SEE-6

Economic Outlook

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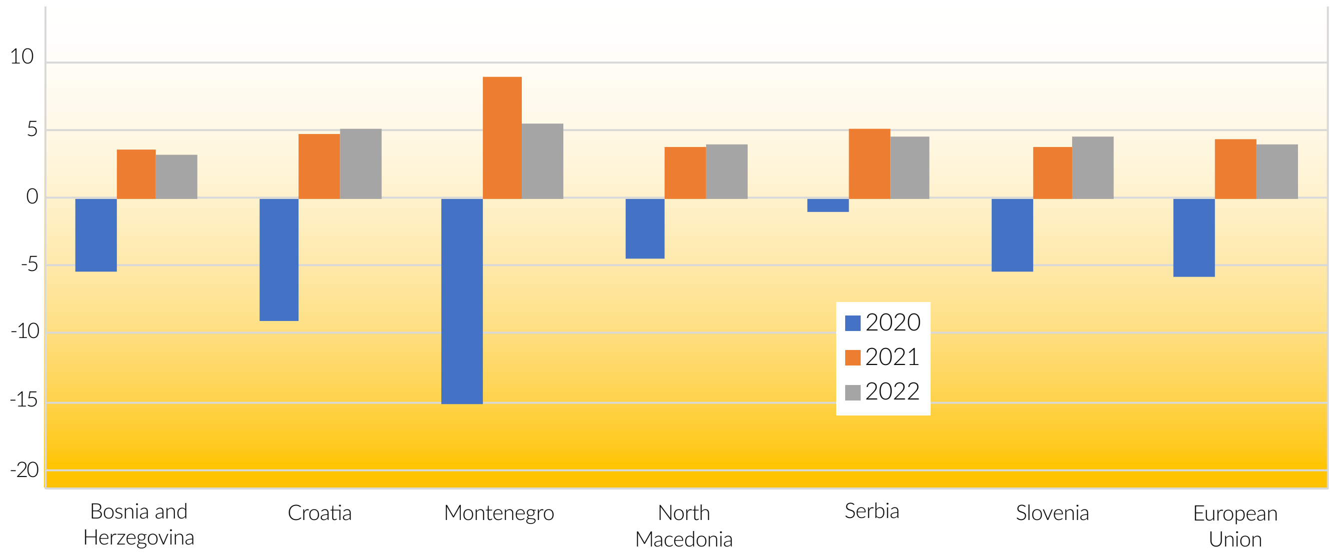
CONTENT

REAL GDP GROWTH FOR SELECTED SEE COUNTRIES AND EU-28



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

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BOSNIA AND HERZEGOVINA

Gradual economic recovery in the second half of 2020

Institutional weaknesses and delays in implementing key regional connectivity projects remain the key factors undermining the country's attractiveness to the private sector

Before starting the COVID-19 pandemic, the macroeconomic situation was stable, and the outlook was favourable. BiH was able to achieve macroeconomic stabilisation and improve internal and external imbalances. Growth in economic activity was nearing its potential, supported by rising public infrastructure investments and external demand. However, economic growth was below the pace needed to speed up convergence with the European Union. The unemployment rate, while declining, remained high among youth and women.

The pandemic has had severe adverse effects on the economy and the population. Following stabilisation of daily cases during the previous summer, daily infections have been at high levels since the onset of the second wave, and the death rate has been exceptionally high. Economic activity has been severely impacted by the health restrictions put into place to contain the pandemic, which led to a substantial contraction in demand. Tourism has been brought to a standstill, and remittances from abroad have plummeted.

Fiscal buffers accumulated in recent years enabled a rapid and robust fiscal response to the pandemic and its aftermath. Related measures included

substantial support to the health sector, sizable financial support to severely affected firms, and increased unemployment spending. In addition, loan moratoria were introduced to ease liquidity constraints, and credit guarantees have been put in place to help reduce borrowing costs and ensure the continued flow of bank credit to hard-hit sectors.

The authorities have made some progress in improving the business environment and enhancing the functioning of the labor market. However, institutional weaknesses, particularly at the State level, a weak rule of law, poor public infrastructure quality, and delays in implementing key regional connectivity projects remain the key factors undermining the country's attractiveness to private sector development and foreign investments.

A sharp drop in growth in 2020 as a result of the decline in aggregate supply and aggregate demand

Data on GDP trends indicate that these developments in the main trading partners and the introduction of "lockdown" negatively impacted economic trends in Bosnia and Herzegovina. Namely, according to BHAS data, in 2020, Bosnia and Herzegovina recorded a decline in GDP of -4.2% compared to 2019. The registered rates were observed by quarters: Q1 2020: 1.8%, Q2 2020: -9.3%, Q3 2020: -6.3% and Q4 2020: -3.8% compared to the same period last year. Let's look at the structure of economic trends in 2020. It can be stated that the decline in GDP in Bosnia and Herzegovina is a consequence of the simultaneous decline in both aggregate supply and aggregate demand, which is the main feature of the negative economic impact of the global Covid-19 pandemic. Bearing in mind that Bosnia and Herzegovina is almost entirely oriented towards the markets of EU countries and the region in terms of foreign trade, it is not surprising that this segment of the economy has been hit hardest by the crisis caused by the pandemic.

According to the data for Q4 2020 (unlike the previous 3 quarters), there was a halt in negative trends within specific macroeconomic indicators, at least when it comes to the production and export sector. Thus, according to BHAS data, in the fourth quarter of 2020 in Bosnia and Herzegovina, there was an increase in the physical volume of industrial production of 5.3% and the first quarter of 2021 of 2.8% compared to the same quarter last year. It is especially worth noting that in December 2020, the manufacturing industry recorded a growth of 6% compared to the same month last year.

After a slight increase in the first two quarters of 2020, the unemployment rate stabilised at pre-pandemic levels

After the unemployment rate rose slightly in the first semester of 2020 due to the emergence of Covid-19, in the third and fourth quarters of 2020 the unemployment rate stabilised at around 16%. However, at the end of 2020 unemployment rate (15.9%) did not change significantly compared to 2019 (15.7%). In the third quarter of 2020, the average number of employees in Bosnia and Herzegovina was 1,210,000 which is 4.4% more than in the second quarter of 2020. However, in the fourth quarter of 2020, the number of employees decreased compared to the third quarter by 2.8%. At the same time, the average number of unemployed in the fourth quarter increased (17.5%) compared to the third quarter of 2020. The most significant decline in employment in the second half of 2020 occurred in the activities of the processing industry, activities of providing accommodation and preparation and serving of food (hotel and catering), wholesale and retail trade, and transport and storage.

Deflation was recorded in the second semester of 2020 and the first quarter of 2021

In December 2020 deflation measured by the consumer price index in Bosnia and Herzegovina amounted to 1.6% compared to December 2019. In the period I-XII 2020 deflation amounted to 1.1%. In the observed period, the decrease in prices was recorded in the sections of clothing and footwear, furniture, household appliances and regular maintenance of the house, the section of the housing, water, electricity, energy, gas and other energy sources as the transport section. Prices in the clothing and footwear section are lower by 10% (yoy). Prices in the transport section decreased by 8.6% (yoy). Prices in the furniture section, household appliances and regular maintenance of the house were decreased by 1.1% (yoy), and prices in the housing, water, electricity, energy, gas and other energy sources decreased by 0.4% (yoy). The fall in prices in these sections had a significant deflationary effect on the overall price level.

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 2019 was further intensified in 2020 due to the spread of the pandemic virus Covid-19. The intensification of the Covid-19 pandemic had a very negative impact on world trade and, therefore, on the international trade of goods in Bosnia and Herzegovina. Thus, in 2020 Bosnia and Herzegovina recorded a decline in total foreign trade by over 10% compared to the previous year, which is a consequence of the simultaneous decline in exports of goods by 8.5% and imports of goods by 13.2%.

On the other hand, if the data on foreign trade are observed more carefully in the last few months, it can be concluded that there has been a slight stabilisation compared to the first half of the year. However, foreign trade indicators are still in negative territory. Such trends in foreign trade implicitly indicate that there was a simultaneous decline in aggregate supply and aggregate demand during the observed period in Bosnia and Herzegovina. Namely, the decline in aggregate supply and export demand resulted in a decline in merchandise exports. In contrast, the weakening of domestic demand led to a decline in private consumption and investment, which led to a decline in imports of goods into Bosnia and Herzegovina.

After budget deficits in the first two quarters of 2020, the budget surplus was registered in the third quarter of 2020

In the third quarter of 2020 government finances improved and the budget surplus was realised again. Revenues increased by 15%, while expenditures increased by 1.3% compared to the second quarter of 2020.[1] The increase in revenues was mainly due to an increase indirect taxes. All of the above led to a slight budget surplus of BAM 9 million at the end of the third quarter of 2020. There was a slight increase in domestic government debt (3.7%) and a minor increase in foreign government debt (0.1%) at the end of the third quarter of 2020 compared to the second quarter of 2020.

1 Unfortunately, there is no data on government finances at the time of writing this review.

Table BH1 Main economic indicators

	Total 2019 year	2020				Total 2020 year
		Q1	Q2	Q3	Q4	
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**2.4**	1.8	-9.3	-6.3	-3.8	**-4.2**
Real private consumption (% change, yoy)	**2.7**	0.4	-8.6	-3.1	-4.5	**-4.0**
Real government consumption (% change, yoy)	**0.9**	0.6	0.4	0.3	0.2	**0.4**
Real investment (% change, yoy)	**4.7**	-1.7	-25.2	-13.0	-9.7	**-12.4**
Industrial output (% change, yoy)	**5.5**	-4.1	-10.7	-2.6	5.3	**-2.0**
Unemployment rate (registered, % pa)	**15.7**	16.7	16.0	14.2	16.6	**15.9**
Nominal GDP (EUR million)	**18,239**	4,517	4,339	4,484	4,562	**17,902**
GDP per capita (EUR)	**5,211**	1,290	1,239	1,281	1,303	**5,114**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**1.2**	1.1	1.1	1.1	1.1	**1.1**
Consumer prices (% change, yoy, pa)	**0.6**	0.4	-1.7	-1.3	-1.6	**-1.1**
Producer prices (% change, yoy, pa)	**0.5**	-1.0	-1.6	-1.3	-0.9	**-1.2**
Average gross wage (% change, yoy, pa)	**4.3**	4.7	3.1	3.9	3.7	**3.9**
Exchange rate (BAM/EUR, pa)	**1.96**	1.96	1.96	1.96	1.96	**1.96**
Exchange rate (BAM/USD, pa)	**1.74**	1.77	1.77	1.67	1.60	**1.70**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**5,862**	1,340	1,184	1,340	1,499	**5,364**
Exports of goods (EUR, % change, yoy)	**-3.4**	-5.2	-24.1	-7.3	-3.9	**-8.5**
Imports of goods (EUR million)	**9,923**	2,187	1,904	2,194	2,328	**8,615**
Imports of goods (EUR, % change, yoy)	**1.0**	-7.1	-27.7	-11,2	-5.4	**-13.2**
Current account balance (EUR million)	**-554**	-159	-122	-170	-104	**-556**
Current account balance (% of GDP)	**-3.0**	-4.3	-2.7	-3.8	-2.3	**-3.1**
Foreign Direct Investment net inflows (EUR million)	**420**	124	72	52	N/A	**N/A**
Foreign exchange reserves (EUR million, eop)	**6,426**	6,357	6,644	6,808	7,076	**7,076**
Foreign debt (EUR million, eop)	**4,127**	4,154	4,421	4,422	4,432	**4,432**
GOVERNMENT FINANCE						
Revenues (BAM million)	**12,923**	3,081	2,815	3,236	N/A	**N/A**
Expense (BAM million)	**11,833**	2,818	3,187	3,227	N/A	**N/A**
Net = Gross operating balance	**1,100**	263	-372	9	N/A	**N/A**
Net acquisition of non-financial assets (BAM million)	**387**	40	102	96	N/A	**N/A**
Net lending/borrowing (BAM million)	**703**	223	-473	-88	N/A	**N/A**
Domestic government debt (EUR million, eop)	**779**	829	1,085	1,126	N/A	**N/A**
Foreign government debt (EUR million, eop)	**5,098**	5,109	5,382	5,390	N/A	**N/A**
Total government debt (eop. % of GDP)	**23.0**	N/A	N/A	N/A	N/A	**24.8**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**9.1**	12.9	11.7	11.4	13.6	**13.6**
Broad money, M4 (% change, yoy, eop)	**8.8**	8.8	6.9	6.3	7.3	**7.3**
Total domestic credit (% change, yoy, eop)	**6.6**	3.7	0.8	-0.4	-2.0	**-2.0**
DMBs credit to households (% change, yoy, eop)	**7.9**	5.3	1.9	0.7	-0.8	**-0.8**
DMBs credit to enterprises (% change, yoy, eop)	**4.7**	0.9	-2.6	-3.2	-4.9	**-4.9**
Money market interest rate (%, pa)	**3.3**	3.1	3.0	N/A	N/A	**N/A**
DMBs credit rate for enterprises short-term (%, pa)	**3.9**	3.8	3.8	3.7	3,7	**3.7**
DMBs credit rate for households short-term (%, pa)	**4.4**	3.7	3.7	4.1	3.2	**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 2021. Therefore, the precondition for realising these projections is overcoming the new circumstances in the short term, improving the international economic environment, and implementing structural reforms in the country and assuming the materialisation of these circumstances according to the projections in 2022 - 2023. Bosnia and Herzegovina are expected to continue the trend of economic growth of about 3% annually (2022: 3.1% and 2023: 3.2%). It is assumed that the key pillar of economic growth during this period should represent domestic demand. Thus, in the period 2022-2023, private consumption is expected to grow at an average rate of about 2% (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 2002-2023, with annual growth rates of 5.8% and 6.7%, respectively. The current account deficit (as a share of GDP) could be expected to remain at approximately the same level (in the range of -2.8% to -3.3% of GDP) for the period 2022-2023. Assuming food prices rise moderately, as do prices utilities, a price increase of 1.3% -1.4% could be expected in the period 2022-2023. 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

	2022	2023	2024
Real GDP (% change)	**3.1**	**3.2**	**N/A**
Real private consumption (% change)	1.9	2.1	N/A
Real government consumption (% change)	0.7	0.5	N/A
Real investment (% change)	8.1	7.7	N/A
Exports of goods and services (constant prices, % change)	5.8	6.7	N/A
Imports of goods and services (constant prices, % change)	4.5	5.1	N/A
Current account balance (% of GDP)	-2.8	-3.3	N/A
Consumer prices (% change, pa)	1.3	1.4	N/A
Exchange rate, national currency/EUR (pa)	1.96	1.96	1.96
Unemployment rate (registered, %, pa)	N/A	N/A	N/A
General government balance (ESA 2010 definition, % of GDP)	N/A	N/A	N/A
Total domestic credit (% change, eop)	3.2	7.0	N/A

CROATIA

Contraction of GDP in 2020 among highest in the EU

Economic fall in 2020 high, but more or less in line with expectations

Estimates of the Croatian GDP fall in 2020 caused by COVID-19 seem to be in line with the previous official expectations and analyst forecasts. The first estimates of the Croatian Bureau of Statistics (end of February 2021) are -8.4%, while the latest Government forecast anticipated it at around -8.0%. Nevertheless, this contraction of the economy is among the highest in the EU member states. According to the Spring European Economic Forecast 2021 of the European Commission, only Spain, Italy, Greece, and France have a higher fall. Like Croatia, these countries have experienced immense loss of earnings from tourism due to travel restrictions caused by the coronavirus. On top of the pandemic, two devastating earthquakes hit Croatia in 2020.

