SEE-6

Economic Outlook

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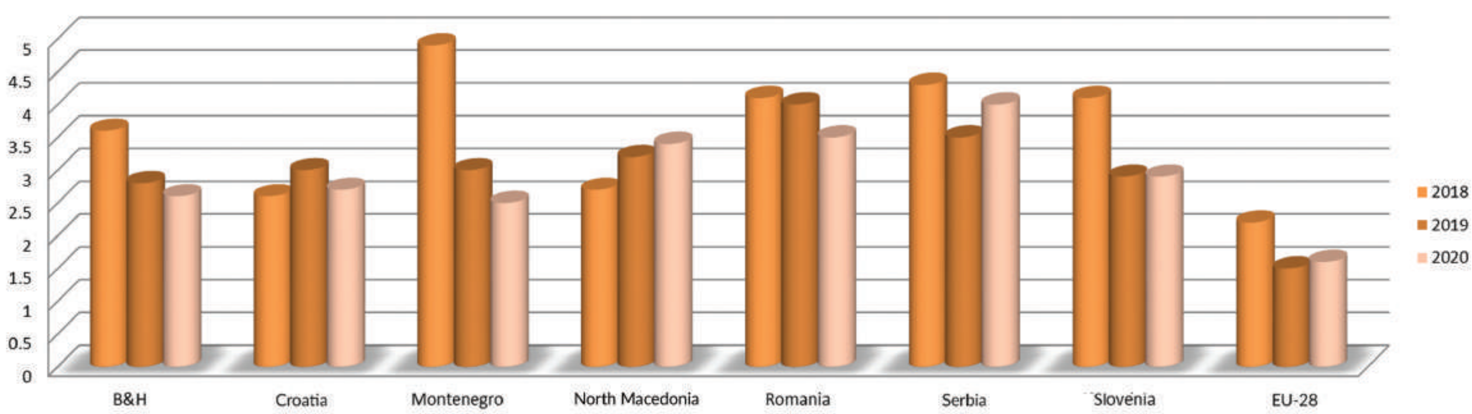
CONTENT

REAL GDP GROWTH FOR SELECTED SEE COUNTRIES AND EU-28



Source: IMF
Note: Real GDP growth (Annual percent change)

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BOSNIA AND HERZEGOVINA

Slowing down economic growth in conditions of political instability

On the road to the EU

Following the submission of additional questions from the European Commission's Questionnaire by the end of the first quarter of 2019, in May 2019 the European Commission adopted an Opinion on Bosnia and Herzegovina's application for membership in the European Union. However, after a general election was held in October 2018, the government was not formed yet. Different views on Euro-Atlantic integration, as well as demands for a change in the electoral law, are the main reasons why the BiH government was not formed one year after the election. As a result, the European path has been significantly slowed down, as no legislative bodies have been formed in BiH that have the legitimacy to work towards meeting the priorities of the European Commission's Opinion. In such circumstances, the European Council will certainly not consider granting BiH candidate status in the near future.

Economic growth continued in 2019, but at lower rates

In the first semester of 2019, economic growth in BiH slowed slightly. In contrast to the average growth of 3.6% in 2018, growth in the first and second quarters of 2019 was 2.8% and 2.6%, respectively. The slowdown in growth was due to an increase in the foreign trade deficit in the men-

tioned period. Namely, in the first semester of 2019, in the structure of GDP, imports increased by 6.3% and exports by 4.8% compared to the same period of the previous year. However, in the first semester of 2019, there was an increase in private consumption (2.8% y/y), government consumption (3% y/y) and especially investment (7% y/y).

Employment growth and fall in unemployment

In the last quarter of 2018 and the first two quarters of 2019, there was a constant increase in the number of employees. The number of employees in the first two quarters of 2019 is 2.3% higher than the number of employees in the same period in 2018. In almost all areas, the number of employees has increased. However, the most significant contribution to the growth of the number of employees was in real estate activities (9% y/y) and information and communication (6.4% y/y). Due to the increase in the number of employees, unemployment has been steadily declining in the mentioned period. In 2018, the lowest survey unemployment rate was registered in BiH and amounted to 18.4%. In addition, the registered unemployment rate continued to decline in 2019 and was 33% in the second quarter of 2019.

Low inflation and average gross wage growth

Inflation measured by the Consumer Price Index was 1.2% in 2018. In the first two quarters of 2019, there was a slight fall in the price level, so in the second quarter of 2019 inflation was 0.6%. The highest price increase in the first two quarters of 2019 was in the sections of alcoholic beverages and tobacco (4.2% y/y) and transportation (2.9% y/y). The increase in the prices of cigarettes and tobacco was most influenced by the increase in excise taxes on tobacco and cigarettes at the beginning of 2019. While the rise in the prices of crude oil and fuel determined the movement of prices in the transport section. The average gross wage continued to rise in the first two quarters of 2019 at rates of 4% and 4.4%, respectively and stood at around EUR 717 at the end of the second quarter.

Exports stagnated and current account deficit increased

In the first two quarters of 2019, exports of goods stagnated (-0.6% and 0.4% y/y in Q1 and Q2, respectively) relative to the same period in 2018. At the same time, imports of goods increased by 4.8% and 4.4% in Q1 and Q2, respectively. Within certain sections of imports under the harmonized system, imports of Pearls, precious stones and metals (73.6% y/y) and Arms and ammunition (58% y/y) increased the most in the mentioned period. Growth in imports, with roughly the same level of exports, led to an increase in the trade deficit but also to an increase in the current account deficit, which stood at EUR 2.3 billion at the end of the second quarter. In the first half of 2019, gross foreign direct investment stood at EUR 332 million, a 53% increase compared with the same period last year.

Budget surplus and reduction of domestic government debt

In 2019 the budget surplus trend continues. Public revenues in the first six months amounted to KM 6.2 billion, while at the same time, expenditures amounted to KM 5.4 billion. Therefore, the budget surplus in the first semester of 2019 was about KM 726 million. This positive trend in government finance has also contributed to the reduction of domestic government debt from EUR 1.7 billion in the first semester of 2018 to EUR 1.5 billion in the first semester of 2019.

Table BH1 Main economic indicators

	2017	2018				2019	
		Q1	Q2	Q3	Q4	Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	3.3	3.5	3.9	3.1	3.9	2.8	2.6
Real private consumption (% change, yoy)	3.2	1.3	1.8	2.7	4.2	2.8	3.2
Real government consumption (% change, yoy)	1.6	-0.2	-0.3	1.1	2.9	3.0	2.5
Real investment (% change, yoy)	12.5	15.3	-1.4	13.6	-4.8	4.3	9.6
Industrial output (% change, yoy)	3.1	1.1	-1.5	1.4	-1.1	0.3	-0.4
Unemployment rate (registered, % pa)	37.4	37.3	36.1	35.7	34.8	34.3	33.0
Nominal GDP (EUR million)	16,043	3,910	4,254	4,457	4,423	4,157	4,472
GDP per capita (EUR)	4,578	1,117	1,215	1,273	1,263	1,188	1,278
PRICES, WAGES, AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	1.7	1.8	1.9	0.9	1.1	1.6	N/A
Consumer prices (% change, yoy, pa)	1.3	0.8	1.4	0.9	1.7	1.0	0.6
Producer prices (% change, yoy, pa)	0.8	3.2	0.8	2.3	2.5	1.4	0.6
Average gross wage (% change, yoy, pa)	1.6	2.1	2.7	3.5	4.2	4.0	4.4
Exchange rate (BAM/EUR, pa)	1.96	1.96	1.96	1.96	1.96	1.96	1.96
Exchange rate (BAM/USD, pa)	1.73	1.59	1.64	1.68	1.71	1.72	1.74
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	5,640	1,422	1,554	1,535	1,559	1,413	1,560
Exports of goods (EUR, % change, yoy)	17.4	10.2	10.0	4.0	3.3	-0.6	0.4
Imports of goods (EUR million)	9,833	2,137	2,400	2,534	2,514	2,352	2,636
Imports of goods (EUR, % change, yoy)	12.5	9.0	4.4	6.6	2.2	4.8	4.4
Current account balance (EUR million)	-695	-207	-146	-104	-174	-258	-238
Current account balance (% of GDP)	-4.3	-5.3	-3.4	-2.3	-3.9	-6.2	-5.3
Gross foreign direct investment (EUR million)	398	144	72	124	59	129	203
Foreign exchange reserves (EUR million, eop)	5,386	5,553	5,663	5,898	5,930	5,853	6,133
Foreign debt (EUR million, eop)	4,006	4,107	4,270	4,240	4,186	N/A	N/A
GOVERNMENT FINANCE							
Revenues (BAM million)	11,779	2,882	3,075	3,250	3,259	3,014	3,187
Expense (BAM million)	10,627	2,462	2,723	2,754	3,417	2,646	2,829
Net = Gross operating balance	1,152	420	352	496	-158	368	358
Net acquisition of non-financial assets (BAM million)	122	31	66	91	238	26	72
Net lending/borrowing (BAM million)	817	389	285	405	-441	342	287
Domestic government debt (EUR million, eop)	3,655	874	862	745	735	760	768
Foreign government debt (EUR million, eop)	20,206	5,048	5,194	5,146	5,093	5,148	5,110
Total government debt (eop. % of GDP)	26	25	25	24.5	24.5	25.4	23.4
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	13.7	12.5	13.1	14.4	14.9	11.2	9.9
Broad money, M2 (% change, yoy, eop)	9.5	8.2	9.2	9.3	9.4	9.0	8.1
Total domestic credit (% change, yoy, eop)	7.1	5.9	6.5	6.3	5.8	5.7	5.5
DMBs credit to households (% change, yoy, eop)	6.7	6.4	6.7	6.9	7.3	7.5	7.4
DMBs credit to enterprises (% change, yoy, eop)	8.0	7.2	6.2	4.8	3.6	2.9	4.8
Money market interest rate (%, pa)	4.4	N/A	N/A	N/A	3.8	N/A	N/A
DMBs credit rate for enterprises short-term (%, pa)	5.4	4.1	3.8	3.6	4.4	4.1	4.2
DMBs credit rate for households short-term (%, pa)	6.1	5.3	4.8	4.9	5.4	5.6	4.6

Notes: * Data refer to consolidated general government. ** On the cash principle, cumulative from the beginning of the year.

Conventional abbreviations: pa - period average; eop - end of the period; yoy - year on year; EUR - Euro, US$ - US dollar; BAM - Bosnia-Herzegovina convertible mark; DMB – deposit money bank.

Sources: Agency for Statistics of Bosnia and Herzegovina, Bosnia and Herzegovina Directorate for Economic Planning, Bosnia and Herzegovina Indirect Taxation Authority, Central Bank of Bosnia and Herzegovina.

Policy assumptions and projections summary

A slight increase in economic growth, mainly through private consumption and investment

According to projections of the Directorate for Economic Planning, the GDP growth rate in 2019 is expected to be slightly lower than in the previous year (3.1% y/y). However, assuming a stable external environment, economic growth is expected to continue in Bosnia and Herzegovina at an average growth rate of 3.8% per annum in the period 2020-2022. During this period, domestic demand through private consumption and investment is expected to be the mainstay of economic growth. On the other hand, public consumption is expected to stagnate over the observed period, which will result in a decrease in its share in the structure of GDP or its contribution to the economic growth of BiH. At the same time, reform measures aimed at improving the business environment in the country should result in greater investment (domestic and foreign), which would strengthen the private sector, employment and, ultimately foreign trade in goods with the world.

Medium-term labor market forecasts are related to the expected economic growth in the region and the EU which should have positive implications for both employment and wages in BiH. Based on the above, the registered unemployment rate in BiH in the period 2019-2022 could be reduced from 33% to 28.8%. Over the same period, inflation is expected to increase slightly from 1.3% in 2019 to 1.7% in 2022. ■

Table BH2 Summary of projections

	2019	2020	2021	2022
Real GDP (% change)	**3.1**	**3.7**	**3.8**	**4.0**
Real private consumption (% change)	1.3	1.6	1.7	1.8
Real government consumption (% change)	N/A	N/A	N/A	N/A
Real investment (% change)	6.9	8.2	10.2	8.5
Exports of goods and services (constant prices, % change)	4.9	7.2	6.7	6.6
Imports of goods and services (constant prices, % change)	2.9	4.7	5.1	4.6
Current account balance (% of GDP)	-4.8	-4.6	-4.2	-4.6
Consumer prices (% change, pa)	1.3	1.4	1.5	1.7
Exchange rate, KM/EUR (pa)	1.96	1.96	1.96	1.96
Unemployment rate (registered, %, pa)	33.0	32.0	30.5	28.8
General government balance (ESA 2010 definition, % of GDP)	N/A	N/A	N/A	N/A
Total domestic credit (% change, eop)	4.5	4.8	5.0	5.5

Notes: Cut-off date for information used in the compilation of projections was April, 2019.
Conventional abbreviations: pa - period average, eop - end of period, EUR - euro.
Sources: B&H Directorate for Economic Planning, World Bank, IMF and author's projections.

CROATIA

Economic growth continued, but reflecting further moderation in several areas

Economic growth jumped unexpectedly in the first quarter of 2019, however dropped again considerably in the second

After considerable moderation in 2018, especially in the last quarter when it was only 2.3%, the GDP in Croatia reached the record level of 3.9% in the first quarter of 2019, the highest since the post-recession recovery. The economy has been continuously growing for 19 consecutive quarters and this represented one of the highest growth rates of the GDP for the first quarter of 2019 among the EU-member states. Such an optimistic growth rate motivated Croatian National Bank and European Commission to revise the growth forecast for 2019 from 2.6% to 3.1%. The main drivers of growth in the first quarter of 2019 were large increase in public investments, particularly coming from EU funds and further strengthening of household consumption, reflecting the continued growth of disposable income.

However, the second quarter of 2019, with a growth rate dropping to only 2.4%, is reflecting a more ordinary growth path of the Croatian economy

with several components further moderating as compared to the previous years. Indeed, such a result was disappointing as the expectations were boosted after the extraordinary good first quarter. The main sources of growth are again attributed to the increase in gross investment in fixed assets and domestic consumption, albeit at a much slower pace than in the previous quarter. The role of the tourism industry and exports as the source of growth decreased in this period.

As for the business sector, the last three quarters were marked by the attempts to resolve the bankruptcy facing the shipyard Group Uljanik (which consists of the shipyards Uljanik, Pula and 3. Maj, Rijeka). The government actively participated in finding solutions for the situation by inviting several potential strategic foreign investors including the largest shipbuilding company from China. The government hoped that they might be interested in the restructuring of the financially distressed shipyards Uljanik and 3. Maj by acquiring the majority ownership, however, with no avail so far. The long agony for the shipyards' workers of 3. Maj was finally resolved this September, as the Government issued a new state guarantee for the loans up to 150 million HRK (about 20 million EUR), which will enable the finalization of ships at the high level of completion and their delivery to the buyer. This enabled the de-blocking of the company's accounts to resume production. However, a suitable solution for the other shipyard Uljanik in Pula, which is in much deeper financial distress, has not been found yet and its agony is continuing. In the meantime, more than 1,000 employees have left the shipyard, making it very difficult for the company to restart the ship production again, once the solution is found.

