SEE-6
Economic Outlook

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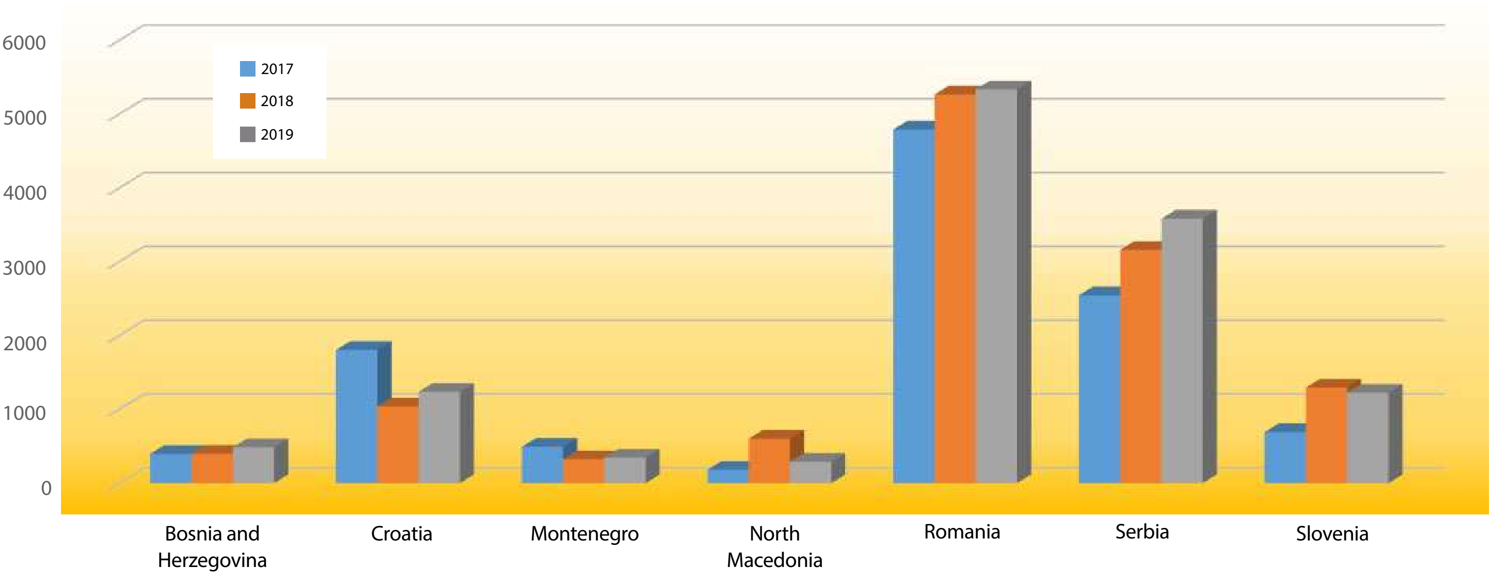


Source: UNCTAD and official data by the seven countries of Southeast Europe

seea | Vol. 6 | No. 1 | June 2020 | e-ISSN 1849-8884 | ISSN 1849-8817

BOSNIA AND HERZEGOVINA

Economic slowdown and continued political uncertainty

The delay in forming governments has blocked much needed reforms

Although the general elections were held in October 2018, 2019 was marked by the state-level government formation process, with the Council of Ministers of Bosnia and Herzegovina forming only at the end of the year. Therefore, the EU accession process and public administration reform are stalled. A countrywide strategic framework on public administration reform for 2018-22, developed by inter-institutional working groups appointed by the Council of Ministers of Bosnia and Herzegovina and the entity and Brcko District governments in March 2018, is lacking as Republika Srpska has still not adopted it. The need for reform is urgent as the public administration in Bosnia and Herzegovina is complex and often has overlapping competencies, duplications of functions and an unclear division of responsibilities across various levels of governments. Pressures from frequent elections and slow implementation of structural reforms together with the ongoing crisis will weigh heavily on the government's ability to accelerate growth.

The country submitted an EU membership application in February 2016. In May 2019 the European Commission issued the Opinion on the application. The Opinion identifies 14 critical priorities for the country to fulfil in order to be recommended for the status of EU candidate country. These priorities

lie in the areas of democracy and functionality of institutions, the rule of law, fundamental rights and public administration reform. The Commission encouraged the authorities to agree and implement socio-economic reform measures, in line with the Economic Reform Programme policy guidance, and to continue engaging in regional cooperation and strengthening bilateral relations with neighbouring countries. Since the government did not implement these reforms by the end of 2019, Bosnia and Herzegovina is still waiting for the status of an EU candidate country.

Growth continued in 2018 amid political uncertainty but has slowed in 2019

There was a slight slowdown in economic growth in 2019. Compared to 2018, when average GDP growth was 3.7%, in 2019, this rate dropped to 2.6%. If we look at the structure of GDP, the leading cause of the decline in economic growth lies primarily in the fall in real consumption (especially private consumption) and then in the fall in real investment and an increase in the foreign trade deficit. The decline in economic growth in major trading partners has further contributed to the slowdown in BiH's economic growth. Of particular concern is that in 2019, industrial production recorded a decline of -5.5% (y/y).

A decline in unemployment, although youth unemployment remains high

The registered unemployment rate decreased in 2019 compared to the previous year and was 33.3% (in 2018 it was 36.0%). This decrease in the unemployment rate was partly driven by the steady increase in the number of employees in 2019. However, at the same time, the number of unemployed persons declined at a higher rate in 2019, which may imply that part of the unemployed emigrated from the country. The (survey) unemployment rate was the highest among young people aged 15-24, accounting for 33.8%. In 2019, 23.1% of unemployed people have been looking for work for less than one year, and as many as 75.7% of unemployed have been looking for work for more than one year.

Inflation has trended down, and gross wages have increased slightly

In 2019, the trend of low general price level continued. The inflation rate was 0.6% in 2019, representing a slight improvement over 2018 when inflation was 1.2%. Inflation slowed due to a fall in prices in the sections clothing and footwear (11.0%), transport (1.0%) and furniture and household appliances (0.8%). On the other hand, prices in the section of alcoholic beverages and tobacco increased by 4.2% as a result of the increase in excise taxes on cigarettes and tobacco in 2019. In the observed period, there was a slight increase in gross wages. At the end of 2019, average gross wages were EUR 739, an increase of 4.3% y / y (in 2018, average gross wages increased by 3.1%).

The decline in foreign trade and the deterioration in the balance of trade

The volume of total foreign trade decreased by 1.4% in 2019 compared to 2018. The decline in foreign trade was due to a significant decrease in exports during 2019, especially in the last two quarters (a decrease of 5.8%, and 7.5%, respectively). At the same time, imports were declining at lower rates, which ultimately resulted in a deterioration in the balance of trade in 2019. Bosnia and Herzegovina, in foreign trade terms, is rather concentrated on the markets of EU countries, placing almost 3/4 of its exports on EU markets. Therefore, the weakening of economic activity in the EU countries led to a weakening of export demand, which was manifested by a decrease in the manufacturing industry and a decrease in commodity exports.

The consolidated budget stayed in surplus for the fourth year in a row

The budget surplus is also likely to be recorded in 2019 (although data for the fourth quarter of 2019 is missing at the time of writing this review). In the first three months of 2019, BAM 9.5 billion of public revenue was collected, an increase of 3.4% over the same period in 2018. The highest contribution to the growth of public revenues was achieved due to the growth of VAT revenues and contributes. On the other hand, total public expenditures amounted to BAM 8.3 billion, an increase of 5.4% over the same period in 2018. These trends in government finances contributed to a decrease in domestic government debt by EUR 147 million at the end of 2019. However, the quality of fiscal governance has remained low. The country lacks medium-term fiscal planning and focuses strongly on maintaining current spending patterns, often at the cost of delaying much-needed public investment.

Table BH1 Main economic indicators

	2018				Total 2018 year	2019			
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4
ECONOMIC ACTIVITY									
Real GDP (% change, yoy)	3.5	3.9	3.4	4.1	3.7	2.8	3.0	3.1	1.6
Real private consumption (% change, yoy)	1.4	2.3	2.2	3.4	2.3	3.8	3.7	2.0	0.0
Real government consumption (% change, yoy)	-0.2	-0.3	1.1	3.0	0.9	3.0	2.5	2.0	1.6
Real investment (% change, yoy)	14.4	-2.1	15.4	-4.9	5.7	8.7	13.5	1.2	1.9
Industrial output (% change, yoy)	5.2	1.6	0.8	-0.5	1.8	-5.1	-3.9	-6.0	-6.8
Unemployment rate (registered, % pa)	37.3	36.1	35.7	34.8	36.0	34.3	33.0	33.1	32.6
Nominal GDP (EUR million)	3,923	4,255	4,469	4,415	17,062	4,154	4,483	4.66	4,567
GDP per capita (EUR)	1,121	1,216	1,277	1,261	4,875	1,187	1,281	1,333	1,305
PRICES, WAGES AND EXCHANGE RATES									
Implicit GDP deflator (% change, yoy)	1.8	1.9	0.9	1.1	1.4	1.6	1.1	1.1	1.1
Consumer prices (% change, yoy, pa)	0.8	1.4	0.9	1.7	1.2	1.0	0.6	0.4	0.2
Producer prices (% change, yoy, pa)	3.2	4.0	4.5	2.5	3.6	1.4	0.6	-0.3	0.1
Average gross wage (% change, yoy, pa)	2.1	2.7	3.5	4.2	3.1	4.0	4.4	4.5	4.3
Exchange rate (BAM/EUR, pa)	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96
Exchange rate (BAM/USD, pa)	1.59	1.64	1.68	1.72	1.65	1.72	1.74	1.75	1.76
FOREIGN TRADE AND CAPITAL FLOWS									
Exports of goods (EUR million)	1,422	1,554	1,535	1,559	6,070	1,414	1,560	1,446	1,442
Exports of goods (EUR, % change, yoy)	12.0	11.9	4.3	3.3	7.9	-0.6	0.4	-5.8	-7.5
Imports of goods (EUR million)	2,245	2,526	2,547	2,514	9,832	2,354	2,636	2,471	2,462
Imports of goods (EUR, % change, yoy)	10.1	6.3	5.6	2.2	6.1	4.8	4.3	-3.0	-2.1
Current account balance (EUR million)	-207	-146	-104	-174	-631	-236	-187	-46	-160
Current account balance (% of GDP)	-5.3	-3.4	-2.3	-3.9	-3.7	-5.7	-4.2	-0.9	-3.5
Foreign Direct Investment net inflows (EUR million)	144	72	124	59	399	133	220	87	47
Foreign exchange reserves (EUR million, eop)	5,553	5,663	5,898	5,930	5,930	5,853	6,133	6,352	6,426
Foreign debt (EUR million, eop)	4,256	4,265	4,234	4,183	4,183	4,227	4,188	4,211	4,127
GOVERNMENT FINANCE									
Revenues (BAM million)	2,882	3,075	3,250	3,259	12,467	3,014	3,187	3,322	N/A
Expense (BAM million)	2,462	2,723	2,754	3,417	11,356	2,646	2,829	2,896	N/A
Net = Gross operating balance	420	352	496	-158	1,110	368	358	426	N/A
Net acquisition of non-financial assets (BAM million)	31	66	91	238	426	26	72	79	N/A
Net lending/borrowing (BAM million)	389	285	405	-441	638	342	287	347	N/A
Domestic government debt (EUR million, eop)	874	862	745	735	3,216	760	768	762	779
Foreign government debt (EUR million, eop)	5,048	5,194	5,146	5,093	19,481	5,148	5,110	5,159	5,098
Total government debt (eop. % of GDP)	N/A	N/A	N/A	N/A	24.5	N/A	N/A	N/A	N/A
MONETARY INDICATORS									
Narrow money, M1 (% change, yoy, eop)	12.5	13.1	14.4	14.9	14.9	11.2	9.9	7.5	9.1
Broad money, M4 (% change, yoy, eop)	8.2	9.2	9.3	9.4	9.4	9.0	8.1	8.0	8.8
Total domestic credit (% change, yoy, eop)	5.9	6.5	6.3	5.8	5.8	5.7	5.5	4.5	6.6
DMBs credit to households (% change, yoy, eop)	6.4	6.7	6.9	7.3	7.3	7.5	7.4	6.6	7.9
DMBs credit to enterprises (% change, yoy, eop)	7.2	6.2	4.8	3.6	3.6	2.9	4.8	3.4	4.7
Money market interest rate (%, pa)	N/A	N/A	N/A	N/A	3.8	N/A	N/A	N/A	N/A
DMBs credit rate for enterprises short-term (%, pa)	5.3	4.8	4.9	5.4	5.1	5.6	4.6	4.0	4.0
DMBs credit rate for households short-term (%, pa)	4.1	3.8	3.6	4.4	3.9	4.1	4.2	4.0	3.8

Policy assumptions and projections summary

The slowdown in economic growth triggered by implemented pandemic measures

Projections are marked by COVID-19 and implemented measures to combat the pandemic. Growth is projected at -3.2% in 2020, a significant revision from the pre-COVID-19 projection of 3.4% for the year. As the situation improves and Socio-Economic program implementation accelerates, investments are expected to increase (5.7% in 2022), and a moderate rise in exports is expected (0.7% and 1.5% in 2021 and 2022, respectively).

Table BH2 Summary of projections

	2020	2021	2022
Real GDP (% change)	-3.2	3.4	3.6
Real private consumption (% change)	-1.4	3.4	3.6
Real government consumption (% change)	0.7	4.7	4.7
Real investment (% change)	-4.7	-0.2	5.7
Exports of goods and services (constant prices, % change)	-0.6	0.7	1.5
Imports of goods and services (constant prices, % change)	-0.2	0.6	3.0
Current account balance (% of GDP)	-5.7	-4.9	-4.0
Consumer prices (% change, pa)	1.2	1.2	1.6
Exchange rate, national currency/EUR (pa)	1.96	1.96	1.96
Unemployment rate (registered, %, pa)	34.8	32.5	31.9
General government balance (ESA 2010 definition, % of GDP)	-0.4	1.4	1.8
Total domestic credit (% change, eop)	4.8	5.0	5.5

Consumption will continue to drive growth, resulting in strong growth imports (3.0% in 2022). As a result of such unfavourable foreign trade developments, the current account balance will deteriorate in 2020 (-5.7% of GDP). Remittances will decline in 2020 but are likely to increase again and stabilize at 8% of GDP in the medium term. Therefore, a slight budget deficit (-0.4%) will be reached in 2020, but the budget balance will be restored in 2021 and 2020. In 2020, there will be an increase in unemployment (34.8%) due to the slowdown in the economy, but in 2021 and 2022, there will be a further decrease in the unemployment rate.

Monetary policy anchored to the Euro will continue to support local currency stability and safeguarding the banking sector will be necessary.

CROATIA

Economic growth more robust than expected in 2019

Economic growth accelerated to 2.9% owing to an increase in public investments and private consumption

The GDP growth in Croatia in 2019 accelerated to 2.9%, after a period of slowdown in 2018 when it fell to 2.7%. The growth in 2019 was more substantial than expected thanks to an extraordinary growth rate achieved in the first quarter when it reached a record level of 4.1% and in the third quarter when it reached 2.9%. More profound than in the previous years, the massive increase of public investments, mainly coming from EU funds was a significant driver of economic growth in 2019. Additional impulse originated from the further strengthening of traditionally high household consumption, reflecting the continued growth of disposable income. In addition to that, despite the fears that the role of the tourist industry would decrease as the essential contributor to growth, this sector in general performed even better in 2019 than in 2018.

Growth was dominantly driven by private consumption and public investments

The boost of public investments owing to increased absorption of the EU funds has been a significant source of economic growth in 2019, much more than in previous years, as many of the infrastructure projects went into the implementation phase. Quarterly real investments rates were especially strong in the first half of the year (11.5% in Q1 and 8.5% in Q2), but high rates also continued in the second half of the 2019 (5.5% in Q3 and 4.0% in Q4).

Private consumption continued to be a reliable driver of economic growth throughout 2019, with exceptionally high real growth rates in the first and the last quarter. Like in the previous year, the household income increased due to further income tax relaxation measures that led to an increase in wages. Household income further increased also owing to the increased revenues from the tourist sector and remittances from abroad. The purchasing power of private consumers was additionally supported with a subdued inflation rate that more than halved throughout 2019 as compared to the rates in 2018.

The government consumption has also continued to rise sharply, according to the Ministry of Finance, especially in the first two quarters of 2019 with growth rates of 3.1% and 3.9% respectively. The government consumption increased due to rise of expenditures for wages that grew for public sector workers by 3% starting in January 2019 as well as due to increases of expenditures that kept coming from public sectors such as health, pensions and public administration.

Exports continuied to be an essential source of growth

The exports of goods have been rising significantly throughout 2019 at the quarterly rates ranging from 6.5 % in the first quarter, 3.8% in the second quarter, to the peak of 9.2% in the third quarter and down to traditionally weak fourth quarter with only 0.9% rate. The reasons behind the extraordinary good growth of exports in the third quarter are the outstanding export of ships and pharmaceuticals. The exports of goods considerably improved in 2019, despite the expectations that they would further deteriorate due to economic slowing down in Croatia's main export markets and consequent decrease of demand. The overall exports continued to have an essential role in overall economic growth in 2019; regardless the fact that exports of goods' net impact to growth have been continuously deteriorating in the last three years, thus contributing to shrinking of current account surplus. At the same time, imports of goods have also been rising sharply, due to higher domestic industry demand in 2019, however at slower rates then exports, also achieving the peak rate of 8.8% in the third quarter and then falling sharply in the fourth quarter (-1.5%).

On the other hand, the exports of services, especially related to tourism, have also been rising in 2019 with a positive continuation of their net contribution to economic growth and current account balance. Imports of services, on the other hand, have continued to slow down in 2019, thus also contributing to the favourable current account balance.

Consequently, the current account runs a significant surplus of 4.5 billion Euro in the third quarter of 2019, with estimates of achieving a total surplus of 2.0% of GDP, much higher than initially planned 1.3%.

Industrial output reflecting significant structural problems

The industrial output grew only during the two out of four quarters of 2019, 2.7% in the first and 1.2% in the third quarter and falling significantly especially in the last quarter (-2.1%). Such a situation reflects a deeper inability of the industry to recover from the fall in the previous years. Unresolved structural problems within the shipbuilding and several other industries (such as railroad and other transport industries as well as several manufacturing industries), which are constantly facing significant competitiveness challenges are consequently having adverse cascading effects on the growth of the whole industry.

Employment continuied to rise while unemployment reached another record low

Developments in the labour market reflected strengthening demand for labour on the wings of strong economic growth in 2019. The employment levels have been rising both in terms of total employment rate (from 60.6% in Q4 2018 to 62.2% in Q4 2019) and in terms of the number of newly employed persons (in total 47,000 more employed in December 2019 compared to January 2019). The new employment traditionally peaked in July with nearly 62,000 newly employed, however mostly related to seasonal workers. The total activity rate has also risen to 67.1% in Q4 2019 compared to 63.3% in the same quarter of 2018. Labour shortages continued to be pronounced in 2019, especially in tourism and hospitality sectors, as well as in construction, which led the Government to uplift the targeted quotas for foreign workers.

The strong economic growth also contributed to further fall of unemployment rate in 2019 that reached another record low level in the last quarter of 2019 when the registered unemployment was only 8.3%, according to the Croatian Bureau of Statistics. However, the continuing fall of registered unemployment for several years now is to a significant part a result of a massive emigration of unemployed persons to the EU countries. Besides, active labour market policies also contributed to the fall of registered unemployment. Namely, the continuing rise of self–employment also contributed significantly. At the level of the whole 2019 self-employed persons participate with close to 13% of all employed, the share that is among the highest in the new EU member states.