The impact of a pandemic on economic activities was less severe in the third and fourth quarter of 2020 when partial recovery of economic activities started on the wings of a much better tourist season than previously expected and well as recovery of exports of goods. According to the Croatian Bureau of Statistics, the economic fall in the third quarter was at the level of -10% (y-o-y), while in the fourth quarter, the GDP fell by -7% (y-o-y).

Impact of the COVID-19 on the economic activities in 2020

As elsewhere in the EU, the negative economic impact of COVID-19 in 2020 was rather massive, especially in the first half of 2020 when the total economic lockdown was in place in Croatia for several weeks. It mainly manifests in the sharp fall of private consumption, exports, imports, industrial production, and the service sector, with particular impact on the tourist sector and travelling.

The negative impact of a pandemic on the economy was weaker in the second half of 2020. The economy started to recover, primarily due to better results of the tourist sector, partial recovery of exports of goods, and industrial sector production.

Private consumption decreased dramatically in the first half of 2020 and partially recovered in the third (Q3) and fourth (Q4) quarter of the year. The continuous government job-keeping support measures, moratorium on bank loans for those out of work and revival of the economic activities considerably buffered the further fall of household income in this period. The improved opportunities for work during the tourist season also brought fewer income uncertainties for some households. All these resulted in a less profound fall of the private consumption in Q3 and Q4 by significantly weaker rates of -7.5% and -4.5%, respectively.

The real government consumption continued to grow in the Q3 and Q4 of 2020, by the rates of 1.5% and 1.6%, respectively. Generally, the public sector operated without significant cuts. At the same time, expenditures increased primarily due to the health sector fighting with the pandemic and the continued need for job keeping and liquidity subsidies directed to the business sector and citizens.

Owing to EU funds, the public investments continued to impact the total economic recovery positively, as they significantly buffered a massive fall of private investments. The fall of total investments was, therefore, in Q3 at the much milder rate of -3.0%. In contrast, in the fourth quarter, total investments even recorded a growth rate of 4.2%, mainly owing to some large on-going projects such as Pelješac Bridge and other infrastructure projects. On a more positive note, the last quarter of 2020 also showed a partial recovery of private investments.

Recovery of both exports and imports in the second half of 2020

The second half of 2020 brought a significant recovery of exports of goods, which experienced a rather severe contraction in the second quarter of 2020. The fall of exports of goods in Q3 was by further -3.0% compared to a year before. In comparison, in the Q4, it even experienced a growth rate of 2.6% yoy, positively contributing to further economic recovery. The recovery of exports in Q4 was led mainly by the exports of capital goods (such as various specialized industrial machinery, electrical machinery, apparatus and appliances) and medical and pharmaceutical products, oil and refined petrol products, and electricity.

On the other hand, the imports of goods recovered at a much slower pace due to decreased demand for intermediate products. Nevertheless, the fall of imports in the second half of 2020 was less profound than in Q2. In the third quarter, the imports of goods fell by further -9.9%, while in the Q4 the imports experienced a much milder fall at the rate of -3.6%, compared to the previous year. In the last two quarters of 2020, road vehicles, metal and textile products, as well as food products dominated the imports of goods.

The exports of the services also experienced a partial recovery due to a better tourist season than anticipated, especially in the third quarter of 2020. However, it stayed negative in the Q4 due to the significant fall of foreign tourists spending by 57.7% yoy, according to Croatian National Bank.

All these developments had a favourable impact on the current account. According to Croatian National Bank, it significantly improved its balance from deficit into a slight surplus of 0.1 billion euro at the end of the last quarter of 2020.

Industrial output also started to recover

The negative impact of the pandemic on industrial output was very significant throughout 2020, with a most dramatic fall in the second quarter at a rate of -8.5% compared to the same period in a year before. In the third quarter, the industrial output recovered considerably along with the gradual opening of the economy after the lockdown, resulting in a much lower fall at the rate of -0.7%. In the last quarter of 2020, industrial production recovered further and went back to a very modest positive rate of 0.1%. The industries that most contributed to the positive growth rate in Q4 are predominantly exporting ones such as chemical, pharmaceutical, metal, ICT, as well as electronic machinery and electrical appliances industry.

Employment levels mostly preserved

Pandemic outbreak and consequent economic lockdown had initial negative effects on the labour market in Croatia. However, these effects were much stronger in the first half of 2020, while the second half of the year brought some stabilization of labour market and even some slight increase of the number of employed as the result of the economic recovery in several sectors. The government job-keeping measures that continued throughout the second half of the year also contributed significantly to preserving current employment levels.

Because of both developments, the rate of registered unemployment has fallen to 8.8% in the third quarter, owing partly to increased seasonal employment during the summer tourist season. However, due to reintroduced travel and business restrictions related to the second wave of the pandemic, that demand decreased, and the rate of registered unemployment has increased back to 9.2% in the fourth quarter of 2020. For the whole of 2020, the first estimation of the registered unemployment is 8.9%, which is lower than initially anticipated.

The negative developments in the labour market were very much neutralized by introducing government job-preservation financial support measures after the pandemic outbreak. In the second half of 2020, the Government better targeted such measures and scaled them concerning the extent of the fall of economic activities of the certain enterprise sector. According to the Croatian National Bank, the total amount of job preservation financial support directed to the business sector in Croatia is in 2020, about 7.5 billion HRK, which is about 2.1 % of the GDP.

Profound fiscal deficit in 2020

Fighting the pandemic had a significant toll on the fiscal health of the Croatian economy, which has returned to the levels of budget deficits that were present five-six years ago and offset the hard-gained fiscal balance completely. Namely, according to the Ministry of Finance, in 2020 total consolidated Budget deficit reached -8.0%, however, a bit better than the expected -8.9%. General government balance reached in 2020 is -7.4%. Nevertheless, fiscal interventions proved prudent to keep the economy alive during the most challenging pandemic waves.

The total expenditures increased considerably. According to the latest data of the Croatian Ministry of Finance from April 2021, the total fiscal effects of COVID-19 support measures to the citizens and business sector amounted to around 14.1 billion HRK (3.8% of GDP). The dominant part of the increased expenditures the Government has financed through new loans and only partly by the careful redistribution of the other envisaged budget expenditures. Consequently, the significant impact of the pandemic is an enormous increase of the general government debt, which by the end of 2020 reached the level of 88.7% of the GDP, which is up 16.1 percentage points compared to pre-pandemic 2019.

Consumer prices fell sharply due to deflationary pressures

As a consequence of pandemic impacts both on the demand and supply side, the Consumer prices index (CPI) has been falling and had negative rates throughout the rest of 2020, with a most profound decrease in the third quarter (-1.3%). The pandemic's deflationary effects primarily affected energy prices for both consumers and producers primarily due to the dramatic fall of oil prices at the world market and a consequent fall of petrol prices at the domestic market. Prices of services also decreased due to lack of demand and lockdown restrictions related to travelling, transport and communication in general.

On the other side, the prices of food and other existential products have risen considerably (1.8% in the whole of 2020), offsetting some of the falls in prices of other goods and services, especially in the last quarter of the year. The first estimates of the CPI rate for 2020 are thus at 0.1%, with prospects of a further increase in 2021.

Table HR1 Main economic indicators

	Total 2019 year	2020 Q1	2020 Q2	2020 Q3	2020 Q4	Total 2020 year
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**2.9**	0.2	-15.4	-10.0	-7.0	**-8.4**
Real private consumption (% change, yoy)	**3.6**	0.7	-14.0	-7.5	-4.5	**-6.2**
Real government consumption (% change, yoy)	**3.3**	4.7	0.5	1.5	1.6	**3.4**
Real investment (% change, yoy)	**7.1**	3.1	-14.7	-3.0	4.2	**-2.9**
Industrial output (% change, yoy)	**0.9**	-2.3	-8.5	-0.7	0.1	**-3.4**
Unemployment rate (registered, % pa)	**7.9**	8.5	9.3	8.8	9.2	**8.9**
Nominal GDP (EUR million)	**53,969**	12,085	11,314	13,483	12,343	**49,159**
GDP per capita (EUR)	**13,270**	2,978	2,845	3,332	3,050	**12,141**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**1.5**	1.0	0.3	-0.3	0.2	**0.4**
Consumer prices (% change, yoy, pa)	**0.8**	1.4	-0.3	-1.3	-0.3	**0,1**
Producer prices (% change, yoy, pa)	**1.3**	0.6	-4.0	-2.9	-2.0	**-2.1**
Average gross wage (% change, yoy, pa)	**4.0**	6.2	3.9	5.1	5.3	**5.1**
Exchange rate (HRK/EUR, pa)	**7.41**	7.48	7.53	7.52	7.55	**7.53**
Exchange rate (HRK/USD, pa)	**6.62**	6.78	6.89	6.44	6.34	**6.61**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**12,836**	3,683	3,218	3,797	4,178	**14,878**
Exports of goods (EUR, % change, yoy)	**4.3**	1.4	-10.4	-3.0	2.6	**-2.9**
Imports of goods (EUR million)	**24,856**	6,100	5,052	5,702	5,909	**22,750**
Imports of goods (EUR, % change, yoy)	**5.0**	-0.9	-24.5	-9.9	-3.6	**-8.1**
Current account balance (EUR million)	**1,520**	-1,443	-510	1,948	-375	**-379**
Current account balance (% of GDP)	**2.8**	-3.9	-3.5	14.2	-3.0	**-0.8**
Foreign Direct Investment net inflows (EUR million)	**-24,082.7**	-24,409.3	-24,339.3	-25,115.6	-24,082.7	**-24,409.3**
Foreign exchange reserves (EUR million, eop)	**18,562**	16,425	17,257	18,372	19,165	**18,943**
Foreign debt (EUR million, eop)	**40,877**	40,537	41,621	41,283	40,624	**40,624**
GOVERNMENT FINANCE						
Revenues (HRK million)	**190,912**	41,743	40,651	45,780	50,285	**178,459**
Expense (HRK million)	**189,713**	46,158	51,562	50,204	58,034	**205,958**
Net = Gross operating balance	**1,399**	-5,600	-10,161	-4.286	-8,048	**-27,225**
Net acquisition of non-financial assets (HRK million)	**200**	1.185	-750	138	299	**274**
Net lending/borrowing (HRK million)	**1,199**	-4,415	-10,911	-4,424	-7,749	**-27,499**
Domestic government debt (EUR million, eop)	**25,711**	26,471	28,722	29,081	29,710	**29,710**
Foreign government debt (EUR million, eop)	**12,831**	13,477	15,106	14,063	14,072	**14,072**
Total government debt (eop. % of GDP)	**72.8**	75.2	85.3	87.2	87.7	**88.7**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**14.3**	17.2	18.0	14.9	17.0	**17.0**
Broad money, M4 (% change, yoy, eop)	**2.9**	8.8	8.7	6.5	9.3	**9.3**
Total domestic credit (% change, yoy, eop)	**4.2**	5.0	3.3	4.1	3.9	**3.9**
DMBs credit to households (% change, yoy, eop)	**7.4**	6.1	3.7	4.2	2.1	**2.1**
DMBs credit to enterprises (% change, yoy, eop)	**1.8**	4.2	4.1	5.0	6.0	**6.0**
Money market interest rate (%, pa)	**0.4**	0.3	0.3	N/A	N/A	**N/A**
DMBs credit rate for enterprises short-term (%, pa)	**2.8**	2.9	2.8	2.8	2.8	**2.8**
DMBs credit rate for households short-term (%, pa)	**6.5**	8.1	7.9	8.0	6.6	**7.6**

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

Strong economic recovery envisaged in 2021 and 2022

The cautious official projections of economic growth for 2021 have recently revised their expectations significantly upward due to faster economic recovery pace in several sectors. The most recent Croatian National Bank projections anticipate the recovery of economic growth in 2021 at the rate of 5.9%, much higher than previously expected (December 2020 projections were at 4.9%), while the Ministry of Finance forecasts from April 2021 envisage the growth rate of 5.2%. European Commission anticipates that the GDP in 2021 will grow by 5.0%, while the World Bank's 2021 projections are less optimistic with a growth rate of 4.7%.

With the start of vaccination at the beginning of 2021, growth prospects have begun to look more realistic. The last projections of growth by the Government of Croatia at the end of April 2021 anticipate a robust growth rate of 6.6% in 2022, followed by 4.1% in 2023 and 3.4% in 2024. This optimism rests mainly on 6.3 billion euro of available EU funding that should come through the Program of Recovery and Resilience that the Government adopted at the end of April 2021. In its Spring Economic Forecast 2021, the European Commission envisages a growth rate of 6.1% in 2022, while the forecast for 2023 is presently non-available. In its recent spring 2021 forecasts, the World Bank anticipates a growth rate of 4.9% in 2022, followed by 4.0% in 2023. However, it is essential to mention that the international organizations did not consider the generous funding in the form of grants envisaged through the EU Recovery and Resilience Facility. Nevertheless, all of these forecasts are very much dependent on developments related to efficient restrain of the pandemic, so the government prognosis apart from the baseline scenario has also a scenario with prevailing negative risks. Most analysts agree that pandemic would be with us much longer than initially expected, so it is realistic to expect frequent revisions of growth prospects accordingly.