Domestic consumption continued to be an important source of economic growth

Private consumption continued to grow strongly in the last three quarters. In the last quarter of 2018 it further strengthened by 3.9% and then peaked strongly in the first quarter of 2019 with a rate of 4.4%. However, it dropped back to 2.7% rate in the second quarter. As in previous quarters, the reasons behind the continuing growth of private consumption are higher disposable incomes of households due to further relaxation of income tax rates and increase of wages coupled with rising revenues from the tourism sector and remittances from abroad. Government consumption has also continued to rise strongly according to the Ministry of Finance, especially in the first quarter of 2019 with a growth of 3.1% and 3.9% in the second quarter. The government consumption increased due to the rise of expenditures for wages that increased for public sector workers by 3% starting in January 2019 and also increases of expenditures coming from public sectors such as health, pensions, and public administration.

The exports also continued to have an important role in overall economic growth in the first half of 2019, although its net impact on growth has been continuously deteriorating since 2017. Nevertheless, after very thin growth in the last quarter of 2018 (0.1%), the exports of goods picked up strongly in the first quarter of 2019 (8.9%), however, decreasing sharply again in the second quarter (0.9%). It is expected that the exports will continue to decrease further in 2019, as the foreign demand continues to weaken in the main EU trading partners such as Germany and Italy, which experience considerable slowing down of economic growth in 2019.

The exports of the services in particularly related to tourism are still high and contributing greatly to the GDP growth; however lower than in the peak 2017, as the earnings from tourism continued to moderate in 2019. Imports of services also continued to moderate in the first half of 2019, while the growth of imports of goods was on the other hand rather strong owing to higher domestic demand due to increased economic growth.

These developments are indeed reflected in further deterioration of the current account balance, especially in the first quarter of 2019 when its deficit was EUR 2.1 billion. Owing to the earnings from the tourism industry the current account deficit in the Q2 decreased significantly to EUR 512 million. However, strong domestic industry demand for imports will protract to weaken current account balance in 2019.

Industrial output failed to recover significantly due to structural problems

The continuance of the strong fall of industrial output (-3.3%) has marked the last quarter of 2018, while the first quarter of 2019 brought only its partial recovery (2.7%) despite the extraordinary economic growth achieved in this quarter. In the second quarter of 2019, it fell again by 0.8% reflecting unresolved structural problems within the shipbuilding and other industries (such as transport and communication industries) that are facing strong competitiveness challenges and consequently having negative spillover effects on the growth of the whole industry.

The fall of registered unemployment has continued also in the first half of the 2019. In the second quarter of 2019 unemployment rate reached only 7.3% (according to the Croatian Bureau of Statistics), which is another record low unemployment level in the post-crisis period. The data of Croatian National Bank, however, differ and show that the registered unemployment stagnated in the Q2 and stood at 8.5%. The fall of unemployment is, similarly to 2018, only partly a result of increased economic growth and new job openings. More determining reason of the continuing fall of registered unemployment is a large emigration of unemployed persons abroad, dominantly to the EU countries. Another reason for the unemployed exiting unemployment registry is also active labour market policies that resulted with a particular rise in self-employment.

Rising employment coupled with further fall of the unemployment

The employment levels, on the other hand, are also rising in terms of the number of employed in 2019 due to an increased demand for workers especially in the tourism industry and construction, but also in other sectors. However, the dynamics of this rise has noticeably moderated, particularly in the second quarter of 2019 when this rise was only 0.9% as compared to the last quarter of 2018 when it was around 3%, reflecting again the deeper structural problems of the economy which prevent more significant job creation.

Fiscal balance keeps further improving

The good results accomplished in consolidating and improving the public finances balance during 2018, also continued into the first half of the 2019. Significant improvement of fiscal health has led the European Commission to declare at the end of February 2019 that Croatia is ready to exit the Excessive Deficit Procedure as macroeconomic imbalances are not jeopardizing its economic growth any longer. Consequently, in March 2019 Standard and Poors returned Croatia its investment rating, for the first time since the economic crisis. The Fitch rating agency did the same in June. This has undoubtedly positively affected the rise of capital investments and consequently economic growth in 2019.

Following the third round of tax reform measures, total government revenues moderated in the first quarter of 2019. These developments were expected due to tax reductions that came into effect in January 2019 such as reductions of VAT from 25 to 13% for several unprocessed food products and baby diapers, as well as for all the medicines to the rate of 5%. The Ministry of Finance estimated the total fiscal impact of these changes at HRK 1.5 billion or 0.4% of GDP. This fall was nevertheless partly substituted by an increase of private consumption due to the rise of wages and strong tourist spending. Fortunately, the moderation of revenues was also accompanied by slower growth of expenditures in the same period, thus avoiding to have more profound negative effects on fiscal balance. According to the recent Ministry of Finance data at the end of May of the 2019, the central government ran a surplus of HRK 3.4bn, as compared to the same period of 2018.

The government has planned the modest budget deficit for the whole 2019 at the level of -0.3% of GDP (ESA 2010 methodology), mainly due to risks linked to potential invoke of remaining guarantees given to Uljanik shipyard. In the course of 2018, the invoked guarantees paid out from the state budget reached 0.7% of the GDP.

The level of total public debt slightly increased in the course of 2019 reaching 75.4% in the first quarter, mainly due to the new government bonds issue. In May 2019 the total government debt amounted HRK 286.8bn, which is up by HRK 2.1 billion, compared to the level at the end of 2018.

Consumer prices falling

The consumer price index (CPI) fell significantly in the first two quarters of 2019 as compared to 2018 (to 0.5% and 0.7% respectively) what was anticipated, thanks to tax measures that came into force from 1st January 2019. Namely, the VAT reductions from 25% to 13% on various unprocessed food products (meat, eggs, fresh fruits, and vegetables, etc.) subdued the rise of prices of these products that are a significant part of the consumer basket. Also, energy prices stayed stagnant for households, while the prices of oil in the first half of the year remained low due to favorable prices at the world market. In addition, the low consumer prices in the Eurozone also contributed to rather law inflation rate in Croatia in the first half of 2019.

Table HR1 Main economic indicators

	2017	2018				2019	
		Q1	Q2	Q3	Q4	Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	2.9	2.5	2.9	2.8	2.3	3.9	2.4
Real private consumption (% change, yoy)	3.6	3.8	3.7	3.9	3.9	4.4	2.7
Real government consumption (% change, yoy)	2.7	2.8	2.5	3.7	2.3	3.1	3.9
Real investment (% change, yoy)	3.8	3.5	3.1	3,9	6.1	11.5	8.2
Industrial output (% change, yoy)	1.9	0.3	0.4	-1.5	-3.3	2.7	-0.8
Unemployment rate (registered, % pa)	12.1	12.1	9.5	8.5	9.2	9.4	7.3
Nominal GDP (EUR million)	49,013	11,298	13,009	14,414	12,619	11,946	13,502
GDP per capita (EUR)	11,882	2,763	3,181	3,525	3,086	2,931	3,497
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	1.1	0.4	0.9	1.0	1.7	1.4	0.9
Consumer prices (% change, yoy, pa)	1.1	1.0	1.9	1.9	1.3	0.5	0.7
Producer prices (% change, yoy, pa)	2.1	1.3	2.4	3.7	2.0	1.5	1.5
Average gross wage (% change, yoy, pa)	3.9	4.8	5.9	5.1	3.7	3.9	3.2
Exchange rate (HRK/EUR, pa)	7.46	7.44	7.39	7.41	7.42	7.42	7.40
Exchange rate (HRK/USD, pa)	6.62	6.05	6.20	6.37	6.50	6.53	6.66
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	13,983	3,293	3,658	3,701	3,854	3,623	3,727
Exports of goods (EUR, % change, yoy)	6.4	-3.0	8.9	6.3	0.1	8.9	0.9
Imports of goods (EUR million)	22,078	5,746	6,111	6,035	6,155	6,177	6,583
Imports of goods (EUR, % change, yoy)	8.1	7.8	5.7	5.1	11.3	6.1	7.9
Current account balance (EUR million)	1,679	-1,824	-114	3,800	-874	-2,105	-512
Current account balance (% of GDP)	3.7	2.6	2.9	3.2	2.6	3.5	2.3
Gross foreign direct investment (EUR million)	461	533	496	90	-157	343	-28
Foreign exchange reserves (EUR million, eop)	15,706	16,480	16,694	16,637	17,438	18,321	19,149
Foreign debt (EUR million, eop)	40,247	40,594	40,380	39,037	38,836	39,432	40,254
GOVERNMENT FINANCE							
Revenues (HRK million)	161,907	38,027	44,065	45,802	46,443	41,055	47,949
Expense (HRK million)	155,436	38,621	38,747	39,124	45,512	41,690	41,514
Net = Gross operating balance	6,471	-594	5,318	6,678	931	-635	6,435
Net acquisition of non-financial assets (HRK million)	7,216	1,297	1, 609	2,631	4,452	1, 605	2,706
Net lending/borrowing (HRK million)	-745	-1,891	3,710	4,047	-3,521	-2,240	3,729
Domestic government debt (EUR million, eop)	22,995	23,182	23,759	23,961	24,312	25,000	25,315
Foreign government debt (EUR million, eop)	14,712	14,622	14,727	14,001	14,247	14,030	14,874
Total government debt (eop. % of GDP)	82.1	80.5	75.8	75.4	74.1	75.4	75.5
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	19.1	23.8	22.8	20.4	20.7	18.6	25.7
Broad money, M4 (% change, yoy, eop)	2.1	5.1	5.7	5.6	5.4	4.4	4.6
Total domestic credit (% change, yoy, eop)	-1.2	-4.7	-2.0	1.2	2.0	3.5	1.8
DMBs credit to households (% change, yoy, eop)	1.2	2.2	3.9	4.0	4.5	3.0	3.3
DMBs credit to enterprises (% change, yoy, eop)	-1.9	-1.4	-0.1	-0.2	0.4	-0.2	-2.3
Money market interest rate (%, pa)	0.4	0.3	0.3	0.3	0.3	0.3	0.3
DMBs credit rate for enterprises short-term (%, pa)	4.3	3.9	3.7	3.3	3.2	2.5	2.7
DMBs credit rate for households short-term (%, pa)	7.6	7.1	7.0	5.9	5.8	5.9	6.1

Conventional abbreviations: pa - period average, eop – end of period, yoy – year on year, HRK – Croatian kuna, EUR- euro, USD – U.S. dollar, DMB – deposit money bank.

Sources: Croatian Burreau of Statistics, Croatian National Bank and Ministry of Finance.

Policy assumptions and projections summary

The economic growth in 2019 accelerated but will continue to moderate in the next three years gradually

This section is prepared based on recent projections of Croatian National Bank (CNB), Ministry of Finance of Croatia and the European Commission. After an extraordinary growth rate achieved in the first quarter of 2019, most of the macroeconomic forecasts for 2019 were revised upwards. In the summer of 2019 both Croatian National Bank and European Commission revised their forecasts for the growth in 2019 to 3.1%, while the Ministry of Finance has kept a more conservative estimate of 2.5% growth rate. However, the disappointing results of the growth in the second quarter have led Croatian National Bank (CNB) to lower down the growth forecast in October to 3.0%, while the World Bank envisages a growth rate of 2.9% in 2019.

As for medium-term projections of GDP growth, the European Commission forecasts gradual slowing down to the rate of 2.7% in 2020 and further down to 2.6% in 2021. The Croatian National Bank forecasts also 2.7% growth for 2020, but a lower rate of 2.5% for 2021 due to decreasing growth rates of Croatia's main export markets in the EU in this period. The World Bank recently upgraded its forecast for 2020 growth to 2.7%, while in 2021 it foresees slower growth of 2.4%.

Table HR2 Summary of projections

	2019	2020	2021	2022
Real GDP (% change)	**3.0**	**2.7**	**2.5**	**2.3**
Real private consumption (% change)	4.2	3.7	2.9	2.7
Real government consumption (% change)	2.7	2.4	1.9	1.0
Real investment (% change)	8.0	6.5	4.3	4.7
Exports of goods and services (constant prices, % change)	2.7	2.8	3.3	3.4
Imports of goods and services (constant prices, % change)	5.8	5.3	5.0	5.0
Current account balance (% of GDP)	1.3	0.4	0.9	0.8
Consumer prices (% change, pa)	0.7	1.1	1.5	1.6
Exchange rate, national currency/EUR (pa)	7.42	7.45	7.45	7.45
Unemployment rate (registered, %, pa)	8.6	7.8	7.0	6.4
General government balance (ESA 2010 definition, % of GDP)	-0.3	0.2	0.4	0.4
Total domestic credit (% change, eop)	3.9	2.0	1.9	1.8

Source: Croatian National Bank, Ministry of Finance, World Bank and European Commission.

It is anticipated that the growth of private consumption in 2019 will be even higher (4.2%) than in 2018, reflecting primarily the continued real growth of the disposable income of households due to rising wages and employment levels, rise of remittances from abroad slowdown of the inflation of consumer prices, low interest rates favourable for borrowing and positive effects of the new round of the tax reform. In addition, the recent pressures of the Trade Unions which already resulted in an increase of wages for workers in the health sector in September (with education and science following the suit) will further contribute to increasing of disposable income in 2019 and the consequent increase of private consumption. The new increase of wages over 6% for all the public sector workers in 2020 has already been announced by the government. The further growth of private consumption is expected to likely slowdown in 2020-2022 period (from 3.7 to 2.7%) as the mentioned factors cease their impact on total private consumption in the mid-term period.

The significant growth of investments will be pronounced in 2019 (8%) owing to the large infrastructure projects that are being financed by the EU funds such as Pelješac Bridge and several other projects in water, railroads and road construction sectors. After private consumption, they will be the second-largest contributor to the growth in 2019. The role of EU capital funds will also increase considerably in 2020 i.e. by the end of the current EU financial perspective, thus contributing considerably to the growth of public investments component. In general, in 2019 the continuation of favorable financing conditions marked with low-interest rates and recent upgrading of Croatia's credit rating will positively impact the growth of the total investment activity, especially the private investments in the years ahead.

The moderation of growth of tourism sector earnings will be continuing also by the end of 2019, although tourism will remain an important contributor to economic growth. According to Croatian National Bank, tourism revenues are expected to slow down its growth from 6.6% in 2018 to 4.0% in 2019, owing to significantly increased competition in the main competitive tourist markets, as well as slowing down of the growth in the countries from where the majority of tourists come (Germany, Italy).

In 2019 the foreign trade deficit, despite the extraordinary results in the first quarter, will continue to deepen, owing to slow down in the growth of exports of goods and services (2.7%) and much more accelerated the growth of imports (5.8%). Such developments are reflecting the lowering of demand in the traditional export markets of Italy and Germany, in particular when it comes to exports of goods. At the same time, the growth in exports of services, in particular coming from tourism, is slowing down thus being less successful than in the previous years to alleviate the deficit. On the other hand, import rates are growing twice as much, owing to an increased domestic demand coming from private consumption rise as well as the increase of investments. As for the years 2021 and 2022, it is expected that the growth of exports will pick up (to 3.3 and 34% respectively) while the growth of imports will lower down (to around 5% in both years), what would positively affect the current account balance in these years, as projected by the Ministry of Finance.

