, the unemployment rate dropped by close to one percentage point to 7.3% compared to the respective period a year earlier.

Consumer price inflation was slightly negative in the first half of the year, but with the diminishing effects of the regulated energy price reductions last year, inflation will be on the rise again in the second half of the year and may reach 2.5% in 2016. In the case of producer prices, 1% deflation was registered in the first six months, which makes real interest rates a burden even with credit lines at preferentially low interest rates of the central bank's 'Funding for Growth Programme'. The policy rate is currently 1.35%, and the Monetary Council is keen to keep this level as long as possible. At this policy rate the forint remains weak.

The general government balance is far better than the -3% requirement of the Stability and Growth Pact. That allows a modest reduction of the public debt/GDP ratio, what is important in order to avoid a relaunch of an Excessive Deficit Procedure against Hungary

By 2015 a long-standing goal by Prime Minister Orbán has been achieved, namely to gain Hungarian majority ownership in the banking sector. With the purchase of MKB and the Budapest banks, Hungarian ownership has surpassed 55.1% of the banking sector's combined balance sheet. This share was only 36.3% before the crisis, in 2008. The expansion of national ownership has not been reflected in better performance as yet. According to the central bank's Financial Conditions Index, which summarises lending developments in the corporate and household segments, the interbank rate and the exchange rate, the contribution of the banking sector to the GDP growth rate has oscillated between about -5% and +1% since early 2009, and was still negative in the first two quarters of 2015. In the second quarter of this year, the annual growth rate of outstanding borrowing by non-financial corporations declined by 3.4%, while sustainable growth would necessitate an about 5% expansion.

Up to 2005 Hungary's economic growth rate was very similar to that of its Visegrad peer countries but since 2006 it has been lagging behind. With the improving Hungarian economic growth performance in the past one and a half years, the question can be raised whether the future will see a catching-up of the Hungarian economy to the regional peers. What could bring about a turn to the better concerning the potential growth rate in Hungary? We think that the key is a lastingly elevated investment rate, principally through increased business sector investment. This change has though important preconditions in terms of policy reform. This reform, as a minimum, should ensure radically improved policy predictability as compared to the prevailing one, primarily but not only in the area of taxes and regulations. The business climate should be improved by breaking with the practice of discriminative sectoral taxes. The hostile government attitude towards foreign-owned firms outside the manufacturing sector should be dropped and a modus vivendi should be found with the financial sector in order to enable a revival of financial intermediation. The extreme centralisation of decisions should be reversed.

There is no perspective for such a policy reform in the current political constellation. With the forthcoming low tide of EU co-financed projects, aggregate demand may fall by 1% to 2% of the GDP in the next two years. There is only a very limited chance for a resolute new growth impulse coming from the financial sector through a significant upturn in lending. Thus Hungary's growth outlook is deteriorating in the medium run, even if the annual GDP growth rate will probably not fall below 2%. This rate, however, is insufficient for catching up either with the regional peers or the highly developed core countries of the EU. Even this moderate growth in the baseline scenario is endangered by substantial risks. The main risks to the current forecast are possible negative developments in the Germany-led Central European automotive cluster, which absorbs the bulk of Hungary's respective output as well. Such negative developments may derive, first, from a further slowdown of the economy in China and accordingly shrinking demand there for German cars and, second, from the far-reaching consequences of the Volkswagen scandal, where Hungary is prominently involved through the Audi factory in Győr and several component-producing firms.

Table 13 / Hungary: Selected economic indicators

	2011	2012	2013	2014 1)	2014 January-June	2015 January-June	2015 Forecast	2016 Forecast	2017 Forecast
Population, th pers., average 2)	9,972	9,920	9,893	9,863	.	.	9,830	9,810	9,800
Gross domestic product, HUF bn, nom. 3)	28,134	28,628	30,065	32,180	14,928	15,592	33,500	35,000	36,800
annual change in % (real)	1.8	-1.7	1.9	3.7	3.9	3.1	2.9	2.1	2.0
GDP/capita (EUR at exchange rate) 3)	10,100	10,000	10,200	10,600	.	.	10,800	11,300	11,900
GDP/capita (EUR at PPP) 3)	17,100	17,100	17,800	18,700	.	.	.	.	.
Consumption of households, HUF bn, nom. 3)	14,341	14,889	15,226	15,651	7,694	7,883	.	.	.
annual change in % (real)	0.8	-2.3	0.2	1.8	2.0	2.9	2.3	1.4	1.4
Gross fixed capital form., HUF bn, nom. 3)	5,569	5,548	6,160	6,971	2,826	2,895	.	.	.
annual change in % (real)	-1.3	-4.4	7.3	11.2	19.2	0.4	2.0	1.0	3.5
Gross industrial production									
annual change in % (real)	5.6	-1.8	1.1	7.7	9.4	7.3	6.0	5.0	4.0
Gross agricultural production									
annual change in % (real)	11.1	-10.0	12.2	9.6	.	.	.	.	.
Construction industry									
annual change in % (real)	-8.0	-6.6	8.4	13.6	21.6	8.0	.	.	.
Employed persons, LFS, th, average 4)	3,812	3,827	3,893	4,101	4,057	4,159	4,200	4,260	4,280
annual change in %	0.8	1.8	1.7	5.3	5.9	2.5	2.5	1.5	0.5
Unemployed persons, LFS, th, average 4)	468	473	441	343	362	329	310	320	320
Unemployment rate, LFS, in %, average 4)	10.9	11.0	10.2	7.7	8.2	7.3	6.9	6.9	6.9
Reg. unemployment rate, in %, end of period	12.4	12.7	9.2	8.7	9.7	8.2	.	.	.
Average monthly gross wages, HUF 5)	213,094	223,060	230,714	237,695	235,002	243,194	245,800	255,700	266,000
annual change in % (real, gross)	1.3	-0.9	1.7	3.2	3.1	3.9	3.1	1.5	1.0
Average monthly net wages, HUF 5)	141,151	144,085	151,118	155,690	153,926	159,293	161,000	167,500	174,300
annual change in % (real, net)	2.4	-3.4	3.1	3.2	3.1	3.9	3.1	1.5	1.0
Consumer prices (HICP), % p.a.	3.9	5.7	1.7	0.0	0.2	-0.3	0.3	2.5	3.0
Producer prices in industry, % p.a.	4.1	4.1	0.6	-0.4	-0.8	-1.0	-0.5	1.7	2.3
General governm.budget, EU-def., % of GDP									
Revenues	44.3	46.3	47.0	47.1	.	.	47.8	47.5	47.5
Expenditures	49.8	48.6	49.4	49.7	.	.	50.2	50.0	50.4
Net lending (+) / net borrowing (-)	-5.5	-2.3	-2.4	-2.5	.	.	-2.4	-2.5	-2.9
Public debt, EU-def., % of GDP	80.8	78.3	76.8	76.2	.	.	76.3	75.5	74.7
Central bank policy rate, % p.a., end of period 6)	7.00	5.75	3.00	2.10	2.30	1.50	1.35	2.00	3.30
Current account, EUR mn 7)	754	1,752	4,036	2,356	907	2,503	5,000	4,900	4,800
Current account, % of GDP 7)	0.7	1.8	4.0	2.3	1.9	4.9	4.7	4.4	4.1
Exports of goods, BOP, EUR mn 7)	71,793	69,961	72,000	74,768	36,897	40,260	81,900	86,400	91,600
annual change in %	8.6	-2.6	2.9	3.8	4.4	9.1	9.5	5.5	6.0
Imports of goods, BOP, EUR mn 7)	68,868	67,028	68,603	72,167	35,616	38,167	78,300	82,100	86,900
annual change in %	8.4	-2.7	2.4	5.2	5.4	7.2	8.5	4.9	5.9
Exports of services, BOP, EUR mn 7)	16,039	16,060	17,039	18,623	8,826	9,128	19,400	20,400	21,200
annual change in %	9.5	0.1	6.1	9.3	9.2	3.4	4.0	5.0	4.0
Imports of services, BOP, EUR mn 7)	12,752	12,263	13,047	13,514	6,458	6,466	13,800	14,400	14,800
annual change in %	6.2	-3.8	6.4	3.6	5.6	0.1	2.0	4.0	3.0
FDI liabilities (inflow), EUR mn 7)	4,429	4,405	4,834	6,309	1,395	246	3,000	.	.
FDI assets (outflow), EUR mn 7)	3,458	2,310	3,807	3,587	1,814	1,837	3,000	.	.
Gross reserves of NB, excl. gold, EUR mn	37,655	33,757	33,696	34,481	35,985	34,657	.	.	.
Gross external debt, EUR mn 7)	135,351	127,667	119,727	119,382	122,238	122,665	118,000	117,800	118,000
Gross external debt, % of GDP 7)	134.4	129.0	118.2	114.5	117.3	115.3	111	106	101
Average exchange rate HUF/EUR	279.37	289.25	296.87	308.71	307.00	307.43	315	315	315
Purchasing power parity HUF/EUR	165.43	168.30	171.19	174.77	.	.	.	.	.

1) Preliminary. - 2) According to census October 2011. - 3) According to ESA 2010. - 4) From 2012 according to census 2011. - 5) Enterprises with 5 and more employees. - 6) Base rate (two-week NB bill). - 7) BOP 6th edition, excluding SPE.

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

KAZAKHSTAN: Tenge set freely floating as economic growth stumbles

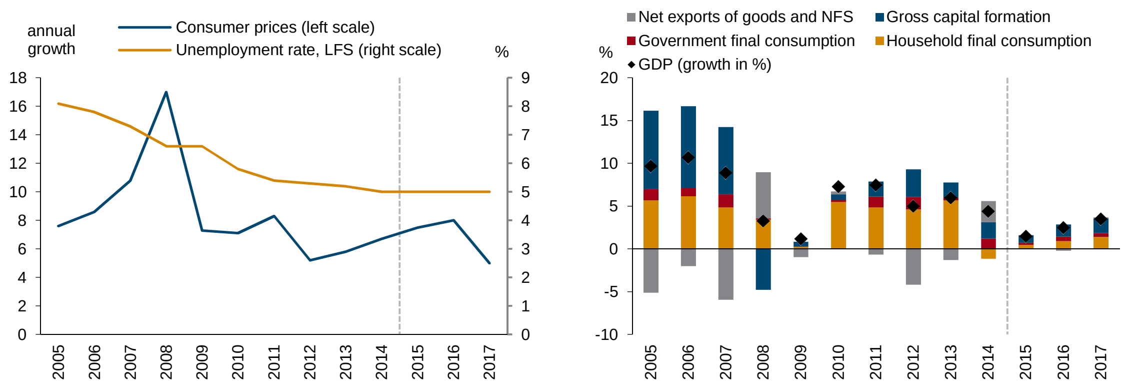
OLGA PINDYUK

Increasing costs of keeping the KZT/USD exchange rate within the given band forced the government to switch to a floating currency regime, as a result of which the tenge depreciated by about 50%. A substantial weakening in external demand and sluggish domestic private consumption and investment will limit GDP growth to 1.5% in 2015. In 2016-2017, growth is expected to accelerate to 2.5% and 3.5%, respectively, since fiscal stimuli are expected to boost investment, while exports will gradually recover.

Figure 47 / Kazakhstan: 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.

According to preliminary data, Kazakhstan's real GDP grew only by 1.7% year on year in the first half of 2015, 2.2pp less as compared with the same period a year earlier. The primary reason for that significant growth slowdown has been the worsening economic performance of the country's key trading partners, Russia and China, and a further decline in global commodity prices. Kazakhstan's export revenues have been experiencing a dramatic slump – during January-June 2015, the value of goods exports decreased by 42% year on year in USD terms. Exports of mineral products, which accounted for 80% of merchandise exports in 2014, halved during that period. Metals, the second biggest export sector, experienced a 21% decline. Food and machinery exports, which are exported primarily to the CIS markets, decreased at double-digit rates as well, with the latter having fallen by a remarkable 69% year on year.

Merchandise imports have been falling at a slower rate than exports, by 15% year on year in January-June 2015. According to data of the National Bank of Kazakhstan, imports have so far declined mainly in value terms, as exporters to Kazakhstan could benefit from increased competitiveness owing to the depreciation of their currencies with respect to the tenge. Regardless of the increasing costs of controlling the exchange rate of the national currency, the Kazakhstani government had appeared adamant to keep the KZT/USD exchange rate relatively stable and had been repeatedly making announcements that the exchange rate would remain limited by the bounds of the corridor (which was broadened from 170-188 KZT/USD to 170-198 KZT/USD in July 2015). However, on 20 August 2015, the government suddenly announced that the national currency would become fully floating effective immediately, and the National Bank would turn to inflation targeting as its main policy goal. On the next day the tenge lost 35% of its value as the exchange rate reached 255 KZT/USD; depreciation deepened in mid-September, when the tenge further depreciated to about 280 KZT/USD. This trend forced the National Bank to resort to interventions in the foreign exchange market to prevent speculative overshooting. As the National Bank will be keeping an eye on the market ready to intervene if necessary, the KZT/USD exchange rate is not likely to experience sharp movements in the near future (provided the global commodity prices remain stable in the next years as we assume).

Though overall the switch to the floating exchange rate and inflation targeting is widely considered to be a move in the right direction, the timing and manner in which it was carried out are rather questionable. Normally inflation targeting is introduced when there are no significant external and financial sector imbalances: then the central bank can focus on inflation control without potentially conflicting objectives, and costs of transition to the new policy are minimal. This was obviously not the case for Kazakhstan, where adjustment to the shock of significant devaluation is going to translate into higher inflation of 7.5-8% p.a. in 2015-2016, to further erode the purchasing power of households, which have already seen their real incomes fall in 2015, and to increase the burden of the external debt for domestic companies. Moreover, giving repeatedly false promises to the market has led to an erosion of trust in the monetary authorities of Kazakhstan. A sign of the low trust is the increased dollarisation in the economy: the share of deposits in foreign currency reached 59% by the end of August 2015, while the share of foreign exchange deposits in total deposits of physical persons was as high as 73%. The share of loans in foreign currency, by contrast, has been steadily decreasing and is currently around 25%. The growing currency mismatch of the banks' balance sheets limits their liquidity and contributes to the slowdown of loans issuing: the loans stock has been on the decline since March 2015 as the issuance of new loans has been falling at double-digit rates in annual terms. On the bright side, the decision to switch to a floating exchange rate will allow the National Bank not to burn further its international reserves, and the devaluation will help the competitiveness of domestic producers.

In an attempt to mitigate the negative effects of the abrupt depreciation, the government has introduced several measures, such as a compensation of the depreciation-related losses to the holders of tenge-denominated deposits (only deposits below KZT 1 million, equivalent to about USD 3700, are covered; the compensation will be given to those who do not withdraw their deposits for 12 months). Besides, the government intends to partially compensate the losses of low-income households through raising stipends and disability benefits, public sector salaries, and a higher indexation of pensions starting from 2016.

The counter-cyclical fiscal stimulus package 'Nurly Zhol' (Path to the Future), introduced earlier, is running and is expected to provide a boost to investment. About USD 3 billion (around 2% of GDP) from the National Oil Fund will be transferred annually during 2015-2017 to finance the development of the country's infrastructure and credit facilities for SMEs. Additional funds to finance the stimulus package will be coming from multilateral development banks (MDBs), with projects focused on the structural reform component, in particular targeting business climate improvements and support to SMEs, which should also support private investment in the country. Besides the government is very active in attracting investment from China through joint investment projects; in September 2015, new joint investment deals worth about USD 23 billion were signed with Chinese companies. The primary focus of Chinese companies has been the transport infrastructure and the oil sector, now the range of projects is expected to broaden to include some manufacturing industries.

A positive and long-awaited development has been the significant decline in the share on non-performing loans (NPLs) in the banking system. The legal and tax obstacles to NPL write-offs have been removed and as a result, by the end of July 2015, the share of NPLs in total loans went down to 9.4%, a minus of about 14pp as compared with the beginning of 2015. The share of NPLs decreased primarily in the portfolio of corporate clients (from some 35% to 6.5%), while in the portfolio of physical persons' loans the share of NPLs did not change much during that period and was at more than 13% in July 2015. However, even cleansed balance sheets will not help much in reviving credit growth if banks continue to experience liquidity issues.

Following more than 19 years of accession negotiations, on 27 July 2015, Kazakhstan became a member of the WTO. The country has agreed to gradually phase out its discriminatory policies such as VAT exemptions to agricultural producers or local content requirements in the mining sector. In 2020, foreign banks and insurance companies will be allowed to open their branches in the country. The accession terms also envisage that the weighted average import tariff of Kazakhstan will be at 6.5%, which is almost 4pp lower than the average import tariff in the Eurasian Economic Union (EAEU); for agriculture the average tariff will be set at 10.2% versus 17.2% in the EAEU. This implies that Kazakhstan's membership in the customs union of the EAEU will be significantly hindered, as de facto there will be border controls with Russia in order to prevent re-exports of Kazakh imports. For Kazakhstani exporters there will be a sizeable list of exclusions from the list of products eligible for free market access to the EAEU.

Primarily as a result of external factors, such as low commodity prices and the poor performance of the Russian and Chinese economies, GDP growth in Kazakhstan during the period 2015-2017 will be slower than we previously forecasted. According to our forecast, in 2015, the economy will grow by a meagre 1.5% due to plunging exports and also sluggish private consumption and investment. Over the biennium 2016-2017, growth is expected to accelerate to 2.5% and 3.5% respectively. Exports will gradually recover primarily in volume terms as Kazakhstani non-oil exporters will be able to benefit from increased competitiveness brought about by the devaluation. Oil exports will grow in 2017 provided production of the Kashagan oil field is resumed as scheduled. Investment is expected to pick up steam in 2016-2017, in particular owing to the fiscal stimulus programmes, improved SME financing, and an increase in FDI.

Table 14 / Kazakhstan: Selected economic indicators

	2011	2012	2013	2014 [1]	2014 January-June	2015 January-June	2015 Forecast	2016 Forecast	2017 Forecast
Population, th pers., average [2]	16,557	16,791	17,035	17,289	17,223	17,479	17,500	17,750	18,000
Gross domestic product, KZT bn, nom. [3]	27,572	30,347	35,275	39,041	15,718	17,092	41,600	45,600	49,300
annual change in % (real)	7.5	5.0	6.0	4.4	3.9	1.7	1.5	2.5	3.5
GDP/capita (EUR at exchange rate) [3]	8,200	9,400	10,200	9,500	.	.	10,100	8,400	8,800
GDP/capita (EUR at PPP) [3]	15,700	16,600	17,500	18,300	.	.	.	.	.
Consumption of households, KZT bn, nom. [3]	11,569	13,623	17,535	18,122	6,554	.	.	.	.
annual change in % (real)	10.9	11.0	12.6	-2.3	-2.4	.	1.0	2.0	3.0
Gross fixed capital form., KZT bn, nom. [3]	5,772	6,761	7,473	7,771	2,627	.	.	.	.
annual change in % (real)	3.9	9.1	4.9	0.2	5.1	.	3.0	5.0	7.0
Gross industrial production									
annual change in % (real)	3.8	0.7	2.5	0.2	-0.4	0.6	-1.0	2.0	5.0
Gross agricultural production									
annual change in % (real)	26.8	-17.8	11.7	1.0	3.3	3.0	.	.	.
Construction industry									
annual change in % (real)	2.8	3.1	3.5	4.1	4.2	5.1	.	.	.
Employed persons, LFS, th, average [4]	8,302	8,507	8,571	8,510	8,619	8,512	8,380	8,460	8,540
annual change in %	1.1	1.0	0.7	-0.7	0.6	-1.2	-1.5	1.0	1.0
Unemployed persons, LFS, th, average [4]	473	475	471	452	463	448	440	450	450
Unemployment rate, LFS, in %, average [4]	5.4	5.3	5.2	5.0	5.1	5.0	5.0	5.0	5.0
Reg. unemployment rate, in %, end of period	0.4	0.4	0.3	0.4	0.6	0.7	.	.	.
Average monthly gross wages, KZT [5]	90,028	101,263	109,141	120,455	114,760	121,433	132,100	148,400	162,100
annual change in % (real, gross)	7.1	7.0	1.9	3.9	3.2	0.5	2.0	4.0	4.0
Consumer prices (HICP), % p.a.	8.3	5.2	5.8	6.7	6.2	5.3	7.5	8.0	5.0
Producer prices in industry, % p.a.	27.2	3.5	-0.3	9.5	10.1	-22.6	-10.0	5.0	3.0
General governm.budget, nat.def., % of GDP									
Revenues	19.5	19.2	18.1	18.8	24.2	23.5	18.0	19.0	19.0
Expenditures	21.5	22.1	20.1	21.5	25.0	23.4	21.0	21.5	21.0
Deficit (-) / surplus (+)	-2.1	-2.9	-2.0	-2.8	-0.9	0.1	-3.0	-2.5	-2.0
Public debt, nat.def., % of GDP	12.3	13.0	12.9	14.8	12.7	14.1	16.0	17.5	18.0
Central bank policy rate, % p.a., end of period [6]	7.5	5.5	5.5	5.5	5.5	5.5	16.0	14.0	12.0
Current account, EUR mn [7]	7,326	823	646	4,511	5,221	-1,998	-5,400	-4,400	-3,800
Current account in % of GDP [7]	5.4	0.5	0.4	2.8	8.0	-2.4	-3.1	-2.9	-2.4
Exports of goods, BOP, EUR mn [7]	61,198	67,629	64,435	60,418	31,282	22,325	52,700	54,600	59,600
annual growth rate in %	32.4	10.5	-4.7	-6.2	-4.7	-28.6	-12.8	3.6	9.2
Imports of goods, BOP, EUR mn [7]	28,985	37,954	38,244	32,800	14,634	15,276	33,800	35,400	38,200
annual growth rate in %	17.0	30.9	0.8	-14.2	-19.5	4.4	3.0	4.7	7.9
Exports of services, BOP, EUR mn [7]	3,116	3,756	3,988	4,945	2,222	2,710	5,700	6,000	6,300
annual growth rate in %	0.5	20.5	6.2	24.0	15.2	22.0	15.3	5.3	5.0
Imports of services, BOP, EUR mn [7]	7,882	9,925	9,379	9,727	4,356	4,753	11,200	11,700	12,400
annual growth rate in %	-7.9	25.9	-5.5	3.7	2.2	9.1	15.1	4.5	6.0
FDI liabilities (inflow), EUR mn [7]	9,885	10,618	7,536	5,306	2,709	2,928	5,800	.	.
FDI assets (outflow), EUR mn [7]	3,719	1,394	1,488	1,756	-198	1,780	2,500	.	.
Gross reserves of NB excl. gold, EUR mn	19,477	16,665	13,940	17,682	14,608	19,001	.	.	.
Gross external debt, EUR mn [7]	96,951	103,150	109,137	129,324	114,143	139,653	146,100	150,000	154,500
Gross external debt, % of GDP [7]	71.8	65.1	62.5	78.9	69.6	79.2	82.9	100.2	97.2
Average exchange rate KZT/EUR	204.11	191.67	202.09	238.10	241.83	206.79	236	305	310
Purchasing power parity KZT/EUR [8]	106.25	108.66	118.23	123.46	.	.	.	.	.

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

1) Preliminary. - 2) According to census March 2009. - 3) According to SNA'08. - 4) From 3rd quarter 2011 according to census March 2009, wiiw estimates for growth in 2011 and 2012. - 5) Excluding small enterprises, engaged in entrepreneurial activity. - 6) Refinancing rate of NB. From September 2015 one day (overnight) repo rate. - 7) Converted from USD and based on BOP 6th edition. - 8) wiiw estimates based on the 2011 International Comparison Project benchmark.

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

KOSOVO: Ambiguous past but strong future growth

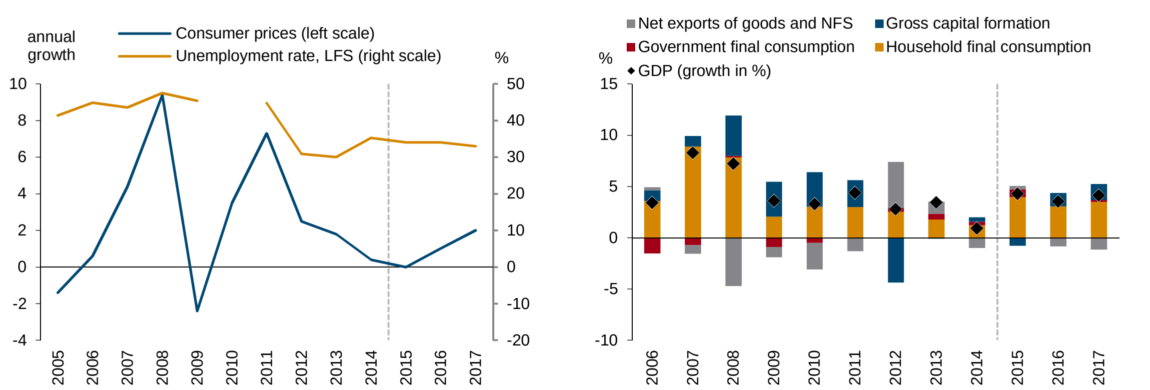
MARIO HOLZNER

The growth outlook for Kosovo remains stable. GDP growth in 2015, 2016 and 2017 is expected to hover around 4%, mainly on account of strong household consumption fuelled by pre election public wage increases and a rise in remittances, as well as improved dynamics in gross fixed capital formation over the medium term. The GDP growth figures for 2014 are ambiguous, with the Agency of Statistics and the Central Bank publishing diverging figures. That ambiguity hints at the need for improved statistics.

Figure 48 / Kosovo: 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.

Although Kosovo statistics have improved substantially over the past several years, there is still scope for enhancement, also in the way data are presented. In recent reports, both the Central Bank of Kosovo (BQK) and the IMF have published a real GDP growth figure of 2.7% for the year 2014. However, data by the Kosovo Agency of Statistics (ASK) suggests that the real output growth rate in 2014 was only 0.9%. (the presumably low economic growth in 2014 was mainly on account of disappointing figures for investment and a temporary electricity production breakdown). An unambiguous and reconciled presentation of data would be very much welcomed as it has also substantial consequences for economic forecasting and consequently policy-making. The wiiw statistics department is in the process of contacting the involved institutions in order to clarify the issue. At the moment we stick to the ASK figures.

In other statistics, recent economic trends have mostly confirmed the latest wiiw forecast update in summer. Hence, overall GDP growth forecasts for the coming years have not been changed. A major driver of the current developments is a peculiar shift in the budget structure in the wake of last year's parliamentary elections. In the public sector, expenditures on wages and salaries were strongly increased whereas capital expenditures massively slashed. This trend will continue for the whole year 2015 as well. Government data for the first seven months of the current year show that compared to the same period of the previous year public payments for wages and salaries have increased by more than 10% while public investment has decreased by almost 12%. Overall government expenditures have increased by more than 4%. At the same time revenues soared by more than 12%, suggesting that, on the one hand, economic activity is picking up and, on the other hand, in net terms the public sector is a drag on the economy, at least in 2015.

Private investment was able to compensate for a part of the cuts in government capital spending. From January to July, cumulative new investment loans increased by more than 12% on the year. Investment was supported by a further significant reduction of effective interest rates on loans to levels of around 8%. Moreover, FDI tripled in the first half of 2015 on the year (from a very low basis); nearly all new projects were realised in the banking, real estate and business activities sectors though. It is questionable to what extent the real sector has benefited from the FDI inflow. Over the medium term it is more important that in April 2015 the Kosovo government signed a EUR 409 million (about 7% of GDP) investment deal for the Brezovica ski resort with a French consortium. Even if only a fraction of the announced sum is invested, this would constitute an important boost for Kosovo's small economy.

Household consumption is fuelled not only by rising wages in the public sector. Over the period of January-July 2015 consumer loans increased by almost 7% year-on-year. Moreover, mortgage loans expanded by some 42% (from low levels though). Even more importantly, remittances increased by about 16% in the first half of 2015 as compared to the same period a year earlier (probably related to intensified Kosovo outward migration). All of this happened against the backdrop of declining inflation rates (since December of last year) which also helped to slightly weaken the country's real effective exchange rate. For the first seven months of this year customs statistics reported an increase in exports by more than 13% and in imports by almost 5% year-on-year (the trade deficit still widened by some 4%).

Overall, we expect real GDP growth to strongly accelerate in 2015 to 4.3%, mainly owing to the wage increases in the public sector and the strong influx of remittances. In the medium term, private investment should replace household consumption as the strongest growth driver. The Kosovo diaspora's remittances are expected to continue to remain important as well, particularly since growth in both Germany and Switzerland – the two main targets of emigration from Kosovo – is forecast to pick up as well in the years to come. Another positive external factor is the further rapprochement of Kosovo and Serbia. The two neighbours signed a landmark accord on 25 August, under the pressure from the EU and Germany. The Community of Serb majority municipalities in Kosovo will be granted considerable autonomy. This agreement will hence contribute to further normalisation of relations between Kosovo and Serbia and will support the region's integration to the EU.

Table 15 / Kosovo: Selected economic indicators

	2011	2012	2013	2014 1)	2014	2015	2015	2016	2017
					January-June			Forecast	
Population, th pers., average 2)	1,796	1,807	1,818	1,813	.	.	1,830	1,847	1,860
Gross domestic product, EUR mn, nom. 3)	4,815	5,059	5,327	5,485	2,553	.	5,700	6,000	6,400
annual change in % (real)	4.4	2.8	3.4	0.9	-0.4	.	4.3	3.5	4.1
GDP/capita (EUR at exchange rate) 3)	2700	2800	2900	3000	.	.	3,100	3,200	3,400
GDP/capita (EUR at PPP) 3)	6200	6500	6700	7000	.	.	.	.	.
Consumption of households, EUR mn, nom. 3)	4,142	4,458	4,652	4,815	.	.	.	.	.
annual change in % (real)	3.5	2.9	2.0	1.4	.	.	4.5	3.5	4.0
Gross fixed capital form., EUR mn, nom. 3)	1,476	1,317	1,323	1,300	.	.	.	.	.
annual change in % (real)	8.1	-13.6	-0.2	0.0	.	.	-3.0	5.0	6.0
Gross industrial production 3)4)									
annual change in % (real)	-5.7	14.9	10.4	-2.3	.	.	8.0	4.0	5.0
Gross agricultural production 3)4)									
annual change in % (real)	0.2	-8.5	1.4	0.4	.	.	.	.	.
Construction output 3)4)									
annual change in % (real)	18.0	-8.5	2.6	-6.0	.	.	.	.	.
Employed persons, LFS, th, average 5)	280	303	338	324	.	.	330	340	350
annual change in %	.	.	11.7	-4.4	.	.	3.0	3.0	4.0
Unemployed persons, LFS, th, average 5)	228	136	145	177	.	.	170	180	170
Unemployment rate, LFS, in %, average 5)	44.8	30.9	30.0	35.3	.	.	34.0	34.0	33.0
Unemployment rate, reg., in %, end of period	.	.	.	.			.	.	.
Average monthly net wages, EUR	348	354	356	416	399	432	460	460	480
annual change in % (real, net)	13.4	-0.8	-1.2	16.4	11.8	8.7	10.0	0.0	2.0
Consumer prices, % p.a.	7.3	2.5	1.8	0.4	0.3	-0.4	0.0	1.0	2.0
Producer prices, % p.a.	4.5	1.9	2.5	1.7	0.2	4.2	4.0	2.0	2.0
General governm.budget, nat.def., % of GDP									
Revenues	27.2	27.3	25.5	24.6	.	.	27.0	28.0	28.0
Expenditures	28.3	28.6	28.0	27.6	.	.	29.0	29.0	30.0
Deficit (-) / surplus (+)	-1.1	-1.2	-2.5	-3.0	.	.	-2.0	-1.0	-2.0
Public debt, nat.def., % of GDP	5.3	8.1	8.9	10.6	10.3	11.2	12.2	12.6	13.8
Central bank policy rate, % p.a., end of period 6)	13.9	12.9	11.1	9.2	10.6	7.6	7.0	6.0	6.0
Current account, EUR mn 7)	-658	-380	-339	-437	-193	-224	-500	-480	-520
Current account, % of GDP 7)	-13.7	-7.5	-6.4	-8.0	-7.6	.	-8.8	-8.0	-8.1
Exports of goods, BOP, EUR mn 7)	317	282	292	324	142	158	360	380	400
annual change in %	5.8	-10.9	3.4	11.3	-5.2	11.9	11.0	5.6	5.3
Imports of goods, BOP, EUR mn 7)	2,364	2,332	2,287	2,383	1,072	1,099	2,500	2,600	2,730
annual change in %	15.8	-1.3	-1.9	4.2	1.3	2.5	4.9	4.0	5.0
Exports of services, BOP, EUR mn 7)	625	641	633	767	290	322	850	900	960
annual change in %	8.9	2.6	-1.4	21.3	12.8	10.9	10.8	5.9	6.7
Imports of services, BOP, EUR mn 7)	369	318	320	431	152	188	530	550	580
annual change in %	-7.4	-13.9	0.9	34.6	29.7	24.1	22.9	3.8	5.5
FDI liabilities (inflow), EUR mn 7)	384	229	280	151	39	164	300	.	.
FDI assets (inflow), EUR mn 7)	5	16	30	27	1	12	40	.	.
Gross reserves of NB excl. gold, EUR mn	573	840	800	747	772	750	.	.	.
Gross external debt, EUR mn 7)	1,428	1,517	1,608	1,737	1,648	1,813	1,800	1,900	2,000
Gross external debt, % of GDP 7)	29.7	30.0	30.2	31.7	30.1	31.8	32.0	31.0	32.0
Purchasing power parity EUR/EUR	0.433	0.431	0.436	0.433	.	.	.	.	.

1) Preliminary. - 2) According to census April 2011. - 3) According to ESA 2010. - 4) According to gross value added (manufacturing industry for industrial production). - 5) Population 15-64. From 2012 new improved sample survey based on census 2011, not comparable with previous years. - 6) Average weighted effective lending interest rate (Kosovo uses the euro as national currency). - 7) BOP 6th edition.

Source: National statistics and IMF. Forecasts by wiiw.