Table HR2 Summary of projections

	2022	2023	2024
Real GDP (% change)	**6.6**	**4.1**	**3.4**
Real private consumption (% change)	4.0	3.7	3.6
Real government consumption (% change)	2.2	2.2	2.3
Real investment (% change)	18.0	8.5	4.5
Exports of goods and services (constant prices, % change)	15.8	6.1	3.9
Imports of goods and services (constant prices, % change)	14.7	6.7	4.2
Current account balance (% of GDP)	0.9	2.2	2.3
Consumer prices (% change, pa)	1.7	2.0	2.3
Exchange rate, national currency/EUR (pa)	7.52	7.53	7.53
Unemployment rate (registered, %, pa)	8.0	7.6	7.2
General government balance (ESA 2010 definition, % of GDP)	-2.6	-1.9	-1.5
Total domestic credit (% change, eop)	3.0	3.3	3.4

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

The tourist sector, which was heavily affected by the pandemic in 2021, is expected to further recover in 2021 owing to planned progress of vaccination, the introduction of EU digital COVID passes and stronger economic recovery. The Government anticipates an increase of visits of foreign tourists by 40% compared to 2020, which is still about 60% of achieved in the record 2019. However, this result would be entirely dependent on the situation with combating the pandemic in Europe and other important markets where tourists come from. From all we know now, swift recovery is not on sight, and the travel and tourist industry might likely take several years to recover to the levels before the pandemic.

The private consumption further recovery in 2021 is more realistic now, on the wings of strengthening of purchasing power of households due to further income tax cuts and an increase of minimal wage, in effect from January 2021. The official prognosis is quite optimistic, and expect the recovery at solid 5.1% in 2021, followed by 4.0% in 2022, 3.7% in 2023 and 3.6% in 2024. International organizations, however, anticipate moderate recovery due to significant change in consumer habits and many uncertainties related to stronger post-pandemic economic recovery. The World Bank remains less optimistic than the Croatian Government and anticipates the rates of private consumption recovery at a modest 2.8% for 2021, following by 3.0%, both in 2022 and 2023. According to them, the most vulnerable portion of the population at the brink of poverty has increased in 2020 caused by unemployment and other losses of income and general welfare. Their purchasing power would stay very limited in the future.

The government consumption would continue to have a positive contribution to GDP growth in times ahead. The official projections expect its further growth in 2021 at the rate of 2.7%, with growth by 2.2% envisaged in 2022 and 2023, followed by 2.3% in 2024. The government consumption would further increase because of the rise of expenditures for the health sector and increased social transfers for workers in the business sector during pandemics and socially vulnerable groups and pensioners.

The Government expects strong rise of consumer prices by 2.0% in 2021. The expected rise of energy prices, which is already significant in the petrol market, would most likely be a most significant contributor to the rise of CPI index growth. Another source of the strong rise of the inflation rate in 2021 is continued growth of food prices. The Government anticipates that the inflation rate would continue to grow by 1.7% in 2022, 2.0% in 2023 and by a further 2.3% in 2024.

As the economic recovery gains stronger momentum, the level of investments would further strengthen in 2021, primarily owing to the anticipated growth of public investments. On the other side, the private investments, which especially plummeted in 2020, would also recover significantly on the wings of economic recovery and restored business optimism. The Government envisages real investments to grow by a further 6.1% in 2021, while it expects a solid rate of real investments of 18% in 2022, followed by 8.5% in 2023 and 4.5% in 2024. The large ongoing infrastructure projects such as Pelješac Bridge and planned post-earthquake reconstruction in Zagreb and Banija region would enable further growth of real public investments. The EU funding would be the main contributor to a strong rate of investments in the coming years. The EU Recovery and Resilience Facility assigned 6.3 billion of Euro to Croatia in the form of grants to mitigate negative pandemic effects on the economy. In addition to those funds, the EU supports the rebuilding of Zagreb with 684 million Euro from EU Solidarity Fund and close to 300 million euro expects approval to reconstruct houses and businesses in the Banija region.

The Government has positive expectations related to further significant recovery of exports and imports in 2021. The exports of goods and services in 2021 would grow by 19.3%, while the imports would grow by 15%. Restoration of the demand in main export markets affects the exports of goods in particular strongly, while the exports of services would be gradual, depending primarily on the pace of recovery of the tourist industry. In 2022, the exports of goods and services would continue to have strong growth by 15.8%, followed by the moderation of growth by 6.1% in 2023 and 3.9% in 2024. As the economy recovers and demand for intermediary goods rises, the imports would also grow strongly by 14.7% in 2022, followed by 6.7% in 2023 and moderate 4.2% in 2024.

Fiscal imbalances caused by pandemic would gradually mitigate in several years. 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 adopting the euro. The Government projects decreases of both of Budget deficit and level of total public debt already in 2021.

The general government balance is expected to decline in 2021 to -3.8% of GDP, followed by - 2.6% in 2022, -1.9% in 2023 and -1.5% in 2024. The level of total public debt ratio is, on the other hand, also planned to decline in 2021 to the level of 86.6% of GDP, following by a further fall to 82.5% in 2022, 79, 5% in 2023 and 76.8% in 2024. EU funding will also support the fiscal consolidation of Croatia through favourable loans and grants that should come via its Recovery and Resilience Facility.

The unemployment levels would also continue to fall due to stronger economic recovery envisaged in the next years. The anticipated rate of registered unemployment in 2021 would be 8.5%, followed by a rate of 8.0% in 2022, 7.6% in 2023 and 7.2% in 2024. On the other side, the demand for workers is likely to increase resulting in rising employment levels by 2.3% in 2021, 1.6% in 2022, 1.6% in 2023 and 1.4% in 2024.

MONTENEGRO

Covid 19 and the debt crisis of the Montenegrin economy

In the first half of 2020, Montenegro managed, thanks to timely taken measures of the health authorities, to achieve good results in the fight against the Covid19 pandemic. According to the data provided by the Institute of Public Health, Montenegro was the first corona free country in Europe in the period from the fourth of May to the fourteenth of June, and no cases of new infection were recorded in that period. This has resulted in a positive expectations and optimistic scenarios regarding the country's economic recovery.

Nevertheless, the sharp deterioration of the epidemiological situation, which began in mid-June, has led to a significant decline in economic activity, especially in the tourism sector, which is a strategic economic branch of state development. According to the European Travel Commission, Montenegro recorded a drop in the number of tourists of 84%, which is the second weakest result after Cyprus. The reduced number of foreign tourists, which are the core of Montenegrin tourism, is the reason for this decline. Furthermore, having in mind the importance of tourism for Montenegro, the country recorded a decline in real GDP of 26.9% in the third quarter and 7.5% in the fourth quarter of 2020 Montenegro (Monstat).

Tourism as a strategic industry in the first three quarters of 2020 fell by 88% compared to the comparable period in 2019. Final consumption, as the sum of personal consumption of households and the state, after a slight increase in the third quarter of 3.3% recorded a decline of 8.47% in the fourth quarter. It is important to note that slight growth results from increased government spending, knowing that it is a kind of countercyclical component of GDP. Gross investments in capital assets decreased by 10.4% and 14.62%, in the third and fourth quarters, respectively.

In the second half of 2020, prices were at a stable level, with a stable and highly liquid banking sector, while we had 37,588 more people who were unemployed in December 2020 compared to December 2019. Interest rates (both lending and deposit) were at approximately the same level as in the comparative period of previous years. Preliminary data indicate that during 2020, the net inflow of foreign direct investment is higher by 53.2 percentage points compared to the previous year. In order to solve the problem of the deficit in the state treasury, Montenegro borrowed 750 million EUR in early December through the issuance of bonds, primarily to finance current spending and liabilities that came due from the previous period.

Having in mind all the above and the overall economic reality, during 2020, in order to remedy the bad economic situation caused by the pandemic, the Government of Montenegro adopted three packages of economic measures, which purpose was to help the economy overcome liquidity problems and help the most vulnerable categories of citizens.

The first package of measures amounted to 280.6 million EUR. The package focused on the social component of support to citizens in terms of delaying loan repayment and the allocation of financial assistance to pensioners and citizens in a state of social need. In addition, new credit lines have been provided through the IDF[1] to improve the economy's liquidity. The second package of measures of 39.2 million EUR included subsidies to closed activities and the tourism sector and subsidies for new employment, payment of salaries to employees who are in quarantine or isolation. The third and most generous package of socio-economic short-term and long-term support measures until 2024 amounts to 1,22 billion EUR. The package mainly focuses on the country's long-term economic development, concentrating on the IT industry and tourism, agriculture, and energy, which are strategic industries.

Political environment

At the end of August, parliamentary elections were held in Montenegro, after which a new government was formed on the fourth of December, 2020. In that sense, the process of cohabitation is in force, bearing in mind that the functions of the President of Montenegro, President of the Parliament and the Prime Minister, are performed by people who represent different political options. After opening the last negotiating chapter on the thirtieth of June, 2020, Montenegro did not meet the criteria for closing an already open negotiating chapter in the second half of the year. In the area of economic policy, the implementation of the Economic Reform Program adopted at the beginning of the year was in force. Also important in the part of fiscal policy is the Decision of the Ministry of Finance on the beginning of application of the Law on fiscalization in trade of products and services from the first of January 2021, and the system of electronic fiscalization from July 2021.

Prices

Consumer prices were at a stable level in the second half of 2020. Within the third and fourth quarter, a decrease of (-0.3%) and (-0.8%) was recorded, while the latest available data from December show an increase of 0.1% compared to the previous month. The highest growth was recorded in the category of transport (1.4%) due to higher prices of fuels and lubricants for motor vehicles. In comparison, a lower growth rate (0.2%) was recorded in the categories of housing, electricity, water and gas. The fall in prices was recorded in the categories of clothing and footwear (-1.2%) and food and non-alcoholic beverages (-0.1%). According to the Central Bank of Montenegro data, the annual inflation rate in December 2020 measured by the Consumer Price Index was (-0.9%) while inflation measured by the Harmonized Index of Consumer Prices was (-1.3%).

1 Investment Development Fund

Labor market and wages

The situation with the Covid19 pandemic and the economic problem in which the country found itself naturally had a very negative impact on the labor market. According to MONSTAT[2] data, the unemployment rate in the third and fourth quarters averaged 20.1%, which is a significant deterioration compared to the comparable period of the previous year, when the unemployment rate averaged 15.6%.

It is also interesting to compare the data immediately before the pandemic and at the end of 2020. Namely, at the end of March 2020, 187,251 citizens were employed in Montenegro, while at the end of December, the total number of employees was 160,978. Although there is a noticeable decline in all industries, the trade sector was most affected with a decline in the employment rate of 13.7%.

During 2020, the average gross salary was 783 EUR, while the average net salary was 524 EUR. Comparing these data with the previous year and taking into account the information on the movement of consumer prices, we come to the information that real wages in the same period recorded a growth of 2.1%. In terms of sectors, the highest net earnings in Montenegro are realized in the sector of financial and insurance activities (976€), followed by the sector of electricity, gas and steam supply (947€), and the sector of mining and quarrying (713€). The lowest salaries were recorded in the administrative and support service sector (339€) and the wholesale and retail trade sector (388€).

When it comes to comparing average salaries in the region's countries, Montenegro is behind Serbia, where the average salary in December was 562 EUR, Slovenia and Croatia with 1,181 and 890 EUR, respectively. Montenegro ranks better than Bosnia and Herzegovina and North Macedonia, where average salaries amount to 490 and 454 EUR.

Foreign trade and capital flows

The current account balance was in deficit in the third and fourth quarters and amounted to 445.1 million EUR. This represents a significant deterioration compared to the same period in 2019 when the deficit amounted to 99.5 million EUR. The huge deficit in the third quarter is the cause of such poor indicators. Observed in relation as a percent of GDP, the current account deficit amounted to 17.9% and 19.6%, respectively.

When it comes to foreign trade, it amounted to 2,471.3 million EUR in 2020, according to the final data of MONSTAT, and recorded a decrease of 18.1% compared to the previous year. Montenegro has a long-term problem in the structure of foreign trade, and even if in 2020 there was an improvement compared to the previous year by 1.4%, only 17.4% of imports are covered by exports. Following the international trade classification standards, the largest share

2 Statistical Office of Montenegro

(81.2 million EUR) in the structure of exports is occupied by raw materials (mineral ores and scrap metal, cork, wood), while imports are dominated by machinery and transport equipment. The largest trading partners in exports were Serbia (101 million EUR), Slovenia (35.8 million EUR) and Kosovo (23.6 million EUR), and the most significant import partners were Serbia (414.9 million EUR), China (218 million EUR) and Germany (204.1 million EUR).

Preliminary data from the Central Bank of Montenegro for 2020 show that the inflow of net foreign direct investments was 467.5 million EUR. This represents an increase of 53.2 percentage points compared to 2019. On the other hand, if we look at the total inflow of foreign direct investment, it amounted to 663 million EUR and is lower by 14.8% compared to the previous year. Almost 250 million EUR lower compared to the record year of 2009 (911 million EUR). The leading cause of this decline is a significantly lower inflow of equity investments.

Decomposing this total inflow of 663 million EUR, we get the information that the structure of equity investments is dominated by foreign direct investment in intercompany debt of almost 390 million EUR (58.8%). In contrast, 240.2 million and 36.2% are equity investments.

On the other hand, the outflow of foreign direct investments during 2020 amounted to 195.5 million EUR and was lower by 58.7% than the reference period in 2019. Residents' investments abroad had a total share of 28.5 million EUR, while 167 million EUR were outflowed based on the withdrawal of funds of non-residents invested in Montenegro.

Monetary developments

Stability and a high level of liquidity are essential features of the banking system of Montenegro in the second half of 2020. In total, the balance sheet of banks at the end of December was at approximately the same level as in 2019 (4,586.5 million EUR). Liquid assets of banks were 59 million higher than in December 2019 and increased by 6.2%. The required reserve of commercial banks with the CBM[3] annually is lower by 80.7 million or 31%. The decline in required reserves was the result of the CBM decision in May 2020 that in order to alleviate the bad economic situation caused by the pandemic, the required reserves rate was reduced from 7.5% to 5.5% on the part of the base consisting of demand deposits and those with maturity up to one year. Also, the required reserves rate was reduced from 6.5% to 4.5% on the base that consists of deposits with a maturity of more than one year.

3 Central Bank of Montenegro

In the structure of banks' assets, the dominant share of 68.9% consists of approved loans, followed by cash and deposit accounts with central banks with 19.3% and securities with 10.3%. In the passive structure, almost 3/4, ie. 73.5%, deposits, followed by capital with 12.8% and loans with 9.9%. The total of approved loans by the banks at the end of December amounted to 3,159.2 million EUR and increased by 3.2% compared to December of the previous year. When it comes to deposits, they amounted to 3,372.9 million EUR in December 2020 and are lower by 3 percentage points annually. In the deposit structure, demand deposits dominated with 71.3%, while term deposits accounted for 27.7% of total deposits. Deposits of the retail sector at the annual level decreased by 4.7%.