The public finances health will continue to be one of the main government priorities. In 2019 it is projected to run a slight deficit of -0.3% mainly due to the threat of activation of remaining state guarantees given to the shipyards within the Group Uljanik. The budget balance is projected to return to a 0.2% surplus in 2020, while a continuation of a positive balance at the level of 0.4% of GDP is envisaged in both 2021 and 2022, according to the Ministry of Finance. The World Bank, however, foresees that a positive fiscal balance of 0.2% will also be achieved already in 2019. The total public debt share in the GDP will also continue to decrease in 2019-2022. In June 2019 the Ministry of Finance presented the Public Debt Management Strategy which projects the further fall of public debt to GDP ratio from 71.6% in 2019 to 68.5% in 2020 and 65.4% in 2021.

As the solid economic growth continues for the fifth year in a row, it is anticipated that the situation at the labour market will continue to be marked with falling rates of registered unemployment and the rise of employment levels. The unemployment rate is projected to further fall from anticipated 8.6% in 2019 to 6.4% in 2022. ■

MONTENEGRO

Continued high growth rates

Recent economic developments

According to official MONSTAT data, the real GDP growth rate of Montenegro in 2018 was 5.1%, while in the first and second quarter of 2019, real growth rates were 3.0% and 3.2%, respectively.

The positive economic trends, which contributed to significant real GDP growth of 5.1% in the previous year, continued their positive trend in the first half of 2019.

In the first six months of 2019, industrial production fell by 12.2% compared to the same period in 2018. The decline in production was recorded in manufacturing by 3.6% and electricity, gas, and steam supply by 25.4%, while the mining and quarrying sector recorded a 13.5% increase in production.

At the beginning of the first quarter of 2019, the Government adopted the Economic Reform Program (ERP) of Montenegro for the period 2019-2021, as the most important document in the economic dialogue with the European Union.

The Government has approved the signing of a contract between the European Investment Fund and the Investment and Development Fund for the issuance of a guarantee of EUR 70 million, which created the preconditions for the formation of a guarantee fund in Montenegro.

Credit rating agency S&P confirmed the B+/B rating for Montenegro in a new report, while maintaining the outlook – *stable*.

The Central Bank Council (CBCG) issued decisions on the revocation of the license to operate to Invest Bank Montenegro (IBM) and the opening of its bankruptcy proceedings. The Government of Montenegro has based on the activation of guarantees, disbursed EUR 2.25 million in arrears to the European Investment Bank (EIB), in the name of IBM.

The Government has adopted the Information on Activation of a State Guarantee issued in favor of the EIB for the purpose of a loan arrangement between the EIB and Atlas Bank, which implies the Government's acceptance of the EIB's request for payment of the guarantee and the need to settle the guaranteed amount of EUR 7.18 million, and the subsequently calculated interest for the period from March 7 to the date of payment.

The Societe Generale Group has signed an agreement on the sale of shares of the Montenegrin subsidiary to the Montenegrin Commercial Bank (CKB), that is, the OTP Group, subject to the approval of the competent banking, antitrust and market regulators.

Political environment

Montenegro remains the *frontrunner* in the process of European integration in the region. When it comes to Chapter 8 - Competition, the only unopened chapter after seven years of negotiations, Montenegro has done what it was asked to do and is waiting for the decision of EU Member States.

Given the recent decisions of European Council, regarding the Western Balkans countries, our Chief Negotiator Aleksandar Drljević said that "the Western Balkans should not be on the sidelines of Europe, and implementing fundamental reforms and fostering good neighborly relations are a prerequisite without which the necessary development and improvement of the standard of citizens cannot be achieved." He emphasized Montenegro's determined commitment to EU membership, regardless of what is happening on the European continent, which is confirmed by its commitment to reform and recognized success in the negotiation process.

Labor market developments

The number of employed persons in the first six months of 2019, averaged to 201,131 and was 8.9% higher than in the same period last year. Eighteen of the nineteen sectors recorded an increase in the number of employees, with the highest growth recorded in the sectors of professional, scientific and technical activities, construction and accommodation services. Only the electricity, steam, and air conditioning sectors saw a decline in the number of employees.

The number of unemployed persons in the first half of 2019 averaged to 37,697, or 17.6% less than in the same period last year. According to the Employment Agency, the unemployment rate was 15.21% in June, down 2.62 p.p. from the unemployment rate in December 2018.

The average gross earnings in Montenegro in the first half of 2019 amounted to €770, while the average earnings without taxes and contributions amounted to €513, which represents an increase of 0.7% and 0.4%, respectively, compared to the first half of 2018. The highest salaries excluding taxes and contributions were recorded in the financial and insurance sectors (€1,002) and electricity supply (€868), while the lowest earnings are still recorded in the administrative and support service sector (€348) and in the trade sector - wholesale and retail (€376).

In terms of net salary (€516), and in relation to other countries of the former Yugoslavia, Montenegro is in third place, just behind Slovenia (€1,108) and Croatia (€875). Bosnia and Herzegovina (€465), Serbia (€455) and Macedonia (€409) follow.

Fiscal policy

Total budget revenues in the first half of 2019 were €1.11 billion, or 23% of the estimated GDP. Total budget expenditures amounted to €887.3 million, or 18.5% of the estimated GDP.

The budget deficit in the period January-June 2019 amounted to €63.3 million or 1.3% of GDP. On a yearly basis, the deficit was reduced by €28.5 million, thanks to the increase in almost all budget revenues. If we exclude capital budget expenditures, which mostly relate to highway construction costs, a current budget surplus of €18.6 million would be recorded.

When it comes to the structure of budgetary spending, social security transfers (30.6%) and gross earnings (26.7%) account for the largest share. Other uses account for 42.7% of budget expenditures. Debt repayment amounted to €317.8 million and recorded a decrease of €192 million annually.

According to the Ministry of Finance, total government debt (without deposits) the end of June 2019. Amounted to €3,133.7 million, or 65.2% of GDP. External debt was €2,621.7 million or 54.6% of GDP, while domestic debt was €511.95 million or 10.66% of GDP. Net government debt at the end of June 2019 amounted to €2,949.7 million or 61.4% of GDP. The currency structure of government debt is favorable. Total domestic debt is denominated in euros, while the external debt is 79.5% in euros, 19.3% in dollars, and 1.2% in other currencies. The majority of sovereign debt is serviced at fixed interest rates (74.9%), so that the interest rate structure of sovereign debt can be assessed as favorable.

The total value of the issued Treasury bills during the first half of 2019 amounted to €77 million, i.e. growth of 3.3% year-on-year (yoy), while Treasury bills worth €72 million were sold, down 47.3% compared to the same period last year, which is also the total debt of the government on the basis of sold treasury bills at the end of June 2019.

Government guarantees at the end of June 2019 amounted to €280 million or 5.8% of estimated GDP. If we include the amount of guarantees in the national debt, it accounts for 71.1% of GDP.

Monetary policy

The banking sector is characterized by security and stability, with profitable operations, high liquidity and solvency.

The first half of 2019 was marked by the introduction of bankruptcy proceedings at two banks in the system.

Regarding monetary developments, despite the problems that arose in the two smaller non-systemic banks, the trend of recovery of bank lending activity, high liquidity and good solvency of the rest of the banking system continued.

The total capital of banks at the end of June 2019 amounted to €571.4 million, an increase of 11.4% yoy.

Total bank loans amounted to €2,950.3 million at the end of the period, 0.7% more than at the end of 2018. The largest portion of total loans at the end of the second quarter was approved to residents (87.8%), of which 43,9% to citizens, 36% to the non-financial sector, 6.7% to the general government, 0.9% to the financial sector, while only a small part of 0.3% to non-governmental and other non-profit institutions.

Observed by purpose, most of the banks' loans were cash loans (25.1%), liquidity loans (18.2%), housing loans (13.4%), refinancing of liabilities to other banks (5.9%), loans for acquisition of fixed assets (5.7%) and overdraft loans (4.4%).

Non-performing loans (excluding interest and accruals) at the end of June 2019 amounted to €141.4 million and accounted for 4.8% of total loans, which means that their share decreased by 2.2 percentage points (pp) on the annual level.

Thirteen banks duly settled their current liabilities in the first quarter of 2019. However, one bank has had unfavorable liquidity ratios since the last two decades of September 2018, below the statutory minimum.

The average weighted nominal interest rate on total bank loans was 5.61% in June 2019. It decreased by 0.25 p.p. on an annual basis.

The average weighted effective active interest rate on total loans continued its declining trend (it was 9.57% in September 2014), reaching 6.20% in June 2019. Compared to December 2018, this interest rate decreased by 0.16 p.p., while compared to June 2018, it decreased by 0.27 p.p.

Prices

Inflation in Montenegro, measured by Consumer Price Index (CPI), in June 2019 compared to the same month last year, was negative and amounted to -0.1%. Consumer prices in June 2019 compared to December 2018 increased by 0.3%. In this period, the highest growth was recorded in the hotels and restaurants category by 3.5% and in the food and non-alcoholic beverages category by 3.2%, while the largest fall in June compared to December 2018 was recorded in the clothing and footwear category (-8.9%).

Considering the monthly price movements, the highest growth of consumer prices was recorded in March (0.6%), while the monthly decrease was recorded in January (-0.3%) and June (-0.7%).

Foreign trade and capital flows

According to preliminary data, in the period January-June 2019, the *current account deficit* amounted to €644.3 million and is 4.2% higher than in the same period last year. The increase in the current account deficit is the result of the increase of deficit on the goods account and a decrease in the surplus in the primary income account.

Total exports of goods amounted to €215.5 million, representing an increase of 2.2%. The increase in exports of other finished goods, road vehicles, cork and wood, meat, etc. had the biggest impact on this growth. *Total imports* of goods amounted to €1.2 billion and were 2.9% higher than in the same period in 2018, as a result of increased imports of electricity, medical and pharmaceutical products, furniture and parts, as well as specialized machinery for some industries.

The goods account deficit, at the end of the second quarter of 2019, amounted to €991.3 million or 3% more than in the previous year due to the increase in imports of goods.

The services account recorded a surplus of €210.7 million in the observed period, which is 6.7% more than in the same period last year. Total services revenue amounted to €534.1 million or 12.5% more than in the first two quarters of 2018, while expenditures amounted to €323.4 million (an increase of 16.7%).

In the first two quarters of 2019, the net inflow of *foreign direct investment* (*FDI*) amounted to €227.3 million, which is *48%* more than in the same period of the previous year, as a result of an increase in inflows from equity investments and a decrease in the total outflow. Total FDI inflow amounted to €374.8 million (down by 7.2%).

The total outflow of FDI amounted to €147.4 million (41% less than in the same period in 2018). Outflow from resident's investments abroad amounted to €62.8 million, while withdrawals of funds from non-residents invested in our country amounted to €84.6 million.

The following tables are presented changes in main economic indicators for Montenegro for 2017, all four quarters of 2018, and the 1st and 2nd quarter of 2019.

Table MN1 Main economic indicators

	2017	2018				2019	
		Q1	Q2	Q3	Q4	Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	4.7	4.5	4.9	5.0	4.8	3.0	3.2
Real private consumption (% change, yoy)	3.49	1.21	5.55	6.17	7.36	6.77	5.07
Real government consumption (% change, yoy)	8.10	2.84	2.57	8.01	5.39	3.72	15.31
Real investment (% change, yoy)	13.99	32.68	24.51	14.47	1.03	1.98	-0.73
Industrial output (% change, yoy)	3.2	6.4	-1.1	-2.6	-1.6	-12.2	10.2
Unemployment rate (registered, % pa)	16.1	16.1	14.4	14.1	16.1	15.0	14.3
Nominal GDP (EUR million)	4,299.1	839.8	1,094.8	1,525.0	1,159.5	876.5	1,138.0
GDP per capita (EUR)	6,908	1,350	1,759	2,451	1,863	1,409	1,829
PRICES, WAGES, AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	3.8	-0.18	1.08	-0.48	-0.87	-1.16	-2.74
Consumer prices (% change, yoy, pa; *q/q-4*)	2.4	2.7	3.2	2.7	1.8	0.5	0.5
Producer prices (% change, yoy, pa)	0.4	-0.6	1.1	2.0	2.9	0.9	1.1
Average gross wage (% change, yoy, pa)	1.9	-0.1	0.04	0.3	0.1	0.6	0.5
Exchange rate (EUR, pa)**	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Exchange rate (EUR/USD, pa)**	N/A	N/A	N/A	N/A	N/A	N/A	N/A
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)*	382.4	99.5	111.4	104.8	120.4	101.1	114.4
Exports of goods (EUR, % change, yoy)	9.01	20.35	32.88	-8.38	18.52	1.66	2.71
Imports of goods (EUR million)	2,242.5	488.8	684.5	667.0	644.9	510.3	696.5
Imports of goods (EUR, % change, yoy)	11.65	9.90	15.36	11.42	6.47	4.40	1.75
Current account balance (EUR million)	-691.5	-303.59	-315.01	200.27	-374.47	-316.77	-327.55
Current account balance (% of GDP)	-16.08	-36.15	-28.77	13.13	-32.30	-36.14	-28.78
Gross foreign direct investment (EUR million)	659.23	138.38	265.24	184.58	269.92	181.76	193.0
Foreign exchange reserves (EUR million, eop)	188.9	101.4	61.0	104.0	92.8	71.6	85.7
Foreign debt (EUR million, eop)***	6,905.2	N/A	N/A	N/A	7,678.8	N/A	N/A
GOVERNMENT FINANCE******							
Revenues (EUR million)	1,566.3	327.5	436.4	509.2	473.1	371.3	452.7
Expense (EUR million)	1,803.1	397.6	458.1	449.2	600.7	442.6	445.7
Net = Gross operating balance	-236.9	-70.1	-21.7	60.0	-127.6	-71.3	7.0
Net acquisition of non-financial assets (EUR million)	439.9	78.1	286.9	-96.0	269.7	239.9	250
Net lending/borrowing (_EUR million)	-676.8	-148.2	-308.6	156.0	-397.3	-311.2	-243.0
Domestic government debt (EUR million, eop)	413.9	469.1	460.6	393.3	392.9	378.6	511.9
Foreign government debt (EUR million, eop)	2,213.9	2,196.1	2,644.3	2,700.5	2,760.0	2,800.7	2,621.7
Total government debt (eop. % of GDP)	61.1	57.1	66.5	66.3	67.6	66.2	65.2
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)**	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Broad money, M4 (% change, yoy, eop)**	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Total domestic credit (% change, yoy, eop)	11.78	9.70	12.80	10.74	8.47	10.18	0.63
DMBs credit to households (% change, yoy, eop)	10.50	10.11	10.43	10.67	11.94	12.44	8.94
DMBs credit to enterprises (% change, yoy, eop)	4.58	4.14	6.30	9.69	5.91	6.26	1.72

Money market interest rate (%, pa)**	N/A	N/A	N/A	N/A	N/A	N/A	N/A
DMBs credit rate for enterprises short-term (%, pa)	5.36	5.11	5.16	5.07	5.10	4.89	4.83
DMBs credit rate for households short-term (%, pa)	8.99	8.60	8.13	7.64	8.76	7.71	7.78

**Data not available for a small, eurized economy like Montenegro

***Foreign debt figures only available as the end of period (eop) ones for 2017 and 2018

Projections

Projections in table MN2 reflect the projections of Central Bank of Montenegro in the next two-year period:

Table MN2 Summary of projections

	2019	2020	2021	2022
Real GDP (% change)	**3.2**	**3.0**	**2.8**	**N/A**
Real private consumption (% change)	2.5	2.4	2.0	N/A
Real government consumption (% change)	1.0	2.0	1.5	N/A
Real investment (% change)	6.0	2.7	1.7	N/A
Exports of goods and services (constant prices, % change)	4.1	2.7	3.6	N/A
Imports of goods and services (constant prices, % change)	3.5	2.3	1.5	N/A
Current account balance (% of GDP)	-16.6	15.4	13.3	N/A
Consumer prices (% change, pa)	0.5	1.5	2	N/A
Exchange rate, national currency/EUR (pa)****	N/A	N/A	N/A	N/A
Unemployment rate (registered, %, pa)	14.5	14.1	13.8	N/A
General government balance (ESA 2010 definition, % of GDP)	N/A	N/A	N/A	N/A
Total domestic credit (% change, eop)	N/A	N/A	N/A	N/A

**** Data not available for a small, eurized economy like Montenegro

NORTH MACEDONIA

Recent economic developments

Oscillation of the GDP

A high amount of uncertainty for the process of the EU accession has led to oscillations in the North Macedonian economy represented through the Real GDP. However, these oscillations have been accompanied by the growth of the Real GDP of 37% from the period of 2018 Q3 to 2019 Q1 and then propelled to decline aching fall of 24%, thus reaching 3.1 (Q2- 2019).

