SEE-6 Economic Outlook

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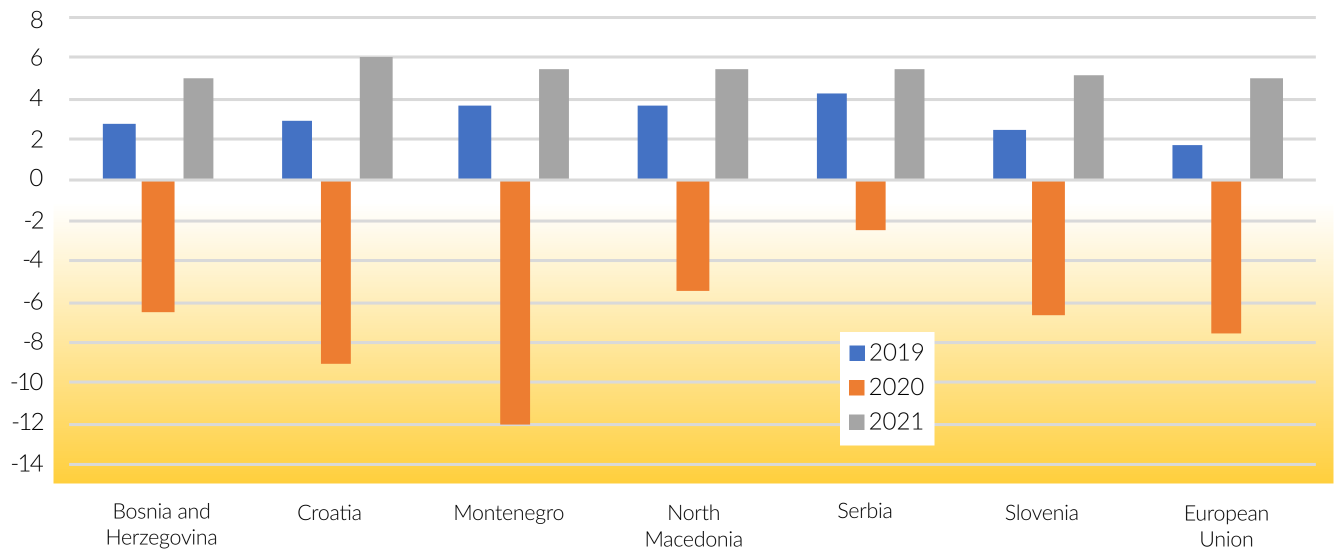

Source: IMF
Note: Real GDP growth (Annual percent change)

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BOSNIA AND HERZEGOVINA

Economic slowdown in the first half of 2020 as a result of mitigation measures

Politically driven delays in the government formation as an obstacle to necessary reforms

Politically driven delays in government formation led to numerous postponements and interruptions of agreed and long overdue reform projects. The country's IMF arrangement has remained on hold since July 2018, on account of announced budgetary measures which were not in line with key programme objectives. There was the only limited implementation of the policy guidance jointly adopted at the Economic and Financial Dialogue with the EU in May 2019. The quality of the 2020 Economic Reform Programme points to continued significant weaknesses in administrative coordination and policy formulation. Cooperation between the various levels of government and institutions has remained severely impeded.

The outbreak of the global COVID-19 pandemic has further complicated the socio-economic situation in Bosnia and Herzegovina. In the initial response to the COVID-19 outbreak, Bosnia and Herzegovina reacted promptly and closely followed global recommendations by introducing mitigation measures to prevent, slow down and control the transmission of the virus.

Despite the initial success of the health authorities to prevent and control the spread of the virus, early relaxation of the restrictive measures was followed by an epidemiological peak during the summer months.

The authorities responded to the outbreak of the COVID-19 crisis by announcing a national emergency and economic support measures. The government requested financial support from the IMF (EUR 330 million from the Rapid Financing Instrument) and the EU, which approved EUR 250 million of macro-financial assistance in the form of a loan to cover the increased external and budgetary financing needs.

Economic growth (in the first quarter of 2020) benefitted from strong domestic demand, reflecting sizeable inflows of workers remittances and low inflation. The public sector remained oversized and inefficient. The financial sector remained stable, and lending increased, while unemployment has declined, partly due to a substantial labour force outflow. However, the economic impact of COVID-19 led to a sharp drop in economic activity and a marked deterioration in the labour market.

A drastic drop in growth in the second quarter of 2020 as a result of mitigation measures

According to preliminary data from the Agency for Statistics of Bosnia and Herzegovina, it is estimated that Bosnia and Herzegovina achieved economic growth of 2.0% in the first quarter of 2020 compared to the same period last year. This growth rate seems somewhat surprising if we take into account the trend of slowing economic activity from last year, as well as the outbreak of the global pandemic of the COVID-19 virus. However, it is also worth noting that restrictive measures regarding the restriction of social contacts in Bosnia and Herzegovina were introduced in late March, so that the full impact of COVID-19 on economic growth will be much more visible in the coming quarters. Thus, already in the second quarter of 2020, GDP fell by -9.3%, which is probably a consequence of the aforementioned restrictive measures introduced in response to the emergence of COVID-19. The decline in GDP was primarily due to the decline in private consumption (-9.4% yoy) and investment (-25.2% yoy), and it was also driven by the deterioration in foreign trade, as exports fell more (-31.7% yoy) than imports (29.0% yoy) in the second quarter of 2020.

The decline in employment and rising unemployment

In the first quarter of 2020 registered unemployment rate (32.6%) did not change compared to the fourth quarter of 2019, but in the second quarter of 2020, it was increased to 34.2%. The growth of registered unemployment rate is a consequence of the simultaneous decline in employment and the growth of unemployment. In the first quarter of 2020, the average number of employees in Bosnia and Herzegovina was 832,210, which is 2.5% more than in the same period last year. However, in the second quarter of 2020, the number of employees decreased compared to the first quarter by 3%, which is possibly related to the beginning of the COVID-19 pandemic. At the same time, the average number of unemployed in the second quarter was 420,785, which is 4.6% more compared to the first quarter of 2020. The largest decline in employment in the first half of 2020 occurred in the sectors Arts, entertainment and recreation (89.9%) and Accommodation and food service activities (92.4%).

Low inflation from 2019 turned into deflation in 2020

Consumer price inflation decelerated during 2019, benefitting from low import prices and low domestic price pressures. Average consumer price index dropped to 0.6% on average in 2019, compared to 1.4% the year before. In the first half of 2020, average consumer prices were 1.0% lower than a year before. Besides low prices for imported energy, price declines for clothing and footwear contributed to the occurrence of deflation in the second quarter of 2020. However, the inflation measure suffers from an outdated consumer basket and insufficient cooperation among key data providers.

In the observed period, there was a slight increase in gross wages. In the first half of 2020, the average net salary amounted to 945 KM and increased by 3.7% compared to the same period last year.

The negative trend in foreign trade was further intensified due to the outbreak of the Covid-19 pandemic

The trend of weakening foreign trade in Bosnia and Herzegovina from the previous year was further intensified in the first two quarters of 2020 due to the outbreak of the Covid-19 pandemic. The global virus pandemic has had a very negative impact on world trade and therefore on foreign trade in Bosnia and Herzegovina. Thus, in Bosnia and Herzegovina in the second quarter of 2020 there was a decrease in exports by 24.1% and a decrease in imports by 27.7% compared to the same period last year. In addition to export demand, there was a certain weakening domestic demand (consumption and investment) which resulted in a decline in imports of goods into Bosnia and Herzegovina. The decline in exports from Bosnia and Herzegovina (24.1% yoy) and a much more pronounced decline in imports (27.7% yoy) resulted in a reduction in the trade deficit (by 15%) in the second quarter of 2020. However, it should be borne in mind that the trade deficit in Bosnia and Herzegovina is still too high compared to similar countries, so this reduction caused by external shocks (cyclical effect) does not represent any progress when it comes to the country's competitiveness.

After many years of surpluses, the budget deficit was registered in the first half of 2020

In the second quarter of 2020, there was a deterioration of government finances. Revenues decreased by 8.6%, while expenditures increased by 13.1% compared to the first quarter of 2020. The decline in revenues was mainly due to a decrease in direct and indirect taxes, which is a consequence of a decrease in economic activity. All of the above led to a budget deficit of BAM 372 million at the end of the second semester of 2020. There was a significant increase in domestic government debt (41.2% yoy), but also a slight increase in foreign government debt (5.3% yoy) at the end of the first semester of 2020, compared to the same period 2019.

Table BH1 Main economic indicators

	2019				Total 2019 year	2020	
	Q1	Q2	Q3	Q4		Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	1.5	1.9	3.3	3.0	**2.4**	2.0	-9.3
Real private consumption (% change, yoy)	2.6	2.1	3.2	3.0	**2.7**	1.4	-9.4
Real government consumption (% change, yoy)	1.9	0.9	0.4	0.3	**0.9**	0.6	0.5
Real investment (% change, yoy)	6.2	11.7	0.4	0.5	**4.7**	-2.6	-25.2
Industrial output (% change, yoy)	-5.1	-3.9	-6.0	-6.8	**5.5**	-3.5	-14.1
Unemployment rate (registered, % pa)	34.3	33.0	33.1	32.6	**33.3**	32.6	34.2
Nominal GDP (EUR million)	4,326	4,616	4,761	4,536	**18,239**	4,499	4,377
GDP per capita (EUR)	1,236	1,318	1,360	1,296	**5,211**	1,285	1,250
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	1.6	1.1	1.1	1.1	**1.2**	1.1	1.1
Consumer prices (% change, yoy, pa)	1.0	0.6	0.4	0.2	**0.6**	0.4	-1.7
Producer prices (% change, yoy, pa)	1.4	0.6	-0.3	0.1	**0.5**	-1.0	-1.6
Average gross wage (% change, yoy, pa)	4.0	4.4	4.5	4.3	**4.3**	4.7	3.1
Exchange rate (BAM/EUR, pa)	1.96	1.96	1.96	1.96	**1.96**	1.96	1.96
Exchange rate (BAM/USD, pa)	1.72	1.74	1.75	1.76	**1.74**	1.77	1.77
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	1,414	1,560	1,446	1,442	**5,862**	1,340	1,184
Exports of goods (EUR, % change, yoy)	-0.6	0.4	-5.8	-7.5	**-3.4**	-5.2	-24.1
Imports of goods (EUR million)	2,354	2,636	2,471	2,462	**9,923**	2,187	1,904
Imports of goods (EUR, % change, yoy)	4.8	4.3	-3.0	-2.0	**1.0**	-7.1	-27.7
Current account balance (EUR million)	-215	-147	-32	-160	**-554**	-194	-118
Current account balance (% of GDP)	-5.7	-4.2	-0.9	-3.5	**-3.0**	-4.3	-2.7
Foreign Direct Investment net inflows (EUR million)	133	220	87	-20	**420**	122	61
Foreign exchange reserves (EUR million, eop)	5,853	6,133	6,352	6,426	**6,426**	6,357	6,644
Foreign debt (EUR million, eop)	4,227	4,188	4,211	4,127	**4,127**	4,154	4,421
GOVERNMENT FINANCE							
Revenues (BAM million)	3,013	3,187	3,309	3,413	**12,923**	3,081	2,815
Expense (BAM_ million)	2,646	2,828	2,896	3,461	**11,833**	2,818	3,187
Net = Gross operating balance	367	359	413	-48	**1,100**	263	-372
Net acquisition of non-financial assets (BAM million)	26	72	79	210	**387**	40	102
Net lending/borrowing (BAM_ million)	342	286	334	-259	**703**	223	-473
Domestic government debt (EUR million, eop)	760	768	762	779	**779**	829	1,085
Foreign government debt (EUR million, eop)	5,148	5,110	5,159	5,098	**5,098**	5,109	5,382
Total government debt (eop. % of GDP)	N/A	N/A	N/A	N/A	**23.0**	N/A	N/A
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	11.2	9.9	7.5	9.1	**9.1**	12.9	11.7
Broad money, M4 (% change, yoy, eop)	8.9	8.1	8.1	8.8	**8.8**	8.8	6.9
Total domestic credit (% change, yoy, eop)	5.6	5.4	5.7	6.6	**6.6**	3.7	0.8
DMBs credit to households (% change, yoy, eop)	7.5	7.4	7.7	7.9	**7.9**	5.3	1.9
DMBs credit to enterprises (% change, yoy, eop)	2.8	4.7	4.5	4.7	**4.7**	0.9	-2.6
Money market interest rate (%, pa)	3.5	3.3	3.1	3.1	**3.3**	3.1	3.0
DMBs credit rate for enterprises short-term (%, pa)	4.1	4.2	4.1	3.0	**3.9**	3.8	3.8
DMBs credit rate for households short-term (%, pa)	5.6	4.6	4.0	3.8	**4.4**	3.7	3.7

Policy assumptions and projections summary

Continued economic growth under the assumption of a short-lived crisis

Projections for the medium-term period are based on assumptions that the virus epidemic is a short-term phenomenon, i.e. that it will be overcome in the second half of 2020. Therefore, the precondition for the realization of these projections is overcoming the new circumstances in the short term, improving the international economic environment and implementing structural reforms in the country. Assuming the materialization of these circumstances according to the projections in the period 2021-2023. Bosnia and Herzegovina is expected to continue the trend of economic growth of about 3% annually (2021: 2.8%, 2022: 3.1% and 2023: 3.2%). It is assumed that the fundamental pillar of economic growth during this period should represent domestic demand. Thus, in the period 2021-2023, private consumption is expected to grow at average rate of about 2% (2021: 1.7%, 2022: 1.9%, 2023: 2.1%). If these circumstances are overcome (the crisis due to the COVID-19 pandemic), an increase in total exports could be expected in the period 2021-2023, with annual growth rates of 4.3%, 5.8% and 6.7%, respectively. Current account deficit (as a share of GDP) could be expected to remain at approximately the same level (in the range of -2.7% to -3.3% of GDP) for the period 2021-2023. Assuming food prices rise moderately as do prices utilities, a price increase of 1.2% -1.4% could be expected in the period 2021-2023. In 2021, stabilization of economic trends in the world is expected, which would enable slightly higher growth of credit activity with a projected rate of 2.0% yoy. In 2022, there would be moderate growth of credit activity again with a rate of 3.2% yoy, and in 2023 a growth with a rate of 7.0% yoy.

Table BH2 Summary of projections

	2021	2022	2023
Real GDP (% change)	**2.8**	**3.1**	**3.2**
Real private consumption (% change)	1.7	1.9	2.1
Real government consumption (% change)	0.5	0.7	0.5
Real investment (% change)	7.1	8.1	7.7
Exports of goods and services (constant prices, % change)	4.3	5.8	6.7
Imports of goods and services (constant prices, % change)	3.2	4.5	5.1
Current account balance (% of GDP)	-2.8	-2.9	-3.2
Consumer prices (% change, pa)	1.2	1.3	1.4
Exchange rate, national currency/EUR (pa)	1.96	1.96	1.96
Unemployment rate (registered, %, pa)	34.0	35.0	36.0
General government balance (ESA 2010 definition, % of GDP)	N/A	N/A	N/A
Total domestic credit (% change, eop)	2.0	3.2	7.0

CROATIA

Economic growth in 2020 dominantly affected by coronavirus lockdown

Economic fall in the second quarter of 2020 above the EU average

The GDP growth in Croatia in the first half of 2020 was dominantly affected by coronavirus economic lockdown introduced in March. While the first quarter of 2020 still recorded a modest real growth of 0.4%, the sharp fall of economic activities in the second quarter was rather massive with a rate of -15.1% as compared to the previous year, the highest in the last thirty years. According to Eurostat, this fall is slightly above the euro area average for the second quarter, which was -14.7% and more than the whole percentage point above the EU average, which was -13.9 %. Although the initial signs of fragile recovery of economic activities started already in June, gradual and stronger economic recovery has been felt in the third quarter of 2020. Dominant force behind more favourable economic development is a much better tourist season than previously expected, as Croatia opened to foreign tourists quite unrestrictive compared to the main EU competitors.