According to the CBM data, in December, the average weighted nominal interest rate (WANIR) of banks on total approved loans was 5.33%, and the average effective interest rate (WAEIR) was 5.84%. Annually observed, both nominal and effective interest rates decreased by 0.13 and 0.17%, respectively. In terms of deposit interest rates, they averaged 0.4% in December and were at almost identical levels compared to comparative values. The difference between the lending and deposit interest rate was 5.44% and was lower compared to December 2019, when the difference was 5.60%.

Fiscal sector

In the third and fourth quarters, total budget revenues amounted to 1,032.4 million EUR or 24.62% of the estimated GDP for 2020 (4,193.2 million EUR). Observed at the level of the whole year, total revenues amounted to 1,869.4 million EUR or 44.6% of estimated GDP. The main cause of the decline in revenues, of course, should be sought in decline in tourism turnover, so the largest negative deviation from the planned revenues was recorded in value-added tax (-14%) and excise duties (-7.2%). In contrast, revenues from taxes and contributions for wages recorded growth, precisely due to sub-subsidized wages within the endangered activities within the II and III packages of economic measures. In this way, revenues are higher by 43.3 million EUR or 6.6% compared to the planned budget revision, despite the decline in employment rates.

According to preliminary data, public expenditure in 2020 amounted to 2,333.2 million EUR or 55.6% of estimated GDP. When we compare this spending with the previous year, we conclude an increase of 109.4 million or 4.9%. The growth was primarily due to greater financing needs for the health system due to the Covid pandemic19 and the financing of three packages of socio-economic measures. In contrast, due to the reduced intensity of works on the primary section of the highway, the capital budget also recorded a decrease of 22.3% compared to the previous year.

According to the Ministry of Finance of Montenegro, total government debt at the end of 2020 amounted to 4,330.83 million EUR or 103.28% of GDP. By decomposing this amount, external debt accounts for 3,835.97 million or 91.46% of estimated GDP, while domestic debt accounts for 495.56 million EUR or 11.82% of GDP. At the end of June 2020, government debt amounted to 87.29% of GDP, which means that a growth of 16% was recorded in just six months. Debt growth primarily occurred in the fourth quarter due to the issuance of bonds on the international capital market for 750 million EUR, with a maturity of 7 years and an interest rate of 2.875%. In addition, the increase in government debt was also influenced by the realization of infrastructure projects (Smokovac-Uvač-Mateševo) and projects in the field of communal activities.

Table MN1 Main economic indicators

	Total 2019 year	2020 Q1	Q2	Q3	Q4	Total 2020 year
ECONOMIC ACTIVITY *						
Real GDP (% change, yoy)	**4.1**	2.6	-20.3	-26.9	-7.5	**-15.2**
Real private consumption (% change, yoy)**	**3.1**	3.5	-14.8	2.1	-10.4	**-5.4**
Real government consumption (% change, yoy)**	**1.0**	0.1	0.6	0.6	-3.8	**-0.9**
Real investment (% change, yoy)**	**-1.7**	-0.2	-26.1	-7.7	-11.5	**-12.3**
Industrial output (% change, yoy)	**-6.3**	12.9	-15.9	-2.8	0.6	**-0.9**
Unemployment rate (LFS, % pa)	**15.1**	16.3	15.2	19.0	21.2	**17.9**
Nominal GDP (EUR million)	**4,950.7**	917.4	902.4	1,213.4	1,160.0	**4,193.2**
GDP per capita (EUR)	**7,959**	1,475	1,451	1,951	1,865	**6,743**
PRICES, WAGES AND EXCHANGE RATES*						
Implicit GDP deflator (% change, yoy)**	**2.0**	0.4	-2.4	0.8	0.2	**-0.2**
Consumer prices (% change, yoy, pa)	**0.4**	0.8	-0.7	-0.3	-0.8	**-0.3**
Producer prices (% change, yoy, pa)**	**2.4**	1.3	-0.4	-0.5	-0.6	**-0.1**
Average gross wage (% change, yoy, pa)	**0.9**	2.2	1.2	1.1	0.8	**1.3**
Exchange rate (______/EUR, pa)	**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**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**465.59**	95.54	86.90	97.40	128.75	**408.59**
Exports of goods (EUR, % change, yoy)	**6.77**	-5.57	-23.87	-19.44	-0.48	**-12.24**
Imports of goods (EUR million)	**2,531.11**	520.87	491.02	511.48	526.07	**2,049.43**
Imports of goods (EUR, % change, yoy)	**1.85**	2.06	-29.54	-25.91	-16.95	**-19.03**
Current account balance (EUR million)	**-744.16**	-321.90	-322.07	-217.69	-227.42	**-1,089.08**
Current account balance (% of GDP)	**-15.03**	-35.09	-35.69	-17.94	-19.60	**-25.97**
Foreign Direct Investment net inflows (EUR million)	**305.13**	134.19	125.03	86.22	122.11	**467.55**
Foreign exchange reserves (EUR million, eop)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Foreign debt (EUR million, eop)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
GOVERNMENT FINANCE						
Revenues (EUR million)	**2,151.5**	423.4	413.7	482.6	549.8	**1,869.4**
Expense (EUR million)	**1,812.3**	454.9	487.0	488.5	587.8	**2,018.2**
Net = Gross operating balance	**339.2**	-31.5	-73.3	-5.9	-38.1	**-148.8**
Net acquisition of non-financial assets (EUR million)	**411.3**	39.0	73.6	89.4	113.0	**315.0**
Net lending/borrowing (EUR million)	**-72.1**	-70.5	-146.9	-95.3	-151.0	**-463.8**
Domestic government debt (EUR million, eop)	**580.0**	535.6	559.4	570.5	495.5	**495.5**
Foreign government debt (EUR million, eop)	**3,128.5**	2,807.8	3,105.2	3,089.8	3,835.3	**3,835.3**
Total government debt (eop. % of GDP)	**74.9**	79.7	87.4	87.3	103.3	**103.3**
MONETARY INDICATORS***						
Narrow money, M1 (% change, yoy, eop)	**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**
Total domestic credit (% change, yoy, eop)	**4.5**	4.3	5.1	5.7	3.2	**3.2**
DMBs credit to households (% change, yoy, eop)	**8.6**	6.5	7.4	5.8	2.7	**2.7**
DMBs credit to enterprises (% change, yoy, eop)	**4.1**	4.1	6.5	8.4	3.2	**3.2**
Money market interest rate (%, pa)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
DMBs credit rate for enterprises short-term (%, pa)	**4.64**	4.48	4.60	4.44	4.51	**4.51**
DMBs credit rate for households short-term (%, pa)	**8.15**	7.70	7.19	6.54	6.43	**6.43**

* **Source**: Monstat, data for GDP in 2020 are preliminary

** Authors' calculations based on Monstat data.

***Preliminary data for Q1 2021

Policy assumptions and projections summary

Table MN2 shows the projections of the Central Bank of Montenegro, following the Program of Economic Reforms from 2021 to 2023.

The latest projections of the World Bank show a decline in the Montenegrin economy in 2020 by 14.9%. These are even weaker projections than the previous period when initial estimates indicated a decline of 12.4%. The projections of the International Monetary Fund also speak of a significant drop of 15.2% in 2020. The current year 2021, according to the projections of international and similar projections of domicile institutions, should be the year of the beginning of the country’s economic recovery. This will largely largely depend on the upcoming tourism season, which will be build upon the adequate immunization of the population and a better epidemiological situation. In addition, an important prerequisite for a good tourism season is the start of the new national airline “To Montenegro”.

A detailed overview of the projections for the next three years, both in terms of estimating real gross domestic product growth and the form of individual macroeconomic and fiscal aggregates, is given in the table below.

Table MN2 Summary of projections

	2022	2023	2024
Real GDP (% change)	**6.5**	**5.8**	**N/A**
Real private consumption (% change)	3.5	2.8	N/A
Real government consumption (% change)	0.0	0.5	N/A
Real investment (% change)	6.4	3.9	N/A
Exports of goods and services (constant prices, % change)	19.1	14.0	N/A
Imports of goods and services (constant prices, % change)	8.0	5.5	N/A
Current account balance (% of GDP)	-15.1	-11.6	N/A
Consumer prices (% change, pa)	1.4	1.2	N/A
Exchange rate, national currency/EUR (pa)	N/A	N/A	N/A
Unemployment rate (registered, %, pa)	14.3	13.8	N/A
General government balance (ESA 2010 definition, % of GDP)	-0.2	1.5	N/A
Total domestic credit (% change, eop)	N/A	N/A	N/A

*Source: Montenegro Economic Reform Programme 2021-2023

NORTH MACEDONIA

Slight economic recovery in the second half of the year

Vaccination - hope for the uncertain economic recovery

The struggle with the pandemic and its effects caused by COVID – 19 is still ongoing. The second and third much stronger wave in North Macedonia, which is still active, have further impeded economic recovery. The annual GDP growth in 2020 is -4.5%, which is a drop of 7.7 percentage points from 2019 when the economic growth rate was 3.2%. Positive shifts in the third and fourth quartile of 2020 reduce the negative growth rate. So, the GDP growth rate from -3.3 (Q3 in 2020) switched to -0.7 in Q4 of 2020.

Economic activity declined due to the unfavourable trends in the industry and certain service activities, such as trade, transport and hospitality industry. Industrial output at the end of 2020 was -9.5%, it is evident that the indicator still has negative values, but there is a sign of positive shifting in the second half of 2020. (Q3, -7.6 and Q4, -2.2).

The construction and agricultural sector are the boosting sector in the last quarter of 2020.

Despite the measures of the Central Government that were taken to assure the aggregate consumption at a high level, the private consumption was negative, but an evident less marked decrease in the analyzed period. The

government consumption maintained the level of aggregate consumption in the second half of 2020.

The decline in total consumption and investment is the most significant contributor to negative growth in 2020.

Mitigated downward trends on the labour market

The year 2020 was challenging for North Macedonia, causing unfavourable changes in many areas, including the labour market. The Labour Force Survey (LFS) data show that in 2020 the total number of employed is lower for more than 2700 persons (0.3%) than in 2019. This decline is confirmed with the quarterly data for 2020. In first three quarters, it is declining, and in the fourth quarter, a slight increase of 0.5% is noticed. The same dynamics are characteristic for the employment rate (15-64), which from 48.1% (Q1) decreased to 46.6% (Q3) and then reached 46.8% (Q4). LFS data shows the decrease of the total number of unemployed from 166,363 persons in 2019 to 155,949 in 2020 (for 6.3%), while the unemployment rate declined from 17.3% to 16.4%, respectively. The total number of unemployed observed quarterly has increased only in the second quarter. Regarding the unemployment rate evident is oscillating trend, 16.2% (Q1), 16.7% (Q2), 16.5% (Q3) and 16.1% (Q4).

The Employment Service Agency data on the number of registered new employments indicates lower in 2020 compared to 2019 for almost 29 thousand persons (for 14.2%). The registered unemployment from 104,409 in January 2020 has increased to 156,432 persons in December, i.e. for 49.8%. The data on the inflow and outflow of the registered unemployed persons in 2020 shows: The number of the first time registered unemployed is 14,802 persons; The number of those who lost their job amounts to 50,584 persons, while at the same time there was outflow from unemployment of 32,424 persons due to employment, implicating increase of unemployment for 18,160 persons; In 2020, 11,327 persons became active job seekers by transfer from the group of other job seekers. The shares of the above mentioned categories, in the total increase of unemployment (52,023 persons) amount: 27.1%, 33.2% and 20.7%, respectively.

COVID-19 extended public debt

Before the pandemic, in 2019, fiscal performance was favourable. The fiscal deficit reached 2 percent of GDP, keeping public debt stable at 48 percent of GDP.

The Macedonian economy during 2020 was affected by the COVID-19 pandemic. On April 9, 2020, the Government adopted the Decision on redistribution of funds between the budget users, with which 105.7 million Euros were reallocated to implement the first and second set of economic measures aimed at protecting the liquidity of companies and protecting jobs. Despite spending restrictions, servicing the highest priority liabilities, and minimizing all less productive budget spending, the country's fiscal position deteriorated, the budget deficit increased to over 5% of GDP and public debt to over 50% of GDP. Therefore, two amendments were made to the Republic of Northern Macedonia for 2020. The total revenues are reduced by 12% (422 million euros), total expenditures increased by 5.2% (213.7 million euros). Based on these planned revenues and expenditures, the deficit for 2020 is positioned at 6.8% of GDP, and then at 8.3% of GDP, which is a precedent in the Macedonian fiscal practice. As of December 31, 2020, the realization of budget revenues exceeded by 2.1%, expenditures were realized according to the plan, the deficit was reduced to 5% of GDP, and public debt amounted to 59.9% of GDP 6,483 million euros.

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

In the outbreak of COVID-19, the monetary policy continued with further relaxation by setting the key interest rate on the history lower level to support the banking system and the overall economy. Such a trend should further decrease the bank loans interest rate to assist the economic entities in overcoming the obstacles imposed by the "new normal". The stability of the denar and the entire banking sector has not been under question. Even though in mid-2020, 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.

Bank assets quality has not deteriorated, showing solid NPLs to gross loans ratio which stands to 4.7%, 4.5%, 3.3% and 33.3% in each quarter of the year 2020. The other bank indicators demonstrate minor deterioration such as ROAA with 0,8%, 1%, 1,4% and 1,3% in each quarter of the year 2020 respectively, liquidity assets/total assets ratio with 24.6%, 23.5%, 23,5% and 23,3% in each quarter of the year 2020, respectively.

At the end of the year 2020, the high profits of the banks demonstrated that the banking sector managed to cope with the pandemic situation. While the total deposits stayed solid, the total domestic credits showed a minor decrease, amid the major shift signify the decreased trend of the credits to enterprises.

The citizens' habits have dramatically changed in the year 2020, contributing to the high annual growth of payment cards utilization by the Internet of 145%. Such trend of consumers having embraced contactless payment and e-banking boosted the positive shift for future bank strategies and fostering banks to reshape their go-to-market strategy.

Price increase

The inflation rate, measured according to the CPI index, amounted to 1.2% on an annual basis, is higher by 0.4 percentage points from the inflation in 2019 (0.8%).

Consumer prices show a more significant change in the third and fourth quarters of 2020. It is the result of the increase in the prices of food. Also, the regulatory increase of electricity prices (7.4%) in August 2020 has fueled inflation. The producer price is also increased.