Is there a gender inequality on the Macedonian labour market?

Gender inequality is one of the challenges of the Macedonian labour market. In the period 2000-2017, the activity rate of women remains significantly lower. In 2017 it was 44.3% (women) and 69.3% (men). The same situation is characteristic for the employment rate, which in 2017 was 34.6% and 53.6%, respectively. Although the employment rates of women are continuously increasing since 2012, the differences between the genders are deepening, because those of men are rising more intensively. Regarding unemployment by gender, women had higher unemployment rates, only in 2000, 2006 and 2009. At the same time, the unemployment rates of women with high level of education were and remained significantly higher. In 2017 the value of this indicator was 21.7% (women) and 15.4% (men).

The gender structure, according the economic status, show lower participation of women as employers and self-employed, while higher share as

unpaid family workers. This is a result of their noteworthy engagement in agriculture. Regarding the participation of men and women in part-time work, women are in more unfavorable situation since they have relatively smaller share, which also declines over time. Having in mind the role of women in taking care of the family, especially the children, their portion in part-time work is important.

In order to improve the situation in the Macedonian labor market concerning gender inequality, it is necessary to increase the competitiveness of the long-term unemployed women with informal forms of education, to develop atypical forms of employment contracts, and to support the transition from fixed to flexible working hours. Having in mind that the discrimination of women during the employment is still very emphasized, it is necessary, the Law to prevent and protect against discrimination, as well as so far determined measures to be consistently applied.

The efficiency of fiscal policy needs to improve

The government has been committed to fiscal consolidation, but however public and publicly guaranteed debt remains high. Also, fiscal risks related to pensions, municipal finances, and state-owned enterprises are also on the rise.

According the last officially data, up to August, 130,323 billion euros are collected, which is considered less than the plan for the 7,3 % percent point. Better realization can be perceived only at import taxes (almost 100 %). Planed expenditures for 2019 were expanded, but, for the past 8 months, they realized 139,351 billion euros' total expenditures, which is 60,97 from the annual plan (less than the plan for the 3.18%). Only transfers have gone up, then both current and capital spending, declined (less than the plan for the 8.54 %). Concerning the capital spending we need to emphasize that their realization is again below the expected (only 28,16 %). This resulted to the lower budget deficit than planned (1,3 %, in front of 2,5 %). The total public government debt has increased as amount above of 5,4 billion euros, but relatively, as % from GDP in Q2 of 2019 is declined for 0,2 %.

Due to this unfavorable situation, the government submits a supplementary budget that adjusted revenues and expenditures for 2 % and reallocated the unrealized planned expenditures, mostly capital expenditures for another public spending. So, this proposal ensures large public wage bills and untargeted social programs. This leads to consideration of inefficient fiscal policy, which needs to improve. Improving the efficiency and equity of public spending as well as strengthening revenue mobilization remain priorities for fiscal policy to reduce the high debt levels, create fiscal buffers to mitigate risks and improve the delivery of public services in North Macedonia.

Monetary and banking sector remains stable and solid

Future decrease of the CB bills rate to 2.25 % in 2019 provides signal for lasting lessening in the monetary policy, compared to 2016 when the CB bills rate stood at 4%.

In the environment when EURIBOR continues to hold negative zones, the ambient in the banking sector demonstrates constant interest rates decrease, contributing to downward trend in net interest income. Nonetheless, the banking sector remains profitable and solid for generating income from financial intermediation with 1.4% ROAA and 12.5% ROAE for mid-2019.

Credit growth registered moderate growth in terms of credit to enterprises and households. On annual basis in mid-2019, the deposits registered the same growth as in the previous period which is due to the deposit growth in both sectors, with a more evident contribution of household. NPLs to gross loans stand to 5.9%, 4,4%, and 5.2% for Large, Medium-sized and Small-sized banks, indicating solid bank assets quality and enhanced risk assessment in the banks. Solid capital adequacy ratios remain sufficient for all sized banks such as 17.4%, 17.2%, and 18.2% for Large, Medium-sized, and Small-sized banks.

The prices are increased

Consumer prices and Production price indexes saw a stable increase in the observed period. The largest increase in production prices was recorded in the fourth quarter of 2018 where an increase of 26.6% is realized since the previous quarter. From there on out the producers' prices fall for a significant percentage of 25% and remain stable in the last two quarters, nevertheless increased for almost a double than last year.

On the side of the demand, the consumer price index the biggest increase in the observational period is noted in the first quarter of 2019 where the index went down up 0.9 percentages. The increase in the production and also in consumer prices was mainly triggered by the rise of the wages in different sectors induced by the government and also variation on the energy and oil prices.

Current account deficit reduction, the second year in a row

Favorable movements in the balance of payments, which began in 2017, continued throughout 2018. The current account deficit declines the second year in a row, down to the historically lowest level of 0.1% of GDP (which is 1.0 pp lower than in the previous year). This change is due to the improvement in the trade balance of goods, which is mainly a result of the stronger export activity of industrial facilities with foreign capital. There was some disruption to this trend in Q1 2019 when the deficit registered a slight annual increase due to the lower surplus in secondary income and services.

The financial account of the balance of payments in 2018 recorded significant net inflows, mainly in the form of foreign direct investments, as well as borrowing on the international financial markets. In contrast, in Q1 2019, in the financial account dominated the inflow of trade credits and a smaller portion of the categories listed in 2018.

The realized financial flows in 2018 enabled complete financing of the current account deficit, as well as a significant increase in foreign reserves during the year. This continues in the first two quarters of 2019. But that was not the case in 2017. Due to the reduced external borrowing of the economy and offsetting the positive effects of FDI inflows with net outflows on some of the short-term financial flows, this year, the deficit had to be financed mainly by foreign reserves, which led to their reduction.

Policy assumptions and projections summary

The decline of the real GDP also infused with political uncertainty, which still lingers in the form of the process of EU accession and ratification of the NATO agreement, is to be expected till the end of the year, reaching 3.5% according to the projections.

The consumer prices are expected to be increased in a further period.

The monetary policy goals in 2020 will continue to be focused on price stability and stable exchange rate, continuous stability of the financial system, supporting macroeconomic stability, and deepening of the financial intermediation level.

Projected values for the balance of payments components for the period 2019 - 2021 indicate a further moderate current account deficit (of about 1.3% of GDP on average for the period). During this period, the current account deficit is expected to be fully financed by the flows in the financial account through foreign direct investments and external borrowing, which will enable further growth of foreign reserves and their maintenance at an appropriate level. ■

Table MK1 Main economic indicators

	2017	2018				2019	
		Q1	Q2	Q3	Q4	Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	0.2	0.9	3.0	3.0	3.7	4.1	3.1
Real private consumption (% change, yoy)	0.7	2.0	1.9	3.0	4.6	2.6	3.1
Real government consumption (% change, yoy)	-2.5	3.0	7.7	9.6	4.7	0.1	1.2
Real investment (% change, yoy)	0.8	-9.3	-16.4	-8.5	1.6	9.9	11.1
Industrial output (% change, yoy)	0.2	5.4	4.9	5.0	6.4	8.8	1.3
Unemployment rate (registered, % pa)	21.9	21.6	21.1	20.8	19.4	17.8	17.5
Nominal GDP (EUR million)	10,014	2,394	2,621	2,798	n.a.	n.a.	n.a.
GDP per capita (EUR)	4,827	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
PRICES, WAGES, AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	3.4	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Consumer prices (% change, yoy, pa)	1.4	1.5	1.5	1.6	1.2	1.2	1.2
Producer prices (% change, yoy, pa)	0.5	0.8	-0.2	-0.8	-1.0	0.2	0.9
Average gross wage (% change, yoy, pa)	1.2	3.1	4.6	3.9	5.3	3.4	3.6
Exchange rate (MKD/EUR, pa)	61.57	61.56	61.50	61.49	61.49	61.51	61.53
Exchange rate (MKD/USD, pa)	54.65	50.10	51.55	52.90	53.89	52.12	54.17
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	4,074.6	1,058.5	1,205.4	1,232.7	1,384.8	1,245.9	1,350.5
Exports of goods (EUR, % change, yoy)	15.4	14.7	16.4	20.0	27.1	17.7	12.0
Imports of goods (EUR million)	5,861.9	1,521.3	1,608.5	1,628	1,858.3	1,718.6	1,784.4
Imports of goods (EUR, % change, yoy)	9.7	10.0	10.7	13.6	16.7	13.0	10.9
Current account balance (EUR million)	-105.2	-141.0	30.8	199.9	-104.7	-156.1	-39.4
Current account balance (% of GDP)	-1.1	-1.3	0.3	1.9	-1.0	-6.1	-1.5
Gross foreign direct investment (EUR million)	351.3	294.2	126.4	41.2	77	220.3	118.7
Foreign exchange reserves (EUR million, eop)	2,336.3	2,577.1	2,642.2	2,709.1	2,867.1	2,866.4	2,928.2
Foreign debt (EUR million, eop)	7,372.5	8,221.1	8,386.2	8,360.8	7,843.7	8,249.7	8,324.1
GOVERNMENT FINANCE*							
Revenues (MKD million)	179,673	43,369	47,279	46,006	51,869	46,076	50,131
Expense (MKD million)	196,561	46,502	48,684	48,476	56,427	49,271	53,970
Net = Gross operating balance	-16,888	-3,133	-1,405	-2,470	-4,558	-3,195	-3,839
Net acquisition of non-financial assets (MKD million)	-18,547	-1,338	-1,872	-1,649	-5,091	-1,396	-3,488
Net lending/borrowing (MKD million)	1,659	-1,795	467	-821	533	-1,799	-351
Domestic government debt (EUR million, eop)	1,581.7	1,588.4	1,607.6	1,616.4	1,649.4	1,655.4	1,703.5
Foreign government debt (EUR million, eop)	2,376.8	2,682.3	2,692.8	2,685.9	2,695.0	2,687.6	2,671.2
Total government debt (eop. % of GDP)	39.5	39.8	40.1	40.1	40.5	38.2	38.4
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	9.9	14.8	13.8	17.1	18.7	17.2	18.5
Broad money, M4 (% change, yoy, eop)	5.1	7.5	10.1	11.7	11.8	11.7	10.5
Total domestic credit (% change, yoy, eop)	5.4	5.7	6.2	7.9	7.3	9	8.1
DMBs credit to households (% change, yoy, eop)	9.5	9.6	9.9	10.4	10.4	9.8	n.a.
DMBs credit to enterprises (% change, yoy, eop)	2.8	4.8	6.4	9.2	6.9	8.2	n.a.
Money market interest rate (%, pa)	1.0	1.0	1.0	1.0	n.a.	n.a.	n.a.
DMBs credit rate for enterprises short-term (%, pa)	5.3	4.8	4.5	4.5	4.5	4.4	n.a.
DMBs credit rate for households short-term (%, pa)	4.5	4.1	4	3.8	3.6	3.6	n.a.

Conventional abbreviations: pa - period average, eop - end of period, yoy - year on year, EUR - Euro, US$ - US dollar, MKD - Macedonian denar, DMB – deposit money bank.

Sources: Sources: Ministry of Finance of the Republic of Macedonia, National Bank of the Republic of Macedonia, State Statistical Office of the Republic of Macedonia.

Table MK2 Summary of projections

	2019	2020	2021	2022
Real GDP (% change)	**3.5**	**3.8**	**4.0**	
Real private consumption (% change)	2.9	3	n.a.	n.a.
Real government consumption (% change)	2.6	2.4	n.a.	n.a.
Real investment (% change)	8.3	9.4	n.a.	n.a.
Exports of goods and services (constant prices, % change)	8.0	8.5	n.a.	n.a.
Imports of goods and services (constant prices, % change)	8.2	9.1	n.a.	n.a.
Current account balance (% of GDP)	-1.1	-1.3	-1.5	n.a.
Consumer prices (% change, pa)	1.5	2.0	2.0	n.a.
Exchange rate, national currency/EUR (pa)	61.6	n.a.	n.a.	n.a.
Unemployment rate (registered, %, pa)	20.2	19.6	n.a.	n.a.
General government balance (ESA 2010 definition, % of GDP)	-3.0	-2.5	n.a.	n.a.
Total domestic credit (% change, eop)	n.a.	n.a.	n.a.	n.a.

Conventional abbreviations: pa - period average, eop - end of period, EUR - euro.

Sources: Ministry of Finance of the Republic of Macedonia, National Bank of the Republic of Macedonia, and the European Economic Forecast, Spring 2019, European Commission Directorate - General for Economic and Financial Affairs, Institutional Paper 102, May 2019.

ROMANIA

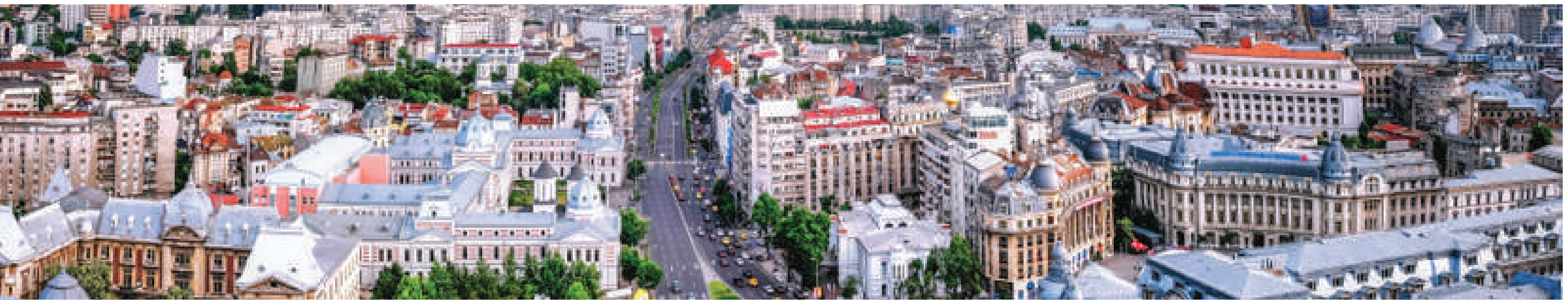
Romanian economy at the beginning of a new political cycle

Unbalanced economic growth

By the end of 2018 and in the first two quarters of 2019, the Romanian economy evolved under the impact of several determinants, located on both demand and supply sides: 1) the changes in real consumption; 2) the expansion of public expenditures; 3) the effects of fiscal measures; 4) external disequilibria and, respectively, 5) rather poor performances in several spheres of private investments. Among these factors, households' demand for goods and services persisted as a key aspect, due to almost double-digit wage growth. In addition, tight labour market conditions continued to manifest in the first two quarters of 2019, with an unemployment rate below 5%.