Fiscal health additionally improved

The responsible fiscal policy also continued in 2019, with outstanding results achieved related to fiscal balance. In the first quarter of the year, the European Commission declared that Croatia has no longer severe external macroeconomic imbalances that led her to introduce the macroeconomic imbalances monitoring measures and Excessive Deficit Procedures in 2014. That recognition led towards restoring Croatia's investment rating by most of the relevant rating agencies (Standard and Poor's, Fitch, Moody's), with a favourable impact on the rise of total investments and overall more positive economic outlook of the country.

The budget continued to run small primary surpluses during 2019, for the third year in a row (at the level of 0.4% of GDP according to the recent estimates), despite the tax cuts effective at the beginning of 2019 that also included reductions of VAT rates for several unprocessed food products, baby diapers and the medicines. Apparently, despite the revenues gap, these measures have not harmed overall fiscal balance. The additional increase of private consumption propelled by the increase of wages and other disposable income (such as remittances from abroad), successfully compensated the fall in revenues caused by tax cuts.

The gross government debt ratio additionally reduced by the end of 2019 to 73.2% due to more substantial economic growth, although several quarterly ratios of total public debt to GDP even increased and peaked in the third quarter reaching 76.4%. Such an increase was a result of sustainable debt management measures, which included the favourable refinancing of old debts at historically lowest and predominantly fixed rates and extended maturities. These measures additionally improved the fiscal balance health and its sustainability in the future.

Consumer prices continued to fall

Consumer prices index (CPI) almost halved in 2019 (0.8%) as compared to the rates in 2018 (1.5%), while quarterly rates were ranging from modest 0.5% to 09%. The most significant fall was achieved in the first two quarters of 2019 (0.5% and 0.7% respectively) mostly owing to the effects of the reduction of VAT from 25% to 13% for some unprocessed food and other products that came into force from 1st January 2019. In the second part of the year, consumer prices also continued to have rather moderate rates of 0.9% in the third quarter and 0.8% in the last quarter. Furthermore, the prices of energy remained rather low throughout the year, also affecting positively producer prices, which remained moderate and at a much lower level than in 2018.

Table HR1 Main economic indicators

	2018				Total 2018 year	2019			
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4
ECONOMIC ACTIVITY									
Real GDP (% change, yoy)	2.2	3.2	3.0	2.2	2.7	4.1	2.4	2.9	2.5
Real private consumption (% change, yoy)	3.8	3.7	3.9	3.9	3.8	4.4	2.7	3.3	4.0
Real government consumption (% change, yoy)	2.8	2.5	3.7	2.3	2.8	3.1	3.9	2.9	3.5
Real investment (% change, yoy)	3.5	3.1	3.9	6.1	4.1	11.5	8.2	5.5	4.0
Industrial output (% change, yoy)	0.3	0.4	-1.5	-3.3	-1.0	2.7	-0.9	1.2	-2.1
Unemployment rate (registered, % pa)	12.1	9.5	8.5	8.7	9.2	9.4	7.3	6.8	8.3
Nominal GDP (EUR million)	11,298	13,009	14,431	12,756	51,654	11,878	13,548	15,283	13,257
GDP per capita (EUR)	2,763	3,181	3,525	3,086	12,632	2,921	3,331	3,758	3,260
PRICES, WAGES AND EXCHANGE RATES									
Implicit GDP deflator (% change, yoy)	0.4	0.9	1.0	1.7	1.8	1.4	0.9	1.8	1.5
Consumer prices (% change, yoy, pa)	1.0	1.9	1.9	1.3	1.5	0.5	0.7	0.9	0.8
Producer prices (% change, yoy, pa)	1.3	2.4	3.7	2.0	2.1	1.5	1.5	-0.1	1.5
Average gross wage (% change, yoy, pa)	4.8	5.9	5.1	3.7	4.9	3.9	3.5	3.5	3.7
Exchange rate (HRK/EUR, pa)	7.44	7.39	7.41	7.42	7.42	7.42	7.42	7.41	7.44
Exchange rate (HRK/USD, pa)	6.05	6.20	6.37	6.50	6.28	6.53	6.66	6.59	6.82
FOREIGN TRADE AND CAPITAL FLOWS									
Exports of goods (EUR million)	3,301	3,667	3,709	3,866	14,543	3,617	3,753	3,969	4,067
Exports of goods (EUR, % change, yoy)	-3.0	8.9	6.3	0.1	3.8	6.5	3.8	9.2	0.9
Imports of goods (EUR million)	5,670	6,035	5,963	6,080	23,748	6,091	6,571	6,207	5,987
Imports of goods (EUR, % change, yoy)	7.8	5.7	5.1	11.3	8.5	7.4	8.8	4.1	-1.5
Current account balance (EUR million)	-1,824	-114	3,800	-874	982	-2,067	-342	4,571	-592
Current account balance (% of GDP)	2.6	2.9	3.2	2.6	1.9	3.5	2.3	3.0	2.9
Foreign Direct Investment net inflows (EUR million)	566.3	519.1	115.6	-159.0	1.042	493.7	-19.4	471.9	291.1
Foreign exchange reserves (EUR million, eop)	16,480	16,694	16,637	17,438	17,438	18,321	19,149	20,425	19,465
Foreign debt (EUR million, eop)	44,339	44,107	42,874	42,710	42,710	43,790	44,873	43,048	40,877
GOVERNMENT FINANCE									
Revenues (HRK million)	38,027	44,065	45,802	46,443	174,337	41,055	47,949	50,684	47,883
Expense (HRK million)	38,621	38,747	39,124	45,512	162,003	41,690	41,514	41,547	48,741
Net = Gross operating balance	-594	5,318	6,678	931	12,334	-635	6,435	9,137	-1,058
Net acquisition of non-financial assets (HRK million)	1,297	1,609	2,631	4,452	9,989	1,605	2,706	3,132	5,613
Net lending/borrowing (HRK million)	-1,891	3,710	4,047	-3,152	992	-2,240	3,729	6,005	4,555
Domestic government debt (EUR million, eop)	23,182	23,759	23,961	24,312	23,687	25,000	25,315	24,985	25,711
Foreign government debt (EUR million, eop)	14,622	14,727	14,001	14,247	14,376	14,030	14,874	14,241	12,831
Total government debt (eop. % of GDP)	80.5	75.8	75.4	74.1	74.9	75.4	75.5	76.4	73.2
MONETARY INDICATORS									
Narrow money, M1 (% change, yoy, eop)	23.8	22.8	20.4	20.7	20.7	18.6	25.7	15.7	14.3
Broad money, M4 (% change, yoy, eop)	5.1	5.7	5.6	5.4	5.5	4.4	4.6	3.6	2.9
Total domestic credit (% change, yoy, eop)	-4.7	-2.0	1.2	2.0	4.4	3.5	1.8	3.0	4.2
DMBs credit to households (% change, yoy, eop)	2.2	3.9	4.0	4.5	6.2	3.0	3.3	7.0	7.4
DMBs credit to enterprises (% change, yoy, eop)	-1.4	-0.1	-0.2	0.4	1.9	-0.2	-2.3	-3.0	0.4
Money market interest rate (%, pa)	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.3	0.3
DMBs credit rate for enterprises short-term (%, pa)	3.9	3.7	3.3	3.2	3.5	2.5	2.7	2.9	3.0
DMBs credit rate for households short-term (%, pa)	7.1	7.0	5.9	5.8	6.5	5.9	6.1	7.1	7.1

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.

Source: Croatian Bureau of Statistics, Croatian National Bank and Ministry of Finance.

Policy assumptions and projections summary

Economic growth better than forecasts in 2019, but expected to fall sharply in 2020 due to COVID-19 impact

The economic outlook section is based on recent projections of the Ministry of Finance of Croatia, the Croatian National Bank, the European Commission, the World Bank and the International Monetary Fund. Most of these institutions have revised their forecasts of 2019 economic growth for Croatia upwards several times, due to much better growth rates achieved in the year. The first estimate of Croatian Bureau of Statistics is that it would be around 3%, while most recently (end of April 2020) the Ministry of Finance estimated it at 2.9%. At the beginning of May 2020, the European Commission decreased its estimates for 2019 from 3.0 in February to 2.9%. The World Bank and the International Monetary Fund also estimate it at 2.9%.

The economic outlook for 2020 dramatically changed due to the enormous uncertainties brought by COVID-19 outbreak and the harsh economic impact of economic lockdown that followed soon after that. The first projections of the economic growth in 2020 came from international organizations already at the beginning of April. Although their projections differ much in numbers, they all predict a deep economic recession for Croatia.

The first 2020 forecasts have rightly predicted the devastating impact of the pandemic on economic growth and thus revised the previous growth rates sharply downwards. Most of the analysts expect that the economy would plummet into the recession worse than the one that happened in 2009 during the global financial and economic crisis. The most recent forecast of the Ministry of Finance at the end of April 2020 envisages a fall of 9.4% in 2020. Most domestic analysts, however, anticipate even sharper fall of more than 10% of GDP, ranging from 10-15%. The World Bank forecasts the fall of the GDP in Croatia in 2020 at the rate of -6.2%. The International Monetary Fund and the European Commission envisage a much sharper fall of -9.0 % and -9.1% respectively.

Due to the uncertain situation related to the length of coronavirus pandemic, at this point, it is hard to have a genuinely valid medium-term projection of GDP growth. Therefore, most of the current forecasts seem somewhat optimistic. The Government of Croatia expects that GDP would swiftly restore its growth in 2021 with a rate of 6.1%, while at this point has no anticipation of growth rate for 2022. The World Bank also forecasts fast recovery of economic growth in 2021 at the rate of 4.6%, followed by the moderation of growth at a rate of 3.2% in 2022. The International Monetary Fund envisages even higher economic growth of 4.9% in 2021, but presently has no projections for 2022.

Table HR2 Summary of projections

	2020	2021	2022
Real GDP (% change)	-9.4	6.1	3.2
Real private consumption (% change)	-7.0	5.8	3.1
Real government consumption (% change)	2.7	2.5	2.4
Real investment (% change)	-9.0	5.6	6.0
Exports of goods and services (constant prices, % change)	-30.00	32.5	5.2
Imports of goods and services (constant prices, % change)	-23.4	27.6	5.8
Current account balance (% of GDP)	-8.2	-5.8	-5.3
Consumer prices (% change, pa)	1.3	1.2	1.5
Exchange rate, national currency/EUR (pa)	7.60	7.55	7.52
Unemployment rate (survey, %, pa)	9.5	9.0	8.0***
General government balance (ESA 2010 definition, % of GDP)	-6.8*	-2.4*	-5.2**
Total domestic credit (% change, eop)	4.3	1.9	1.8

Source: Ministry of Finance of Republic of Croatia*, Croatian National Bank, World Bank** and International Monetary Fund***.

The high negative growth rate in 2020 would be primarily a consequence of severe impact on tourist sector with almost a free fall of tourist earnings on which the Croatian economy heavily depends (tourist sector directly contributes to around 12% of GDP, while indirect contribution is around 20%). The Croatian Minister of Tourism envisages that the tourist earnings would fall in 2020 by 60-75%. The recent government growth projections for 2020 were based on the fall of tourist earnings by 70%. The recovery of tourist earnings in the following years very much depends on the length of coronavirus pandemic and efficient restart of the economy not only in Croatia but also in the countries where most of Croatia's visitors came from.

The growth of personal consumption that was one of the main drivers of economic growth in Croatia for many years would also significantly decrease in 2020, as a large proportion of employees would be out of the job or living on a minimum wage provided by the Government within the economic support measures. Most affected would be incomes of low skilled workers and those with temporary work contracts, as their incomes dramatically fall or are absent. In addition to that, the wages of workers in public services and administration are expected to go down in order to spread the burden of crisis to all the employees. Namely, the expected increase of wages for all the public workers by 6% in three tranches during 2020, (which Trade Unions successfully negotiated at the end of 2019), is now under the question and would most likely not materialize. The Croatian Ministry of Finance predicts a fall of private consumption by -7.0% in 2020, but a restoration of its growth at the rate of 5.8% in 2021. The World Bank predicts milder fall of private consumption in 2020 at the level of -3.3 %, however, most analysts consider this projection overoptimistic, as both disposable incomes and consumer habits have dramatically changed during the pandemic. On the other hand, the government consumption is one of the rare indicators that are expected to rise in 2020 by 2.7%, mainly due to increased expenditures for the health sector fighting with the pandemic, as well as due to sizable support measures directed to the business sector and its employees in order not to dive even deeper into recession.The inflation rate, however, is not expected to rise significantly due to the impact of the pandemic in 2020. According to the Ministry of Finance, there would be no rise in consumer prices, but deflation pressures instead at the rate of -0.3% in 2020. In 2021, the inflation rate would grow back to 0.9%, as the impact of pandemic ceases. The International Monetary Fund, however, predicts that the consumer prices will grow in 2020 at 1.3%, while in 2021 expects the rate of 1.2%.

The pandemic would also drastically affect the rate of investments in 2020, however most severely the private ones. As for the public investments that are underway and mostly financed by the EU funds (such as Pelješac Bridge, several railway and motorway routes, as well as several energy sector projects) it is anticipated that their implementation will continue as scheduled as the works did not interrupt even during the complete economic lockdown. Nevertheless, the Croatian Ministry of Finance expects that the real investments would fall by 9.0% in 2020, while optimistically predicts a swift recovery in 2021 with the growth of investments at a rate of 5.6%. The World Bank for 2020 forecasts milder fall by -4.6%, while anticipates a recovery for 2021 and 2022 with the growth of investments by 5.1% and 6.0% respectively.

Exports and imports would also be drastically affected, given the fact that there is a global outbreak of coronavirus in more than 180 countries in the world. The largest Croatia's foreign trade markets, especially for exports such as Germany and Italy were at the same time most severely affected by virus pandemic, so the negative spillover effect of their eventual slow recovery would be very much felt in Croatian economy too. The Government anticipates the sharp fall in exports by 30%, while the imports would fall by 23.4% in 2020. The Government, however, expects fast recovery of growth of both exports and imports in 2021, by 32.5% and 27.6% respectively. The initial prognosis of the World Bank is that exports would fall by around 20% in 2020. However, as the economy stabilizes in 2021, it is expected that exports would grow by 19.4%, thus offsetting the fall in the previous year almost entirely. At the same time, the imports would fall slower at the rate of 13.4% in 2020, while reversing back to growth rate at 12.7 % in 2021. Consequently, the current account deficit will deepen to -8.2% of GDP in 2020 as initial estimates of the World Bank reckon, but would gradually improve to -5.8% as the situation stabilizes in 2021, and further on to -5.3% of GDP in 2022.

The fiscal balance, which was a prime government concern for many years, has been put aside in 2020 as the sizable fiscal intervention was adopted to buffer the first destructive wave of adverse effects of coronavirus on the Croatian economy. So far, the Government already introduced two rounds of quite generous support measures to both entrepreneurs and employees to help them to survive the first strike of economic lockdown and to prevent bankruptcies and keep their businesses and jobs alive. As these measures to support the survival of the economy were among the most generous in the world, it is realistic to expect their aggravating medium-term impact on the pace of the post-corona economic recovery in Croatia. It would most likely take years to bring back the level of public debt ratio to the pre-corona crises level of 73.2% as it was in 2019. The Government prognosis for 2020 is that it will jump to 86.7%, but would fall to 83.2% in 2021. The Government also expects that the budget deficit in 2020 would reach -6.8%, but plans a fast fall to -2.4% of GDP already in 2021. Most analysts consider this as overly optimistic, given the announcements of additional business support measures in May and June, plus the enormous fall of budget revenues during the lockdown. The World Bank estimates that the budget deficit could reach 8% of GDP in 2020. However, it expects that the public deficit would gradually improve during 2021 when ESA 2010 government balance is anticipated at the level of -6.4% of GDP, with a further fall of the deficit to -5.2 of GDP in 2022.

The negative impact of coronavirus on Croatian economy, as elsewhere in the world, will be the most visible by a significant rise of unemployment levels. The data at the end of April 2020 show that only in one month of lockdown, the number of unemployed jumped by around 20,000 persons, compared to March 2020, increasing the total number of unemployed to 156,667 persons. However, the number of unemployed would be several times higher without the government support to entrepreneurs, by providing their employees a minimal net wage of 3.250 HRK in March and 4,000 HRK in April and May, if they keep them at work. By the end of March, 485.000 employees and 84,000 entrepreneurs consumed that measure. Ministry of Finance thus anticipates the rise of unemployment to 9.5% in 2020, followed by a slight fall to 9.0% in 2021. The World Bank anticipates that the total unemployment will rise to around 9% in 2020, while the IMF envisages even more inexorable rise of unemployment levels to 11.5%.

According to current IMF projections, such a situation would most likely stabilize in 2021 when the GDP growth returns and unemployment would drop back to around more typical 8%. As for registered unemployment, the Government expects that it would rise in 2020 only by 3.3 percentage points compared to 2019, owing to the introduced wage support measures.

MONTENEGRO

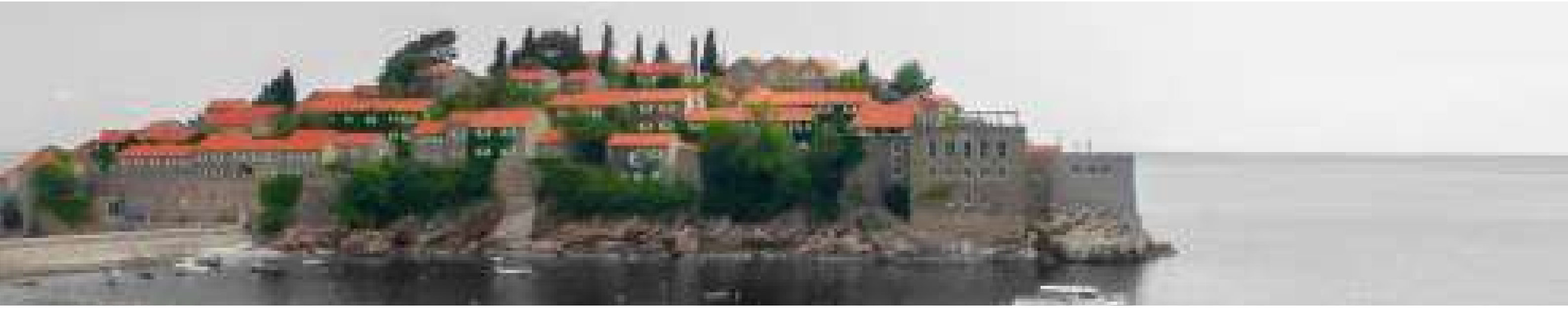
Continued high growth rates

Following the high growth rate of 4.7% in 2017, Montenegrin economy achieved an even higher growth rate of 5.1% in 2018, which exceeded expectations and projections of the Government of Montenegro and relevant international organizations. Positive growth tendencies from 2018 continued in 2019. According to the data of Statistical Office of Montenegro – Monstat, GDP real growth rates were 3.0, 3.2, 4.7 and 3.1, for four quarters of 2019, respectively. According to the European Commission's Economic Forecast for Spring 2020, Montenegro's GDP growth rate in 2019 was 3.6%.*

The representatives of relevant international institutions have confirmed that Montenegro is a stability factor in the region, playing an active role in all regional initiatives. At the same time, Montenegro is recognized as an example of good-neighbourly cooperation and as a country that is continuously aligning its policies with the European Union (EU) policy.