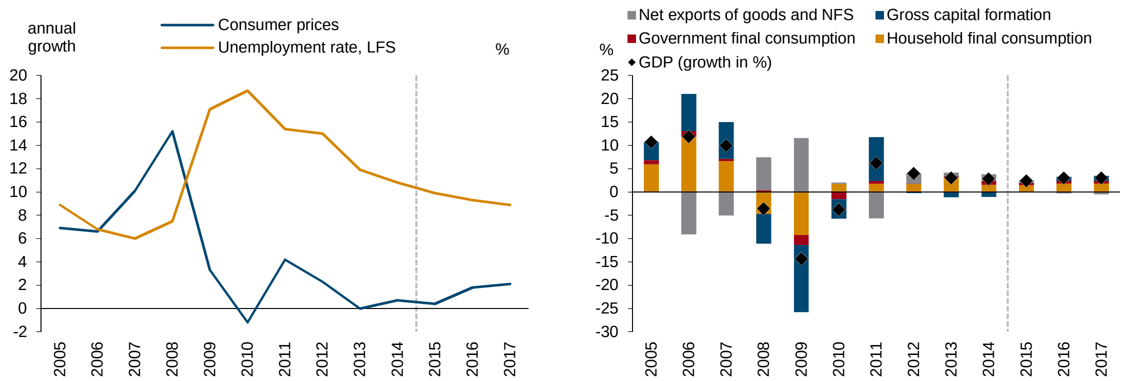
LATVIA: Growing below potential

SEBASTIAN LEITNER

For 2015, our GDP growth forecast for Latvia remains almost unchanged at 2.4%. As expected, the slump in Russian demand has been offset by growth in exports to the EU and Asian markets. While household consumption is developing at a good pace, investment activity remains stagnant. In both 2016 and 2017 we expect an upswing in GDP growth to 3%, driven by stronger external demand and investment activity in both the public and private sectors.

Figure 49 / Latvia: 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.

Latvian goods exports to the CIS countries fell by 15% year-on-year in nominal terms in the first seven months of 2015, due in particular to the recession in Russia. However, monthly figures show that the negative impact is decreasing and exports to the CIS will gradually stabilise. While external demand from the euro area countries (including the Baltic neighbours Estonia and Lithuania) is stagnant, the one of the other EU Member States is developing at a good pace. Exports to the rest of the world even expanded by 18% in nominal terms year-on-year; however, only about 15% of the goods are destined for non-EU and non-CIS countries. Concerning commodities, wood and machinery, the two most important export sectors, are reporting satisfactory growth figures.

In the steel industry, the high hopes concerning full resumption of production and re-employment of employees at Liepajas metalurgs, the largest company in the sector, have been disappointed and exports are not taking off. Worldwide prices for steel are on the downturn, particularly since Chinese producers suffer from low domestic demand and thus flood the world market. The Ukrainian KVV group, which took over insolvent Liepajas metalurgs last year, has sorted out its latest problems with suppliers of scrap metal and the gas and electricity utilities. However, its complaints about too high costs at the Latvian factory and the claims for subsidies from the government show a bumpy road ahead for steel production in Latvia. For manufacturing in total, we see an upward development driven not only by exports to non-CIS destinations, but also by domestic demand in particular. Since prices of imports are on decline also this year, the nominal growth rate of imported goods is even lower than that of exports. The contribution of net trade to GDP will however be once again negative in 2015.

Although throughout 2015 consumer confidence indicators declined slightly compared to last year, household consumption and retail figures are on the upward trend. Households benefit from still low inflation, strongly rising wage incomes and a cut of the flat income tax rate from 24% to 23% as of the beginning of 2015. Thus, the expected growth in household consumption of about 2.5% in 2015 will keep the Latvian economy developing at a good pace. However, precautionary savings and deleveraging keep household investments in real estate anaemic.

Given the low level of external demand, capacity utilisation also declined this year. Thus private fixed capital investments will remain almost stagnant in 2015; the same applies to public investments. The availability of fresh EU funds will result in public as well as private investments growing more swiftly from 2016 onwards. The significant decrease in oil prices resulted in consumer prices remaining almost stagnant so far this year. However, with prices rising particularly in the service sector (owing to high wage increases) and an upswing in external as well as domestic demand, we will see a stronger upward movement of harmonised consumer prices in 2016 and 2017.

Latvia is currently growing below potential as are its Baltic neighbours, primarily on account of the economic slump in Russia. Thus growth in employment is meagre. However, demographic developments result in a further decline in the working-age population and thus also unemployment figures. Towards the end of 2015 the unemployment rate is expected to have fallen below 10% for the first time since the outbreak of the economic crisis in 2008. In the two years to come we expect a more gradual reduction.

At the end of September 2015 the Latvian government finalised its budget proposal for 2016. Due to government revenues increasing below potential, the planned reduction of the flat income tax rate from 23% to 22% has to be suspended. Minor changes on the revenue side include higher excise taxes, an increase in the non-taxable minimum income and, in addition, a wage-dependent non-taxable income bracket, making the effective tax rate on personal income more progressive. The strongest hikes in government expenditures are to be found in the defence budget, which is increased to 1.4% of GDP (up from 1% in 2015). The medium-term target is set at 2% for 2018. Minor increases of expenditures in real terms are foreseen for the ministries of health and internal affairs.

Despite the Russian economic downturn and bans on Latvian products, we forecast the GDP to rise by 2.4% in 2015. Given the expected speed-up in demand in the EU and a rise in domestic investment activity driven by the inflow of EU funds, we have revised our forecast for the upswing in overall economic activity slightly upwards, to 3% both for 2016 and 2017.

Table 16 / Latvia: Selected economic indicators

	2011	2012	2013	2014 [1)]	2014 January-June	2015 January-June	2015 Forecast	2016 Forecast	2017 Forecast
Population, th pers., average [2)]	2,060	2,034	2,013	1,994	.	.	1,995	1,987	1,979
Gross domestic product, EUR-LVL mn, nom. [3)]	20,244	21,811	22,763	23,694	11,312	11,699	24,400	25,600	26,900
annual change in % (real)	6.2	4.0	3.0	2.8	2.5	2.3	2.4	3.0	3.0
GDP/capita (EUR at exchange rate) [3)]	9,800	10,800	11,300	11,900	.	.	12,200	12,900	13,600
GDP/capita (EUR at PPP) [3)]	14,700	15,800	16,600	17,300	.	.	.	.	.
Consumption of households, EUR-LVL mn, nom. [3)]	12,246	13,020	13,733	14,148	7,051	7,300	.	.	.
annual change in % (real)	2.9	2.9	5.3	2.5	2.5	2.5	2.5	3.0	3.0
Gross fixed capital form., EUR-LVL mn, nom. [3)]	4,501	5,551	5,291	5,372	2,300	2,355	.	.	.
annual change in % (real)	24.1	14.4	-6.0	0.3	5.0	1.3	1.3	3.0	4.0
Gross industrial production [4)]									
annual change in % (real)	9.0	6.2	-0.9	-1.1	-1.5	3.8	4.2	5.0	4.0
Gross agricultural production									
annual change in % (real)	2.8	17.3	1.5	2.8	.	.	.	.	.
Construction industry									
annual change in % (real)	12.4	13.7	8.1	7.9	18.9	-2.2	.	.	.
Employed persons, LFS, th, average [5)]	970.5	875.6	893.9	884.6	885.4	891.2	890	895	900
annual change in %	3.1	1.6	2.1	-1.0	0.1	0.6	0.6	0.6	0.6
Unemployed persons, LFS, th, average [5)]	176.4	155.1	120.4	107.6	112.5	98.9	100	90	90
Unemployment rate, LFS, in %, average [5)]	15.4	15.0	11.9	10.8	11.3	10.0	9.9	9.3	8.9
Reg. unemployment rate, in %, end of period [5)6)]	11.5	10.5	9.5	8.5	8.9	8.6	.	.	.
Average monthly gross wages, EUR-LVL	660.2	684.4	715.7	765.0	751.0	800.3	820	880	950
annual change in % (real, gross)	-0.1	1.4	4.6	6.2	6.4	6.2	6.3	6.0	5.5
Average monthly net wages, EUR-LVL	469.5	488.0	515.4	560.0	551.0	590.7	600	640	680
annual change in % (real, net)	0.1	1.6	5.6	8.0	8.3	6.8	7.0	5.5	4.0
Consumer prices (HICP), % p.a.	4.2	2.3	0.0	0.7	0.6	0.4	0.4	1.8	2.1
Producer prices in industry, % p.a.	7.7	4.1	1.7	0.4	0.7	-0.4	-0.5	1.0	1.5
General governm.budget, EU-def., % of GDP									
Revenues	35.6	36.1	36.0	36.0	.	.	33.9	33.5	33.1
Expenditures	38.9	36.9	36.8	37.5	.	.	35.4	34.8	34.1
Net lending (+) / net borrowing (-)	-3.4	-0.8	-0.8	-1.5	.	.	-1.5	-1.3	-1.0
Public debt, EU-def., % of GDP	42.8	41.3	39.0	40.7	.	.	37.0	36.0	35.0
Central bank policy rate, % p.a., end of period [7)]	3.50	2.50	0.25	0.05	0.15	0.05	0.05	0.05	0.20
Current account, EUR mn [8)]	-573	-719	-544	-467	-262	-200	-500	-900	-1,000
Current account, % of GDP [8)]	-2.8	-3.3	-2.4	-2.0	-2.3	-1.7	-2.0	-3.5	-3.7
Exports of goods, BOP, EUR mn [8)]	8,300	9,645	9,810	10,180	4,825	4,959	10,440	10,860	11,510
annual change in %	24.7	16.2	1.7	3.8	3.5	2.8	2.6	4.0	6.0
Imports of goods, BOP, EUR mn [8)]	10,743	12,208	12,351	12,454	5,977	6,075	12,700	13,200	13,860
annual change in %	31.9	13.6	1.2	0.8	0.8	1.6	2.0	3.9	5.0
Exports of services, BOP, EUR mn [8)]	3,471	3,768	3,900	3,853	1,831	1,915	4,040	4,320	4,670
annual change in %	13.8	8.6	3.5	-1.2	-0.2	4.6	4.9	6.9	8.1
Imports of services, BOP, EUR mn [8)]	1,991	2,145	2,127	2,107	981	1,057	2,280	2,470	2,690
annual change in %	13.8	7.7	-0.8	-0.9	-1.0	7.8	8.2	8.3	8.9
FDI liabilities (inflow), EUR mn [8)]	1,075	840	743	661	307	380	700	.	.
FDI assets (outflow), EUR mn [8)]	75	127	373	428	247	54	250	.	.
Gross reserves of NB excl. gold, EUR mn [9)]	4,666	5,373	5,565	2,448	2,383	2,783	.	.	.
Gross external debt, EUR mn [8)]	29,603	30,254	30,501	33,542	32,615	34,582	34,900	35,800	37,100
Gross external debt, % of GDP [8)]	147.0	137.6	133.7	141.6	137.7	141.7	143.0	140.0	138.0
Average exchange rate EUR-LVL/EUR	1.0050	0.9922	0.9981	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000
Purchasing power parity EUR-LVL/EUR	0.6697	0.6783	0.6793	0.6858	.	.	.	.	.

Note: Latvia has introduced the Euro from 1 January 2014. Up to and including 2013 all-time series in LVL as well as the exchange rates and PPP rates have been divided for statistical purposes by the conversion factor 0.702804 (LVL per EUR) to achieve euro-fixed series (EUR-LVL).

1) Preliminary. - 2) According to census March 2011. - 3) According to ESA 2010. - 4) Enterprises with 20 and more employees. - 5) From 2012 according to census March 2011. - 6) In % of labour force (LFS). - 7) From 2014 official refinancing operation rate for euro area (ECB), refinancing rate of National Bank before. - 8) BOP 6th edition. - 9) From January 2014 (Euro introduction) only foreign currency reserves denominated in non-euro currencies.

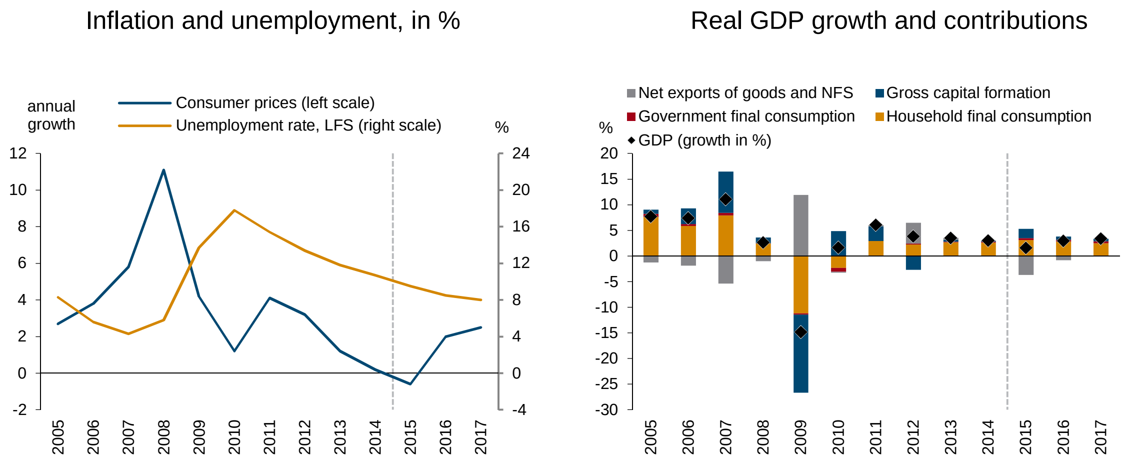
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

LITHUANIA: Economic ties are changing

SEBASTIAN LEITNER

Throughout 2015, growth of the Lithuanian economy has been dampened by a slump in external demand in the CIS countries and the lower demand for oil products. Only part of the shortfall can be offset by exports to the EU and Asian markets or growth in other product categories. Consumer demand has developed apace and investment activity is flourishing. We forecast a reasonable GDP growth rate of 2% for 2015 and an upswing to 3% and 3.4% for 2016 and 2017, respectively.

Figure 50 / Lithuania: Main macroeconomic indicators



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

Lithuanian goods exports have kept declining throughout 2015 – in January to October 2015 by 3.6% in nominal terms year-on-year. The recession in Russia, but also in Belarus and Ukraine, drags down trade with these countries. Thus in the same period exports to Russia fell by 40% and no sign of stabilisation is in sight up to now. Lithuanian entrepreneurs have been successfully redirecting trade by conquering new markets most recently, particularly in the food sector; nevertheless, the shortfall in Russian demand could not be offset completely. However, the transport sector, being strongly exposed to Russian transit trade, as well as tourism were hit less than expected. The third reason for trade to decline was the slump in external demand for refined oil products and the fall in prices, squeezing the profits of the Lithuanian refinery Mazeiku Nafta, which accounts for about a third of the country's total exports. At the same time we see an increase in trade with the Northern and Western trading partners. In 2016 and thereafter exports will probably gain momentum since the economic downturn will level off in the Eastern neighbours. Since domestic demand evolves at a good pace, imports are likely to increase by about 3% nominally in 2015 and net trade will drag down overall GDP growth.

Although export prospects are not too favourably at the moment, gross fixed investments started to pick up in the second quarter of 2015 throughout the economy. The construction of dwellings continues to increase gradually and public investment, particularly in energy infrastructure and road maintenance, will result in gross fixed investments growing by about 8% in 2015. By the end of this year, Lithuania will have taken some important steps to become more energy independent from Russia in terms of gas and electricity. NordBalt and LitPol, connecting the Lithuanian grid both with Sweden and Poland, are just being finalised which should also reduce the price of electricity for households by about 7% in 2016.

The fall in prices for imports, particularly for oil and gas, and the excess supply of food resulted in falling consumer prices in the first eight months of the year. Stronger economic stimulus in the rest of the EU is likely to lead to rising consumer prices in 2016 and 2017. Simultaneously, average real wages continue to increase substantially as in the previous year – in the first half of 2015 by almost 6% net year-on-year. Employment will increase by about 1% in 2015, strongly driven by higher labour demand in construction. Simultaneously, negative net migration and ongoing demographic developments are causing the unemployment rate to drop faster than expected: towards the end of 2015 already to about 9.5% of the labour force. However, those demographic developments pose risks for fiscal sustainability. The European Commission expects an adjustment effort in excess of 3% of GDP in the long term for Lithuania, the highest costs relative to GDP compared to all other EU countries.

Throughout this year various ministries have worked intensively on a comprehensive reform of the labour law and complementary laws concerning the social protection system. The aim is to liberalise the labour market even further, with the hope to increase the number of jobs. First drafts have sparked protest of unions in September, opposing particularly the foreseen 3-day notice period for dismissal, the introduction of a maximum 60-hour week and the expansion of atypical work in general, a reduction of guarantees for working parents and restrictions to trade union activities. The discussions in the parliament on the comprehensive liberalisation package will become highly conflictive, even more so since Lithuania is heading towards parliamentary elections in autumn 2016. Up to now the polls show that the Social Democrats, the strongest party in the parliament, headed by Prime Minister Butkevičius, still enjoy stable public support; however, this could change in the coming months with disputes over the new labour code building up. Thus, the increase in the minimum wage by EUR 25 to EUR 350 (about EUR 580 in purchasing power parity terms) in January next year can be interpreted as a measure to ease off upcoming resistance. Moreover, the budget proposal of the government aims at increasing old-age pensions by 6% and at raising the non-taxable income bracket in 2016. Next year’s defence budget will be increased by one third, thus amounting to 1.5% of GDP, compared to 0.8% in 2013. The government wants to attain a level of 2% of GDP in 2018 – thus the Russian intervention in Ukraine has resulted in a massive reallocation of resources towards military expenses in the whole Baltic Sea region.

Given the improving situation in the labour market and swiftly rising incomes, household consumption remains the most important driver of growth for the Lithuanian economy in 2015 and the years thereafter. However, its positive impact is gradually declining due to increased precautionary savings and it cannot completely offset the negative effects of the shortfall in external demand. Overall, we expect GDP to expand by 2% in 2015. For 2016 and 2017 we slightly raise our forecast for an accelerated GDP growth to 3% and 3.4% growth rates, respectively. The assumed drivers of that development are an economic stabilisation in the eastern neighbours and growth in the euro area gaining momentum. Moreover, public investment activity should be facilitated by the availability of EU funds from the 2014-2020 planning period. The budget deficit, which declined substantially last year, will increase slightly to 1.4% in 2015 owing to tax revenues having remained below expectations. In the years to follow it will remain most probably at the same level, resulting in a continuously falling public debt to GDP ratio.

Table 17 / Lithuania: Selected economic indicators

	2011	2012	2013	2014 [1]	2014	2015	2015	2016	2017
					January-June			Forecast	
Population, th pers., average [2]	3,028	2,988	2,958	2,932	.	.	2,900	2,875	2,860
Gross domestic product, EUR-LTL mn, nom. [3]	31,263	33,335	34,962	36,444	17,390	17,617	36,800	38,700	41,000
annual change in % (real)	6.0	3.8	3.5	3.0	4.1	0.4	1.6	3.0	3.4
GDP/capita (EUR at exchange rate) [3]	10,300	11,200	11,800	12,400	.	.	12,700	13,500	14,300
GDP/capita (EUR at PPP) [3]	17,000	18,300	19,400	20,200	.	.	.	.	.
Consumption of households, EUR-LTL mn, nom. [3]	19,471	20,786	21,885	22,817	10,944	11,351	.	.	.
annual change in % (real)	4.6	3.6	4.3	4.2	4.5	6.1	5.0	4.5	4.0
Gross fixed capital form., EUR-LTL mn, nom. [3]	5,781	5,788	6,457	6,894	3,078	3,466	.	.	.
annual change in % (real)	20.1	-1.8	8.3	5.4	9.5	10.9	8.0	10.0	9.0
Gross industrial production (sales)									
annual change in % (real)	6.4	3.7	3.3	-0.1	-2.2	4.5	4.6	6.0	7.0
Gross agricultural production									
annual change in % (real)	10.3	14.2	-1.8	6.2	.	.	.	.	.
Construction industry									
annual change in % (real)	22.1	-7.1	11.3	17.0	23.8	7.6	.	.	.
Employed persons, LFS, th, average [4]	1,371	1,276	1,293	1,319	1,302	1,327	1,330	1,340	1,350
annual change in %	2.0	1.8	1.3	2.0	1.6	1.9	0.8	0.8	0.7
Unemployed persons, LFS, th, average [4]	249	197	173	158	174	142	140	124	117
Unemployment rate, LFS, in %, average [4]	15.4	13.4	11.8	10.7	11.8	9.7	9.5	8.5	8.0
Reg. unemployment rate, in %, end of period [2)5)]	12.0	11.4	11.1	9.3	8.6	8.5	.	.	.
Average monthly gross wages, EUR-LTL [6]	593	615	646	677	676	707	710	770	840
annual change in % (real, gross)	-1.2	0.7	4.0	4.7	4.0	5.7	6.0	6.5	6.0
Average monthly net wages, EUR-LTL [6]	462	478	501	527	527	549	550	590	630
annual change in % (real, net)	-1.3	0.5	3.8	5.1	4.4	5.4	5.8	4.8	4.3
Consumer prices (HICP), % p.a.	4.1	3.2	1.2	0.2	0.3	-0.8	-0.6	2.0	2.5
Producer prices in industry, % p.a.	13.9	5.0	-2.4	-4.9	-4.0	-9.0	-8.0	0.0	1.0
General goverm.budget, EU-def., % of GDP									
Revenues	33.5	33.0	32.9	34.1	.	.	33.5	33.2	33.0
Expenditures	42.5	36.1	35.5	34.8	.	.	34.9	34.4	34.2
Net lending (+) / net borrowing (-)	-8.9	-3.1	-2.6	-0.7	.	.	-1.4	-1.2	-1.2
Public debt, EU-def., % of GDP	37.2	39.8	38.8	40.7	.	.	43.0	40.0	39.0
Central bank policy rate, % p.a., end of period [7]	1.24	0.52	0.27	0.12	0.26	0.05	0.05	0.05	0.20
Current account, EUR mn [8]	-1,209	-393	539	1,305	88	-873	-1,500	-1,800	-2,000
Current account, % of GDP [8]	-3.9	-1.2	1.5	3.6	0.5	-5.0	-4.1	-4.7	-4.9
Exports of goods, BOP, EUR mn [8]	19,422	22,427	23,998	23,750	11,174	10,787	22,840	23,750	25,410
annual change in %	30.4	15.5	7.0	-1.0	-3.8	-3.5	-3.8	4.0	7.0
Imports of goods, BOP, EUR mn [8]	21,487	23,530	24,918	24,686	11,758	12,044	25,550	26,700	28,430
annual change in %	29.9	9.5	5.9	-0.9	-0.8	2.4	3.5	4.5	6.5
Exports of services, BOP, EUR mn [8]	4,033	4,793	5,390	5,850	2,789	2,845	6,130	6,560	7,220
annual change in %	17.8	18.8	12.5	8.5	10.5	2.0	4.8	7.0	10.1
Imports of services, BOP, EUR mn [8]	2,766	3,404	4,033	4,212	2,022	2,015	4,470	4,830	5,410
annual change in %	20.2	23.1	18.5	4.4	7.5	-0.3	6.1	8.1	12.0
FDI liabilities (inflow), EUR mn [8]	1,095	454	531	270	195	101	800	.	.
FDI assets (outflow), EUR mn [8]	94	215	322	433	160	61	300	.	.
Gross reserves of NB excl. gold, EUR mn [9]	6,120	6,203	5,705	6,991	6,009	1,910	.	.	.
Gross external debt, EUR mn [8]	25,149	26,031	24,596	25,723	25,164	28,483	28,700	29,400	30,300
Gross external debt, % of GDP [8]	80.4	78.1	70.4	70.6	69.0	77.4	78.0	76.0	74.0
Average exchange rate EUR-LTL/EUR	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000
Purchasing power parity EUR-LTL/EUR	0.6070	0.6089	0.6086	0.6160	.	.	.	.	.

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

1) Preliminary. - 2) According to census March 2011. - 3) According to ESA 2010. - 4) From 2012 according to census March 2011. - 5) In % of working age population. - 6) Including earnings of sole proprietors. - 7) 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). - 8) BOP 6th edition. - 9) From January 2015 (Euro introduction) only foreign currency reserves denominated in non-euro currencies.

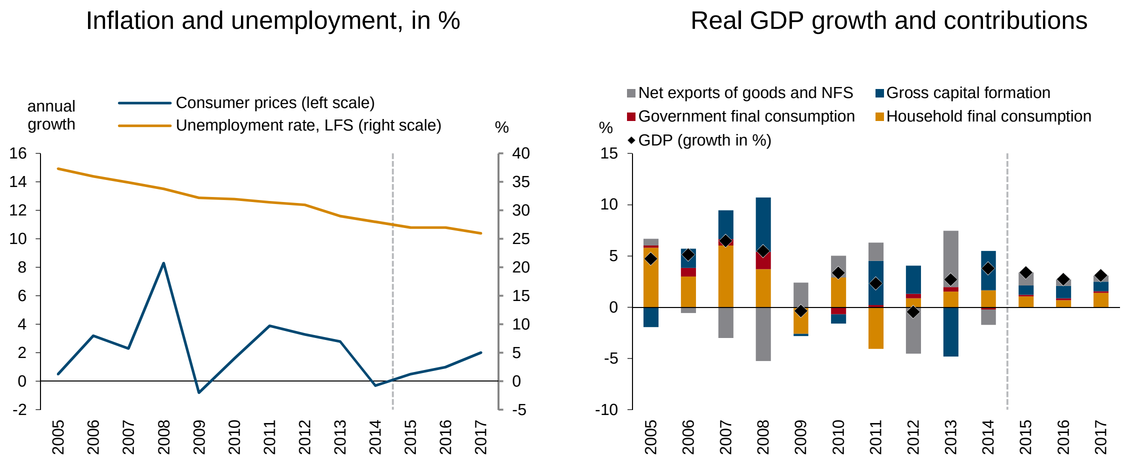
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

MACEDONIA: Growth and stability trade-off, again

VLADIMIR GLIGOROV

The current year's growth may turn out to be disappointing owing to a slowdown in both consumption and investment. Nonetheless, the growth rate should prove to be among the highest in the region. Assuming the maintenance of political and social stability, the growth rate should remain at around 3% over the medium term. Faster growth is possible, if political stabilisation is assured after the early elections in April next year and significant economic improvements are achieved in the region.

Figure 51 / Macedonia: Main macroeconomic indicators



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

Stability has been the key word since the country has achieved independence almost a quarter of a century ago. Certainly since 1994 and after the near civil war in 2001, stability has been the main target to which growth prospects were subservient. This changed somewhat after the 2009 crisis as it allowed for more relaxed fiscal and monetary policies. In addition, ahead of the crisis and in the early year or two into it, wages in the public sector were hiked, which had a positive effect on overall economic activity.

With all that, an important adjustment has taken place in the last few years. Exports have increased substantially faster than imports, and the current account deficit has shrunk considerably. In addition, investments have shot up, both public and private. Saving has also increased and final consumption has declined. This has gone together within a fixed exchange rate regime and low inflation, which has flirted with deflation occasionally. In the first year of the crisis, 2009, wages increased by about 10%, which however did not have negative effects on the trade balance, with exports increasing by about 40% in current euros between 2009 and 2014 (imports rose by about 20%).

So, Macedonia is an example of a country that has pursued a wage policy consistent with the fixed exchange rate regime and thus avoided loss of competiveness, which, while depressing growth ahead of the crisis, proved to be a boon during the crisis as it allowed a looser wage policy and strong export performance. In addition, fiscal austerity before the crisis allowed for an expansion of capital spending without worrisome developments of the public debt, which despite doubling as a share of GDP remains at slightly above 40% only.

The concern with stability translated into an austere policy mix of fixed exchange rate, restrictive monetary policy and balanced budget. That depressed the growth rate in the period between 1994 and 2006. The strategy was to preserve external and fiscal stability and the stability of prices, with growth expected to come from net exports. That proved hard to achieve and cost the country dearly as unemployment stayed stubbornly above 30%. This proved sustainable because political concerns trumped the social ones. In the period after the outbreak of the global financial crisis, expansionary economic policy led to some increase in employment and to a fall in the rate of unemployment, even though it has come down to the very high level of around 27%. Political stability, however, was preserved through the readiness to hold early elections whenever the loss of legitimacy of the government came to be seen as probable. So, in the crisis, concerns with growth, employment and welfare have trumped the concerns with stability on the back of stabilising policies ahead of the crisis.

This year, however, political stability was threatened by the rapid loss of trust in the government that has been in power since 2006. Both main coalition parties, the Macedonian and the Albanian one, faced crises of legitimacy as allegations of corruption, electoral manipulation and human rights valuations surfaced. An escalation was avoided with the help of EU (and US) mediation which ended up in the promise of yet another early election by the beginning of April next year at the latest. This has calmed things down for the time being.

Still, these political developments have brought the issue of stability of the country to the fore. There are also social issues to be faced given that employment is still quite scarce and unemployment plentiful. Initial expectations were that the political crisis would not have significant negative economic consequences. That remains to be seen, but the data for the first half of the year are encouraging, with GDP posting growth of 2.9% compared to the first half of the previous year. With a similarly strong second half, growth should top 3% for the year as a whole.

The main issue is additional growth of investment. Government, household and total final consumption shares in GDP have already adjusted by about 10 percentage points all in all while investments have gone up together with the improvement in net exports (though it is bound to deteriorate this year and going forward as growth persists). On the supply side, industrial production has increased its otherwise low share at the expense of services. Further adjustments on the demand side could only mean some additional increase in government consumption and continued strong investment performance while growth of industry can only be quite slow. With that, growth around 3% is sustainable in the medium run.

One factor that may change things is an improved prospect for the start of negotiations with the EU. If a breakthrough is achieved by the end of next year, which is not terribly likely, but is not impossible depending on the outcome of the Macedonian elections and of the policy of the new Greek government, that should prove conducive to an acceleration of the growth rate.

Table 18 / Macedonia: Selected economic indicators

	2011	2012	2013	2014 1)	2014 January-June	2015 January-June	2015 Forecast	2016 Forecast	2017 Forecast
Population, th pers., mid-year	2,059	2,061	2,064	2,068	.	.	2,080	2,085	2,090
Gross domestic product, MKD mn, nom. 2)	464,186	466,703	499,559	525,843	253,360	266,455	546,400	567,000	596,000
annual change in % (real)	2.3	-0.5	2.7	3.8	4.0	2.9	3.4	2.7	3.1
GDP/capita (EUR at exchange rate) 2)	3,700	3,700	3,900	4,100	.	.	4,300	4,400	4,600
GDP/capita (EUR at PPP) 2)	8,800	9,100	9,500	10,000	.	.	.	.	.
Consumption of households, MKD mn, nom. 2)3)	343,080	344,852	359,204	367,297	185,471	189,205	.	.	.
annual change in % (real)	-5.4	1.2	2.1	2.3	1.9	2.1	1.5	1.0	2.0
Gross fixed capital form., MKD mn, nom. 2)	109,219	109,071	117,382	121,500	.	.	.	.	.
annual change in % (real)	13.3	6.5	4.8	5.5	.	.	4.0	4.0	4.0
Gross industrial production 4)									
annual change in % (real)	6.9	-2.7	3.2	4.8	4.5	0.8	3.0	5.0	5.0
Gross agricultural production 5)									
annual change in % (real)	-0.4	-5.6	6.4	3.0	.	.	3.0	3.0	3.0
Construction output, hours worked									
annual change in % (real)	28.5	8.1	43.1	-3.4	9.1	16.4	5.0	5.0	5.0
Employed persons, LFS, th, average	645.1	650.6	678.8	690.2	686.9	698.4	700	710	720
annual change in %	1.1	0.8	4.3	1.7	2.0	1.7	1.5	1.0	1.0
Unemployed persons, LFS, th, average	295.0	292.5	277.2	268.8	271.2	259.4	260	260	250
Unemployment rate, LFS, in %, average	31.4	31.0	29.0	28.0	28.3	27.1	27	27	26
Reg. unemployment rate, in %, end of period	29.9	25.8	22.8	23.4	22.5	22.9	23	23	23
Average monthly gross wages, MKD	30,602	30,669	31,025	31,325	31,029	31,879	32,100	32,700	33,700
annual change in % (real, gross)	-2.6	-3.0	-1.6	1.3	0.3	3.0	2.0	1.0	1.0
Average monthly net wages, MKD	20,847	20,902	21,145	21,394	21,194	21,696	21,900	22,300	23,000
annual change in % (real, net)	-2.4	-2.9	-1.6	1.5	0.5	2.7	2.0	1.0	1.0
Consumer prices, % p.a.	3.9	3.3	2.8	-0.3	-0.2	-0.3	0.5	1.0	2.0
Producer prices in industry, % p.a.	11.9	1.4	-1.4	-1.9	-2.2	-3.2	-2.0	1.0	2.0
General governm. budget, nat.def., % of GDP									
Revenues	31.7	32.1	30.2	30.4	27.1	29.3	31.0	31.0	31.0
Expenditures	34.2	36.0	34.2	34.3	32.9	32.9	34.0	33.0	33.0
Deficit (-) / surplus (+)	-2.6	-3.9	-4.0	-3.9	-5.8	-3.6	-3.0	-2.0	-2.0
Public debt, nat.def., % of GDP	32.0	38.3	40.4	45.1	.	.	46.0	46.0	46.0
Central bank policy rate, %, p.a., end of period 6)	4.00	3.73	3.25	3.25	3.25	3.25	3.25	3.25	3.50
Current account, EUR mn 7)	-189	-240	-134	-69	-200	-98	-360	-370	-390
Current account, % of GDP 7)	-2.5	-3.2	-1.7	-0.8	-4.9	-2.3	-4.0	-4.0	-4.0
Exports of goods, BOP, EUR mn 7)	2,396	2,307	2,375	2,780	1,288	1,458	3,060	3,240	3,400
annual change in %	21.0	-3.7	2.9	17.0	16.1	13.1	10.0	6.0	5.0
Imports of goods, BOP, EUR mn 7)	4,301	4,315	4,238	4,635	2,207	2,317	4,870	5,110	5,370
annual change in %	22.4	0.3	-1.8	9.4	7.8	4.9	5.0	5.0	5.0
Exports of services, BOP, EUR mn 7)	1,045	1,067	1,155	1,277	582	658	1,380	1,463	1,536
annual change in %	39.8	2.1	8.2	10.6	16.4	13.0	8.0	6.0	5.0
Imports of services, BOP, EUR mn 7)	686	757	780	919	470	476	947	994	1,044
annual change in %	11.4	10.5	2.9	17.9	29.1	1.3	3.0	5.0	5.0
FDI liabilities (inflow), EUR mn 7)	370	265	302	37	106	108	300	.	.
FDI assets (outflow), EUR mn 7)	26	134	73	-160	1	-2	0	.	.
Gross reserves of NB, excl. gold, EUR mn	1,802	1,918	1,803	2,221	1,663	2,024	.	.	.
Gross external debt, EUR mn 7)	4,847	5,172	5,220	5,992	5,747	6,342	6,600	6,700	6,800
Gross external debt, % of GDP 7)	64.2	68.2	64.3	70.2	67.3	71.4	74.0	73.0	70.0
Average exchange rate MKD/EUR	61.53	61.53	61.58	61.62	61.65	61.59	61.50	61.50	61.50
Purchasing power parity MKD/EUR	25.58	24.98	25.60	25.52	.	.	.	.	.