Recovery of the total foreign trade in the second half of 2020

The current account balance in all quarters of 2020 recorded a moderate deficit, mainly due to the reduction of the secondary income account surplus in conditions of significantly reduced travel due to the Covid-19 pandemic.

In 2020 the trade deficit narrowed on an annual basis, in conditions of decline in both the import and export component of about 10%. Lower performances were registered in all export and import categories. However, the most significant decline was registered at the export of industrial facilities from the automotive industry in foreign ownership and the raw material import of the export-oriented facilities in the economy and the import of equipment and machinery and energy. The largest impact on exports and imports due to the COVID-19 pandemic was concentrated in the second quarter, with an annual decline of about 35% and 31%, respectively. However, in the third and fourth quarters, with the temporary stabilization of the pandemic situation, the gradual easing of measures to prevent its spread and the reactivation of the capacities included in the global supply chains, a significant slowdown in decline in exports and imports was observed. Not only that, but the export registered a further accelerated recovery in the last quarter of the year when the total export activity increased by 5.5%.

FDI in all three quarters of 2020 (Q2, Q3, Q4), except for Q1, decreased mainly as a result of reinvestment of profits (Q3 and Q4) and debt instruments (Q2).

The level of foreign exchange reserves remains solid and adequate and is maintained in the safe zone. They recorded quarterly growth in Q2 due to government borrowing from the IMF in April 2020 and the issuance of Eurobonds in the international financial markets. While in all other quarters, this change is negative due to the National Bank interventions in the foreign exchange market and the regular repayment of public sector liabilities abroad.

Table MK1 Main economic indicators

	Total 2019 year	2020 Q1	Q2	Q3	Q4	Total 2020 year
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**3.2**	0.9	-14.9	-3.3	-0.7	**-4.5**
Real private consumption (% change, yoy)	**3.5**	-0.3	-13.0	-4.1	-4.3	**-5.6**
Real government consumption (% change, yoy)	**-0.8**	10.7	9.8	13.5	6.6	**10.1**
Real investment (% change, yoy)	**9.5**	1.0	-34.4	4.2	-13.0	**-10.2**
Industrial output (% change, yoy)	**3.7**	-3.7	-25.2	-7.6	-2.2	**-9.5**
Unemployment rate (registered, % pa)	**17.3**	16.2	16.7	16.5	16.1	**16.4**
Nominal GDP (EUR million)	**11,209.0**	2,608.0	2,332.9	2,781.1	3,044.0	**10,766**
GDP per capita (EUR)	**5,398.0**	1,256	1,123	1,339	1,466	**5,187**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**1.1**	1.9	-1.0	0.4	N/A	**N/A**
Consumer prices (% change, yoy, pa)	**0.8**	0.6	0.5	1.5	2.2	**1.2**
Producer prices (% change, yoy, pa)	**0.9**	0.4	0.4	0.8	1.5	**0.8**
Average gross wage (% change, yoy, pa)	**4.3**	10.6	5.1	7.5	5.1	**7.0**
Exchange rate (MKD/EUR, pa)	**61.51**	61.61	61.69	61.70	61.70	**61.67**
Exchange rate (MKD/USD, pa)	**54.95**	55.89	56.09	52.84	51.75	**54.13**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**5,323.30**	1,132.84	879.49	1,351.65	1,448.58	**4,812.55**
Exports of goods (EUR, % change, yoy)	**9.0**	-9.0	-34.5	-0.7	5.5	**-9.6**
Imports of goods (EUR million)	**7,292.92**	1,679.15	1,231.88	1,755.10	1,955.21	**6,621.34**
Imports of goods (EUR, % change, yoy)	**10.2**	-2.4	-31.1	-2.4	-1.6	**-9.2**
Current account balance (EUR million)	**-372.3**	-156.1	-91.9	-52.7	-72.4	**-373.0**
Current account balance (% of GDP)	**-3.3**	-1.4	-0.9	-0.5	-0.7	**-3.5**
Foreign Direct Investment net inflows (EUR million)	**363.3**	135.9	-6.7	-7.8	84.3	**205.7**
Foreign exchange reserves (EUR million, eop)	**3,262.6**	3,017.3	3,639.7	3,480.2	3,359.9	**3,359.9**
Foreign debt (EUR million, eop)	**8,154.4**	8,312.4	8,786.7	9,093.7	8,630.3	**8,630.3**
GOVERNMENT FINANCE						
Revenues (MKD million)	**203,822**	46,484	40,953	48,600	53,735	**189,770**
Expense (MKD million)	**217,445**	53,894	59,486	58,527	71,731	**243,636**
Net = Gross operating balance	**-13,623**	-7,410	-18,533	-9,927	-17,996	**-53,866**
Net acquisition of non-financial assets (MKD million)	**-15,443**	-1,633	-2,280	-3,175	-7,181	**-14,269**
Net lending/borrowing (MKD million)	**1,820**	-5,777	-16,253	-6,752	-10,815	**-39,597**
Domestic government debt (EUR million, eop)	**1,793.3**	1,971.3	2,090.4	2,102.8	2,133.4	**2,133.4**
Foreign government debt (EUR million, eop)	**2,763.5**	2,608.1	3,471	3,470.3	3,382.5	**3,382.5**
Total government debt (eop. % of GDP)	**40.7**	42.3	51.4	51.5	51.0	**51.0**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**17.2**	19.9	21.3	17.8	16.4	**16.4**
Broad money, M4 (% change, yoy, eop)	**9.3**	8.9	9.8	6.9	6.9	**6.9**
Total domestic credit (% change, yoy, eop)	**6.0**	5.8	6.6	7.3	4.7	**4.7**
DMBs credit to households (% change, yoy, eop)	**10.5**	10.1	8.8	9.5	8.0	**8.0**
DMBs credit to enterprises (% change, yoy, eop)	**1.9**	1.8	4.6	5.2	1.1	**1.1**
Money market interest rate (%, pa)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
DMBs credit rate for enterprises short-term (%, pa)	**4.2**	3.8	3.6	3.5	3.5	**3.6**
DMBs credit rate for households short-term (%, pa)	**3.6**	3.6	4.0	4.2	N/A	**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, https://www.ceicdata.com/en/indicator/macedonia/gdp-deflator-growth

Policy assumptions and projections summary

The process of the vaccination of the population in North Macedonia has started. However, it is far away from the needed level due to the delays in the supply of vaccines. Reaching the satisfactory level of immunized people will release the measures for movement and travelling restrictions and encourage and boost economic activity. Furthermore, it will decrease the medical treatment expenditures for Covid-19 positive patients.

The scenario for the real GDP growth is optimistic, and in 2022, it is expected to be 4.5%, 4% in 2023 and 3.8 in 2024. The real investment will take a huge role in positive shifting. Therefore, the real investment is expected in 2022 to increase from negative -10.2 in 2020 to the positive annual growth rate of 13.2%.

In the future, inflation will increase, and it is expected to reach 1.5% in 2021. The projections for the consumer price present the inevitable trend of increase. Hence, it is expected 1.6 in 2022, 1.8 in 2023 and 2.0 in 2024.

The measures are undertaken to mitigate the Covid-19 pandemic consequences are depreciating the negative trends on the labour market in North Macedonia. Based on the predictions for the duration of the Covid-19 pandemic and the country's potential economic growth, the expectations for the next period indicate possible improvements in employment and unemployment, but with a relatively slow pace.

The high uncertainty remains present and the significant risks related to developing the pandemic, vaccination process, and further measures. Hence the actions undertaken by the monetary policy and banking sector impose further challenges in supporting the real sector, hypothetically encouraging the companies and the citizens to digests all resources in order to be back on track.

Increased availability and effectiveness of vaccines and treatments to deal with the virus and additional fiscal stimulus, and continued favorable financial conditions are expected to lead to recovery in the foreign trade sector. These conditions will mean some growth in exports and imports of goods and services and a reduction in the current account deficit. However, there is still high uncertainty and risks associated with the development of the pandemic and the prospects for dealing with it, leading to a worsening of the predicted conditions.

Table MK2 Summary of projections

	2022	2023	2024
Real GDP (% change)	**4.5**	**4.0**	**3.8**
Real private consumption (% change)	4.7	N/A	N/A
Real government consumption (% change)	3.1	N/A	N/A
Real investment (% change)	13.2	N/A	N/A
Exports of goods and services (constant prices, % change)	12.0	N/A	N/A
Imports of goods and services (constant prices, % change)	13.1	N/A	N/A
Current account balance (% of GDP)	-3.1	-2.8	-2.6
Consumer prices (% change, pa)	1.6	1.8	2.0
Exchange rate, national currency/EUR (pa)	N/A	N/A	N/A
Unemployment rate (registered, %, pa)	16.6	16.0	15.7
General government balance (ESA 2010 definition, % of GDP)	-3.2	N/A	N/A
Total domestic credit (% change, eop)	N/A	N/A	N/A

Sources: https://www.imf.org/en/Countries/MKD, https://tradingeconomics.com/macedonia/forecast, https://www.theglobaleconomy.com/Macedonia/

S E R B I A

(In)visible consequences for the Serbian economy at the end of the pandemic year

Economic fall among the lowest in Europe

The fall of the Serbian GDP in 2020 is estimated at 1%, which is the lowest fall of economic activity in the region and one of the lowest in Europe. According to the latest Eurostat data, Serbia has the fifth-best result in Europe in economic activity stabilization, trailing only Ireland, Turkey, Norway and Lithuania. Such a positive outcome is mainly a result of the three underlying factors: high growth at the beginning of 2020, massive bailout, and resilient structure of the Serbian economy.

In the first quarter of 2020, Serbian economic activity achieved an exceptionally high 5.2% growth rate, which partially offset the significant 6.2% fall in the second quarter when the severe effects of pandemic and containment measures were at the pick. In April 2020 Serbian Government started to implement measures to mitigate severe effects of the pandemic worth 12.5% of GDP, which preserved liquidity and employment, especially in the SME sector. Government

measures to mitigate the effects of the crisis took full effects in the third and fourth quarter of 2020, when GDP fall stabilized around 1.4% and 1.1%, respectively. Eventually, the current structure of the Serbian economy and industry was beneficial in overcoming the effects of the pandemic. In particular, the most affected sectors, such as tourism or production of durables, have a lower share in Serbian GDP relative to other European countries. On the other side, higher shares of resilient sectors such as agriculture and food production helped avoid larger economic falls.

The GDP deflator had a slight increase in the first quarter of 2020 compared to 2019. The first quarter of 2020 had a decrease of almost 44% (from 2.5% in Q1 2020 to 1.1% in Q2 2020). This decrease is a result of the COVID-19 virus appearance.

The appearance of the COVID-19 led to the rising prices of the products in Health and Communications as well as wages in these sectors as a result of higher demands

On the other hand, consumer prices remain almost steady when we compare 2019 with a total of 2020 (1.9% to 1.7%). The irregular period is between Q1- Q2 (decrease from 1.8% to 1.0%) and Q2 - Q3 of 2020 (an increase of 1.0% to 1.9%). The first mentioned period decrease is due to the fact of the first-time appearance of the COVID-19.

Despite the virus and its consequences on the sectors incomes, the average gross wage (%) dropped nominally about 10%. Analyzing the period Q1-Q4 2020, it did not have prominent oscillations during that time. Comparing wages (without taxes and contributions) by sectors, it is noticed that the highest real growth in 2020, compared to 2019, is achieved in the sectors of Information and Communication (20.9%), Health and Social protection (15.9%), Water supply and wastewater management (13.4%) and Administrative and support service activities (10.1%).

Summarised speaking, observing the level of groups of products and services, the consumer prices in 2020 were noted to rise in the groups of Health (due to high demand for health products) and Communications (due to increased demand for distant modes of communication). As a result of lower demand, Clothing and footwear had a fall in prices. It can be concluded that prices in Health and Communication, due to higher demand, affected wages in these sectors. Observed by purpose, the prices had the greatest impact on the average annual growth of consumer prices in 2020: services, unprocessed foods and processed foods.

The structure of the yoy growth rate of consumer prices in Q4 2020 by purpose (p.p): 0.8 p.p Services, 0.4 p.p Unprocessed food, 0.4 p.p Processed food, 0.3 p.p Industrial products without food and energy and - 0.4 p.p Energy. Observed by basic groups of consumption, the most significant contribution was given to the prices of food, non-alcoholic beverages, and alcoholic beverages and tobacco prices. The structure of the yoy growth rate of consumer prices in Q4 2020 by basic product groups (p.p): 0.8 p.p Food and non-alcoholic beverages, 0.6 p.p Other, 0.4 p.p Alcoholic beverages and tobacco, 0.3 p.p Apartment, water, el. Energy, gas and other fuels and -0.6 p.p Transport.

As a result, NBS contributed to maintaining RSD/EUR it stabile with monetary policy implementation in the period Q1-Q4 2020. On the other hand, a slight decrease happens in USD/RSD in Q3 and Q4 of 2020 (compared to 2019) due to the stock exchange index dropping and fear of investing in risky assets.

The exchange rate stability is the primary objective of the Central Bank of Serbia despite the consequences of the COVID-19 crisis

The National Bank of Serbia provides help in all quarters of 2020. One way was directly lowering introductory interest rates (money market) and indirectly lowering other rates. The result of this measure has led to DMBs credits rising.

The total domestic credit also rose from 10.7% in Q1 2020 to 16.0% in Q2 2020, which resulted from more borrowing to reduce the consequences of the virus appearance. The percentage of this indicator remained almost steady, averagely speaking, in other quarters of 2020. It is projected that this indicator will slightly fall in the periods of 2021.

Serbia's leading foreign trade partner in 2020 was Germany

Serbian statistics on Foreign trade and capital flows for 2020 undoubtedly reflect the ongoing impact of the crisis caused by the global COVID-19 pandemic. The consequences of the mentioned virus have shaken the global trade landscape to its core and created disruptions on an unprecedented scale. Serbia, as a small emerging country, has not remained immune either. The crisis mainly affected the intensity of Serbia's cooperation with trading partners who have suffered a severe blow by the crisis and slowed down many international trade processes. The latest available country-specific data from the Statistical Office of the Republic of Serbia confirm that Serbia's major trade partners in 2020 remained the countries with which state signed free trade agreements (EU member states and CEFTA countries). During the mentioned year, Serbia's leading foreign trade partner was Germany, with a share of 13.1% in total exports and 13.7% in total imports (both shares increased compared to 2019). The top five export destinations for Serbia in the reference period were Germany (EUR 2,197 million), Italy (EUR 1,428 million), Bosnia and Herzegovina (EUR 1,210 million), Romania (EUR 1,109 million), and Hungary (EUR 805 million).