Montenegro contributes to regional cooperation strengthening through the Berlin Process, by its commitment to the Connectivity Agenda, as well as the Multi-Annual Action Plan for the Regional Economic Area of the six Western Balkans countries under the CEFTA legal framework.

*https://ec.europa.eu/info/sites/info/files/economy-finance/ip125_en.pdf



Furthermore, Montenegro confirms it is a responsible NATO member that continues to play an essential role in spreading the Euro-Atlantic values in the Western Balkans.

In line with the Economic Reform Programme (ERP), the Government of Montenegro will continue to implement fiscal policy measures and structural reforms in the forthcoming period, aimed at the achievement of the public finances surplus from 2021 and the reduction of the public debt level, as important factors for further strengthening of macroeconomic stability and achieving sustainable economic growth.

According to the preliminary EUROSTAT data for 2018, Montenegrin GDP per capita, amounting to 48 percent of the EU average, is the highest among the countries in the region with the status of a candidate or potential candidate country for EU membership.**

During 2019, prices remained stable and within projected frameworks. Tourism and construction activities grew, while the industrial and forestry production declined. The banking system was stable, liquid and solvent. Foreign direct investments recorded the year-on-year increase.***

** Montenegro Economic Reform Programme 2020-2022. Available at: http://www.gov.me/en/homepage/Montenegro_Economic_Reform_Programme/

***Central Bank of Montenegro Bulletin, January 2020

Political environment

EU accession negotiations with Montenegro were opened in June 2012. To date, 32 negotiating chapters have been opened, of which three have been provisionally closed. Only Chapter 8 – Competition remains unopened. Montenegro's Chief Negotiator Aleksandar Drljević recently said that, depending on developments with Covid-19, he hopes that this chapter will be opened in June 2020. It will represent an adequate valorization of the results achieved, bearing in mind that Montenegro has improved the legislative and institutional framework in the field of competition and state aid and received official confirmation of the fulfilment of the initial benchmarks for Chapter 8. Regarding the Montenegrin accession agenda, Chief Negotiator said that in addition to opening Chapter 8, obtaining closing benchmarks in Chapters 23 - Justice and Fundamental Rights and 24 - Justice, Freedom and Security, and provisional closure of Chapters 7 - Intellectual Property Law and 20 - Entrepreneurship and industrial policy, are expected in the near future.****

In the Montenegro 2019 Report, the European Commission said that in the upcoming period, Montenegro should focus in particular on competition policy, environment and climate change, as well as public procurement. Strengthening the administrative capacity for ensuring the application of the acquis remains an essential challenge for Montenegro. Progress towards meeting the interim benchmarks set in the rule of law chapters 23 and 24 will be key for further progress in the negotiations overall.

As for the economic criteria, Montenegro has made some progress and is moderately prepared in developing a functioning market economy and coping with competitive pressures and market forces within the Union. However, further efforts are needed to enhance human capital development and reducing the mismatch between education outcomes and labour market needs.

Prices

In December 2019, the annual CPI inflation amounted to 1%, while the HICP inflation amounted to 1.2%.

The producers' prices of manufactured products recorded the annual growth of 2.4% due to price increase in all three sectors: manufacturing industry (0.1%), electricity, gas and steam supply (3.8%), and mining and quarrying (6.1%).

Development of GDP components

Industrial production recorded the year-on-year decline of 6.3% in 2019. Output decline was recorded in the manufacturing industry (-10%) and electricity, gas and steam supply (-7.1%), while the mining and quarrying sector recorded a production growth of 20.8%.

**** https://www.eu.me/mn/press/saopstenja/pregovori-o-pristupanju/item/4180-drljevic-na-okruglom-stolu-oei-otvaranje-poglavlja-8-adekvatna-valorizacija-rezultata

Manufacturing industry recorded output decline in eight sectors. The highest decline occurred in the manufacture of leather and leather products (-33.3%), followed by the manufacture of basic pharmaceutical products (-27.4%), the manufacture of other non-metal minerals products (-18.8%), etc. The highest increase in output was recorded in the manufacture of tobacco products (higher than 200%), while the lowest was in the manufacture of rubber and plastic products (1%).

Preliminary Monstat data show that in 2019, construction recorded a year-on-year increase of 10.7% in the value of executed construction works, as well as a 4.2% increase in effective working hours. Tourism sector recorded an increase of 20.1%, year-on-year, in the number of tourist arrivals in collective accommodation. A total of 4.7 million overnight stays were realized, up by 11.2% from 2018.

Labor market and wages

Monstat records show that 198,566 people were employed in December 2019, recording the month-on-month decrease of 2.2%, but also a 2.3% increase year-on-year.

According to the data for all four quarters of 2019, Montenegro had 287.3 thousand of the economically active population, out of which 243.8 thousand of employed persons (84.9%) and 43.5 thousand unemployed (15.1%). The number of employed persons in comparison with the previous year has increased by 2.7%, and the number of unemployed has increased by 2.1%. There were 213.1 thousand of economically inactive. The number of inactive, compared with the previous year, has decreased by 3.1%.

Sectors with the most employees were the wholesale and retail trade and repair of motor vehicles and motorcycles (19.7%), state administration and defence, compulsory social insurance (11.2%), accommodation and food service activities (7.8%), education (7.6%), construction (7.1%), manufacturing industry and health and social work activities (each 6.4%), and transportation and warehousing (6.2%).

In December 2019, monthly decrease in unemployment amounted to 0.8%, while the year-on-year decrease was 9.1%. The unemployment rate for 2019. stood at 15.1%, which makes it 0.1 percentage points lower than at the end of 2018.

Average gross and net salaries were 0.4% higher in December 2019 compared with the previous month. Average real earnings without taxes and contributions recorded the year-on-year increase of 0.4%. The average gross wage in 2019. was €773, while the average wage without taxes and contributions (net) was €515.

Foreign trade and capital flows

According to Monstat final data, total foreign trade in the period January-December 2019., amounted to €3,016.2 million, representing an increase of 2.1% compared to the same period of the previous year.

Exports amounted to €415.5 million, while the imports stood at €2,600.7 million. Compared with 2018, exports grew by 3.8%, while imports grew by 1.8%. The coverage of imports by exports was 16.0% and is higher than in the same period of 2018 when it amounted to 15.7%.

In the exports structure, according to Standard International Trade Classification (SITC), products classified by material (sector 6), have the most significant share, amounting to €97.2 million (of which: Non-ferrous metals - €63.2 mil., Iron and steel - €18.5 m. etc.). The most important trading partners were: Serbia (€107.9 mil.), Hungary (€45.0 mil.) and Bosnia and Herzegovina (€29.8 mil.). Exports of goods and services increased due to the growth in export of services, primarily in the tourism and transport sectors, as well as by the moderate growth in the export of goods.

In the imports structure (according to SITC), Machines and Transportation Devices (Sector 7) have the most significant share, amounting to €578.1 mil. (of which: Road vehicles - €185.6 mil., Electric machines, appliances and devices - €108.0 mil., etc.). The most important trading partners were: Serbia (€500.4 mil.), Germany (€244.2 mil.) and China (€221.9 mil.). The most extensive total trade was with CEFTA signatories and the EU. Imports of goods and services increased due to the increased imports of electricity, medical and pharmaceutical products, etc.

In the period January-December 2019, net foreign direct investments (FDI) inflow amounted to 344.7 million euros or 6.9% more than in the same period last year. The total inflow of FDI amounted to 769.9 million euros (a 10.3% decrease), as a result of decreased inflows arising from equity investments.

The inflow of equity investments amounted to 412.3 million euros or 53.6% of total recorded FDI inflow. In the structure of equity investments, investments in companies and banks accounted for 242.3 million euros (a decrease of 28.1%), while the inflow arising from investments in real estate amounted to 170 million euros (a 6.9% decrease). FDI inflow in the form of intercompany debt amounted to 321.7 million euros or 41.8% of total inflow, which is 7.2% more than in the same period of the previous year.

In the period January-December 2019, total FDI outflow amounted to €425.2 million, recording the year-on-year decline of 20.6%. Outflow from residents' investments abroad amounted to 95.7 million euros, while withdrawals of non-resident funds invested in Montenegro amounted to €329.5 million.

Based on the continuous supervision of the banking system, the system is liquid, solvent and with non-performing loans at the record low level, with a constant downward trend of interest rates. The liquidity of banks is satisfactory.

At the end of December 2019, total assets and liabilities of banks amounted to €4,603.1 million, recording a month-on-month decrease of 2% and a year-on-year increase of 4.4%. When we exclude two banks that are not part of the December 2019 statistics, from the December 2018 data, for comparability, total assets and liabilities of banks recorded an increase of 11.3% on the annual level.

In the structure of banks' assets, total loans accounted for 66.5%, followed by cash and deposit accounts with 18.8% and securities with 12.6%, while other asset items accounted for 2.1%. On the liabilities side, the most significant share of 75.5% is made up of deposits, followed by capital with 13%, borrowings with 8.1%, while other liabilities items accounted for 3.4% of total liabilities and capital.

At the end of December 2019, total banks' loans amounted to 3,061.7 million euros, recording a month-on-month decline of 1%, but also a year-on-year increase of 4.5%. When we exclude two banks that are not part of the December 2019 statistics from the December 2018 data, for comparability, total loans recorded an annual increase of 11.7%. The non-performing loans (NPL) ratio is 4.62 percent and is at the record low level.

At the end of December 2019, the total capital of banks amounted to €600.3 million, recording a monthly decline of 2% and an annual increase of 17%. Bank deposits amounted to 3,475.7 million euros in December 2019, recording a month-on-month decline of 2.1%, as well as annual growth of 0.5%. When we exclude two banks that are not part of the December 2019 statistics from the December 2018 data, for comparability, total deposits recorded an annual increase of 8%.

At the end of December 2019, the total reserve requirement of banks at the Central Bank amounted to €260.1 million, which represents a month-on-month growth of €2 million or 0.8%, and a year-on-year increase of €8.3 million, or 3.3%. The effective reserve requirement rate, measured as the ratio of allocated reserve requirement to total deposits, amounted to 7.48% at the end of December 2019, and it was higher than in the same month a year ago when it amounted to 7.28%.

In December 2019, the weighted average nominal interest rate (WANIR) on approved loans amounted to 5.46% while the weighted average effective interest rate (WAEIR) amounted to 6.01%. At the annual level, the WANIR and the WAEIR dropped by 0.29 percentage points and 0.35 percentage points, respectively.

The WANIR on new loans amounted to 5.41% while the WAEIR amounted to 6.02%. The nominal interest rate recorded a monthly growth of 1.03 percentage points, while the effective interest rate rose by 1.28 percentage points. Both rates recorded an annual increase of 0.59 and 0.51 percentage points, respectively.

The weighted average deposit effective interest rate (WADEIR) stood at 0.40% in December 2019 and it decreased by 0.02 percentage points concerning the previous month and 0.16 percentage points compared to the same period of the previous year.

Fiscal stance

Fiscal adjustment measures that were launched in 2017 aim to reduce the budget deficit and create conditions for a gradual decline in public debt. Their implementation continued in 2019.

Government's plan in the fiscal framework is to continue the fiscal consolidation of public finances in 2020, along with expected surplus in 2021 and 2022 and to establish a downward trend for the public debt, to reach 62.5% in 2020. These objectives over the medium term will be achieved firstly through stable growth of public revenues, primarily guided by increased economic activities. Secondly with the tax base expansion through more intensive activities, such as the reduction of the grey economy, reforming the tax administration, as well as revenues resulting from a concession fee from a long-term lease of the Airports of Montenegro.

Public revenues in 2019 amounted to €2,150.9 mil. or 44.7% of the estimated GDP (€ 4,817.1 million). Compared to 2018, total revenue collection increased by €181.4 million or 9.2%, mostly due to tax revenues increases by €147.1 mil. or 8.4%. In terms of revenue structure, the most significant increase was recorded in value-added tax by €78.8 mil., contributions €21.8 mil. And income tax €16.9 mil. Compared to the plan, revenues are higher by €85.0 mil. or 4.1%.

Public expenditure (in accordance with the current methodology of the Ministry of Finance, Public expenditure is calculated as the sum of Expense and Net acquisition of non-financial assets) in 2019 amounted to €2,248.4 mil., or 46.7% of the estimated GDP, and compared to the previous year it increased by €96.0 mil. or 4.5%. In 2019, Expense amounted to €1,909.6 mil., mainly as a result of higher allocations in: gross earnings, capital expenditures and transfers to institutions, individuals, non-governmental and public sector. Net acquisition of non-financial assets amounted to €338.79 mil.in 2019, which represents an increase of 20 million compared to 2018.

According to revenue and expenditure trends, in 2019, a public finance deficit of €97.6 million was realized, or 2.0% of GDP, down by €85.4 mill. from the previous year.

The result achieved in 2019 indicates a further downward trend in the budget deficit, as a result of increased budget revenues and optimization of current budget spending, which is in line with the main fiscal policy objective of consolidating public finances and creating conditions for their long-term sustainability.

Bearing in mind that the realized deficit is in under 3% of GDP, it can be stated that the fiscal rule established by the Law on Budget and Fiscal Responsibility is fulfilled, which is at the same time in line with the level of deficit prescribed by the Maastricht criteria.

Changes in the main economic indicators for Montenegro, for all four quarters of 2018 and 2019 are presented in the following table.

Table MN1 Main economic indicators

	2018				Total 2018 year	2019			
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4
ECONOMIC ACTIVITY									
Real GDP (% change, yoy)	4.8	5.2	5.3	4.9	5.1	3.0	3.2	4.7	3.1
Real private consumption (% change, yoy)	4.05	7.02	7.20	7.78	6.6	7.05	5.85	3.33	3.42
Real government consumption (% change, yoy)	9.84	9.44	12.04	9.32	10.1	0.03	10.78	-3.69	7.48
Real investment (% change, yoy)	27.34	22.40	13.52	-0.35	14.2	-0.81	0.26	5.01	0.49
Industrial output (% change, yoy)*	40.2	24.4	12.2	17.5	22.4	-13.9	-8.9	0.1	-1.8
Unemployment rate (registered, % pa)	16.1	14.4	14.1	16.1	15.2	15.0	14.3	15.2	15.9
Nominal GDP (EUR million)	848.7	1,108.2	1,531.1	1,175.1	4,663.1	886.0	1,151.5	1,630.6	1,239.7
GDP per capita (EUR)	1,364	1,781	2,461	1,889	7,495	1,424	1,851	2,621	1,993
PRICES, WAGES, AND EXCHANGE RATES									
Implicit GDP deflator (% change, yoy) *	3.3	4.5	2.6	2.7	3.2	1.4	0.7	1.7	2.3
Consumer prices (% change, yoy, pa)	2.7	3.2	2.7	1.8	2.6	0.5	0.5	-0.3	0.7
Producer prices (% change, yoy, pa)	0.6	1.6	2.0	2.7	1.7	1.5	2.7	2.9	2.4
Average gross wage (% change, yoy, pa)	-0.1	0.04	0.3	0.1	0.1	0.6	0.5	1.0	1.3
Exchange rate (USD/EUR, pa) **	N/A	N/A	N/A	N/A	1.18	N/A	N/A	N/A	1.12
Exchange rate (______/USD, pa)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
FOREIGN TRADE AND CAPITAL FLOWS									
Exports of goods (EUR million)*	99.49	111.37	104.80	120.40	436.06	101.15	114.16	120.86	129.32
Exports of goods (EUR, % change, yoy)	20.35	32.88	-8.38	18.52	14.02	1.67	2.50	15.33	7.41
Imports of goods (EUR million)	488.84	684.46	667.04	644.90	2,485.24	510.30	696.81	690.16	633.33
Imports of goods (EUR, % change, yoy)	9.90	15.36	11.42	6.47	10.82	4.39	1.80	3.47	-1.79
Current account balance (EUR million)	-303.59	-315.01	200.27	-374.47	-792.80	-316.47	-328.02	240.15	-339.28
Current account balance (% of GDP)	-35.77	-28.42	13.08	-31.87	-17.0	-35.72	-28.48	14.73	-27.37
Foreign Direct Investment net inflows (EUR million)	50.79	102.83	64.12	104.74	322.48	82.73	144.53	39.39	78.09
Foreign exchange reserves (EUR million, eop)	682.84	958.20	1,004.93	1,006.15	1,006.15	945.34	800.68	842.83	1,382.75
Foreign debt (EUR million, eop)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
GOVERNMENT FINANCE									
Revenues (EUR million)	365,79	492,85	575,68	535,47	1969,79	417,77	513,58	592,35	627,17
Expense (EUR million)	418,18	438,92	429,26	538,68	1825,04	437,07	431,61	454,21	586,77
Net = Gross operating balance	-52,39	53,93	146,42	-3,21	144,75	-19,3	81,97	138,14	40,4
Net acquisition of non-financial assets (EUR million)	21,89	76,01	79,54	140,6	318,04	50,91	50,48	96,46	140,94
Net lending/borrowing (EUR million)	-74,27	-22,09	66,89	-143,82	-173,29	-70,21	31,48	41,69	-100,55
Domestic government debt (EUR million, eop)	469.2	460.7	393.4	393.0	393.0	378.6	512.0	504.5	580.0
Foreign government debt (EUR million, eop)	2,196.1	2,644.4	2,700.5	2,760.0	2,760.0	2,800.7	2,621.7	2,623.4	3,128.5
Total government debt (eop. % of GDP)	57.2	66.6	66.3	67.6	67.6	64.8	63.8	63.7	75.6
MONETARY INDICATORS									
Narrow money, M1 (% change, yoy, eop)	N/A	N/A	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	N/A	N/A
Total domestic credit (% change, yoy, eop)	9.70	12.80	10.74	8.47	8.47	10.18	0.63	1.55	4.52
DMBs credit to households (% change, yoy, eop)	10.11	10.43	10.67	11.94	11.94	12.44	8.94	8.56	8.60
DMBs credit to enterprises (% change, yoy, eop)	4.14	6.30	9.69	5.91	5.91	6.26	1.72	2.10	4.14
Money market interest rate (%, pa)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
DMBs credit rate for enterprises short-term (%, pa)	5.11	5.16	5.07	5.10	5.10	4.89	4.83	4.62	4.64
DMBs credit rate for households short-term (%, pa)	8.60	8.13	7.64	8.76	8.76	7.71	7.78	7.89	8.15

* Authors' calculations based on Monstat data (Industrial output calculated as average quarterly growth rate).
**Montenegro Economic Reform Programe (ERP) data.

Policy assumption and projections summary

Projections in table MN2 reflect the official projections of the Government of Montenegro presented in the "Montenegro Economic Reform Programme 2020 - 2022".

Montenegrin economy's growth model over the medium term will be based on the continued high-level investment activity, private consumption growth, and increase in exports of goods and services resulting from an improved diversification of the economy, and growing revenues in the tourism sector. In the first two years of the medium term, the domestic demand will be a significant incentive for economic activity in the country. The latter two years of the forecast period are characterized by a change in the growth composition, favouring the higher contribution of net exports to the GDP growth.

The cumulative nominal GDP growth rate in the period 2019-2022 will be 16.9 percent, while the cumulative real growth rate in the same period will be 13 percent. Following the estimated growth of 3.1 percent in 2019, the real growth trend in the following years varies, from 3.4 percent in 2020, 2.8 percent in 2021 to 3.2 percent in 2022, averaging at 3.1 percent over the four years.

The Economic Citizenship Programme, adopted in 2019, envisages investments of foreign investors in line with the criteria set by the Government of Montenegro in exchange for Montenegrin citizenship. The Government's economic policy over the medium term continues to focus on the development of priority economic sectors, defined by key documents: tourism, energy, agriculture, and manufacturing sectors.