1) Preliminary. - 2) According to ESA'10. - 3) Including NPISHs. - 4) Enterprises with 10 and more employees. - 5) For 2014 wiiw estimates. - 6) Central Bank bills (28-days). - 7) BOP 6th edition.

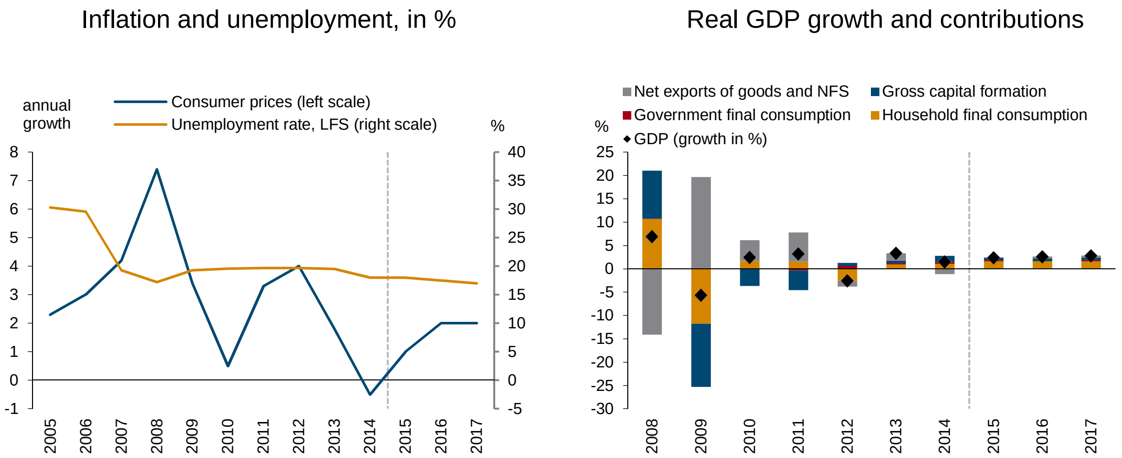
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

MONTENEGRO: Legitimacy crisis ahead of NATO accession

VLADIMIR GLIGOROV

With stability assured, the adjustment process in Montenegro now needs to deal with external imbalances. This means that consumption will have to grow slowly, if at all. Everything thus hinges on: (i) investment growth, which is quite sensitive to security and stability risks; and (ii) tourism, which has performed rather well to date. Bearing that in mind, we can expect a growth rate of around 3% being maintained over the medium term.

Figure 52 / Montenegro: Main macroeconomic indicators



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

The economy continues to perform relatively well given that it is highly dependent on the export of services and on foreign investments. This year's GDP growth should top 3% on the back of a good tourist season and continued good investment performance, most of it foreign. One would have thought that consistently high external imbalances and the unilateral euroisation would have worked out a serious problem of sustainability of macroeconomic stability in the event of a crisis as the one that occurred in 2008-2009. And clearly, the risks are there, but have been managed relatively successfully by the policy-makers so far. The banking sector, presenting a serious challenge at the beginning of the financial crisis in 2009, has been stabilised. There is clearly the problem of high foreign debt, but that may not be unusual for a very small, open and basically services-oriented economy on the Adriatic coast with formidable Balkan mountains. Growth prospects for the medium term are similarly encouraging assuming that stability, economic and political, is sustained. Clearly, the policy-makers are managing stability in an economy with high macroeconomic imbalances, which can be corrected only in the long run.

What puzzles observers is the very large current account deficit of around 20% (and higher before the crisis) that gets financed from foreign investments. Clearly, there has to be an end to how much foreign investments can be put into any country and into a micro country (less than 1 million inhabitants) such as Montenegro. However, the investment needs and correspondingly opportunities are still far from being exhausted. This goes as much for the investments on the coast, which is of primary tourist interest, as to the hinterland, which offers opportunities for transport and transit businesses. So, the current model of development based on foreign investments and growth of services is in principle sustainable for quite some time, let alone in the medium run.

There is much chagrin in the local public for the continued deindustrialisation. Indeed, almost nothing has remained from the socialist past. There are still some hopes – probably doomed to be continuously disappointed – for the aluminium plant and for the steel mill, but those are likely to be phased out eventually. Smaller industrial ventures still manage to survive and there are opportunities in small and medium-sized enterprises in a number of sectors in the continental part of the country. Finally, there are clean energy resources such as water power too.

However, tourism provides major opportunities together with shipping and other maritime activities, e.g. in larger ports such as Bar. The country continues to be closely connected with neighbouring Serbia and Croatia and its development does in part depend on that of these two neighbours. It is a sign of the resilience of the local economy that it has managed to perform comparatively well given that the two bigger neighbours have not. That again is a reason for optimism that the economic model followed so far is sustainable.

One major element of it was fiscal prudence in good times, which made it possible for the government to weather the crisis without fiscal austerity even though the costs of the problems in the banking and in the industrial sectors were rather high. Public debt has increased, but at about 60% of GDP it is still lower than in most neighbouring countries. Thus, the government has been able to rely on fiscal measures to smooth consumption and investment and thus preserve social and political stability. Even though the country uses the euro as it official currency, without of course having access to the liquidity provided by the ECB, the adjustment to the crisis has been managed without strong wage repression and increase in unemployment. Consumption has declined as the current account has contracted, but not dramatically. Also, the unemployment rate has gone up somewhat, but the more important problem is the persistent high unemployment rate that was there even before the crisis. There is some continued dispute about the correct figures, but there is no doubt that the labour market has been depressed for a long time now.

Montenegro is the most advanced candidate country and is negotiating with the EU for some time now already. The progress is slow, in part because of a lack of administrative capacity of this small country. Given the challenges, the government and the public are more interested in the stability that the process of EU accession provides than about how fast it indeed is. Both sides are in fact taking their time.

Stability should be improved additionally if, as expected, Montenegro gets an invitation from NATO to join it at the end of this year or the beginning of the next. This, however, has proved to be a divisive issue and some kind of a crisis of legitimacy has emerged at the beginning of autumn 2015. There are underlying causes of the crisis though, as the same people and the same party have been running the country for almost 30 years now. In addition, the opposition is ethnic and not just political, mostly Serbian parties oppose the Montenegrin governing party. This has somewhat changed recently, with a political rather than ethnic opposition emerging, but their successfulness is yet to be tested.

In any case, the challenge the country faces, as do some other Balkan countries too, is to move from ethnic to political competition. It is hard to stabilise democracy without putting ethnic differences aside. This current political crisis is connected with the upcoming accession to NATO and also with the new religious law that equalises the Serbian and Montenegrin Orthodox Christian churches. The front line issue is corruption and electoral fraud, very much like in Macedonia, but those are somewhat overshadowed by the ones that allude to ethnic differences.

Given that stability is preserved, the adjustment process in Montenegro needs to deal with the external imbalances, which means that consumption will have to grow slowly if at all. So, it all depends on the growth of investment, which is quite sensitive to security and stability risks, and on tourism, which has performed rather well so far. With that in mind, a growth rate of around 3% should be maintained in the medium term.

Table 19 / Montenegro: Selected economic indicators

	2011	2012	2013	2014 1)	2014	2015	2015	2016	2017
					January-June			Forecast	
Population, th pers., mid-year 2)	620	621	621	622	.	.	625	625	625
Gross domestic product, EUR mn, nom.	3,234	3,149	3,327	3,425	1,436	1,501	3,500	3,700	3,900
annual change in % (real)	3.2	-2.5	3.3	1.5	0.3	3.4	2.4	2.6	2.8
GDP/capita (EUR at exchange rate)	5,200	5,100	5,400	5,500	.	.	5,600	5,900	6,200
GDP/capita (EUR at PPP)	10,600	10,300	10,700	10,700	.	.	.	.	.
Consumption of households, EUR mn, nom.	2,667	2,632	2,712	2,722	1,280.0	1,322.4	.	.	.
annual change in % (real)	1.9	-3.2	1.1	1.3	.	.	2.0	2.0	2.0
Gross fixed capital form., EUR mn, nom.	596	584	639	680	379.0	433.5	.	.	.
annual change in % (real)	-10.3	-3.3	8.8	0.7	.	.	4.0	5.0	4.0
Gross industrial production									
annual change in % (real)	-10.3	-7.0	10.6	-11.4	-15.3	9.6	5.0	5.0	5.0
Net agricultural production									
annual change in % (real)	9.5	-12.7	5.0	3.0	.	.	.	.	.
Construction output 3)									
annual change in % (real)	15.8	-11.9	1.2	5.0	.	.	.	.	.
Employed persons, LFS, th, average 2)	195	200	202	216	213	219	220	220	220
annual change in %	.	2.4	1.0	7.1	6.6	2.5	2.0	1.0	1.0
Unemployed persons, LFS, th, average 2)	48	49	49	48	49	48	50	50	50
Unemployment rate, LFS, in %, average 2)	19.7	19.7	19.5	18.0	18.8	18.0	18.0	17.5	17.0
Reg. unemployment rate, %, average	15.9	15.3	15.8	16.1	14.9	14.7	.	.	.
Average monthly gross wages, EUR	722	727	726	723	724	727	730	750	770
annual change in % (real, gross)	-2.1	-3.3	-2.7	0.3	-0.3	-0.6	0.0	1.0	1.0
Average monthly net wages, EUR	484	487	479	477	477	480	480	490	500
annual change in % (real, net)	-2.0	-3.3	-3.8	0.3	-0.7	-0.3	0.0	1.0	1.0
Consumer prices, % p.a.	3.3	4.0	1.8	-0.5	-0.3	0.9	1.0	2.0	2.0
Producer prices in industry, % p.a. 4)	3.2	1.9	1.6	0.1	-0.5	0.5	1.0	2.0	3.0
General governm.budget, nat.def., % of GDP									
Revenues	39.7	35.8	37.4	39.5	40	39.2	40.0	40.0	38.0
Expenditures	43.4	42.4	41.1	42.5	45.5	56.2	45.0	43.0	40.0
Deficit (-) / surplus (+)	-3.7	-6.6	-3.8	-3.0	-5.5	-17.0	-5.0	-3.0	-2.0
Public debt, nat.def., % of GDP	46.0	54.0	56.3	56.7	57.5	60.2	60.0	60.0	60.0
Central bank policy rate, % p.a., end of period 5)	9.06	8.83	8.68	8.50	8.6	8.1	8.0	8.0	8.0
Current account, EUR mn 6)	.	.	-487	-526	-447	-490	-525	-555	-585
Current account, % of GDP 6)	.	.	-14.6	-15.4	.	.	-15.0	-15.0	-15.0
Exports of goods, BOP, EUR mn 6)	.	.	396	357	157	149	360	380	400
annual change in %	.	.	.	-9.7	-22.1	-5.7	0.0	5.0	5.0
Imports of goods, BOP, EUR mn 6)	.	.	1,724	1,734	807	835	1,800	1,870	1,940
annual change in %	.	.	.	0.6	-2.1	3.5	4.0	4.0	4.0
Exports of services, BOP, EUR mn 6)	.	.	994	1,031	271	295	1,110	1,170	1,230
annual change in %	.	.	.	3.6	4.2	8.9	8.0	5.0	5.0
Imports of services, BOP, EUR mn 6)	.	.	341	340	151	174	370	390	410
annual change in %	.	.	.	-0.3	0.0	15.1	10.0	5.0	5.0
FDI liabilities (inflow), EUR mn 6)	.	.	337	375	169	193	390	.	.
FDI assets (outflow), EUR mn 6)	.	.	13	21	14	7	20	.	.
Gross reserves of NB, excl. gold, EUR mn 7)	303	348	424	545	530	818	.	.	.
Gross external public debt, EUR mn	1,064	1,295	1,433	1,562	1,584	2,160	1,600	1,700	1,800
Gross external public debt, % of GDP	32.9	41.1	43.1	45.6	46.2	61.7	45.0	45.0	45.0
Purchasing power parity EUR/EUR	0.4909	0.4911	0.5017	0.5135	.	.	.	.	.

1) Preliminary. - 2) According to census April 2011. - 3) Gross value added. - 4) Domestic output prices. - 5) Average weighted lending interest rate of commercial banks (Montenegro uses the euro as national currency). - 6) BOP 6th edition. - 7) Data refer to reserve requirements of Central Bank.

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

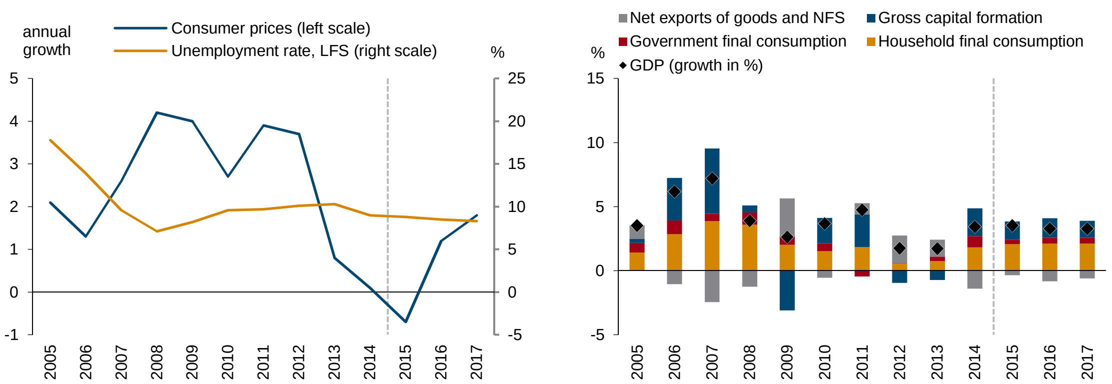
POLAND: A time of generous promises

LEON PODKAMINER

The current moderate and broad-based growth has yet to eliminate the excessive unemployment and put a stop to deflationary tendencies. The recent elections are unlikely to change Poland's economic trajectory over the biennium 2016-2017. Continuing moderate growth (at a rate in excess of 3%) will bring about gradual improvements without giving rise to major internal or external imbalances.

Figure 53 / Poland: 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.

GDP grew fairly moderately (3.4%, year-on-year) in the first half of 2015 – roughly at the speed recorded since the first quarter of 2014. Household consumption keeps growing steadily at about 3% while growth of public consumption slowed down to 2.4% in the second quarter of 2015 (from 4.7% in 2014). The strong expansion of gross fixed capital formation (GFCF) has been continuing, though it has lost some of its impetus in the second quarter of 2015. All the same GFCF contributed 1.2 percentage points to the overall GDP growth in the first half of the year. A sizeable increase in inventories in 2014 is followed by a corrective destocking now. The change in inventories in the first half of 2015 reduced the GDP growth rate by some 0.8 percentage points. The trade balance has stopped to contribute to GDP growth in the second quarter (after adding 1.1 percentage points to the GDP growth rate in the first quarter). Nonetheless, according to the official (but not yet definitive) estimates the volume of exports (of goods and non-factor services combined) rose by 6.6% in the first half of the year while the volume of imports by 5.7%.

Gross value added has continued to increase rather strongly in industry (by 4.8% in the first half of the year) and construction (by close to 4%). Overall, net profits earned by the non-financial corporate sector rose by 10% in the first half of 2015. Manufacturing corporations' profits have risen by over 13%. The average real wage in the private sector rose by 3.4% and the sector's employment by 1%.

The positive trends observed in the first half of the year have persisted later on. During the first eight months of 2015 the volume of manufacturing sales rose by 4.5% and of sales of output of the construction sector by 3.7%. Sales of manufactured investment goods are rising fast (by close to 10%), followed by sales of consumer durables (6.4%), intermediate inputs (4.2%) and consumer non-durables (3.7%). Interestingly, the number of housing units constructed has been stagnant while the volume of civil engineering and other construction works has been rising very strongly. There is little doubt that this reflects the availability of EU funds earmarked for infrastructural investment programmes. The bulk of investment goes to manufacturing and the sector generating and supplying electricity, steam and gas.

The investment outlays[49] in the latter sector increased especially strongly (by about 40%). Within manufacturing, investment outlays rose very strongly in some technologically more advanced branches (e.g. pharmaceuticals, motor vehicles and electrical equipment). Also investments in the water-supply and construction sectors increased strongly in the first half of 2015 (by over 17% and 24% respectively). By contrast, the volume of investment outlays in the trade sector contracted by 8%.

The moderate output growth since 2010 has been combined with fast disinflation which at mid-2014 turned into accelerating deflation. Although the inflation forecast suggests stronger deflation than even a couple of months ago[50], the deepening of deflation seems to have stopped now. Positive inflation is unlikely to return before the spring of 2016 though. The declared 2% inflationary goal of monetary policy seems likely to be reached only sometime in the second half of 2017. Price developments – and the still large levels of unemployment – clearly indicate that the economy still suffers from a persistent shortage of aggregate demand. In March 2015 the notoriously hawkish National Bank of Poland reluctantly lowered its policy interest rate to the still rather high level of 1.5%. Currently the bulk of business investment can still be safely financed by means other than the rather expensive (given the deflationary tendencies) bank loans (and by corporations' own means in particular). But the 'dear money' policy may have been unnecessarily limiting the business investment expansion of smaller businesses (as it has been limiting the expansion of households' demand for housing loans). Also, dear money may have been conducive to supporting the strength of the Polish currency vs. the euro.

The parliamentary elections held on 25th October 2015 were a contest between the main opposition party, Law and Justice Party (PiS), led by the former prime minister Jarosław Kaczyński, and the ruling Civic Platform (PO), which is led by Ewa Kopacz, the incumbent prime minister (and heiress to Donald Tusk, present president of the European Council). Earlier this year, Poland's president (associated with

[49] Investment outlays assuming the form of buildings and structures rose by 14% in the first half of 2015, outlays in the form of new machinery and equipment by 11% while investment in means of transport remained flat.

[50] In its March 2015 Inflation Report, the National Bank's CPI estimate for 2015 was -0.5%. This figure was revised to -0.8% in the July Inflation Report. While the core inflation estimate was unchanged (at -0.4%), the estimates for prices of less predictable items, energy and food, were revised from -3% to -3.2% and from -0.7% to -1.9% respectively.

PO) was voted out of office, having lost the electoral contest to Andrzej Duda, a younger (and little-known) PiS contender. The skilful election campaign with lavishly supplied populist slogans had appealed to the traditionally-minded and to the economically disadvantaged parts of the electorate. The latter group included numerous young and well-educated persons forced into 'irregular' occupations that were legalised – and have been long tolerated – by the PO governments. In its electioneering PiS followed the same tactics. Clearly cornered, PO desperately tried to match the competitors by promising many 'nice' things which its governments had been unable to consider, let alone deliver, during its long eight years in power.

The victory of PiS may still turn out to be Pyrrhic – as PiS may still fail to find partners adventurous enough to join them in forming a government. In that case PO – in coalition with smaller parties – may still remain in power. Whatever the eventual outcome of the post-election manoeuvring, the next government will find it difficult, or even impossible, to keep the most consequential pre-election promises. Of course some changes (such as those concerning the personal income tax as applied to the poorest families, or repel of regulations permitting unbridled exploitation of employees) could – and should – be made. But it is very unlikely that e.g. the retirement age will be pushed back to 65 years for men (or 60 years for women), or that government social spending will suddenly be increased by a factor of two or more.

In effect nothing of substance will change very much as far as the medium-term macroeconomic conditions are concerned. The next government will continue to stick to a rather liberal agenda, even if paying more attention to 'social issues' and the concerns of the economically disadvantaged groups.[51]

Concluding, the political turmoil is unlikely to substantially affect the Polish economy in 2016-2017. The current fiscal policy has been fixing the contours for what could be done in 2016 anyway. Also, the monetary policy cannot be expected to change before mid-2016 (when the present NBP President will leave his office). But, given the generally long lags in the transmission of monetary policy instruments, even then an eventual change in the orientation of that policy would possibly affect the real economy only sometime in 2017. Continuing moderate growth (still running well below the 'potential') is to be expected – also beyond the current forecast horizon. A much stronger growth in domestic demand, and in investment in particular, would be needed if the country's GDP growth were to assume the magnitudes more consistent with its income level, which is still relatively low. But for the growth rates approaching their 'potential' magnitudes a radical change in the economic and social policy orientation would have to happen not only in Poland, but also at the European Union level.

[51] In 2005-2007, while in power (having won the elections promising 'solidarity instead of liberalism') the PiS government conducted exemplarily liberal economic and social policies.

Table 20 / Poland: Selected economic indicators

	2011	2012	2013	2014 1)	2014	2015	2015	2016	2017
					January-June			Forecast	
Population, th pers., average 2)	38,534	38,536	38,514	38,487	.	.	38,525	38,500	38,550
Gross domestic product, PLN bn, nom. 3)	1,554	1,616	1,663	1,729	823.3	851.6	1,780	1,860	1,960
annual change in % (real)	4.8	1.8	1.7	3.4	3.6	3.6	3.5	3.3	3.3
GDP/capita (EUR at exchange rate) 3)	9,800	10,000	10,300	10,700	.	.	11,000	11,600	12,100
GDP/capita (EUR at PPP) 3)	16,600	17,400	17,900	18,600	.	.	.	.	.
Consumption of households, PLN bn, nom. 3)	939.7	979.4	997.8	1,023.8	520.5	527.7	.	.	.
annual change in % (real)	3.0	1.0	1.2	3.0	2.8	3.6	3.5	3.6	3.6
Gross fixed capital form., PLN bn, nom. 3)	315.6	314.0	312.9	337.0	125.4	136.0	.	.	.
annual change in % (real)	9.3	-1.5	1.1	9.2	10.1	8.5	7.0	7.0	6.0
Gross industrial production (sales) 4)									
annual change in % (real)	6.8	1.3	2.3	3.4	4.5	4.7	4.5	5.0	4.5
Gross agricultural production									
annual change in % (real)	0.1	1.2	0.5	6.9	.	.	.	.	.
Construction industry 4)									
annual change in % (real)	15.3	-5.2	-10.3	4.3	9.8	1.7	.	.	.
Employed persons, LFS, th, average 5)	16,131	15,591	15,568	15,862	15,683	15,912	16,000	16,100	16,100
annual change in %	1.1	0.2	-0.1	1.9	1.8	1.5	0.8	0.5	0.3
Unemployed persons, LFS, th, average 5)	1,723	1,749	1,793	1,567	1,716	1,388	1,540	1,490	1,460
Unemployment rate, LFS, in %, average 5)	9.7	10.1	10.3	9.0	9.9	8.0	8.8	8.5	8.3
Reg. unemployment rate, in %, end of period	12.5	13.4	13.4	11.5	12.0	10.3	-	-	-
Average monthly gross wages, PLN	3,404	3,530	3,659	3,783	3,913	4,051	3,890	4,070	4,310
annual change in % (real, gross)	1.4	0.1	2.8	3.4	3.6	4.5	3.5	3.5	4.0
Consumer prices (HICP), % p.a.	3.9	3.7	0.8	0.1	0.5	-0.9	-0.7	1.2	1.8
Producer prices in industry, % p.a.	7.3	3.3	-1.2	-1.3	-1.1	-2.2	-1.5	0.0	1.5
General governm.budget, EU-def., % of GDP									
Revenues	39.0	39.2	38.2	38.6	.	.	38.6	38.3	39.0
Expenditures	43.9	42.9	42.2	41.8	.	.	41.5	41.1	41.5
Net lending (+) / net borrowing (-)	-4.9	-3.7	-4.0	-3.2	.	.	-2.9	-2.8	-2.5
Public debt, EU-def., % of GDP	54.8	54.4	55.7	50.1	.	.	50.2	50.1	50.0
Central bank policy rate, % p.a., end of period 6)	4.5	4.3	2.5	2.0	2.5	1.5	1.5	1.5	2.0
Current account, EUR mn 7)	-19,647	-14,458	-5,028	-8,298	-4,665	2,008	-2,100	-6,700	-9,300
Current account, % of GDP 7)	-5.2	-3.7	-1.3	-2.0	-2.4	1.0	-0.5	-1.5	-2.0
Exports of goods, BOP, EUR mn 7)	132,420	141,026	149,113	158,657	77,890	85,208	172,100	184,100	193,300
annual change in %	12.1	6.5	5.7	6.4	7.6	9.4	8.5	7.0	5.0
Imports of goods, BOP, EUR mn 7)	145,709	149,156	149,448	161,911	79,504	83,206	173,200	185,300	196,400
annual change in %	12.9	2.4	0.2	8.3	9.1	4.7	7.0	7.0	6.0
Exports of services, BOP, EUR mn 7)	29,370	31,949	33,592	36,279	17,196	18,304	37,400	38,500	40,000
annual change in %	9.8	8.8	5.1	8.0	7.2	6.4	3.0	3.0	4.0
Imports of services, BOP, EUR mn 7)	24,206	25,947	25,948	27,705	12,663	13,445	28,800	29,700	30,900
annual change in %	3.2	7.2	0.0	6.8	6.9	6.2	4.0	3.0	4.0
FDI liabilities (inflow), EUR mn 7)	13,274	5,771	658	12,826	7,654	3,061	3300	.	.
FDI assets (outflow), EUR mn 7)	3,415	1,055	-2,524	4,609	3,003	2,425	1800	.	.
Gross reserves of NB excl. gold, EUR mn	71,691	78,403	74,257	79,379	71,484	89,906	.	.	.
Gross external debt, EUR mn 7)	250,947	279,739	278,948	291,878	287,004	306,552	305,100	322,700	340,700
Gross external debt, % of GDP 7)	66.6	72.4	70.4	70.6	69.5	72.3	72.0	72.0	73.0
Average exchange rate PLN/EUR	4.1206	4.1847	4.1975	4.1843	4.1755	4.1397	4.20	4.15	4.20
Purchasing power parity PLN/EUR	2.4221	2.4122	2.4122	2.4209	.	.	.	.	.

1) Preliminary. - 2) According to census March 2011. - 3) According to ESA 2010. - 4) Enterprises with 10 and more employees. -
5) From 2012 according to census March 2011. - 6) Reference rate (7-day open market operation rate). - 7) BOP 6th edition, including SPE.

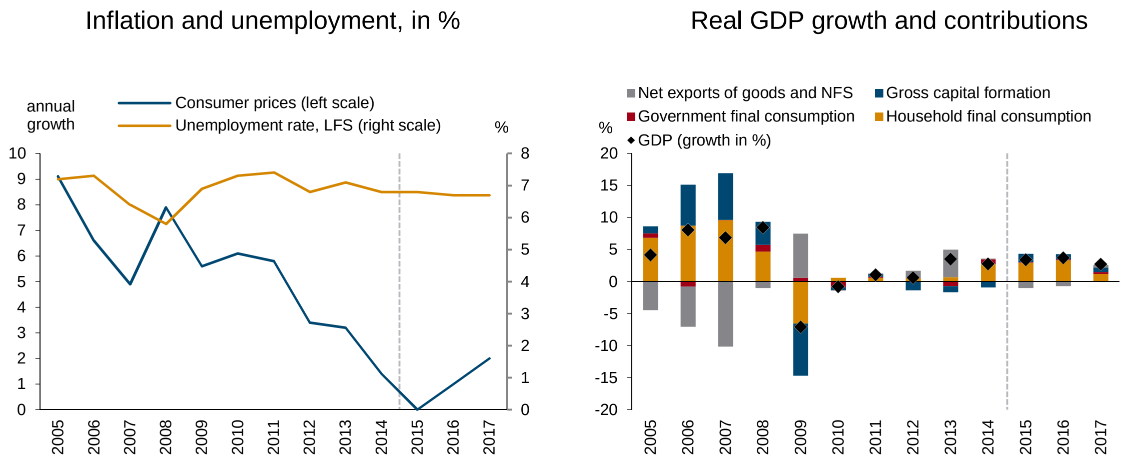
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

ROMANIA: Investments and consumption fuel growth

GÁBOR HUNYA

In all likelihood, expanding private consumption and a recovery in investments will lead to an acceleration in economic growth in the order of 3.4% in 2015. VAT cuts and wage rises in the public sector may further accelerate consumption growth in 2016, yet trigger an increase in the foreign trade deficit. On average, consumer prices are stable; unemployment is hovering just below 7%, while signs of structural labour shortages are emerging.

Figure 54 / Romania: Main macroeconomic indicators



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

Romania is about to achieve good growth performance with real GDP up by 3.4% in 2015, which is likely to accelerate further in 2016 to 3.7% on account of robust private consumption and recovering investments. Consumption is stimulated by rising wages and VAT rate cuts. Investments have expanded due to the final efforts by the government to absorb EU funds earmarked for the 2007-2013 financing period. Construction has recovered while the expansion of industry has slowed down. The latter has not yet shown up in exports which expand at a similar rate as last year. The foreign trade balance has improved lately due to lower oil and gas prices, but if these prices level out and consumer demand keeps rising, imports will grow ahead of exports.

The expansion of private consumption has been supported by low inflation and rising wages. It got another push in the third quarter of 2015 as the VAT rate for foodstuffs was reduced to 9% from the standard rate of 24% on 1 June. Food products constitute close to one third of the consumer basket, thus the tax cut allowed the population to restructure its expenditures to other consumption segments. Lower taxes had also a major impact on inflation; consumer prices were 1.9% lower in August 2015 than a year before. The government plans to continue with tax cuts, bringing down the standard VAT rate to 20% in 2016 and to 19% in 2017. Initially this will give a further boost to consumption and imports and keep inflation down even if import prices recover eventually.

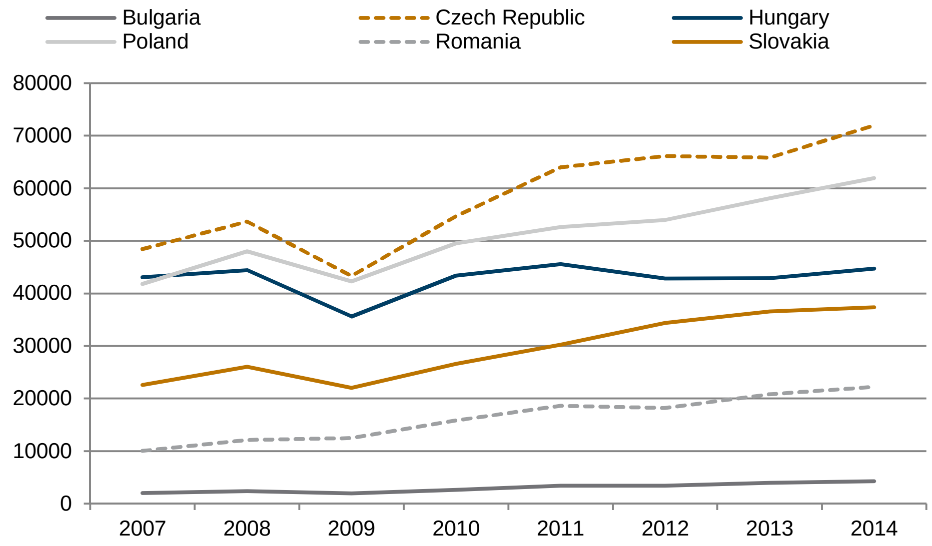
The current state of public finances gives ample room for tax cuts without increasing the fiscal deficit in relation to GDP. Up to now, the widening of the tax base has compensated for lower rates, and revenues continued to expand ahead of expenditures. The use of increased fiscal space has been under dispute, however. The National Bank of Romania (BNR), the EU Commission and the IMF see a risk in rapid tax cuts, while the government prefers handing out benefits to consumers. Tax cuts instead of increasing expenditures on investments or public services such as education and health, has been a deliberate choice of the government coalition led by the Social Democratic Party (PSD). Short-term popularity gains are chased due to the shaky position of Prime Minister Ponta in the wake of corruption charges and also in view of the forthcoming parliamentary elections in late 2016.

Monetary policy was relaxed very cautiously in the first half of the year. The latest monetary policy rate cut, to 1.75%, took place in May 2015 and the rate was kept steady later despite inflation turning negative. The BNR would like to curtail the emerging credit boom in the household sector, while the corporate sector still continues deleveraging. Loans in domestic currency replace foreign exchange loans and the ratio of non-performing loans is on the decline. The financial sector is working out the problems including those related to the Swiss franc appreciation without major interference either by the government or by the BNR.

The labour market reacted positively to the boom first of all in the construction sector. The decline in the relatively low unemployment rate (just below 7%) continues simultaneously with increasing job vacancy rates. Labour shortage has emerged due to skills mismatches in several sectors of the economy. There is also a widening mismatch between wage development and labour productivity dynamics; labour productivity hardly grows, but employment in industry expands. The BNR warns of possible wage-cost related inflationary pressure which may offset the effects of tax cuts in the coming year or in 2017 at the latest.

The export expansion continued in the first half of 2015 but at a slower pace than earlier while imports increased faster. The current account deficit narrowed, nevertheless, owing to high surpluses in services produced primarily in the transport, IT, and the professional and management consulting services positions. The current account deficit is expected to widen in the second half of the year and especially in 2016 due to increasing demand for imported consumer goods. The change in export composition is obvious comparing the first semester of 2015 with the same period two years before. The share of transport equipment rose from 42.7% to 44.6%, while that of chemicals shrank from 6.2% to 5.1%; changes in other segments were marginal. For comparison: the value of Romanian machinery and transport equipment exports (SITC 7) was hardly more than one quarter of Hungary’s in 2008 vs. one half in 2014; while Romania increased exports in this category by 80%, Hungary did not achieve any growth (Figure 55). Romania has become an increasingly favoured location for outsourcing and not only of manufacturing but also of telecommunications, computer and information services. Net exports of the latter category amounted to EUR 1.3 billion in 2014[52] and is about to expand to EUR 1.5 billion in 2015.