On the other hand, during 2020, Serbia's major external trade partner in imports was Germany (EUR 3,122 million), followed by China (EUR 2,875 million), Italy (EUR 1,927 million), Russian Federation (EUR 1,388 million), and Hungary (EUR 1,139 million). Compared to 2019, the total volume of exports and imports has decreased for most of the partner countries (the exception in terms of imports is China - the share of imports from this country increased from 9% in 2019 to 12.5% in 2020, mostly due to imports of medical equipment). The largest decrease in the share of exports was recorded in terms of exports to Italy.

When it comes to the review of the exports and imports share by activity (classification of activities according to NACE Rev. 2), data from the Statistical Office of the Republic of Serbia suggest that the largest share in exports during 2020 was recorded for the manufacture of electrical equipment (10.8%); motor vehicles and trailers (10.8%); food products (10.2%); basic metals (8%); and manufacture of crop and animal production, hunting and related services (7.6%). Contrastingly, the largest share in imports was recorded for the manufacture of machinery and equipment (9.3%); chemicals and chemical products (9.2%); electrical equipment (7.5%); basic metals (6.4%); and manufacture of computer, electronic and optical products (6%).

Exports of goods showed a more expressive resistance to the COVID-19 crisis than the imports of goods

Regarding foreign merchandise trade, which this study focuses on, the analysis of data from the Statistical Office of the Republic of Serbia shows that both exports and imports of goods decreased on an annual basis (-2.8% and -3.8%, respectively, in 2020 compared to 2019). Also, analysis shows that exports of goods were characterized by a more expressive resistance to the crisis caused by the COVID-19 pandemic than the imports of goods. In other words, despite external challenges and global recession, export of goods remained relatively resilient and recorded a decline of only -2.8% in 2020 with slow returning to previous growth path already in the last quarter of 2020. Import decline in 2020 was deeper, and it is expected that investments and private consumption will drive its recovery during 2021 and years to come. The fact that the annual values are, nevertheless, mostly driven by the impact of the crisis is evidenced by the data of mentioned statistical institution. According to these data, the value of year-on-year merchandise exports and imports is estimated to have declined by 19.9% and 20.2%, respectively, in the second quarter of 2020, i.e. immediately after the outbreak pandemic. A recent study by the National Bank of Serbia indicates that the decline mostly influenced the decline in exports of goods in exports of the processing industry (in the conditions of slowing global demand). Also, it indicates that the decline in imports of goods was primarily driven by lower imports of energy and reproduction products.

At the end of the analysis of data on foreign merchandise trade, it is important to point out a few more facts: regarding data of Statistical Office of the Republic of Serbia, import value far exceeded export value during 2020 (EUR 22,957 million and EUR 17,052 million, respectively); and according to the study published by the National Bank of Serbia, regardless of the pandemic, the export of agricultural products achieved strong growth in 2020 after a great season, and the import of capital products and consumer goods continued to grow in the same reference period.

The current account deficit remained high in 2020

Observing the external sector statistics, it is noticeable that the most significant changes are recorded in the current account balance segment. Namely, according to data released by Eurostat, the current account balance in 2020 witnessed a deficit of EUR -2,084 million, unlike the previous year when the nation's current account in the twelve months stood at a deficit of EUR -3,273 million. Additionally, the highest value of Serbia's current account balance during 2020 was recorded in the fourth quarter (EUR -227 million), while the lowest value, as expected, was registered in the first quarter of 2020 (EUR -1,016 million). The current account deficit remained high in 2020 (concerning a value of -7.1% in 2019), standing at -4.5% of the country's GDP. In one of the National Bank of Serbia's 2020 publications, it was highlighted that this deficit remains fully covered by the net inflows of foreign direct investments for years. More precisely, for six years in a row, mentioned investments were enough to cover the current account deficit fully.

Although the COVID-19 pandemic had a substantial impact on capital flows to emerging countries, capital inflows to Serbia even under those conditions remained relatively high. Foreign direct investment net inflows, as representatives of the difference between inflows of non-residents, and outflows of residents abroad, both based on foreign direct investment, according to the data of the National Bank of Serbia, at the end of 2020 were lower by EUR 649 million or 18.3% compared to 2019. In other words, Serbia's foreign direct net investment inflows narrowed sharply to EUR 2,902 million in 2020 from EUR 3,551 million in the previous year. Of that amount, Serbia

Foreign direct investment net inflows in Serbia during 2020 were the highest in the region

recorded even EUR 1,971 million foreign direct investment net inflows from EU member states, led by investments from Netherlands (EUR 709 million), Slovenia (EUR 466 million), and Germany (EUR 367 million). Also, it is essential to mention one more National Bank of Serbia's observation within which this financial institution states that comparatively, although lower than in the previous year, the foreign direct investment net inflows in Serbia during 2020 were the highest in the region.

Foreign exchange reserves remained broadly stable during 2020

According to the National Bank of Serbia, it is noticeable that foreign exchange reserves remained broadly stable during the observed period of the COVID-19 crisis, i.e. maintained at an adequate level, which further strengthened the resilience of the domestic financial system to earthquakes from the international environment. At the end of December 2020, Serbia's foreign exchange reserves amounted to EUR 15,550 million, which is 4.4%, i.e. EUR 661 million more than at the end of the corresponding month the previous year (EUR 14,889 million). Foreign exchange reserves at this level provide coverage of the money supply M1 of 130% and more than six months of imports of goods and services, which is twice the standard that determines the adequate level of coverage of imports of goods and services by foreign exchange reserves.

The increase in foreign exchange reserves in December 2020, according to the National Bank of Serbia's estimation, was realized in an environment in which the state further reduced its foreign exchange liabilities based on foreign exchange loans and foreign exchange securities (net EUR 91 million). The increase in foreign exchange reserves at the end of 2020 was mainly affected by the inflows from the privatization of Komercijalna Banka (EUR 395 million) and the activities of the National Bank of Serbia through the net purchase of foreign currency on the domestic foreign exchange market (total net effect of spot and swap transactions - EUR +244 million). An additional contribution to the higher level of foreign exchange reserves was made by net inflows based on donations (EUR 122 million), efficient management of foreign exchange reserves and other bases (EUR 47 million in total). These inflows multiple exceeded the outflows based on the mentioned net deleveraging of the state (EUR 91 million), foreign exchange required reserves due to normal activities of banks, as well as on other bases (total net EUR 56 million), and fully amortized the negative impact of market factors (total net EUR 14 million).

Serbia's foreign debt increased in 2020

The impact of the COVID-19 pandemic on the foreign debt is not hardly noticeable either - the level of foreign debt was stable during the first quarter of 2020, while its slightly rising values started from the second quarter of 2020, immediately after the appearance of the first cases of Coronavirus infection in Serbia. Enriched with the National

Bank of Serbia's statistical data, the foreign debt of Serbia during 2020 amounted to EUR 30,813 million, which was an increase of 9.1% or EUR 2,559 million compared to 2019 (EUR 28,254 million). The structure of foreign debt by maturity deteriorated in terms of reducing the share of short-term debt - from EUR 4,781 million (share of 20.4% of foreign debt) at the end of 2019, short-term debt has grown to EUR 5,556 million (share of 22% of foreign debt) at the end of 2020.

The government has postponed the policy of fiscal stabilization

The persistent trend of fiscal stabilization in the aftermath of fiscal consolidation was interrupted by the outbreak of the COVID-19 pandemic in 2020. In response to the economic difficulties caused by the pandemic and containment measures, the government provided massive fiscal bailout to the economy and households. This lead to the record high 8.1% fiscal deficit in 2020, and consequently to the sharp increase in public indebtedness from 53 up to 58% of GDP. By the end of 2020, the government has adopted a fiscal strategy and annual budget for 2021, which envisaged a gradual return to the fiscal stabilization path. The fiscal deficit was projected at 3% of GDP.

Nevertheless, it turns out that the process of fiscal planning and budgeting was not credible. The government announced that a new fiscal support package would be provided to the private sector only two months later. At the same time, the rebalanced budget which framed the costs of fiscal support was adopted in April.

According to the rebalanced budget, the fiscal deficit in 2021 is more than doubled and projected at 7% of GDP. The new package of fiscal support worth 2.2 bil EUR (4.3% of GDP) encompasses a similar set of measures as in 2020: 1 bil Eur of indirect support (guarantees to private companies) and 1.2 bil Eur of direct support to private companies and households, including 360 mil Eur of controversial "helicopter" money for all adult citizens. In addition, rebalanced budget capital has foreseen a considerable surge in productive capital investments that will stimulate economic growth.

Even though the government has abandoned the fiscal stabilization policy in 2021, it did not shake the investors' confidence and credit rating agencies in the stability of Serbian public finance. In February 2021, the government issued for the first time 12-year Eurobonds worth 1 bil EUR at auspicious 1.92% yield, while in March, Moody's has increased credit rating from Ba2 to Ba3. In addition, it was announced that in June 2021, long-term bonds issued in RSD would be included in the JPMorgan GBI-EM index. However, if realized, a large projected fiscal deficit in 2021 will surely drive public debt above the 60% Maastricht threshold. The government will soon run out of fiscal space, and adopt a debt-stabilizing budget in 2022 is highly anticipated and necessary.

Table SRB1 Main economic indicators

	Total 2019 year	2020 Q1	Q2	Q3	Q4	Total 2020 year
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**4.2**	5.2	-6.2	-1.4	-1.1	**-1.0**
Real private consumption (% change, yoy)	**3.5**	2.8	-8.4	-1.1	-2.7	**-2.5**
Real government consumption (% change, yoy)	**2.0**	11.2	8.4	-1.1	4.6	**5.6**
Real investment (% change, yoy)	**17.2**	12.0	-11.8	-4.5	-4.1	**-2.8**
Industrial output (% change, yoy)	**0.3**	-1.5	-9.7	3.5	9.5	**0.4**
Unemployment rate (registered, % pa)	**10.4**	9.7	7.3	9.0	9.9	**9.0**
Nominal GDP (EUR million)	**45,967**	11,078	10,810	11,931	12,648	**46,468**
GDP per capita (EUR)	**6,583**	1,589	1,552	1,716	1,821	**6,691**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**2.4**	2.5	1.1	1.2	1.1	**1.5**
Consumer prices (% change, yoy, pa)	**1.9**	1.8	1.0	1.9	1.9	**1.7**
Producer prices (% change, yoy, pa)	**0.68**	0.4	-3.3	-2.0	-2.1	**-1.8**
Average gross wage (% change, yoy, pa)	**10.46**	10.36	8.66	9.53	8.84	**9.34**
Exchange rate (RSD/EUR, pa)	**117.85**	117.54	117.59	117.59	117.58	**117.58**
Exchange rate (RSD/USD, pa)	**105.28**	106.71	106.28	99.28	98.15	**102.6**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**17,536**	4,237	3,597	4,371	4,846	**17,052**
Exports of goods (EUR, % change, yoy)	**7.7**	3.3	-19.9	-0.7	6.7	**-2.8**
Imports of goods (EUR million)	**23,875**	5,987	4,743	5,794	6,433	**22,957**
Imports of goods (EUR, % change, yoy)	**8.9**	7.7	-20.2	-0.8	-1.5	**-3.8**
Current account balance (EUR million)	**-3,273**	-1,016	-340	-501	-227	**-2,084**
Current account balance (% of GDP)	**-7.1**	-9.2	-3.1	-4.2	-1.8	**-4.5**
Foreign Direct Investment net inflows (EUR million)	**3,551**	798	620	285	1,200	**2,902**
Foreign exchange reserves (EUR million, eop)	**14,889**	14,476	15,654	14,964	15,550	**15,550**
Foreign debt (EUR million, eop)	**28,254**	28,655	30,959	30,719	30,813	**30,813**
GOVERNMENT FINANCE						
Revenues (RSD billion)	**2,279**	537	476	588	655	**2,255**
Expense (RSD billion)	**2,023**	534	673	579	618	**2,405**
Net = Gross operating balance (RSD billion)	**255**	3	-197	8	36	**-150**
Net acquisition of non-financial assets (RSD billion)	**266**	55	61	59	118	**293**
Net lending/borrowing (RSD billion)	**-11**	-52	-258	-51	-82	**-443**
Domestic government debt (EUR million, eop)	**9,883**	10,457	11,085	11,216	11,434	**11,434**
Foreign government debt (EUR million, eop)	**14,065**	13,852	15,742	15,388	15,235	**15,235**
Total government debt (eop. % of GDP)	**53**	53	58	58	58	**58**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**14.04**	26.59	44.26	35.87	35.02	**35.02**
Broad money, M4 (% change, yoy, eop)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Total domestic credit (% change, yoy, eop)	**8.13**	10.7	16.0	17.7	14.5	**14.5**
DMBs credit to households (% change, yoy, eop)	**9.24**	9.04	12.6	14.3	11.8	**11.8**
DMBs credit to enterprises (% change, yoy, eop)	**7.62**	11.2	12.3	11.8	8.4	**8.4**
Money market interest rate (%, pa)	**1.63**	0.99	0.49	0.24	0.23	**0.49**
DMBs credit rate for enterprises short-term (%, pa)	**3.08**	2.6	3.1	2.6	2.8	**2.8**
DMBs credit rate for households short-term (%, pa)	**6.2**	5.4	5.99	5.7	1.8	**4.7**

**The average exchange rate is calculated by the authors based on calculations from NBS

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

Policy assumptions and projections summary

The mid-term macroeconomic framework that was presented in the Fiscal Strategy 2021-2023 was quite optimistic, as it assumes that in 2021 strong economic growth at 6% rate will be archived along with fiscal stabilization at a 3% fiscal deficit, i.e. without the strong support of the government to the economic recovery of firms and households. Nevertheless, already in February 2021 Government realized that achieving such a high growth rate without support is not realistic. A new package of fiscal support to the economy was adopted, while planned public investments were increased. According to the revised macroeconomic framework, growth in 2021 is again optimistically projected at 6% but with somewhat different GDP components and a large increase in fiscal deficit projected at 7% of GDP. On the other side, growth forecasts of the Fiscal Council, European Commission and IMF are less optimistic, varying between 5% to 5.5%. On the other side, mid-term growth for 2022 and 2023 is forecasted by the government at a potential growth rate of around 4%, which is also in line with the EC and IMF forecasts. The highlight of the mid-term growth forecasts is the decline of net export contribution close to zero, following the expectations about strong growth of export. Overall, economic growth will correspond to the growth rate of domestic absorption. However, the latest revision of the macroeconomic framework, wherein the net export contribution was revised from -0.8 to -1.8, indicates that such expectations may be premature. The new package of Government support to the private sector will most likely impede the increase of unemployment in 2021. However, in the mid-run, it is reasonable to expect that unemployment will slightly increase. After postponing fiscal stabilization in 2021, it is most likely that since 2022 government will reduce spending, bringing the fiscal deficit down to debt-declining values.