The following table presents core macro-economic and fiscal aggregates, precisely their projections over the next two-year period. The macroeconomic framework assumptions over the medium term are based on the global economic activity trends, forecasted growth for significant trade and economic partners of Montenegro, the Euro area, as well as the countries in the region.

Table MN2 Summary of projections*

	2020	2021	2022
Real GDP (% change)	3.4	2.8	3.2
Real private consumption (% change)	2.4	1.9	1.9
Real government consumption (% change)	4.5	-0.5	0.0
Real investment, gross (% change)	2.3	-2.3	-0.9
Exports of goods and services (constant prices, % change)	3.8	4.1	2.4
Imports of goods and services (constant prices, % change)	2.4	-0.6	-1.6
Current account balance (% of GDP)	-16.3	-13.3	-10.4
Consumer prices (% change, pa)	0.5	0.0	0.5
Exchange rate, national currency/EUR (pa)	N/A	N/A	N/A
Unemployment rate (registered, %, pa)	14.3	14.1	13.7
General government balance ** (ESA 2010 definition, % of GDP)	0.0	1.3	1.3
Total domestic credit (% change, eop)***	3.5	3.0	3.5

* Ministry of Finance, ERP Baseline scenario
** General government net lending/borrowing
*** Domestic loans (corporate and household)

Projections for some of the macroeconomic indicators are as follows:

• The current account deficit in the balance of payments will decline from an estimated 17.1 percent of GDP in 2019 to 10.4 percent of GDP in 2022, due to planned imports and exports dynamics;

• The inflow of investments over the medium term will continue to grow, charged by high confidence of foreign investors, so the expected net FDI will make on average 9.6 percent of GDP in the period 2020-2022;

• Loans to the corporate and household sectors will continue to boost the rise of the economic activity;

• The unemployment rate will fall from an estimated 14.6 percent in 2019, to 13.7 percent in 2022;

• Following higher growth in 2020 of 1.6 percent due to the announced increase of wages for employees in the health and education sectors, the wages will grow at the average nominal rate of 0.5 percent in the latter two years of the medium term; the real wages will record a decline of 0.5 percent in the period 2020-2022 in line with the projected inflation trend, while they will record an increase of 0.5 percent in 2019, according to the estimates;

• Stable growth of consumer prices is expected in the observed period, with growth averaging at 1.3 percent. The projection is based on projections of stable oil and food prices in the global market, the Euro area inflation projections of the European Central Bank for 2019 and 2020, as well as targets for the afterwards period.

NORTH MACEDONIA

Political crisis replaced by stable growth and stability, yet the economy is featuring a new challenge

The economy in the upcoming outbreaks in 2020

Statistical data of the real GDP growth in 2019 in each quarter evident positive incensement. The average growth rate in 2019 is 3.55 percent. This growth, according to the statistical data, is based on mainly on the growth of production in professional, scientific and technical activities; administrative and support service activities as well as information and financial services. The least growth in GDP was achieved through agriculture.

Private consumption in the second half of 2019 declined. In the first two quartals of the year it was 4.4 percent, but then it dropped in Q3 for 34.1% while in Q4 for 45.45%.

Growth in 2019 mainly arises from government consumption (Q4 is 7.1 percent) and an increase in gross-investment in the second half of the year. Therefore, the gross-investment and the increase in fourth-quarter in 2019 respectively to the same quarter in 2018 is 79.6%.

Unemployment in North Macedonia in the last five years (2015-2019) has decreased by about 82500 persons (33.2 percent), and the unemployment rate reduced from 26.1 to 17.3 percent. It was a continuous decline from year to year that was particularly emphasized in 2019. This is a significant change compared to the period 2010-2014 when unemployment declined to about 31600 persons (10.9 percent). It was mainly determined by the: Increased number of employed persons; Declining inflow of new generations of the young labour force (15-24) due to population ageing; Still intensive emigration abroad of the young and middle age labour force.

Decreasing unemployment and unfavourable changes in its structural features

Along with the unemployment decrease in the observed period, significant changes in structural features of the unemployed were recorded. So, more intense was the decrease of unemployed men which resulted in an increased share of unemployed women in total unemployment from 37.9 (2015) to 43.4 percent (2019). Despite the decline of the unemployed young persons (15-24) for about one-third (34.0 percent), in 2019 the youth unemployment rate (35.6 percent) was two-timed higher than of the age group 25-49 (16.3 percent) and nearly three times higher of the aged 50+ (11.9 percent). As for the unemployed by educational attainment, there are available data for the period 2015-2018. They show that the number of unemployed has decreased with different intensity. Thus, at those with low-level of education for 33.7 percent, with secondary education for 17.7% and with tertiary education for 8.6%. Hereof, the number of unemployed with tertiary education remains very high (about 40000 persons) and its share in the total unemployed increased from 16.6 to 19.8 percent. In the same period and long-term unemployment, the decrease was noticed, but the share of unemployed persons four years and longer remains dominant (54.5 percent in 2018).

The need to consolidate fiscal policy remains

Revenues in the previous eight quarters for 2018-2019 are continually increasing. Besides, that also expenditures. The gap between them is always bigger and bigger. The main features of this budget policy are the low level of planned capital expenditures. Due to this and other weaknesses such as low efficiency of public spending, fiscal deficits and increased public debt, the need for the consolidation of fiscal policy remains.

Stable monetary and banking sector–cushion for pending health crises

The monetary policy in 2019 continued to be focused on price stability and stable exchange rate, the stability of the financial system and deepening of the financial intermediation level. Future decrease of the CB bills rate to 2% in January 2020 provides a signal for a lasting lessening in the monetary policy, compared to 2016 when the CB bills rate stood at 4%.

Since the banking sector represents the main channel for financial intermediation in the country, it is crucial to remain stable and profitable, and it generated 1.3% ROAA and 11.7% ROAE at end 2019. Total deposits and total loans demonstrate the continuity of annual growth of both deposits and loans, with simultaneous decrease of the average interest rate of the total credits on the level 4-5%, and the average interest rate on the deposits on 1.3%. Capital adequacy of the banking sector remains sufficient with around 16.3% for end 2019, which reflect the stable and stable banking sector and represent a cushion for bank stability. NPLs to gross loans stands to 4.6%, indicating bank assets quality and enhanced risk assessment in the banks. The percent of liquidity supports such a statement in total assets is 26.9% at end 2019.

The consumer price index is the stable, moderately increased index of producer prices

The inflation rate, in Q2 - 2019 measured according to the CPI index, is 1.2% on an annual basis. It is unchanged compared to Q1 2019. Consumer price in Q3 is lower by 0.6 p.p. compared to Q2 2019. However, the main conclusion which derives from the statistical data is that they stay stable for the analyzed period.

Index of produces prices evident slightly increase and it is with a positive trend in 2019. The production price in Q2 increase in 0.7 p.p. compared with the Q1. The lower increase is evident between the second and third quarter and is amounted by 0.3 p.p.

External imbalance widened in 2019

Despite the favourable movements in 2018, in 2019 there was a deepening of the current account deficit, in almost all quarters. The exception was Q3 when the surplus was registered (a movement characteristic for this period of the year). This is mainly due to the deteriorating balance in the exchange of goods and services (especially in Q4). Exports of goods in the last quarter of 2019 saw a small annual decline for the first time in the last seven years. This is due to the reduction of exports in a part of the foreign-owned capacities and some of the traditional sectors. The more explicitly exporting clothing and textiles, iron and steel. During that period, a small increase in imports was also registered, which is a result of higher raw material imports realized by the new production facilities in the economy.

In both 2018 and 2019, net cash inflows were recorded on the financial account of the balance of payments mainly in the form of foreign direct investment, as well as government borrowing on international financial markets. Such achievements were partially offset by net outflows in the "currencies and deposits" category, and to a lesser extent by the corporate sector's debt repayment based on trade loans. Conversely in the first and second quarters of 2019, the categories trade credits (in Q1) and currency and deposits of banks (in Q2) appear as net inflows.

The financial flows realized in 2018 and 2019 enabled full financing of the current account deficit, as well as significant accumulation of foreign reserves.

Table MK1 Main economic indicators

	2018				Total 2018 year	2019			
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4
ECONOMIC ACTIVITY									
Real GDP (% change, yoy)	0.3	1.7	2.4	6.2	2.7	3.8	3.4	3.6	3.4
Real private consumption (% change, yoy)	2.1	1.8	4.8	5.8	3.7	4.4	4.4	2.9	2.4
Real government consumption (% change, yoy)	-0.9	3.6	5.4	0.3	2	3.8	4.8	2.0	7.1
Real investment (% change, yoy)	-12.5	-16.8	-9.4	6.4	-7.3	-0.2	-0.4	14.1	11.5
Industrial output (% change, yoy)	5.4	4.9	5	6.4	5.4	8.8	1.3	7.3	-1.3
Unemployment rate (registered, %, pa)	21.6	21.1	20.8	19.4	20.7	17.8	17.5	17.1	16.6
Nominal GDP (EUR million)	2,462	2,624	2,725	2,887	10,679	2,613	2,731	2,844	3,047
GDP per capita (EUR)	N/A	N/A	N/A	N/A	5,153	N/A	N/A	N/A	N/A
PRICES, WAGES, AND EXCHANGE RATES									
Implicit GDP deflator (% change, yoy)	5.3	5.4	2.5	1.7	4.3	3.6	1.5	2.3	N/A
Consumer prices (% change, yoy, pa)	1.5	1.5	1.6	1.2	1.5	1.2	1.2	0.6	0.0
Producer prices (% change, yoy, pa)	0.8	-0.2	0.8	-1.0	-0.3	0.2	0.9	1.2	1.1
Average gross wage (% change, yoy, pa)	3.1	4.6	3.9	5.3	4.2	3.4	3.6	4.7	5.7
Exchange rate (MKD/EUR, pa)	61.56	61.50	61.49	61.49	61.51	61.53	61.51	61.49	61.51
Exchange rate (MKD/USD, pa)	50.10	51.55	52.90	53.89	52.12	54.17	54.75	55.3	55.56
FOREIGN TRADE AND CAPITAL FLOWS									
Exports of goods (EUR million)	1,058.5	1,205.4	1,232.7	1,384.8	4,881.4	1,247.4	1,351.3	1,364.4	1,373.1
Exports of goods (EUR, % change, yoy)	14.7	16.4	20.0	27.1	19.8	17.8	12.1	10.7	-0.8
Imports of goods (EUR million)	1,521.3	1,608.5	1.628	1,858.3	6,616.2	1,720.3	1,786.6	1,796.9	1,986.7
Imports of goods (EUR, % change, yoy)	10.0	10.7	13.6	16.7	12.9	13.1	11.1	10.4	6.9
Current account balance (EUR million)	-144.5	23.9	195.8	-107.1	-14.9	-158.1	-47	178.5	-286.9
Current account balance (% of GDP)	-1.3	0.3	1.9	-1.0	-0.1	-6.0	-1.7	6.2	-9.4
Foreign Direct Investment net inflows (EUR million)	233.5	69.7	-3.8	304.4	603.7	40.2	11.0	62.9	176.5
Foreign exchange reserves (EUR million, eop)	2,577.1	2,642.2	2,709.1	2,867.1	2,867.1	2,866.4	2,928.2	3,127.5	3,262.6
Foreign debt (EUR million, eop)	8,221.1	8,386.2	8,360.8	7,843.7	7,843.7	8,249.5	8,337.2	8,581.0	8,191.2
GOVERNMENT FINANCE									
Revenues (MKD million)	43,369	47,275	45,992	51,869	188,505	46,039	50,075	51,036	56,761
Expense (MKD million)	46,502	48,680	48,462	56,427	200,071	49,244	53,917	52,131	62,250
Net = Gross operating balance	-3,133	-1,405	-2,470	-4,558	-11,566	-3,205	-3,842	-1,095	-5,489
Net acquisition of non-financial assets (MKD million)	-1,338	-1,872	-1,649	-5,091	-9,950	-1,399	-3,488	-2,344	-8,211
Net lending/borrowing (MKD million)	-1,795	467	-821	533	-1,616	-1,806	-354	1,249	2,722
Domestic government debt (EUR million, eop)	1,588.4	1,607.6	1,616.4	1,649.4	1,649.4	1,655.4	1,703.5	1,775.7	1,793.3
Foreign government debt (EUR million, eop)	2,682.3	2,692.8	2,685.9	2.695	2.695	2,687.6	2,671.2	2,669.3	2,763.5
Total government debt (eop. % of GDP)	39.9	40.2	40.2	40.6	40.6	38.3	38.6	39.2	40.2
MONETARY INDICATORS									
Narrow money, M1 (% change, yoy, eop)	14.8	13.8	17.1	18.7	18.7	17.2	18.5	18.8	17.2
Broad money, M4 (% change, yoy, eop)	7.5	10.1	11.7	11.8	11.8	11.7	10.5	10.8	9.3
Total domestic credit (% change, yoy, eop)	5.7	6.2	7.9	7.3	7.3	9	8.1	5.6	6.0
DMBs credit to households (% change, yoy, eop)	9.6	9.9	10.4	10.4	10.4	9.8	9.8	9.9	10.9
DMBs credit to enterprises (% change, yoy, eop)	4.8	6.4	9.2	6.9	6.9	8.2	5.5	1.8	2.8
Money market interest rate (%, pa)	1.0	0.9	0.9	N/A	N/A	N/A	N/A	N/A	N/A
DMBs credit rate for enterprises short-term (%, pa)	4.8	4.5	4.5	4.5	4.6	4.4	4.3	4.1	3.9
DMBs credit rate for households short-term (%, pa)	4.1	4.0	3.8	3.6	3.9	3.6	3.6	3.5	3.6

Sources: Ministry of Finance of the Republic of North Macedonia, National Bank of the Republic of North Macedonia, State Statistical Office of the Republic of North Macedonia. https://ec.europa.eu/eurostat/databrowser/view/teibp051/default/table?lang=en, https://www.ceicdata.com/en/indicator/macedonia gdp-deflator-growth)

Policy assumption and projections summary

Today we are witnessing the quick spread of the pandemic caused by the virus COVID-19 in the world. This pandemic is still ongoing and with no precise prediction of its ending. Besides its impact on the health of the world population, a pandemic caused by virus COVID-19 have and would have an enormous impact on the economies. Hence, the projection is that the economy will be faced with the decline in production, private consumption and investment. The previous predictions for the real growth of GDP were 3.2 in 2020 and 3.3 in 2021. It is still early to make a precise projection, but one of the optimistic scenarios is that real GDP will not be lower from the reached level in the last financial and economic world recession in 2009 (-0.4).

The annual rate of inflation in 2018 was 1.5% and in 2019 1.8%. The projections for 2020 is 1.9% and 2% in 2021.

According to the previously mentioned circumstances and the decline in economic activity, these projections should be considered with caution.

It is also impossible to predict the fiscal situation, relevantly and realistically, because there is no precise data. In any case, there will be massive losses in the economy, which will cause problems in maintaining the liquidity of the budget. Then the problem with the level of indebtedness of the country will also remain. Facing a doubly deeper recession than the 2008 crisis, the government has embarked on an expansionary fiscal policy that helps maintain growth and employment. Due to the weaknesses in public finance management, the situation will deteriorate, so that public debt will increase from about 50% of GDP (5,500 million euros) to over 60% (6,800 million euros).

The situation caused by COVID-19 pandemic will be a unique challenge for the monetary policy as well as the banking sector. It will require essential responses from monetary policy to use all instruments on its disposal for maintaining price stability and keeping the stable exchange rate, as well as maintaining banking stability. The foreign reserves level should be the solid offset of any shocks on the exchange market pressure.

The reliable and stable banking sector ought to be a quarantine that it will be in the position to support the economic agencies (households and companies), despite the increased risks caused by uncertainty. The banking sector should undertake the leading role in assisting the clients in overcoming the economic difficulties during the first period of the pandemic, as well as to support them in the period of recovery which will undoubtedly be a long and challenging process. Increased credit risk for the banks, increased allowances for loan reserves and NPL are primary inevitable responses aligned with the crises. Nevertheless, the current condition of the banking sector should be a guaranty that it can undertake the risks challenged with the crises and support economy in the forthcoming months.

Projections for 2020 made by the Ministry of Finance shows that unemployment in Northern Macedonia will continue with the decreasing trend. Having in mind the changes in structural features of the unemployed population, the employment policy and active labour market measures should pay more attention to unemployed women, youth, those with tertiary education and unemployed four years and longer.

Table MK2 Summary of projections

	2020	2021	2022	2023
Real GDP (% change)	-4.0	7.0	4.5	4.0
Real private consumption (% change)	-2.2	5.3	3.5	3.3
Real government consumption (% change)	N/A	N/A	N/A	N/A
Real investment (% change)	-3.7	12.0	7.8	5.8
Exports of goods and services (constant prices, % change)	-5.5	13.5	9.7	8.7
Imports of goods and services (constant prices, % change)	-2.8	11.3	8.2	7.3
Current account balance (% of GDP)	-2.2	-1.3	-1.8	-1.9
Consumer prices (% change, pa)	-0.9	0.8	1.2	1.6
Exchange rate, national currency/EUR (pa)	61.5	N/A	N/A	N/A
Unemployment rate (registered, %, pa)	20.4	18.9	N/A	N/A
General government balance (ESA 2010 definition, % of GDP)	-6.5	-3.1	-2.8	-2.8
Total domestic credit (% change, eop)	0.5	8.4	7.1	6.4

Sources: https://www.imf.org/en/Publications/CR/Issues/2020/04/16/Republic-of-North-Macedonia-Request-for-Purchase-Under-the-Rapid-Financing-Instrument-Press-49340,
https://www.ceicdata.com/en/indicator/macedonia/forecast-unemployment-rate

Given the changes in the global environment, as well as domestic measures taken to prevent the spread of the coronavirus, adverse effects are expected in the external sector. As the Macedonian economy is small and open, the decline in economic activity globally, and especially in the European Union (where much of Macedonia's exports are concentrated) will have a direct impact on Macedonia's export sector. Some of the export facilities have already temporarily stopped production, which will undoubtedly mean reduced export activity of the country. Also, a reduced FDI inflow, a significant outflow of existing foreign capital, as well as a reduced inflow of remittances, can be expected.

ROMANIA

Romanian Economy at the Eve of Troubled Times

An unbalanced economic growth

During the second half of 2019, the Romanian economy' dynamics was strongly influenced by private consumption and certain investments rebound. Rises in wages and pensions substantially supported the households' consumption. Meanwhile, the labour market conditions remained tight, with unemployment falling to a 27-year low in December 2019 and real average wages increasing by 8.6 % year-on-year (yoy).

The inflation tensions persist in the second half of 2019 with a 3.7 % change in consumer prices. This situation reflects the structural unbalances and the induced effects of expansionary fiscal policy and local currency's depreciation pressures. Equally, inflation dynamics reflects the uncertainty associated with the design and implementation of economic policies. A synthesis of these evolutions is reported in Table 1.

For the respective period, a striking feature of the Romanian economic activity was the contraction of industrial output, mainly due to the evolutions in manufacturing (in particular, textile products and clothing), mining and electricity, gas, steam and air conditioning supply sectors. Opposite, the construction and information and communications technology (ICT) had been the drivers of

industrial production, while there was a certain improvement in the production of food goods. In a broader perspective, 2019 has emphasised the vulnerabilities of the Romanian industrial activity, mostly in areas with a higher sensitivity to external demand (e.g. automotive and textiles). The related effects induced to the whole economy, by several endogenous and exogenous shocks occurring in the industry, are significant since it is about a quarter of Romania's GDP.