Figure 55 / Exports of machinery and transport equipment in Romania and peers, SITC 7, EUR million



Source: wiiw database.

All in all, the growth prospects of the Romanian economy have improved lately while the fiscal and external balances have been maintained and related risks are expected to increase only with some delay. Output and investments are to recover owing to both foreign demand and VAT cuts stimulating domestic private consumption. The effects of the recession in Ukraine and Russia are negligible due to very weak trade links. (Romania is close to energy self-sufficiency.) There is also some, albeit minor, positive contribution of labour to growth for demographic reasons this year and the next. Economic growth will thus accelerate in 2016 (GDP +3.7%), but slow down to 2.7% in 2017. In 2017 the one-time effects of tax cuts will phase out and labour supply will decline again, thus capital inflow will have to accelerate to keep up growth.

[52] The net exports of telecommunications, computer and information services of Hungary amounted to only EUR 0.3 billion, and of Bulgaria to 0.4 billion. in 2014. (Source: National Banks of the respective countries.)

Table 21 / Romania: Selected economic indicators

	2011	2012	2013	2014 1)	2014 January-June	2015 January-June	2015 Forecast	2016 Forecast	2017 Forecast
Population, th pers., average 2)	20,148	20,058	19,984	19,904	.	.	19,880	19,830	19,780
Gross domestic product, RON bn, nom. 3)	565.1	595.4	637.5	666.6	285.8	302.7	700	740	780
annual change in % (real)	1.1	0.6	3.5	2.8	2.7	3.8	3.4	3.7	2.7
GDP/capita (EUR at exchange rate) 3)	6,600	6,700	7,200	7,500	.	.	7,900	8,400	8,900
GDP/capita (EUR at PPP) 3)	13,300	14,000	14,500	14,600	.	.	.	.	.
Consumption of households, RON bn, nom. 3)	347.7	366.2	385.5	406.3	185.9	197.2	.	.	.
annual change in % (real)	1.0	0.8	2.6	4.1	5.0	5.2	4.8	5.5	2.0
Gross fixed capital formation, RON bn, nom. 3)	153.0	162.8	157.5	146.6	51.6	56.6	.	.	.
annual change in % (real)	2.9	0.1	-5.4	-7.2	-8.2	9.2	6.0	3.0	3.0
Gross industrial production 4)									
annual change in % (real)	7.5	2.4	7.9	6.1	9.1	2.4	4.0	5.0	3.0
Gross agricultural production									
annual change in % (real)	8.9	-21.9	24.5	2.1	.	.	.	.	.
Construction industry 4)									
annual change in % (real)	2.7	1.4	-0.6	-6.7	-10.4	10.4	.	.	.
Employed persons, LFS, th, average 5)	9,138	8,605	8,549	8,614	8,540	8,451	8,640	8,680	8,680
annual change in %	-1.1	0.9	-0.7	0.8	0.6	-1.0	0.3	0.5	0.0
Unemployed persons, LFS, th, average 5)	730	627	653	629	640	640	630	620	620
Unemployment rate, LFS, in %, average 5)	7.4	6.8	7.1	6.8	7.0	7.1	6.8	6.7	6.6
Reg. unemployment rate, in %, end of period	5.2	5.5	5.7	5.3	4.9	4.9	.	.	.
Average monthly gross wages, RON 6)	1,980	2,063	2,163	2,328	2,318	2,485	2,500	2,600	2,800
annual change in % (real, gross)	-1.6	0.8	0.8	6.5	4.0	6.9	6.0	5.0	4.0
Average monthly net wages, RON 6)	1,444	1,507	1,579	1,697	1,677	1,797	1,800	1,900	2,000
annual change in % (real, net)	-1.9	1.0	0.8	6.3	3.8	6.8	6.0	5.0	4.0
Consumer prices (HICP), % p.a.	5.8	3.4	3.2	1.4	1.3	0.4	0.0	1.0	2.0
Producer prices in industry, % p.a.	7.1	5.3	2.0	-0.2	-0.3	-2.0	-2.0	0.0	1.0
General governm.budget, EU-def., % of GDP									
Revenues	33.8	33.5	33.1	33.4	.	.	34.0	34.0	33.5
Expenditures	39.1	36.5	35.2	34.9	.	.	35.5	36.0	36.0
Net lending (+) / net borrowing (-)	-5.3	-2.9	-2.2	-1.5	.	.	-1.5	-2.0	-2.5
Public debt, EU-def., % of GDP	34.2	37.4	38.0	39.8	.	.	39.0	38.0	37.0
Central bank policy rate, % p.a., end of period 7)	6.00	5.25	4.00	2.75	3.50	1.75	1.75	2.00	2.25
Current account, EUR mn 8)	-6,186	-6,060	-1,542	-687	-728	-57	-600	-1,200	-1,800
Current account, % of GDP 8)	-4.6	-4.5	-1.1	-0.5	-1.1	-0.1	-0.4	-0.7	-1.0
Exports of goods, BOP, EUR mn 8)	40,102	39,855	43,893	46,812	22,677	24,380	50,100	53,100	55,800
annual change in %	22.6	-0.6	10.1	6.6	7.6	7.5	7.0	6.0	5.0
Imports of goods, BOP, EUR mn 8)	49,063	48,779	49,709	53,158	25,296	27,290	57,400	62,000	65,100
annual change in %	17.7	-0.6	1.9	6.9	7.8	7.9	8.0	8.0	5.0
Exports of services, BOP, EUR mn 8)	8,685	9,866	13,434	15,102	7,115	7,952	16,600	17,400	18,300
annual change in %	10.9	13.6	36.2	12.4	13.3	11.8	10.0	5.0	5.0
Imports of services, BOP, EUR mn 8)	7,031	7,392	8,733	9,236	4,223	4,736	10,300	10,900	11,600
annual change in %	11.0	5.1	18.1	5.8	2.9	12.2	11.0	6.0	6.0
FDI liabilities (inflow), EUR mn 8)	1,745	2,181	2,894	2,926	1,283	1,717	3,000	.	.
FDI assets (outflow), EUR mn 8)	19	-175	-24	207	-57	381	400	.	.
Gross reserves of NB excl. gold, EUR mn	33,193	31,206	32,525	32,216	31,236	30,111	.	.	.
Gross external debt, EUR mn 8)	99,926	100,857	98,069	94,744	95,187	90,821	86,700	93,500	100,600
Gross external debt, % of GDP 8)	75.0	75.5	68.0	63.2	63.5	57.6	55.0	56.0	57.0
Average exchange rate RON/EUR	4.2391	4.4593	4.4190	4.4437	4.4641	4.4475	4.44	4.43	4.42
Purchasing power parity RON/EUR	2.1091	2.1242	2.2043	2.2849	.	.	.	.	.

1) Preliminary. - 2) According to census October 2011. - 3) According to ESA 2010. - 4) Enterprises with 4 and more employees. -
5) From 2012 according to census October 2011. - 6) Half-year data refer to enterprises with 4 and more employees. -
7) One-week repo rate. - 8) BOP 6th edition.

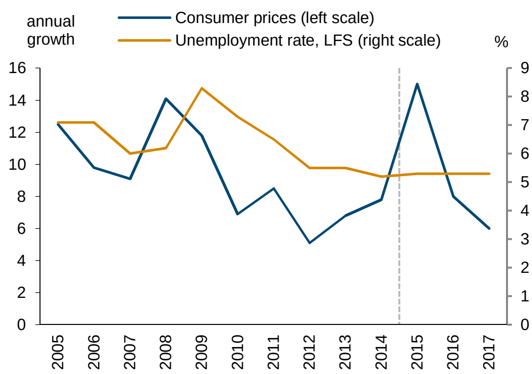
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

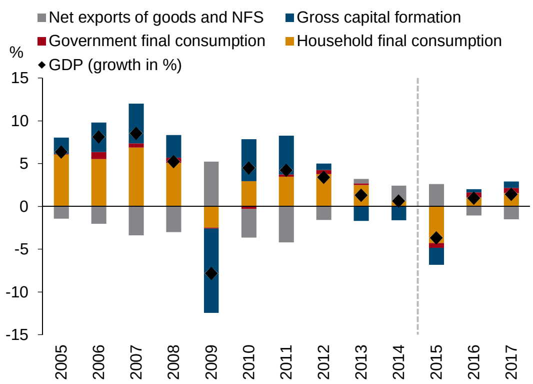
RUSSIAN FEDERATION: Recession already over?

PETER HAVLIK

The Russian economy plunged into a full-blown recession in 2015. Both exports and (even more so) imports were slashed, while the current account surplus surged upwards. The recession may have already bottomed out by mid-2015, yet there is no consensus as to the country's future prospects. Depending on the oil price, Russia may face another mild GDP decline in 2016, although stabilisation or even a modest growth seems more likely. Nevertheless, growth will remain unimpressive even in the medium term since restructuring will not materialise.

Figure 56 / Russia: Main macroeconomic indicators





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

The Russian economy plunged into a full-blown recession in 2015, even though not as severe as many observers originally expected. According to Rosstat data released in early September, real GDP dropped by 3.4% in January-June 2015 year-on-year, industrial production by nearly 3%, investments by 6% and real wages by nearly 9%. Consumer price inflation surged to double digits (see Table RU). The plunge in the oil price and the associated rouble devaluation starting in late 2014 resulted in an additional sharp contraction of foreign trade: exports dropped by more than 10% in January-June 2015 (in nominal EUR terms), imports were cut by almost a quarter.[53] In volume terms, there was a modest

[53] Owing to EUR/USD exchange rate movements, the trade contraction was much more pronounced when expressed in USD terms. However, trade with the EU contracted more than average: exports dropped by 34% in the first half of 2015,

expansion of exports (+5%) while real imports fell by about 20%. The trade and current account surpluses nearly doubled in terms of GDP in the first half of 2015; the estimated contribution of net exports to GDP growth was strongly positive.

The main puzzling economic unknown is now whether the bottom of the recession has already been reached by the second quarter of 2015, and there is no consensus in this respect. Obviously, the official expectation is that both low energy prices and a 'difficult geopolitical environment' are here to stay for some time (mutual sanctions have been prolonged and expanded, respectively, in mid-2015 and the government's working assumption was that sanctions will last until 2018). Given these circumstances, both the government and the Central Bank of Russia (CBR) elaborated several scenarios of economic growth with prospects being scaled down during the summer since earlier, more optimistic assumptions regarding oil prices have become less likely. Neither is the oil price now expected to return to its previous level (USD 98/bbl for Urals on average in 2014) nor will sanctions be rapidly abolished (although the latter factor impacts GDP growth forecasts much less than the oil price). Both these factors make the current outlook very much different from that in 2009 when oil prices quickly recovered and no sanctions were in place.

In view of reduced energy export revenues – in rouble terms partly compensated by devaluation – government expenditures have been slashed by some 10% in 2015 (except defence, some social benefits and agricultural subsidies) and the budget turned to a deficit in the first half of 2015. The draft federal budget for 2016 reckons with a deficit below 3% of GDP, sets limits for internal and external government debts (RUB 9,000 billion and USD 55.1 billion as of 1 January 2017, respectively). Additional funds will be raised by issuing new government bonds and by taxing windfall profits of energy exporters due to rouble devaluation.

The latest (September 2015) CBR baseline forecast scenario for 2016-2018 works with an oil price of 50 USD/bbl during the whole period.[54] In the CBR baseline scenario, GDP is projected to fall also in 2016 (by nearly 1%), to stagnate in 2017 and to grow slowly in 2018 (by 2-3%). In the optimistic CBR scenario, GDP growth should become slightly positive already in 2016 and gradually accelerate to 2.5-3.5% by 2018. Both scenarios reckon with a very slow expansion of exports and final consumption; GDP growth should be driven mainly by investments. Forecasts released in September 2015 by the respected Gaidar Institute are even more pessimistic: GDP and investments will stagnate at best in 2016. The baseline scenario assumes a constant oil price at 55 USD/bbl in 2016 and reckons with a drop in GDP (-1.6%) as both investments and exports will continue to decline.[55]

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imports by even 45% (both in USD terms). The cumulated import contraction has thus been already close to a scenario which was viewed as extreme in 2014 (see Havlik, 2014).

54 Alternatively, the optimistic variant reckons with an increase in the oil price to 70-80 USD/bbl until 2018, while the pessimistic (risk) scenario works with an oil prices staying below 40 USD/bbl in the whole period – see Central Bank of Russia, Draft Macroeconomic Development Scenarios, September 2015 (www.cbr.ru).

55 In the CBR 'risk' scenario, the additional shortfall in export revenues would result in a recession lasting through 2016 and even beyond. Similarly pessimistic views regarding medium-term growth prospects are shared by some other analysts, e.g. the Development Center at Moscow's Higher School of Economics or the Institute for Forecasting, Russian Academy of Sciences. Even the optimistic scenario (oil price 70 USD/bbl) elaborated recently by the Gaidar Institute reckons with a weak consumption-led recovery in 2016 while investments will again slightly fall – see http://iep.ru/ru/publikatcii/7690/publication.html.

None of the existing scenarios are particularly encouraging regarding economic developments even in the medium and long term. Obviously, without cooperation and integration with the EU (now apparently abandoned or at least much more difficult), economic growth is likely to remain more or less flat in the foreseeable future. An inward-looking development strategy, even under the working assumption that the current financial and trade sanctions will be eventually lifted, will hardly yield the envisaged (and urgently needed) modernisation results at least in the medium term (admittedly, low energy prices over a sustained long period might support the necessary reform pressure on economic diversification). Russian prospects thus remain gloomy (and not only in economic terms). The economy has been suffering from long-lasting structural deficiencies, especially regarding the excessive dependence on energy, and from serious institutional bottlenecks which deter investments and stimulate capital flight. Recently, more assertive external policies represent another bottleneck for economic development.

Nevertheless, and despite rising tensions, Russia succeeded in launching the Eurasian Economic Union (EAEU) on the basis of the Single Economic Space and Customs Union with Belarus and Kazakhstan in January 2015. Besides the free trade in goods (with some important exceptions such as energy), the EAEU agreement envisages also free movement of labour, capital and services among the participating countries (Armenia already joined the EAEU in January 2015 and Kyrgyzstan joined in mid-2015 as well). In theory, coordinated economic policies among EAEU members will use 'Maastricht-like' indicators such as limits on budget deficit, government debt, inflation and interest rates. In practice, however, the EAEU is facing a lot of frictions and bureaucratic obstacles; even the free trade in goods is not fully implemented, there are many non-tariff barriers, etc.[56] Needless to say, Russian policies towards Ukraine and the unilateral (without the consent of other EAEU partners) imposition of import restrictions on Western foodstuffs elevated the conflict potential in EAEU integration. The current recession affecting all EAEU member states and trade disruptions due to unilateral Russian actions have not been instrumental to a smooth functioning of the EAEU either.

Summing up, Russia is facing a recession (GDP is expected to drop by nearly 4% in 2015) and prospects for sustainable recovery have markedly deteriorated given the geopolitical factors and oil price prospects. While inflation will gradually subside barring additional external shocks, economic growth will remain unimpressive – if there is any growth at all.[57] Apart from lasting Western sanctions – resulting in a sharply deteriorating investment climate, higher risks and capital outflows – it is especially the collapse of the oil price and the associated rouble depreciation which has caused the most immediate economic damage. Even barring a further escalation of the Ukraine conflict, modernisation ambitions will doubtlessly suffer also in the medium and long term due to lower FDI inflows and reduced imports of advanced technologies – despite efforts to mobilise additional domestic resources and import substitution programmes which may bring some (weak) growth stimulus. In any case, the serious and most likely lasting damage to Russian external relations with Ukraine and the West will be very difficult to repair, hindering the future development of the whole post-Soviet space.

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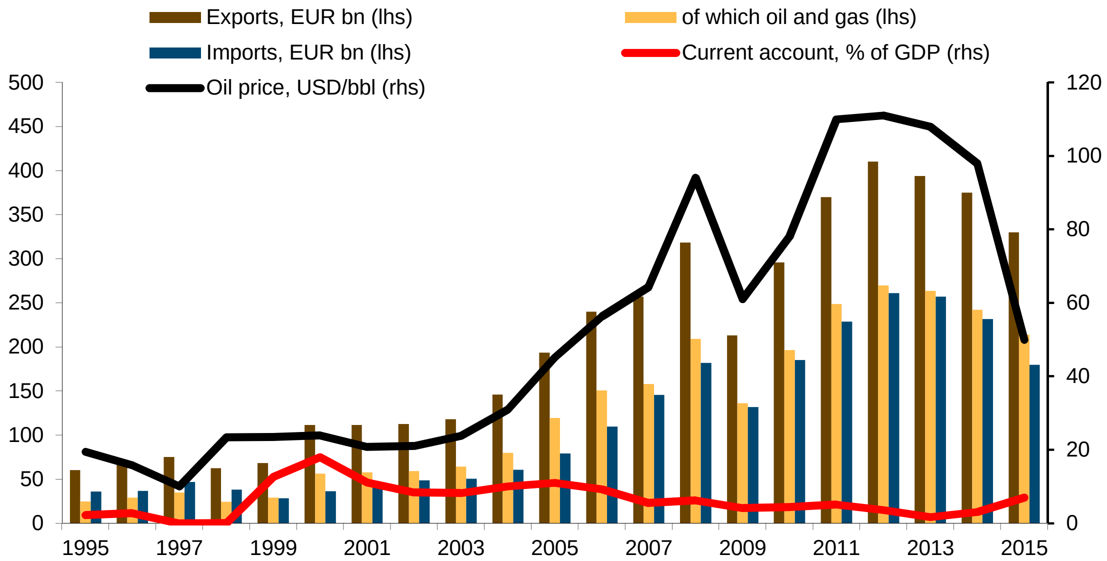
56 In fact, trade with the EAEU dropped just as much as total trade in the first half of 2015.

57 For more detailed arguments and a comprehensive analysis see Havlik (2015).

Figure 57 / Russian Federation: External surpluses thanks to energy



References

Havlik, P. (2014), 'Economic Consequences of the Ukraine Conflict', *wiiw Policy Notes and Reports*, No. 14, November.

Havlik, P. (2015), 'Russian Federation 2015: From Stagnation to Recession and Back', *wiiw Research Reports*, No. 406, September.

Table 22 / Russia: Selected economic indicators

	2011	2012	2013	2014 1)	2014 January-June	2015 January-June	2015 Forecast	2016 Forecast	2017 Forecast
Population, th pers., average 2)	142,961	143,202	143,507	146,091	146,056	146,291	146,000	146,000	146,000
Gross domestic product, RUB bn, nom.	55,967	62,176	66,190	71,406	32,754	34,056	78,000	85,000	90,000
annual change in % (real)	4.3	3.4	1.3	0.6	0.6	-3.5	-3.7	1.0	1.4
GDP/capita (EUR at exchange rate)	9,600	10,900	10,900	9,700	.	.	7,600	7,800	8,200
GDP/capita (EUR at PPP)	17,000	18,300	18,900	19,400	.	.	.	.	.
Consumption of households, RUB bn, nom.	27,193	31,019	34,672	38,037	17,590	.	.	.	.
annual change in % (real)	6.8	7.8	5.0	1.3	2.1	.	-8.0	2.0	3.0
Gross fixed capital form., RUB bn, nom.	11,950	13,639	14,460	14,706	5,351	.	.	.	.
annual change in % (real)	9.1	6.7	0.9	-2.0	-3.2	.	-8.0	3.0	3.0
Gross industrial production 3)									
annual change in % (real)	5.0	3.4	0.4	1.7	1.4	-2.6	-2.5	3.0	3.0
Gross agricultural production									
annual change in % (real)	23.0	-4.8	5.8	3.7	3.0	2.9	.	.	.
Construction output									
annual change in % (real)	5.1	2.5	0.1	-4.5	-5.7	-7.0	.	.	.
Employed persons, LFS, th, average 2)	70,857	71,545	71,391	71,524	71,135	71,919	71,000	71,500	72,000
annual change in %	1.3	1.0	-0.2	0.2	0.0	1.1	-0.7	0.7	0.7
Unemployed persons, LFS, th, average 2)	4,922	4,131	4,138	3,889	3,968	4,314	4,000	4,000	4,000
Unemployment rate, LFS, in %, average 2)	6.5	5.5	5.5	5.2	5.3	5.7	5.3	5.3	5.3
Reg. unemployment rate, in %, end of period 2)4)	1.7	1.4	1.2	1.2	1.1	1.3	.	.	.
Average monthly gross wages, RUB	23,369	26,629	29,792	32,495	31,537	33,175	34,800	38,700	42,300
annual change in % (real, gross)	2.8	8.4	4.8	1.2	3.0	-8.5	-7.0	3.0	3.0
Consumer prices, % p.a.	8.5	5.1	6.8	7.8	7.0	16.1	15.0	8.0	6.0
Producer prices in industry, % p.a. 5)	17.3	6.8	3.4	6.1	6.2	11.7	12.0	7.0	5.0
General governm.budget, nat.def., % of GDP									
Revenues	37.3	37.1	36.9	37.5	38.7	37.4	37.0	38.0	39.0
Expenditures	35.7	36.7	38.2	38.7	35.4	40.0	40.0	40.0	41.0
Deficit (-) / surplus (+)	1.5	0.4	-1.3	-1.2	3.3	-2.6	-3.0	-2.0	-2.0
Public debt, nat.def., % of GDP 6)	9.0	10.0	10.5	11.8	9.8	10.3	15.0	14.0	13.0
Central bank policy rate, % p.a., end of period 7)	8.00	8.25	5.50	17.00	7.5	11.5	10.0	8.0	6.0
Current account, EUR mn 8)	69,855	55,452	26,197	43,968	27,649	42,960	78,000	67,000	60,000
Current account, % of GDP 8)	5.1	3.6	1.7	3.1	4.1	8.1	7.0	5.9	5.0
Exports of goods, BOP, EUR mn 8)	370,131	410,300	393,911	374,555	186,143	162,901	330,000	330,000	350,000
annual change in %	25.0	10.9	-4.0	-4.9	-3.1	-12.5	-11.9	0.0	6.1
Imports of goods, BOP, EUR mn 8)	228,764	261,202	256,951	231,782	111,636	83,816	180,000	200,000	220,000
annual change in %	23.5	14.2	-1.6	-9.8	-8.9	-24.9	-22.3	11.1	10.0
Exports of services, BOP, EUR mn 8)	41,680	48,495	52,787	49,471	23,644	22,499	45,000	47,000	50,000
annual change in %	12.5	16.4	8.8	-6.3	-6.2	-4.8	-9.0	4.4	6.4
Imports of services, BOP, EUR mn 8)	65,706	84,736	96,643	91,066	42,198	38,237	80,000	80,000	85,000
annual change in %	15.8	29.0	14.1	-5.8	-3.1	-9.4	-12.2	0.0	6.3
FDI liabilities (inflow), EUR mn 8)	39,557	39,353	52,107	17,199	17,976	5,978	20,000	.	.
FDI assets (outflow), EUR mn 8)	48,008	37,980	65,120	42,431	20,919	6,513	50,000	.	.
Gross reserves of CB, excl. gold, EUR mn 9)	350,786	367,323	341,787	279,383	316,970	282,782	.	.	.
Gross external debt, EUR mn 8)	416,416	480,440	530,481	493,153	537,712	501,941	501,400	453,300	396,000
Gross external debt, % of GDP 8)	30.4	30.9	33.9	34.8	38.0	45.0	45.0	40.0	33.0
Exchange rate RUB/EUR, average	40.9	39.9	42.3	50.5	48.0	64.4	70.0	75.0	75.0
Purchasing power parity RUB/EUR 10)	23.0	23.7	24.4	25.2	.	.	.	.	.

Note: Data for population, GDP and its components, budget from 2014 (employment thsd. persons, nominal wages from 2015) including Crimean Federal District.

1) Preliminary. - 2) According to census October 2010. - 3) Excluding small enterprises. - 4) In % of labour force (LFS). - 5) Domestic output prices. - 6) wiiw estimate. - 7) From 2013 one-week repo rate, refinancing rate before. - 8) Converted from USD and based on BOP 6th edition. - 9) Including part of resources of the Reserve Fund and the National Wealth Fund of the Russian Federation. -
10) wiiw estimates based on the 2011 International Comparison Project benchmark.

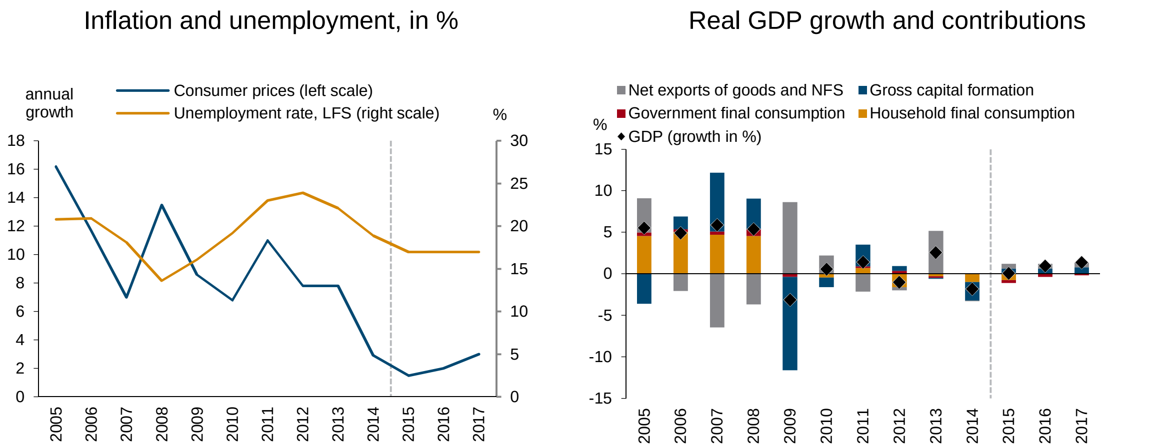
Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.

SERBIA: Investment is the key

VLADIMIR GLIGOROV

Growth will stabilise in the course of the current year, the upside risks to the forecast being the country's weak performance in the latter half of the previous year. Growth prospects should improve at a moderate pace in the medium term. Assuming that political stability is assured and reforms are sustained over that period, adjustment of the main GDP components, in tandem with a relatively strong investment performance and continued export growth, should allow on average for real GDP growth in the order of 3% for the next five years or so.

Figure 58 / Serbia: Main macroeconomic indicators



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

This year's growth may turn out better than forecasted due to the stronger rebound from last year's slump. If that happens, it will be due to investments on the demand side and due to industrial production on the supply side. In addition, exports are doing relatively well, though imports are recovering too, so the contribution of net exports to GDP growth may be more muted. In any case, on balance, stagnation is more likely than growth by 0.5%, which is the official forecast. In the medium term, growth should accelerate to about 2%, again, mostly on investment and export growth.

Serbia was traditionally a country with a relatively high inflation rate because of the monetary policy that relied on periodic devaluations. In essence, the exchange rate would be pegged, informally more often than explicitly, in order to sap the price increases while wages would be allowed to continue growing, so relatively fast inflation (usually at around 10%) would be slowed down due to the stable exchange rate until an accumulation of excessive external imbalances would force a devaluation and the speed-up of inflation in order to correct the real wages. This has changed in the last couple of years as the loss of employment has put pressure on the growth of wages and there have been periods of freezes of wage growth in the public sector. This year wages were cut by 10% and pensions similarly on average, which led to falling consumption and stagnant imports and thus a stable exchange rate. On the back of that, the central bank was able to start to cut the policy rate sharply while deflationary pressures remained. So, while some revival of inflationary pressures can be expected, those should not push the inflation rate towards the official central target of 4% with a corridor of 1.5 percentage points up or down.

The government has been concentrated on bringing the fiscal deficit down because the development of the public debt has been assessed to be on an unsustainable path. Indeed, according to the current forecasts, it will peek at 80% of GDP by next year or the year after, before it levels off and possibly starts to decline due to accelerating growth and cuts in government spending on compensations. Additional cuts in nominal wages are not planned and in fact some rises have been promised, so savings should be achieved through cuts in public employment. Also, additional cuts in subsidies should prove possible if the current programmes for privatisation and restructuring (which include bankruptcies and liquidations) of public enterprises are carried out.

These additional measures may have to wait for early elections which seem increasingly probable at least according to public pronouncements of the ruling party. Though the support of the government and especially of the prime minister is very strong, the assessment seems to be that the renewed support from the public and the new composition of the governing coalition, with perhaps even a single-party government, could prove supportive of additional changes and not only in economic policy.

Early elections, if they were to occur in late winter or early spring of next year, would also allow for a reshaping of the opposition. The left has been weakened by the developments in Greece while the nationalists are more popular in the media than in the polls. The latter also rely on Russian support whose strength is hard to tell. It is possible that both of these strands of opposition will prove to be weaker than currently perceived, which would prove stabilising not just for the government but also more broadly. It would also signal that the current president, who is strongly pro-Russian, may not be able to win a second mandate, which would weaken his influence even when he is still in office.

The election results would be more than certain if the negotiations with the European Union start in earnest by the end of this year. Assuming relatively positive economic numbers at the end of the year and heightened support from the EU, the prime minister and his party would be assured a new four-year mandate. In that period, the constitution could be changed and the process of normalisation with Kosovo should become irreversible. These, in any case, are current forecastable ends and means.

In the medium term, the adjustment to sustainable growth should proceed with little help from increased government spending, but capital investment should increase (mainly in infrastructure). Similarly, household consumption should not post too much of a growth, which should allow for net exports to continue to contribute positively to growth of GDP. Unlike in the past, the policy rate should remain low and monetary policy more supportive if inflation remains subdued. That could lead to the inflation targeting regime to start operating in earnest, which would allow for monetary policy to be more active and more predictable.

Overall, this year will prove stabilising for growth with growth prospects improving at a moderate pace in the medium term. Assuming political stability is preserved and the reforms are sustained, in the medium run the adjustment of main GDP components with a relatively strong investment performance and continued growth of exports, should allow for real GDP growth of 3% on average for the next five years or so.

Table 23 / Serbia: Selected economic indicators

	2011	2012	2013	2014 [1]	2014 January-June	2015 January-June	2015 Forecast	2016 Forecast	2017 Forecast
Population, th. pers., mid-year [2]	7,237	7,201	7,167	7,132	.	.	7,040	7,010	7,000
Gross domestic product, RSD bn, nom. [3]	3,408	3,584	3,876	3,878	1,840	1,854	3,900	4,000	4,200
annual change in % (real)	1.4	-1.0	2.6	-1.8	-0.7	-0.5	0.1	0.9	1.4
GDP/capita (EUR at exchange rate) [3]	4,600	4,400	4,800	4,600	.	.	4,500	4,500	4,700
GDP/capita (EUR at PPP) [3]	9,500	9,700	9,800	9,600	.	.	.	.	.
Consumption of households, RSD bn, nom. [3]	2,596	2,728	2,886	2,921	720	725	.	.	.
annual change in % (real)	0.9	-2.1	-0.4	-1.3	-1.4	-1.0	-1.0	0.0	0.0
Gross fixed capital form., RSD bn, nom. [3]	627	759	668	666	160	177	.	.	.
annual change in % (real)	4.6	13.2	-12.0	-2.7	-2.2	6.5	4.0	4.0	5.0
Gross industrial production [4]									
annual change in % (real)	2.5	-2.2	5.3	-6.5	-1.1	2.4	5.0	5.0	5.0
Gross agricultural production									
annual change in % (real)	0.9	-17.3	21.7	2.0	.	.	.	.	.
Construction output [5]									
annual change in % (real)	5.9	-9.8	11.1	-4.0	.	.	.	.	.
Employed persons, LFS, th, average [6]	2,253	2,228	2,311	2,421	2,408	2,566	2,500	2,530	2,560
annual change in %	-6.0	-1.1	.	4.8	8.1	6.6	3.0	1.0	1.0
Unemployed persons, LFS, th, average [6]	671	701	656	563	612	558	510	520	520
Unemployment rate, LFS, in %, average [6]	23.0	23.9	22.1	18.9	20	18	17	17	17
Reg. unemployment rate, in %, end of period	27.6	28.6	29.1	28.4	29	28	.	.	.
Average monthly gross wages, RSD	52,733	57,430	60,708	61,426	59,865	59,444	61,100	62,900	65,400
annual change in % (real, gross)	0.1	1.0	-1.9	-0.9	-1.3	-2.1	-2.0	1.0	1.0
Average monthly net wages, RSD	37,976	41,377	43,932	44,530	43,398	43,218	44,300	45,600	47,400
annual change in % (real, net)	0.2	1.1	-1.5	-1.5	-1.0	-1.7	-2.0	1.0	1.0
Consumer prices, % p.a.	11.0	7.8	7.8	2.9	2.3	1.3	1.5	2.0	3.0
Producer prices in industry, % p.a.	12.7	6.8	2.7	1.3	0.6	1.7	2.0	2.0	2.0
General governm.budget, nat.def., % of GDP									
Revenues	40.0	41.1	39.7	41.8	41.1	43.4	40.0	40.0	40.0
Expenditures	44.8	47.9	45.1	48.4	47.3	45.3	45.0	44.0	43.0
Deficit (-) / surplus (+)	-4.8	-6.8	-5.5	-6.7	-6.2	-1.9	-5.0	-4.0	-3.0
Public debt, nat.def., % of GDP	45.4	56.2	59.6	71.0	.	.	75.0	80.0	85.0
Central bank policy rate, % p.a., end of period [7]	9.75	11.25	9.50	8.00	8.5	6.0	5.0	5.0	5.0
Current account, EUR mn [8]	-3,656	-3,671	-2,098	-1,985	-1,037	-668	-1,950	-2,100	-1,900
Current account, % of GDP [8]	-10.9	-11.6	-6.1	-6.0	-6.5	-4.4	-6.0	-7.0	-6.0
Exports of goods, BOP, EUR mn [8]	8,118	8,376	10,515	10,641	5,279	5,588	11,200	11,800	12,400
annual change in %	18.4	3.2	25.5	1.2	11.9	5.8	5.0	5.0	5.0
Imports of goods, BOP, EUR mn [8]	13,614	14,011	14,674	14,752	7,177	7,504	15,200	15,700	16,300
annual change in %	17.6	2.9	4.7	0.5	3.1	4.5	3.0	3.0	4.0
Exports of services, BOP, EUR mn [8]	3,027	3,093	3,422	3,810	1,680	1,931	4,200	4,400	4,600
annual change in %	13.8	2.2	10.6	11.3	10.3	15.0	10.0	5.0	5.0
Imports of services, BOP, EUR mn [8]	2,873	2,981	3,109	3,344	1,538	1,681	3,600	3,800	4,000
annual change in %	7.6	3.8	4.3	7.6	8.3	9.2	8.0	5.0	5.0
FDI liabilities (inflow), EUR mn [8]	3,544	1,009	1,548	1,500	821	742	700	.	.
FDI assets (outflow), EUR mn [8]	225	256	250	264	115	67	100	.	.
Gross reserves of NB, excl. gold, EUR mn	11,497	10,295	10,734	9,351	9,597	9,694	.	.	.
Gross external debt, EUR mn	24,125	25,645	25,746	25,792	25,261	26,512	28,000	29,000	30,000
Gross external debt, % of GDP	72.2	80.9	75.1	78.0	76.4	84.3	89	91	91
Average exchange rate RSD/EUR	101.95	113.13	113.14	117.31	115.70	121.00	124	126	128
Purchasing power parity RSD/EUR	49.66	51.14	55.03	56.89	.	.	.	.	.