The key components of the massive fall of economic activities in 2020

The impact of coronavirus outbreak and consequent economic lockdown on Croatian economic growth in 2020 was very profound. It was most strongly reflected in the sharp fall of exports, imports, private consumption, industrial production and service sector (tourist sector, transport, restaurants, small shops, cultural industry, etc.).

The public investments were one of the rare macroeconomic indicators that managed to keep their head above the water in that period owing to continued absorption of the EU funds for some on-going project such as Pelješac bridge and several other roads and rail infrastructure projects. The investment rate in the first quarter this was 3.1%. However, the private investments plummeted incredibly strong in the second quarter during the economic lockdown, resulting in a fall of total investments by -14.7% in the second quarter of 2020.

Private consumption which was a traditionally strong driver of Croatian economic growth for many years, also decreased dramatically, especially in the second quarter during the economic lockdown when it plummeted to -11.6%. This was a result of contracting demand due to shrinking household income, which considerably limited their purchasing power. Consumer habits also changed due to uncertainties related to the length of economic lockdown as well as prospects of keeping jobs.

On the other side, the real government consumption was the only economic indicator, which continued to grow also in the second quarter of 2020 (4.8% in the first quarter and 0.7% in the second). The primary sources of that growth were sizable job preservation and liquidity subsidies directed to the business sector, as well as increased expenditures for the health sector fighting with the pandemic.

Sharp fall of both exports and imports

The exports of goods experienced a severe fall in the first half of 2020, especially in the second quarter hit by the economic lockdown. The closing of borders and contraction of demand resulted in the sharp decrease of its value to -14.5% compared to the previous year.

At the same time, imports of goods plummeted even higher in the Q2 (-23.2%), as most of the industries heavily dependent on imports have halted their production during the economic lockdown due to a breakdown of their usual supply chains throughout the world.

The exports of services, especially related to tourism, have suffered the greatest negative impact, due to closed borders of Croatia's traditional foreign visitors (Italy, Germany, Austria, and Slovenia). This is particularly important as the tourist sector had, for many years, an important positive net contribution to economic growth and current account balance.

Consequently, the negative current account impact of economic lockdown was quite significant and from a significant surplus of 1.5 billion Euro in the whole 2019, it went into negative 3.9% in the first quarter and -3.5% in the second quarter of 2020.

Industrial output also fell significantly

The industrial output also experienced a sharp fall in the first half of 2020. In the first quarter, it contracted for -2.5%, followed by -7.8% in the second quarter when the most severe effects of economic lockdown were felt throughout the industrial sectors. However, the crises caused by coronavirus outbreak only aggravated the old structural problems and competitiveness of Croatian industry. They made the need for its restructuring towards more viable and sustainable industrial sectors even more urgent.

Employment level largely preserved in 2020 owing to government job preservation measures to buffer effects of coronavirus

Coronavirus and consequent economic lockdown primarily affected the labour market developments in the first half of 2020. In the first month of the lockdown, the number of unemployed jumped by around 20,000 persons, increasing the total number of unemployed to 156,667 persons at the end of April 2020. Consequently, the rate of registered unemployment has risen to 8.5% in the first quarter and further on to 9.3% in the second quarter of 2020.

However, the initial significant rise of unemployment was successfully buffered by generous government measures targeted to entrepreneurs to preserve the current employment levels. The number of unemployed would undoubtedly be several times higher without the government job-preservation support. The Government provided the employees of private sector a minimal net wage of 3,250 HRK in March and 4,000 HRK in April and May, under the condition to keep them at work. According to Croatian Employment Service by the end of June 2020, 96,402 employers received a job-preservation subsidy for 443,839 workers. Thanks to these measures, the number of unemployed persons decreased by the end of June to 150,651, nevertheless still 38,482 persons higher than in June 2019. The Government prolonged the measures also after June 2020 for the categories of entrepreneurs in the most affected sectors (such as tourism, transport and agriculture).

Back to the fiscal imbalance

The achieved results related to the long-awaited fiscal balance were washed away by the coronavirus destructive economic impact, especially in the second quarter of 2020 with economic lockdown in place.

The main reason behind returning to deep budget deficit were sizable fiscal interventions to buffer the severe adverse effects of coronavirus on the Croatian economy. So far, the Government introduced four rounds of support measures to both entrepreneurs and employees in order to prevent bankruptcies and keep their businesses and jobs alive. The government job preserving and liquidity subsidies in the first half of 2020 which amounted, according to Croatian National Bank, around 6.6 Billion Kuna were almost entirely financed by domestic resources. Apart from the new loans, the Government also made a redistribution of envisaged budget expenditures, which required the budget rebalance. The general government debt increased by the end of June 2020 to the level of 85.3% of GDP, what is up by 12.1 percentage points from its level at the end of 2019.

Consumer prices fell sharply due to deflationary pressures

After a growth recorded in the first quarter of 1.4%, consumer prices index (CPI) experienced a sharp fall in the second quarter. It went into a negative rate (-0.3%) owing to the deflationary effects of the coronavirus outbreak and consequent economic lockdown.

Consumer prices started to fall most dramatically in April, mainly due to the powerful effects of the fall of prices of oil at the world market and a consequent fall of petrol prices at the domestic market. Besides, the lack of consumer demand added to the fall as the economy was practically paralysed during the lockdown.

Table HR1 Main economic indicators

	2019				Total 2019 year	2020	
	Q1	Q2	Q3	Q4		Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	2.7	4.1	2.4	2.9	**2.9**	0.4	-15.1
Real private consumption (% change, yoy)	3.8	4.4	2.7	3.3	**3.6**	1.4	-11.6
Real government consumption (% change, yoy)	3.1	3.9	2.9	3.5	**3.3**	4.8	0.7
Real investment (% change, yoy)	11.5	8.2	5.5	4.0	**7.1**	3.1	-14.7
Industrial output (% change, yoy)	2.7	-0.9	1.2	-2.1	**0.9**	-2.5	-7.8
Unemployment rate (registered, % pa)	9.4	7.3	6.8	8.3	**7.9**	8.5	9.3
Nominal GDP (EUR million)	11,878	13,548	15,289	13,257	**53,969**	12,062	11,243
GDP per capita (EUR)	2,921	3,331	3,758	3,260	**13,270**	2,972	2,771
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	1.8	1.4	0.9	1.8	**1.5**	0.9	-0.1
Consumer prices (% change, yoy, pa)	1.5	0.5	0.7	0.9	**0.8**	1.4	-0.3
Producer prices (% change, yoy, pa)	2.1	1.5	1.5	-0.1	**1.3**	0.6	-4.0
Average gross wage (% change, yoy, pa)	4.9	3.9	3.5	3.5	**4.0**	1.9	1.3
Exchange rate (HRK /EUR, pa)	7.42	7.42	7.42	7.41	**7.41**	7.48	7.53
Exchange rate (HRK /USD, pa)	6.28	6.53	6.66	6.59	**6.62**	6.78	6.89
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	3,617	3,753	3,969	4,067	**12,836**	3,682	3,209
Exports of goods (EUR, % change, yoy)	6.5	3.8	9.2	0.9	**4.3**	1.1	-14.5
Imports of goods (EUR million)	6,091	6,571	6,207	5,987	**24,856**	6,100	5,052
Imports of goods (EUR, % change, yoy)	7.4	8.8	4.1	-1.5	**5.0**	1.0	-23.2
Current account balance (EUR million)	-2,067	-342	4,571	-592	**1,499**	-1, 437	-667
Current account balance (% of GDP)	3.5	2.3	3.0	2.9	**2.8**	-3.9	-3.5
Foreign Direct Investment net inflows (EUR million)	500.5	24.3	485.3	267.5	**1,277.6**	435.0	236.2
Foreign exchange reserves (EUR million, eop)	18,321	19,880	20,425	18,562	**18,562**	16,512	17,313
Foreign debt (EUR million, eop)	43,790	44,873	43,048	40,877	**40,877**	40,447	41,251
GOVERNMENT FINANCE							
Revenues (HRK million)	41,055	47,949	50,684	47,883	**187,571**	42,437	40,801
Expense (HRK million)	41,690	41,514	41,547	48,741	**173,492**	45,687	50,706
Net = Gross operating balance	-635	6,435	9,137	-1,058	**14,079**	-3,250	-9,905
Net acquisition of non-financial assets (HRK million)	1, 605	2,706	3,132	5,612	**13,055**	1,185	750
Net lending/borrowing (HRK million)	-2,240	3,729	6,005	-6,471	**1,024**	4,435	10,655
Domestic government debt (EUR million, eop)	25,000	25,315	24,985	25,711	**25,711**	26,471	18,665
Foreign government debt (EUR million, eop)	14,030	14,874	14,241	12,831	**12,831**	13,477	15,106
Total government debt (eop. % of GDP)	75.4	75.5	76.4	73.2	**72.8**	75.2	85.3
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	18.6	25.7	15.7	14.3	**14.3**	17.2	18.0
Broad money, M4 (% change, yoy, eop)	4.4	4.6	3.6	2.9	**2.9**	8.8	8.7
Total domestic credit (% change, yoy, eop)	3.5	1.8	3.0	4.2	**2.8**	5.0	3.3
DMBs credit to households (% change, yoy, eop)	3.0	3.3	7.0	7.4	**7.4**	6.1	3.7
DMBs credit to enterprises (% change, yoy, eop)	-0.2	-2.3	-3.0	0.4	**0.4**	4.2	4.1
Money market interest rate (%, pa)	0.4	0.4	0.3	0.3	**0.4**	0.3	0.3
DMBs credit rate for enterprises short-term (%, pa)	2.5	2.7	2.9	3.0	**2.8**	2.9	2.8
DMBs credit rate for households short-term (%, pa)	5.9	6.1	7.1	7.1	**6.5**	8.1	7.9

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 expected to fall sharply in 2020 due to COVID-19 impact, but strong economic recovery envisaged in 2021 and 2022

The most recent economic outlook projections for 2020 were at the beginning of autumn generally revised towards more optimistic ones compared to the initial ones from April and May, by both the Croatian Government and international organisations. The Croatian Ministry of Finance forecasts from the end of October project milder fall of economic activities of 8.0% (as compared to initial -9.4%), based on the encouraging results achieved in the third quarter when most of the economic sectors and especially tourist industry achieved more substantial recovery than initially expected. The Croatian National Bank also estimates the fall of economic growth of 8.0%. The World Bank's autumn projections were also revised upwards to the fall of 8.1%, while the International Monetary Fund was more cautious and kept the rate of GDP fall at -9.0%. European Commission, however, is less optimistic and anticipates that GDP fall in 2020 would be at -9.6%.

However, as the second wave of coronavirus intensified in September and October, the growth projections at the end of October started to be more cautious again. Despite better economic results than initially expected, most analysts forecast that the fall of GDP could be between 9 and 10%. Most of them agree that the economy could not survive another lockdown, as the costs of the first one introduced in March were close to 3 billion EUR (22 billion HRK), according to Croatian National Bank.

In autumn, it was certain that the coronavirus pandemic would probably last longer than anyone expected and that efficient fight with it has no clear horizon yet. Therefore, it seems that the restoration of economic growth would be less swift then predicted initially. The Government of Croatia thus expects that in 2021 the Croatian GDP will grow 5%, followed by a growth rate of 3.4% in 2022 and 3.1% in 2023. The international organisations also revised their growth expectations. The World Bank revised forecasts of the recovery of economic growth in 2021 to the rate of 5.9%, followed by the moderation of growth at a rate of 4.2% in 2022. The International Monetary Fund also revised its expectations downwards for 2020, however, followed by a more optimistic growth rate of 6% in 2021, compared to the other international forecasts. The European Commission in its recent November forecast envisages the rebound of growth in 2021 at 5.7%, followed by the slower growth rate of 3.7% in 2022.

Table HR2 Summary of projections

	2021	2022	2023
Real GDP (% change)	**5.0**	**3.4**	**3.1**
Real private consumption (% change)	4.5	3.0	2.7
Real government consumption (% change)	2.2	2.1	2.2
Real investment (% change)	3.9	5.3	5.2
Exports of goods and services (constant prices, % change)	24.0	5.9	5.0
Imports of goods and services (constant prices, % change)	19.3	5.6	5.1
Current account balance (% of GDP)	0.4	0.4	0.3
Consumer prices (% change, pa)	0.8	1.2	1.3
Exchange rate, national currency/EUR (pa)	7.52	7.53	7.53
Unemployment rate (registered, %, pa)	9.0	7.6	7.2
General government balance (ESA 2010 definition, % of GDP)	-2.9	-2.1	-1.6
Total domestic credit (% change, eop)	1.9	2.2	2.3

Source: Ministry of Finance of Republic of Croatia and Croatian National Bank.

Coronavirus impact on tourist sector in Croatia was less severe than initially expected. The contraction of tourist activities in the primary summer season of 2020 is estimated to be around 45-50%, instead of 70% as the Government predicted. The situation would have been even more favourable without the second wave of the pandemic that started at the end of August throughout Europe, which led towards banning the travel and quarantine requests for its citizens who travel to Croatia. The Government expects further recovery of the tourist sector in 2021 as the control over pandemic strengthens, and disruptions in international travelling mitigate.

The private consumption recovered relatively quickly after the reopening of the economy that started gradually in mid of May 2020. Two factors had a significant impact on that recovery. One is the Government job-preservation support measures and avoidance of massive lay-offs, which consequently prevented dramatic fall of disposable income of households. The other factor is increased private consumption during the tourist season. Favourable recovery of private consumption led towards the autumn revision of the official forecast from -7.0% to -6.3% in 2020. However, the recovery rates of private consumption in 2021 and 2022 would be less swift: 4.5% and 3.0% respectively, followed by 2.7% in 2023. Change in consumer habits, more cautious and delayed spending due to uncertainties related to the length of the pandemic, as well as slower economic recovery are the main reason behind lower expectations for the next years. On the other hand, lowering of the income tax rates in effect from January 2021 would contribute to the purchasing power of households to recover private consumption. International organisations such as World Bank is however less optimistic and revised its expectations downwards for 2020 to -7.8%, with slower rates of recovery in 2021 at 2.8% and 3.3% in 2022. The World Bank argues that the purchasing power of the low households will mostly be affected by the massive decrease in income and that introduced government safety measures would not be sufficient to limit their welfare losses.

Government consumption, on the other hand, continued to grow throughout 2020. This was mainly due to increased expenditures related to the sizable financial infusion to the enterprise sector for preserving jobs and keeping their liquidity. Also, the other major spender was the health sector in its fight with the pandemic. The projections for 2020 were recently lowered to 2.4% (instead of 2.7% initially), while the rates of 2.2% and 2.1% are envisaged for 2021 and 2022 respectively.