Also, even if the positive change in real investments (variations in inventories and acquisitions fewer disposals of valuables) was significant in the second half of 2019, this was lop-sided towards real estate (logistics and industrial, offices and retail). In contrast, the increase in investments in new production capacities was relatively lower. Still critical is that investments in Romanian infrastructure remain far below their potential. As for foreign direct investments' net inflows, with a total of EUR 5.33 billion in 2019 (compared to EUR 5.26 billion in 2018), these focus on manufacturing (around one-third of the total) followed by construction, real estate, trade, financial intermediation and insurance. In addition, the share of the gross added value of multinational companies exceeds 60 % in automotive and ICT sectors.

The headway of Romanian economy should be placed in the context of the European Union's poor performance, in the last quarter of 2019 (with the weakest growth rate since the fourth quarter of 2013), which had reflected the social and political climate (e.g. Brexit, widespread strikes in France or Italian political tensions) as well as the slumping world trade.

Further deepening of external disequilibrium and an increase in external debt

The second half of 2019 was characterised by a worsening of the external trade outcomes with imports advancing almost twice faster than exports (yoy change). The consumption goods remained the main determinant of imports and exports (with EU absorbing more of 76% of Romania's 2019 exports and providing around 75% of its imports). Their path was affected by the fluctuations of the real exchange rates with major trade partners. As a consequence, the current account deficit rose above 4.5 % of GDP in the last quarter of 2019 – 2019 Q4.

Meanwhile, Romania's total external debt went up by EUR 6 billion (6%) in 2019, to EUR 106 billion. The increase of direct public debt is mainly related to the Eurobonds issued by the Finance Ministry, worth EUR 5 billion, and revaluations due to price changes of the securities issued by the Government (worth around EUR 2.23 billion), diminished by the repayments related to direct public debt (amounting to EUR 3.1 billion). Moreover, almost 70% of the external debt is represented by long-term external debt. Still, in 2019 Q4, the long-term external debt service reaches EUR 16.7 billion, while the short-term external debt service was three times larger (EUR 50.7 billion). Thus, the time structure of external debt service was a significant factor of macroeconomic disequilibria, and its impact may act as a driving force of external unbalances.

Financial systemic risks continuous escalation

The external unbalances twinned by the evolutions of the private financial sector's systemic risk. As National Bank of Romania (NBR) notes in its Financial Stability Report from December 2019 (p.5-6): "The overall level of systemic risks to financial stability in Romania is on the rise, similarly to global developments, and the outlook for the years ahead shows the furthering of this trend. Current assessments do not signal the presence of severe risks. However, three high systemic risks have been identified, as follows: (i) tensions surrounding domestic macroeconomic equilibria, (ii) weakening in investors' sentiment towards emerging economies, and (iii) the risk of an uncertain and unpredictable legislative framework in the financial and banking sector. The structure and cost of financing of the current account deficit and budget deficit carry a moderate risk, while the default risk for loans to the private sector is low".

Inflation remains a critical determinant of the overall financial stability. The annual CPI inflation rate overshot, in 2019 Q4, the upper bound of the variation band of the flat target (with fuel prices accounting for over half of the advance in the annual inflation rate in 2019 Q4). Besides the significant base effect from fuel prices, such evolution reflected the impact of various supply-side shocks on some food and agriculture items (fruit, pig-meat) whose pass-through into consumer prices was eased by the persistent excess aggregate demand.The depreciation of the RON versus the major currencies added to the inflationary impact, through the 'imported' component of inflation. At end-2019, the contribution of indirect tax changes to the annual CPI inflation rate amounted to 0.3 percentage points, is mainly accounted for by hikes in excise duties on tobacco products and fuels.

In 2019 Q4, the annual adjusted CORE2 inflation rate continued to follow the upward trend seen since the beginning of the year, coming in at 3.7% in December. This evolution reflects the pressures from companies' unit labour costs (with manufacturing posting two-digit annual rates of increase for most of the year) amid further robust wage dynamics, alongside modest and declining productivity gains for the analysis period.

Another factor of prices' volatility was related to the changes in the fruits' consumption group. This revealed strong movements in 2019 Q4 (with annual growth rate surging to 16.7%, up by 14.7% points from end-2019 Q3). Nonetheless, the other adjusted CORE2 components witnessed relatively favourable developments: the annual growth rate of prices of non-food items stayed around 2.4%, while that of services went up slightly to 4%.

These global dynamics was weakly offset by some exogenous components with a slight disinflationary impact (such as tobacco products and goods and services with administered prices). This was correlated with the cut in heating prices in November, followed by local measures on subsidies for households (while an opposite influence had the decision to increase the contribution for high-efficiency cogeneration in December, which impacted the electricity bill).

As for the monetary component of inflation, it can be noticed that the annual growth rate of broad money (M3) regained momentum in October through November 2019, for the first time in the past eight quarters. Such evolution should be placed in the context of the rise in money supply in arrears to the budget execution and to EU funds. Their impact was only incompletely offset by a faster increase in non-bank entities' government security holdings. The trajectory of the global money supply was mainly driven by its most liquid component (M1), whose annual dynamics displayed an outpouring (to a seven-quarter high), curtailing mainly from developments in corporate overnight deposits and, to a lower extent, from the rebound in household overnight deposits and currency in circulation. Contrastingly, the growth rate of time deposits with a maturity of up to 2 years continued to slow down, to a nine-quarter low. In this context, the share of M1 in M3 continued to widen, reaching 64.4 % in November, which was a new post-October 1994 record high.

A dire feature of nominal sector's evolution in 2019 Q3 and Q4 was associated with that the annual growth rate of credit to the private sector slowed down slightly in the first two months of 2019 Q4, in direct correlation with the developments in the annual dynamics of the credit flow and in those of loans granted through lines of credit, as well as with the pick-up in sales of non-performing loans. From a sectors' perspective, the slower growth rate of credit to the private sector was mainly due to the weaker dynamics of loans to non-financial corporations. The most recent 2019 Coface Romania survey shows that the number of insolvent companies was with 22% less than in the previous year. The data indicate a gradual decrease of insolvent companies with revenues over EUR 0.5 million (medium and large companies). Still, the number of companies interrupting their activity in 2019 increased to almost 160,000 (highest in the last decade).

As NBR's 2019 Financial Stability Report argues (p.10) the main structural vulnerabilities to financial stability in Romania were related to (a) weak payment discipline in the economy and vulnerabilities in companies' balance sheets; (b) low financial intermediation and, respectively, (c) some demographic problems. The first category derives from the fact that a significant number of companies do not comply with the capitalisation requirement. These companies had reported a non-performing loan ratio of 22% in September 2019, which represents more than one-third of the total non-performing corporate loans. These entities account for two-thirds of total overdue payments other than those to banks and one-third of the newly-insolvent companies. The second category derives from financial intermediation in Romania being the lowest among the EU Member States (e.g. the bank credit-to-GDP ratio at 27% in September 2019). Besides, by the end of 2019, the country's resident population suffered a contraction mainly due to a negative natural population change and to hasten of emigration. This, in conjunction with the relatively elevated unemployment rate among the youth aged 15-24 years and a faster ageing population, might easily lead to labour market tensions, a shrinkage in internal labour supply and to higher long-run volatility of aggregate demand.

Monetary policy remains prudent

By reflecting the uncertainties surrounding the evolutions of global financial stability as well as the macroeconomic environment in the second half of 2019, the monetary policy of the National Bank of Romania was rather prudent. In its November meeting, the Board of NBR decided to keep the monetary policy rate at 2.5 % per annum and leave unchanged the deposit facility rate and the lending facility rate at 1.5 % and, respectively, 3.5 % per annum (jointly with careful observation of money market liquidity). In addition, the Board decided to maintain the current level of the minimum reserve requirement ratio on RON-denominated liabilities of credit institutions.

The evolution of interest rates (as an essential transmission channel for the effects of monetary policy) had incorporated the signals associated with monetary policy decisions. For instance, it can be noticed that the volatility of the daily average interbank money market rate had further advanced in 2019 Q4, while its monthly average remained virtually unchanged in October and then augmented gradually, exceeding in December the monetary policy rate. Meanwhile, the average interest rate on non-bank clients' new loans declined slightly in October 2019 (but more pronounced in November - to a 20-month low of 6.96 %).

The design of monetary policy was based on several critical assumptions among which: (i) a downward trend for the output of economic activity; (ii) a possible rise in the unemployment rate; (iii) a certain increase in-country' risk premium; (iv) some increases in default rates and a potential gradual rise in non-performing loans ratio and, respectively, (v) a persistence (at least at some extent) of inflation pressure.

Fiscal policy's expansionary effects

The adverse effects of the previous expansionary fiscal policy measures (public sector employees' wages increase or rise in pensions and the social allowance for the retired) have been largely manifested in the second half of 2019. For instance, the second budget revision, implemented at the end of November, has reflected a substantial amendment of the budget deficit from 2.76% to 4.43% of GDP, according to the cash methodology. On the positive side, this second revision was progress towards transparency of the budgetary construction, by updating the revenue projection and by including certain outstanding obligations in the budgetary expenditures.

The changes in the budget in the second half of 2019 were due to scheduled expenditure increases on public wages and social spending, led by an increase in pensions (see also Table 1). Budget revenues grew by more than 8% in Q3 (compared to the Q2) and more than 15% in Q4, reflecting better consumption and income taxes' collection and higher social security contributions paid. Also, the government expenditures were dominated by social benefits and compensation of employees (summing-up 65% of total expenditures and almost 58% in Q4). The structural problems revealed in the first-half of 2019 persist in the second-half: (a) the need for more effective revenue collection and, respectively, (b) the pressure exercised by social expenditures.

An upward trend in external debt

While Romania preserves, by the end of 2019, one of the lowest external debt-to-GDP ratios (with a government debt equivalent to 35.2 % of the GDP in 2019 Q4), the rising of public debt was mainly due to soaring public deficit. Altogether, Romania's foreign debt increased to 106 billion euro ($115 billion) at the end of 2019 from 99.841 billion euro at the end of 2018.

We note that the long-term external debt service ratio fell to 18% at end-2019, against 22.3% at end-2018. The weight of direct public debt and publicly guaranteed debt in long-term component of external debt surpassed 53% in 2019 Q4. The short-term external debt service (50,730.8 EUR million - cumulative data from the beginning of the year) was more than three times larger than long-term external debt service (16,736.6 EUR million) by the end of 2019.

Labour market conditions remain tight

By the end of the year, the labour market tightened, and unemployment reached historic lows. The Romania unemployment rate reached 4% by the end of December 2019. The unemployment affected mainly workers with a low and medium level of education, for which the unemployment rate was 6.3%, respectively 4.0%. The unemployment rate for higher education graduates was only 1.6%. For people aged 15-24 years, the long-term unemployment rate (unemployed for six months and over) was 8.9%, and the incidence of long-term unemployment was 52.9%. Nevertheless, the shortage of labour force in various sectors had remained significant. PwC's 2019 HR Barometer discloses that 54% of Romanian companies intend to increase employee numbers, in 2020, by 11% on average. The IT&C sector has the highest demand for new employees, followed by industry, automotive and retail.

In 2019, the employment rate for the working-age population (15-64 years) was 65.8%. As in the previous years, the employment rate was higher for men (74.6% against 56.8% for women). Moreover, the employment rate was higher for residents of the urban area (67.1% against 64.2% in the rural area).

The labour cost index for industry, construction and services (compared to the same period of 2018) increased with 13.2% in Q3 and with 12% in Q4. For information and communication sectors the figures equalled 9.5% in both quarters.

These two trends (the scarcity of labour force supply and the significant increase in unit labour costs), alongside the differences across education levels and the persistence in gender differences and job conditions, will probably continue to manifest during 2020.

Table RO1 Main economic indicators*

	2018				Total 2018 year	2019			
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4
ECONOMIC ACTIVITY									
Real GDP (% change, yoy)	4.4	4.5	4.5	4.4	4.4	5.0	4.4	3.0	4.3
Real private consumption (% change, yoy)	8.1	6.6	5.6	7.8	6.9	6.5	5.2	4.2	7.1
Real government consumption (% change, yoy)	0.2	-6.7	1.0	1.4	-0.6	-13.8	6.6	-0.3	5.9
Real investment (% change, yoy)	3.6	-2.8	-1.8	-1.4	-1.0	3.9	18.9	25.6	15.2
Industrial output (% change, yoy)	5.2	5.0	2.6	0.7	3.3	2.0	1.5	-0.1	-1.9
Unemployment rate (registered, % pa)	4.3	4.3	4.1	4.1	4.2	3.8	3.9	4.0	4.0
Nominal GDP (EUR million)	38,878.5	47,067.4	57,051.8	61,638.6	204,636.3	42,650.3	50,939.9	61,222.0	67,212.1
GDP per capita (EUR)	1,990	2,410	2,930	3,160	10,490	2,200	2,620	3,150	3,460
PRICES, WAGES AND EXCHANGE RATES									
Implicit GDP deflator (% change, yoy)	1.9	4.0	5.4	5.6	4.2	4.5	3.8	4.1	4.5
Consumer prices (% change, yoy, pa)	4.7	5.3	4.9	3.7	4.6	3.7	4.0	3.8	3.7
Producer prices (% change, yoy, pa)	3.9	6.4	5.9	4.7	5.2	5.4	3.2	2.9	3.9
Average gross wage (% change, yoy, pa)	33.9	36.8	35.4	35.6	35.4	15.3	13.1	12.4	11.5
Exchange rate (RON/EUR, pa)	4.6553	4.6521	4.6468	4.6597	4.6535	4.7351	4.7477	4.7317	4.7665
Exchange rate (RON/USD, pa)	3.7860	3.9021	3.9949	4.0835	3.9416	4.1681	4.2229	4.2560	4.3047
FOREIGN TRADE AND CAPITAL FLOWS									
Exports of goods (EUR million)	20,699.5	21,280.6	21,287.1	21,834.6	85,101.8	22,027.0	22,518.8	22,369.6	23,196.8
Exports of goods (EUR, % change, yoy)	10.1	10.7	7.5	9.1	9.3	6.4	5.8	5.1	6.2
Imports of goods (EUR million)	21,383.5	22,575.5	22,850.3	24,430.9	91,240.6	23,928.5	24,197.7	24,767.2	25,831.6
Imports of goods (EUR, % change, yoy)	12.5	11.5	10.9	11.3	11.5	11.9	7.2	8.4	5.7
Current account balance (EUR million)	-840.1	-2,607.9	-3,082.8	-2,430.6	-8,961.4	-1,121.9	-3,255.7	-3,560.5	-2,249.2
Current account balance (% of GDP)	-2.2	-5.5	-5.4	-3.9	-4.4	-2.6	-6.4	-5.8	-3.3
Foreign Direct Investment net inflows (EUR million)	1,555.16	228.04	2,736.36	746.34	5,265.9	1,235.20	1,462.17	1,686.80	949.97
Foreign exchange reserves (EUR million, eop)	33,560.45	30,572.27	30,232.34	31,864.46	31,864.46	30,808.30	31,362.27	34,190.03	31,706.46
Foreign debt (EUR million, eop)	68,476.05	66,854.62	67,023.74	68,186.37	68,186.37	67,380.39	72,791.69	74,726.00	73,170.39
GOVERNMENT FINANCE									
Revenues (RON million)	64,668	74,067	77,549	86,941	303,225	74,682.4	73,939.9	80,043.9	92,465.2
Expense (RON million)	72,332	77,364	80,992	100,303	330,991	80,160.2	88,422.5	88,422.5	113,792.6
Net = Gross operating balance	-7,664	-3,297	-3,443	-13,362	-27,766	-5,477.8	-14,482.6	-7,012.4	-21,327.4
Net acquisition of non-financial assets (RON million)	231.1	223.0	264.8	-599.2	119.7	41.9	-48.4	43.9	N/A
Net lending/borrowing (RON million)	-7,860	-3,539	-6,226	-10,312	-27,936	-11,561	-7,892	-12,638	-13,376
Domestic government debt (EUR million, eop)	32,920.4	33,692.4	35,497.8	37,659.4	37,659.4	35,923.4	36,347.8	38,999.7	41,968.7
Foreign government debt (EUR million, eop)	31,798.4	31,850.1	31,706.6	33,127.7	33,127.7	33,234.6	35,003.5	36,951.8	36,182.8
Total government debt (eop. % of GDP)	34.5	34.1	33.9	34.7	34.3	33.8	33.9	35.4	35.2

MONETARY INDICATORS									
Narrow money, M1 (% change, yoy, eop)	14.9	14.3	11.4	11.6	12.9	12.3	12.7	15.4	17.8
Broad money, M4 (% change, yoy, eop)	11.7	12.9	10.3	8.8	8.8	9.0	7.7	9.3	10.9
Total domestic credit (% change, yoy, eop)	5.9	7.0	6.4	7.9	7.9	7.7	6.7	7.2	7.0
DMBs credit to households (% change, yoy, eop)	9.4	10.0	9.4	9.2	9.2	8.0	6.9	7.4	7.6
DMBs credit to enterprises (% change, yoy, eop)	2.0	3.5	3.1	6.3	6.3	7.4	6.4	6.9	6.3
Money market interest rate (%, pa)	2.03	2.63	3.28	3.17	2.78	3.10	3.29	3.09	3.02
DMBs credit rate for enterprises short-term (%, pa)	4.82	5.33	6.10	6.02	5.57	6.07	6.17	5.91	5.76
DMBs credit rate for households short-term (%, pa)	5.76	5.79	6.02	6.18	5.94	6.06	6.32	6.29	6.13

* 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 -insse.ro, https://www.economy.com/romania/; Eurostat Databases (European Commission) - https://ec.europa.eu/eurostat/; The National Bank of Romania - bnr.ro; The Romanian Ministry of Finance - https://www.mfinante.gov.ro/

When quarterly data were not readily available or in the required format, the indexes were computed by authors based on the above-mentioned sources.

Policy assumptions and projections summary

The National Commission for Strategy and Prognosis expect in its Winter 2020 medium-term forecast for 2019-2023 a 4.1% growth rate of the Romanian economy during 2020 (while it also expects the growth rate to slightly accelerate in the coming years, then ease towards 4% in 2023). A summary of projections is reported in Table 2. Similarly, the European Commission' European Economic Forecast for Winter 2020 (p.27) notes that: "Real GDP growth is forecast to remain robust at 3.8% in 2020 and 3.5% in 2021. The significant fiscal stimulus planned in 2020 and 2021 is expected to give a new boost to private consumption while also stimulating imports". In a somehow more pessimistic view, the International Monetary Fund in 2019 October edition of its World Economic Outlook forecasted a slowing down to 3.5% in 2020 for Romania's real GDP, an inflation rate of 3.27%, a 3.495 % of GDP general government deficit and a further widening of current account deficit to 5.22% of GDP.

Nevertheless, various sources consider that, without extended structural reforms, growing fiscal and current account deficits might substantially influence the medium and long-run sustainability of Romania' economic growth. As EC's Country Report Romania 2020 (February 2020) explicitly mentions (p.4): "Strong domestic demand, stimulated by tax cuts and large wage increases, has been the economy's growth engine in recent years. This consumption-led growth model has pushed the country's current account and public finances into rising deficits. In addition, adverse demographic developments have led to significant labour and skill shortages, limiting the country's growth potential".