1) Preliminary . - 2) From 2011 according to census October 2011. - 3) According to ESA 2010. - 4) Excluding arms industry. -
5) According to gross value added. - 6) Until 2013 survey of April and October, quarterly thereafter. From 2013 based on census 2011. -
7) Two-week repo rate. - 8) BOP 6th edition.

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

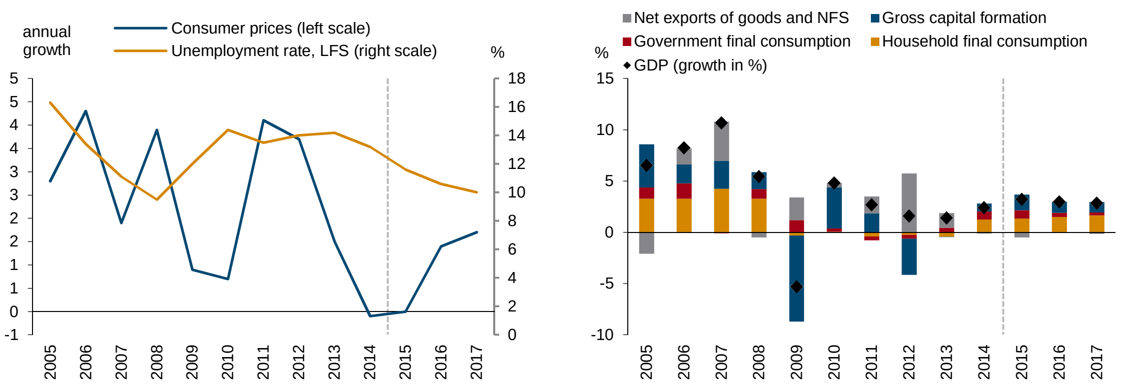
SLOVAKIA: Investments spurring growth

DORIS HANZL-WEISS

In 2015, surging investments will boost Slovak GDP growth, which is expected to reach 3.2%. Better conditions on the labour market will encourage household consumption and imports. At the same time, global uncertainties will restrain export growth, resulting in net exports contributing negatively to economic growth. Over the next two years we expect annual real GDP growth in the order of 3%.

Figure 59 / Slovakia: 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.

After recording a rise of 2.4% in 2014, GDP growth accelerated further in the first half of 2015 and reached 3.2% year-on-year. Gross fixed capital formation continued its strong upward trend and increased by 8.5% over the first half of 2015 year-on-year. This has been due to the speeding-up of EU structural funds spending, the drawing period ending this year. Government consumption rose by 2.9%, household consumption by 1.9% in the same period. Still this is below the levels implied by labour market improvements. Employment rose dynamically, unemployment declined by almost 2 percentage points and real wages increased by 2.5%. In addition, consumer prices did not increase, but fell by 0.3% in the first half of 2015. Net exports, which had been the main growth driver in the previous years, lost momentum: while exports of goods and services grew by 4.4% in the first half of 2015, imports increased by 5.2%. Exports of goods to Germany, which is the most important trading partner for Slovakia, grew by 6.6%, while exports to the Czech Republic, the second most important trading partner, stayed constant. Exports to Russia and China, previously two promising markets for the Slovak car industry, collapsed and fell by 35% and 26% respectively in the first half of the year.

Looking at sectoral growth trends, industrial production increased by 5.5% in the first seven months of 2015 year-on-year. Monthly growth rates, however, fluctuated heavily, peaking in March and July (+11%, +12%). This was due to the fluctuations in the sectoral performance of the transport equipment sector, the largest sector of Slovak manufacturing. The transport equipment sector finally took over its role as the main growth driver in June, after showing subdued performance in the second half of 2014 and the first months of 2015. Recently the Slovak government has signed a letter of intent with Jaguar Land Rover for building a new car assembly plant. If built, this would add about 150,000-300,000 cars made in Slovakia. In 2014, the three main car companies in Slovakia produced about 970,000 cars, of which Volkswagen Bratislava manufactured 394,000 cars, PSA Peugeot-Citroën 255,000 and KIA 324,000. The construction sector, which suffered from a six-year decline since the outbreak of the crisis, has finally recovered and increased by 15% over the first seven months as compared to the same period a year earlier. The services sector recorded a small increase in value added.

Following developments in the real economy with some delay, trends in the labour market were very positive in the first half of 2015: employment rose by 2.6% and the unemployment rate (LFS) fell to 11.8%. Still, the unemployment rate remains rather high and especially problematic as much of it is attributed to a high share of long-term unemployed and youth unemployment, and high unemployment among the Roma minority population. A new law on vocational education came into force this year and could help to improve the situation.

In 2014, the Slovak budget deficit and public debt amounted to -2.9% and 53.6% as a share of GDP, respectively. Both figures are expected to decrease in the coming years but less than official figures suggest. The official targets defined in the Slovak Stability Programme (April 2015) are set at -2.6% in 2015, -1.9% in 2016 and -0.9% in 2017. The official debt to GDP ratio should fall below 53% in 2016. This is important because of Slovakia's Fiscal Responsibility Act since 2011, which defines various thresholds with certain consequences (at 50%, 53%, 55%, 57%, and 60% debt to GDP level).[58] However, additional spending seems likely this year, as the drawing of the EU structural funds for the period 2007-2013 will finish at the end of 2015, pushing up infrastructure investments. In addition, parliamentary elections will take place at the beginning of March 2016, tempting the (social-democratic SMER-led) government to spend more. The last measure of the first social package, announced in June 2014,[59] will be implemented this year. This encompasses a reduction of gas prices for households and might even include cash rebates. In May 2015, the second social package was announced including a reduction of VAT for selected foodstuffs (to 10%), aid to regions with high unemployment and various other social measures. A third package is scheduled just before the elections. On the revenue side, additional income stems from opening the second pension pillar (thus people have the possibility to exit the second pillar and join the first one) and the sale of a 49% share of Slovak Telekom to Deutsche Telekom for EUR 900 million.

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58 Between 53% and 55%, the government must submit to the parliament a proposal of measures for debt reduction and the wages of government members are frozen to the level of the previous fiscal year. Between 50% and 53%, the Ministry of Finance sends a letter to the parliament explaining the reasons for higher debt and presenting measures to reduce it.

59 Overall, the first social package included 15 measures such as free rail transport for students and pensioners, an increase of the minimum wage or the introduction of a minimum pension.

For this year, wiiw has revised its growth forecast for Slovakia upwards to 3.2%. Growth will be pulled by a strong surge in investment due to increased absorption efforts at the end of the drawing period of EU structural funds. In addition, government spending will rise dynamically owing to the upcoming parliamentary elections at the beginning of next year. No major changes are to be expected after these elections, either on the political side or for the economy: the Social Democrats (SMER), led by Robert Fico, lead in opinion polls, while the other parties are small and dispersed. A continuation of Fico's policy can be expected, including further debt reduction, a possible increase of state influence in the energy sector and selective social measures. Household consumption should speed up in the rest of this year as well because conditions of the improved labour market situation. However, this will also result in increased imports and, together with less dynamic exports, net exports will turn negative this year. For the next two years, we expect growth to decline slightly, reaching about 3% annually (meaning a downward revision). Investment and government consumption are expected to slow down, while household consumption should speed up. Missing export stimuli (e.g. from China or Russia) will limit improvements in the export dynamics and thus negative net exports will put a brake on faster growth. Furthermore, the recent Volkswagen scandal poses some risks for Volkswagen Bratislava too, which is Slovakia's largest company by turnover, as well as the country's largest exporter and one of its main employers.

Table 24 / Slovakia: Selected economic indicators

	2011	2012	2013	2014 1)	2014 January-June	2015 January-June	2015 Forecast	2016 Forecast	2017 Forecast
Population, th pers., average 2)	5,398	5,408	5,413	5,419	5,417	5,421	5,424	5,429	5,434
Gross domestic product, EUR mn, nom. 3)	70,160	72,185	73,593	75,215	36,096	37,123	77,600	81,000	84,800
annual change in % (real)	2.7	1.6	1.4	2.4	2.4	3.2	3.2	3.0	2.9
GDP/capita (EUR at exchange rate) 3)	13,000	13,400	13,600	13,900	.	.	13,900	14,900	15,600
GDP/capita (EUR at PPP) 3)	18,900	19,600	20,000	20,800	.	.	.	.	.
Consumption of households, EUR mn, nom. 3)	39,583	40,770	40,995	41,867	20,681	21,060	.	.	.
annual change in % (real)	-0.7	-0.5	-0.8	2.2	2.6	1.9	2.4	2.7	3.0
Gross fixed capital form., EUR mn, nom. 3)	16,946	15,393	15,045	15,893	6,872	7,463	.	.	.
annual change in % (real)	12.7	-9.3	-2.7	5.7	3.9	8.5	6.5	4.5	3.5
Gross industrial production									
annual change in % (real)	5.3	7.9	4.9	4.0	6.5	4.5	5.0	4.0	4.0
Gross agricultural production									
annual change in % (real)	8.7	-5.7	6.7	0.9	.	.	.	.	.
Construction industry									
annual change in % (real)	-1.8	-12.5	-5.3	-4.1	-1.8	12.9	.	.	.
Employed persons, LFS, th, average 4)	2,351	2,329	2,329	2,363	2,342	2,404	2410	2430	2450
annual change in %	1.5	0.6	0.0	1.5	0.6	2.6	2.0	1.0	0.7
Unemployed persons, LFS, th, average 4)	368	378	386	359	370	322	320	290	270
Unemployment rate, LFS, in %, average 4)	13.5	14.0	14.2	13.2	13.7	11.8	11.6	10.6	10.0
Reg. unemployment rate, in %, end of period	13.6	14.4	13.5	12.3	12.8	11.6	.	.	.
Average monthly gross wages, EUR	786	805	824	858	839	858	880	910	940
annual change in % (real, gross)	-1.6	-1.2	1.0	4.2	4.5	2.6	2.5	2.0	2.0
Consumer prices (HICP), % p.a.	4.1	3.7	1.5	-0.1	-0.1	-0.3	0.0	1.4	1.7
Producer prices in industry, % p.a.	4.5	1.9	-1.0	-3.5	-3.5	-3.1	-2.0	1.5	2.0
General governm.budget, EU-def., % of GDP									
Revenues	36.4	36.0	38.4	38.9	.	.	37.9	36.9	36.9
Expenditures	40.6	40.2	41.0	41.8	.	.	40.7	39.5	39.2
Net lending (+) / net borrowing (-)	-4.1	-4.2	-2.6	-2.9	.	.	-2.8	-2.6	-2.3
Public debt, EU-def., % of GDP	43.4	52.1	54.6	53.6	.	.	53.4	53.5	53.0
Central bank policy rate, % p.a., end of period 5)	1.00	0.75	0.25	0.05	0.15	0.05	.	.	.
Current account, EUR mn 6)	-3,497	684	1,446	590	952	-16	-630	-970	-1,470
Current account, % of GDP 6)	-5.0	0.9	2.0	0.8	2.6	0.0	-0.8	-1.2	-1.7
Exports of goods, BOP, EUR mn 6)	54,673	60,159	62,145	62,658	31,530	32,468	65,200	67,800	70,500
annual change in %	17.6	10.0	3.3	0.8	3.3	3.0	4.0	4.0	4.0
Imports of goods, BOP, EUR mn 6)	54,709	57,653	59,097	59,309	29,273	30,944	63,000	66,200	69,500
annual change in %	17.4	5.4	2.5	0.4	3.2	5.7	6.2	5.0	5.0
Exports of services, BOP, EUR mn 6)	5,228	6,049	6,892	6,833	3,316	3,286	6,800	7,000	7,200
annual change in %	8.1	15.7	13.9	-0.8	1.2	-0.9	-1.0	3.0	3.0
Imports of services, BOP, EUR mn 6)	5,498	5,628	6,481	6,749	3,237	3,187	6,600	6,900	7,200
annual change in %	0.2	2.4	15.2	4.1	6.3	-1.5	-2.0	5.0	5.0
FDI liabilities (inflow), EUR mn 6)	3,961	1,356	757	27	254	1,583	1,700	.	.
FDI assets (outflow), EUR mn 6)	1,962	-958	976	184	828	1,374	1,400	.	.
Gross reserves of NB excl. gold, EUR mn	659	620	670	1,165	702	1,345	.	.	.
Gross external debt, EUR mn 6)	55,312	54,882	60,444	67,776	66,154	67,252	68,900	69,500	71,300
Gross external debt, % of GDP 6)	78.8	76.0	82.1	90.1	88.0	86.7	88.8	85.8	84.1
Purchasing power parity EUR/EUR	0.6872	0.6829	0.6794	0.6663	.	.	.	.	.

1) Preliminary. - 2) According to census May 2011. - 3) According to ESA 2010. - 4) From 2012 data according to census May 2011. - 5) Official refinancing operation rates for euro area (ECB). - 6) BOP 6th edition.

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

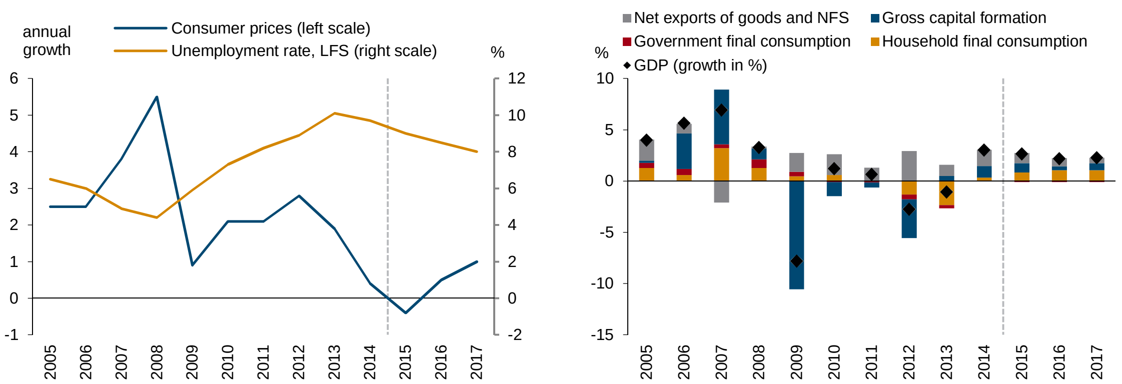
SLOVENIA: Recovery continues

HERMINE VIDOVIC

Slovenia's economy has continued down its growth path in 2015. The rebound has been driven by rising external demand and a mild recovery in private consumption. GDP growth in 2016 and 2017 will be moderate on account of lower EU-funded investments at the beginning of the new cycle. Exports and the gradual recovery of household consumption will remain the main engines of growth.

Figure 60 / Slovenia: Main macroeconomic indicators

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



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

Having increased by 3% in 2014, Slovenia's GDP continued to grow in the first half of 2015 (by 2.7%) as against the same 2014 period – backed by rising net exports and a remarkable increase in inventories. Household consumption growth gained momentum, while gross fixed capital formation remained stagnant after a temporary recovery in 2014. Government consumption was flat. Construction, which in 2014 had shown signs of recovery from a sharp contraction, fell again in 2015 mainly because of a decline in the construction of infrastructure facilities prevailing in the past two years. Industrial production continued to rise and was up by 4.8% in the first seven months of the year. The highest growth was reported for the manufacture of 'other transport equipment' and car manufacturing, with output rising 30% and 24% respectively. Overall, confidence in the economy in 2015 is the highest since the outbreak of the crisis and is based on greater confidence in the manufacturing sector and among consumers. Despite the notable GDP growth, employment declined in the first half of 2015 (based on Labour Force Survey data), while the unemployment rate fell only slightly, to 9.5%. In July 2015 registered unemployment fell for the first time since 2012, but imbalances remain: more than half of the unemployed are long-term unemployed and the share of those with tertiary education has been steadily on the rise. Wage growth has continued to be moderate, with average monthly gross wages increasing by 1% in real terms during the first half of 2015. Considering fiscal consolidation it is to be expected that wage growth, particularly in the public sector, will remain moderate over the next two years.

In foreign trade, goods exports rose by 5.8% and imports by 3.7% in nominal terms during the first seven months of 2015, resulting in a higher trade surplus (plus EUR 300 million) than in the same period a year earlier. Also the surplus in services trade was higher than in the corresponding 2014 period, due to rising exports (mainly tourism and transport) along with nearly stagnating imports. Overall, the current account closed with a surplus of EUR 1.6 billion, i.e. EUR 220 million more than in the first seven months of 2014.

In the first half of the year the general government deficit was slightly lower than in the same period a year earlier, resulting from increased tax revenues – value added and corporate income taxes – and social insurance contributions, in particular for student work, from the beginning of the year. Expressed as a share in GDP, the general government deficit stood at 3.8% as compared with 4.4% a year earlier. At the end of June public debt amounted to about 81% of GDP. According to the Minister of Finance, the deficit goal of less than 3% of GDP still seems to be within reach in 2015. In the first half of the year, the absorption of EU funds was higher than in 2014, but it is expected to decline significantly in 2016 with the beginning of the new EU financial perspective. As a consequence, the growth-enhancing impact of EU funding prevailing in the past two years will become weaker and increase only gradually in the coming years.

The draft budget proposals for 2016 and 2017 (under discussion) envisage a further reduction of the deficit – in compliance with the EU Stability Pact and the fiscal rule implementation act recently adopted by the Slovenian parliament – to 2.24% and 1.75% of the GDP respectively. Priority is given to healthcare and police (refugee crisis), flood safety, the judiciary, infrastructure and education. Gross wages in the public sector should only rise in accordance with productivity in the private sector as determined in the social pact. The further reduction of budgetary expenditures might, however, result in lower than expected GDP growth taking into account that also withdrawals of EU funds from the new financial perspective (which may fuel economic growth) will start only with some delay. In late September Fitch upgraded Slovenia’s outlook from stable to positive. The key rating drivers are, among other things, the implementation of the above-mentioned fiscal rule act, the expected gradual decline of public debt from 2016 onwards, the improvement of banks’ capacity to resist shocks (non-performing loans are still high, at 11% in July, but declining), improved capital ratios as well as the ability of the current government to agree on key reforms. Already in August Moody’s announced a stable outlook on Slovenia’s banking system for the next 12-18 months by arguing that ongoing GDP growth will be beneficial for the banks’ financial performance. After the restructuring of the country’s largest banks in 2013, Moody’s expects the banking system to return to profitability in 2015 after five loss-making years.

The volume of total loans continued to decrease in 2015, down by 2.5% in July as against December 2014. Lending to households (particularly housing loans) and lending to the government increased this year, while lending to enterprises and non-financial institutions (NFIs) fell by another 5.6%. The increase in housing loans was mainly due to the appreciation of the Swiss franc in January this year, while consumer loans were still on the decline. Corporate deleveraging has been continuing at domestic banks, but at a slower pace than in the past years. By contrast, ‘financially more stable enterprises’ borrow abroad by taking advantage of more favourable interest rates there than on the domestic market.[60]

The privatisation of 15 enterprises, approved by the previous government in 2013, is proceeding slowly. As of September 2015 only five companies – coating manufacturer Helios, laser producer Fotona, Ljubljana airport, the food processing company Zito and Nova Kreditna Banka Maribor – have been sold. The sale of Telekom Slovenija and the chemical-processing company Cinkarna Celje failed.

Based on the available data for the first months of the year, wiiw made an upward revision of its forecast for Slovenia's GDP growth in 2015 given the higher than expected growth of domestic demand. Accordingly, GDP is forecast to grow by 2.7% in 2015, and by slightly above 2% in both 2016 and 2017 as a result of lower disbursements of EU structural funds at the beginning of the new financial perspective. External demand and the gradual recovery of private consumption following an improvement in the labour market and thus increasing disposable income will remain the key drivers of economic growth. The current account will continue to be in surplus in the forecasting period. Government consumption will remain subdued owing to budget consolidation measures.

60 *Slovenian Economic Mirror*, August-September 2015, p. 18.

Table 25 / Slovenia: Selected economic indicators

	2011	2012	2013	2014 1)	2014 January-June	2015 January-June	2015 Forecast	2016 Forecast	2017 Forecast
Population, th pers., average 2)	2,053	2,057	2,060	2,062	2,061	2,062	2,061	2,061	2,061
Gross domestic product, EUR mn, nom. 3)	36,896	35,988	35,908	37,303	18,253	18,801	38,200	39,200	40,500
annual change in % (real)	0.7	-2.7	-1.1	3.0	2.9	2.7	2.7	2.2	2.3
GDP/capita (EUR at exchange rate) 3)	18,000	17,500	17,400	18,100	.	.	18,500	19,000	19,600
GDP/capita (EUR at PPP) 3)	21,500	21,600	21,700	22,600	.	.	.	.	.
Consumption of households, EUR mn, nom. 3)	20,338	20,117	19,437	19,553	9,498	9,529	.	.	.
annual change in % (real)	0.0	-2.4	-4.2	0.6	1.0	1.1	1.6	2.0	2.0
Gross fixed capital form., EUR mn, nom. 3)	7,451	6,934	7,069	7,324	3,643	3,693	.	.	.
annual change in % (real)	-4.9	-8.8	1.6	3.2	5.3	0.0	0.0	0.0	3.5
Gross industrial production									
annual change in % (real)	1.3	-1.1	-0.9	2.2	1.5	4.6	4.8	4.0	4.5
Gross agricultural production									
annual change in % (real)	0.6	-11.0	-3.3	8.7	.	.	.	.	.
Construction industry 4)									
annual change in % (real)	-24.8	-16.8	-2.5	19.5	38.7	-5.8	.	.	.
Employed persons, LFS, th, average	936	924	906	917	914	911	920	920	930
annual change in %	-3.1	-1.3	-1.9	1.2	2.0	-0.3	0.0	0.5	1.0
Unemployed persons, LFS, th, average	83	90	102	98	101	95	90	90	80
Unemployment rate, LFS, in %, average	8.2	8.9	10.1	9.7	10.1	9.5	9.0	8.5	8.0
Reg. unemployment rate, in %, end of period	12.1	13.0	13.5	13.0	12.8	12.0	12.5	11.5	10.0
Average monthly gross wages, EUR	1,525	1,525	1,523	1,540	1,528	1,536	1,550	1,570	1,610
annual change in % (real, gross)	0.2	-2.4	-2.0	0.9	0.4	1.0	1.0	1.0	1.5
Average monthly net wages, EUR	987	991	997	1,005	999	1,001	1,010	1,020	1,040
annual change in % (real, net)	0.3	-2.1	-1.2	0.6	0.2	0.7	0.7	0.7	1.0
Consumer prices (HICP), % p.a.	2.1	2.8	1.9	0.4	0.7	-0.7	-0.4	0.5	1.0
Producer prices in industry, % p.a.	4.6	0.9	0.0	-0.7	-1.0	0.3	0.5	1.0	1.0
General governm.budget, EU-def., % of GDP									
Revenues	43.5	44.4	45.4	44.9	.	.	44.8	43.4	43.0
Expenditures	49.8	48.1	60.1	49.8	.	.	47.8	46.2	45.5
Net lending (+) / net borrowing (-)	-6.2	-3.7	-14.6	-4.9	.	.	-3.0	-2.8	-2.5
Public debt, EU-def., % of GDP	46.4	53.7	70.8	80.8	.	.	82.0	82.0	81.0
Central bank policy rate, % p.a., end of period 5)	1.00	0.75	0.25	0.05	0.15	0.05	.	.	.
Current account, EUR mn 6)	70	930	2,023	2,607	1,172	1,184	2,500	2,100	1,900
Current account, % of GDP 6)	0.2	2.6	5.6	7.0	6.4	6.3	6.6	5.4	4.7
Exports of goods, BOP, EUR mn 6)	21,042	21,256	21,692	22,989	11,276	11,947	24,300	25,500	26,800
annual change in %	12.9	1.0	2.1	6.0	3.8	6.0	5.5	5.0	5.0
Imports of goods, BOP, EUR mn 6)	22,016	21,337	20,983	21,779	10,696	11,169	22,700	23,800	24,900
annual change in %	13.6	-3.1	-1.7	3.8	2.6	4.4	4.0	5.0	4.5
Exports of services, BOP, EUR mn 6)	4,906	5,107	5,314	5,555	2,559	2,699	5,800	6,100	6,500
annual change in %	5.4	4.1	4.1	4.5	4.6	5.5	5.0	5.0	6.0
Imports of services, BOP, EUR mn 6)	3,500	3,596	3,552	3,819	1,795	1,816	3,800	3,900	4,100
annual change in %	1.6	2.7	-1.2	7.5	15.1	1.2	0.8	2.0	4.0
FDI liabilities (inflow), EUR mn 6)	637	28	71	746	611	425	800	.	.
FDI assets (outflow), EUR mn 6)	-4	-439	24	146	176	161	350	.	.
Gross reserves of NB excl. gold, EUR mn	642	593	580	736	767	786	.	.	.
Gross external debt, EUR mn 6)	41,669	42,872	41,658	46,314	45,784	44,978	44,300	43,500	42,500
Gross external debt, % of GDP 6)	112.9	119.1	116.0	124.2	122.7	117.9	116	111	105
Purchasing power parity EUR/EUR	0.8354	0.8092	0.8051	0.7993	.	.	.	.	.

1) Preliminary. - 2) From 2011 according to register-based census 2011. - 3) According to ESA'10. - 4) Enterprises with 20 and more employees and output of some non-construction enterprises. - 5) Official refinancing operation rates for euro area (ECB). - 6) BOP 6th edition.

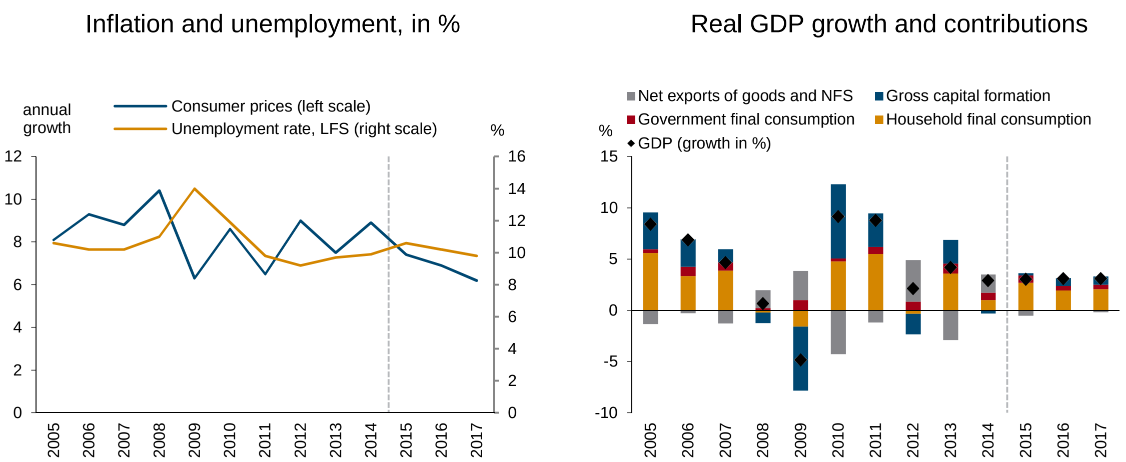
Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.

TURKEY: Shifting from external to internal demand

SERKAN ÇIÇEK

Economic growth has accelerated in the first half of 2015, driven by a hike in final consumption expenditures and an increase in private investment despite the current political uncertainties. However, the parity between dollar and euro and weak global growth led to the contribution of exports to Turkish GDP growth turning slightly negative. Overall, we expect GDP growth of around 3% for 2015 and the years to come.

Figure 61 / Turkey: Main macroeconomic indicators



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

Although the Justice and Development Party (AKP) has won the parliamentary polls, it has lost its parliamentary majority that it had since 2002. None of the four parties in parliament could ensure an absolute majority. After the election, the AKP's coalition talks with the two opposition parties (CHP and MHP) yielded no results (the pro-Kurdish HDP had ruled out the possibility of a coalition with the AKP even before the elections). The opposition parties accused the AKP and President Recep Tayyip Erdogan of deliberately stalling coalition negotiations by letting 45 days pass, by which the time limit allowed to form a government after formal issuance of a mandate expires. Three months after the election of 7 June 2015, a new election has been called by President Erdogan for 1 November 2015. These developments have increased uncertainties for the Turkish economy.

Despite these uncertainties, real GDP growth has been still following its trend, which has been around 3-4% since 2011, with a growth rate of 3.1% in the first half of 2015. In this period, growth was mainly driven by consumption spending, which grew by 3.8%. Sales of durable goods, especially automobiles, underpinned the growth of household consumption. A rise in hourly wages in real terms was the main driver of private domestic demand at the beginning of the year. On the other hand, public purchases of goods and services (especially due to a rise in highway construction expenditures and capital transfers to special provincial administrations ahead of the parliamentary elections) and compensation of employees registered an increase by about 20% and 10%, respectively, and caused government consumption spending to rise faster than expected in the medium-term programme of the government. Therefore, we forecast that final demand (both private and public) will continue to expand at a moderate pace for the rest of the year.

On the central government budget side, we see a surplus in the first half of 2015 compared to the same period of the previous year. The central government expenditures increased by some 11% while the target was 5.5% for the same period in the government's medium-term programme. Both interest expenditures and primary expenditures rose by about 12% and 10%, respectively. Purchases of goods and services and compensation of employees have rapidly accelerated among primary expenditures.

The central government revenues soared at a rate well above the historical average, by almost 16% in the first two quarters of 2015. The high increase in minimum wages and the hike in sales of automobiles were the main drivers behind the collection of tax revenues in this period. Since primary expenditures are expected to be elevated for the rest of the year, we forecast the general government budget balance to turn out to be negative and the budget deficit as a share of GDP to rise slightly to 1.5% in 2015.

The inflation rate was at 8.2% (end-of-period) while the average inflation rate over the year was 8.9% in 2014. A sharp drop in global oil prices in late 2014 helped inflation rates to decline at the beginning of 2015. But high prices for unprocessed food restricted the decrease in the inflation rate. In the first eight months of 2015, the annual inflation rate declined to 7.1% with the help of a correction in food prices. Even though the inflation forecast of the Central Bank of the Republic of Turkey (CBRT) in its third inflation report is 6.9% for 2015, we forecast higher inflation rates because of the ongoing depreciation of the domestic currency. With global oil prices remaining flat and moderate unprocessed food prices, our projected consumer price inflation decelerates from 7.4% in 2015 to 6.2% in 2017.

After loosening the monetary policy between May and July 2014 by cutting the one-week repo rate by a cumulative 175bp because of political pressures, the CBRT maintained a flat policy rate until the beginning of 2015. Because the pressures continued ahead of the election, the CBRT gradually cut its policy rate to 7.50% in the first two months of 2015. But then, the Governor of the CBRT Erdem Basci gave President Erdogan a presentation on 'restoring confidence to the economy and limiting public debt' in order to soften the political pressures. Since then, the CBRT has kept interest rates unchanged in order to restrict the high volatility in exchange rates, although the inflation outlook has been improving when the 12-month moving average inflation rate decreased from 8.9% in December 2014 to 7.8% in September 2015. As currently there is uncertainty especially regarding the global markets and the volatility in food and energy prices, we assume that the CBRT will keep the policy rate at this level in 2015. Since the domestic currency has already depreciated during the year, we do not expect a higher depreciation that will force the CBRT to raise the policy rates in case of an increase in the policy rate of the Fed. For 2016 and 2017, therefore, we forecast the policy rates to fall moderately, to 7.0% and 6.5%

respectively, as we expect the inflation outlook to improve slightly. In addition, we do not expect any additional political pressures over interest rates to push economic growth.

The Turkish lira has been weakening, especially against the US dollar. On 15 September 2015, the lira reached an all-time low against the dollar, ending the day at 3.06 TRY per USD. As of that day, the Turkish lira had lost 31.5% against the dollar since 1 January 2015. The fragility of the exchange rate arises from several factors. On the global part, the expected interest rate hike by the US Fed is quite important. On the domestic side, the chronically large and ongoing deficit of the current account plays an important role. But more recently, political uncertainties are more likely to influence the depreciation process of the domestic currency. The ceasefire between the Turkish army and the PKK collapsed in July 2015 just after the June elections. Opposition parties accused the AKP to cancel the ceasefire in order to leave the HDP under the threshold in the re-elections and thus to obtain the parliamentary majority. Since the domestic currency has already depreciated during the year, we forecast a further mild depreciation regarding uncertainties over the rest of the year.

The 12-month rolling cumulative current account deficit has been decreasing since the end of 2011 from USD 77 billion to USD 45 billion in July 2015, amounting to more than 6% of GDP. The trade deficit also narrowed by 17% in the first eight months of 2015 as compared to the same period of the previous year. The main drivers behind the decline in the trade deficit are the change in the parity of the US dollar to the euro as well as the economic slowdown in the Asian countries and especially in Russia, the depreciation of the domestic currency and the sharp drop in energy and commodity prices. In the first eight months of 2015, exports declined by 8.7% in US dollars, but rose by 12% in euro terms in comparison with the same period of the previous year (according to the overall export volume index, there is no change in exports in the first seven months of 2015 as compared with the same period a year earlier). We expect imports to continue to fall in dollar terms with the global oil prices remaining flat (due to a supply glut in the oil market following the negotiations with Iran), ongoing slight depreciation of the domestic currency and ongoing tensions on Turkey's southern borders. Therefore, the current account deficit is anticipated to recover further over the rest of 2015 and decline from 5.6% in 2015 to 5.0% in 2017 as a share of GDP.