Still, in 2018, HICP inflation stood at 4.1%, the highest in the EU. Annual consumer price growth remained strong in the first and second quarters of 2019, around 4%. However, it is expected to decelerate in the third quarter. Inflation evolutions synthetically reflect the uncertainty around the perspectives of the economic environment and the construction and implementation of economic policies.

Despite the fact that the dynamics of real GDP was positive, with an annual growth of 4.1% in 2018, the pace of economic growth is slowing down.



In the first half of 2019, the GDP increased by 4.6% for the unadjusted series and by 4.7% for seasonally adjusted series, while the overall 2019 real GDP growth is predicted to reach 4% (*European Commission Summer 2019 Economic forecast*). The industrial output fell in the last quarter of 2018, as well as in the first quarter of 2019, with a further stabilization in the second quarter (with the exception of a -6.3% fall in unadjusted series for June 2019). This was the fourth straight decline in industrial output and the steepest fall since May 2009, as electricity, gas, steam and air conditioning supply output dropped sharply. Nonetheless, the industrial output grew moderately in the second quarter of 2019, due mainly to a significant recovery in the construction sector (while other sectors such as mining and quarrying displayed negative evolutions). Broadly, the manufacturing industry was affected by the declining demand for foreign trading partners and insufficient rate of new internal orders (particularly in capital goods production). For entire 2018, the composition of net investments is still somehow unbalanced by the high weight of non-tradable sectors with respect to tradable and productivity-enhancing ones.

Thus, the progress of the Romanian economy should be placed in the context of 2019 first quarter's expansion of the European economy, despite the difficult global context. More exactly, growth in the Euro Area was stronger than expected in the first quarter of the year due to a number of temporary factors (among which mild winter conditions and a rebound in car sales). Nonetheless, this context is unclear due to the persistence of less favorable external factors (perhaps, most importantly, the global trade tensions) and to economic policies' uncertainty caused either by the beginning of a new European political cycle or by the final configuration of Brexit.

Deepening of external disequilibrium

The external shocks have been reflected by a worsening of external unbalances. The commercial deficit increased due to an acceleration of both exports and imports in comparison with the same period of 2018. The consumption goods remained the main determinant of imports and exports being affected by the fluctuations of the real exchange rates with major commercial partners. Net exports had a substantial negative contribution to GDP and, so, an increase in the commercial balance deficit (as well as in the entire current account) can be expected (with a cumulative trade deficit between January and July 2019 of EUR 9,457 million, 27% more than the same period of 2018). The capital account reached a cumulative surplus of EUR 1,399 million (41% more than the same period of 2018). However, the main determinant was here the capital transfers of the general government. The direct investments by non-residents increased between January and July 2019, reaching a total of EUR 2.92 billion, compared with EUR 2.38 billion in the same period of 2018. The Foreign Direct Investments- to-GDP ratio rose above 2% and covered an important fraction of the trade deficit. Of this amount, equity (including estimated net reinvestment of earnings) amounted to EUR 2,102 million, and intercompany lending (loans contracted by local subsidiaries from parent groups abroad) recorded a net value of EUR 814 million. Nonetheless, in the first seven months of 2019, the number of newly established foreign capital companies increased, with 3,348 new companies having a share capital totaling 13.59 million US dollars, a 37.4 increase over the January-July 2018 period.

Increased financial systemic risks

For the analyzed period, the external disequilibrium was mirrored by the evolutions of internal financial sector's systemic risk. As National Bank of Romania (NBR) notes in its *Financial Stability Report* from June 2019 (p.5-6): "The latest assessments on systemic risks to financial stability in Romania do not point to any severe risks. Nevertheless, systemic risks have increased overall compared with the end-2018 assessment, three of them ranking as high (...). The other two are assessed as moderate and low respectively. All risks, except for those regarding the deterioration in investors' sentiment towards emerging economies and the default risk for loans to the private sector, are estimated to follow an upward trend in the period ahead... the risk of an uncertain and unpredictable legislative framework in the financial and banking sector, with implications for banking sector solvency, returned to a high level in the latter part of 2018 ... The end of 2018 saw heightened uncertainties following the unexpected adoption of GEO No. 114/2018, which introduced inter alia a tax on bank assets. The specific provisions incorporated several aspects that affected financial stability: (i) calibrating the tax amount depending on the level of ROBOR market rates, which could have had a detrimental impact on monetary policy effectiveness, (ii) a significantly higher level of the tax rate compared with international practice, (iii) a tax base consisting of all financial assets of credit institutions".

Inflation remains a core determinant of financial stability. The annual adjusted CORE2 inflation rate had displayed a clear upward trend, rising in Q2 versus end-Q1 to 3.3 %. The average annual inflation recorded mixed developments during Q2: the average annual CPI inflation rate calculated based on the national methodology followed a downward path in April-June, arising at 4.1 % at end-Q2, while the average annual HICP inflation rate remained at 4% in June, with the differential versus the EU remaining significant.

More specifically, an important driving factor of inflation, in the first half of 2019, was represented by the price developments in the components of services and food items. Thus, the prices of telephony and television services rose because of the legislative changes leading to an increase in taxes applicable to telecommunication companies. Equally important was the evolution of processed food prices.

In addition, there was a certain monetary component of inflation with a monthly average growth rate of monetary aggregate M3 ('broad money') between February and June 2019 of around 0.40% (while for 'narrow money- the monetary aggregate M1 - this rate was around 0.95%).

Overall, longer-term interbank money market rates went up in the second quarter of 2019 and, hence, saw their positive spread vis-à-vis the monetary policy rate widens, while the average interest rate on interbank transactions fell only marginally versus the previous three months. The EUR/RON exchange rate remained almost stable in the first two months of 2019' second quarter, at the higher readings recorded at the beginning of the year, but afterward witnessed a relatively sharp downward correction. The annual growth rate of credit to the private sector saw its decline come to a halt, decelerating April very slowly through May 2019 against the 7-year peak seen a quarter earlier. Although the non-performing loans ratio for loans to households remained on a downward path, the quality of exposures in domestic currency deteriorated, the strongest effect being visible for unsecured consumer loans. The quality of the portfolio of loans granted to non-financial corporations continued to improve over the analyzed period, yet at a slower speed. The dynamics of overdue payments to non-banks indicate an improvement in payment discipline in the private sector and a slight deterioration across state-owned companies, while insolvency remained on a downward trend (the total number of companies undergoing insolvency proceedings decline with 33% in the first half of 2019. According to a *Coface Romania survey*, almost three-quarters of the decrease in the number of insolvency cases are recorded for the segment of companies that: did not file their financial statements - 37 %; did not record income -14 %; or whose turnover recorded in 2018 was under EUR 100,000 - 27 %. In structural terms, a high level of indebtedness is manifested, as in 2018, in low-tech and medium low-tech industries.

Monetary policy remains tight

Between May and July 2019, the National Bank of Romania had kept the monetary policy rate at 2.50 %, left unchanged the deposit facility rate at 1.50 %, and the lending facility rate at 3.50 %, while maintaining strict control over money market liquidity. Moreover, the central bank kept the minimum reserve requirement ratios on both RON and foreign currency-denominated liabilities of credit institutions at 8.0 %.

In the second quarter of 2019, key money market rates remained significantly above the monetary policy rate, while the average interest rate on interbank transactions returned slightly below the policy rate, in the middle of a certain normalization of liquidity conditions on the market. Among the main ideas underlying the design of the NBR's monetary policy, was the view that the recent developments in core inflation indicated significant demand-pull and wage cost-push inflationary pressures, in line with the size and strengthening trend of the cyclical position of the economy.

Fiscal policy maintains its expansionist nature

Romania's strongly pro-cyclical budget deficit has continued widening to an annualized 5.5% of GDP during Q1 of 2019, by far the highest among EU members.

On the fiscal revenues side, a few new measures were implemented in 2019, both with regard to fiscal facilities and to tax increases. The employees in the construction sector were exempted from paying the personal income tax for a 10-year period, and social security contributions were reduced for both employees and employers. The VAT rate was reduced for water supply and sewerage services, and the reduced rate of 5% was extended to certain transport services and for the housing market.

On the budgetary expenditures side, public sector employees' wages increased with a ¼ of the difference between the salary provided by law for 2022 and the level thereof in 2018. As of September 1, 2019, it is expected that the pension point will rise by 15% and the social allowance for the retired by 10%.

It can be argued that Romania's public finances currently face two structural challenges: more effective revenue collection and keeping pension and wage growth under control. Fiscal revenues are among the lowest in the CEE countries (32% of GDP) and on a descending trend with low tax revenues (25.4% of GDP); while expenditures surged thanks to 24% higher public sector wages than last year. The adoption of the new pension law in June and effective in September 2019, will further increase the fiscal cost by an estimated share of 0.8% of GDP.

Among the lowest external debt-to-GDP ratios (but on an upward trend)

While in regional context, Romania displays one of the lowest external debt-to-GDP ratios (with a government debt equivalent to 35.10 % of the country's GDP in 2018), public debt increased by more than RON 9 billion (roughly EUR 2 billion) during the first five months of 2019, to more than EUR 71 billion. Such a rise accounted for around 1% of the GDP. Meanwhile, the long-term external debt had increased in July 2019 with 7.38%, compared to December 2018, by reaching a level of EUR 73,331.2 million. Meanwhile, in January-July 2019, Romania's budget deficit rose by 52 % versus the similar period of last year, to RON 18.1 billion (EUR 3.8 billion).

Tight labour market conditions

In the first half of 2019, the number of employees economy-wide descended (annual change of 1.4 % in Q1 and 1.1 % in April-May, down from 1.6% in the second half of 2018). From a structural perspective, a disturbing evolution was the deceleration owed to the private sector, amid the slower hiring pace in market services (more pronounced in administrative and support services and in ICT) and industry downsizing (especially in the automotive sector). However, a rebounded demand-to-supply ratio was recorded in construction (possible under the impact of the tax incentives introduced in this sector). A specific feature of Romanian labour market is still the excess labour supply remaining very low January through May 2019, with the registered unemployment rate and the ILO unemployment rate reaching 3.1 % and 3.9%, respectively, at the end of this period. Nonetheless, there are some notable geographical disparities in the labour market conditions. At the end of March 2019, the highest rates of registered unemployment were recorded in the South-West region (5.5%) and the North-East region (4.8%). The lowest rates of registered unemployment were recorded in Bucharest (0.9%) and the West region (2.2%).

In Q1 of 2019, average gross wage earnings grew swiftly, i.e. 15.3 % in annual terms (compared to 13 % in Q4 of 2018), largely due to: a new economy-wide rise in the gross minimum wage, since the beginning of 2019 (by 9 %, to RON 2,080); the setting of a minimum wage of RON 2,350 for highly-skilled personnel and of RON 3,000 for employees in the construction sector.

It can be predicted that these two tendencies (the scarcity of labour force supply and the significant increase in unit labour costs) jointly with the persistence in gender differences and in job conditions, as well as with the differences across education levels will also remain, on short and medium-term, significant obstacles to sustainable economic growth.

Table RO1 Main economic indicators

	2017	2018				2019	
		Q1	Q2	Q3	Q4	Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	7.0	4.3	4.1	3.7	4.0	5.0	4.5
Real private consumption (% change, yoy)	9.0	-0.3	2.2	2.3	1.6	0.8	0.6
Real government consumption (% change, yoy)	5.2	-2.3	-1.4	8.2	-3.3	-2.8	0.4
Real investment (% change, yoy)	3.5	13.6	-0.6	-6,0	0.8	4.6	18.7
Industrial output* (% change, yoy)	7.8	5.1	4.7	2.9	0.8	1.8	1.3
Unemployment rate (registered, % pa)	4.9	4.8	4.3	4.0	4.2	4.2	4.1
Nominal GDP (EUR million)	187,516.8	48,277.0	49,650.9	51,515.0	52,484.4	53,045.4	54,059.9
GDP per capita (EUR)	8,300	2,000	2,400	2,900	3,100	2,200	2,600
PRICES AND WAGES							
Implicit GDP deflator (% change, yoy)	4.7	1.4	3.4	5.1	5.3	4.7	3.9
Consumer prices (% change, yoy, pa)	1.34	3.73	4.53	4.56	4.3	4.1	3.9
Producer prices (% change, yoy, pa)	3.5	3.5	6.1	6.4	4.87	5.6	4.2
Average gross wage (% change, yoy, pa)	14.7	8.7	0.7	1.1	1.13	n.a.	n.a.
Exchange rate (RON/EUR, pa)	4,5681	4,6553	4,6521	4,6468	4,6597	4.7351	4.7477
Exchange rate (RON/USD, pa)	4,0525	3,7860	3,9021	3,9949	4,0835	4.1681	4.2229
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	62,644.10	20,489.5	21,006.5	21,259.6	21,739.1	21,910.9	21,657.1
Exports of goods (EUR, % change, yoy)	9.2	2.5	2.52	1.20	2.26	0.79	-1.16
Imports of goods (EUR million)	75,603.90	21,844.4	22,466.0	22,929.6	23,755.6	24,009.8	23,777.9
Imports of goods (EUR, % change, yoy)	12.2	2.2	2.85	2.06	3.60	1.07	-0.87
Current account balance (EUR million)	-5,970	-1,355.0	-1,459.5	-1,670.1	-2,016.4	-2,098.9	-2,120.9
Current account balance (% of GDP)	-3.2	-2.81	-2.94	-3.24	-3.84	-3.96	-3.92
Gross foreign direct investment (EUR million) net inflows	n.a.	850.49	601.02	909.35	282.95	444.82	313.86
Foreign exchange reserves (EUR million, eop)	34,824.7	34,725	31,766	31,421	36,130	37,510	40,225
Foreign debt (EUR million, eop)	68,161.6	64,804.5	65,590.1	67,201.0	68,186.4	67,196.9	72,503.0
GOVERNMENT FINANCE							
Revenues (RON million)	239,822	64,668	74,067	77,549	86,941	69,369	73,939
Expense (RON million)	264,064	72,332	77,364	80,992	100,303	80,302	88,422
Net = Gross operating balance	-24,242	-7,664	-3,297	-3,443	-13941	-10,932	-14,482
Net acquisition of non-financial assets (RON million)	n.a.	n.a.	n.a.	2.349	n.a.	n.a.	n.a.
Net lending/borrowing (RON million)	-24,242	-7,664	-3,297	-3,443	-13,941	-10,932	-14,482
Domestic government debt (EUR million, eop)	31,454.9	34,860.0	33,054.9	32,971.1	34,948.0	34,895.7	38,240.6
Foreign government debt (EUR million, eop)	99,198.6	n.a.	n.a.	n.a.	100,646.7	n.a.	110,457.1
Total government debt (eop. % of GDP)	35.2	34.5	34.3	34.2	35.0	34.1	34.2
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	17.0	14.9	14.3	11.4	2.2	1.8	1.2
Broad money, M4 (% change, yoy, eop)	11.5	11.7	12.9	10.2	4.9	4.2	0.4
Total domestic credit (% change, yoy, eop)	5.52	5.05	4.34	n.a.	4.11	n.a.	n.a.
DMBs credit to households (% change, yoy, eop)	7.8	9.4	10	9.4	9.2	8.0	6.9
DMBs credit to enterprises (% change, yoy, eop)	22.2	13.7	0.5	1.1	10.9	6.6	21.6
Money market interest rate (%, pa)	1.776	1.846	2.45	3.11	3.00	2.94	3.13
DMBs credit rate for enterprises short-term (%, pa)	1.05	1.21	1.78	2.21	2.17	2.15	2.16
DMBs credit rate for households short-term (%, pa)	0.90	0.94	1.00	1.14	1.6	1.5	1.5

Conventional abbreviations: pa – period average; eop – end of period; yoy – year on year; EUR – euro; DMB – deposit money bank.