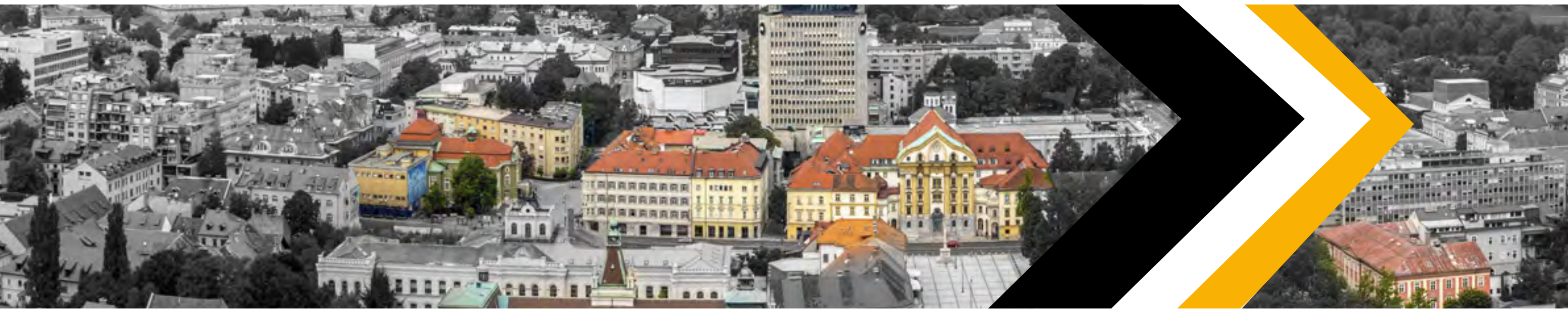
Table SRB2 Summary of projections

	2022	2023	2024
Real GDP (% change)	**4.0**	**4.0**	**4.0**
Real private consumption (% change)	2.8	2.9	N/A
Real government consumption (% change)	2.5	1.8	N/A
Real investment (% change)	7.1	7.8	N/A
Exports of goods and services (constant prices, % change)	12.5	10.5	10.4
Imports of goods and services (constant prices, % change)	11.2	9.4	8.8
Current account balance (% of GDP)	-3.0	-3.2	-3.3
Consumer prices (% change, pa)	2.2	3.0	N/A
Exchange rate, national currency/EUR (pa)	118	118	118
Unemployment rate (registered, %, pa)	N/A	N/A	N/A
General government balance (ESA 2010 definition, % of GDP)	1.5	1.0	0.5
Total domestic credit (% change, eop)	N/A	N/A	N/A

Source: The Fiscal Strategy 2021-2023, IMF, IMF WEO, Own estimates

When it comes to projections regarding the trends of the exports and imports of goods and services in Serbia over the next three-year period, it is possible to single out IMF's forecasts according to which it is expected that during 2022 the percentage change in exports and imports of goods and services will be 12.5% and 11.2%; 10.5% and 9.4% during 2023; and 10.4% and 8.8% during 2024, respectively. In other words, a strong recovery in exports and a slight increase in imports are expected already during 2022. According to European Commission's latest publications, the growth of exports during the rebound is predicted based on the launch of new production capacities resulting from foreign direct investments attracted during the previous period, while imports are projected to grow primarily due to import-intensive public investment and private consumption.

Also, according to IMF's predictions, it can be expected that the current account deficit (as a share of GDP) will remain at the approximately same level (in the range of -3.0% to -3.3% of GDP) in the 2022-2024. In other words, taking into account the value from 2020 (-4.5%), the current account deficit is expected to narrow slightly in the coming years. A stable current deficit covered by the expected surge of foreign direct investment will contribute to the stability of the exchange rates in the short and mid-run.



SLOVENIA

The economy less hit during the second wave of the pandemic

Export-oriented activities and construction recovered

Due to the COVID-19 pandemic and the related containment measures, the gross domestic product declined by 5.5% in 2020. The economic activity continued to be strongly affected also in the first quarter of 2021. The contraction of economic activity was most pronounced in the 2nd quarter of last year (-12.9% year-on-year), during the first wave of the pandemic when the measures to contain the spread of the coronavirus were most strict and broad. As a consequence, the volume of industrial production, investment and private consumption were significantly reduced. With the loosening of containment measures during the summer months, economic activity started to recover in June and continued to improve into the 3rd quarter of the year. However, a strong resurgence in COVID-19 infections towards the end of the 3rd quarter implied reinstatement of stringent containment measures. In contrast to the first wave, the measures mainly affected service activities while export-oriented activities (manufacturing and transport) and construction recovered throughout the second half of the year. Consequently, the year-on-year decline in the gross domestic product was much smaller in the last quarter (-4.5%) and the drop at the annual level lower than anticipated.

Extensive anti-corona packages

A range of measures to alleviate the negative consequences of the COVID-19 for the population and the economy and support faster economic recovery have been adopted at the national and ECB levels and by the European Commission. This comprehensive policy support significantly softened last year's contraction of economic activity, supported employment and limited insolvencies. Still, employment decreased and the unemployment rate increased slightly. The impact of the anti-corona measures will also be crucial this year to sustain the economic activity during the third wave and support the economic recovery, particularly in the service sector, in the second half of the year.

Service activities affected most

While during the first wave of the pandemic the economic activity declined in most sectors, the second wave of the pandemic affected service activities particularly. At the annual level, turnover from the sale of services was 11.1% lower than in 2019. It declined most in accommodation and food service activities (37.1%). It was significantly lower also in administrative and support service activities (by 24.2%) – mainly due to a sharp drop in the turnover of travel agencies.

Industrial production recovered in the second half of 2020

While industrial production was still slightly down year-on-year in the 3rd quarter (-2.8%), it exceeded the 2019 level in the last quarter of the year (1.6%). At the annual level, the value of industrial production was 5.1% lower than in 2019. It was lower in electricity, gas, steam and air conditioning supply (by 9.1%), in manufacturing (by 4.8%), and in mining and quarrying (by -2.1%). From the technological intensity point of view, production in medium-high and medium-low industries was down in 2020 compared to 2019 despite a sharp increase in the second half of 2020. On the other hand, the production in high-technology industries was higher in 2020 by 5.9%, owing to high growth during the first half of the year.

Private consumption contracted severely

Significant reduction in private consumption expenditure (9.8% compared to 2019) was a considerable element of last year's gross domestic product decline. The decrease was associated mainly with high uncertainty about the future, lack of spending opportunities and restriction on travelling. On the other hand, household disposable income was not significantly affected by the crisis due to the government extensive support measures. The decrease in final household consumption expenditure was slightly more prominent in the 2nd quarter (-17.3% y-o-y) than in the 4th quarter (-14.5% y-o-y). A closer look reveals that during the first wave, the drop was mainly in expenditure for other goods and services, while in the second wave, the consumption of durable goods was affected more. Government consumption was the only consumption aggregate that strengthened in 2020, mainly due to the large-scale anti-COVID-19 support measures and increased employment.

Real investment recovered in the last quarter

A decline in (gross) investment was another major element of gross domestic product contraction in 2020. Real investment shrunk by 5.8%, with the gross fixed capital formation being 4.1% lower at an annual level compared to 2019. While the gross fixed capital formation dropped significantly during the 2nd quarter (-13.8% y-o-y), it has been rising in quarterly terms in the second half of the year and was 2.0% up y-o-y in the 4th quarter. The increase was mainly observed in construction (2.8% and 4.3% y-o-y in the 3rd and 4th quarter, respectively) while investment in machinery and equipment was still slightly down year-on-year in the last quarter of 2020, but the decline was much smaller than in the 2nd quarter (-1.7% and -21.6%, respectively).

Growth in goods exports turned positive

Foreign trade was severely hit in 2020 amid a fall in world trade, international restrictions on travel and national containment measures. The decrease was much more prominent for services than goods trade. The latter already recorded positive growth on a year-on-year basis in the last quarter of the year: exports of goods were up by 4.1% and imports by 0.1%. In 2020 as a whole, exports of goods dropped by 5.6% and imports of goods by 8.9% compared to the previous year. The corresponding drop in the exports and imports of services was much higher (20.2% and 17.5%), with the most significant decrease being observed in the tourism and travel industry. However, a slow recovery in the external trade of services could be observed from quarter to quarter. The contribution of net exports to gross domestic product growth nevertheless stayed positive in 2020, as imports fell more than exports.

The current account surplus strengthened further

The surplus of the current account strengthened further in the second half of the year and stood at EUR 3.3 billion in 2020, a 0.5 billion increase over 2019. It increased mainly due to the sharp rise in goods trade surplus, resulting from a more substantial shock in domestic demand than the decline in foreign demand during the crises and an improvement in terms of trade. Services trade surplus declined further in the pandemic, primarily due to a fall in the surplus in travel and transport services.

The number of employed persons started to increase

After a sharp drop in the number of employed persons during the first wave of the pandemic, their number increased in the second half of the year. However, only the number of employees with employment contracts increased while the number of self-employed persons was down year-on-year throughout 2020. In the last quarter, their number was lower y-o-y by 4.4% (or by 5,000). At the annual level, the employment rate in the age group 20-64 was 75.6%, 0.8 p.p. lower than in 2019. The decline would have been more significant in the absence of government measures to support employment and limit insolvencies.

During the first wave of the epidemic, between April and June, almost a tenth of employed persons was on layoff, representing 45% of all those absent from work, while during the second wave (4th quarter), people on layoff represented 28% of all those absent from work. More women than men were on layoff.

After being in decline since 2013, the unemployment rate slightly increased in 2020. At the annual level, the ILO unemployment rate stood at 5.0% in 2020, 0.5 percentage points higher than in 2019. In the last quarter of 2020, there were 53,000 unemployed persons in Slovenia, about the same as in the 2nd and 3rd quarters of 2020, but by 29.8% more than in the last quarter of 2019.

Private sector wage growth slowed down

In 2020, the year-on-year growth of the average gross wage (5.9%) was significantly affected by the payment of crisis allowances and new employment in the public sector, and the inclusion of employed persons in intervention job retention schemes in the private sector. The average gross and net (after taxes and contributions) wages were EUR 1,856 and EUR 1,209.

After having increased markedly in the 2nd quarter, the year-on-year wage growth in the private sector slowed noticeably in the 3rd and 4th quarters of the year. In the public sector, significant wage growth was observed during both waves of the pandemic due to the extraordinary payment of allowances for hazardous work, higher workloads and new employment, particularly in health and social care. At the annual level, the average monthly gross wage in the private and public sector was 4.4% and 7.8% higher, respectively, than in 2019.

General government balance deteriorated further

After being positive for two years, the general government balance turned negative (EUR 3.9 billion) in 2020 due to the deterioration in economic conditions and measures taken by the state to lessen the effects of the COVID-19 pandemic. After increasing in the 2nd quarter, the general government deficit dropped in the 3rd quarter but increased again during the second wave of the pandemic. It stood at 8.2% of gross domestic product at the annual level. The deficit was mostly the result of an increase in expenditure, but general government revenue also declined in 2020.

In the second part of the year, the y-o-y increase in general government expenditure was 2.2% and 16.6% in the 3rd and 4th quarter, respectively. The bulk of the increase stemmed from higher subsidies, other current transfers and employee compensation. On the other hand, the general government revenue declined y-o-y by 3.1% and 4.9% in the 3rd and 4th quarter, mainly due to a decrease in tax revenue.

Contraction in corporate and consumer loans

Year-on-year growth in household loans slowed further towards the end of last year and stood at only 0.1% in the last quarter. The decline in loans was primarily attributable to reductions in spending by households due to the uncertainty and the inability to spend due to containment measures. The year-on-year contraction in household loans was mainly on account of a decline in consumer loans, which was stronger in the second half of the year, while y-o-y growth in housing loans remained positive and relatively stable through the year. At the outbreak of the pandemic, the enterprise sector also strengthened further their saving relative to their investment. Year-on-year growth in loans to enterprises had been negative since June 2020 and stood at -2.9% and -2.1% in the 3rd and 4th quarter of the year.

Lower energy prices drive deflation

Year-on-year growth in consumer prices turned negative again in the last quarter of 2020 amid the second wave of the pandemic. At the annual level, inflation stood at -0.1%. The largest driver of the deflation remains the year-on-year fall in energy prices, in particular lower prices of oil products, following the decline in oil prices at the world market. Food price inflation slowed in the final quarter, and so did the service price inflation, the latter due to the constrained private consumption during the second wave of the pandemic.