The lifting of sanctions on Iran may also have some impacts on the Turkish economy besides the rest of the world. The sanctions restrained the trade between industrialised countries - especially the countries in Europe - and Iran. The share of oil imports from Iran in total oil imports of Turkey was 30% in 2014 while it had been 51% in 2011. It had shifted from Iran mostly to Iraq and Nigeria; but the same is not true for natural gas imports because the share and the volume of gas imports from Iran have not changed significantly due to long-lasting agreements. On the other hand, both the volume and price of imports have been changing, which affects the amount of oil imports of Turkey from Iran. On the export side, we should distinguish the exports to Iran into two parts: exports and exports except gold. Due to the sanctions, Turkey paid oil and gas imports from the country via gold bullion, which is the main reason for the fluctuations in the amount of exports to Iran. In fact, we do not observe any substantial change in the amount of exports except gold to Iran. Thus we forecast that the possible benefits from the lifting of sanctions will not be too large since the trade share of Iran in Turkey's foreign trade is already high as a neighbouring country. But other possible benefits might be a decrease in oil payments of Turkey because of an additional decrease in oil prices in case of a stronger supply glut in the oil market, an increase in exports because of a prospective economic recovery in Iran and an increase in exports to other Gulf countries via Iran – export markets that Turkey lost because of the war in Syria and Iraq and political frictions with Egypt.

As for gross fixed capital formation, we saw a fall by 1% in 2014 but an increase by 5% in the first half of 2015. Public investment showed strongly negative growth in the first quarter (-10%) but then turned out to be positive in the second quarter with a growth rate of 1% in 2015. Therefore, the hike in private investment dominated the growth performance of gross fixed capital formation in the first half of 2015. In detail, machinery and equipment expenditures became the main driver of investment. Public machinery and equipment expenditures rose by 2% while private machinery and equipment expenditures by 7% in the first two quarters of 2015 compared to the corresponding period of the preceding year. Construction activity of the private sector registered positive growth whereas it contracted in the public sector in the first half of 2015.

In summary, we expect domestic demand to continue to expand modestly throughout the current year thanks to a rise in both public and private consumption expenditures. On the other hand, we have revised our forecast for Turkey's GDP growth downwards, from 3.3% to 3.0% for 2015. For 2016 and 2017, we expect the CBRT to loosen its policy rate in line with the improvements in the inflation outlook. In addition, we project exports to recover owing to the base effect and ongoing depreciation of the domestic currency which may help the GDP growth rate to expand at a moderate pace of 3.1% in the following years.

Table 26 / Turkey: Selected economic indicators

	2011	2012	2013	2014 1)	2014 January-June	2015 January-June	2015 Forecast	2016 Forecast	2017 Forecast
Population, th pers., average	74,224	75,176	76,148	77,182	.	.	78,500	79,400	80,400
Gross domestic product, TRY bn, nom.	1,298	1,417	1,567	1,747	839	926	1,930	2,130	2,330
annual change in % (real)	8.8	2.1	4.2	2.9	3.7	3.1	3.0	3.1	3.1
GDP/capita (EUR at exchange rate)	7,500	8,100	8,100	7,800	.	.	7,300	8,400	8,700
GDP/capita (EUR at PPP)	13,300	13,600	14,000	14,300	.	.	.	.	.
Consumption of households, TRY bn, nom.	924	994	1,110	1,204	578	646	.	.	.
annual change in % (real)	7.7	-0.5	5.1	1.4	1.5	5.1	3.8	2.8	3.0
Gross fixed capital form., TRY bn, nom.	283	287	319	352	178	201	.	.	.
annual change in % (real)	18.0	-2.7	4.4	-1.3	-2.0	5.2	2.8	2.8	2.8
Gross industrial production									
annual change in % (real)	10.1	2.5	3.0	3.6	4.2	2.6	3.8	3.5	3.5
Gross agricultural production 2)									
annual change in % (real)	5.2	5.5	2.8	2.0	.	.	.	.	.
Construction industry									
annual change in % (real)	11.5	0.8	7.7	2.9	5.3	-0.1	.	.	.
Employed persons, LFS, th, average	24,100	24,820	25,520	25,931	25,768	26,324	26,400	26,900	27,400
annual change in %	6.7	3.0	2.8	1.6	1.7	2.2	1.8	2.0	2.0
Unemployed persons, LFS, th, average	2,616	2,517	2,750	2,854	2,682	2,999	3,130	3,060	2,980
Unemployment rate, LFS, in %, average	9.8	9.2	9.7	9.9	9.5	10.3	10.6	10.2	9.8
Reg. unemployment rate, in %, end of period	.	.	.	.	.	.	.	.	.
Average monthly gross wages, TRY	.	.	.	.	.	.	.	.	.
annual change in % (real, gross)	.	.	.	.	.	.	.	.	.
Consumer prices (HICP), % p.a.	6.5	9.0	7.5	8.9	8.7	7.7	7.4	6.9	6.2
Producer prices in industry, % p.a.	13.0	5.3	5.9	10.9	13.5	4.0	6.5	5.8	5.2
General governm. budget, nat.def., % of GDP									
Revenues	34.6	35.7	37.8	37.3	.	.	39.5	39.5	39.5
Expenditures	35.9	37.7	39.2	38.2	.	.	41.0	41.0	40.5
Net lending (+) / net borrowing (-)	-1.3	-2.0	-1.5	-0.9	.	.	-1.5	-1.5	-1.0
Public debt, nat.def., % of GDP 3)	39.1	36.2	36.1	33.5	.	.	35.0	35.5	36.0
Central bank policy rate, % p.a., end of period 4)	5.75	5.50	4.50	8.25	8.75	7.50	7.50	7.00	6.50
Current account, EUR mn 5)	-53,828	-37,659	-48,752	-35,179	-17,908	-19,980	-35,000	-35,000	-35,000
Current account, % of GDP 5)	-9.7	-6.1	-7.9	-5.9	-6.3	-6.2	-5.6	-5.2	-5.0
Exports of goods, BOP, EUR mn 5)	102,365	126,137	121,819	127,237	62,424	69,641	139,000	153,000	168,000
annual change in %	12.0	23.2	-3.4	4.4	2.2	11.6	9.0	10.0	10.0
Imports of goods, BOP, EUR mn 5)	166,271	177,043	182,049	175,303	83,869	92,068	187,000	200,000	215,000
annual change in %	24.1	6.5	2.8	-3.7	-8.8	9.8	6.5	7.0	7.5
Exports of services, BOP, EUR mn 5)	29,561	34,078	35,506	38,142	15,704	17,940	42,000	46,000	50,000
annual change in %	6.7	15.3	4.2	7.4	2.9	14.2	9.0	8.5	8.5
Imports of services, BOP, EUR mn 5)	15,191	16,472	18,290	19,152	9,077	10,445	21,000	22,000	23,000
annual change in %	1.2	8.4	11.0	4.7	1.4	15.1	8.0	5.0	5.0
FDI liabilities (inflow), EUR mn 5)	11,679	10,303	9,359	9,474	5,109	5,665	11,000	.	.
FDI assets (outflow), EUR mn 5)	1,724	3,167	2,716	5,377	1,675	1,933	3,500	.	.
Gross reserves of NB excl. gold, EUR mn	60,531	75,749	80,435	88,058	81,897	90,050	.	.	.
Gross external debt, EUR mn	234,890	256,970	282,175	331,704	294,602	362,162	361,100	392,700	417,300
Gross external debt, % of GDP	42.3	42.0	45.6	55.2	49.0	58.2	58.0	59.0	60.0
Average exchange rate TRY/EUR	2.34	2.31	2.53	2.91	2.97	2.86	3.10	3.20	3.35
Purchasing power parity TRY/EUR	1.31	1.38	1.47	1.59	.	.	.	.	.

1) Preliminary. - 2) Based on UN-FAO data, 2014 wiiw estimate. - 3) Defined according to EU standards. - 4) One-week repo rate. - 5) BOP 6th Edition.

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

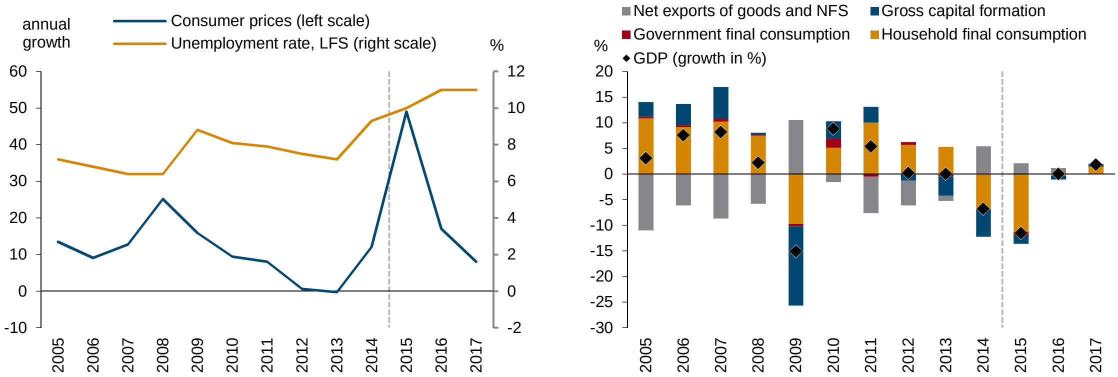
UKRAINE: Bottoming out

VASILY ASTROV

After three quarters of deep recession, the recent months suggest a gradual bottoming out of the economy, albeit at a very low level. Fiscal austerity and high inflation continue to weigh heavily on domestic demand, while exports have so far not been able to take full advantage of the competitive exchange rate. The recent sovereign debt restructuring should provide only a minor relief to the budget and will not prevent the public debt to GDP ratio from rising further.

Figure 62 / Ukraine: 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.

Ukraine continues to face formidable economic challenges: in the second quarter of 2015, real GDP fell by 14.6% year-on-year after an even bigger contraction in the first quarter (-17.2%). This time, the main drag on economic dynamics was private consumption which plunged by a whopping 28% on account of very high inflation – the legacy of both past currency devaluations and the gas tariff hike implemented as of 1 April. Public consumption exhibited a marked turnaround: after growing by 5% in the first quarter, it dropped by 7% in the second, as increased defence spending was apparently over-compensated by the drastic reduction in energy subsidies. Fixed investments declined as well, but not as strongly as in the first quarter (by ‘only’ 14%), while the contribution of net exports was once again positive, as imports fell ahead of exports (by 32% and 23% in real terms, respectively).

On a quarterly (seasonally adjusted) basis, however, GDP in the second quarter of 2015 was nearly unchanged (-0.5%), suggesting that the economy has finally started to bottom out. This is also confirmed by the recent monthly dynamics of industrial production: most indicators suggest that the decline has slowed down markedly and in some cases has been even reversed on an annual basis. The latter applies, for instance, to mining and metals production, which in September 2015 recorded 3% year-on-year output growth. One has to keep in mind that these could be the signs of fragile stabilisation at a very low level, which reflects above all the very low statistical base: the bulk of production declines took place in the second half of last year.

Generally, the dynamics of industrial production – though strongly negative (-16.6% in January-September 2015 year-on-year) – has been much more favourable than that of imports (-36% in US dollar terms in January-August, according to National Bank statistics). The domestic industry, particularly consumer goods production, has been able to benefit from the currency devaluation and gain market shares in an overall shrinking domestic market. However, industrial producers have been much more successful in substituting imports than in exporting: exports went down by 35% in January-August.

This can be only partly blamed on the destruction of production and transportation capacities in the war-torn Donbas:[61] the other provinces (except one) recorded strong export declines as well, including the country's industrial 'heartland' outside of Donbas: Dnipropetrovsk and Zaporyzhye (by 25% and 24% in January-July 2015, respectively). The reasons for the observed export slump are manifold and include the declining world commodity prices, e.g. for metals and grain, as well as the severe disruption of trade with Russia, particularly in the military sector.[62] However, it is also clear that industry has been unable to take advantage of the free access to the EU markets unilaterally granted since April 2014, at least so far. In January-August 2015, goods exports to the EU dropped by 36% – more than to some other regions such as Africa and Asia. While Ukrainian products may have now become price-competitive, other factors such as their generally inferior quality and the differences in standards apparently play a bigger role.

In the first eight months of 2015, budget revenues were reportedly 6.5% above the plan, boosted primarily by high inflation, and there is little doubt that the official deficit target of 4.1% of GDP for this year will be met or even over-shot. In addition, the recently agreed debt restructuring deal (see Box below) should provide a minor relief to the budget as well. These developments allowed the government to enact a 13% hike in public wages and pensions already in September 2015 – instead of December, as initially planned (some USD 450 million has been allocated for these purposes). Despite this welcome step, the overall fiscal stance remains highly restrictive: for instance, even after the recent hike, public sector wages and pensions still remain 25% below the level of December 2014 in real terms. We stick to our view that the wisdom of budget consolidation at a time of a severe recession is highly questionable – especially since it is not fiscal problems which are at the root of the current crisis.

61 Areas under the separatists' control are no longer part of official statistics anyway.

62 Goods exports to Russia declined by 59% in January-August 2015 in US dollar terms.

BOX 5 / UKRAINE'S DEBT RESTRUCTURING DEAL

On 27 August 2015, Ukraine reached an agreement on the restructuring of its privately held external sovereign debt worth some USD 18 billion. The deal was required by the IMF as one of the conditions for its Extended Fund Facility (EFF) loan package to Ukraine and comes close to meeting the stated IMF target of saving USD 15.3 billion in external debt payments over the period 2015-2018.

The details of the agreed deal are as follows:

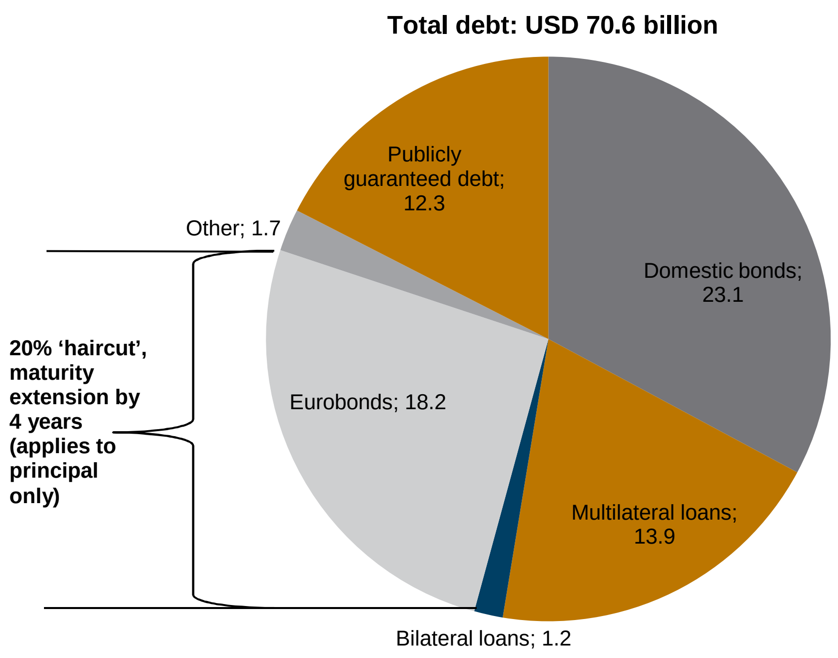
- a 20% debt 'haircut', corresponding to USD 3.6 billion;

- an extension of maturities by four years on the remaining debt, i.e. the redemption of bonds scheduled for 2015-2023 will take place in 2019-2027;

- the above extension applies to principal only; interest will continue to be paid in line with the original schedule and will be hiked to a uniform rate of 7.75% (instead of the weighted average rate of 7.22% previously);

- an issue of the so-called 'value recovery instruments' for the period 2021-2040, the yield on which will be indexed to real GDP growth: zero yield if GDP growth is below 3%, 15% of GDP growth exceeding 3%, and 40% of GDP growth exceeding 4%; these conditions will start to apply after Ukraine's GDP has exceeded USD 125.4 billion[63] (we project that this year GDP will stand at around USD 90 billion).

Figure 63 / Structure of public debt as of 31 August 2015, in USD billion



Source: Ministry of Finance of Ukraine.

63 http://forbes.net.ua/nation/1402140-parlament-daet-dobro-vr-podderzhala-restrukturizaciyu-gosdolga

Our assessment of the agreed deal is mixed. On the one hand, it is a welcome step towards reducing the burden of debt service on the country's budget, which at 5% of GDP is rather high. However, the agreed 20% 'haircut' applies only to privately held external debt, which accounts for only one quarter of the total: neither domestic nor official external debt are affected – see Figure 63. Thus, USD 3.6 billion written off represents only 5% of total public debt. Because of the agreed higher interest on the remaining debt, the net annual savings to the budget should be only some 0.2% of GDP, according to our calculations. The savings will be even lower if Russia refuses to participate in the deal – as it has done so far, insisting that the USD 3 billion owed by Ukraine to Russia's National Welfare Fund in the form of Eurobonds and due in December 2015 should be treated as official rather than as private debt, which would make it ineligible for restructuring. Overall, given the scale of economic problems Ukraine is facing and the strong support by the IMF behind debt restructuring, it is conceivable that the government could have secured much better terms of the deal.

Finally, it should be borne in mind that the agreed 'haircut' on privately held debt will be more than offset by increased borrowing from official lenders. The latter should reach USD 16.3 billion this year, including USD 10 billion from the IMF and smaller amounts from the World Bank, the EU, EBRD, EIB and foreign governments. As a result, the stock of public debt (including debt of the National Bank) is likely to approach 100% of GDP by the end of 2015 – up from 70% last year.

How long the 'shock therapy' will be pursued remains however an open question, given that the popularity of Prime Minister Arseniy Yatsenyuk – the key figure behind the austerity course – has plunged to a mere 2-3%. He appears to be currently on the losing end both to President Poroshenko (whose protégé Mikhail Saakashvili, formerly president of Georgia and now governor of the important Odessa region, has been publicly at odds with Mr. Yatsenyuk) and Yuliya Tymoshenko, whose party has successfully managed to strike a delicate balance between being a junior partner in the ruling coalition and criticising the government's most unpopular reforms at the same time. Under these conditions, a major reshuffling of the government following the local elections on 25 October 2015 appears increasingly likely.

The prospects for economic recovery continue to be highly uncertain. While, as mentioned above, the recent months have shown certain signs of stabilisation, the dismal economic performance in the first half of 2015 makes us revise our GDP growth forecast for the year as a whole downwards, to -11.5%. With further energy tariff hikes on the government agenda, fiscal austerity will continue to weigh on both private and public consumption also next year (although probably less so than in 2015). In addition, any relaxation of foreign exchange controls – especially if done prematurely – may result in another wave of depreciation and inflation, adding to the erosion of real incomes. The uncertain status of Donbas – even assuming that the conflict is 'frozen' and no escalation of fighting takes place – is likely to dampen overall confidence and the investment climate. So, domestic demand will probably weaken further, although this may be offset by a tepid recovery of exports benefiting from ceasefire in Donbas and the newly competitive exchange rate, and result in overall GDP stagnation in 2016.

The Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU which will take effect in January 2016 involves not only chances but also risks. The latter may materialise if Ukraine fails to attract sufficient foreign direct investment to finance the costly adoption of numerous EU standards as required by the DCFTA agreement. Having already lost the bulk of the Russian market and facing highly uncertain prospects of successful EU integration, Ukraine runs the risk of being stuck 'in-between' for years to come.

Table 27 / Ukraine: Selected economic indicators

	2011	2012	2013	2014 1)	2014 January-June	2015 January-June	2015 Forecast	2016 Forecast	2017 Forecast
Population, th pers., average	45,706	45,593	45,490	43,001	43,031	42,876	42,820	42,770	42,750
Gross domestic product, UAH bn, nom. 2)	1,349	1,459	1,505	1,567	688	817	1,900	2,220	2,440
annual change in % (real)	5.4	0.2	0.0	-6.8	-2.9	-15.8	-11.5	0.0	1.8
GDP/capita (EUR at exchange rate) 2)	2,700	3,100	3,100	2,300	.	.	1,900	1,800	1,700
GDP/capita (EUR at PPP) 2)	6,500	6,700	6,800	6,600	.	.	.	.	.
Consumption of households, UAH bn, nom. 2)	906	1,002	1,100	1,108	521	571	.	.	.
annual change in % (real)	15.7	8.4	7.7	-9.6	2.1	-24.2	-16.0	-0.5	2.0
Gross fixed capital form., UAH bn, nom. 2)	248	283	273	219	97	99	.	.	.
annual change in % (real)	6.5	3.3	-6.5	-23.0	-18.4	-19.6	-18.0	-5.0	5.0
Gross industrial production									
annual change in % (real)	8.0	-0.5	-4.3	-10.1	-4.0	-20.5	-14.0	0.0	3.0
Gross agricultural production									
annual change in % (real)	19.9	-4.5	13.3	2.2	-3.9	-9.3	.	.	.
Construction output									
annual change in % (real)	18.6	-8.3	-14.5	-20.4	-7.8	-28.3	.	.	.
Employed persons, LFS, th, average	20,324	20,354	20,404	18,073	18,486	16,408	16,200	16,000	16,000
annual change in %	0.3	0.1	0.2	-6.4	-4.2	.	.	-1.2	0.0
Unemployed persons, LFS, th, average	1,733	1,657	1,577	1,848	1,730	1,667	1,800	2,000	2,000
Unemployment rate, LFS, in %, average	7.9	7.5	7.2	9.3	8.6	9.2	10.0	11.0	11.0
Reg. unemployment rate, in %, end of period 3)	1.8	1.8	1.8	1.7	1.7	1.7	.	.	.
Average monthly gross wages, UAH 4)	2,633	3,026	3,265	3,480	3,366	3,882	4,300	4,900	5,400
annual change in % (real, gross)	8.9	14.3	8.2	-5.4	-0.4	-22.1	-18.0	-2.0	2.0
annual change in % (real, net)	8.7	14.4	8.2	-6.5	-0.4	-23.9	-18.0	-2.0	2.0
Consumer prices, % p.a.	8.0	0.6	-0.3	12.1	5.8	48.1	49.0	17.0	8.0
Producer prices in industry, % p.a. 5)	19.0	3.7	-0.1	17.1	7.0	42.5	40.0	15.0	6.0
General governm.budget, nat.def., % of GDP									
Revenues	29.5	30.5	29.4	29.1	32.6	36.5	31.0	31.0	31.0
Expenditures	31.2	34.0	33.6	33.7	35.6	35.0	35.0	34.5	34.5
Deficit (-) / surplus (+) 6)	-1.7	-3.5	-4.2	-4.6	-3.0	1.5	-4.0	-3.5	-3.5
Public debt, nat.def., % of GDP	35.1	35.3	38.8	70.2	52.5	75.7	97.0	101.0	101.0
Central bank policy rate, % p.a., end of period 7)	7.75	7.50	6.50	14.00	9.50	30.00	18.0	12.0	10.0
Current account, EUR mn 8)	-7,351	-11,153	-12,441	-3,476	-1,479	-243	-1,100	-600	-600
Current account, % of GDP 8)	-6.0	-7.9	-8.8	-3.5	-3.0	-0.7	-1.4	-0.8	-0.9
Exports of goods, BOP, EUR mn 8)	44,812	50,127	44,518	38,235	19,447	15,421	31,800	32,500	33,100
annual change in %	25.7	11.9	-11.2	-14.1	-11.4	-20.7	-16.8	2.1	1.9
Imports of goods, BOP, EUR mn 8)	57,764	67,124	61,185	43,626	21,912	16,759	33,300	33,300	34,000
annual change in %	34.8	16.2	-8.8	-28.7	-22.5	-23.5	-23.7	0.0	2.0
Exports of services, BOP, EUR mn 8)	15,278	17,186	17,032	11,257	5,648	5,403	10,500	10,500	11,000
annual change in %	10.6	12.5	-0.9	-33.9	-26.8	-4.3	-6.8	0.0	5.0
Imports of services, BOP, EUR mn 8)	9,613	11,351	12,141	9,350	4,641	4,415	8,400	8,400	8,800
annual change in %	0.4	18.1	7.0	-23.0	-16.2	-4.9	-10.0	0.0	5.0
FDI liabilities (inflow), EUR mn 8)	5,177	6,360	3,396	641	-400	1,249	300	.	.
FDI assets (outflow), EUR mn 8)	138	762	324	414	318	79	300	.	.
Gross reserves of NB excl. gold, EUR mn	23,593	17,186	13,592	5,429	11,308	8,353	.	.	.
Gross external debt, EUR mn 8)	97,940	102,120	102,852	103,557	100,742	113,351	113,000	113,500	114,000
Gross external debt, % of GDP 8)	80.5	71.9	72.5	103.9	101.1	149.1	148.7	158.5	163.5
Average exchange rate UAH/EUR	11.092	10.271	10.612	15.716	14.1	23.9	25.0	31.0	35.0
Purchasing power parity UAH/EUR 9)	4.546	4.786	4.895	5.535	.	.	.	.	.

Note: From 2014 data and forecasts excluding the occupied territories of Crimea and Sevastopol and from 2015 (except for population) parts of the anti-terrorist operation zone. Construction and gross industrial production (including E (water supply, sewage, waste management, remediation) refer to NACE Rev. 2).

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

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

Appendix

Table 28 / Central and East European new EU member states (NMS-11): an overview of economic fundamentals, 2014

	Bulgaria	Croatia	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	*NMS-11* [1]	*EU-28* [2]
GDP in EUR at exchange rates, EUR bn	42.8	43.0	154.7	20.0	104.2	23.7	36.4	413.1	150.0	75.2	37.3	*1,101*	*13,959*
GDP in EUR at PPP, EUR bn	90.7	67.9	241.4	26.7	184.1	34.5	59.2	714.1	291.8	112.9	46.7	*1,870*	*13,959*
GDP in EUR at PPP, EU-28=100	0.6	0.5	1.7	0.2	1.3	0.2	0.4	5.1	2.1	0.8	0.3	*13.4*	*100.0*
GDP in EUR at PPP, per capita	12,500	15,800	22,900	20,300	18,700	17,300	20,200	18,600	14,600	20,800	22,600	*18,000*	*27,400*
GDP in EUR at PPP per capita, EU-28=100	46	58	84	74	68	63	74	68	53	76	82	*66*	*100*
GDP at constant prices, 1990=100	140.1	105.1	145.8	152.8	132.7	117.9	130.9	209.7 [3]	146.5	178.7	155.3	*171.6*	*148.8*
GDP at constant prices, 2007=100	106.0	89.3	102.5	97.7	100.3	93.0	104.4	124.1	108.2	113.5	96.2	*110.8*	*101.3*
Industrial production real, 2007=100 [4]	90.0	83.9	101.5	114.6	102.7	103.3	109.5	125.3	128.8	129.9	92.0	*93.5*	*163.7*
Population, thousands, average	7,224	4,236	10,525	1,315	9,863	1,994	2,932	38,487	19,904	5,419	2,062	*103,961*	*509,604*
Employed persons, LFS, thousands, average	2,981	1,566	4,974	625	4,101	885	1,319	15,862	8,614	2,363	917	*44,206*	*217,709*
Unemployment rate, LFS, in %	11.4	17.3	6.1	7.4	7.7	10.8	10.7	9.0	6.8	13.2	9.7	*9.0*	*10.2*
General gov. revenues, EU-def., in % of GDP	35.8	42.3	40.1	38.5	47.1	36.0	34.1	38.6	33.4	38.9	44.9	*39.0*	*45.2*
General gov. expenditures, EU-def., in % of GDP	38.6	48.1	42.1	37.9	49.7	37.5	34.8	41.8	34.9	41.8	49.8	*41.6*	*48.1*
General gov. balance, EU-def., in % of GDP	-2.8	-5.7	-2.0	0.6	-2.5	-1.5	-0.7	-3.2	-1.5	-2.9	-4.9	*-2.7*	*-2.9*
Public debt, EU def., in % of GDP	27.1	85.1	42.6	10.4	76.2	40.7	40.7	50.1	39.8	53.6	80.8	*50.6*	*86.8*
Price level, EU-27=100 (PPP/exch. rate)	47	63	64	75	57	69	62	58	51	67	80	*59*	*100*
Compensation per employee, monthly, in EUR [5]	559	1,317	1,207	1,436	1,000	1,108	1,045	1,011	649	1,273	2,049	*997*	*3,032*
Compensation per employee, monthly, EU-28=100	18.4	43.4	39.8	47.4	33.0	36.5	34.5	33.3	21.4	42.0	67.6	*32.9*	*100.0*
Exports of goods in % of GDP	49.2	22.7	71.4	57.3	71.7	43.0	65.2	38.4	31.2	83.3	61.6	*50.2* [6]	*31.5* [6]
Imports of goods in % of GDP	55.6	37.4	65.8	62.3	69.2	52.6	67.7	39.2	35.4	78.9	58.4	*50.8* [6]	*30.3* [6]
Exports of services in % of GDP	15.8	23.8	12.3	26.6	17.9	16.3	16.1	8.8	10.1	9.1	14.9	*12.1* [6]	*11.8* [6]
Imports of services in % of GDP	9.9	7.0	10.9	18.2	13.0	8.9	11.6	6.7	6.2	9.0	10.2	*8.6* [6]	*10.1* [6]
Current account in % of GDP	1.2	0.8	0.6	1.0	2.3	-2.0	3.6	-2.0	-0.5	0.8	7.0	*-0.1* [6]	*1.8* [6]
FDI stock per capita in EUR, 2014 [7]	5,322	5,886	9,498	12,363	8,263	6,083	4,404	4,418	3,099	8,085	4,911	*5,501*	*9,211*

Note: NMS-11: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia. PPP: Purchasing power parity.

1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) 1989=100, which in the Polish case is the appropriate reference year. - 4) EU-28 working-day adjusted. - 5) Gross wages plus indirect labour costs, according to national account concept. - 6) Data for NMS-11 and EU-28 include transactions within the region (sum over individual countries). - 7) Excluding SPE, data for EU-28 refer to 2013.

Source: wiiw Annual Database, Eurostat, AMECO.

Table 29 / Southeast Europe and selected CIS countries: an overview of economic fundamentals, 2014

	Albania	Macedonia	Monte-negro	Serbia	Turkey	Bosnia - Herzegovina	Kosovo	Belarus	Kazakhstan	Russia	Ukraine [1]	*NMS-11* [2]	*EU-28* [3]
GDP in EUR at exchange rates, EUR bn	10.0	8.5	3.4	33.1	601.2	13.9	5.5	58.9	164.0	1,415.1	99.7	*1,101*	*13,959*
GDP in EUR at PPP, EUR bn	22.5	20.6	6.7	68.2	1,101.1	28.8	12.7	130.1	316.2	2,829.1	283.1	*1,870*	*13,959*
GDP in EUR at PPP, EU-28=100	0.2	0.1	0.05	0.5	7.9	0.2	0.1	0.9	2.3	20.3	2.0	*13.4*	*100.0*
GDP in EUR at PPP, per capita	7,800	10,000	10,700	9,600	14,300	7,500	7,000	13,700	18,300	19,400	6,600	*18,000*	*27,400*
GDP in EUR at PPP per capita, EU-28=100	28	36	39	35	52	27	26	50	67	71	24	*66*	*100*
GDP at constant prices, 1990=100	.	132.5	.	.	249.6	.	.	198.8	192.0	118.4	64.7	*171.6*	*148.8*
GDP at constant prices, 2007=100	123.5	118.0	109.1	103.8	124.6	106.8	128.5	130.9	140.1	111.5	88.9	*110.8*	*101.3*
Industrial production real, 2007=100 [4]	306.0	102.7	121.8	88.4	121.8	111.6	192.0	134.9	124.0	108.5	116.4	*93.5*	*163.7*
Population, thousands, average	2,894	2,068	622	7,132	77,182	3,826	1,813	9,475	17,289	146,091	43,001	*103,961*	*509,604*
Employed persons, LFS, thousands, average	1,037	690	216	2,421	25,931	812	324	4,551	8,510	71,524	18,073	*44,206*	*217,709*
Unemployment rate, LFS, in %	17.5	28.0	18.0	18.9	9.9	27.5	35.3	0.5	5.0	5.2	9.3	*9.0*	*10.2*
General gov. revenues, nat. def., in % of GDP	26.3	30.4	39.5	41.8	37.3	43.9	24.6	38.6	18.8	37.5	29.1	*39.0* [5]	*45.2* [5]
General gov. expenditures, nat. def., in % of GDP	31.5	34.3	42.5	48.4	38.2	45.9	27.6	37.3	21.5	38.7	33.7	*41.6* [5]	*48.1* [5]
General gov. balance, nat. def., in % of GDP	-5.2	-3.9	-3.0	-6.7	-0.9	-2.0	-3.0	1.3	-2.8	-1.2	-4.6	*-2.7* [5]	*-2.9* [5]
Public debt, nat. def., in % of GDP	70.2	45.8	56.7	71.0	33.5	45.9	10.6	39.8	14.8	11.8	70.2	*50.6* [5]	*86.8* [5]
Price level, EU-28=100 (PPP/exch. rate)	44	41	51	48	55	48	43	45	52	50	35	*59*	*100*
Average gross monthly wages, EUR at exchange rate	264	508	723	524	638 [6]	659	416 [7]	458	506	644	221	*997* [6]	*3,032* [6]
Average gross monthly wages, EU-28=100	8.7	16.8	23.8	17.3	21.0 [6]	21.7	13.7	15.1	16.7	21.2	7.3	*32.9* [6]	*100.0* [6]
Exports of goods in % of GDP	9.4	32.6	10.4	32.2	21.2	24.3	5.9	46.7	36.8	26.5	38.4	*50.2* [8]	*31.5* [8]
Imports of goods in % of GDP	31.6	54.3	50.6	44.6	29.2	54.0	43.4	50.2	20.0	16.4	43.8	*50.8* [8]	*30.3* [8]
Exports of services in % of GDP	18.9	15.0	30.1	11.5	6.3	9.7	14.0	10.4	3.0	3.5	11.3	*12.1* [8]	*11.8* [8]
Imports of services in % of GDP	15.7	10.8	9.9	10.1	3.2	3.0	7.9	7.5	5.9	6.4	9.4	*8.6* [8]	*10.1* [8]
Current account in % of GDP	-12.9	-0.8	-15.4	-6.0	-5.9	-7.6	-8.0	-6.9	2.8	3.1	-3.5	*-0.1* [8]	*1.8* [8]
FDI stock per capita in EUR, 2014	1,574	1,944	6,430	3,423	1,885	1,556	1,639	1,545	6,096	2,131	1,228	*5,501*	*9,211* [9]

Note: NMS-11: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia. PPP: Purchasing power parity, wiiw estimates for Belarus, Kazakhstan, Russia and Ukraine; IMF for Kosovo.