NBR's inflation projections lay between 2.8% in Q1 of 2020 and 3.0 % in Q4. Still, uncertainty intervals for such projections exceed 1.1%. Among the potential determinants of 2020 inflation tensions, NBR's Inflation Report -February 2020 includes (a) a further rise in demand and inflation expectations; (b) a gradual strengthening of inflationary pressures from prices of imported goods, in line with the progressive rise in external inflation; (c) unfavourable evolutions in global commodity prices (energy, agriculture and food items); (d) labour shortage and the mismatch between labour supply and demand; (e) future movements in administered prices, mostly in terms of the pace and magnitude of electricity and natural gas markets' liberalisation.

Table RO2 Summary of projections*

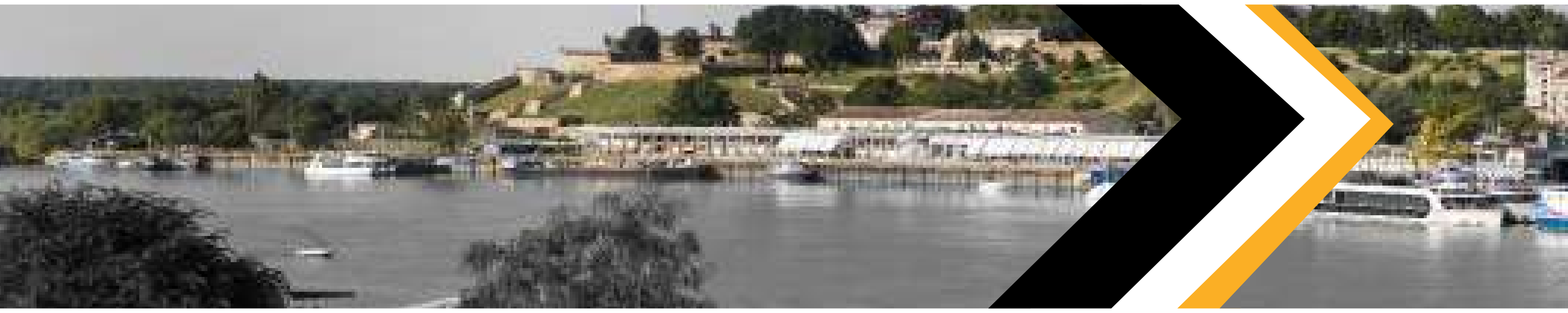
	2020	2021	2022	2023
Real GDP (% change)	4.1	4.2	4.2	4.0
Real private consumption (% change)	4.4	4.2	4.0	3.8
Real government consumption (% change)	3.9	3.0	3.0	2.6
Real investment (% change)	7.9	7.4	7.5	7.1
Exports of goods and services (constant prices, % change)	4.6	4.5	4.4	3.9
Imports of goods and services (constant prices, % change)	5.7	5.1	4.6	4.0
Current account balance (% of GDP)	-4.5	-4.0	-3.8	-3.5
Consumer prices (% change, pa)	3.1	2.9	2.8	2.6
Exchange rate, national currency/EUR (pa)	4.75	4.75	4.80	4.80
Unemployment rate (registered, %, pa)	3.8	3.7	3.6	3.5
General government balance (ESA 2010 definition, % of GDP)	-4.01	-3.88	-3.81	-3.57
Total domestic credit (% change, eop)	1.9	N/A	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 – Medium-term forecast 2019-2023 (Winter 2020 edition). In the World Economic Outlook Database (October 2019 update; data for 2020-2024), the International Monetary Fund (IMF) forecasts moderate real GDP growth of 3.50% in 2020, respectively 3.00% in 2021, 2022 and 2023.

Source: National Commission for Strategy and Prognosis Romania – Medium-term forecast 2019-2023 – Winter 2020 and Autumn 2019 editions; International Monetary Fund – World Economic Outlook Database (October 2019 update; data for 2020-2024).

At the end of 2019, a plausible baseline scenario for the Romanian economy during 2020 involved moderate economic growth. Still, significantly driven by strong demand, and in the context of lower (but perhaps more volatile) inflation, some important changes in the design of fiscal policy and widening of current account deficit. However, in an ex-post note, the pandemic crisis is likely to impact the economic activity severely and to change all the forecasting premises fundamentally. The fall in demand and the disruption of the supply-chain effects are clearly expected to lead to a pullback in business activity and to substantial human costs, but the magnitude of such effects is yet difficult to assess.



S E R B I A

The good business climate for FDIs

Construction sector brings impressive growth of the real GDP in the last quarter of 2019 and leads to the rising employment rate

The real GDP growth in 2019 was approximatively 4,2%. Meaning that compared to 2018, it had a small decrease of about 0,2 p.p. the overall growth of GDP influenced the first and the second quarter of 2019. By the expenditure approach of gross domestic product, real investment posted 29.6% growth in the 4th quarter, retaining the role of the dominant carrier of economic growth. By the production approach, in the fourth quarter of 2019 construction sector brought the most significant contribution to GDP growth. In this component, construction of the Main Gas Pipeline, Highway (corridor 11 and finishing works on corridor 10) and rail works contributed significantly to the growth of construction activity. The drop in average real GDP is expected in 2020 and 2021 as a result of virus COVID-19.

In the last quarter of 2019 more employed people were in the Construction sector. That is, consequently, because of construction activity growth. Comparing to the previous quarter of the same year, more female was employed while the number of employed males decreased by 13 600. For both genders, the most unemployed area was Šumadija and Western Serbia. The initial unemployment rate was in the Belgrade area. It can be concluded that that result is a consequence of the Belgrade area development, in which new challenges and new jobs are brought.

In the last quarter of the 2019 year, the unemployment rate dropped compared to the same quarter of the previous year, because of the rise of the employment

rate (Q4 2018 47,4% and Q4 2019 49,7%) and drop of inactivity rate. We can conclude that more people who were inactive in jobs searching, found one.

The economy of Serbia is a service-based upper-middle-income economy with the tertiary sector accounting for two-thirds of total gross domestic product (GDP) and functions on the principles of the free market. Nominal GDP in 2019 has reached about 45.580 billion EUR, which is approximately 6,545 EUR per capita, while GDP based on purchasing power parity (PPP) stood at approximately 114.398 billion EUR (16,423 EUR per capita).

The Gross Domestic Product per capita in Serbia reached approximately 6400 EUR in Dec 2018. The GDP per capita in Serbia is equivalent to 54 percent of the world's average.

Manufacturing affected the high level of industrial output and price level and exchange rate remain relatively steady

The first thing that the 2019 year brought was total industrial production, which was higher in 2019 for 0.3% than in 2018. The cumulative growth in 2019 was recorded in all three sectors: Manufacturing (0.2%), Electricity Supply, energy, gas, steam and air conditioning (0.5%) and mining (1.2%). The sector of Manufacturing is divided into 24 areas. The increase in growth was identified in 18 areas, and the decrease was identified in 11 areas, comparing to the previous year. The five areas which have the highest weight (about 33%) experienced a cumulative decline in 2019 compared to the previous year. Those areas were: food products; coke oven products and products of petroleum; beverages products; chemicals and their products; manufacture of motor vehicles and trailers.

In 2019 (as of December) consumer prices saw year-on-year growth of 1.9%, while the average year-on-year growth of prices amounted to 1.7%. The second thing which 2019 brought was the stable exchange rate, and the interannual growth of consumer prices (p/a) is in the target price level of the National Bank of Serbia for 2019. (3%±1,5 p.p.). Observed by purpose, the most significant influence on the total consumer price growth in 2019 was that of prices of unprocessed food and prices of services. Observed by main divisions of consumption, the most substantial contribution was that of prices of food and nonalcoholic beverages, alcoholic beverages and tobacco.

Increase of gross salaries and wages in the period January – December 2019, relative to the same period last year, amounted to 10.5% in nominal terms, i.e. 8.4% in real terms. Simultaneously, net salaries and wages increased by 10.6% in nominal terms and by 8.5% in real terms. Compared with the same month last year, average gross salaries and wages for December 2019 increased by 14.0% in nominal terms and by 11.9% in real terms, while average net salaries and wages increased by 14.1% in nominal terms and by 12.0% in real terms.

Good business climate lead to rising FDIs

In 2018, Serbia exported about 17.4 billion EUR and imported about 23.5 billion EUR, resulting in a negative trade balance of -6.1 billion EUR. In 2018, Serbia's exports per capita were 2.49k EUR, and its imports per capita were 3.37k EUR. The top exports of Serbia were insulated wire, cars, rubber tires, hot-rolled iron and electric motors. The top imports of Serbia were crude petroleum, packaged medicaments, cars, petroleum gas and refined petroleum.

Serbia has substantially benefited from trade and economic integration with the EU. The EU is traditionally Serbia's principal trading partner accounting for nearly 65% of Serbia's total exports and around 64% of Serbia's total imports of goods in 2019, with similar percentages persisting over the years. The value of Serbian exports to the EU more than tripled from nearly 3.4 billion EUR in 2009 to almost 11.3 billion EUR in 2019.

The three highest export share commodity groups were firstly electrical machinery and equipment and parts thereof, sound recorders and reproducers, television image and sound recorders and reproducers and parts and accessories of such articles; secondly nuclear reactors, boilers, machinery and mechanical appliances; parts thereof; third plastics and articles thereof. The lowest share of exports had edible fruit and nuts, with only 3.1% of the total export.

On the other side, the three highest import commodity groups were commodities not specified according to kind; secondly mineral fuels, oils and products of their distillation, bituminous substances, mineral waxes; and thirdly electrical machinery and equipment and parts thereof, sound recorders and reproducers, television image and sound recorders and reproducers and parts and accessories of such articles. The lowest share of imports had paper and paperboard, articles of paper pulp, paper or paperboard with only 2.4%.

The factors which influence pleasant business climate are strategic location, relatively inexpensive multilingual labour, EU free trade agreements, the lowest corporate taxes and high foreign exchange reserves. In 2019 foreign exchange reserves rose compared to 2018 for about 1,12 p.p. All that led to FDI's coming from the European Union, Russia and China. Mainly FDI's went to the manufacturing area, and that is the indirect cause of high-level industrial output.

As the main point of Government finance - revenues and expenses, they rose in 2019 comparing to 2018. However, they gave a positive net operating balance in quarters of all years. Revenues rose as a result of rising VAT revenues, donations and excise duties. Expenses rose as a cause of rising employee wages, rising transfers to The Pension and Disability Insurance fund, National Health Insurance Fund, National Employment Service and Military Insured Social Security Fund; and also rising expenditures on capital investments. Domestic government debt dropped in 2019 and affected total government debt which is in 2019 lower than in 2018. There can be many reasons for this; two primaries were exchange rate oscillations (strengthening of the national) and payout of debts. Else ways, foreign government debt in 2019 compared to 2018 oscillate. It had small dropping (Q1 2019, Q2 2019 to Q1 2018, Q2 2018) and small rising (Q3 2019, Q4 2019 compared to Q3 2018, Q4 2018 respectively).

Revenues and expenses rose in 2019, with positive net gross operating balance and with total government debt percentage dropping

Serbia's External Debt reached about 27.8 billion EUR in Dec 2019, compared with 27.8 billion EUR in the previous quarter. Current Account recorded a deficit of 99.3 million EUR in Jan 2020. Foreign Direct Investment (FDI) increased by about 240.28 million EUR in Jan 2020. Serbia's Direct Investment Abroad expanded by approximately 6.6 million EUR in Jan 2020. It is Foreign Portfolio Investment fell by 21.3 million EUR in Dec 2019. The country's Nominal GDP was reported at 12.2 billion EUR in Dec 2019.

Table SRB1 Main economic indicators

	2018				Total 2018 year	2019			
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4
ECONOMIC ACTIVITY									
Real GDP (% change, yoy)	5.0	5.0	4.2	3.5	4.4	2.7	2.9	4.8	6.2
Real private consumption (% change, yoy)	2.9	3.3	3.1	3.0	3.2	3.3	3.2	3.0	3.1
Real government consumption (% change, yoy)	2.3	4.9	4.1	3.2	4.2	2.4	2.2	4.6	2.5
Real investment (% change, yoy)	26.0	20.6	16.7	11.1	17.8	7.2	8.2	17.5	29.6
Industrial output (% change, yoy)	5.9	2.3	-1.4	-1.1	1.4	-1.5	-2.5	2.0	3.2
Unemployment rate (survey, % pa)*	14.8	11.9	11.3	12.9	12.7	12.1	10.3	9.5	9.7
Nominal GDP (EUR million)	10,496	10,658	10,816	10,856	42,826	10,994	11,314	11,610	11,900
GDP per capita (EUR)	1,400	1,500	1,600	1,637	6,137	1,500	1,600	1,620	1,650
PRICES, WAGES, AND EXCHANGE RATES									
Implicit GDP deflator (% change, yoy)	1.8	1.9	2.6	1.8	2.0	2.0	2.7	2.4	2.5
Consumer prices (% change, yoy, pa)	1.6	1.8	2.4	2.0	2.0	2.4	2.3	1.3	1.9
Producer prices (% change, yoy, pa)	0.9	1.9	3.7	2.5	2.2	1.3	1.4	-0.2	0.2
Average gross wage (% change, yoy, pa)	8.4	2.3	2.7	2.9	4.0	9.3	9.9	12.3	11.9
Exchange rate (RSD/EUR, pa)**	118.43	118.17	118.14	118.35	118.27	118.23	117.97	117.72	117.53
Exchange rate (RSD/USD, pa)**	96.33	99.13	101.57	103.67	100.28	105	103.77	107.43	104.92
FOREIGN TRADE AND CAPITAL FLOWS									
Exports of goods (EUR million)	3,816	4,198	4,068	4,133	16,215	4,084	4,474	4,385	4,527
Exports of goods (EUR, % change, yoy)	8.6	6.0	8.7	10.0	8.3	9.3	9.4	10.2	8.7
Imports of goods (EUR million)	5,071	5,419	5,401	5,961	21,919	5,529	5,877	5,781	6,525
Imports of goods (EUR, % change, yoy)	13.7	9.9	11.8	11.3	11.6	9.7	11.0	11.4	11.4
Current account balance (EUR million)	-713	-310	-522	-531	-2,076	-818	-696	-599	-1,046
Current account balance (% of GDP)	-1,046	-2.96	-4.25	-5.43	-5.2	-8.8	-6.6	-5.5	-5.2
Foreign direct investment net inflows (EUR million)	730	684	589	1,155	3,157	792	1,017	922	852
Foreign exchange reserves (EUR million, eop)	10,235	11,104	11,172	11,262	11,262	11,440	12,146	13,295	13,378
Foreign debt (EUR million, eop)	24,055	24,360	24,280	23,328	26,901	23,744	23,892	24,349	24,355
GOVERNMENT FINANCE									
Revenues (RSD billion)***	474	527	537	568	2,105	526	552	568	632
Expense (RSD billion)***	441	457	462	514	1,874	478	492	489	564
Net = Gross operating balance (million RSD) ***	33	70	75	54	231	48	60	79	68
Net acquisition of non-financial assets (RSD million)***	29	40	54	77	199	36	53	63	114
Net lending/borrowing (RSD million)	4	30	21	-23	32	12	7	16	-46
Domestic government debt (EUR million, eop)	9,919	9,887	9,923	9,568	9,568	9,617	9,759	9,883	9,993
Foreign government debt (EUR million, eop)	13,802	14,151	14,035	13,446	13,446	13,780	13,797	14,065	13,951
Total government debt (eop. % of GDP)	56	57	57	54	54	52	52	53	53
MONETARY INDICATORS									
Narrow money, M1 (% change, yoy, eop)	9.4	13.54	15.09	18.32	18.3	16.36	15.52	19.34	14.05
Broad money, M4 (% change, yoy, eop)****	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Total domestic credit (% change, yoy, eop)	2.0	3.9	6.3	7.6	7.6	7.0	6.1	6.8	8.1
DMBs credit to households (% change, yoy, eop)	6.9	8.9	11.7	12.5	12.5	12.1	9.2	8.4	9.2
DMBs credit to enterprises (% change, yoy, eop)	0.6	2.9	4.1	6.8	6.8	6.7	6.8	8.7	7.6
Money market interest rate (%, pa)	2.51	2.40	2.37	2.40	2.42	2.15	1.82	1.43	1.12
DMBs credit rate for enterprises short-term (%, pa)	3.4	3.6	3.2	3.3	3.4	3.2	3.1	2.9	3.1
DMBs credit rate for households short-term (%, pa)	8.1	7.9	7.8	7.4	7.8	6.8	6.4	6.2	5.6

Notes: * This unemployment rate is calculated based on the survey.** The average exchange rate is calculated by the authors based on calculations 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 the 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, IMF.

Policy assumptions and projections summary

The appearance of COVID-19 in almost all countries, and Serbia included, will lead to enormous changes in economic activity. In one scenario, the economy will be precise as the one after the recession in 2008. The other scenario is that it will much worse and much deeper than the scenario that happened after the 2008 recession.

Because of the small possibility to tell how long the virus will last in all countries, and will it have its second phase, it will be hard to predict economic movements in the next quarters. The Ministry of Finance published projections for Serbia before COVID-19 happening. The Fiscal Council of the Republic of Serbia published a document named Revised Fiscal Strategy. Those documents are used as a core base for their projection calculations and summary in the table RS2. By the document Macroeconomic Developments in Serbia issued by The National Bank of Serbia, it is assumed that COVID-19 will have less impact than in other European countries due to strong fundamentals.

We can assume that without any analysis, that after the pandemic, producers in Serbia will produce less, purchasing power will drop, and the population unemployment rate will rise. Immediately after the ending of the pandemic, the living situation of an individual will be different. To try to make it easier, economic mitigation measures brought by the Government will bring some stimulations to private consumption and enterprises (SME and other). The primary purpose of those measures is to 'hold' indicators like private consumption, exports- imports and unemployment rate. The term 'hold' used in the previous sentence, means it will try to help those indicators not to get much worse and to try to remain stable. Tax reduction will for sure cause dropping of government revenues, and that will implicate dropping net gross operating balance.

Table SRB2 Summary of projections

	2020	2021	2022
Real GDP (% change)	-2.5	4.0	4.0
Real private consumption (% change)	3.9	3.6	3.7
Real government consumption (% change)	1.5	1.3	0.4
Real investment (% change)	6.4	5.4	5.7
Exports of goods and services (constant prices, % change)	8.1	8.4	8.4
Imports of goods and services (constant prices, % change)	7.4	7.1	7.2
Current account balance (% of GDP)	-6.1	-5.5	-4.7
Consumer prices (% change, pa)	1.4	1.9	2.5
Exchange rate, national currency/EUR (pa)	117	118	118
Unemployment rate (registered, %, pa)	13.4	13.0	12.9
General government balance (ESA 2010 definition, % of GDP)	-0.5	-0.5	-0.4
Total domestic credit (% change, eop)	8.2	7.6	7.5

Conventional abbreviations: pa-period average, eop-end of the period, EUR – Euro, RSD- Serbian Dinar.
Sources: Author's projections, The World Bank. International Monetary Fund - World Economic Outlook, April 2020, Ministry of Finance of the Republic of Serbia, Fiscal Council.

According to the World Bank projections for 2020 and 2021, real GDP will amount to -2.5% and 4.0% retrospectively. By the document of the Fiscal Council, real private consumption change will be 2.7%, 2.5% and 2.5% in 2020, 2021 and 2022 retrospectively. For the same time period it is projected 2.2%, 2.4% and 2.4% private consumption change (2020,2021,2022 retrospectively). The reason will be recession after COVID-19 and its mitigation measures.

The exchange rate is projected with small changes or not at all (due to foreign exchange market operations of the National Bank of Serbia as well as high foreign reserves). It is expected that the unemployment rate will drop more than institutionally projected, as a result of more firm bankrupts, firm liquidity problems and others.