Sources: National Institute of Statistics Romania, The National Bank of Romania, National Commission for Strategy and Prognosis Romania (Spring 2019), Ameco and Eurostat Databases (European Commission), European Central Bank (EUROSYSTEM), Euribor-rates.eu; * Quarterly data computed by authors based on Eurostat Database.

Table RO2 Summary of projections

	2019	2020	2021	2022
Real GDP (% change)	**5.5**	**5.7**	**5.0**	**5.0**
Real private consumption (% change)	6.1	6.0	5.2	5.2
Real government consumption (% change)	4.5	4.0	2.5	2.4
Real investment (% change)	6.9	7.9	7.4	7.5
Exports of goods and services (constant prices, % change)	6.9	7.1	7.0	7.0
Imports of goods and services (constant prices, % change)	7.8	7.9	7.8	7.8
Current account balance (% of GDP)	-3.3	-2.9	-2.7	-2.4
Consumer prices (% change, pa)	3.4	2.6	2.5	2.4
Exchange rate, national currency/EUR (pa)	4.74	4.71	4.69	4.67
Unemployment rate (registered, %, pa)	4.1	4.0	3.9	3.8
General government balance (ESA 2010 definition, % of GDP)	-3.4	-4.6	n.a.	n.a.
Total domestic credit (% change, eop)	2.1	1.9	n.a.	n.a.

Conventional abbreviations: pa – period average; eop – end of period; yoy – year on year; EUR – euro; DMB – deposit money bank.

* Projections on real GDP growth are made by the National Commission for Strategy and Prognosis Romania (Spring 2019). In the World Economic Outlook Database (October 2019), IMF forecasts a moderate real GDP growth of 4.00% in 2019, 3.50% in 2020 and 3.00% in 2021 and 2022. At the same time, the European Commission advances a real GDP growth of 4.0% in 2019 and 3.7% for 2020 (European Semester economic forecast for Romania).

Sources: National Commission for Strategy and Prognosis Romania (Spring 2019), National Institute of Statistics Romania, National Bank of Romania, Ameco Database.

Policy assumptions and projections summary

The Romanian Association of Banks' estimate for the GDP growth is over 4%. Similarly, the *European Commission* has revised upwards its economic growth forecast for Romania, for both 2019 and 2020, according to its *Summer 2019 Economic Forecast*. It expects Romania's economy to grow by 4% in 2019 (up from the 3.3% estimation released in May), and by 3.7% in 2020. Likewise, the *International Monetary Fund* (IMF) increased its forecast for Romania's economic growth in 2019, from 3.1% to 4%. So, the Executive Board of IMF considers such growth to be driven "by continued fiscal stimulus and strong wage growth, and be accompanied by further widening of current account and fiscal deficits" (*Press Release no. 19/321*). Finally, The *World Bank* increased its forecast on Romania's economic growth this year to 4.2% (*Europe and Central Asia Economic Update, October 9, 2019*). In June this year, the World Bank was estimating a 3.6% economic growth for Romania in 2019.

Even so, these forecasts draw attention to the potential risk of an increase in macroeconomic imbalances and to a possible setback of the income convergence with the EU. Supplementary, the forecasts note that, on medium-term, Romania's economic growth is expected to curb as the available fiscal space shrinks, and the labour market increasingly tightens.

NBR's inflation projections lay between 3.7% in Q3 of 2019 and 4.2 % in Q4, while for Q1 of 2020, it stands at 3.2%. Still, uncertainty intervals for such projections exceed 0.85%, and all the mentioned figures are above the target inflation of 2.5%.

It is plausible to expect that systemic risk sources may be located among those identified by the largest banks from Romania in *National Bank of Romania's Quarterly Risk Survey*, June 2019 (Year III, No. 7- page 8) to be "Severe/ high systemic risk/highly or challenging to manage": "(1) Uncertain and unpredictable legislative framework in the financial and banking sector, with implications for banking sector solvency; (2) Tensions surrounding domestic macroeconomic equilibria; (3) Higher financing costs following an interest rate hike and/or a weaker exchange rate, with a negative impact on the debt servicing capacity of borrowers, especially households and SMEs; (4) Fast deterioration of investors' sentiment towards emerging economies in the context of external developments (e.g. global economic growth, political changes and heightening geopolitical tensions, the European banking sector) and/or domestic developments (e.g. pro-cyclical fiscal policy, widening current account deficit)". To these, it should be added that the current Romanian political cycle may lead to a shift in public policies and, particularly, in the fiscal ones, with potential effects on wages and labour market, costs of borrowing and public debt.

For the second half of 2019, two evolutionary scenarios may be considered. First, the Romanian economy will continue to grow, reaching a yearly rate of around 4%. In this scenario, such growth will be driven mainly by internal consumption and imports (with a worsening of the trade deficit). Meanwhile, no significant changes in residents and non-residents' investments are to be expected. Inflation will remain above target, joint by an upward trend in the interest rates. The exchange rates of RON will mildly adjust and no severe shocks will be received from EU economies.

Second, the uncorrelated real wages/ labour productivity couple will exercise an inflationary pressure (eventually in a tight correlation with a still expansionary fiscal policy and further decline in tax collection efficiency). In this scenario, a further contraction of foreign direct investments is possible, alongside a deepening of government budget balance and current account balance deficits. The manifestation of labour market's frictional factors may be more acute and the regional employment disparities might deepen. Even if it is extremely difficult to assess the likelihood of these two scenarios, it is quite safe to say that the uncertainty surrounding the macroeconomic environment will remain high in the second half of 2019. ■


China
America
France
Japan
Germany
April
May
June
July
Product 1
Product 2
Product 3
Product 4
29%
Customer 1
Customer 2
Customer 3
78
58
45

S E R B I A

The rebalance of the national budget with increase in public expenditures

Opening new chapters for EU membership with credit rate upgraded

One part of achieving full membership in the EU, was verified by the opening new negotiating chapters (Chapter 20 which is about "Enterprise and industrial policy" and Chapter 26 "Education and culture") in the 2017 year. In the middle of the same year, chapters 7 "Intellectual property law" and Chapter 29 "Customs union" were opened. By the end of this year, three more chapters are expected to be opened. These negotiating about chapters, along with Association Agreement between the European Communities and their member states, and the Republic of Serbia; adoption of the Economic Reform Programme for the period 2017-2019, the Employment Policy and Social Policy Reform Programme, the revised National Programme for the Adoption of the EU Acquis, implementation of the Public Finance Management Reform Programme for the period 2016-2020, the harmonization of national legislation, as well as the adoption of general and sectoral national development strategies, including Fiscal strategy, aim at enabling the Republic of Serbia to comply in the shortest possible time with the preconditions of EU membership.

Along with opening new chapter 9 “Financial services” in 2019, Serbia’s credit rating for long-term foreign currency of Fitch, one of the rating credit agencies, is upgraded, and it is “BB+” . This rate has been increased since May when it was BB, and for the first time since 2005, when the rating has started, it resulted in this rate. This will have an influence on EU membership and the opposite in the near future.

The GDP dropped in two quarters of 2019 comparing to the same two quarters of 2018.

The GDP in 2017 is lower than SEEA authors predicted (2.9%, SEE Vol.3 February 2017). Through the first two quarters of 2018. the Serbian economy has continued to grow. The last two quarters of the same year resulted in real GDP drop. That trend continues in the first quarter of 2019. but in the second quarter, it has a slight rise, when we compare to 2017. with the second quarter of 2019. we have a rise of 0.9%. In 2020 it is expected the growth of 4.0%. Real private consumption has almost the same trend as real GDP, except Q2 2018, when compared to the real GDP has a small increase; also, Q1 of 2019. for real GDP, it has a small decrease, but private consumption has a slight increase and Q2 of 2019. for real GDP and private consumption has, respectively, increase and decrease. The economy recovered in the first quarter of 2018. compared to the previous year, mainly because of the increase in industrial production, which rose in Q1 in 2018 — compared to 2017. Industrial production dropped in the second quarter of 2018. and continued dropping until the last quarter of 2018, when it had a slight increase of 0.2%. After that quarter, it had decreased by 0.9%, but then in Q2 in 2019. it recovered with an increase in production for 3.1%.

Unemployment rate dropped, more female employed

In this publication number, we used the labor force survey, which took the population aged 15 and more. The reason is that official documents are using the same method of monitoring the unemployment rate. By that survey employment rate dropped in the last quarter of 2018. and then remain steady in the first quarter of 2019. In the second quarter of 2019. rose on 49.2%. In that period the unemployment rate fluctuates from 14.8% in the first quarter of 2018. until the second quarter of 2019. when it was 10.3%. It can be that because the employed rate rose, the unemployment rate dropped in the second quarter in 2019. According to the Statistical Office of Serbia, there were more male unemployed from the first quarter of 2018 until the second quarter of 2019. then female. It can be caused because of many reasons: more men register their unemployment status, some women did not register their status on National Employment Service, some men are working illegally or freelancing. Although, we can not be sure what reason is with the largest share in this. When we are looking at the education level, more people with high school education are unemployed then without education or elementary education. That percentage of unemployed with high school education dropped in the second quarter of 2019. compared to the first quarter of 2018., but the unemployed rate of people with high education rose from the first quarter of 2019. when it was 68.4 thousand to 71.6 thousand in the second quarter of 2019, the first three sectors with the largest increase in the number of the employed are in manufacturing, construction, and professional scientific and technical activities.

Consumer prices are higher inter-annually in the two-quarters of 2019., then the lower limit on the targeted inflation of National Bank of Serbia for the same year.

When we are analyzing the contribution of consumer prices by purpose, we can see that the share of unprocessed food is the biggest, and processed food has the smallest share in the whole contribution of customer price growth. In that unprocessed food, vegetable prices rose and took 25,8% inter-annually.

By the Statistical Office in the overall structure per year growth rates of food prices and soft drinks in the first two quarters of 2019, the fruit was the only “deflationary element.” On a seasonally adjusted basis data for the period January-June 2019, the total basket of fruit in the average has dropped to about 5%. The biggest impact on this one there was a deflationary trend cheapening of apples, nuts, bananas, and lemons from which some of their retail prices are highly correlated with the average cost of a total basket of fruit.

The average gross wage has a recovering trend, and the RSD/EUR exchange rate is fluctuating for about +/-1%

Looking at the period from 2017. Until Q2 of 2019. We see that the average gross wage has been increasing since the 2017 year. The most real growth of wages was in the Information and communication sector, but the highest wage was in Air transport.

The exchange rate for RSD/EUR is in 2018. and the first two quarters of 2019. lower than in 2017. From the first quarter of 2018. it has an almost stable trend. It is expected a small percentage rise in the next two years.

In 2018. total trade with the world has increased, despite that, Serbia remained in the foreign trade deficit. The largest exporter of Serbia was the region of Vojvodina, and the importer was the Belgrade region. In the first two quarters of 2019. Serbia has almost the same trend as in 2018. In the next years, 2020 and 2021, it is projected to import dropping.

Foreign debt has an almost stable trend from 2017 — until the second quarter of 2019. The average percentage change in that period was approx — 1 %.

Expansive fiscal measures

Since the fiscal consolidation undertook in 2015 was successful accomplished, the Serbian government has started in 2018 to gradually introduce expansive fiscal measures: growth in public sector wages, growth in capital expenditures and decrease in the tax burden on wages. These measures of fiscal expansion did not have detrimental effects on fiscal balance in the first half of 2019, partially due to collections of one-off public revenues, such as the tax on airport concession and profit of the National Bank. By the end of August 2019 budget surplus was around 395 mil, considerably higher than envisaged by the Law on Budget for 2019. The decline in public debt has continued, and most likely, by the end of 2019 debt to GDP will be around 50%. Good fiscal prospects reflected on the level of interest rates on government debt. In June 2019, Serbia has issued 1 bil Eurobond at rate 1.62, which is the lowest level ever achieved; for instance, at the height of post-crisis fiscal turbulence Eurobond was sold at 7.5%.

Positive fiscal developments in the first half of 2019 lead to the rebalance of the national budget which for the first time since 2014 proposed an increase in public expenditures (up to the annual deficit of 0.5%). Unfortunately, despite negative experience with the pro-cyclical fiscal policy prior to the global crisis, the government has again decided to increase public sector wages above the economically reasonable level. On average, salaries in the general government nominally increased by 9.5%, exceeding the expected nominal growth rate of GDP in 2020 (5-7%). Such a high increase in public sector wages will reduce fiscal space for productive capital investment, new employments in public sectors and relaxation of the tax burden on business in 2020, weakening long-term growth potentials. ■

Table SRB1 Main economic indicators

	2017	2018				2019	
		Q1	Q2	Q3	Q4	Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	2.0	4.9	4.9	4.1	3.4	2.7	2.9
Real private consumption (% change, yoy)	2.0	3.1	3.4	3.3	3.2	3.3	3.2
Real government consumption (% change, yoy)	3.7	2.1	4.8	4.0	3.3	2.5	2.4
Real investment (% change, yoy)	17.7	16.3	11.6	8.3	3.2	7.8	8.6
Industrial output (% change, yoy)	3.9	5.9	2.3	-1.4	-1.2	-2.1	3.1
Unemployment rate (survey, %)*	13.5	14.8	11.9	11.3	12.9	12.1	10.3
Nominal GDP (EUR million)	39,183	9,713	10,659	11,027	11,383	10,197	11,284
GDP per capita (EUR)	5,581	1,400	1,500	1,600	1,600	1,500	1,600
PRICES, WAGES, AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	2.7	1.8	1.9	2.6	1.8	2.0	2.7
Consumer prices (% change, yoy, pa)	3.0	1.6	1.8	2.4	2.0	2.4	2.3
Producer prices (% change, yoy, pa)	2.6	0.8	3.0	3.6	1.1	1.7	0.7
Average gross wage (% change, yoy, pa)	0.9	5.1	5.9	6.2	6.8	9.3	9.9
Exchange rate (RSD/EUR, pa)**	121.34	118.43	118.17	118.14	118.35	118.23	117.97
Exchange rate (RSD/USD, pa)**	107.50	96.33	99.13	101.57	103.67	104.06	104.95
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	15,051	1,459	1,495	1,389	1,217	1,555	1,496
Exports of goods (EUR, % change, yoy)	12.1	9.2	6.6	9.3	10.6	10.6	10.8
Imports of goods (EUR million)	19,396	1,945	1,883	1,785	1,881	2,061	1,887
Imports of goods (EUR, % change, yoy)	13.6	13.2	9.4	11.4	10.9	12.1	12.3
Current account balance (EUR million)	-2,051	-376	-155	-233	-350	-891	-746
Current account balance (% of GDP)	-5.2	-3.87	-1.45	-2.11	-3.07	-8.74	-6.61
Gross foreign direct investment (EUR million)	2,418	723.5	682.1	598.1	1,184.2	800.5	994.9
Foreign exchange reserves (EUR million, eop)	9,962	10,235	11,104	11,173	11,262	11,441	12,146
Foreign debt (EUR million, eop)	23,539	24,055	24,360	24,280	23,328	23,744	23,892
GOVERNMENT FINANCE							
Revenues (RSD billion)***	1,973	474	527	537	568	525	551
Expense (RSD billion)***	1,763	441	457	462	514	478	491
Net = Gross operating balance (RSD million)***	211	33	70	75	54	47	59
Net acquisition of non-financial assets (RSD million)***	134	29	40	54	77	36	53
Net lending/borrowing (RSD)	77	4	30	21	-23	11	6
Domestic government debt (EUR million, eop)	9,089.1	9,743.9	9,743.2	9,821.6	9,413.5	9,480	9,566.4
Foreign government debt (EUR million, eop)	12,369.5	12,285.3	12,653.9	12,574.5	12,077	12,413	12,461.9
Total government debt (eop. % of GDP)	57.9	56.3	56.8	56.8	54.5	50.9	51.4
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	10.2	9.4	13.5	15.1	18.3	16.4	15.5
Broad money, M4 (% change, yoy, eop)****	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Total domestic credit (% change, yoy, eop)	1.2	2.0	3.9	6.3	7.6	7.0	6.1
DMBs credit to households (% change, yoy, eop)	7.8	6.9	8.9	11.7	12.5	12.1	9.2
DMBs credit to enterprises (% change, yoy, eop)	0.2	0.6	2.9	4.1	6.8	6.7	6.8
Money market interest rate (%, pa)	2.8	2.5	2.4	2.4	2.4	2.1	1.8
DMBs credit rate for enterprises short-term (%, pa)	3.7	3.4	3.6	3.2	3.3	3.2	3.1
DMBs credit rate for households short-term (%, pa)	8.2	8.1	7.9	7.8	7.4	6.8	6.4