1) Exluding the occupied territories of Crimea and Sevastopol. - 2) wiiw estimates. - 3) wiiw estimates and Eurostat. - 4) EU-28 working-day adjusted. - 5) EU definition: expenditures and revenues according to ESA 2010, excessive deficit procedure. - 6) Gross wages plus indirect labour costs, according to national account concept. - 7) Average net monthly wages. - 8) Data for NMS-11 and EU-28 include transactions within the region. - 9) Year 2013.

Source: wiiw Annual Database, Eurostat, AMECO.

Table 30 / GDP per capita at current PPPs (EUR), from 2015 at constant PPPs and population

	1991	1995	2000	2005	2010	2011	2012	2013	2014	2015	2016	2017
											Forecast	
Bulgaria	4,400	5,100	5,500	8,600	11,500	11,800	12,100	12,100	12,600	12,900	13,200	13,600
Croatia	6,800	6,900	9,500	13,400	14,900	15,500	16,000	16,100	16,000	16,100	16,300	16,600
Czech Republic	8,800	11,500	14,100	18,600	20,600	21,600	21,800	21,900	22,900	23,800	24,400	25,000
Estonia	5,500	5,300	8,600	13,900	16,100	18,100	19,200	19,800	20,300	20,700	21,200	21,800
Hungary	6,800	7,600	10,500	14,500	16,500	17,100	17,100	17,800	18,700	19,200	19,600	20,000
Latvia	6,400	5,000	7,100	11,800	13,300	14,700	15,800	16,600	17,300	17,700	18,200	18,700
Lithuania	7,100	5,200	7,600	12,300	15,300	17,000	18,300	19,400	20,200	20,500	21,100	21,800
Poland	4,500	6,300	9,200	11,600	15,800	16,600	17,400	17,900	18,600	19,300	19,900	20,600
Romania	4,000	4,800	5,000	8,000	12,600	13,300	14,000	14,500	14,700	15,200	15,800	16,200
Slovakia	5,800	7,100	9,700	13,900	18,600	18,900	19,500	20,000	20,800	21,500	22,100	22,700
Slovenia	8,500	11,100	15,500	20,000	21,100	21,500	21,600	21,700	22,600	23,200	23,700	24,200
NMS-11	5,400	6,600	8,700	12,000	15,600	16,300	16,900	17,400	18,000	18,600	19,100	19,600
Albania	1,400	2,000	3,500	5,200	7,100	7,300	7,300	7,400	7,800	8,000	8,300	8,600
Macedonia	4,300	4,000	5,400	6,900	8,900	8,800	9,100	9,500	10,000	10,300	10,600	10,900
Montenegro	.	.	5,700	7,000	10,200	10,600	10,300	10,700	10,700	11,000	11,300	11,600
Serbia	.	3,100	5,000	7,400	9,000	9,500	9,700	9,800	9,600	9,600	9,700	9,800
Turkey	3,700	4,300	7,600	9,100	12,200	13,300	13,600	14,000	14,300	14,700	15,200	15,700
Bosnia & Herzeg.	.	.	3,900	5,400	6,800	7,100	7,200	7,300	7,500	7,600	7,800	8,000
Kosovo	.	.	.	5,200	5,900	6,200	6,500	6,700	7,000	7,300	7,600	7,900
Belarus	3,900	3,200	5,000	8,100	11,700	12,500	13,100	13,300	13,700	13,200	13,200	13,400
Kazakhstan	4,900	3,800	3,700	7,300	13,600	15,700	16,600	17,500	18,300	18,600	19,100	19,800
Russia	6,700	4,700	5,900	9,900	15,600	17,000	18,300	18,900	19,400	18,700	18,900	19,200
Ukraine	3,500	2,400	3,100	4,800	5,700	6,500	6,700	6,800	6,600	5,800	5,800	5,900
Austria	19,000	19,900	25,700	29,000	32,000	33,200	34,100	34,100	34,900	35,200	35,700	36,400
Germany	18,900	19,300	23,100	26,900	30,200	31,800	32,500	32,700	34,000	34,600	35,300	36,000
Greece	12,900	12,800	16,600	21,000	22,100	20,100	19,600	19,400	19,600	19,700	20,300	20,700
Ireland	12,900	15,500	25,700	33,800	33,000	34,500	34,700	35,400	36,800	38,100	39,400	40,200
Italy	17,600	18,400	23,200	24,700	26,300	26,800	26,600	26,300	26,400	26,600	27,000	27,500
Portugal	10,900	11,400	15,500	18,500	20,600	20,300	20,100	20,900	21,400	21,700	22,100	22,500
Spain	13,300	13,600	18,900	23,300	24,700	24,500	24,600	24,600	25,100	25,800	26,500	27,000
United States	19,700	22,000	39,400	35,600	36,400	35,700	40,000	39,800	41,100	42,400	43,700	44,600
EU-28 average	12,800	15,100	19,600	23,200	25,300	26,000	26,500	26,600	27,400	27,900	28,500	29,100

European Union (28) average = 100

	1991	1995	2000	2005	2010	2011	2012	2013	2014	2015	2016	2017
Bulgaria	34	34	28	37	45	45	46	45	46	46	46	47
Croatia	53	46	48	58	59	60	60	61	58	58	57	57
Czech Republic	69	76	72	80	81	83	82	82	84	85	86	86
Estonia	43	35	44	60	64	70	72	74	74	74	74	75
Hungary	53	50	54	63	65	66	65	67	68	69	69	69
Latvia	50	33	36	51	53	57	60	62	63	63	64	64
Lithuania	55	34	39	53	60	65	69	73	74	73	74	75
Poland	35	42	47	50	62	64	66	67	68	69	70	71
Romania	31	32	26	34	50	51	53	55	54	54	55	56
Slovakia	45	47	49	60	74	73	74	75	76	77	78	78
Slovenia	66	74	79	86	83	83	82	82	82	83	83	83
NMS-11	42	44	44	52	62	63	64	65	66	67	67	67
Albania	11	13	18	22	28	28	28	28	28	29	29	30
Macedonia	34	26	28	30	35	34	34	36	36	37	37	37
Montenegro	.	.	29	30	40	41	39	40	39	39	40	40
Serbia	.	.	26	32	36	37	37	37	35	34	34	34
Turkey	29	28	39	39	48	51	51	53	52	53	53	54
Bosnia & Herzeg.	.	.	20	23	27	27	27	27	27	27	27	27
Kosovo	.	.	.	22	23	24	25	25	26	26	27	27
Belarus	.	21	26	35	46	48	49	50	50	47	46	46
Kazakhstan	.	25	19	31	54	60	63	66	67	67	67	68
Russia	52	31	30	43	62	65	69	71	71	67	66	66
Ukraine	27	16	16	21	23	25	25	26	24	21	20	20
Austria	148	132	131	125	126	128	129	128	127	126	125	125
Germany	148	128	118	116	119	122	123	123	124	124	124	124
Greece	101	85	85	91	87	77	74	73	72	71	71	71
Ireland	101	103	131	146	130	133	131	133	134	137	138	138
Italy	138	122	118	106	104	103	100	99	96	95	95	95
Portugal	85	75	79	80	81	78	76	79	78	78	78	77
Spain	104	90	96	100	98	94	93	92	92	92	93	93
USA	154	146	201	153	144	137	151	150	150	152	153	153
EU-28 average	100	100	100	100	100	100	100	100	100	100	100	100

Sources: wiiw Annual Database incorporating national and Eurostat statistics, wiiw estimates, Eurostat, EC - Autumn Report 2014.

Table 31 / Indicators of macro-competitiveness, 2010-2017, EUR based, annual averages

	2010	2011	2012	2013	2014	2015	2016	2017
							Forecast	
Bulgaria								
Producer price index, 2010=100	100.0	109.2	114.0	112.3	110.9	110.9	112.0	114.3
Consumer price index, 2010=100	100.0	103.4	105.9	106.3	104.6	109.8	110.9	112.6
GDP deflator, 2010=100	100.0	106.9	108.5	107.7	108.2	108.7	110.1	111.8
Exchange rate (ER), NC/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2010=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	100.0	100.3	100.0	98.9	96.8	101.5	101.0	101.0
Real ER (PPI-based), 2010=100	100.0	103.7	105.3	103.8	104.5	103.4	102.9	103.4
PPP, NC/EUR	0.8671	0.9259	0.9195	0.9302	0.9222	0.92	0.91	0.92
Price level, EU28 = 100	44	47	47	48	47	47	47	47
Average monthly gross wages, EUR (ER)	331	351	374	396	423	460	480	500
Average monthly gross wages, EUR (PPP)	747	741	795	833	898	970	1,020	1,060
GDP per employed person, 2010=100	100.0	105.1	105.9	107.2	107.2	107.58	108.82	110.06
Unit labour costs, ER adj., 2010=100	100.0	100.6	106.5	111.6	119.2	127.6	131.9	136.0
Unit labour costs, PPP adj., Austria=100	25.4	25.5	26.2	26.8	28.1	29.9	30.5	31.2
Croatia								
Producer price index, 2010=100	100.0	107.0	112.8	112.5	109.6	109.6	110.7	111.8
Consumer price index, 2010=100	100.0	102.2	105.6	108.1	108.3	108.0	108.5	109.6
GDP deflator, 2010=100	100.0	101.7	103.3	104.1	104.1	103.8	104.3	105.4
Exchange rate (ER), NC/EUR	7.286	7.434	7.517	7.574	7.630	7.65	7.69	7.74
ER, nominal, 2010=100	100.0	102.0	103.2	103.9	104.7	105.0	105.5	106.2
Real ER (CPI-based), 2010=100	100.0	97.2	96.8	96.8	95.8	95.1	93.7	92.7
Real ER (PPI-based), 2010=100	100.0	99.6	101.0	100.1	98.6	97.4	96.4	95.3
PPP, NC/EUR	5.129	5.006	4.824	4.811	4.837	4.77	4.73	4.70
Price level, EU28 = 100	70	67	64	64	63	62	61	61
Average monthly gross wages, EUR (ER)	1,054	1,049	1,048	1,048	1,042	1,050	1,070	1,090
Average monthly gross wages, EUR (PPP)	1,497	1,557	1,632	1,650	1,644	1,680	1,730	1,790
GDP per employed person, 2010=100	100.0	103.0	96.0	97.6	94.6	93.26	92.65	92.41
Unit labour costs, ER adj., 2010=100	100.0	96.6	103.6	101.9	104.5	106.4	109.2	111.4
Unit labour costs, PPP adj., Austria=100	54.3	52.4	54.3	52.3	52.6	52.9	53.6	54.4
Czech Republic								
Producer price index, 2010=100	100.0	103.7	106.2	106.9	107.9	109.0	110.4	112.1
Consumer price index, 2010=100	100.0	102.2	105.8	107.2	107.7	108.2	109.8	111.7
GDP deflator, 2010=100	100.0	99.8	101.2	102.6	105.1	105.7	107.4	109.3
Exchange rate (ER), NC/EUR	25.28	24.59	25.15	25.98	27.54	27.50	27.25	27.00
ER nominal, 2010=100	100.0	97.3	99.5	102.8	108.9	108.8	107.8	106.8
Real ER (CPI-based), 2010=100	100.0	101.9	100.5	97.1	91.5	92.0	92.8	93.9
Real ER (PPI-based), 2010=100	100.0	101.3	98.6	96.2	93.3	93.5	94.1	95.0
PPP, NC/EUR	18.28	17.76	17.66	17.74	17.65	17.6	17.6	17.6
Price level, EU28 = 100	72	72	70	68	64	64	65	65
Average monthly gross wages, EUR (ER)	944	995	997	964	930	960	1,010	1,070
Average monthly gross wages, EUR (PPP)	1,305	1,377	1,419	1,412	1,450	1,510	1,570	1,630
GDP per employed person, 2010=100	100.0	101.6	101.0	99.5	100.7	103.64	105.92	108.13
Unit labour costs, ER adj., 2010=100	100.0	103.7	104.6	102.7	97.9	98.5	101.3	104.5
Unit labour costs, PPP adj., Austria=100	45.6	47.2	46.1	44.3	41.4	40.8	41.5	42.8
Estonia								
Producer price index, 2010=100	100.0	104.2	107.0	114.8	111.6	109.4	109.4	110.5
Consumer price index, 2010=100	100.0	105.1	109.5	113.1	113.6	113.5	115.5	118.0
GDP deflator, 2010=100	100.0	105.3	108.1	112.4	114.7	114.4	116.5	118.7
Real ER (CPI-based), 2010=100	100.0	101.9	103.5	105.3	105.2	105.0	105.3	105.9
Real ER (PPI-based), 2010=100	100.0	99.0	98.8	106.1	105.1	102.0	100.5	100.0
PPP, NC/EUR	0.6864	0.6947	0.7092	0.7291	0.7467	0.74	0.74	0.74
Price level, EU28 = 100	69	69	71	73	75	74	74	74
Average monthly gross wages, EUR (ER)	792	839	887	949	1,005	1,060	1,150	1,240
Average monthly gross wages, EUR (PPP)	1,154	1,208	1,251	1,302	1,346	1,440	1,550	1,670
GDP per employed person, 2010=100	100.0	100.8	105.1	105.6	108.1	108.61	112.10	115.98
Unit labour costs, ER adj., 2010=100	100.0	105.0	106.6	113.4	117.4	123.2	129.5	134.9
Unit labour costs, PPP adj., Austria=100	45.1	47.3	46.5	48.4	49.1	50.7	52.6	54.5

(Table 31 ctd.)

(Table 31 ctd.)

	2010	2011	2012	2013	2014	2015	2016	2017
							Forecast	
Hungary								
Producer price index, 2010=100	100.0	104.1	108.4	109.1	108.7	108.1	110.0	112.5
Consumer price index, 2010=100	100.0	95.4	101.4	144.8	115.7	116.0	118.9	122.5
GDP deflator, 2010=100	100.0	102.2	105.8	109.0	112.6	113.9	116.5	120.1
Exchange rate (ER), NC/EUR	275.5	279.4	289.3	296.9	308.7	315	315	315
ER, nominal 2010=100	100.0	101.4	105.0	107.8	112.1	114.3	114.3	114.3
Real ER (CPI-based), 2010=100	100.0	99.4	98.8	96.5	92.3	93.8	94.8	96.2
Real ER (PPI-based), 2010=100	100.0	97.5	95.4	93.6	91.3	88.2	88.3	89.0
PPP, NC/EUR	164.4	165.4	168.3	171.2	174.8	175.1	176.5	179.2
Price level, EU28 = 100	60	59	58	58	57	56	56	57
Average monthly gross wages, EUR (ER)	735	763	771	777	770	780	810	840
Average monthly gross wages, EUR (PPP)	1,232	1,288	1,325	1,348	1,360	1,400	1,450	1,480
GDP per employed person, 2010=100	100.0	100.9	98.8	99.0	97.4	97.89	98.54	100.04
Unit labour costs, ER adj., 2010=100	100.0	102.8	106.1	106.8	107.5	108.4	112.0	114.8
Unit labour costs, PPP adj., Austria=100	36.1	37.1	37.0	36.5	36.0	35.7	36.4	36.9
Latvia								
Producer price index, 2010=100	100.0	107.7	112.2	114.0	114.5	113.9	115.0	116.8
Consumer price index, 2010=100	100.0	104.2	106.6	106.6	107.4	107.8	109.7	112.0
GDP deflator, 2010=100	100.0	106.4	110.2	111.6	113.0	113.6	115.7	118.1
Real ER (CPI-based), 2010=100	100.0	101.4	102.4	100.3	100.2	100.5	100.8	101.4
Real ER (PPI-based), 2010=100	100.0	102.7	105.3	106.5	108.7	107.1	106.6	106.6
PPP, NC/EUR	0.6434	0.6697	0.6783	0.6793	0.6858	0.68	0.69	0.69
Price level, EU28 = 100	64	67	68	68	69	68	69	69
Average monthly gross wages, EUR (ER)	628	657	690	717	765	820	880	950
Average monthly gross wages, EUR (PPP)	984	986	1,009	1,054	1,115	1,200	1,280	1,380
GDP per employed person, 2010=100	100.0	103.0	118.7	119.8	124.5	126.53	129.68	132.83
Unit labour costs, ER adj., 2010=100	100.0	101.6	92.5	95.3	97.9	103.2	108.1	113.9
Unit labour costs, PPP adj., Austria=100	45.4	46.0	40.6	40.9	41.2	42.7	44.2	46.2
Lithuania								
Producer price index, 2010=100	100.0	113.9	119.6	116.7	111.0	102.1	102.1	103.1
Consumer price index, 2010=100	100.0	104.1	107.4	108.7	108.9	108.3	110.4	113.2
GDP deflator, 2010=100	100.0	105.2	108.0	109.4	110.7	110.0	112.3	115.1
Real ER (CPI-based), 2010=100	100.0	101.0	101.5	101.2	100.9	100.1	100.6	101.6
Real ER (PPI-based), 2010=100	100.0	108.2	110.5	108.0	104.5	95.2	93.8	93.3
PPP, NC/EUR	0.5907	0.6070	0.6089	0.6086	0.6160	0.61	0.61	0.62
Price level, EU28 = 100	59	61	61	61	62	61	61	62
Average monthly gross wages, EUR (ER)	576	593	615	646	677	710	770	840
Average monthly gross wages, EUR (PPP)	975	976	1,010	1,062	1,100	1,170	1,260	1,360
GDP per employed person, 2010=100	100.0	103.9	116.0	118.5	119.7	120.81	123.21	126.57
Unit labour costs, ER adj., 2010=100	100.0	99.0	92.1	94.7	98.3	102.1	108.5	115.3
Unit labour costs, PPP adj., Austria=100	34.9	34.5	31.0	31.2	31.8	32.5	34.1	36.0
Poland								
Producer price index, 2010=100	100.0	107.3	110.8	109.5	108.0	106.4	106.4	108.0
Consumer price index, 2010=100	100.0	103.9	107.7	108.6	108.7	107.9	109.2	111.1
GDP deflator, 2010=100	100.0	103.2	105.5	106.7	107.2	106.7	107.9	110.1
Exchange rate (ER), NC/EUR	3.995	4.121	4.185	4.198	4.184	4.20	4.15	4.20
ER, nominal, 2010=100	100.0	103.2	104.8	105.1	104.7	105.1	103.9	105.1
Real ER (CPI-based), 2010=100	100.0	97.7	97.2	96.2	96.0	94.9	95.8	94.9
Real ER (PPI-based), 2010=100	100.0	98.8	97.7	96.3	97.1	94.3	94.1	92.9
PPP, PLN/EUR	2.385	2.422	2.412	2.412	2.421	2.38	2.38	2.39
Price level, EU28 = 100	60	59	58	57	58	57	57	57
Average monthly gross wages, EUR (ER)	807	826	844	872	904	930	980	1,030
Average monthly gross wages, EUR (PPP)	1,352	1,405	1,464	1,517	1,563	1,630	1,710	1,800
GDP per employed person, 2010=100	100.0	103.7	109.1	111.2	112.9	115.93	118.92	122.81
Unit labour costs, ER adj., 2010=100	100.0	98.7	95.8	97.1	99.2	99.0	102.2	103.5
Unit labour costs, PPP adj., Austria=100	45.7	45.0	42.3	42.0	42.1	41.4	42.1	42.5

(Table 31 ctd.)

(Table 31 ctd.)

	2010	2011	2012	2013	2014	2015	2016 Forecast	2017
Romania								
Producer price index, 2010=100	100.0	107.1	112.7	115.0	114.8	112.5	112.5	113.6
Consumer price index, 2010=100	100.0	105.8	109.4	112.9	114.5	114.5	114.5	116.7
GDP deflator, 2010=100	100.0	104.7	109.6	113.4	115.4	117.2	119.4	122.7
Exchange rate (ER), NC/EUR	4.212	4.239	4.459	4.419	4.444	4.44	4.43	4.42
ER, nominal, 2010=100	100.0	100.6	105.9	104.9	105.5	105.4	105.2	104.9
Real ER (CPI-based), 2010=100	100.0	102.0	97.7	100.2	100.4	100.4	99.2	99.9
Real ER (PPI-based), 2010=100	100.0	101.0	98.3	101.3	102.4	99.5	98.2	98.0
PPP, NC/EUR	2.085	2.109	2.124	2.204	2.285	2.30	2.31	2.34
Price level, EU28 = 100	50	50	48	50	51	52	52	53
Average monthly gross wages, EUR (ER)	452	467	463	489	520	560	590	630
Average monthly gross wages, EUR (PPP)	912	939	971	981	1,020	1,090	1,130	1,200
GDP per employed person, 2010=100	100.0	102.2	109.2	113.8	116.1	119.59	123.57	126.85
Unit labour costs, ER adj., 2010=100	100.0	101.2	93.8	95.3	99.9	104.3	105.2	110.6
Unit labour costs, PPP adj., Austria=100	34.9	35.2	31.6	31.4	32.0	33.0	33.2	34.3
Slovakia								
Producer price index, 2010=100	100.0	104.5	106.5	105.4	101.7	99.7	101.2	103.2
Consumer price index, 2010=100	100.0	104.1	108.0	109.6	109.4	109.4	111.0	112.9
GDP deflator, 2010=100	100.0	101.6	102.9	103.5	103.3	103.2	104.6	106.4
Real ER (CPI-based), 2010=100	100.0	101.0	102.0	102.0	101.3	101.2	101.1	101.3
Real ER (PPI-based), 2010=100	100.0	99.3	98.4	97.5	95.8	92.9	92.9	93.4
PPP NC/ EUR	0.6684	0.6872	0.6829	0.6794	0.6663	0.66	0.66	0.66
Price level, EU28 = 100	67	69	68	68	67	66	66	66
Average monthly gross wages, EUR (ER)	769	786	805	824	858	880	910	940
Average monthly gross wages, EUR (PPP)	1,151	1,144	1,179	1,213	1,288	1,330	1,380	1,420
GDP per employed person, 2010=100	100.0	101.2	103.8	105.3	106.3	107.59	109.66	112.07
Unit labour costs, ER adj., 2010=100	100.0	101.0	100.8	101.8	105.0	106.4	107.9	109.1
Unit labour costs, PPP adj., Austria=100	37.9	38.2	36.9	36.5	36.9	36.8	36.9	37.0
Slovenia								
Producer price index, 2010=100	100.0	104.6	105.5	105.5	104.8	105.3	106.4	107.4
Consumer price index, 2010=100	100.0	102.1	105.0	107.0	107.4	106.9	107.5	108.5
GDP deflator, 2010=100	100.0	101.1	101.4	102.2	103.1	102.8	103.2	104.2
Real ER (CPI-based), 2010=100	100.0	99.0	99.2	99.6	99.4	98.9	97.9	97.5
Real ER (PPI-based), 2010=100	100.0	99.3	97.4	97.6	98.7	98.2	97.7	97.2
PPP, NC/EUR	0.8404	0.8354	0.8092	0.8051	0.7993	0.79	0.78	0.78
Price level, EU28 = 100	84	84	81	81	80	79	78	78
Average monthly gross wages, EUR (ER)	1,495	1,525	1,525	1,523	1,540	1,550	1,570	1,610
Average monthly gross wages, EUR (PPP)	1,779	1,825	1,885	1,892	1,927	1,960	2,010	2,070
GDP per employed person, 2010=100	100.0	103.9	102.4	103.3	105.2	107.65	110.05	111.12
Unit labour costs, ER adj., 2010=100	100.0	98.2	99.7	98.6	98.0	96.3	95.4	96.9
Unit labour costs, PPP adj., Austria=100	71.6	70.2	69.0	66.8	65.0	62.9	61.6	62.1
Albania								
Producer price index, 2010=100	100.0	102.6	103.8	103.3	102.9	101.6	101.2	101.0
Consumer price index, 2010=100	100.0	103.4	105.5	107.6	109.3	111.5	114.1	116.9
GDP deflator, 2010=100	100.0	102.4	103.4	103.7	104.7	107.0	109.3	112.4
Exchange rate (ER), NC/EUR	137.8	140.3	139.0	140.3	140.0	140.0	141.0	141.0
ER, nominal, 2010=100	100.0	101.8	100.9	101.8	101.6	101.6	102.3	102.3
Real ER (CPI-based), 2010=100	100.0	98.5	98.8	98.4	99.6	101.5	101.6	102.6
Real ER (PPI-based), 2010=100	100.0	95.7	95.0	93.9	95.4	93.3	90.9	89.3
PPP, NC/EUR	59.97	61.56	62.65	62.85	61.86	62.5	63.0	63.8
Price level, EU28 = 100	44	44	45	45	44	45	45	45
Average monthly gross wages, EUR (ER)	252	260	270	259	264	270	280	290
Average monthly gross wages, EUR (PPP)	580	593	599	578	598	610	630	640
GDP per employed person, 2010=100	100.0	103.1	106.4	119.8	120.8	119.25	121.70	124.94
Unit labour costs, ER adj., 2010=100	100.0	99.9	100.5	85.7	86.7	90.4	91.2	92.5
Unit labour costs, PPP adj., Austria=100	30.5	30.4	29.6	24.7	24.5	24.9	25.0	25.1

(Table 31 ctd.)

(Table 31 ctd.)

	2010	2011	2012	2013	2014	2015	2016	2017
							Forecast	
Macedonia								
Producer price index, 2010=100	100.0	111.9	113.5	111.9	109.7	107.5	108.6	110.8
Consumer price index, 2010=100	100.0	103.9	107.3	110.3	110.0	110.6	111.7	113.9
GDP deflator, 2010=100	100.0	103.7	104.8	109.3	110.8	111.3	112.5	114.7
Exchange rate (ER), NC/EUR	61.52	61.53	61.53	61.58	61.62	61.5	61.5	61.5
ER, nominal, 2010=100	100.0	100.0	100.0	100.1	100.2	100.0	100.0	100.0
Real ER (CPI-based), 2010=100	100.0	100.8	101.4	102.6	101.7	102.3	101.8	102.3
Real ER (PPI-based), 2010=100	100.0	106.2	104.8	103.3	103.1	100.3	99.8	100.3
PPP, NC/EUR	23.80	25.58	24.98	25.60	25.52	25.4	25.3	25.4
Price level, EU28 = 100	39	42	41	42	41	41	41	41
Average monthly gross wages, EUR (ER)	491	497	498	504	508	520	530	550
Average monthly gross wages, EUR (PPP)	1,270	1,196	1,228	1,212	1,227	1,260	1,290	1,330
GDP per employed person, 2010=100	100.0	101.2	99.9	98.2	100.3	102.26	103.53	105.27
Unit labour costs, ER adj., 2010=100	100.0	100.0	101.6	104.4	103.1	103.9	104.5	105.9
Unit labour costs, PPP adj., Austria=100	36.5	36.4	35.8	36.0	34.9	34.4	34.3	34.7
Montenegro								
Producer price index, 2010=100	100.0	103.2	105.1	106.8	106.9	108.0	110.2	113.5
Consumer price index, 2010=100	100.0	103.3	107.5	109.5	109.0	110.1	112.3	114.5
GDP deflator, 2010=100	100.0	100.9	100.8	103.1	104.6	104.4	107.5	110.3
Real ER (CPI-based), 2010=100	100.0	100.2	101.6	101.9	100.9	101.8	102.3	102.8
Real ER (PPI-based), 2010=100	100.0	98.0	97.1	98.8	100.7	95.6	96.6	97.1
PPP, NC/EUR	0.4922	0.4909	0.4911	0.5017	0.5135	0.51	0.52	0.52
Price level, EU28 = 100	49	49	49	50	51	51	52	52
Average monthly gross wages, EUR (ER)	715	722	727	726	723	730	750	770
Average monthly gross wages, EUR (PPP)	1,453	1,471	1,480	1,447	1,408	1,440	1,460	1,480
GDP per employed person, 2010=100	100.0	110.0	104.7	107.2	101.5	101.93	104.62	107.97
Unit labour costs, ER adj., 2010=100	100.0	91.8	97.1	94.7	99.6	100.2	100.3	99.7
Unit labour costs, PPP adj., Austria=100	50.5	46.2	47.4	45.2	46.6	46.1	45.6	45.0
Serbia								
Producer price index, 2010=100	100.0	112.7	120.4	123.6	125.2	127.7	130.3	132.9
Consumer price index, 2010=100	100.0	111.0	119.7	129.0	132.7	134.7	137.4	141.5
GDP deflator, 2010=100	100.0	109.6	116.4	122.7	125.0	125.6	127.7	132.2
Exchange rate (ER), NC/EUR	103.04	101.95	113.13	113.14	117.31	124	126	128
ER, nominal, 2010=100	100.0	98.9	109.8	109.8	113.8	120.3	122.3	124.2
Real ER (CPI-based), 2010=100	100.0	108.8	103.0	109.4	108.0	103.5	102.4	102.3
Real ER (PPI-based), 2010=100	100.0	108.2	101.3	104.1	103.6	98.9	97.9	96.8
PPP, NC/EUR	46.68	49.66	51.14	55.03	56.89	56.6	56.7	57.8
Price level, EU28 = 100	45	49	45	49	48	46	45	45
Average monthly gross wages, EUR (ER)	460	517	508	537	524	490	500	510
Average monthly gross wages, EUR (PPP)	1,016	1,062	1,123	1,103	1,080	1,080	1,110	1,130
GDP per employed person, 2010=100	100.0	107.8	107.9	106.8	100.1	97.02	96.73	96.93
Unit labour costs, ER adj., 2010=100	100.0	104.2	102.1	109.1	113.6	110.3	112.1	114.5
Unit labour costs, PPP adj., Austria=100	35.9	37.3	35.5	37.1	37.8	35.9	36.3	36.7
Bosnia and Herzegovina								
Producer price index, 2010=100	100.0	105.5	105.8	104.0	103.4	104.4	106.5	108.7
Consumer price index, 2010=100	100.0	103.7	105.8	106.0	105.0	106.1	108.2	110.4
GDP deflator, 2010=100	100.0	102.5	103.4	103.1	104.0	104.9	106.9	109.1
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	100.0	100.6	99.9	98.7	97.2	98.1	98.6	99.1
Real ER (PPI-based), 2010=100	100.0	100.2	97.8	96.1	97.4	97.4	97.9	98.3
PPP, NC/EUR	0.9690	0.9620	0.9436	0.9537	0.9452	0.94	0.95	0.95
Price level, EU28 = 100	50	49	48	49	48	48	48	49
Average monthly gross wages, EUR (ER)	622	650	660	660	659	670	690	710
Average monthly gross wages, EUR (PPP)	1,256	1,321	1,367	1,354	1,364	1,390	1,420	1,460
GDP per employed person, 2010=100	100.0	104.2	103.5	105.0	107.4	104.41	103.08	101.09
Unit labour costs, ER adj., 2010=100	100.0	100.2	102.4	101.1	98.7	103.1	107.6	113.0
Unit labour costs, PPP adj., Austria=100	42.9	42.9	42.4	41.0	39.2	40.3	41.6	43.3

(Table 31 ctd.)

(Table 31 ctd.)