SLOVENIA

Slovenia's economy is cooling due to the uncertainties in the international environment

National carrier Adria Airways went bankrupt

In autumn 2019, Slovenian carrier Adria Airways went bankrupt. Adria was the flag carrier of Slovenia operating scheduled and charter flights to European destinations. Founded in 1961, Adria also offered air connections between Central and Southeastern Europe. Starting in January 2019, the airline shut down operations from Germany to London, Vienna and Zurich, following significant route cuts from its central hub in Ljubljana. In the following months, there were frequent flight cancellations, unpaid compensation claims, and sporadic route launches and cuts. On 23 September, Adria Airways started to suspend flight operations, and lessors had repossessed several of the carrier's aircraft due to non-payment of leasing contracts. The Slovenian government did not decide for state aid to Adria because, among other reasons, Adria's privatization in 2016 was widely considered to be very harmful. On 30 September, Adria Airways had officially filed for bankruptcy. The government was studying an option to set up a new airline within a few months. The motivations behind re-launching a national airline were several, including significant loss to tourism

and capacity loss of cargo services due to the lost air links, as well as to employ all the people that were left jobless. However, in the weeks following Adria's bankruptcy, foreign airlines have stepped up their presence in Slovenia to such a high degree that there was no need for a new Adria anymore.

Economic growth moderated throughout the year

Slovenia's economic growth continued to slow down in the second half of 2019, to 2.4% and 1.7% y-o-y in the third and fourth quarters, respectively. Compared to 2018, growth almost halved in 2019 as a whole end stood at 2.4%. The decline in growth was a consequence of weaker growth in exports and investment.

In the third quarter of the year, growth continued to be primarily driven by investment and export growth. However, in the last quarter, the y-o-y growth in the exports of goods and investment slumped to 0.9% and 0.1%, respectively, with gross fixed capital formation recording a decline (-4.5%) compared to the last quarter of 2018. The slowdown in external trade movements was a result of the moderation of economic activity in Slovenia's main trading partners. Growth in imports of goods exceeded growth in exports of goods in the third quarter of 2019. However, it turned negative in the last quarter (-0.6% y-o-y) due to weak investment and low growth in industrial production, and the contribution to gross domestic product growth of net exports turned positive.

While growth in government consumption picked up in the third quarter of the year (3.4% y-o-y), it turned negative (-2.0% y-o-y) in the last quarter. Private consumption growth also moderated in the last quarter of the year (1.2% y-o-y) but was, nevertheless, the most crucial component of economic growth in this quarter.

In the second half of the year, the growth in industrial output moderated. In the last few months of the year, particularly production in medium-high technology industries strengthened again. However, considering 2019 as a whole, high-technology production increased the most (9.3%). The value of industrial production in 2019 was 3.0% higher than in the previous year, but the growth in 2019 was 2.0 percentage points lower than in 2018.

The value of industrial production was higher in manufacturing (by 3.4%) but lower in electricity, gas, steam and air conditioning supply, and mining and quarrying (by 0.8% and 3.6%, respectively).

The lowest unemployment rate on record

Despite the slowdown in economic activity, labour market conditions improved further towards the end of last year. In 2019 as a whole, the number of persons employed increased by 2.5%, which is less than in 2018, reflecting slower growth in economic activity. The number of persons employed reached the highest level on record. Employment growth was still based mainly on the hiring of foreigners as a consequence of the shortage of domestic labour, and partly on the increased labour market participation of individuals who previously had not been actively seeking employment.

In 2019, the year on year fall in unemployment had slowed amid the already relatively low level of unemployment. According to LFS, the unemployment rate declined to 4.0% in the last quarter of the year, which is the lowest unemployment rate recorded in more than 20 years. It stood at 4.5% in 2019 as a whole.

The substantial increase in wages continued in the second half of 2019. Gross earnings increased by 4.5% and 4.2% y-o-y in the third and fourth quarters of the year. In 2019 as a whole, year on year wage growth was higher in the public sector (5.4% in gross earnings) than in the private sector (3.9% in gross earnings) as a consequence of wage rises agreed with trade unions at the end of 2018, regular promotions, and the increase in the minimum wage.

General government balance in surplus

After having turned slightly negative (-0.6% of GDP) in the first quarter of 2019, the general government balance was in surplus and rising throughout the rest of the year. In the fourth quarter, the surplus amounted to EUR 146 million or 1.2% of GDP and was EUR 23 million lower compared to the fourth quarter of 2018. In 2019 as a whole, the surplus amounted to 0.5% of GDP.

In the third and fourth quarter, the y-o-y growth in revenue was mostly due to revenue growth from social contributions, and revenue growth from taxes on income and wealth, respectively. On the expenditure side, the y-o-y growth was most pronounced in social benefits and social transfers in the third quarter, and gross fixed capital formation in the last quarter of the year.

The debt-to-GDP ratio decreased further in 2019. Supported by economic growth, it stood at 66.1% and was 4.3 percentage points down compared to 2018.

Despite Bank of Slovenia's recommendations from November 2018 concerning the maintenance of moderate growth in consumer loans, their volume continued to rise at a rate of more than 10% y-o-y in 2019. In November 2019, the Bank of Slovenia, therefore, changed the recommendation into a binding instrument. It placed caps on the maturity of consumer loans and the ratio of the annual debt servicing costs to the borrower's net income. Year-on-year growth in consumer loans declined to 8.9% in December and averaged 11.7% in 2019. The y-o-y growth in housing loans was stable over the first three quarters of 2019 (around 5.0%) but slightly increased in the last quarter of the year (to 5.6%), most probably as a compensation for the decline in consumer loans.

Tightening of household lending

In 2019, the total growth in loans continued to be mainly driven by household loans, but the contribution to growth from corporate loans increased. In particular, the y-o-y growth in corporate loans strengthened in the period from August to November, standing at above 2% and reaching 3% in November.

Higher prices of services primarily drive inflation

Inflation slowed in the second half of last year, with headline inflation reaching an average rate of 1.6% in 2019, which is similar to 2018, but the structure of inflation changed significantly. In 2019, domestic inflationary pressures strengthened, while external pressures weakened considerably in line with developments in oil prices. Inflation was primarily driven by higher prices of services that were the result of rising wages (unit labour costs) and strengthened domestic private consumption.

The current account surplus widens

The current account surplus amounted to 6.4% and 6.9% of the gross domestic product in the third and fourth quarters of 2019. In 2019 as a whole, the surplus stood at 6.6% of gross domestic product and was EUR 566 Mio or 0.5 percentage points higher than in 2018. The main factor for the widening surplus was a higher trade surplus in services, and, to a smaller degree, a trade surplus in goods.

In the second half of 2019, the FDI inflow more than halved compared to the same period of 2018. On a yearly level, the inward FDI amounted to EUR 1.2 billion in 2019, with most of the inflow taking place in the first quarter of the year. The increase was mainly in the form of equity and reinvested earnings (EUR 1.1 billion and EUR 0.3 billion), while the net debt to foreign owners decreased.

Table SI1 Main economic indicators

	2018				Total 2018 year	2019			
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4
ECONOMIC ACTIVITY									
Real GDP (% change, yoy)	4.3	3.7	4.6	3.8	4.1	3.3	2.5	2.4	1.7
Real private consumption (% change, yoy)	3.6	2.8	2.0	2.8	2.8	2.5	3.8	3.2	1.2
Real government consumption (% change, yoy)	2.4	3.1	3.2	4.0	3.2	3.9	1.1	3.4	-2.0
Real investment (% change, yoy)	12.1	4.5	14.9	6.4	9.3	0.4	-1.5	5.5	0.1
Gross-fixed capital formation (% change, yoy)	9.7	8.8	11.4	6.7	9.1	10.0	6.7	2.2	-4.5
Industrial output (% change, yoy)	7.8	5.6	3.5	2.5	4.9	3.1	4.1	3.9	1.9
Unemployment rate (registered, % pa)	9.0	8.1	7.9	8.0	8.2	8.3	7.5	7.4	7.5
Nominal GDP (EUR million)	10,564	11,509	11,812	11,871	45,755	11,162	12,115	12,393	12,337
GDP per capita (EUR)	5,111	5,567	5,706	5,717	22,083	5,364	5,812	5,932	5,891
PRICES AND WAGES									
Implicit GDP deflator (% change, yoy)	-0.2	2.3	3.8	2.8	2.2	-0.1	2.9	4.0	2.8
Consumer prices (% change, yoy, pa)	1.3	1.9	1.9	1.9	1.7	1.3	1.6	2.0	1.5
Producer prices (% change, yoy, pa)	2.2	2.1	2.4	1.6	1.4	1.1	0.9	0.3	0.4
Average gross wage (% change, yoy, pa)	3.6	3.6	3.0	3.3	3.4	4.6	3.9	4.5	4.2
Exchange rate (______/EUR, pa)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Exchange rate, EUR/USD (pa)	1.23	1.19	1.16	1.14	1.18	1.14	1.12	1.11	1.11
FOREIGN TRADE AND CAPITAL FLOWS									
Exports of goods (EUR million)	7,479	7,861	7,555	7,921	30,816	7,999	8,320	7,835	7,894
Exports of goods (EUR, percent change, yoy)	7.6	7.9	3.6	4.1	5.8	5.4	5.9	5.7	0.9
Imports of goods (EUR million)	7,147	7,428	7,153	7,794	29,521	7,567	7,860	7,635	7,607
Imports of goods (EUR, percent change, yoy)	9.7	7.9	5.3	6.3	7.3	4.3	6.2	9.0	-0.6
Current account balance (EUR million)	704	713	837	530	2,784	667	849	787	848
Current account balance (percent of GDP)	6.7	6.2	7.1	4.5	6.1	6.0	7.0	6.4	6.9
Gross foreign direct investment (EUR million)	284	216	483	311	1,295	856	45	165	159
Foreign exchange reserves (EUR million, eop)	716	715	781	816	816	858	906	917	905
Foreign debt (EUR million, eop)	42,796	42,857	41,948	42,100	42,100	42,408	43,672	44,804	44,062
GOVERNMENT FINANCE*									
Revenues (EUR million)**	4,702	5,090	5,052	5,418	20,262	4,943	5,304	5,399	5,582
Expense (EUR million)**	4,713	4,969	5,001	5,250	19,933	5,034	5,213	5,284	5,436
Net = Gross operating balance (EUR million)**	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Net acquisition of non-financial assets (EUR million)**	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Net lending/borrowing (EUR million)**	-11	122	51	168	330	-92	91	115	146
Domestic government debt (EUR million, eop)	26,355	26,356	26,255	26,179	26,179	26,688	26,764	27,098	26,680
Foreign government debt (EUR million, eop)	3,785	3,013	3,011	3,002	3,002	1,899	1,895	1,889	1,880
Total government debt (percent of GDP)	72.1	70.6	70.4	70.4	70.4	68.1	67.7	68.1	66.1
MONETARY INDICATORS									
Narrow money, M1 (% change, yoy, eop)	N/A	N/A	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	N/A	N/A
Total domestic credit (% change, yoy, eop)	2.5	4.8	5.6	2.3	2.3	3.0	2.6	1.7	6.3
DMBs credit to households (% change, yoy, eop)	6.0	6.2	6.5	6.5	6.5	6.6	6.1	5.9	5.9
DMBs credit to enterprises (% change, yoy, eop)	0.3	-1.0	-1.0	-1.4	-1.4	0.2	1.6	2.3	1.2
Money market interest rate (%, pa)	-0.36	-0.36	-0.36	-0.36	-0.36	-0.37	-0.37	-0.4	-0.5
DMBs credit rate for enterprises short-term (%, pa)	2.1	2.1	2.3	2.1	2.2	1.8	1.8	1.8	1.7
DMBs credit rate for households short-term (%, pa)	3.5	3.3	3.2	3.3	3.3	3.3	3.2	3.2	3.0

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.

Policy assumptions and summary of projections

Uncertainty about the size and duration of the COVID-19 pandemic and its impacts on economic activity

Due to the spread of COVID-19, the situation in the world economy and Slovenia has deteriorated significantly. Severe disruption to industry and service activities took place due to nationwide lockdowns to protect human health. The depth of the GDP decline will depend on the extent and duration of the coronavirus spread. Moreover, the recovery after the end of the crisis will depend on the scope and content of economic policy measures. The data presented in the summary of projections' table is based on the Covid-19 scenario prepared by the Institute for Macroeconomic Analysis and Development. However, the current projection is subject to considerable uncertainty and possible downward risks if the strict containment measures need to be extended.

Under the assumption that strict containment measures will remain in force until the end of May and a gradual recovery to economic activity would begin in the second half of this year, the gross domestic product in Slovenia is forecast to decline by 8.1% in 2020 and regain positive growth in 2021 (3.5%). The decline in Slovenia is going to be higher than on average in the advanced economies due to Slovenia's high export dependence. Due to the major drop in economic activity, the registered unemployment rate is forecast to rise to 9.1% this year and stay on a similar level in 2021 (9.0%)

Table SI2 Summary of projections

	2020	2021
Real GDP (% change)	-8.1	3.5
Real private consumption (% change)	-3.1	-0.4
Real government consumption (% change)	3.0	1.0
Gross-fixed capital formation (% change)	-18.5	7.0
Exports of goods and services (constant prices, % change)	-19.4	10.0
Imports of goods and services (constant prices, % change)	-19.4	7.8
Current account balance (% of GDP)	0.8	3.2
Consumer prices (% change, pa)	0.7	2.7
Exchange rate, national currency/EUR (pa)	1.107	1.108
Unemployment rate (registered, %, pa)	9.1	9.0
General government balance (% of GDP)	-6.6	-2.1
Total domestic credit (% change, eop)	N/A	N/A

Sources: Institute for Macroeconomic Analysis and Development – COVID-19 scenario, and IMF – World Economic Outlook, April 2020.

Several measures have been adopted in Slovenia to mitigate the consequences of the COVID-19 pandemic for citizens and the economy. The aim is to preserve jobs and keep businesses in operation, improve the liquidity of businesses, revive investment activity, provide emergency assistance to the self-employed, and support the vulnerable population groups. Additional measures will be needed for the recovery of the economy after the pandemic ends. As a consequence, the general government balance will turn negative in 2020. According to WEO, it will stand at -6.6% of the gross domestic product in 2020 and remain negative also in the following year (-2.1%) ■

ANALYSIS

FDI net inflows in selected SEE countries

In the context of globalisation, when state borders become less and less an obstacle to the movement of goods and capital, foreign investors increasingly invest their capital abroad in order to ensure economic benefits and higher profits. One of the critical factors in the economic development of every country is foreign direct investment.

The volume and intensity of the distribution of foreign investments on a global level depend, above all, on the situation in the world economy. For investors, the treatment they can get in a particular country is crucial, as well as the relatively cheap labour, the availability of raw materials and the size of the market itself.

In order to create optimal conditions that will contribute to attracting foreign direct investments, it is essential to provide a pleasant investment climate for foreign investors. Most countries have liberalised the regulations that determine the framework of foreign investments, all with the aim of their greater competitiveness and thus higher inflow of foreign capital. Improving macro competitiveness and creating an attractive business environment are the essential preconditions for attracting foreign investment and the arrival of large multinational companies.

In this issue of the publication, the analysis is focused on net foreign direct investment in selected SEE countries in the period 2018-2019.*

* In analysis used data obtained from partner institutions participating in the writing of the publication, which are presented in the publication itself in the segment of main macroeconomic indicators.

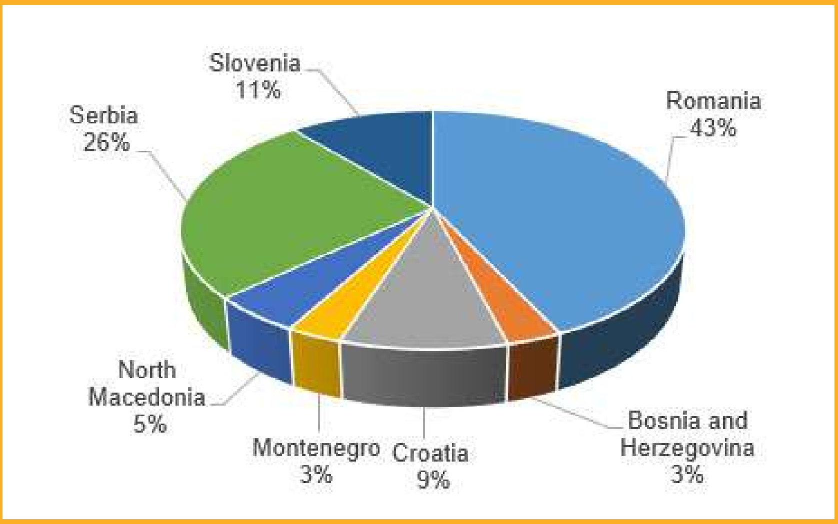
	Foreign Direct Investment net inflows (EUR million)	
Country	2018	2019
Bosnia and Herzegovina	399	487
Croatia	1041	1237
Montenegro	323	345
North Macedonia	602	290
Romania	5265	5334
Serbia	3158	3583
Slovenia	1294	1225

As can be seen from the table, Romania had the most significant inflow of foreign direct investment, which is significantly higher compared to most of the countries covered by this analysis. Comparing these countries, we see that in the observed period (2018 and 2019) over 10.5 billion EUR of foreign direct investment came to Romania while Serbia received about 6.7 billion EUR. Of the other countries in terms of inflow of foreign direct investment, Slovenia (2.5 billion EUR) and Croatia (2.3 billion EUR) stand out, while other countries received a significantly smaller amount of investment in the observed period (Bosnia and Herzegovina and North Macedonia around 900 million EUR, Montenegro 668 million EUR).

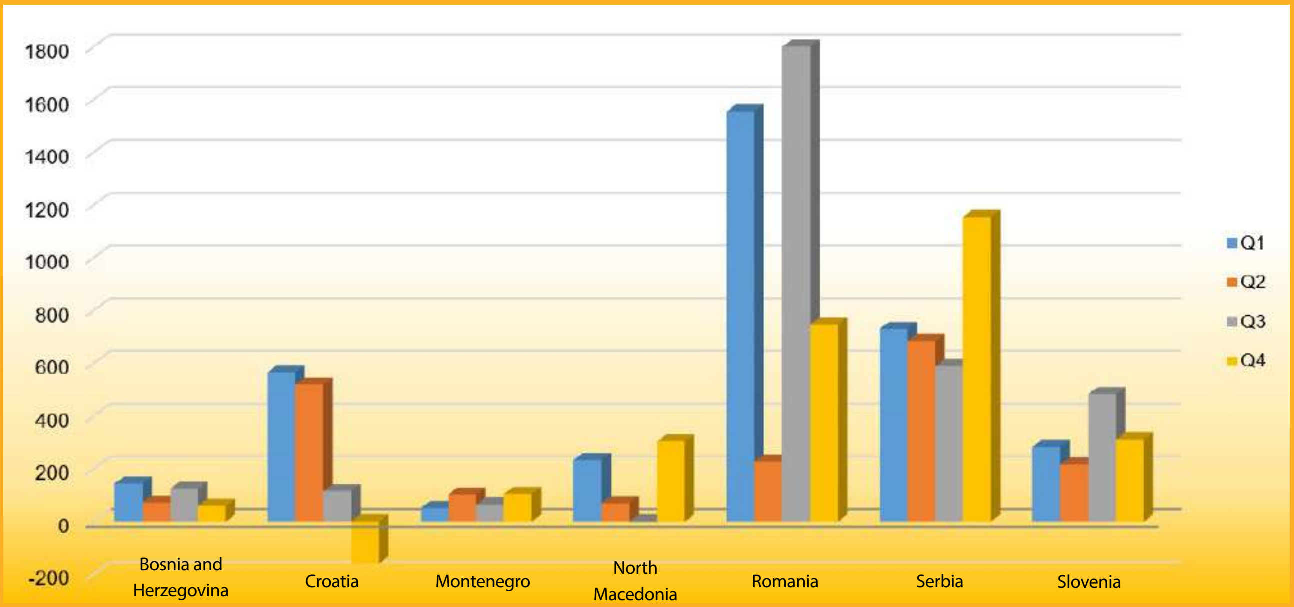
The following table shows the inflow of foreign direct investments by quarters during 2018.