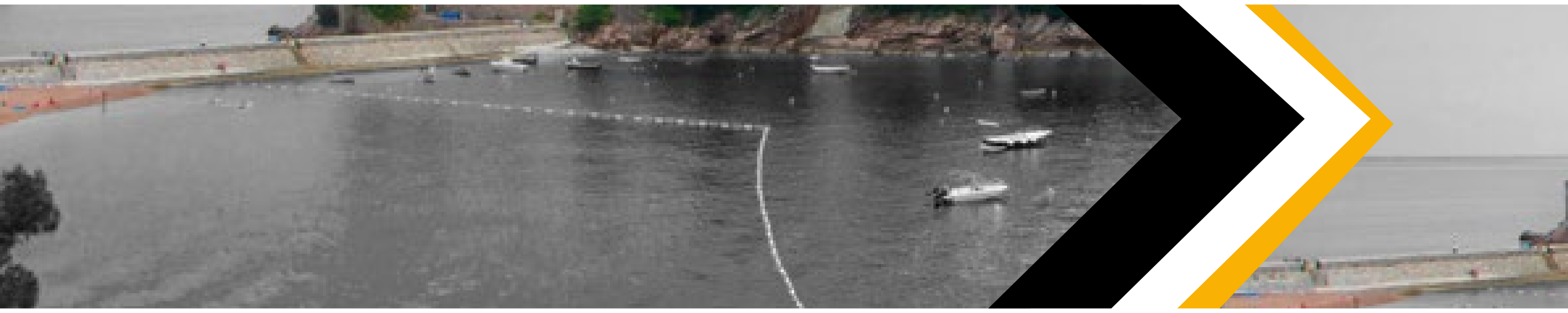
The expected inflation rate at the level of whole 2020 year will be only slightly positive (0.2%). The deflation pressures were very profound in the second quarter of 2020 during the economic lockdown, especially related to energy prices, but the partial economic recovery has brought an increase of prices of food, drinks and tobacco and also a slight rise of energy prices. The Government forecasts that inflation rate would grow back in 2021 to pre-crisis levels (0.8%) mainly due to further increase of energy prices and petrol because of stronger recovery of demand. It also expects further growth of consumer prices to 1.2% in 2022 and 1.3% in 2022.

As rightly predicted in the official spring forecasts, the pandemic primarily drastically affected the rate of private investments in 2020. According to the latest revisions of the Government expectations for 2020, they will fall at a rate of -10%. On the other side, the public investments that are already underway (such as Pelješac Bridge, several railway and motorway routes, as well as several energy sector projects), were not negatively affected as the already assigned EU funds dominantly finance them. For that reason, the latest forecast of the Croatian Ministry of Finance (30 October 2020) expects the smaller fall of the total real investments in 2020 by -6.1% instead of previous -9.0%. The new EU funds at the disposal to mitigate adverse corona economic effects (Recovery and Resilience Fund) will also contribute significantly to the future strong recovery of total investments, envisaged in 2021 at the rate of 3.9%, 5.3% in 2022 and 5.2% in 2023. In addition, the positive contribution to total investments is expected by the planned reconstruction of Zagreb after the earthquake, which will be also be supported by the substantial EU solidarity funding (683.7 million Euro).

Exports and imports were initially drastically affected, especially in the second quarter of 2020. However partial economic recovery of the export sector after the lockdown mitigated some of that fall. Therefore, the newest projections of Ministry of Finance revised more optimistically its forecasts for the total fall of exports of goods and services in 2020 to -24.7% and imports to -17.6%. Consequently, the expected current account deficit is more favourably projected at -0.4% in 2020. However, due to a recent strong rise of corona infections across the EU and world, the Government is more cautious now with regard the recovery rates in 2021, with projections of the slower rate of rebound of exports at 24.0% and imports at 19.3% as demand might be limited by the newly introduced economic lockdowns in the main export markets. It is expected that the rates of exports and imports will be normalised to the pre-crisis path in 2022-2023. The exports are projected to grow by 5.9% in 2022 and 5.0% in 2023, while imports would grow by 5.6% in 2022 and 5.1% in 2023.

Achieved fiscal balance in which much-dedicated effort was invested in 2016-2019 period, was consciously sacrificed in 2020 in order to keep the economy alive through the fiscal "infusions" of funds to the business sector for job-preservation and liquidity needs. The total fiscal interventions for both job-preservation and liquidity support measures are by the mid-October 2020 estimated to be around 10 billion Kuna (around 1.32 billion EUR). Given the fact that sizable fiscal interventions to the business sector will continue till the end of the year and the envisaged fall of the GDP, the total consolidated Budget deficit for 2020 is in October 2020 projected at -8.0% (instead of -6.7%). It would be followed by a smaller deficit of -2.9% in 2021, -2.1% in 2022 and -1.6% in 2022. However, as the fiscal interventions were mostly financed by loans and less by internal financial reserves and reorganisation of budget expenditures; consequently, it resulted in an enormous increase in total public debts. According to the Ministry of Finance, it would take more than five years to bring back the level of public debt ratio to the pre-corona crises level of 72.8% as it was in 2019. The Government projections for 2020 is that the total public debt will be at 87.3% of the GDP. It expects that the level of public debt will fall in 2021 to 85.3%, because of stronger economic recovery, followed by the level of 83.4% in 2022 and 81.2% in 2023. Regaining fiscal balance will remain the Government's prime goal, as Croatia joined the Exchange Rate Mechanism (ERM II) in July 2020, paving the way to the process of the adoption of the Euro.

The rise of unemployment in 2020 was not as high, as initially expected, mainly due to the Government job-preservation support measures as well as partial economic recovery after the economic lockdown. At the end of October 2020, the Government presented the new job-preservation support measures for the rest of 2020. They now better target and more precisely scale the support concerning the extent of the fall of economic activities of the certain enterprise sector. In the second budget rebalance adopted at the end of October, the Ministry of Finances anticipates the slower rise of registered unemployment in 2020 at the rate of 9.3%, followed by the slight fall to 9.0% in 2021 and more profound fall to 7.6% in 2022 and 7.2% in 2023 as a result of economic recovery gaining stronger momentum.



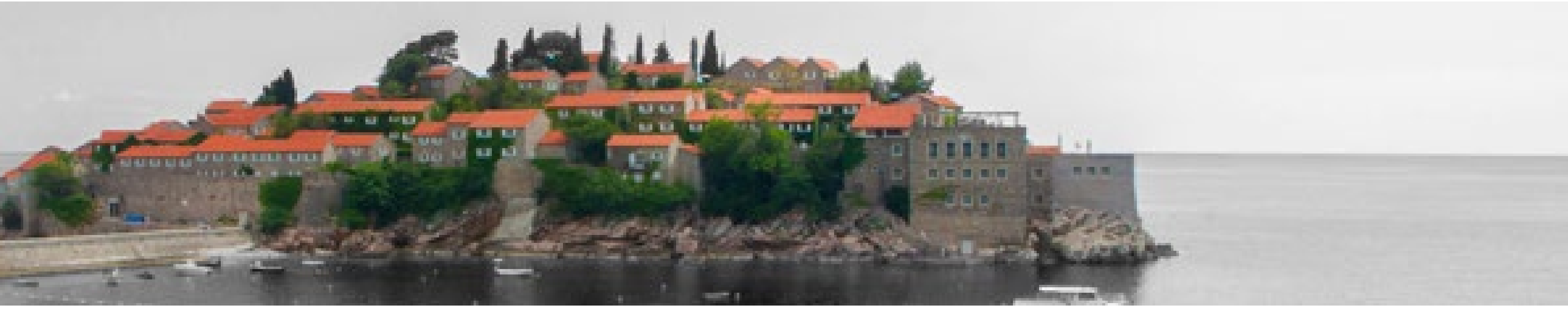
MONTENEGRO

Tourism dependent economy severely hit by COVID-19

In the first half of 2020, the Montenegrin economy, as well as most economies around the world, was affected by the Covid-19 pandemic. In March 2020, after the first cases were reported, we witnessed a trend of gradual lockdown, i.e. mandatory isolation for infected citizens, locking down whole cities, as well as closing the borders for the citizens of countries that recorded a high number of cases. The economic shock that started after the health crisis changed the modus operandi of the economy, forcing policymakers to impose certain restrictions. We can say with certainty that the countries relying on tourism have been hit hardest.

Given that the health crisis became more severe in the second quarter of 2020, and that it is hard to predict when it will end, 2020. is the year marked by a set of public health as well as economic challenges. That being said, the size of the COVID-19 effect remains uncertain. Still, it is estimated it will have a substantial impact with prolonged effects.

Directorate for Statistics – Monstat preliminary data shows that the economy grew 2.7% in the first quarter of 2020, with a sharp decline of 20.2% in the second quarter, which was mostly the result of weak domestic and external demand. The European Commission Economic



Report states that Montenegro's GDP fell by a preliminary 8.8% y-o-y in the first half of 2020.

As expected, the first two quarters of 2020 were marked by a sharp decline in tourist arrivals, given the worldwide lockdown measures. The tourism sector was hit hardest by the pandemic, recording 78.5% fewer tourist arrivals than in the same period last year. However, the easing of measures affected the tourism sector positively. Overall, the pandemic's negative effect on tourism caused a strong ripple effect on domestic consumption and investment.

In the first six months of 2020, industrial production fell by 0.8% compared to the same period in 2019, mostly due to a decline in the electricity, gas, and steam supply sector by 10.2%. Growth was recorded in industries of mining and quarrying, and the manufacturing industry, of 12.9% and 3.4% respectively.

The budget recorded a deficit of 4.7% of GDP. The yearly inflation rate, measured by the Consumer Price Index (CPI), was -0.2% in June 2020. The external sector marked a slight reduction of the current account deficit (1%). In comparison, the net foreign direct investments (FDI) grew by 14.1%. The banking sector was stable, with loan growth of 1.3%, directed mostly at households and the non-financial sector.

By the end of June 2020, the government had adopted two packages of measures targeting the economy. The first one of €280 million, aimed at maintaining liquidity, and support for the most vulnerable groups, and another one of €75 million, to preserve jobs and support the faster

Political environment

recovery of the Montenegrin economy. These measures led to a reallocation of budget expenditures and the adoption of a budget revision for 2020.

Central Bank of Montenegro (CBM) adopted a set of measures to maintain the stability of the banking sector. A moratorium on loan repayment was introduced in March, as well as a framework for bank loan restructuring, a ban on dividend payments, and a one-year moratorium on repayment for bank loan users from the tourism, agriculture, forestry, and fisheries sector, until the end of August 2021. An amendment to the Decision on the required reserve of banks with the CBM was also introduced, to free up liquidity to provide additional support to the domestic economy affected by the COVID-19 crisis.

According to EUROSTAT data for 2019, Montenegrin GDP per capita is at 49.6 per cent of the EU average (purchasing power standard). It is still the highest among the countries in the region with the status of a candidate or potential candidate for EU membership.

EU accession negotiations with Montenegro were opened in June 2012. Montenegro opened the only chapter that was unopened in the negotiation process – Chapter 8: Competition and State Aid, on June 30th, 2020, considered one of the most demanding in the negotiating process.

The critical prerequisite for a fast recovery of the economy in 2021 would be for COVID-19 cases to remain limited during the winter and spring. Montenegro's economy could revive thanks to investments in the area of construction works and a recovery of private consumption driven by growing employment and remittances from abroad.

Prices

In December 2019, the annual CPI inflation was 1%, while the HICP inflation was 1.2%. As regards June 2020, consumer prices recorded a monthly increase of 0.1% and fell by 0.9% compared to December 2019. In the same period, prices decreased in the sector of transport (-9.5%), clothing and footwear (-4%), and increased in the categories of alcoholic beverages and tobacco (2.8%) and food and non-alcoholic beverages (2%), health (1.5%) and recreation and culture (0.5%). The annual CPI inflation was -0.2%, while the HICP inflation was -1%.

Labor market and wages

The adverse effects of the COVID-19 pandemic also affected the Montenegrin labor market. In the observed period, the number of employed persons was on average 185,737, which is 7.7% lower than in June 2019. All sectors, except the arts, entertainment, and recreation sector (with a growth rate of 1.1%) recorded a decrease in the number of employees. The largest decrease was recorded in the sectors: administrative and support service activities (-28.6 %), accommodation and food services (-19.3%), agriculture, forestry and fishing (-16.3%), construction (-11.7%), and manufacturing (-8.8%). Compared to December 2019, the average number of employees in June decreased by 10.3%.

The highest number of employees is in the sector of wholesale and retail trade, repair of motor vehicles and motorcycles (19.8%) and state administration and defence, compulsory social security (11.5%), while the lowest number of employees are employed in the sectors of mining and quarrying (0.7%) and agriculture, forestry and fishing and real estate (0.9%).

The registered number of unemployed person in the first six months of this year, on average, amounted to 38,525, or 2.2% more than in the same period last year. Compared to December 2019, the registered number of unemployed person in June increased by 11.4%. The pandemic severely hit the tourism sector, which accounts for more than 20% of GDP, which significantly contributed to these results.

In the first six months of 2020, the average wage in Montenegro was €783, while the average salary without taxes and contributions was €523. Compared to the same period in 2019, they increased by 1.7% and 1.9%, respectively. The highest wages excluding taxes and contributions were recorded in the financial and insurance sector (€967) and electricity supply sectors, gas, steam and air conditioning (€897), while the lowest are recorded in the sector of administrative and support service activities (€363) and the sector of wholesale and retail trade, repair of motor vehicles and motorcycles (€388). The highest growth in wages without taxes and contributions was recorded in the sector of health and social protection (11.1%) and education (8.3%). In comparison, wages grew the least in the sector of state administration and defence (0.2%). A decrease in wages was recorded in eight sectors, with the largest being in the agriculture and forestry sector and fisheries (-5.8%), accommodation and food services (-4.8%), with the smallest decrease in the arts, entertainment, and recreation (-0.5%).

Among the countries of ex-Yugoslavia, Montenegro ranks third (€527) in terms of net wages, followed by Serbia (€508), Bosnia and Herzegovina (€488), and North Macedonia (€435). The highest net wages are in Slovenia (€1.175) and Croatia (€895).

Foreign trade and capital flows

There was a slight decline in the current account deficit due to the reduction of the foreign trade deficit, as well as improvements in the balance on the primary income account. According to preliminary data, in the period January-June 2020, the current account deficit amounted to €638.4 million, which is 1% lower than the deficit recorded in the same period last year.

The foreign trade deficit was €827.9 million, which is 16.5% lower than in the same period of 2019. A high level of import dependence is still evident in foreign trade. The negative effects of the crisis were reflected simultaneously in exports and imports of goods and services, which recorded double-digit rates of decline. Total exports of goods were €182.4 million, representing a decrease of 15.3%. In comparison, the value of imported goods was one billion euros (a decrease of 16.3%).