Notes: * This unemployment rate is calculated based on the survey.** The average exchange rate is calculated by the author based on calculation from NBS *** On the cash principle, cumulative from the beginning of the year,**** Data on M4 are not compiled by the NBS

Conventional abbreviations: pa-period average, eop-end of period, yoy-year on year, EUR – Euro, US$-US dollar, DMB- deposit money bank, RSD- Serbian Dinar

Sources: Republic Statistical Office, National Bank of Serbia, Ministry of Finance of the Republic of Serbia, Eurostat

Table SRB2 Summary of projections

	2019	2020	2021	2022
Real GDP (% change)	**3.3**	**3.2**	**4.0**	**4.0**
Real private consumption (% change)	3.2	3.2	3.4	3.3
Real government consumption (% change)	2.5	2.0	2.4	2.3
Real investment (% change)	6.6	6.0	6.0	6.0
Exports of goods and services (constant prices, % change)	9.6	8.8	9.2	9.0
Imports of goods and services (constant prices, % change)	9.4	8.2	8.0	8.1
Current account balance (% of GDP)	-5.5	-5.0	-5.0	-5.0
Consumer prices (% change, pa)	2.0	2.0	2.5	2.4
Exchange rate, RSD/EUR (pa)	118	119	120	119
Unemployment rate (%, pa)	13.1	12.8	12.8	11.9
General government balance (ESA 2010 definition, % of GDP)	-0.1	-0.3	-0.5	-0.4
Total domestic credit (% change, eop)	8.5	7.5	6.5	6.7

Conventional abbreviations: pa-period average, eop-end of period, EUR – Euro, RSD- Serbian Dinar
Sources: Author's projections, Fiscal strategy of the Republic of Serbia for 2019 with projections for 2020 and 2021, the IMF WEO

SLOVENIA

Economic growth moderates under the impact of international developments

NLB's privatization process completed

One of the largest and the most demanding privatization process in Slovenia was successfully completed. In June 2019, the sale of the remaining 10 percent minus one share of the Republic of Slovenia's stake in the largest bank, Nova Ljubljanska Banka (NLB), took place. The Slovenian state will remain the bank's largest single shareholder, owning a 25% stake plus one share. The first phase of NLB's privatization process was completed in November 2018 when Slovenia sold 59.1% of NLB's issued share capital in an initial public offering (IPO), which was part of the restructuring plan of NLB agreed with the European Commission under state aid procedure. With completion of the sale, some of the commitments given by the Republic of Slovenia to the European Commission (EC) upon the approval of the state aid granted in 2013 have ceased to apply. Back then, the Slovenian government stepped in to recapitalize NLB (and two other banks - NKBM and Abanka), narrowly avoiding an international bailout.

Economic growth mostly is driven by investments an private consumption

Slovenia's economic growth slowed down to 3.8% y-o-y in the last quarter of 2018 and, further, to 3.3% and 2.5% in the first and second quarters of 2019, respectively. Growth continued to be driven primarily by investment, but export growth also accelerated in the first part of 2019, particularly exports of medicinal and pharmaceutical products. The latter is mostly related to the opening of a regional pharmaceutical distribution center (rather than domestic production). Stronger imports of these products, coupled with robust growth in domestic consumption and strong growth in construction works, contributed to an acceleration of growth in imports. Import growth exceeded export growth in the second quarter of 2019; thus, the contribution to gross domestic product growth of net exports turned negative. Y-o-y growth in investment has strengthened slightly from the end of 2018. Gross fixed capital formation increased by 10.0% and 6.9% y-o-y in the first two quarters of 2019. The increase was more prominent in construction (13.4% in the second quarter), while investment in machinery and equipment was much lower than in the previous quarters (1.3% in the second quarter), reflecting the high-risk external situation.

In the first half of 2019, the value of industrial production increased compared to the same period of 2018 (by 3.7%). The most significant increase was in manufacturing (by 3.9%), followed by mining and quarrying (by 2.1%), and by electricity, gas, and steam supply (by 1.1%). Production growth in manufacturing was mainly a consequence of accelerated production growth in the pharmaceutical industry.

Private consumption, which has been the most important component of final consumption expenditure, somewhat slowed down in the first quarter of 2019 (2.3%) and then picked up in the second quarter (3.4%) underpinned by an increase in the real wage bill. On the other hand, government consumption increased by 1.0% only in the second quarter, significantly less than in the previous quarters.

Employment and wages continue to rise

In the first six months of 2019, employment continued to rise, albeit at a slower pace than in previous years. A large share of enterprises, particularly in labor-intensive industries, continues to face a shortage of appropriately skilled workers due to a mismatch between the skills of young people entering the labour market and the skills sought after by employers. Thus, the hiring of foreign workers contributed more than two-thirds to total employment growth. The y-o-y fall in unemployment has slowed this year amid the already relatively low level of unemployment. The number of unemployed persons (43,000) decreased by 19.3% compared to the 2nd quarter of 2018. According to the Labor Force Survey (LFS), the unemployment rate declined by 1 percentage point y-o-y and stood at 4.2% in the second quarter of 2019.

After starting to rise faster last year, wages increased further in the first half of 2019: gross earnings by 4.3% and net earnings by 3.6%. The increase was higher in the public sector (4.5% in net earnings) than in the private sector (3.3% in net earnings). The wage growth in the public sector was a result of the implementation of agreements with trade unions at the end of 2018 and the increase in the minimum wage at the beginning of 2019. The latter also resulted in further wage growth in the private sector.

General government balance remains in surplus, the debt-to-GDP ratio decreases further

In 2017, the general government balance turned positive after having a significant negative balance from the onset of 2008 crisis. In the first quarter of 2019, the general government balance turned slightly negative (-0.6% of GDP) but again recorded surplus (1.0% of GDP) in the second quarter. General government revenues continued to increase relatively rapidly. On the expenditure side, investment continued to strengthen a wage expenditure was also up.

The debt-to-GDP ratio decreased further in 2018. Supported by economic growth and active public debt management, it stood at 70.1% and was 4.0 percentage points down compared to 2017. Due to the population, aging structural reforms of the pension, healthcare and long-term care systems are becoming increasingly urgent if Slovenia is to ensure the long-term sustainability of its public finances.

Strong growth in consumer loans continues

The volume of consumer loans was rising at a rate of more than 10% y-o-y in the first two quarters of 2019, while growth in housing loans remained moderate and stable. While primarily loans to households contributed to the overall increase in loans in 2018, loans to corporates contributed an increasing amount to growth in the first half of 2019. Growth in loans to corporates rose markedly in June, primarily due to specific major one-off transactions in the trade sector.

Inflation primarily driven by domestic factors

In June 2019 consumer prices grew on average by 1.8% at the annual level. In the first half of 2019, inflation was primarily driven by domestic factors. In addition to favorable economic conditions and rising household consumption, inflation continues to be driven mainly by higher prices of services. Inflationary pressures from external factors remained relatively low as lower levels of oil prices in the world market were holding down growth in domestic energy prices.

The current account surplus narrows while FDI strengthens

The current account surplus amounted to 5.5% of GDP in the second quarter of 2019, down 0.6 percentage point on a year earlier. The main factor for the narrowing surplus was a lower surplus in trade in goods. On the other hand, FDI inflow strengthened further, including via privatization and takeovers in the insurance and non-financial activities. In one year period up to June 2019, the inflow of FDI was EUR 1.4 billion. Most of the increase was in the form of equity and reinvested earnings (EUR 1.1 and 0.5 billion). Slovenian outward FDI was on a significantly lower level; an increase of EUR 118 million was recorded compared to June 2018.

Policy assumptions and summary of projections

Slightly slower growth, driven mainly by private consumption and investment

In the Autumn Forecast, the prospects of economic growth were revised downwards. The gross domestic product is forecast to slow down to 2.8% in 2019, and remain at similar levels in the next two years (3.0% and 2.7% respectively). The revision took place due to the economic slowdown in trading partners and more uncertainty in the external environment. The negative contribution of net exports will thus be more pronounced, and the growth of gross fixed capital formation lower.

With continued employment and wage growth as well as high confidence among consumers, private consumption is expected to play a significant role in maintaining solid growth rates over the forecast horizon. Although investment growth is set to moderate compared to the very high level of 2018, a further increase in investment, construction investment, in particular, will also support economic growth. The growth of government consumption is forecast to decline in 2019–2021 gradually.

Employment growth is expected to slow down to 3.2% and 2.8% in 2019 and 2020, respectively, under the impact of weaker growth in economic activity and, increasingly, demographic trends. The unemployment rate, as measured by the Labor Force Survey (LFS), will decline to 4.3% and 4.0%, respectively, in 2019 and 2020.

Inflation is expected to rise moderately over the forecast period (from 1.8% in 2019 to 2.3% in 2021) driven by further growth in demand, particularly in the services sector, but also in non-energy goods, as well as wage increases.

Table SI1 Main economic indicators

	2017	2018				2019	
		Q1	Q2	Q3	Q4	Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	4.8	4.3	3.7	4.6	3.8	3.3	2.5
Real private consumption (% change, yoy)	2.3	4.0	3.3	2.2	4.1	2.3	3.4
Real government consumption (% change, yoy)	0.3	2.4	3.1	3.2	4.0	3.9	1.0
Real investment (% change, yoy)	10.4	9.9	9.1	11.9	7.1	10.0	6.9
Industrial output (% change, yoy)	7.7	7.8	5.6	3.5	2.5	3.2	4.1
Unemployment rate (registered, % pa)	9.5	9.0	8.1	7.9	8.0	8.3	7.5
Nominal GDP (EUR million)	42,987	10,564	11,509	11,812	11,871	11,169	12,124
GDP per capita (EUR)	20,809	5,111	5,567	5,706	5,717	5,368	5,817
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	1.6	-0.2	2.3	3.8	2.8	-0.1	2.9
Consumer prices (% change, yoy, pa)	1.4	1.3	1.9	1.9	1.9	1.3	1.6
Producer prices (% change, yoy, pa)	2.2	2.2	2.1	2.4	1.6	1.1	0.9
Average gross wage (% change, yoy, pa)	2.7	3.6	3.6	3.0	3.3	4.6	3.9
Exchange rate (EUR/USD, pa)	1.13	1.23	1.19	1.16	1.14	1.14	1.12
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	28,478	7,537	7,932	7,605	8,059	8,271	8,725
Exports of goods (EUR, % change, yoy)	11.0	8.1	8.4	3.9	5.6	8.2	10.0
Imports of goods (EUR million)	26,899	7,209	7,506	7,234	8,056	7,887	8,507
Imports of goods (EUR, % change, yoy)	11.1	10.3	8.7	5.6	9.5	7.9	13.8
Current account balance (EUR million)	2,635	693	699	800	401	650	663
Current account balance (% of GDP)	6.1	6.6	6.1	6.8	3.4	5.8	5.5
Gross foreign direct investment (EUR million)	1,065	284	216	483	311	847	44
Foreign exchange reserves (EUR million, eop)	743	716	715	781	816	858	906
Foreign debt (EUR million, eop)	43,191	42,796	42,857	41,948	42,100	42,475	43,588
GOVERNMENT FINANCE							
Revenues (EUR million)	18,935	4,707	5,098	5,058	5,415	4,979	5,331
Expense (EUR million)	18,941	4,712	4,967	4,999	5,248	5,042	5,207
Net lending/borrowing (EUR million)	-6	-4	131	60	167	-63	124
Domestic government debt (EUR million, eop)	23,615	26,355	26,356	26,255	26,179	26,688	26,764
Foreign government debt (EUR million, eop)	5,125	3,785	3,013	3,011	3,002	1,899	1,895
Total government debt (eop. % of GDP)	74.1	75.6	72.9	71.4	70.4	68.1	67.7
MONETARY INDICATORS							
Total domestic credit (% change, yoy, eop)	5.3	2.5	4.8	5.6	2.3	3.0	2.6
DMBs credit to households (% change, yoy, eop)	6.4	6.0	6.2	6.5	6.5	6.6	6.1
DMBs credit to enterprises (% change, yoy, eop)	0.0	0.3	-1.0	-1.0	-1.4	0.2	1.6
Money market interest rate (%, pa)	-0.35	-0.36	-0.36	-0.36	-0.36	-0.37	-0.37
DMBs credit rate for enterprises short-term (%, pa)	2.3	2.1	2.1	2.3	2.1	1.8	1.8
DMBs credit rate for households short-term (%, pa)	3.3	3.5	3.3	3.2	3.3	3.3	3.2

Notes: * Data refer to consolidated general government. ** ESA 2010.

Conventional abbreviations: pa - period average; eop - end of period; yoy - year on year; EUR – euro; DMB – deposit money bank.

Sources: Statistical Office of the Republic of Slovenia, Bank of Slovenia, Ministry of Finance, Institute for Macroeconomic Analysis and Development - IMAD and calculations by IER.calculations by IER.