	2018			
Country	Q1	Q2	Q3	Q4
Bosnia and Herzegovina	144	72	124	59
Croatia	566	519	115	-159
Montenegro	51	103	64	105
North Macedonia	233	69	-4	304
Romania	1555	228	2736	746
Serbia	730	684	589	1155
Slovenia	284	216	483	311

If we present this through percentage amounts, of the total amount of foreign direct investment in 2018, slightly less than half of FDI (43%) went to Romania, to Serbia 26%, while other countries managed to attract significantly less FDI in progress 2018.

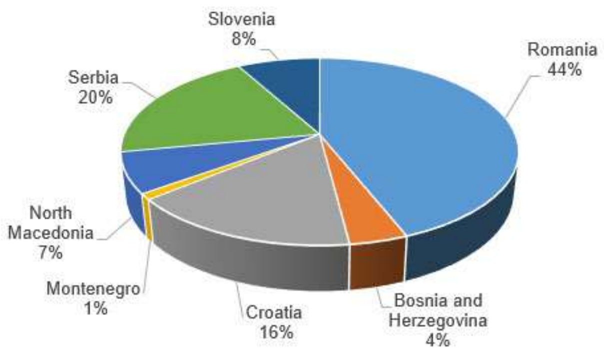


Analysing the inflow of foreign direct investments by quarters, Q3 was the most generous for Romania and Slovenia, considering that in that period these countries received 2.7 billion EUR, i.e. 483 million EUR. For Serbia, Northern Macedonia and Montenegro it was Q4 (1.1 billion EUR, 304 million EUR and 105 million EUR, respectively), and for Croatia and Bosnia and Herzegovina Q1 (566 million EUR and 144 million EUR, respectively).

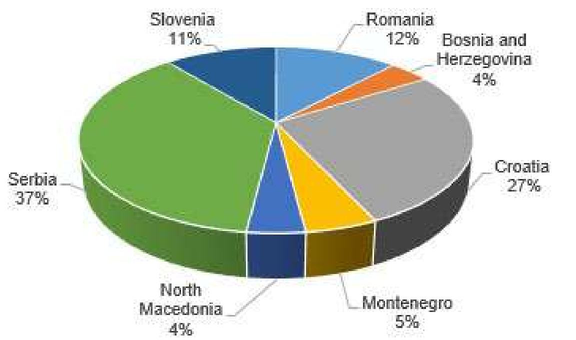


A more detailed overview of the percentage share of FDI for each country during 2018 is shown in the following graphs.

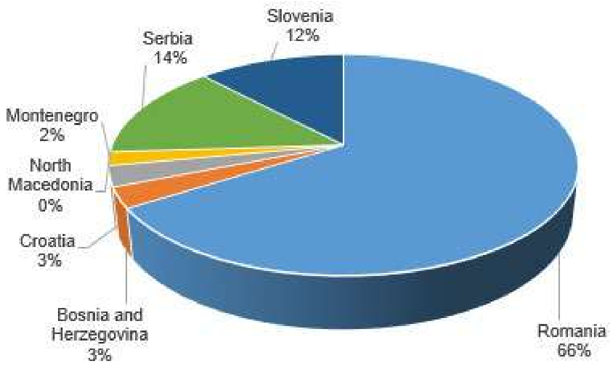
Percentage share of FDI Q1/2018



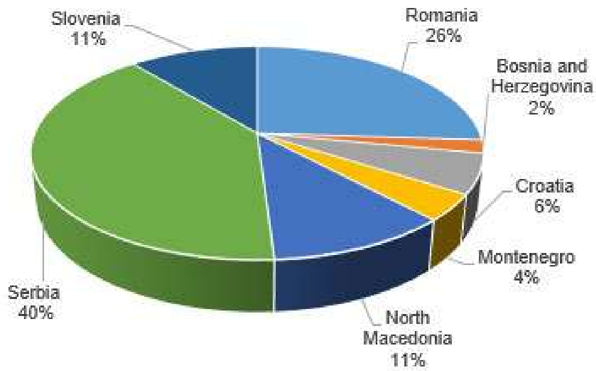
Percentage share of FDI Q2/2018



Percentage share of FDI Q3/2018



Percentage share of FDI Q4/2018



In Bosnia and Herzegovina in 2018 compared to 2017, there was a decline in FDI influx, which amounted in 2018 to 399 million EUR. The sectors that attracted the most foreign investments in the country are the manufacturing (34% of total FDI stock), banking (25%), telecommunications and trade (12% each).

Foreign direct investment inflows to Croatia collapsed as an effect of the global economic crisis (the tourism sector was particularly affected). In 2018 total FDI inflows reached to 1.04 billion EUR, which is a significant decrease compared to the previous year. The sectors that received most FDI are financial services (29.9%), wholesale (8.6%), real estate (6.7%) and telecommunications (6%).

The net inflow of foreign direct investment into Montenegro fell to 323 million EUR in 2018, compared to 484.3 million EUR from the previous year. The sectors attracted most of the FDI are tourism, real estate, energy, telecommunications, banking and construction.

In 2018, net FDI flows to North Macedonia increased significantly and reached 602 million EUR, which is significantly more than in 2017. Manufacturing is the sector that attracted most FDI (39%), ahead of financial and insurance activities (19%).

The net inflow of foreign direct investment to Romania in 2018 amounted to 5.27 billion EUR, an increase of 9.8% compared to 2017. The main sectors in 2018 were manufacturing (30.9% of total FDI stock), construction and real estate transactions (16.8%), trade (15.8%), financial intermediation and insurance (11.5%).

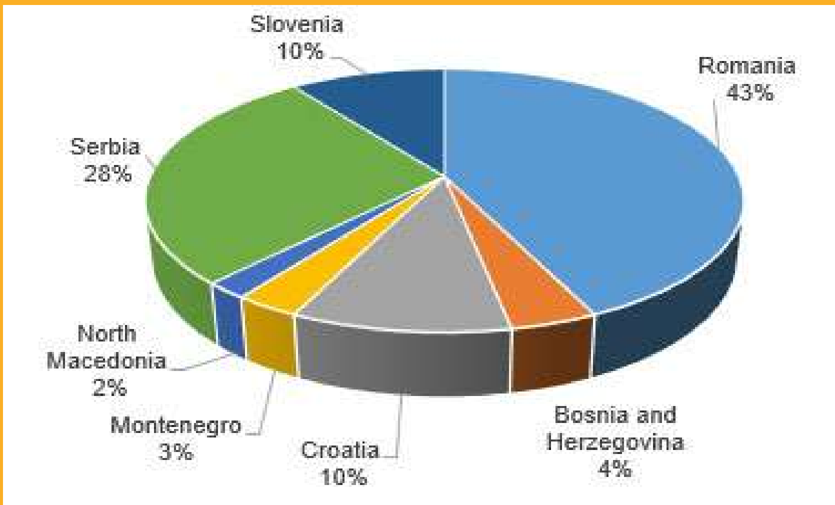
As a result of the country's improved business climate, the inflow of FDI into Serbia rose to 3.2 billion EUR in 2018. The sectors attracted most of the FDI are transport, financial services, metal products, mining and manufacturing.

FDI inflows in Slovenia rose with about 700 million EUR in 2017 to 1.3 billion EUR in 2018. The sectors that attracted the most FDI are manufacturing (35.8%), financial and insurance services (19.4%), wholesale and retail (17.8%), and real estate (6.7%).

The following table shows the inflow of foreign direct investments by quarters during 2019.

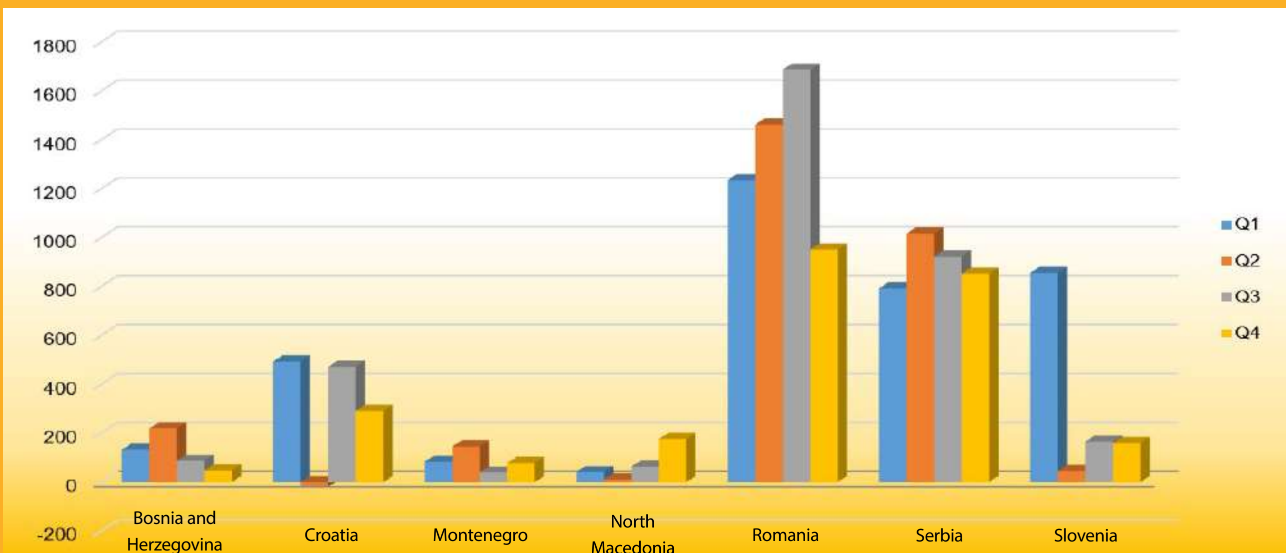
	2019			
Country	Q1	Q2	Q3	Q4
Bosnia and Herzegovina	133	220	87	47
Croatia	493	-19	472	291
Montenegro	83	145	39	78
North Macedonia	40	11	63	176
Romania	1235	1462	1687	950
Serbia	792	1017	922	852
Slovenia	856	45	165	159

If we would present it through percentage amounts, of the total amount of foreign direct investments that entered these countries, about 42% went to Romania, to Serbia 29%. In contrast, other countries managed to attract significantly less FDI during 2019.



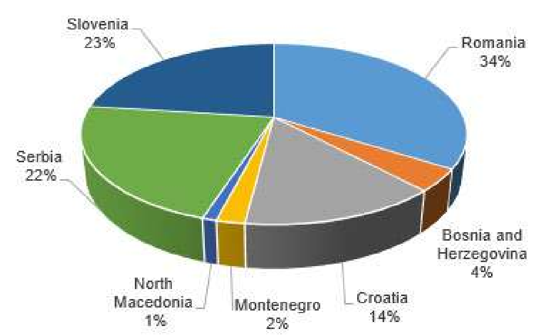
Compared to the previous year, Serbia recorded an increase in foreign direct investment by 425 million EUR. That was mainly directed to the automotive sector (17.7%), agriculture, food/beverage (10.8%), while other sectors individually have participation less than 9% (textile & clothing, electrical & electronics, constructions, machinery and equipment, metallurgy & metalworking).

Analysing the inflow of foreign direct investment by quarters in 2019, Q3 was the most generous for Romania, considering that it received almost 1.7 billion EUR in that period. For Serbia, Bosnia and Herzegovina and Montenegro it was Q2 (1.0 billion EUR, 220 million EUR and 145 million EUR, respectively), for Croatia and Slovenia Q1 (493 million EUR and 856 million EUR, respectively). At the same time, in North Macedonia, most FDI entered Q4 (176 million EUR).

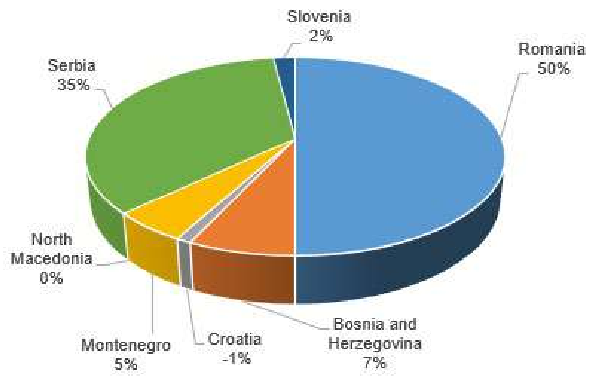


A more detailed overview of the percentage share of FDI for each country during 2019 is shown in the following graphs.

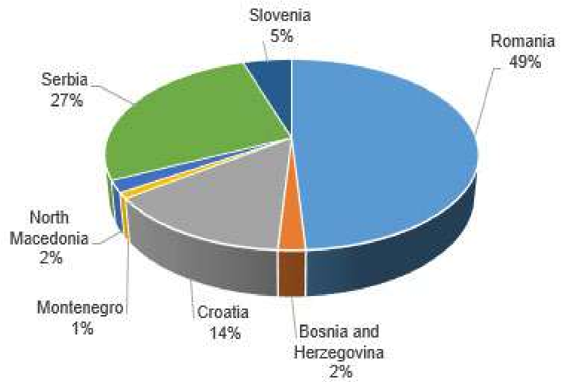
Percentage share of FDI Q1/2019



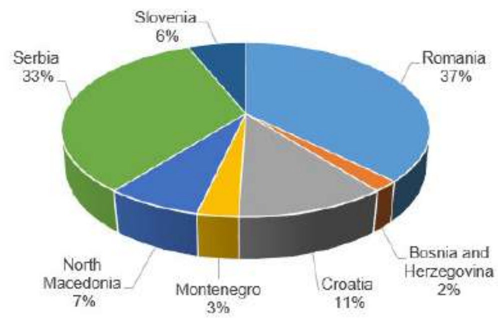
Percentage share of FDI Q2/2019



Percentage share of FDI Q3/2019



Percentage share of FDI Q4/2019



The World Bank estimates that the economy Bosnia and Herzegovina grew by 2.8% in 2019. In the first six months of 2019, the foreign direct investment amounted to 332.34 million EUR, which is an increase of 53.6% compared to the same period in 2018 as well as significantly more than the total amount of FDI in Q3 and Q4 2019.

In 2019, foreign direct investments in Croatia totalled 1.24 billion EUR, up 19% on the year, and that was the highest annual amount of FDI since 2014. From 1993 through 2019, Croatia received 31.8 billion EUR in FDI. In that period, banking accounted for over 22% of FDI, followed by investments in wholesale (9.3%) and real estate transactions (6.9%).

In the first four months of 2019, total net FDI in Montenegro amounted to 101.2 million EUR. In comparison to the same period from the previous year, it decreased by 6.3%. Total inflow amounted to 214.0 million EUR or 3.9% higher in comparison to January-April 2018, thanks to a significant increase in investments in companies and banks. Due to significant investments in companies and the banking sector, this share in total FDI inflow increased in 2018-2019 compared to previous years and amounts about 40%. The sectors attracted most of the FDI are tourism, real estate, energy, telecommunications, banking and construction.

In North Macedonia, during 2019 there was a significant drop in FDI inflows (290 million EUR) compared to the previous year. The flow of foreign direct investment into North Macedonia totalled 55.6 million EUR in the first half of 2019, compared to 302 million EUR in the same period of 2018.

Foreign direct investment in Romania totalled 5.3 billion EUR in 2019, up from 5.26 billion EUR in 2018, an increase in FDI was thus only 30 million EUR, or 0.5%, in 2019. Foreign direct investment (FDI) in Romania increased in the first 11 months of 2019 by about 2.55% compared to the same period last year.

The foreign direct investment influx in Serbia in 2019 rose 14% compared to the previous year. Investments in the manufacturing sector allowed FDI in the country to retain its current level. In the first eight months of 2019, Serbia attracted 40% more foreign investments than in the same period in 2018. The growth of foreign direct investments in Serbia is primarily influenced by political stability, better infrastructure, quality and relatively cheap labour, trade openness of our country, and also a large number of industrial zones in which new plants are being built, expanding existing ones, which are close to large cities.

In Slovenia, FDI reached 1.4 billion EUR between June 2018 and June 2019, which is almost double the 721.1 EUR million recorded between June 2017 and 2018. Slovenia experienced an investment boom in Q1 2019 when FDI amounted 856 million EUR. Foreign direct investment in Slovenia increased sharply in 12 months ending with March 2019 because of several large takeovers. In those 12 months, foreign investment increased by 1.5 billion EUR), compared with an increase of 428 million EUR in the period from April 2017 till March 2018.

Each of these countries seeks to maintain its competitive advantage over other countries and strengthens its position in the world market that will enable it to attract a larger amount of FDI.

Bosnia and Herzegovina can offer investors low levels of corporate taxation, several well-developed industrial zones, a stable banking sector and its strategic location.

Croatia has a high-quality infrastructure and high touristic potential, a well-educated workforce and a strategic position. Improving the investment climate in the country is reflected in tax reductions and employment incentives for manufacturing, technology centres and support services.

Montenegro has the potential to become a magnet for investment because of its business-focused economic system and a low corporate tax rate. Tourism and renewables will continue to be attractive sectors for investments in the coming period. In Montenegro Development Directions 2018-2021, FDIs are recognised as an essential factor in increasing the growth and competitiveness of the economy.

North Macedonia's legal and regulatory framework is generally favourable to foreign investors and provides numerous incentives to attract them. Investors benefit from a ten-year tax exemption personal and corporate income and free access to public services. Labour costs are low, but on the other hand, often there is a shortage of skilled labour. The country has made significant efforts to harmonise its legal framework with the criteria, standards and practices of the European Union. The ministry of economy plans to keep providing incentives to foreign investors in order to improve the business climate in the country.

In terms of FDI, Romania has numerous advantages. In addition to a large domestic market, the country has a strong industrial tradition, coupled with a cost of labour among the lowest in the EU and a well-educated workforce. This has been the reason for the development of a significant industrial sector, particularly car making, but also services. Furthermore, Romania has one of the lowest tax rates in the EU.

Factors favourable to FDI in Serbia include the economic reforms it is undergoing as part of its EU accession process and IMF agreement, its strategic location, a relatively inexpensive and skilled labour force, and free trade agreements with the EU, Russia, Turkey and countries that are members of the Central European Free Trade Agreement. Many investors see Serbia as an export platform rather than as a market in its own right.

Slovenia is entirely open to foreign investment, following the principles of the European Union and the OECD, and does not discriminate between national and foreign investors. Several factors make Slovenia an attractive location for foreign direct investment (FDI): modern infrastructure with access to vital EU transportation corridors, an important port on the Adriatic Sea with access to the Mediterranean, a highly-educated and professional workforce, proximity to Central European and Balkan markets, and membership in the Schengen Area, EU, and Eurozone.

It is in the interest of each country to be as competitive as possible regionally and globally. In that way, it will be in a position to be a desirable investment destination, which will directly affect its economic growth and development.

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Print: Donat graf d.o.o, Grocka, Serbia

SEE-6 Economic Outlook is published twice a year (Spring and Autumn edition).