Services account recorded a surplus of €48 million, which represents a decrease of 77.2%, compared to the same period of 2019. Total revenues from services amounted to €292.7 million (decrease of 45.2%), while the expenses were €244.7 million (decrease of 24.3%). Due to the pandemic, for the first time in the last ten years, a significant reduction in tourism-related income was recorded. Estimated revenues from tourism in the period January-June 2020 were €54.8 million, which is 78.5% less than the same period last year, which is a direct result of reduced arrivals and overnight stays of foreign tourists. The primary income account recorded a surplus for €25.6 million and is higher by 278.3% compared to the same period last year. In comparison, the surplus on the secondary income account amounted to €115.9 million, which is 10.8% lower than the one recorded in the same period of 2019.

According to preliminary data, in the period January-June 2020, the net inflow of FDI was €259.2 million, which is 14.1% more compared to the same period in 2019. These developments are the result of smaller FDI outflow compared to the same period in 2019, with a simultaneous increase in inflows based on intercompany debt. In the same period, FDI inflows increased based on debt investments, while equity investments decreased. In the structure of total FDI inflow, the share of the intercompany debt was 65.4%, investments in companies and banks 18.3%. In comparison, investments in real estate accounted for 11.5%. Withdrawals of funds by non-residents amounted to €106.6 million. The total outflow of FDI in the period January-June 2020 amounted to €119.6 million, which is 18.9% less compared to the same period in 2019.

Monetary developments

During the first six months of 2020, the banking sector was stable and liquid. The lending activity of banks has intensified to some extent, especially towards households and the non-financial sector, so the total credit growth amounted to 1.3% compared to the end of 2019.

Financing conditions in international financial markets affect the reduction of lending interest rates, which have reached minimum historical values. The downward trend of average weighted nominal and effective interest rates on total approved bank loans continued. At the end of June 2020, the weighted average nominal interest rate (WANIR) stood at 5,41%, or 0.05 percentage points (p.p.) lower compared to December 2019, while the weighted average effective interest rate (WAEIR) was 5.93% (0.08 p.p. lower).

As regards the deposit interest rates, the weighted average deposit effective interest rate (WADEIR) stood at 0.41%.

At the end of June 2020, bank loans were €3,101 million, which is €39.3 million or 1.3% more than at the end of 2019, and €150.7 million or 5.1% more than at the end of June 2019. The largest part (91.3%) of total approved bank loans at the end of the second quarter was approved to residents, of which 44.9% to households, 36.4% to the non-financial sector, 8.7% to the General Government, 1% to the financial sector, and 0.4% to non-governmental and other non-profit institutions. Loans granted to non-residents accounted for 8.7% of total loans.

In the same period deposits were €3,300.9 million, which is €174.8 million or 5% lower compared to the end of 2019.

The pandemic caused the expected deterioration in the quality of the loan portfolio with the non-performing bank loans (NPLs) increasing by €18.6 million or 12.8% compared to the end of the previous year. At the end of June 2020, NPLs were €163.2 million.

The total debt of the household sector based on loans was €1,391 million at the end of June 2020. The indebtedness of households grew by €33.3 million or 2.5% compared to the end of 2019, or €95.7 million, i.e. 7.4% on an annual basis. The household sector mainly borrows from banks for more than one year. At the end of June, 98.1% of the total loans granted to this sector were long-term loans. Indebtedness per capita amounted to EUR 2,236.8, which is 2.5% higher than at the end of the previous year, while compared to June 2019 it recorded a growth of 7.4%.

Fiscal sector

Lower economic activity put additional pressure on public finances, given the fast-growing costs of financing the government's policy response to the pandemic.

According to the Ministry of Finance, in the first six months of 2020, public[1] revenues were €837.1 million, or 18.2% of the estimated GDP for 2020. Compared to the same period in 2019, public revenues are lower by 10.1%, or €94.2 million, where the largest decrease was recorded in tax revenues (i.e. value-added tax), in the amount of €56.8 million. The structure of public revenues is dominated by tax revenues (64.8%), followed by contributions (26.3%), while all other revenues account for 8.9% of public revenues.

Public expenditures in the period January-June 2020 were €1.05 billion, or 22.9% of estimated GDP. Compared to the same period in 2019, public spending was higher by 8.7%, or €84.5 million. The increase in expenditures was mostly due to higher expenditures for reserves (an increase of €34.5 million) as a result of current budget reserve increase, which was used to finance the packages to help the economy affected by the coronavirus.

The pandemic also affected budget revenues and triggered the growth of consolidated budget expenditures in the first half of 2020. The budget deficit in the period January-June 2020 was €214.9 million, or 4.7% of GDP.

1 The table shows Budget revenues and budget expenditures

It is expected that the completion of the debt-financed first section of the Bar-Boljare highway (foreseen for mid-2021) will help to ease the pressure on public finances in 2022.

At the end of June 2020, the gross state debt of Montenegro amounted to €3,664.6 million or 79.5% of GDP, and compared to the end of 2019 it is lower by €43.9 million or 1.2%. Out of that, domestic debt is €559.4 million or 12.1% of GDP, while the external debt is €3,105.2 million or 67.4% of GDP. Net government debt amounted to 71.3% of GDP. The decrease of government debt during the first six months of 2020 was mostly affected by debt repayment based on Eurobonds issued in 2015. The level of public debt poses a serious risk, and its management remains one of the biggest challenges in the coming period.

Changes in the main economic indicators for Montenegro, for all four quarters of 2019 and the first two quarters of 2020 are presented in the following table.

Table MN1 Main economic indicators[2]

	2019				Total 2019 year	2020	
	Q1	Q2	Q3	Q4		Q1	Q2
ECONOMIC ACTIVITY*							
Real GDP (% change, yoy)	3.0	3.2	4.7	3.1	**4.1**	2.7	-20.2
Real private consumption (% change, yoy)	7.05	5.85	3.33	3.42	**4.9**	3.21	-14.89
Real government consumption (% change, yoy)	0.03	10.78	-3.69	7.48	**3.5**	1.36	-3.04
Real investment (% change, yoy)	-0.81	0.26	5.01	0.49	**1.0**	3.55	-25.41
Industrial output (% change, yoy)	-14.4	-9.4	0.1	-1.7	**-6.3**	12.9	-15.9
Unemployment rate (LFS, % pa)	15.0	14.3	15.2	15.9	**15.1**	16.3	15.2
Nominal GDP (EUR million)	886.0	1,151.5	1,630.6	1,239.7	**4,950.7**	913.1	900.5
GDP per capita (EUR)	1,424	1,851	2,621	1,993	**7,959**	1,468	1,448
PRICES, WAGES, AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)**	1.4	0.7	1.7	2.3	**2.0**	0.4	-2.0
Consumer prices (% change, yoy, pa)	0.5	0.5	-0.3	0.7	**0.4**	0.8	-0.7
Producer prices (% change, yoy, pa)**	1.5	2.7	2.9	2.4	**2.4**	1.3	-0.4
Average gross wage (% change, yoy, pa)	0.6	0.5	1.0	1.3	**0.9**	2.2	1.2
Exchange rate (______/EUR, pa)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
Exchange rate (______/USD, pa)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	101.18	114.14	120.91	129.37	**465.59**	95.54	86.89
Exports of goods (EUR, % change, yoy)	1.70	2.49	15.37	7.44	**6.77**	-5.57	-23.87
Imports of goods (EUR million)	510.35	696.91	690.39	633.45	**2,531.11**	520.88	489.45
Imports of goods (EUR, % change, yoy)	4.40	1.82	3.50	-1.77	**1.85**	2.06	-29.77
Current account balance (EUR million)	-316.49	-328.14	239.96	-339.49	**-744.16**	-321.90	-316.46
Current account balance (% of GDP)	-35.72	-28.50	14.72	-27.38	**-15.03**	-35.25	-35.14
Foreign Direct Investment net inflows (EUR million)	82.73	144.53	39.39	78.23	**344.88**	134.19	125.03
Foreign exchange reserves (EUR million, eop)***	926.93	796.91	855.52	1,325.78	**1,325.78**	905.49	1,171.99
Foreign debt (EUR million, eop)	N/A	N/A	N/A	N/A	**8,309.96**	N/A	N/A
GOVERNMENT FINANCE							
Revenues (EUR million)	417.77	513.58	592.36	627.25	**2,150.95**	423.41	324.34
Expense (EUR million)	437.07	431.61	454.20	586.51	**1,909.40**	454.93	423.26
Net = Gross operating balance	-19.30	81.96	138.16	40.73	**241.55**	-31.52	-98.92
Net acquisition of non-financial assets (EUR million)	50.91	50.48	96.46	140.94	**338.79**	38.99	45.48
Net lending/borrowing (EUR million)	-70.21	31.48	41.69	-100.21	**-97.24**	-70.51	-144.40
Domestic government debt (EUR million, eop)	378.64	511.95	504.52	579.96	**579.96**	535.61	559.55
Foreign government debt (EUR million, eop)	N/A	N/A	2,623.37	3,128.47	**3,128.47**	2,807.84	3,101.82
Total government debt (eop. % of GDP)	64.78	63.85	63.73	75.56	**75.56**	72.57	79.47
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
Broad money, M4 (% change, yoy, eop)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
Total domestic credit (% change, yoy, eop)	10.18	0.63	1.55	4.52	**4.52**	4.26	5.11
DMBs credit to households (% change, yoy, eop)	12.44	8.94	8.56	8.60	**8.60**	6.46	7.39
DMBs credit to enterprises (% change, yoy, eop)	6.26	1.72	2.10	4.14	**4.14**	4.06	6.46
Money market interest rate (%, pa)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
DMBs credit rate for enterprises short-term (%, pa)	4.89	4.83	4.62	4.64	**4.64**	4.48	4.60
DMBs credit rate for households short-term (%, pa)	7.71	7.78	7.89	8.15	**8.15**	7.70	7.19

* Preliminary data for quarterly GDP in 2019 and 2020.
** Authors' calculations based on Monstat data.
***Includes Foreign Currency, Foreign Currency Deposits, and Foreign Currency Securities included in the official reserve assets.

2 Data obtained from Central Bank of Montenegro

Policy assumptions and projections summary

Projections in table MN2 reflect the projections of the Central Bank of Montenegro.

The World Bank published a Fall 2020 Regular Economic Report, estimating a sharp decline in GDP growth rate for Montenegro for 2020 of 12.4%. European Commission forecast is that the decline in imports and investment due to coronavirus-related disruptions and lower domestic demand is expected to help to ease the trade deficit in 2020 and 2021. The completion of the first section of the Bar-Boljare highway in 2021, and a solid recovery of tourism and remittances in 2022, will also support the containment of the current account deficit. Considerable FDI inflows into energy, telecommunications (5G), and tourism projects (estimated at some 30% of GDP), have been announced by the foreign investors' council for 2021 and 2022.

The following table presents core macro-economic and fiscal aggregates, precisely their projections over the next two-year period, using two scenarios.

Table MN2 Summary of projections*

	2021 Scenario 1*	2021 Scenario 2**	2022 Scenario 1***	2022 Scenario 2****
Real GDP (% change)	**7,5**	**1.5**	**4,3**	**8,6**
Real private consumption (% change)	6,5	1,5	3,5	6,5
Real government consumption (% change)	1	2	1,5	2
Real investment (% change)	5	2,5	3	8
Exports of goods and services (constant prices, % change)	37	10,9	36	53,7
Imports of goods and services (constant prices, % change)	14	6	17,5	22,4
Current account balance (% of GDP)	N/A	N/A	N/A	N/A
Consumer prices (% change, pa)	1,5	0,5	1	1,5
Exchange rate, national currency/EUR (pa)	N/A	N/A	N/A	N/A
Unemployment rate (registered, %, pa)	16	17	15	15
General government balance (ESA 2010 definition,% of GDP)	N/A	N/A	N/A	N/A
Total domestic credit (% change, eop)	N/A	N/A	N/A	N/A

*Scenario 1 – the main assumption that COVID-19 is present in the first half of 2021

**Scenario 2 – the main assumption that COVID-19 is present during all 2021

***Base for this scenario is 2021 Scenario 1

**** Base for this scenario is 2021 Scenario 2

NORTH MACEDONIA

COVID-19 has taken a major toll on the North Macedonia economy

Economy's last bidding during the pandemic

In the past months, the Republic of North Macedonia is confronted with severe challenges that are caused by the pandemic. Since the start of the COVID-19 pandemic and the precautionary measures that had to be undertaken for the wellbeing and healthcare for the population, the real GDP is expected to be almost 13 percentage points smaller than at the end of 2019. This result is mainly due to the expected fall in private consumption of almost 12 percentage points in the second quarter of 2020. The measures of the Central Government not to reduce the wages of the public sector in order to maintain as higher aggregate consumption as possible did maintain the private consumption, but keeping it stable in the future will be a much harder challenge. Adding to the current situation, the expected fall of real investment and industrial output for a quarter less than the end of 2019 as a result of decreased consumption from the domestic and foreign consumption, the decline in real GDP and GDP per capita is to be expected. Newly recommended government measures for SME's and increased government consumption could soften the fall of the GDP but on account of raising the public debt (which is relatively high as it is). Even if these measures were to take effect, it is doubtful if

they could restart the economy so quickly, especially when the future of the pandemic is still doubtful.

The labour market started to shift downwards

The Covid-19 pandemic has influenced the whole Macedonian economy, particularly the labour market. According to the data from the State Statistical Office, the number of employed persons was increasing in 2019 and Q1/2020 when reached 811106 persons. In Q2/2020 it decreased to 793416 persons. The employment rate (15-64) followed the same trend, and from 48.1% (Q1/2020) in the second quarter declined to 47.1%. The number of unemployed was continuously declining up to Q1/2020 and got more than 156 thousand persons, but in Q2 this number increased for almost 3000 persons. The unemployment rate was decreasing up to 16.2% (Q1/2020) and then started to rise (16.7% in Q2/2020).

According to the Employment Service Agency, the number of registered applications for employment in Q1 and Q2/2020 were 45705 and 82745 persons, respectively. Compared to the same quarter of 2019, when they amount 49068 (Q1) and 97634 persons (Q2), it is evident that in 2020 the dynamics of new employment is significantly slowed. As for the registered unemployment, the available data indicates that in Q1 and Q2/2020, the inflow of unemployed from all sources of unemployment was raised, surpassing the outflow from unemployment. As a result, the total number of registered unemployed since the pandemic outbreak (March 2020), by the end of the second quarter of 2020 was increased for 25723 persons or 23.9%. Compared to 2019, when registered unemployment decreased by 3.7%, it is evident that the unemployment increase that started at the beginning of 2020 was significantly intensified in Q2.

Both data sources show that the Macedonian labour market started to face some downward trends in the second quarter of 2020, which are mainly a consequence of Covid-19 pandemic. These negative trends are not still so emphasized because of the measures taken to mitigate them.

COVID-19 deteriorated fiscal position

Before the pandemic, in 2019, the fiscal performance was favourable. Almost all revenues were increases compare with the previous year, as expenditures. The fiscal deficit reached 2 percent of GDP, keeping public debt stable at 49,4 percent of GDP, and was projected to widen to 2½ percent of GDP in 2020 mainly due to higher pension benefits and a public sector wage hike.