	2010	2011	2012	2013	2014	2015	2016 Forecast	2017
Kosovo								
Producer price index, 2010=100	100.0	104.5	106.5	109.2	111.0	112.1	114.4	116.6
Consumer price index, 2010=100	100.0	107.3	110.0	112.0	112.4	112.4	113.5	115.8
GDP deflator, 2010=100	100.0	104.8	107.1	109.0	111.2	110.8	112.7	115.5
Real ER (CPI-based), 2010=100	100.0	104.1	103.9	104.2	104.1	104.0	103.5	104.0
Real ER (PPI-based), 2010=100	100.0	99.2	98.4	100.9	104.5	104.5	105.1	105.6
PPP, NC/EUR	0.4170	0.4330	0.4310	0.4360	0.4330	0.43	0.43	0.43
Price level, EU28 = 100	42	43	43	44	43	43	43	43
Average monthly gross wages, EUR (ER)	286	348	354	356	416	460	460	480
Average monthly gross wages, EUR (PPP)	686	804	821	817	961	1,080	1,070	1,110
GDP per employed person, 2010=100 [1)]	100.0	106.5	101.4	93.9	99.1	101.44	102.09	102.74
Unit labour costs, ER adj., 2010=100	100.0	114.2	122.0	132.6	146.8	158.6	157.6	163.4
Unit labour costs, PPP adj., Austria=100	16.6	18.9	19.6	20.8	22.6	24.0	23.5	24.2
Belarus								
Producer price index, 2010=100	100.0	171.4	301.7	342.7	386.6	463.9	556.6	656.8
Consumer price index, 2010=100	100.0	153.2	243.9	288.5	340.8	402.1	482.5	569.4
GDP deflator, 2010=100	100.0	171.3	300.5	364.2	429.9	507.3	608.7	718.3
Exchange rate (ER), NC/EUR	4,007	8,051	10,778	11,834	13,220	18,000	22,000	24,000
ER, nominal, 2010=100	100.0	200.9	269.0	295.4	330.0	449.3	549.1	599.0
Real ER (CPI-based), 2010=100	100.0	74.0	85.7	90.9	95.6	82.8	80.1	85.3
Real ER (PPI-based), 2010=100	100.0	81.0	103.6	107.3	110.3	96.3	93.1	99.2
PPP, NC/EUR	1476	2504	4283	5145	5985	6992.7	8266.9	9610.8
Price level, EU28 = 100	37	31	40	43	45	39	38	40
Average monthly gross wages, EUR (ER)	304	236	341	428	458	390	380	420
Average monthly gross wages, EUR (PPP)	825	759	858	984	1,011	1,000	1,020	1,040
GDP per employed person, 2010=100	100.0	105.8	109.4	111.3	113.8	111.44	111.94	114.02
Unit labour costs, ER adj., 2010=100	100.0	73.4	102.6	126.5	132.4	114.9	112.3	120.3
Unit labour costs, PPP adj., Austria=100	27.4	20.1	27.2	32.8	33.7	28.8	27.6	29.7
Kazakhstan								
Producer price index, 2010=100	100.0	127.2	131.7	131.3	143.7	129.4	135.8	139.9
Consumer price index, 2010=100	100.0	108.3	113.9	120.5	128.6	138.3	149.3	156.8
GDP deflator, 2010=100	100.0	117.8	123.6	135.6	143.7	150.8	161.3	168.5
Exchange rate (ER), NC/EUR	195.7	204.1	191.7	202.1	238.1	236	305	310
ER, nominal, 2010=100	100.0	104.3	98.0	103.3	121.7	120.6	155.9	158.4
Real ER (CPI-based), 2010=100	100.0	100.7	109.9	108.7	97.9	106.0	87.3	88.8
Real ER (PPI-based), 2010=100	100.0	115.8	124.2	117.5	111.2	100.0	80.0	79.9
PPP, NC/EUR	98.3	106.3	108.7	118.2	123.5	128.3	135.2	139.1
Price level, EU28 = 100	50	52	57	59	52	54	44	45
Average monthly gross wages, EUR (ER)	397	441	528	540	506	560	490	520
Average monthly gross wages, EUR (PPP)	790	847	932	923	976	1,030	1,100	1,160
GDP per employed person, 2010=100	100.0	104.9	107.4	112.9	118.7	122.40	124.27	127.42
Unit labour costs, ER adj., 2010=100	100.0	106.0	124.1	120.6	107.4	115.3	98.7	103.5
Unit labour costs, PPP adj., Austria=100	31.0	32.8	37.2	35.3	30.9	32.6	27.8	28.5
Russia								
Producer price index, 2010=100	100.0	117.3	125.3	129.5	137.4	153.9	164.7	172.9
Consumer price index, 2010=100	100.0	108.5	114.1	121.8	131.3	151.0	163.0	172.8
GDP deflator, 2010=100	100.0	115.9	124.5	130.8	140.2	159.1	171.6	179.2
Exchange rate (ER), NC/EUR	40.27	40.87	39.94	42.27	50.46	70	75	75
ER, nominal, 2010=100	100.0	101.5	99.2	105.0	125.3	173.8	186.2	186.2
Real ER (CPI-based), 2010=100	100.0	103.7	108.7	108.0	97.0	80.3	79.8	83.3
Real ER (PPI-based), 2010=100	100.0	109.8	116.7	114.1	103.3	82.6	81.2	84.0
PPP, NC/EUR	20.72	22.99	23.73	24.40	25.24	28.3	30.1	31.0
Price level, EU28 = 100	51	56	59	58	50	40	40	41
Average monthly gross wages, EUR (ER)	520	572	667	705	644	500	520	560
Average monthly gross wages, EUR (PPP)	1,011	1,016	1,122	1,221	1,287	1,230	1,280	1,360
GDP per employed person, 2010=100	100.0	102.9	105.4	107.0	107.5	104.31	104.61	105.35
Unit labour costs, ER adj., 2010=100	100.0	106.8	121.6	126.6	115.1	91.6	94.8	102.9
Unit labour costs, PPP adj., Austria=100	34.8	37.1	40.9	41.7	37.2	29.2	30.0	31.8

1) wiiw estimate for employed persons in 2010 (no survey done).

(Table 31 ctd.)

(Table 31 ctd.)

	2010	2011	2012	2013	2014	2015	2016 Forecast	2017
Ukraine								
Producer price index, 2010=100	100.0	119.0	123.4	123.3	144.4	202.1	232.4	246.4
Consumer price index, 2010=100	100.0	108.0	108.6	108.3	121.4	180.9	211.7	228.6
GDP deflator, 2010=100	100.0	114.2	123.3	127.2	146.0	200.0	233.7	252.3
Exchange rate (ER), NC/EUR	10.53	11.09	10.27	10.61	15.72	25.0	31.0	35.0
ER, nominal, 2010=100	100.0	105.3	97.5	100.8	149.2	237.4	294.3	332.3
Real ER (CPI-based), 2010=100	100.0	99.5	105.3	100.1	75.4	70.5	65.5	61.8
Real ER (PPI-based), 2010=100	100.0	107.3	116.9	113.1	91.1	79.4	72.5	67.1
PPP, NC/EUR	4.323	4.546	4.786	4.895	5.535	7.51	8.64	9.20
Price level, EU28 = 100	41	41	47	46	35	30	28	26
Average monthly gross wages, EUR (ER)	213	237	295	308	221	170	160	150
Average monthly gross wages, EUR (PPP)	518	579	632	667	629	570	570	590
GDP per employed person, 2010=100	100.0	105.1	105.1	104.9	107.4	105.98	107.43	109.23
Unit labour costs, ER adj., 2010=100	100.0	106.2	131.8	137.9	97.0	76.3	69.2	66.4
Unit labour costs, PPP adj., Austria=100	35.6	37.7	45.3	46.4	32.0	24.5	22.4	20.5
Austria								
Producer price index, 2010=100	100.0	104.0	104.9	104.0	102.9	104.3	106.0	107.5
Consumer price index, 2010=100	100.0	103.2	105.8	107.9	109.6	110.9	112.8	114.6
GDP deflator, 2010=100	100.0	101.9	103.9	105.5	107.2	108.7	110.4	112.0
Real ER (CPI-based), 2010=100	100.0	100.1	100.0	100.5	101.5	102.6	102.8	102.9
Real ER (PPI-based), 2010=100	100.0	98.8	96.9	96.2	96.9	97.3	97.3	97.3
PPP, NC/EUR	1.102	1.107	1.102	1.118	1.105	1.110	1.110	1.110
Price level, EU28 = 100	110	111	110	112	111	111	111	111
Average monthly gross wages, EUR	3,107	3,178	3,278	3,346	3,418	3,470	3,530	3,580
Average monthly gross wages, EUR (PPP)	2,818	2,871	2,974	2,994	3,093	3,127	3,179	3,225
GDP per employed person, 2010=100	100.0	102.0	101.9	101.8	101.9	101.77	102.32	103.00
Unit labour costs, ER adj., 2010=100	100.0	100.3	103.6	105.8	107.9	109.7	111.0	111.9
Unit labour costs, PPP 2010 adjusted	0.56	0.56	0.58	0.59	0.61	0.62	0.62	0.63

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

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

Table 32 / Indicators of macro-competitiveness, 2010-2017, annual changes in %

	2010	2011	2012	2013	2014	2015	2016	2017	2010-14
							Forecast		average
Bulgaria									
GDP deflator	1.2	6.9	1.6	-0.7	0.4	0.4	1.3	1.6	1.8
Real ER (CPI-based)	0.9	0.3	-0.3	-1.1	-2.1	4.9	-0.5	0.0	-0.5
Real ER (PPI-based)	5.3	3.7	1.5	-1.4	0.6	-1.0	-0.5	0.5	1.9
Average gross wages, real (PPI based)	-1.9	-3.1	2.1	7.6	8.1	7.5	3.5	2.3	2.5
Average gross wages, real (CPI based)	3.3	2.3	4.1	5.6	8.5	2.4	3.5	2.8	4.8
Average gross wages, EUR (ER)	6.4	5.8	6.6	6.0	6.8	8.7	4.3	4.2	6.3
Employed persons (LFS)	-6.2	-3.4	-1.1	0.0	1.6	1.6	1.7	1.6	-1.8
GDP per empl. person, NC at 2010 ref. pr.	6.6	5.1	1.4	1.2	0.0	0.4	1.2	1.1	2.8
Unit labour costs, ER (EUR) adjusted	-0.2	0.6	5.2	4.8	6.8	7.1	3.3	3.1	3.4
Croatia									
GDP deflator	0.8	1.7	1.6	0.8	0.0	-0.3	0.5	1.0	1.0
Exchange rate (ER), EUR/NC	0.7	-2.0	-1.1	-0.7	-0.7	-0.3	-0.5	-0.6	-0.8
Real ER (CPI-based)	-0.2	-2.8	-0.4	0.1	-1.1	-0.7	-1.5	-1.1	-0.9
Real ER (PPI-based)	2.0	-0.4	1.4	-0.9	-1.5	-1.2	-1.0	-1.1	0.1
Average gross wages, real (PPI based)	-4.5	-5.1	-4.2	1.1	2.8	0.6	1.5	1.4	-2.0
Average gross wages, real (CPI based)	-1.5	-0.7	-2.3	-1.5	0.0	0.9	2.0	1.4	-1.2
Average gross wages, EUR (ER)	0.3	-0.5	-0.1	0.1	-0.6	0.7	1.9	1.9	-0.2
Employed persons (LFS)	-4.0	-3.2	-3.6	-2.7	2.7	2.2	1.9	1.8	-2.2
GDP per empl. person, NC at 2010 ref. pr.	2.4	3.0	1.5	1.7	-3.0	-1.5	-0.7	-0.3	1.1
Unit labour costs, ER (EUR) adjusted	-2.0	-3.4	-1.5	-1.6	2.5	1.8	2.6	2.0	-1.2
Czech Republic									
GDP deflator	-1.4	-0.2	1.4	1.4	2.5	0.5	1.6	1.8	0.7
Exchange rate (ER), EUR/NC	4.6	2.8	-2.2	-3.2	-5.7	0.1	0.9	0.9	-0.8
Real ER (CPI-based)	3.6	1.9	-1.4	-3.4	-5.8	0.5	0.9	1.1	-1.1
Real ER (PPI-based)	1.6	1.3	-2.6	-2.5	-3.0	0.1	0.7	0.9	-1.1
Average gross wages, real (PPI based)	2.2	-1.2	0.1	-0.8	1.3	2.5	2.8	2.8	0.3
Average gross wages, real (CPI based)	1.1	0.3	-1.0	-1.4	1.9	3.0	2.6	2.6	0.1
Average gross wages, EUR (ER)	6.9	5.4	0.2	-3.3	-3.5	3.2	5.2	5.9	1.0
Employed persons (LFS)	-1.0	0.4	0.4	1.0	0.8	0.9	0.2	0.2	0.3
GDP per empl. person, NC at 2010 ref. pr.	3.3	1.6	-1.3	-1.5	1.2	3.0	2.2	2.1	0.7
Unit labour costs, ER (EUR) adjusted	3.4	3.7	1.5	-1.9	-4.7	0.6	2.9	3.2	0.4
Estonia									
GDP deflator	1.5	5.3	2.7	4.0	2.0	-0.2	1.8	1.9	3.1
Real ER (CPI-based)	0.6	1.9	1.5	1.7	-0.1	-0.2	0.3	0.6	1.1
Real ER (PPI-based)	0.2	-1.0	-0.1	7.4	-0.9	-3.0	-1.5	-0.5	1.0
Average gross wages, real (PPI based)	-2.0	1.6	3.0	-0.3	8.9	7.6	8.5	6.8	2.2
Average gross wages, real (CPI based)	-1.6	0.8	1.4	3.6	5.4	5.6	6.6	5.6	1.9
Average gross wages, EUR (ER)	1.1	5.9	5.7	7.0	5.9	5.5	8.5	7.8	5.1
Employed persons (LFS)	-4.2	6.7	1.9	1.0	0.6	1.6	-0.8	-0.8	1.1
GDP per empl. person, NC at 2010 ref. pr.	6.9	0.8	3.2	0.5	2.3	0.5	3.2	3.5	2.7
Unit labour costs, ER (EUR) adjusted	-5.5	5.0	2.4	6.4	3.5	5.0	5.1	4.2	2.3
Hungary									
GDP deflator	2.3	2.2	3.5	3.1	3.2	1.2	2.3	3.1	2.9
Exchange rate (ER), EUR/NC	1.8	-1.4	-3.4	-2.6	-3.8	-2.0	0.0	0.0	-1.9
Real ER (CPI-based)	4.4	-0.6	-0.6	-2.4	-4.3	1.7	1.0	1.5	-0.7
Real ER (PPI-based)	2.7	-2.5	-2.2	-1.9	-2.4	-3.5	0.2	0.8	-1.3
Average gross wages, real (PPI based)	-2.5	1.0	0.5	2.8	3.4	3.9	2.3	1.7	1.0
Average gross wages, real (CPI based)	19.3	10.3	-1.5	-27.5	28.9	3.1	1.5	1.0	3.9
Average gross wages, EUR (ER)	3.1	3.8	1.1	0.8	-0.9	1.3	3.8	3.7	1.6
Employed persons (LFS)	0.0	0.8	1.8	1.7	5.3	2.4	1.4	0.5	1.9
GDP per empl. person, NC at 2010 ref. pr.	0.8	0.9	-3.4	0.2	-1.6	0.5	0.7	1.5	-0.6
Unit labour costs, ER (EUR) adjusted	2.4	2.8	4.7	0.6	0.7	0.9	3.3	2.5	2.2
Latvia									
GDP deflator	-1.0	6.4	3.6	1.3	1.2	0.6	1.9	2.0	2.3
Real ER (CPI-based)	-3.6	1.4	0.9	-2.1	0.0	0.3	0.3	0.6	-0.7
Real ER (PPI-based)	-1.0	2.7	2.6	1.2	2.0	-1.5	-0.5	0.0	1.5
Average gross wages, real (PPI based)	-5.7	-3.2	-0.4	2.9	6.5	7.7	6.3	6.4	-0.1
Average gross wages, real (CPI based)	-2.3	0.0	1.3	4.6	6.2	6.8	5.4	5.7	1.9
Average gross wages, EUR (ER)	-3.9	4.6	5.0	3.9	6.7	7.2	7.3	8.0	3.2
Employed persons (LFS)	-4.3	3.1	1.6	2.1	-1.0	0.6	0.6	0.6	0.3
GDP per empl. person, NC at 2010 ref. pr.	0.5	3.0	2.4	0.9	3.9	1.6	2.5	2.4	2.1
Unit labour costs, ER (EUR) adjusted	-4.4	1.6	2.6	3.0	2.7	5.5	4.7	5.4	1.1

(Table 32 ctd.)

Table 32 (ctd.)

	2010	2011	2012	2013	2014	2015	2016	2017	2010-14
							Forecast		average
Lithuania									
GDP deflator	2.4	5.2	2.7	1.3	1.2	-0.6	2.1	2.5	2.5
Real ER (CPI-based)	-0.9	1.0	0.5	-0.3	-0.3	-0.7	0.5	1.0	0.0
Real ER (PPI-based)	7.1	8.2	2.1	-2.3	-3.2	-8.9	-1.5	-0.5	2.3
Average gross wages, real (PPI based)	-12.3	-9.7	-1.1	7.7	10.2	13.9	8.5	8.0	-1.5
Average gross wages, real (CPI based)	-4.4	-1.2	0.6	3.9	4.6	5.4	6.3	6.4	0.6
Average gross wages, EUR (ER)	-3.3	2.9	3.8	5.1	4.8	4.8	8.5	9.1	2.6
Employed persons (LFS)	-5.1	2.0	1.8	1.3	2.0	0.8	0.8	0.7	0.4
GDP per empl. person, NC at 2010 ref. pr.	7.1	3.9	2.0	2.2	1.0	1.0	2.0	2.7	3.2
Unit labour costs, ER (EUR) adjusted	-9.7	-1.0	1.8	2.8	3.8	3.8	6.3	6.2	-0.6
Poland									
GDP deflator	1.8	3.2	2.2	1.1	0.5	-0.5	1.2	2.0	1.8
Exchange rate (ER), EUR/NC	8.3	-3.1	-1.5	-0.3	0.3	-0.4	1.2	-1.2	0.7
Real ER (CPI-based)	9.0	-2.3	-0.6	-1.0	-0.2	-1.2	0.9	-0.9	0.9
Real ER (PPI-based)	7.1	-1.2	-1.1	-1.4	0.8	-2.8	-0.3	-1.2	0.8
Average gross wages, real (PPI based)	2.1	-1.6	0.4	4.9	4.8	4.4	4.6	4.3	2.1
Average gross wages, real (CPI based)	1.2	1.6	0.1	2.8	3.3	3.5	3.4	4.0	1.8
Average gross wages, EUR (ER)	12.6	2.3	2.1	3.3	3.7	2.9	5.4	5.1	4.8
Employed persons (LFS)	0.6	1.1	0.2	-0.1	1.9	0.9	0.6	0.0	0.7
GDP per empl. person, NC at 2010 ref. pr.	3.1	3.7	1.6	1.9	1.5	2.7	2.6	3.3	2.3
Unit labour costs, ER (EUR) adjusted	9.2	-1.3	0.6	1.4	2.2	-0.3	3.2	1.3	2.4
Romania									
GDP deflator	5.4	4.7	4.7	3.4	1.8	1.6	1.9	2.7	4.0
Exchange rate (ER), EUR/NC	0.7	-0.6	-4.9	0.9	-0.6	0.1	0.2	0.2	-0.9
Real ER (CPI-based)	4.6	2.0	-4.3	2.6	0.3	0.0	-1.3	0.7	1.0
Real ER (PPI-based)	2.0	1.0	-2.7	3.1	1.1	-2.9	-1.3	-0.3	0.9
Average gross wages, real (PPI based)	-1.2	-2.8	-1.0	2.8	7.8	9.6	4.0	6.6	1.1
Average gross wages, real (CPI based)	-2.8	-1.6	0.8	1.6	6.2	7.4	4.0	5.6	0.8
Average gross wages, EUR (ER)	3.8	3.4	-1.0	5.8	6.2	7.7	5.4	6.8	3.6
Employed persons (LFS)	0.0	-1.1	0.9	-0.7	0.8	0.3	0.5	0.0	0.0
GDP per empl. person, NC at 2010 ref. pr.	-0.8	2.2	-0.3	4.2	2.0	3.0	3.3	2.7	1.5
Unit labour costs, ER (EUR) adjusted	4.6	1.2	-0.7	1.5	4.9	4.4	0.9	5.1	2.3
Slovakia									
GDP deflator	0.5	1.6	1.3	0.5	-0.2	0.0	1.3	1.7	0.7
Real ER (CPI-based)	-1.4	1.0	1.1	0.0	-0.6	-0.1	-0.1	0.2	0.0
Real ER (PPI-based)	-2.6	-0.7	-0.9	-0.9	-1.8	-3.0	0.0	0.5	-1.4
Average gross wages, real (PPI based)	2.9	-2.2	0.5	3.4	7.9	4.7	1.9	1.3	2.5
Average gross wages, real (CPI based)	2.6	-1.8	-1.3	0.9	4.2	2.6	2.0	1.6	0.9
Average gross wages, EUR (ER)	3.3	2.2	2.4	2.4	4.1	2.6	3.4	3.3	2.9
Employed persons (LFS)	-2.1	1.5	0.6	0.0	1.5	2.0	0.8	0.8	0.3
GDP per empl. person, NC at 2010 ref. pr.	7.0	1.2	1.0	1.4	0.9	1.2	1.9	2.2	2.3
Unit labour costs, ER (EUR) adjusted	-3.5	1.0	1.4	0.9	3.2	1.3	1.5	1.1	0.6
Slovenia									
GDP deflator	-1.0	1.1	0.3	0.8	0.8	-0.3	0.4	1.0	0.4
Real ER (CPI-based)	0.0	-1.0	0.2	0.4	-0.2	-0.5	-1.0	-0.5	-0.1
Real ER (PPI-based)	-1.0	-0.7	-1.9	0.1	1.1	-0.5	-0.5	-0.5	-0.5
Average gross wages, real (PPI based)	1.9	-2.5	-0.8	-0.2	1.8	0.1	0.3	1.5	0.0
Average gross wages, real (CPI based)	1.8	-0.1	-2.7	-2.0	0.7	1.0	0.8	1.5	-0.5
Average gross wages, EUR (ER)	3.9	2.0	0.1	-0.2	1.1	0.6	1.3	2.5	1.4
Employed persons (LFS)	-1.5	-3.1	-1.3	-1.9	1.2	0.3	0.0	1.1	-1.3
GDP per empl. person, NC at 2010 ref. pr.	2.8	3.9	-1.4	0.9	1.8	2.3	2.2	1.0	1.6
Unit labour costs, ER (EUR) adjusted	1.1	-1.8	1.5	-1.0	-0.7	-1.7	-0.9	1.6	-0.2
Albania									
GDP deflator	4.5	2.4	1.0	0.2	1.0	2.1	2.2	2.8	1.8
Exchange rate (ER), EUR/NC	-4.2	-1.8	0.9	-0.9	0.2	0.0	-0.7	0.0	-1.2
Real ER (CPI-based)	-2.8	-1.5	0.3	-0.4	1.3	1.9	0.1	1.0	-0.6
Real ER (PPI-based)	-6.7	-4.3	-0.7	-1.2	1.6	-2.2	-2.6	-1.7	-2.3
Average gross wages, real (PPI based)	-3.9	2.3	1.8	-2.8	2.3	4.2	4.1	4.3	-0.1
Average gross wages, real (CPI based)	-7.0	1.5	0.8	-5.0	0.2	1.0	1.3	1.5	-2.0
Average gross wages, EUR (ER)	-7.6	3.0	3.8	-4.0	2.0	2.2	3.7	3.6	-0.7
Employed persons (LFS)	0.6	-0.6	-1.8	-10.2	1.3	3.9	1.1	0.9	-2.2
GDP per empl. person, NC at 2010 ref. pr.	3.1	3.1	3.2	12.6	0.8	-1.3	2.1	2.7	4.5
Unit labour costs, ER (EUR) adjusted	-10.4	-0.1	0.6	-14.8	1.2	4.3	0.9	1.4	-4.9

(Table 32 ctd.)

Table 32 (ctd.)

	2010	2011	2012	2013	2014	2015	2016	2017	2010-14
							Forecast		average
Macedonia									
GDP deflator	2.0	3.7	1.0	4.3	1.4	0.5	1.0	2.0	2.5
Exchange rate (ER), EUR/NC	-0.4	0.0	0.0	-0.1	-0.1	0.2	0.0	0.0	-0.1
Real ER (CPI-based)	-0.9	0.8	0.6	1.2	-0.9	0.6	-0.5	0.5	0.2
Real ER (PPI-based)	5.1	6.2	-1.4	-1.4	-0.2	-2.8	-0.5	0.5	1.6
Average gross wages, real (PPI based)	-7.1	-9.5	-1.2	2.6	3.0	4.6	0.9	1.0	-2.6
Average gross wages, real (CPI based)	-0.6	-2.5	-3.0	-1.6	1.3	2.0	0.9	1.0	-1.3
Average gross wages, EUR (ER)	0.6	1.2	0.2	1.1	0.9	2.3	1.9	3.8	0.8
Employed persons (LFS)	1.3	1.1	0.8	4.3	1.7	1.4	1.4	1.4	1.8
GDP per empl. person, NC at 2010 ref. pr.	2.1	1.2	-1.3	-1.6	2.1	2.0	1.2	1.7	0.5
Unit labour costs, ER (EUR) adjusted	-1.4	0.0	1.5	2.8	-1.2	0.7	0.6	1.4	0.3
Montenegro									
GDP deflator	1.6	0.9	-0.1	2.2	1.4	-0.2	3.0	2.5	1.2
Real ER (CPI-based)	-1.5	0.2	1.4	0.3	-1.0	0.9	0.5	0.5	-0.1
Real ER (PPI-based)	-3.8	-2.0	-0.9	1.7	1.9	-5.1	1.0	0.5	-0.6
Average gross wages, real (PPI based)	12.2	-2.1	-1.2	-1.7	-0.5	0.0	0.7	-0.3	1.2
Average gross wages, real (CPI based)	10.6	-2.3	-3.2	-1.9	0.1	0.0	0.7	0.7	0.5
Average gross wages, EUR (ER)	11.2	1.0	0.7	-0.1	-0.4	1.0	2.7	2.7	2.4
Employed persons (LFS)	-2.2	0.8	2.4	1.0	7.1	1.7	0.0	0.0	1.8
GDP per empl. person, NC at 2010 ref. pr.	4.8	2.4	-4.8	2.4	-5.3	0.4	2.6	3.2	-0.2
Unit labour costs, ER (EUR) adjusted	6.1	-1.4	5.8	-2.4	5.1	0.6	0.1	-0.5	2.6
Serbia									
GDP deflator	5.9	9.6	6.3	5.4	1.9	0.5	1.6	3.6	5.8
Exchange rate (ER), EUR/NC	-8.8	1.1	-9.9	0.0	-3.6	-5.4	-1.6	-1.6	-4.3
Real ER (CPI-based)	-4.6	8.8	-5.4	6.2	-1.3	-4.1	-1.1	-0.1	0.6
Real ER (PPI-based)	0.6	8.2	-6.4	2.8	-0.5	-4.5	-1.1	-1.1	0.8
Average gross wages, real (PPI based)	-5.5	-1.4	2.0	2.9	-0.1	-2.5	0.9	1.9	-0.5
Average gross wages, real (CPI based)	0.6	0.1	1.0	-1.9	-1.7	-2.0	0.9	0.9	-0.4
Average gross wages, EUR (ER)	-2.0	12.3	-1.9	5.7	-2.4	-6.4	2.0	2.0	2.2
Employed persons (LFS)	-8.4	-6.0	-1.1	3.7	4.8	3.3	1.2	1.2	-1.5
GDP per empl. person, NC at 2010 ref. pr.	9.8	7.8	0.1	-1.1	-6.3	-3.1	-0.3	0.2	1.9
Unit labour costs, ER (EUR) adjusted	-10.8	4.2	-1.9	6.8	4.1	-2.9	1.6	2.1	0.3
Bosnia and Herzegovina									
GDP deflator	1.5	2.5	0.9	-0.3	0.9	0.9	1.9	2.0	1.1
Real ER (CPI-based)	0.0	0.6	-0.6	-1.3	-1.4	0.9	0.5	0.5	-0.6
Real ER (PPI-based)	-2.0	0.2	-2.4	-1.7	1.3	0.0	0.5	0.5	-0.9
Average gross wages, real (PPI based)	0.1	-1.0	1.2	1.9	0.4	0.6	1.0	0.9	0.5
Average gross wages, real (CPI based)	-1.0	0.7	-0.5	-0.1	0.7	0.6	1.0	0.9	0.0
Average gross wages, EUR (ER)	1.1	4.5	1.5	0.1	-0.2	1.7	3.0	2.9	1.4
Employed persons (LFS)	-1.9	-3.2	-0.3	1.0	-1.2	4.7	3.5	4.5	-1.1
GDP per empl. person, NC at 2010 ref. pr.	2.7	4.2	-0.6	1.4	2.2	-2.7	-1.3	-1.9	2.0
Unit labour costs, ER (EUR) adjusted	-1.6	0.2	2.2	-1.3	-2.3	4.5	4.4	5.0	-0.6
Kosovo									
GDP deflator	4.7	4.8	2.2	1.8	2.1	-0.4	1.7	2.5	3.1
Real ER (CPI-based)	1.4	4.1	-0.1	0.3	-0.1	-0.1	-0.5	0.5	1.1
Real ER (PPI-based)	1.1	-0.8	-0.9	2.6	3.6	0.0	0.5	0.5	1.1
Average net wages, real (PPI based)	11.6	16.4	-0.2	-1.9	14.9	9.5	-2.0	2.3	7.9
Average net wages, real (CPI based)	12.3	13.4	-0.8	-1.2	16.4	10.6	-1.0	2.3	7.8
Average net wages, EUR (ER)	16.2	21.7	1.7	0.6	16.9	10.6	0.0	4.3	11.1
Employed persons (LFS) 2)	-2.0	-2.0	1.4	11.7	-4.4	2.0	3.0	2.9	0.8
GDP per empl. person, NC at 2010 ref. pr.	5.4	6.5	1.4	-7.4	5.5	2.4	0.6	0.6	2.1
Unit labour costs, ER (EUR) adjusted	10.2	14.2	0.3	8.6	10.7	8.0	-0.6	3.7	8.7
Belarus									
GDP deflator	11.1	71.3	75.5	21.2	18.0	18.0	20.0	18.0	36.7
Exchange rate (ER), EUR/NC	-0.6	-50.2	-25.3	-8.9	-10.5	-26.6	-18.2	-8.3	-21.3
Real ER (CPI-based)	5.0	-26.0	15.8	6.1	5.1	-13.4	-3.3	6.6	0.1
Real ER (PPI-based)	9.7	-19.0	27.9	3.6	2.8	-12.7	-3.3	6.6	3.9
Average gross wages, real (PPI based)	9.2	-8.9	9.9	21.2	6.0	-3.6	0.0	0.9	7.0
Average gross wages, real (CPI based)	15.0	1.9	21.5	16.4	1.3	-2.0	0.0	0.9	10.9
Average gross wages, EUR (ER)	23.3	-22.3	44.5	25.4	7.0	-14.8	-2.6	10.5	13.2
Employment registered	1.3	-0.3	-1.7	-0.7	-0.6	-1.8	-0.4	-0.4	-0.4
GDP per empl. person, NC at 2010 ref. pr.	6.3	5.8	3.4	1.7	2.2	-2.1	0.4	1.9	3.9
Unit labour costs, ER (EUR) adjusted	15.9	-26.6	39.7	23.3	4.7	-13.3	-2.3	7.1	9.0

2) wiiw estimate in 2010-2012 due to missing data in 2010 and break in time serie 2012.

(Table 32 ctd.)

Table 32 (ctd.)

	2010	2011	2012	2013	2014	2015	2016	2017	2010-14
							Forecast		average
Kazakhstan									
GDP deflator	19.6	17.8	4.9	9.7	6.0	5.0	6.9	4.5	11.4
Exchange rate (ER), EUR/NC	5.1	-4.1	6.5	-5.2	-15.1	0.9	-22.6	-1.6	-2.9
Real ER (CPI-based)	-4.9	4.3	9.1	-1.1	-9.9	8.3	-17.7	1.8	-0.7
Real ER (PPI-based)	10.3	0.7	7.2	-5.3	-5.4	-10.1	-20.0	-0.2	1.3
Average gross wages, real (PPI based)	-7.9	-8.8	8.7	8.1	0.8	21.9	7.0	6.1	-0.1
Average gross wages, real (CPI based)	7.6	7.1	6.9	1.9	3.4	2.0	4.0	4.0	5.4
Average gross wages, EUR (ER)	21.2	11.2	19.8	2.2	-6.3	10.7	-12.5	6.1	9.1
Employed persons (LFS)	2.7	1.1	1.0	0.7	-0.7	-1.5	1.0	0.9	1.0
GDP per empl. person, NC at 2010 ref. pr.	4.5	6.1	3.9	5.2	5.2	3.1	1.5	2.5	5.0
Unit labour costs, ER (EUR) adjusted	16.0	4.8	15.3	-2.8	-10.9	7.3	-14.4	4.8	3.9
Russia									
GDP deflator	14.2	15.9	7.4	5.0	7.2	13.4	7.9	4.4	9.9
Exchange rate (ER), EUR/NC	9.6	-1.5	2.3	-5.5	-16.2	-27.9	-6.7	0.0	-2.6
Real ER (CPI-based)	14.7	3.7	4.8	-0.6	-10.2	-17.2	-0.7	4.4	2.2
Real ER (PPI-based)	22.2	9.8	6.3	-2.2	-9.5	-20.1	-1.6	3.4	4.8
Average gross wages, real (PPI based)	-2.2	-4.9	6.7	8.2	2.8	-4.4	3.9	4.1	2.0
Average gross wages, real (CPI based)	5.2	2.8	8.4	4.8	1.2	-6.9	3.0	3.1	4.4
Average gross wages, EUR (ER)	23.2	9.9	16.6	5.7	-8.6	-22.4	4.0	7.7	8.8
Employed persons (LFS)	0.8	1.3	1.0	-0.2	0.2	-0.7	0.7	0.7	0.6
GDP per empl. person, NC at 2010 ref. pr.	3.7	2.9	2.4	1.6	0.5	-3.0	0.3	0.7	2.2
Unit labour costs, ER (EUR) adjusted	18.8	6.8	13.9	4.1	-9.0	-20.4	3.5	8.5	6.5
Ukraine									
GDP deflator	13.7	14.2	8.0	3.1	14.8	37.0	16.8	8.0	10.7
Exchange rate (ER), EUR/NC	3.2	-5.0	8.0	-3.2	-32.5	-37.1	-19.4	-11.4	-7.1
Real ER (CPI-based)	10.6	-0.5	5.8	-4.9	-24.7	-6.4	-7.0	-5.8	-3.6
Real ER (PPI-based)	21.1	7.3	8.9	-3.2	-19.5	-12.9	-8.6	-7.5	2.0
Average gross wages, real (PPI based)	-0.7	-1.2	10.8	8.0	-9.0	-11.7	-0.9	4.0	1.3
Average gross wages, real (CPI based)	9.7	8.9	14.3	8.2	-4.9	-17.1	-2.6	2.0	7.0
Average gross wages, EUR (ER)	23.8	11.7	24.1	4.4	-28.4	-23.2	-5.9	-6.3	5.2
Employed persons (LFS)	0.4	0.3	0.1	0.2	-6.4	-10.4	-1.2	0.0	-1.1
GDP per empl. person, NC at 2010 ref. pr.	3.7	5.1	0.0	-0.2	-0.5	-1.3	1.4	1.7	1.6
Unit labour costs, ER (EUR) adjusted	19.4	6.2	24.1	4.6	-28.1	-21.3	-9.3	-4.0	3.6
Austria									
GDP deflator	1.0	1.9	2.0	1.5	1.6	1.4	1.6	1.5	1.6
Real ER (CPI-based)	-0.3	0.1	-0.1	0.5	1.0	1.1	0.2	0.1	0.2
Real ER (PPI-based)	-0.3	-1.2	-1.9	-0.8	0.7	0.4	0.1	0.0	-0.7
Average gross wages, real (PPI based)	-1.6	-1.7	2.3	3.0	3.3	0.1	0.1	-0.1	1.0
Average gross wages, real (CPI based)	-0.7	-0.9	0.6	0.1	0.5	0.3	0.0	-0.2	-0.1
Average gross wages, EUR (ER)	1.1	2.3	3.1	2.1	2.2	1.5	1.7	1.4	2.2
Employed persons (LFS)	0.9	0.9	0.8	0.5	0.2	0.7	0.7	0.7	0.6
GDP per empl. person, NC at 2010 ref. pr.	1.0	2.0	-0.1	-0.1	0.2	-0.2	0.5	0.7	0.6
Unit labour costs, ER (EUR) adjusted	0.1	0.3	3.3	2.2	2.0	1.7	1.2	0.7	1.6

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

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

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