According to the Summer 2019 Economic Forecast of the European Commission, the general government balance is forecast to remain positive in the next few years. It is expected to reach 0.7% of GDP by the end of 2019 and increase to 0.9% in 2020. Revenue growth will remain underpinned primarily by rising revenues from taxes and social contributions, but higher inflows from EU funds are also expected. Expenditure growth, on the other hand, will be driven mainly by an increase in compensation of employees and social transfers, and a rise in government investments due to the closing of the EU financial framework 2014–2020. ■

Table SI2 Summary of projections

	2019	2020	2021	2022
Real GDP (percent change)	**2,8**	**3,0**	**2,7**	**NA**
Real private consumption (% change)	3,4	2,7	2,2	NA
Real government consumption (% change)	2,2	1,7	1,4	NA
Real investment (% change)	6,8	6,8	7,0	NA
Exports of goods and services (constant prices, % change)	7,8	5,0	4,8	NA
Imports of goods and services (constant prices, % change)	9,2	5,8	5,5	NA
Current account balance (% of GDP)	4,9	4,7	4,3	NA
Consumer prices (% change, pa)	1,8	2,0	2,3	NA
Exchange rate, national currency/EUR (pa)	1,12	1,12	1,12	NA
Unemployment rate (registered, %, pa)	7,7	7,2	6,9	NA
General government balance (ESA 2010 definition, % of GDP)	0,7	0,9	NA	NA
Total domestic credit (% change, eop)	NA	NA	NA	NA

Notes: Cut-off date for information used in the IMAD's compilation of projections was 5 September 2019.

Conventional abbreviations: pa - period average; eop - end of period; USD - US dollar.

Sources: Institute for Macroeconomic Analysis and Development - IMAD (Autumn Forecast of Economic Trends 2019) and European Commission (Summer 2019 Economic Forecast).

ANALYSIS

Exports and imports in selected SEE countries

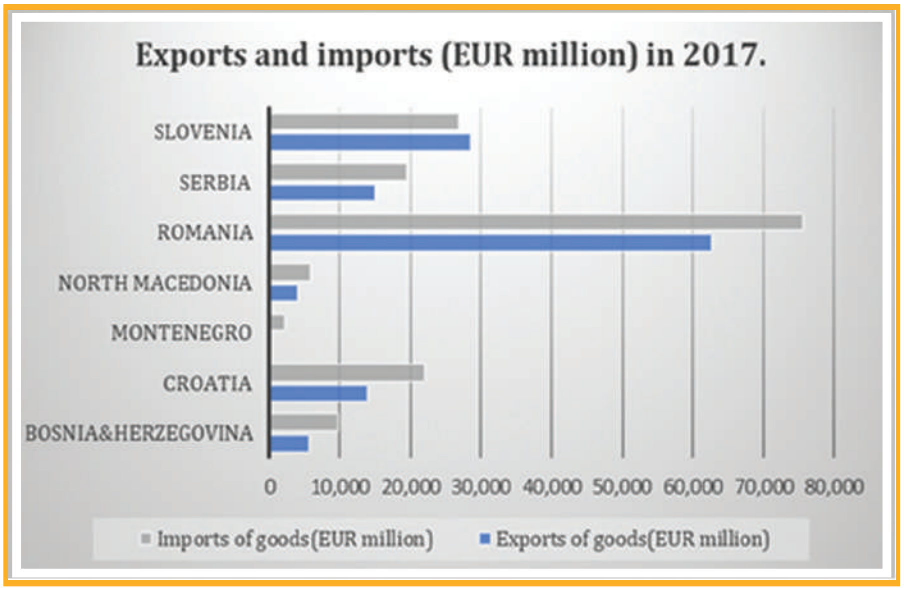
In this number of the publication, we are giving the review of analyzed countries based on their export-import outcomes in 2017, the last two quarters of 2018. and the first two quarters of the 2019 year.

The first table provides us information about the 2017 year for exports of goods and imports of goods in EUR million.

	2017	
Country	**Exports of goods (EUR million)**	**Imports of goods (EUR million)**
Bosnia & Herzegovina	5,640	9,833
Croatia	13,983	22,078
Montenegro	382.4	2,242
North Macedonia	4,074	5,861
Romania	62,644	75,603
Serbia	15,051	19,396
Slovenia	28,478	26,899

As you can see from the table, all countries, except Slovenia had a deficit in balance. The highest amount for both, foreign trade sides, the export, and import, had Romania. Observing the table above, we can conclude that Montenegro has the lowest value of both indicators, even below billion, comparing to other countries.

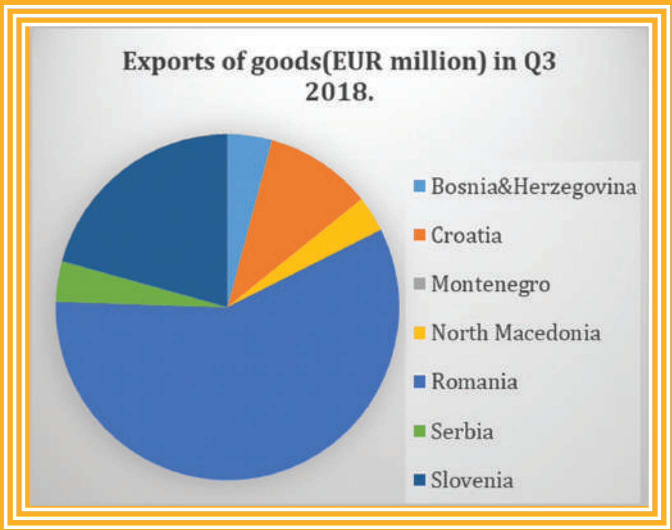
To see the sides of trades, the graph below shows us for all countries, imports of goods as well as the exports of goods in the mentioned year.

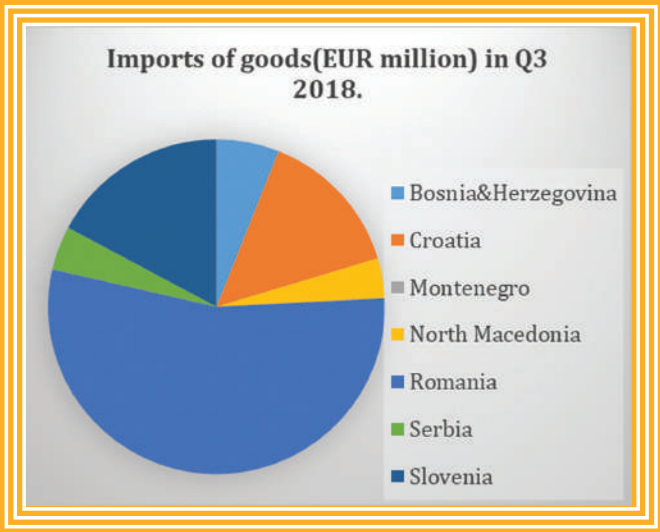


In the next table, data for export and import, for Q3 and Q4 of the 2018 year is shown.

2018	Q3	Q4	Q3	Q4
Country	**Exports of goods (EUR million)**		**Imports of goods (EUR million)**	
Bosnia & Herzegovina	1,535	1,559	2,534	2,514
Croatia	3,701	3,854	6,035	6,155
Montenegro	104.8	120.4	667.0	644.9
North Macedonia	1,232	1,384	1,628	1,858
Romania	21,259	21,739	22,929	23,755
Serbia	1,389	1,217	1,785	1,881
Slovenia	7,605	8,059	7,234	8,056

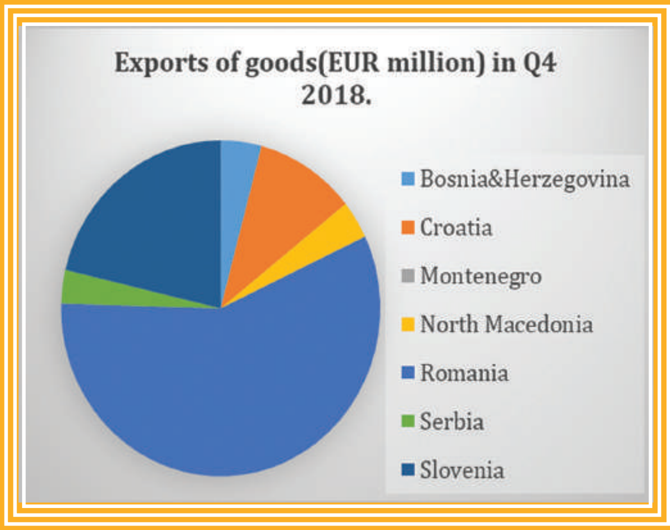
As shown in the table above, in the column exports of goods, we see that all countries except Serbia had an increase in Q4 of 2018. On the other side - imports of goods, all countries had an increase except Bosnia & Herzegovina and Montenegro, which had decrease comparing these two quarters of 2018. In the graph below we can see which country had the highest export and import of goods in Q3 of 2018. Within certain sections of imports in Bosnia & Herzegovina, imports of pearls, precious stones, and metals; arms and ammunition most increased in this period.

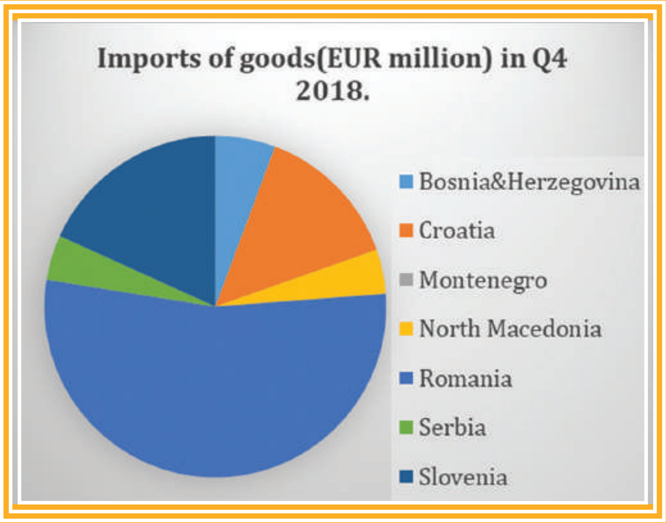




We can see that Slovenia had a smaller share of imports than exports. That means it had surplus in that quarter. All other countries had imports > exports; they had deficit of balance of trade. Montenegro can not be seen on the graph and the reason is its value, which is below other values (like mentioned before, below billion)

In the next graphs the same information about export and import of goods is shown, but for the fourth quarter of 2018.





Next table is showing balance trade in the first quarter of 2019. As we can see, all countries have a deficit, the only exception is Slovenia, which had a surplus - export>import.

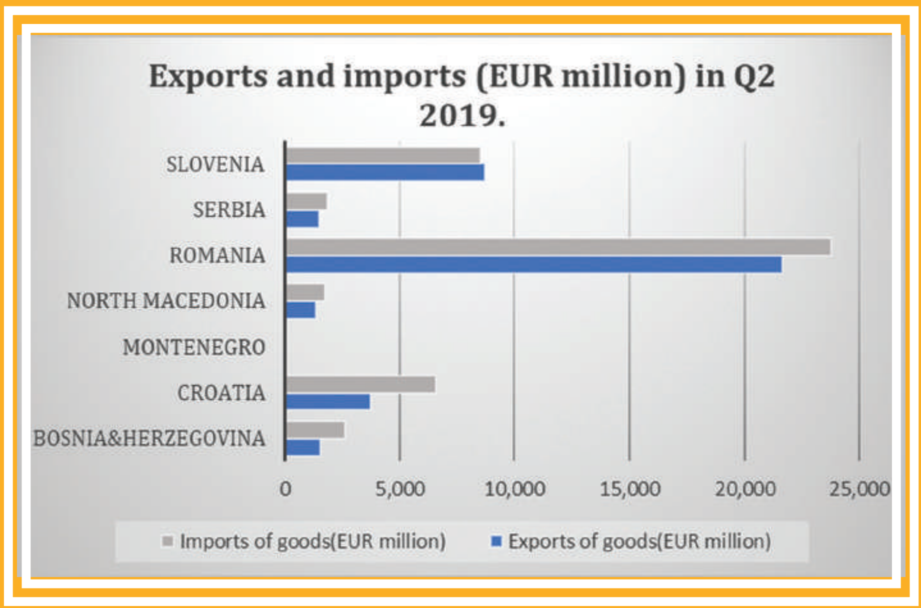
2019	Q1	Q1
Country	**Exports of goods (EUR million)**	**Imports of goods (EUR million)**
Bosnia & Herzegovina	1,413	2,352
Croatia	3,623	6,177
Montenegro	101.1	510.3
North Macedonia	1,245	1,718
Romania	21,910	24,009
Serbia	1,555	2,061
Slovenia	8,271	7,887

The table below shows export/import for the second quarter of 2019 year.

2019	Q2	Q2
Country	**Exports of goods (EUR million)**	**Imports of goods (EUR million)**
Bosnia & Herzegovina	1,560	2,636
Croatia	3,727	6,583
Montenegro	114.4	696.5
North Macedonia	1,350	1,784
Romania	21,657	23,777
Serbia	1,496	1,887
Slovenia	8,725	8,507

Slovenia's export growth accelerated in both quarters of 2019, particularly because of exports of medicinal and pharmaceutical products. The latter is mostly related to the opening of a regional pharmaceutical distribution center (rather than domestic production). Stronger imports of these products contributed to an acceleration of growth in imports. The biggest impact on the growth of Montenegro export, had road vehicles, cork, and wood, meat, etc., and on the import side, the biggest impact had electricity, medical and pharmaceutical products, furniture, as well as machinery. For country Croatia, export growth has been continuously deteriorating since 2017 and that this trend will continue further as a result of foreign demand weaken in the main EU trading partners. The exports of the services in tourism are still high and had a contributing influence on GDP growth. For North Macedonia, the current account deficit declines the second year in a row. This change is a result due to the improvement in the trade balance of goods, which is mainly a result of the stronger export activity of industrial facilities with foreign capital. Bosnia & Herzegovina had growth in imports, hence, that led to an increase in the trade deficit. Romania's main determinant of import and export was consumption goods. Foreign trade of this country was affected by the fluctuations of the real exchange rates with major commercial partners. Net exports had a substantial negative contribution to GDP and, so, an increase in the commercial balance deficit. Serbia is an importer of chemicals and chemical products, fuel and oil, basic metals, machinery and equipment, and motor vehicles. On the other side, it exports mostly cars, insulated wire, rubber tires, electric motors, frozen fruits and nuts, and other categories. The top destination for exporting and importing goods from this country is Germany.

In the next graph, it is shown export & import for the second quarter of 2019. Romania had the highest value for both indicators, as in the previous quarters, and Montenegro the lowest (below billion).



We can compare two tables above first quarter of 2019 year and second quarter of 2019, and see that all countries had increase of both indicators except Romania (Export – first quarter of 2019. is 21,910 eur million and in the second 21,657eur million; import-24,009eur million in the first quarter and then 23,777eur million in the second quarter of 2019) and Serbia (Export – in the first quarter of 2019. 1,555 eur million, and the second quarter of 2019. was 1,496eur million; import – in the first quarter was 2,061eur million, in the second quarter was 1,887eur million) which had a decrease in both sides of balance of trade.

In the next period, we can expect that reform measures in Bosnia & Herzegovina should result in strengthening foreign trade. Croatia's export will slow down in the growth, and import will accelerate because of lowering demand in the traditional export markets (Italy and Germany) and slowing down tourism, which in previous years was more successful. Montenegro will slowly go into surplus of balance. The deficit of North Macedonia in the projected period is expected to be fully financed by the flows in the financial account through foreign direct investments and external borrowing, which will enable further growth of foreign reserves and their maintenance at an appropriate level. Romania's export will slow down as well as imports, but it will be higher than export as in the previous years. Slovenia's surplus will reduce, and the reason is slowing down export and increasing imports. It is projected that in the next periods' balance with deficit is possible. Serbia's deficit will remain, but it will be lower than before.

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