The rapid spread of COVID-19 in 2020 is taking a major toll on the economy. The Government declared a state of emergency on March 18, closed external borders, and imposed social-distancing restrictions. Fiscal revenues started to decline from the following month, especially in May, when they dropped by over 10 % compared to the previous month, i.e. over 20 % from March. At the same time, public spending increased monthly in line with declining revenues. This result is due to government health measures and cushions the impact of the shock on our people and economy. The Government is implementing necessary temporary measures to limit the social and economic impact by protecting the liquidity of companies, preserving jobs and providing social care for the jobless and vulnerable households. So, with fiscal measures, companies and individuals who have business activity in affected sectors have been exempted from advanced monthly payments of corporate income tax through June. Also, affected firms will receive a subsidy for social security contributions, subject to maintaining employment at the pre-virus level. The second set of measures was announced on April 1, to prevent layoffs and set the conditions right for the recovery once the global outbreak abates. A wage subsidy equal to the minimum wage is planned to affected companies to help them maintain jobs. Also, vulnerable households who were part of the informal economy and lost their income will receive financial support. To offset these costs, there will be targeted and temporary cuts on the expenditure side, including in capital expenditure, the public sector wage bill, and the purchase of goods and services, both at the central and local level. State-owned enterprises will also reduce expenditure. At the same time, spending on health, as well as unemployment and social benefits, is likely to be higher than budgeted. As a result, the general government deficit up to Q2 increases to 4½ percent of GDP in 2020 before receding to about 3 percent in 2021.

Furthermore, finally, public debt is increasing from 49, 4% of the GDP at the end of 2019 to 51, 4 % in Q1 and 60, 3 % in Q2. With them, having in mind financing needs in 2020–21 in the event of further shocks, including potential contingent liabilities, exceed the high-risk thresholds.

Monetary policy facing the outbreak of COVID-19 delivered a signal for further lessening by decreasing CB bills rate to 2% in January, 1.75% in April and 1.5% in May 2020. The undertaken monetary measures maintained credit support on a very solid level. Hence at the end of 2019, the credit growth amounted 6%, and in mid-2020, stands at 8%, with positive trends in lending to the corporate sector. Decreased deposits and credits trends in the first and second quarter of 2020, turned to smooth stabilization and rise at the mid-2020.

Resilient Monetary and Banking sector - challenges imposed by COVID-19

To facilitate loan servicing during the Covid crisis, banks and savings houses offered an extension of instalment payments to the citizens and businesses, which has been exploited in around 70%. NPLs to gross loans stands to 4.7% as of June 30 2020, indicating bank assets quality, with 4.3%, 6,1% and 3.1% for large, medium-sized and small size banks. The other bank indicators demonstrate minor deterioration such as ROAA with 0,8 and 1% in the first and second quarter of 2020, liquidity assets/ total assets with 24.6% to 23.5% in the first and second quarter of 2020, respectively.

Furthermore, since the onset of the corona crisis, consumers have embraced contactless payment and e-banking, representing the substantial element for ongoing payment transactions in the pandemic situation. Such practice might be a very positive shift for future bank strategies, fostering banks to rethink and reshape their go-to-market strategy, primarily having in mind ambiguity for the pandemic extent.

At mid-2020, the North Macedonia's central bank has revoked the founding and operating license of Eurostandard Bank AD Skopje, which represented 1.3% of the system's total assets, 1.7% of deposits and 1.6% of loans as of June 30, 2020. This activity did not endanger the banking system's stability and was imposed due to the non-compliance with the minimum requirements for operating a bank.

Stable prices in the time of the pandemic

Consumer prices and Production prices indexes saw a stable decrease in 2019. The average gross wage also saw a small but stable rise in the same observational period. On the side of the demand, the consumer price index the most significant decrease in the observational period is noted in the first quarter of 2019, where the index went down for 0.6 percentages. The decrease in production and also in consumer prices was mainly triggered by the decrease in transportation costs and also a stable decline in electricity and liquid fuels. This stability of the prices and inflation index in the time of COVID-19 pandemic comes as a result of highly regulated and controlled prices by the central Government.

The negative sign of the external sector categories "ally" of the pandemic COVID 19

In 2019, the current account deficit deepened in almost all quarters, except for Q3. This is mainly due to the deterioration of the balance of trade in goods and services, especially in the last quarter of the year. However, the situation in Q1 and Q2 in 2020 is becoming far more dramatic.

The state of emergency in the world and the domestic economy, caused by the covid virus19, adversely affect the foreign trade sector in the domestic economy, further widening the trade deficit in the current account. In Q1 and especially Q2 in 2020, there was a decline in foreign trade, which was recorded for the first time in the past seven years in both the export and import component on an annual basis. The decline in exports is mainly due to the export of the new facilities in the economy, which are mainly from the automotive industry. That sector has been significantly affected by the negative effects of the pandemic, with some facilities being temporarily closed since the second half of March. The decline in imports is mainly due to lower raw material imports of the new export-oriented facilities. This is a reflection of the lower global demand for cars and the correspondingly lower exports in this period, but also the disturbing supply chains.

Versus net inflows on the financial account of the balance of payments in 2019, in Q1 and Q2 in 2020 are registered net outflows, with more moderate intensity in Q2. In Q1 net outflows were registered in the categories: loans, currencies and deposits and portfolio investments, while direct investments registered solid net inflows. In Q2, when the consequences of the corona crisis are felt more intensively, the outflows are recorded in the categories: currencies and deposits and direct investments, and the net inflows are recorded in the categories: portfolio investments and loans. These net inflows in Q2 in 2020, which are mainly due to IMF loans and issued Eurobonds, again increase the foreign reserves that were reduced in Q1 in 2020 compared to the end of 2019. The decrease in Q1 occurs as a result of regular repayments of liabilities to external creditors, and to a lesser extent, due to the National Bank's interventions in the foreign .

Table MK1 Main economic indicators

	2019				Total 2019 year	2020	
	Q1	Q2	Q3	Q4		Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	3.8	3.4	3.6	3.4	**3.6**	0.2	-12.7
Real private consumption (% change, yoy)	4.4	4.4	2.9	2.4	**3.5**	1.2	-11.6
Real government consumption (% change, yoy)	3.8	4.8	2	7.1	**4.5**	2.4	1.5
Real investment (% change, yoy)	-0.2	-0.4	14.1	11.5	**6.6**	-0.5	-25.6
Industrial output (% change, yoy)	8.8	1.3	7.3	-1.3	**3.7**	-3.7	-25.2
Unemployment rate (registered, % pa)	17.8	17.5	17.1	16.6	**17.3**	16.2	16.7
Nominal GDP (EUR million)	2,650	2,755	2,889	3,047	**11,340**	2,689	2,428
GDP per capita (EUR)	1,277	1,327	1,391	1,468	**5,463**	1,295	1,169
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	3.6	1.5	2.3	2.1	**2.4**	1.5	1.2
Consumer prices (% change, yoy, pa)	1.2	1.2	0.6	0	**0.8**	0.6	0.5
Producer prices (% change, yoy, pa)	0.2	0.9	1.2	1.1	**0.9**	0.4	0.4
Average gross wage (% change, yoy, pa)	3.4	3.6	4.7	5.7	**4.3**	10.6	5.1
Exchange rate (MKD/EUR, pa)	61.53	61.5	61.49	61.51	**61.51**	61.61	61.69
Exchange rate (MKD/USD, pa)	54.17	54.75	55.3	55.56	**54.95**	55.89	56.09
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	1,245.3	1,345.3	1,361.75	1,373.08	**5,325.43**	1,130.54	876.41
Exports of goods (EUR, % change, yoy)	17.6	11.6	10.5	-0.8	**9.1**	-9.2	-34.9
Imports of goods (EUR million)	1,720.4	1,786.6	1,798.06	1,986.76	**7,291.82**	1,679.3	1,231.51
Imports of goods (EUR, % change, yoy)	13.1	11.1	10.4	6.9	**10.2**	-2.4	-31.1
Current account balance (EUR million)	-158.1	-47	178.5	-286.9	**-313.5**	-148.8	-85.9
Current account balance (% of GDP)	-6	-1.7	6.2	-9.4	**-2.8**	-5.5	-0.8
Foreign Direct Investment net inflows (EUR million)	59.3	29.2	82.3	192.5	**363.3**	127.1	-15.0
Foreign exchange reserves (EUR million, eop)	2,866.4	2,928.2	3,127.5	3,262.6	**3,262.6**	3,017.3	3,639.7
Foreign debt (EUR million, eop)	8,249.5	8,337.2	8,581	8,191.2	**8,191.2**	8,338.9	8,781.7
GOVERNMENT FINANCE							
Revenues (MKD million)	46,042	50,076	50,986	56,718	**203,822**	46,484	40,953
Expense (MKD million)	49,243	53,915	52,085	62,202	**217,445**	53,894	59,486
Net = Gross operating balance	-3,201	-3,839	-1,099	-5,484	**-13,623**	-7,410	-18,533
Net acquisition of non-financial assets (MKD million)	-1,399	-3,488	-2,344	-8,212	**-15,443**	-1,633	-2,280
Net lending/borrowing (MKD million)	-1,802	-351	1,245	2,728	**1,820**	-5,777	-16,253
Domestic government debt (EUR million, eop)	1,655.4	1,703.5	1,775.7	1,793.3	**1,793.3**	1,971.3	2,090.4
Foreign government debt (EUR million, eop)	2,687.6	2,671.2	2,669.3	2,763.5	**2,763.5**	2,608.1	3,471
Total government debt (eop. % of GDP)	38.3	38.6	39.2	40.2	**40.2**	41.8	50.7
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	17.2	18.5	18.8	17.2	**17.2**	19.9	21.3
Broad money, M4 (% change, yoy, eop)	11.7	10.5	10.8	9.3	**9.3**	8.9	9.8
Total domestic credit (% change, yoy, eop)	9	8.1	5.6	6	**6**	5.8	6.6
DMBs credit to households (% change, yoy, eop)	9.8	9.8	9	10.9	**10.9**	10.7	N/A
DMBs credit to enterprises (% change, yoy, eop)	8.2	5.5	1.8	2.8	**2.8**	2.1	N/A
Money market interest rate (%, pa)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
DMBs credit rate for enterprises short-term (%, pa)	4.4	4.3	4.1	3.9	**4.2**	3.8	N/A
DMBs credit rate for households short-term (%, pa)	3.6	3.6	3.5	3.6	**3.6**	3.6	N/A

Source: 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, and https://www.ceicdata.com/en/indicator/macedonia/gdp-deflator-growth

Policy assumptions and projections summary

The situation caused by COVID -19 pandemic indicated that we must not neglect the vast uncertainty and likelihood that the pandemic crisis might further enlarge in the months to come. Hence the measures and action undertaken by the monetary policy and banking sector impose new challenges and should support the fragile real sector, hypothetically encouraging the economy back on track.

Declining in real GDP are expected in the future period. The projections of real GDP growth are 7% in 2021, 4.5% in 2022 and 4% in the year 2023. It is also expected that the unemployment rate will continue to increase. According to the IMF,[1] it is forecasted to reach about 20% in December 2020.

Changes in the price for electricity by the regulatory commission could see consumers and producers price rise in the future. It is projected that the Consumer prices index in 2021 will be 0.8. In the next two years, a higher level of prices is expected, and the index will be 1.2 in 2022, while in 2023 1.6.

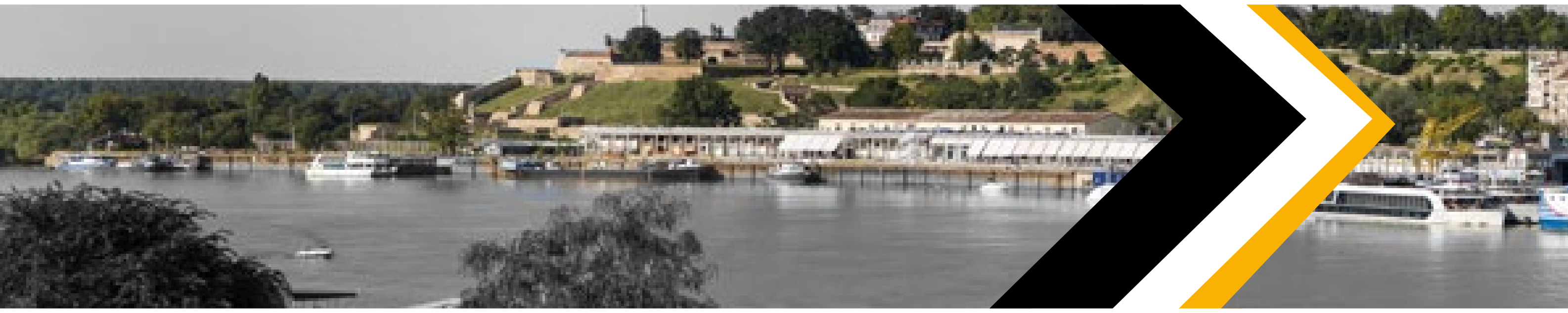
In the external sector after the dramatic fall in exports and imports in 2020 is expected their strong recovery in 2021. The improvement in the trade balance will reduce the current account deficit after 2020. However, the stronger or longer-lasting than expected deterioration of the external environment, or the more extended disruption of supply chains, due to the further duration and spread of the pandemic, would exacerbate the decline in exports and imports beyond 2020.

1 IMF, https://www.imf.org/external/datamapper/LUR@WEO/MKD?year=2020 (Accessed: 27.10.2020)

Table MK2 Summary of projections

	2021	2022	2023
Real GDP (% change)	**7**	**4.5**	**4**
Real private consumption (% change)	5.3	3.5	3.3
Real government consumption (% change)	N/A	N/A	N/A
Real investment (% change)	12	7.8	5.8
Exports of goods and services (constant prices, % change)	11.3	9.5	9.0
Imports of goods and services (constant prices, % change)	10.2	8.9	8.3
Current account balance (% of GDP)	-1.3	-1.8	-1.9
Consumer prices (% change, pa)	0.8	1.2	1.6
Exchange rate, national currency/EUR (pa)	N/A	N/A	N/A
Unemployment rate (registered, %, pa)	18.9	17	N/A
General government balance (ESA 2010 definition, % of GDP)	-3.1	-2.8	-2.8
Total domestic credit (% change, eop)	8.4	7.1	6.4

Sources: 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://tradingeconomics.com/macedonia/unemployment-rate?embed/forecast



S E R B I A

The appearance of COVID-19 pandemic and its influence on the economy

Solid economic activity despite COVID-19 pandemic

The COVID-19 pandemic had led to contractions. The real GDP growth had a reduction in the second quarter of 2020, as a result of the appearance of the virus COVID-19. The real GDP in Q2 of 2020, was due to substantial decrease in private consumption (from 3.2% in Q1 2020 to -7.9% in Q2 2020) and real investment (from 10.8% in Q1 2020 to -11.9% in Q2 2020). The decrease went lower in the summer period because of reduction in prevention measures taken to stop spreading the virus (after May most measures had been withdrawn). In the third quarter, real GDP is recovered, mainly as a result of financial support of the government, and the borrowing abroad (foreign debt increases in 2020).

In the second quarter of 2020, observed by industry activities, fall of real GDP is noted in the sector of wholesale and retail and repairs motor vehicles, transport and storage and accommodation and food services with 16.7%; industry sector and water supply and wastewater management with 7.7%; the sector of professional, scientific, innovative and technical activities and administrative and support service activities with 20.6%.

Significant real gross growth added values, were recorded in the sector of information and communication with 5.4% and the sector of state administration and compulsory social security, education and health and social care with 7.1%.

The appearance of COVID-19 had small an influence on labour rates (employment, unemployment and inactivity). The unemployment rate in the second quarter of 2020 was 7.3%. Comparing to the first quarter of the same year, that percent of unemployed people went lower for 2.4 pp., due to the number of inactive persons which grew by about 113 thousand.

The exchange rate is stable due to intervening on the foreign exchange market

The consumer price in the second quarter of 2020 was influenced mainly by prices of services (0.7pp.) and processed food (0.4 pp.). The main contribution on the division of products was by food and non-alcoholic beverages (0.7 pp.); alcoholic beverages and tobacco (0.3pp.) and housing, water, electricity, gas and other fuels (0.3pp.).

Producer prices dropped in the first and the second quarter of 2020 compared to a total producer price in 2019. In the first quarter, they drop to about 0.3 pp, and in the second quarter for more than 2.5 pp (compared to the total of 2019 when they were 0.68%). In the second quarter of 2020, index of producer's prices of vegetables followed the cyclical trend of average retail prices of vegetables entirely, and it was with a fall of 28.8%. The most deflationary elements remain the increase of fruit and meat. The enormous influence on the growth of the price of fruit was due to prices of apples, lemons and oranges. On the other side, in the total prices of meat, prices of the pig meat had the largest share of 63.2%. The remnant referred to minor price growths of dried, smoked and salted meat, and other types of meat, except beef, where fall was recorded due to unrealised arrangements with China and Turkey.

The average gross wage in the Q2 went lower, but even though it was expected to be much lower, it went to 8.66%, driven by an increase in the minimum wage from the beginning of the 2020 and also due to increase in public sector wages from 2019.

The Serbian dinar is stable, resulted in the first two quarters of 2020 with 117.6 RSD/EUR (Q1 2020 – 117.57; Q2 2020 – 117.58). The main reason for this is the intervening of the National Bank of Serbia on the foreign exchange market.

FDI's remain the leading cause of growing real GDP

The export of goods went lower in Q2 2020 comparing to the Q1 2020 (5,566 EUR mil. to 4,679 EUR million). Even though, current account balance (EUR million) was improved in the second quarter of 2020, for about 510 EUR million, resulted in -802 EUR mi, comparing to the Q1 2020 due to lower import of goods. The main foreign trade partners in the first two quarters of 2020 for export are Germany, Italy, Bosnia and Herzegovina, Romania and Russia, sorted in order of participation in the total export. On the other hand, the leading countries for import in the first two quarters of 2020 are Germany, China, Russia, Italy and Hungary, sorted in order of participation in the total import. Share of countries of EU (European Union) in total foreign trade is 60,4%, and the second place belongs to CEFTA (Central European Free Trade Association). The Manufacturing industry belongs to the most important industry of export, with more than 90,4% participation in total export.

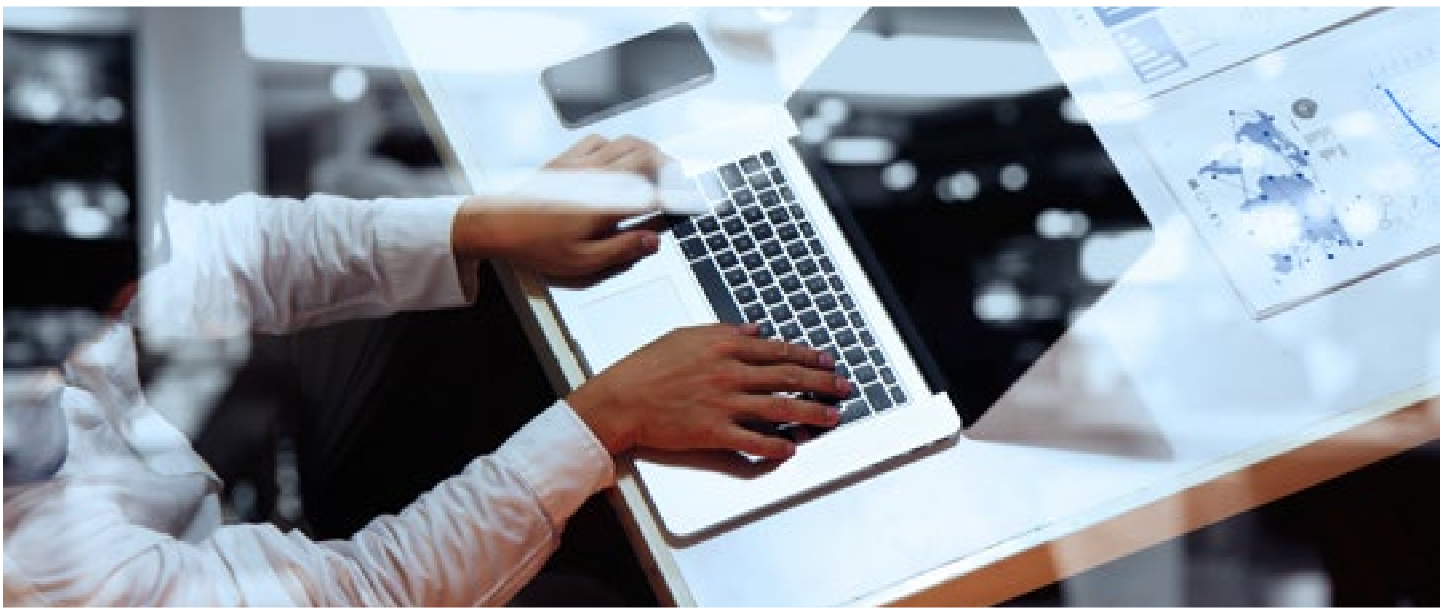
In 2019, and the analysed period of 2020, foreign direct investment net inflows (EUR million) remain one of the leading cause for the growth of the real GDP. FDI top three rankings per sector by the number of projects are Automotive industry, Textile & Clothing and Electrical & Electronics. In the first quarter of 2020, the Netherlands invested most in Serbia, with 210.7 mil. EUR, in the second place, was Austria with 70mil. EUR and in the third place was China with 59.3 mil EUR. In the second quarter of 2020, the first place of investments inflows was also the Netherlands but with a higher investment amount of 284.7 mil. EUR, in the second place, was China with 85.1 mil. EUR and in the third place was Germany with 66.9 mil. EUR. The direct investments outflow was in the first quarter of 2020 to Austria (4.7 mil. EUR), Slovenia (4.3 mil EUR) and Bosnia and Herzegovina (3.0 mil. EUR) in order of size amount. In the second quarter of 2020, direct investments outflow by the highest amount were Montenegro (6.4 mil. EUR), Slovenia (5.7 mil. EUR) and Russia (3.0 mil. EUR) respectively.

The foreign debt at the end of 2019. was 24,355 (EUR million). However, in the first quarter of 2020, foreign debt got higher for about 370 EUR million. This increase was before the appearance of the COVID-19 and before the economic package of the Government of Serbia. It was the result mainly of unfavourable exchange rate differences and net-borrowing on the domestic market. In the second quarter of 2020, as we can see from the table, foreign debt increases more, and it gets 27,228 EUR million. This amount is due to additional borrowing, which was necessary to be taken to help the economy during COVID-19 crisis.

Massive fiscal support to the economy

The program of economic measures to mitigate the severe effects of the coronavirus epidemic on the economy of Serbia was presented at the end of March 2020. This program envisaged massive bailout package that predominantly comprises fiscal measures of direct financial support to business and households: postponing of the tax liabilities of the private sector (2.9% of GDP), minimum wage compensations for all employees in SME and 50% of employees in large companies (1.8% of GDP), guarantees for liquidity credits to the private sector (4.8% of GDP) and other measures, including “helicopter” money for households (1.3% of GDP). Therefore, the bailout package predominantly comprises fiscal measures of direct financial support to business and households estimated at 3.1 billion EUR, which accounts for 6.7% of projected GDP.

Massive bailout package of fiscal support was effective in saving the economy from total collapse in the second quarter of 2020 when the harsh containment measures were enforced. However, it has interrupted positive outcomes of recent fiscal consolidation, i.e. longstanding fiscal stabilisation and steady decline in public debt. The fiscal authorities estimated that loss of public revenues in 2020, driven by the pro-cyclical response to downfall in economic activities, will be around 1 bil. EUR. With an additional 3 bil. EUR burden of public debt falling due in 2020, initial estimations of the overall fiscal deficit (bailout package, revenue loss, debt falling due) exceeded 7 bil. EUR (9% of GDP). Large deficit imposed government financing needs up to 6.5 bil. EUR predominantly financed by the issue of Eurobonds, which in turn sharply increased public debt for five percentage points in the second quarter of 2020. Nevertheless, initially estimated severity of the public financing deterioration was alleviated, mostly due to better collection of public revenues than expected, and the projected value of fiscal deficit is updated to 7% of GDP. Despite somewhat better fiscal results than expected in the second half of 2020, bailout package in combination with sever effects of pandemic totally exhausted fiscal space, making mid-term sustainability of public finances very vulnerable.



Relaxed monetary policy

The National Bank of Serbia, like many other central banks, was supportive during this crisis. With formally document" Decision on temporary measures for banks to mitigate the consequences of the COVID-19 pandemic in order to preserve the stability of the financial system", helped the population in the Republic of Serbia during COVID-19.

Measures taken to provide the same help to industry and the Serbian citizens were lowering all introductory (basic) interest rates and giving two debt payment moratoria (payment delays). The money market interest rate, given averagely, in the first quarter of 2020 was 0.99% and in the second quarter was 0.49%. That helped the economy for not falling even further. The moratorium accepted approximately about 94% citizens and about 90 firms.

Table SRB1 Main economic indicators

	2019				Total 2019 year	2020	
	Q1	Q2	Q3	Q4		Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	2.6	2.9	4.8	6.2	**4.1**	5.1	-6.4
Real private consumption (% change, yoy)	3.3	3.2	3.0	3.1	**3.2**	3.2	-7.9
Real government consumption (% change, yoy)	2.4	2.1	4.7	2.5	**2.9**	11.8	8.9
Real investment (% change, yoy)	7.2	8.2	17.5	29.6	**15.6**	10.8	-11.9
Industrial output (% change, yoy)	-1.9	-2.6	2.2	3.4	**0.3**	4.4	-7.8
Unemployment rate (registered, % pa) *	12.1	10.3	9.5	9.7	**10.4**	9.7	7.3
Nominal GDP (EUR million)	10,994	11,314	11,610	11,900	**45,967**	11,025	10,750
GDP per capita (EUR)	1,583	1,629	1,671	1,733	**6.619**	1,600	1,500
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	2.0	2.7	2.4	2.5	**2.5**	2.3	1.2
Consumer prices (% change, yoy, pa)	2.4	2.3	1.3	1.4	**1.9**	1.8	1.0
Producer prices (% change, yoy, pa)	1.3	1.4	-0.2	0.2	**0.68**	0.4	-3.3
Average gross wage (% change, yoy, pa)	9.26	9.89	12.25	11.89	**10.46**	10.36	8.66
Exchange rate (RSD/EUR, pa)**	118.23	117.97	117.72	117.53	**117.85**	117.57	117.58
Exchange rate (RSD/USD, pa)**	105	103.77	107.43	104.92	**105.28**	106.57	106.76
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	4,084	4,474	4,385	4,527	**17,536**	5,566	4,679
Exports of goods (EUR, % change, yoy)	8.1	8.0	9.0	8.7	**7.7**	3.0	-20.7
Imports of goods (EUR million)	5,529	5,877	5,781	6,525	**23,875**	6,878	5,481
Imports of goods (EUR, % change, yoy)	7.8	9.0	9.6	11.4	**8.9**	8.1	-19.3
Current account balance (EUR million)	-1,445	-1,403	-1,396	-1,998	**-6,242**	-1,312	-802
Current account balance (% of GDP)	-8.8	-6.6	-5.5	-5.2	**-6.6**	-8.8	-3.4
Foreign Direct Investment net inflows (EUR million)	740.5	965.5	878.4	966.7	**3,551**	794.9	654.7
Foreign exchange reserves (EUR million, eop)	11,440	12,146	13,295	13,378	**13,378**	13,115	13,956
Foreign debt (EUR million, eop)	23,744	23,892	24,349	24,355	**24,355**	24,725	27,228
GOVERNMENT FINANCE							
Revenues (RSD billion)***	526	552	568	632	**2,279**	537	475
Expense (RSD billion)***	478	492	489	564	**2,023**	534	673
Net = Gross operating balance ***	48	60	79	68	**255**	-3	-197
Net acquisition of non-financial assets (RSD million)***	36	53	63	114	**266**	55	61
Net lending/borrowing (RSD million)	12	7	16	-46	**-11**	-52	-258
Domestic government debt (EUR million, eop)	9,617	9,759	9,883	9,993	**9,993**	10,457	11,085
Foreign government debt (EUR million, eop)	13,780	13,797	14,065	13,951	**13,951**	13,852	15,742
Total government debt (eop. % of GDP)	52	52	53	53	**53**	53	58
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	16.36	15.52	19.34	14.04	**16.11**	26.59	44.26
Broad money, M4 (% change, yoy, eop)****	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
Total domestic credit (% change, yoy, eop)	7.0	6.1	6.8	8.1	**7.0**	10.7	16.0
DMBs credit to households (% change, yoy, eop)	12.1	9.2	8.4	9.2	**9.7**	9.04	12.6
DMBs credit to enterprises (% change, yoy, eop)	6.7	6.8	8.7	7.6	**7.5**	11.2	12.34
Money market interest rate (%, pa)	2.15	1.82	1.43	1.12	**1.63**	0.99	0.49
DMBs credit rate for enterprises short-term (%, pa)	3.18	3.12	2.93	3.08	**3.08**	2.61	3.07
DMBs credit rate for households short-term (%, pa)	6.82	6.39	6.23	5.50	**6.24**	5.41	5.99

Policy assumptions and projections summary

Like other countries, Serbia was hit by the COVID-19 pandemic. The pandemic caused different fall of the economies, depending on more factors. One factor is the dependence of the country on tourism. Regarding that, one benefit of Serbia was that it not depends so much on tourism as other countries, it depends mostly on agriculture. That situation (benefit) brought a lower reduction in Serbia's real GDP than other countries which depend more on this sector.

The aims in the coming period, of the Fiscal Policy of the Republic of Serbia, are directed to remaining fiscal stabilisation and lowering total government debt. In 2021 the capital investments will be the primary focus (that will result in higher investments percentage). It will be more invested in the health sector, increased the pensions and wages of the public sector (increase the expenses), and also it will bring the economy tax relief.

According to the document titled "Fiscal Strategy 2021-2023"of Ministry of Finance, projections are made on actual economic trends, and planned effects resulted in the economic policy of the country. The fiscal strategy for the coming period envisages the stabilisation of the public finances and significantly lower levels of deficits that will return the public debt to the zone of a declining trend. However, those projections are based on assumptions that the health crisis will be a curb.

Table SRB2 Summary of projections

	2021	2022	2023
Real GDP (% change)	**6.0**	**4.0**	**4.0**
Real private consumption (% change)	5.4	2.8	2.9
Real government consumption (% change)	0.4	2.5	1.8
Real investment (% change)	13.3	7.1	7.8
Exports of goods and services (constant prices, % change)	9.6	9.1	9.3
Imports of goods and services (constant prices, % change)	9.3	7.7	7.8
Current account balance (% of GDP)	-5.9	-5.5	-5.2
Consumer prices (% change, pa)	2.0	2.2	3.0
Exchange rate, RSD/EUR (pa)	118	119	N/A
Unemployment rate (registered, %, pa)	9.5	8.8	N/A
General government balance (ESA 2010 definition, % of GDP)	N/A	N/A	N/A
Total domestic credit (% change, eop)	58.7	57.9	56

Notes: *This unemployment rate is calculated based on the LFS 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

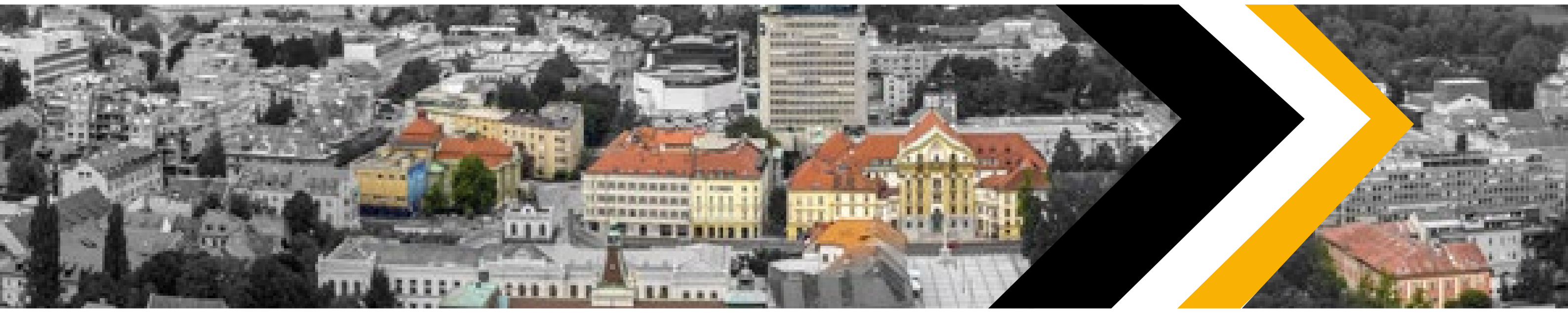
Conventional abbreviations: pa-period average, eop-end of the period, yoy-year on year, EUR – Euro, US$-US dollar, DMB- deposit money bank, RSD- Serbian Dinar

Sources: Republic Statistical Office, National Bank of Serbia, Ministry of Finance of the Republic of Serbia, European Commission's Directorate-General for Economic and Financial Affairs, CEIC, WIIW Forecast Report Autumn 2020

The real GDP (% change) is projected by the Ministry of Finance of the Republic of Serbia by 6.0% in 2021, 4.0% in 2022 and the same in 2023. However, by the WIIW Forecast Report Autumn 2020 (later only WIIW), those percentages differ. It is projected that in 2021 real GDP will be 4.5% and that in 2022 will be 4.1%. By the IMF the real GDP in 2021 is projected to be 5.5%, in 2022. 6% and in 2023. it is projected to be 4.5%. The private consumption also differs in WIIW projections and the Ministry of Finance of the Republic of Serbia. It is projected in 2021 with 4.0% and in 2022 3.2% by WIIW and 2021 5.4% and 2022 2.8% by Ministry. That means it will get higher in the coming years compared to 2020. year, it is assuming as a result of economic recovery. On the other side, projections of government consumption percentages are lower in coming years, than in 2020. year.

The exchange rate, according to the same document, in 2021, is projected with 118 and in 2022 with 119. On the other side, by the Serbian institutions, it is expected that changes in the exchange rate will be relatively small, due to foreign market operations of the National Bank and its foreign reserves. That will lead the exchange rate stable.

It is expected that exports and imports rebound strongly in 2021,2022 and 2023. The total domestic credit, which was increased due to borrowing as a result of the reduction in the effects caused by COVID-19, will (it is projected) gradually decrease in the coming years.



SLOVENIA

Contraction of economic activity due to the COVID-19

In the first half of 2020, economic activity was strongly affected by the Covid-19 containment measures and the collapse in international trade due to the pandemic. On 15 March, a Covid-19 epidemic was declared for the whole country, amid the formation of new Slovenian government following the resignation of Prime Minister in late January. Large-scale support measures were put in place to limit the damage on businesses and employment. The measures included a subsidised pay compensation for temporary lay-offs and exemption from the payment of social security contributions for workers who were temporarily laid off. Self-employed workers, farmers and religious workers whose business had been affected by the crisis were entitled to a monthly basic income and exemption from the payment of social security contributions. Also, state guarantees and credit lines were put in place to help bridge liquidity problems of businesses and citizens. Last but not least, the government introduced tourist vouchers for Slovenian residents to provide direct assistance to the tourism industry.

The shutdown measures were successful in containing the coronavirus spread in the country and in mid-May 2020 Slovenia was the first EU country to declare the epidemic was over within its territory. With the loosening of containment measures, economic activity started to recover already in

June and continued to improve in the 3rd quarter of the year. However, the epidemiological situation began to deteriorate in many trading partners as well as at home towards the end of the 3rd quarter, implying a gradual reinstatement of more stringent containment measures. On 19 October 2020, for the second time, the government officially declared a Covid-19 epidemic for the entire country.

The severe decline in economic activity in the 2nd quarter

With the spread of the coronavirus and the adoption of strict containment measures, economic activity declined in most sectors in the middle of March with a severe decline following in April. Service activities were affected most, especially tourism (travel agencies and tour operators), accommodation and food service activities, transport and trade, but also industrial production contracted amid the decline in foreign demand and disruptions of global supply chains. At the monthly level, industrial production dropped by 10.9% and 14.7% in March and April, respectively. With the gradual relaxation of containment measures, the economic activity started to improve gradually in May and June, increasing by 9.6% and 4.3% at the monthly level. In the first half of 2020, the value of industrial production decreased by 10.1% compared to the same period of 2019. The decrease was two-digit in electricity, gas, steam and air conditioning supply (-14.2%) and mining and quarrying (-13.2%), while it was smaller in manufacturing (-9.8%). Regarding technological intensity, the y-o-y decrease in production in the first six months of 2020 was the highest for the medium-technology intensive industries (-15%), followed by low-technology intensive industries (-9%), while high-technology intensive industries recorded substantial growth (11.5%), which was higher than in the first half-year of 2019.

The contraction of economic activity was even more pronounced in the service sector. In the first six months of 2020, turnover from the sale of services was 13.3% down compared to the same period of 2019. The decline was most pronounced in the accommodation and food service activities (39.6% year-on-year) followed by administrative and support service activities (23.7% year-on-year). It was also notably lower compared to the first six months of 2019 in transport (13.8%) and retail trade (9.6%).

The gross domestic product contracted by 2.4% y-o-y in the 1st quarter, while the decline in the 2nd quarter was as high as 13.1% y-o-y. The decline in growth was a consequence of substantial fall in private consumption (-6.3% and -17.4% y-o-y in the 1st and 2nd quarter, respectively) associated mainly with the closure of all non-essential shops and service activities during the lockdown period as well as high uncertainty about the future, and a drop in investment, especially gross fixed capital formation, which contracted by 5.4% and 16.5% y-o-y in the 1st and 2nd quarter, respectively. The y-o-y growth in exports of goods and services turned slightly negative in the 1st quarter and slumped to -21.3% in the 2nd quarter of the year. However, the corresponding decline in imports was even more substantial (-1.5% and -23.7%, respectively) due to the deterioration of economic sentiment, the decline in production and the fall in investment in machinery and equipment, accompanied by a fall in household consumption. Thus, the contribution to gross domestic product growth of net exports remained positive. Government consumption was the only consumption aggregate that strengthened in the first half of 2020, mainly as a result of the large-scale anti-Covid-19 support measures.

Labour market deterioration eased by measures to preserve jobs

According to the Labour Force Survey (LFS), the number of employed persons in Slovenia in the first quarter of 2020 was 0.4% higher year-on-year. The situation, however, differed among the two groups of the employed: the numbers of self-employed persons decreased by 11.6% while the number of employees increased by 2.7% year-on-year. The labour market situation deteriorated markedly in the second part of March, in April and partly in May, while it started to improve at the monthly level in June. In the 2nd quarter of 2020, the number of employed persons was lower by 2.3% y-o-y, mostly due to the temporary lay-offs.

According to the LFS, the number of unemployed persons stood at 53 thousand in the 2nd quarter of 2020 and was higher by 9 thousand compared to the same period of 2019. The sectors with the most massive inflow into unemployment were accommodation and food service activities, trade, and manufacturing. As measured by the LFS, the unemployment rate in the 1st quarter of 2020 (4.6%) was still 0.3 of a percentage point lower than in the same period of 2019, while it increased by one percentage point y-o-y to reach 5.2% in the 2nd quarter. The unemployment rate was the highest among young people in the 15–24 age group (16%; a 9.5 p. p. increase compared to the 2nd quarter of 2019).

Year-on-year growth in the average gross wage increased markedly in the 2nd quarter of 2020 (8.8%). When it comes to private sector activities, wage growth was mainly the consequence of the methodology for reporting wages for workers on temporary lay-off. In contrast, the wage growth in the public sector was mostly attributable to the payment of allowances for hazardous working conditions and additional workloads, and the payment of the bonus for work in crisis conditions.

General government balance turned negative

General government balance turned negative in the 1st quarter (EUR -0.7 billion) and deteriorated further to EUR -1.7 billion (16.1% of GDP) in the 2nd quarter of 2020. This was a combined effect of the decline in general government revenue (by 3.4% and 8.6% in the 1st and 2nd quarter, respectively, compared to the same periods of 2019) and the increase in general government expenditure (by 9.5% and 26.2% y-o-y in the 1st and 2nd quarter, respectively). The general government revenue declined as a result of the decrease in economic activity due to the Covid-19 pandemic and the associated decline in tax revenues, as well as due to approved tax deferrals, instalment payments of tax liabilities and tax exemptions introduced as part of the anti-COVID-19 measures. Also, the tax reform adopted in 2019 decreased the tax burden on labour and lowered the revenue stream from this source. On the other hand, general government expenditure increased substantially due to the one-time anti-COVID-19 measures. The most massive increase was recorded in subsidies on production, which were connected to measures for the preservation of employment (e.g. compensations for temporary lay-offs, basic monthly income and social security contributions exemptions), followed by social benefits.

After having decreased over the mid-term to 65.6% in 2019, the debt-to-GDP ratio significantly increased in the first six months of 2020. At the end of the 2nd quarter, it stood at 78.2%, 10.5 of a percentage point higher compared to the 2nd quarter of 2019.

Corporate and household loans down

The worsening economic situation caused by the Covid-19 epidemic was reflected in decline in loans growth to both households and enterprises. While year-on-year growth in corporate loans accelerated in the first three months of 2020, reaching a 4.5% y-o-y increase in March, it slowed down considerably in the following months, mainly on account of corporate deleveraging. Starting in June, a decline in y-o-y growth was recorded (-0.5%), which also continued in July and August (-0.4% and -2.6%, respectively).

Growth in household loans declined rapidly in the first half of 2020, mainly due to the sharp slowdown in consumer loans. The y-o-y growth in household loans fell from 5.9% in December 2019 to 1.7% in June 2020, while growth in consumer loans dropped from 8.9% to -1.4% over the same period. A decline in y-o-y growth in consumer loans advanced during the summer months.

Lower energy prices drive deflation

Year-on-year growth in consumer prices strengthened somewhat in the first two months of 2020 (standing at around 2% y-o-y), influenced mainly by higher food and energy prices, but then declined sharply with the outbreak of the Covid-19. Throughout the 2nd quarter of the year, deflation was recorded on a year-on-year basis, which was mainly attributable to lower energy prices, in particular lower prices of oil products, but also lower electricity prices as a result of the Slovenian government's measure which reduced electricity bills for household and small businesses. The latter was lifted in June, which was the main factor causing deflation to shrink from -1.2% (in April and May) to -0.3% (in June). Food price growth had accelerated notably during the epidemic and eased in June.

The current account surplus remains high

The current account surplus remained high in the 1st and 2nd quarter of 2020, standing at 7.7% and 6.0% of the gross domestic product, respectively. Compared to the same periods of 2019, it increased mainly due to the higher surplus in trade in goods, which was primarily the result of a larger decline in imports of goods compared to exports of goods.

In the first six months of 2020, Slovenia recorded an inflow of FDI in the amount of EUR 0.5 billion, which is about half the value compared to the same period of 2019. The decrease was entirely due to a significant drop in the amount of equity capital inflow, while the amount of reinvested earnings doubled and made up a large part of this year's FDI inflow (EUR 371 million).

Table SI1 Main economic indicators

	2019 Q1	2019 Q2	2019 Q3	2019 Q4	Total 2019 year	2020 Q1	2020 Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	4.4	3.3	3.1	2.0	**3.2**	-2.4	-13.1
Real private consumption (% change, yoy)	4.9	6.6	5.8	2.2	**4.8**	-6.3	-17.4
Real government consumption (% change, yoy)	2.5	2.4	2.5	-0.3	**1.7**	4.2	-0.9
Real investment (% change, yoy)	3.7	-2.4	5.8	-1.3	**1.5**	-3.0	-12.1
Real gross fixed capital formation (% change)	11.9	9.2	4.8	-1.2	**5.8**	-5.4	-16.5
Industrial output (% change, yoy)	2.5	4.4	4.1	1.6	**3.1**	-1.4	-17.3
Unemployment rate (LFS, % pa)	4.8	4.2	4.8	4.0	**4.5**	4.6	5.2
Nominal GDP (EUR million)	11,252	12,190	12,489	12,462	**48,393**	11,270	10,828
GDP per capita (EUR)	5,407	5,848	5,978	5,951	**23,165**	5,377	5,163
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	-0.4	2.6	3.8	2.9	**2.3**	0.0	2.6
Consumer prices (% change, yoy, pa)	1.3	1.6	2.0	1.5	**1.6**	1.5	-0.9
Producer prices (% change, yoy, pa)	1.1	0.9	0.3	0.4	**0.7**	-0.1	-0.6
Average gross wage (% change, yoy, pa)	4.6	3.9	4.5	4.2	**4.3**	3.2	8.8
Exchange rate (______/EUR, pa)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
Exchange rate (EUR/USD, pa)	1.14	1.12	1.11	1.11	**1.12**	1.10	1.10
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	7,983	8,295	7,831	7,904	**32,013**	7,843	6,415
Exports of goods (EUR, % change, yoy)	5.0	5.6	5.7	1.0	**4.3**	-0.4	-21.3
Imports of goods (EUR million)	7,569	7,861	7,628	7,625	**30,682**	7,267	5,822
Imports of goods (EUR, % change, yoy)	4.2	6.3	9	-0.5	**4.7**	-1.5	-23.7
Current account balance (EUR million)	716	690	662	655	**2,723**	863	653
Current account balance (% of GDP)	6.4	5.7	5.3	5.3	**5.6**	7.7	6.0
Foreign Direct Investment net inflows (EUR million)	753	213	236	320	**1,521**	205	327
Foreign exchange reserves (EUR million, eop)	369	400	390	384	**384**	446	459
Foreign debt (EUR million, eop)	42,337	43,508	44,550	43,796	**43,796**	45,866	48,143
GOVERNMENT FINANCE							
Revenues (EUR million)	4,946	5,301	5,382	5,598	**21,226**	4,760	4,844
Expense (EUR million)	5,018	5,216	5,243	5,500	**20,977**	5,455	6,585
Net = Gross operating balance	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
Net acquisition of non-financial assets (_____ million)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
Net lending/borrowing (EUR million)	-72	84	139	98	**249**	-695	-1,741
Domestic government debt (EUR million, eop)	26,688	26,764	27,098	26,680	**26,680**	28,857	31,713
Foreign government debt (EUR million, eop)	1,899	1,895	1,889	1,880	**1,880**	1,879	1,870
Total government debt (eop. % of GDP)	68.1	67.7	67.7	65.6	**65.6**	69.0	78.2
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
Broad money, M4 (% change, yoy, eop)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
Total domestic credit (% change, yoy, eop)	3,0	2,6	1,7	6,3	**6,3**	6,4	11,0
DMBs credit to households (% change, yoy, eop)	6,6	6,1	5,9	5,9	**5,9**	4,2	1,7
DMBs credit to enterprises (% change, yoy, eop)	0,2	1,6	2,3	1,2	**1,2**	4,5	-0,5
Money market interest rate (%, pa)	-0,37	-0,37	-0,38	-0,54	**-0,41**	-0,54	-0,54
DMBs credit rate for enterprises short-term (%, pa)	1,8	1,8	1,8	1,7	**1,8**	1,6	2,0
DMBs credit rate for households short-term (%, pa)	3,3	3,2	3,2	3,0	**3,2**	3,1	2,9

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

Policy assumptions and projections summary

High uncertainty around economic recovery

The data presented in the summary of projections are mainly based on the Autumn Forecast of Economic Trends prepared by the Institute for Macroeconomic Analysis and Development (IMAD). There is a higher-than-usual degree of uncertainty around this forecast because the evolution of the pandemic and the need for stepping up containment measures are hard to anticipate. At the time the projection was published, the number of infections has already been rising quickly in Slovenia, making it more and more inevitable to reinstate more stringent measures again. Therefore, the decline in the gross domestic product could be more profound than presented in the current projection and the recovery from the crisis slower.

In its Autumn Forecast, IMAD predicts a 6.7% decline in GDP in 2020, followed by a swift but fragile recovery in 2021 and 2022, when gross domestic product is projected to grow by 5.1% and 3.7%, respectively. The pace of recovery will highly depend on the likelihood of new outbreaks, consumer and business confidence, the situation in Slovenia's main trading partners as well as the extent and efficiency of government support measures to support the restart of economic activity. This year, a decline in value-added will be observed for most economic activities, in particular in tourism, recreational, sports, cultural and personal services, and transport. In 2021 and 2022, manufacturing activities are expected to recover most spurred by foreign demand. Also, construction is projected to recover relatively quickly supported by funds from the EU Recovery and Resilience Facility. On the other hand, the potential prolongation of social distancing measures in the following year might jeopardise the recovery of several service activities.

Due to the high degree of uncertainty in the domestic and international environment, the investment will decline substantially this year, particularly gross fixed capital formation (-13.0%). Similarly, a significant drop in external trade is expected due to the worldwide epidemic proportions. Private consumption is projected to drop by 6.6% this year as a consequence of social distancing, lockdowns and precautionary saving. Under the assumption that new significant activity shutdowns are not required anymore, investment, private consumption, and external trade are projected to resume growth in 2021.

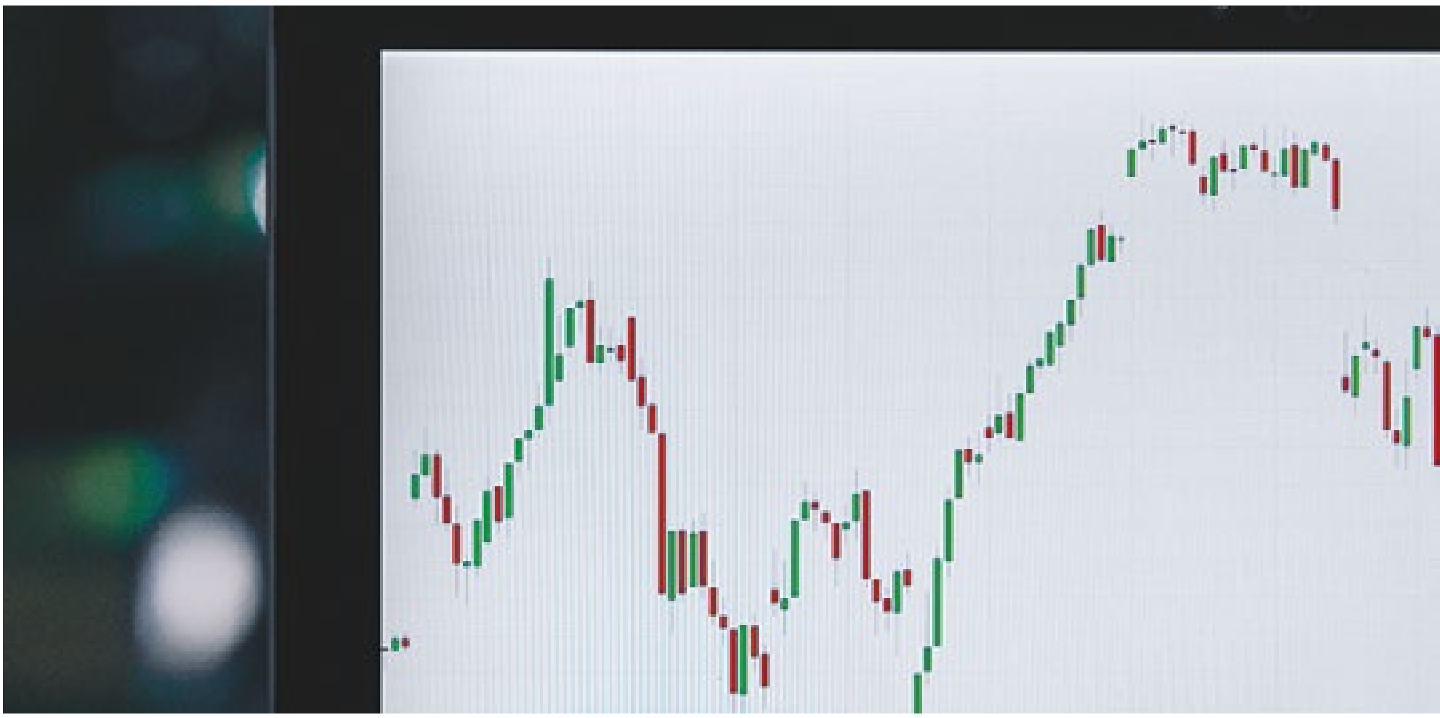
The LFS unemployment rate is estimated to stand at 5.6% and 5.4% in 2020 and 2021, respectively, and would decrease more markedly in 2022. It would have been much higher in the absence of anti-Covid-19 measures which have significantly mitigated the deterioration in labour market conditions.

Due to the comprehensive packages of measures adopted to alleviate the negative consequences of the epidemic, government consumption will strengthen this year, and the general government balance will turn negative. 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%).

Table SI2 Summary of projections

	2021	2022	2023
Real GDP (% change)	**5.1**	**3.7**	**N/A**
Real private consumption (% change)	4.7	3.0	N/A
Real government consumption (% change)	1.0	1.3	N/A
Real investment (% change)	N/A	N/A	N/A
Real gross fixed capital formation (% change)	11.0	8.5	N/A
Exports of goods and services (constant prices, % change)	9.3	6.6	N/A
Imports of goods and services (constant prices, % change)	9.6	6.8	N/A
Current account balance (% of GDP)	6.3	6.3	N/A
Consumer prices (% change, pa)	1.6	1.9	N/A
Exchange rate, national currency/EUR (pa)	1.181	1.181	N/A
Unemployment rate (LFS, %, pa)	5.4	4.8	N/A
General government balance (ESA 2010 definition, % of GDP)	-2.1	N/A	N/A
Total domestic credit (% change, eop)	N/A	N/A	N/A

Source: Institute for Macroeconomic Analysis and Development – Autumn Forecast of Economic trends 2020, and IMF – World Economic Outlook, April 2020.



ANALYSIS

COVID-19: Stock Market Reactions in SEE countries

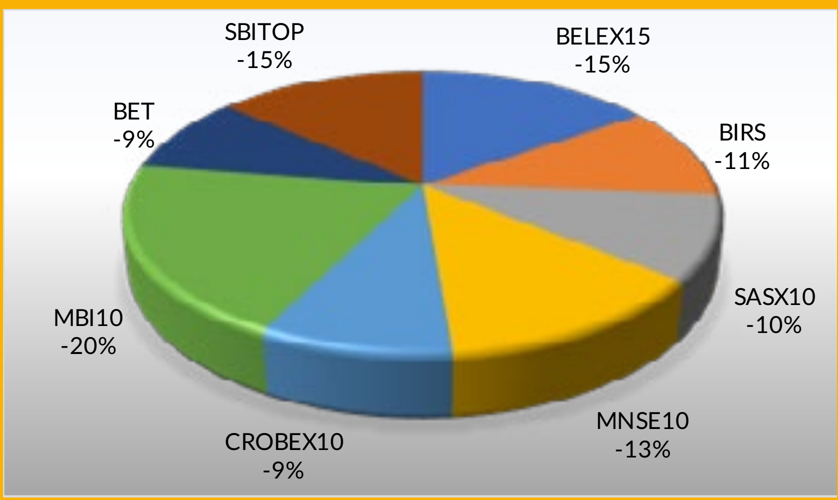
Within this issue of SEE-6 Economic Outlook, it will be shown the impact of the COVID-19 virus pandemic on the stock markets in SEE countries. The outbreak of the COVID - 19 pandemic has disturbed the financial markets all over the world. The World Health Organization (WHO) officially declared a global pandemic on March 11, 2020. Since then, according to the International Monetary Fund (IMF), world stock exchanges have reacted aggressively loosing about 16 USD billion over the less than two months. COVID-19 related economic fallout represents one of the largest market declines in the rich history of the global stock market.

The impact of the COVID-19 pandemic on the stock exchange in SEE countries will be analysed through the movement of values of the key stock exchange indices - movement direction, duration of the bear market, as well as time required to return to pre-crisis levels. For the analysis, we selected the key stock indices in the SEE countries, as follows:

- Bosnia and Herzegovina – The Stock exchange index of Republic of Srpska - BIRS and Sarajevo stock exchange index 10 – SASX10,
- Croatia - CROBEX10,
- Montenegro – MNSE10,
- North Macedonia - MBI10,
- Romania - BET,
- Serbia - BELEX15
- Slovenia – SBITOP.

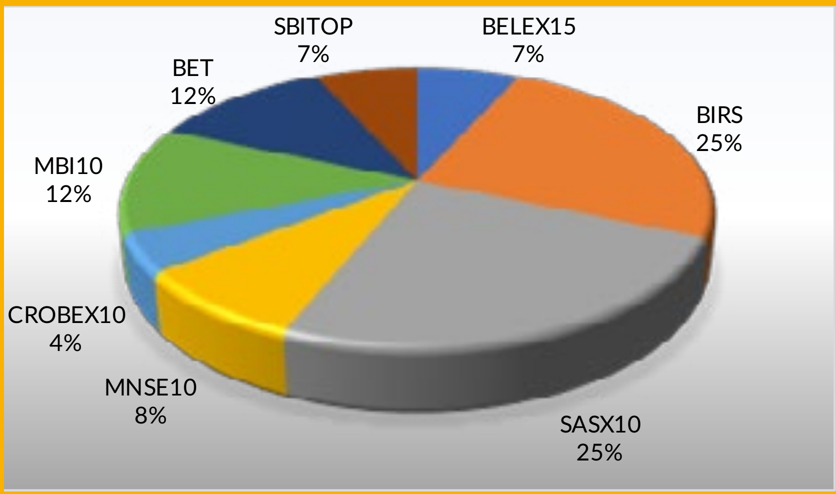
Under the influence of the COVID-19, stock markets in the observed seven SEE countries have fallen by an average of 15.7% since the outbreak of the global pandemic (as soon as it has officially started by the WHO). The largest market decline could be observed in Montenegro -24.9%, Serbia -19.4% and Slovenia -17.2%. Observed indices experienced a slightly lower drop-off in Croatia -11.1% and Romania -11.4%.

Graph: How big was the sell-off of indices at the stocks market in WB?



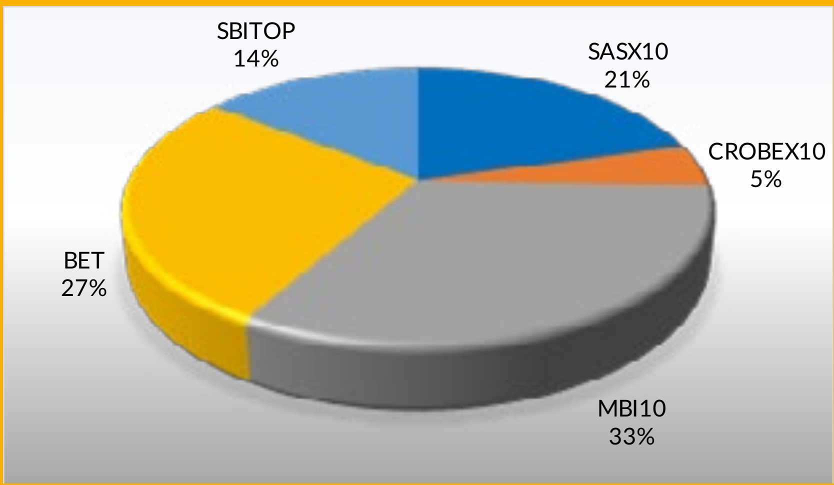
If the duration of the market decline is observed, it could be noticed that COVID-19 has not had a very long impact on the decline in stock prices. Croatian stock market index recorded its lowest value only eight days since the crisis outbreak. In contrast, markets in Serbia and Slovenia required for about twelve days to hit the bottom levels. Both indices in Bosnia and Herzegovina recorded the lowest pandemic value around 44 days after the crisis onset.

Graph: How many days COVID-19 take to the bottom?



Stock markets in the observed countries have relatively quickly returned to the pre-pandemic values, except for Serbia, Bosnia and Herzegovina (Banja Luka stock exchange and Sarajevo stock exchange) and Montenegro, where stock markets did not even reach pre-pandemic levels by November. Croatian market index recovered only about 26 days after the onset of the crisis. Among the observed markets that successfully recovered, North Macedonian index – MBI10 took the longest to reach the pre-crisis value.

Graph: How many days did take for the market to recover to the pre-crisis value?



Analysis of the financial markets in the SEE countries has shown that the situation has, in no small extent, stabilised concerning the sharp decline that occurred immediately after the pandemic onset. However, regardless of the noticeable signs of stabilisation, it is challenging to objectively assess whether the crisis has passed, bearing in mind that the pandemic has continued. This is particularly important to underline due to the specific cause of the decline. Pandemics are considered to be exogenous shocks whose effects are spreading through the economic system, and could still cause significant economic uncertainties and market fluctuations. Additionally, taking into account the countercyclical policy measures, primarily aimed at improving market liquidity, provided in the form of loans that need to be paid back, economies and financial markets in the observed SEE countries, are still facing a period of significant risks and uncertainties.

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