Table SL1 Main economic indicators

	Total 2019 year	2020 Q1	2020 Q2	2020 Q3	2020 Q4	Total 2020 year
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**3.2**	-2.3	-12.9	-2.4	-4.5	**-5.5**
Real private consumption (% change, yoy)	**4.8**	-6.4	-17.3	-0.6	-14.5	**-9.8**
Real government consumption (% change, yoy)	**1.7**	4.1	-1.1	1.3	2.8	**1.8**
Real investment (% change, yoy)	**1.5**	-2.4	-10.1	-17.4	8.2	**-5.8**
Real gross-fixed capital formation (% change, yoy)	**5.8**	-3.5	-13.8	-0.8	2.0	**-4.1**
Industrial output (% change, yoy)	**3.1**	-1.4	-17.4	-2.8	1.6	**-5.1**
Unemployment rate (LFS, % pa)	**4.5**	4.6	5.2	5.1	5.1	**5.0**
Nominal GDP (EUR million)	**48,393**	11,283	10,915	12,164	11,935	**46,297**
GDP per capita (EUR)	**23,165**	5,384	5,205	5,792	5,652	**22,014**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**2.3**	0.0	3.1	1.3	0.9	**1.3**
Consumer prices (% change, yoy, pa)	**1.6**	1.5	-0.9	0.0	-0.7	**-0.1**
Producer prices (% change, yoy, pa)	**0.6**	-0.1	-0.6	-0.3	-0.1	**-0.2**
Average gross wage (% change, yoy, pa)	**4.3**	3.2	8.8	4.8	6.7	**5.9**
Exchange rate (___/EUR, pa)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Exchange rate (EUR/USD, pa)	**1.12**	1.10	1.10	1.17	1.19	**1.14**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**32,013**	7,852	6,423	7,359	7,993	**29,627**
Exports of goods (EUR, % change, yoy)	**4.3**	-0.1	-21.2	-4.5	4.1	**-5.6**
Imports of goods (EUR million)	**30,682**	7,282	5,842	6,626	7,348	**27,098**
Imports of goods (EUR, % change, yoy)	**4.7**	-1.3	-23.2	-10.5	0.1	**-8.9**
Current account balance (EUR million)	**2,723**	818	646	899	909	**3,272**
Current account balance (% of GDP)	**5.6**	7.3	5.9	7.4	7.6	**7.1**
Foreign Direct Investment net inflows (EUR million)	**1,521**	202	314	32	132	**681**
Foreign exchange reserves (EUR million, eop)	**384**	446	459	477	507	**507**
Foreign debt (EUR million, eop)	**43,796**	45,848	48,124	47,913	48,189	**48,189**
GOVERNMENT FINANCE						
Revenues (EUR million)	**21,160**	4,771	4,893	5,228	5,303	**20,195**
Expense (EUR million)	**20,953**	5,522	6,526	5,610	6,404	**24,062**
Net = Gross operating balance	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Net acquisition of non-financial assets (EUR million)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Net lending/borrowing (EUR million)	**208**	-752	-1,633	-382	-1,101	**-3,868**
Domestic government debt (EUR million, eop)	**26,680**	28,857	31,713	31,617	32,258	**32,258**
Foreign government debt (EUR million, eop)	**1,880**	1,879	1,870	1,870	2,061	**2,061**
Total government debt (eop. % of GDP)	**65.6**	68.9	78.2	78.4	80.8	**80.8**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**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**
Total domestic credit (% change, yoy, eop)	**6.3**	6.4	11.0	11.4	8.4	**8.4**
DMBs credit to households (% change, yoy, eop)	**5.9**	4.2	1.7	1.3	0.1	**0.1**
DMBs credit to enterprises (% change, yoy, eop)	**1.2**	4.5	-0.5	-2.9	-2.1	**-2.1**
Money market interest rate (%, pa)	**-0.41**	-0.54	-0.54	-0.55	-0.56	**-0.55**
DMBs credit rate for enterprises short-term (%, pa)	**1.8**	1.6	2.0	2.1	1.9	**1.9**
DMBs credit rate for households short-term (%, pa)	**3.2**	3.1	2.9	2.9	2.8	**2.9**

Source: 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

Economic projections generally revised upwards

The economic outlook projections for 2021 were generally revised upwards by national in international organizations. Nevertheless, the future recovery will largely depend on the path of the pandemic, including vaccination progress and whether the new COVID-19 strains prove susceptible to vaccines, the effectiveness of policy and the adjustment capacity of the economy.

In its Spring Forecast 2021, the Institute for Macroeconomic Analysis and Development (IMAD) from Slovenia predicts that gross domestic product will increase by 4.6% and 4.4% in 2021 and 2022, respectively, and moderate to 3.3% in 2023. The estimate lies on the assumption that the epidemiological situation in the country will improve, also on account of increased vaccination coverage, and the economic recovery would start in the 2nd quarter and accelerate in the second half of the year. Economic activity is expected to reach pre-crisis levels of 2019 in 2022. Fiscal policy measures at the national and EU levels will continue to play a crucial role in the economic recovery, together with monetary policy measures of the ECB. The European Commission Winter 2021 Forecast for Slovenia is slightly more optimistic and projects a 4.7% and 5.2% increase in the gross domestic product in 2021 and 2022, respectively. On the other hand, the IMF is more cautious in its April 2021 Forecast and predicts a 3.7% and 4.5% increase in the gross domestic product over the next two years.

Similar to the situation during the second wave of the epidemic, economic recovery will remain differentiated across sectors in 2021. Further growth is expected in manufacturing and construction, as well as in related service activities. Gross domestic product growth is expected to be supported by positive net exports, particularly in goods trade, amid significantly improved export expectations. In addition, growth will be supported by both strong domestic demand and growth in investment, especially infrastructure and housing investment.

According to IMAD, private consumption will pick up after last year's drop and is projected to grow by 4.0% and 4.7% in 2021 and 2022. Its growth will be spurred by gradual re-opening of service activities, growth in disposable income and accumulated savings during the economic lockdown. Growth in government consumption will increase further in 2021 (2.4%) and then gradually decline in the following years (1.7% and 1.4% in 2022 and 2023, respectively). This year's growth in government consumption will be the result of expenditures related to the containment of COVID-19 virus and a gradual increase in other expenditure on goods and services, which were depressed during the pandemic. Employment in the general government sector is projected to increase further this year, affected by pandemic related employment as well as the EU presidency.

Employment growth will strengthen, and the unemployment rate decline

According to IMAD, employment growth will continue to strengthen over the projection horizon, with the unemployment rate decreasing to the pre-crisis level in 2023. With the easing of epidemiological conditions, employment will continue to recover gradually this year, while the unemployment rate in 2021 will remain similar to that last year (5.0%). In the next two years, the unemployment rate is projected to gradually decline to 4.8% and 4.5%. The projection assumes that government measures will continue to mitigate the negative impact of the COVID-19 crisis on the labour market, particularly in the first half of 2021, and will be lifted only gradually.

According to WEO, the general government deficit will narrow to -6.2% of the gross domestic product in 2021 and further decrease over the projection horizon.

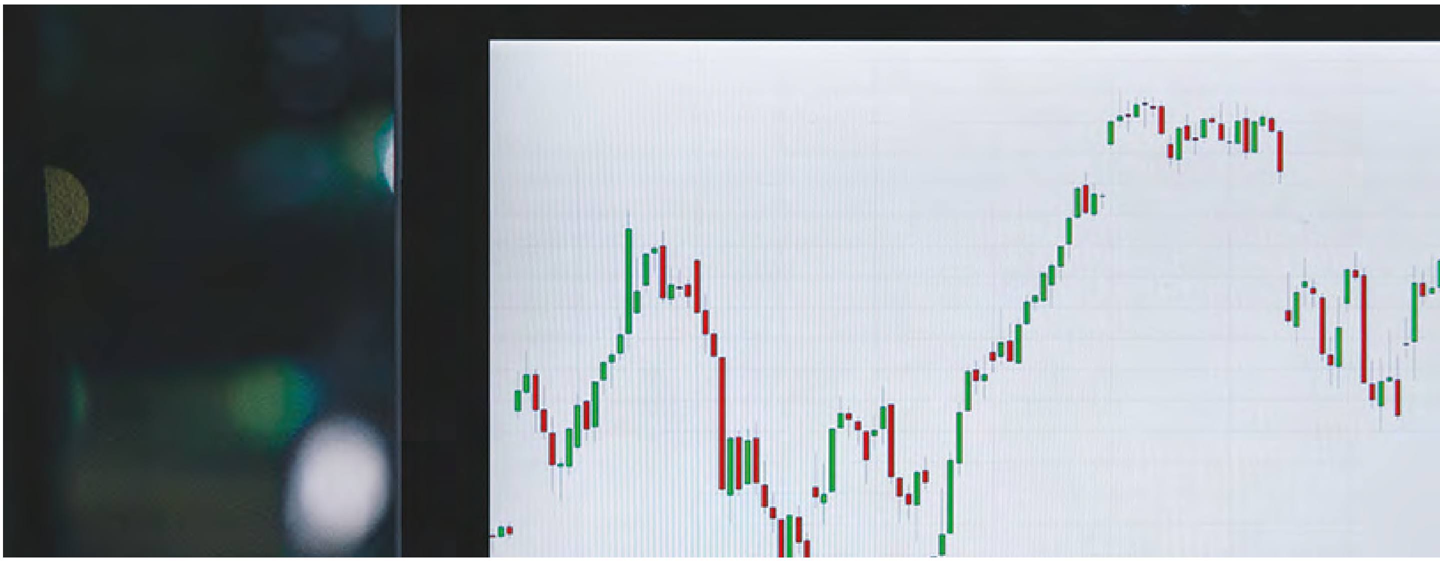
Consumer prices are predicted to grow

According to IMAD, inflation will stand at 0.8% in 2021 and accelerate further to 1.2% and 1.7% in the following two years. The European Commission and IMF forecasts also project a 0.8% increase in consumer prices this year while the respective estimates for 2022 are somewhat higher: 1.7% and 1.5%. This year's inflation will be mainly driven by higher energy and food prices, while growth in goods and services prices will also contribute to the rising price levels in 2022.

Table SL2 Summary of projections

	2022	2023	2024
Real GDP (% change)	**4.4**	**3.3**	**N/A**
Real private consumption (% change)	4.7	2.9	N/A
Real government consumption (% change)	1.7	1.4	N/A
Real investment (% change)	N/A	N/A	N/A
Real gross-fixed capital formation (% change)	8.0	6.5	N/A
Exports of goods and services (constant prices, % change)	7.3	5.5	N/A
Imports of goods and services (constant prices, % change)	8.1	6.1	N/A
Current account balance (% of GDP)	6.1	5.8	N/A
Consumer prices (% change, pa)	1.2	1.7	N/A
Exchange rate, EUR/USD (pa)	1.208	1.208	N/A
Unemployment rate (LFS, %, pa)	4.8	4.5	N/A
General government balance (ESA 2010 definition, % of GDP)	-4.2	-3.4	N/A
Total domestic credit (% change, eop)	N/A	N/A	N/A

Source: Institute for Macroeconomic Analysis and Development – Spring Forecast of Economic trends 2021, and IMF – World Economic Outlook, April 2021.



ANALYSIS

Financial inclusion in the SEE countries

This issue of the SEE-6 Economic Outlook is focused on analyzing financial inclusion, referring to accessing and using formal financial services. To be more specific, it is related to providing affordable, accessible, and relevant financial products and services to individuals and firms. Financial inclusions strive to remove barriers within the financial sector to encourage economic growth, drive development and improve living conditions equally for businesses and individuals alike.

We collected the data for this analysis from the Global Findex database for three research periods 2011, 2014 and 2017, as described in Demirguc-Kunt and Klapper (2012). The Global Findex database is built based on the surveys realized using randomly selected, nationally representative samples in 144 countries, covering roughly 1000 people in each economy. The latest edition of the database (2020) will point to advances in digital technology that are key to achieving the increased financial access to services. However, the results for the 2020 database will be not known until 2021, when the Findex 2020 data is published. Therefore, in this research, we will use the latest available data from 2017.

Chart 1 shows the percentage of respondents who report having an account at a bank or another type of financial institution. The level of financial inclusion varies among analyzed countries and with observed years. Slovenia has the highest number of account holders, followed by Croatia. These two countries have a stable percentage of individuals who reported having an account at the financial institution. On the other hand, Bosnia and Herzegovina and Romania reported the lowest percentage of respondents with formal financial accounts. Positive trends of increasing the percentage of individuals included in the formal financial system are evident for most countries, excluding Serbia and Romania who had an unstable trend of increase in 2014 and a decrease in 2017 and Croatia

with a slight drop in the percentage of account holders. Slovenia is the only country exceeding the percentage of account holders compared to the Eurozone average of 95%. Increasing the percentage of account holders is an important financial tool that serves as the basis for savings and access to credit markets and everyday transactions such as purchasing goods and services, paying utilities, or sending and receiving money.

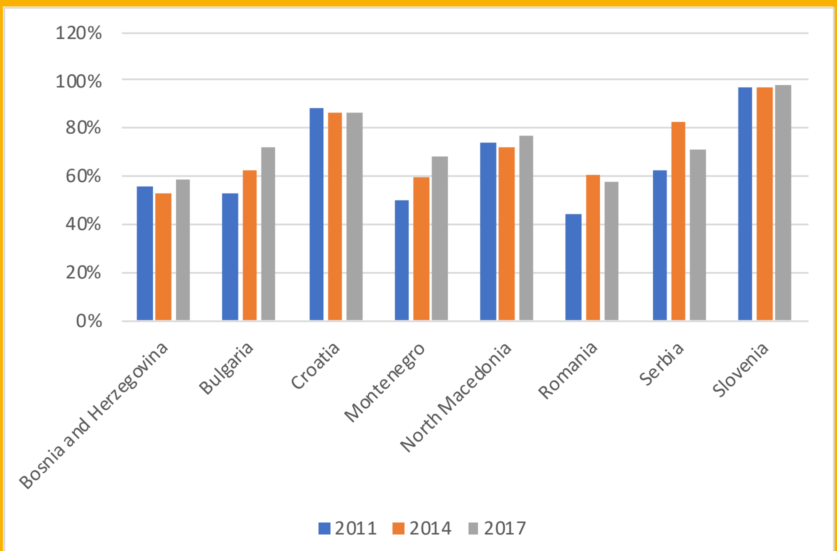
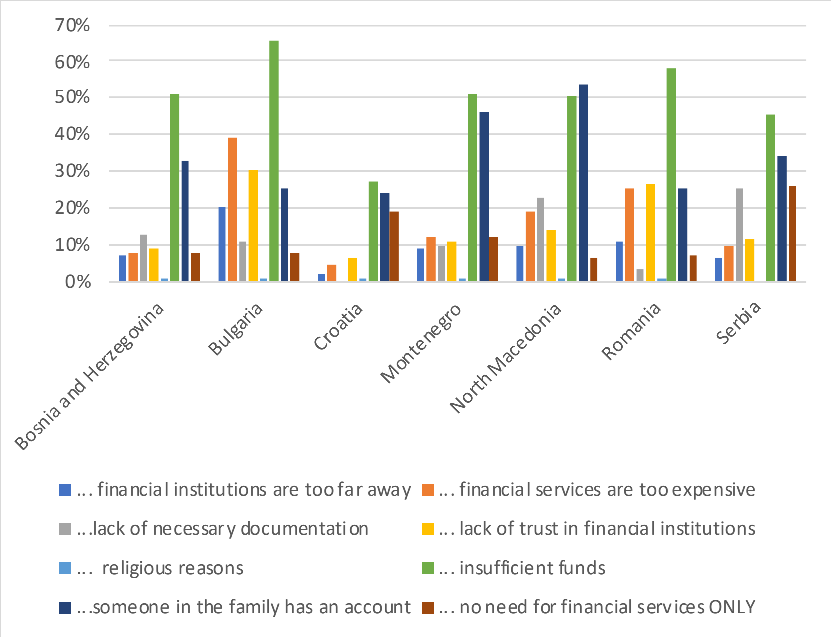


Chart 1: The percentage of respondents who report having an account at a bank or another type of financial institution

Source: Demirgüç-Kunt et al., 2018, based on the authors' calculation

Analysis of why individuals do not hold an account at a financial institution shows differences and coincides with the economy's socio-economic status (Chart 2). The major reason respondents stated across analyzed counties is insufficient funds. The second most important reason is that someone in the family has an account and that several individuals use the same account for financial transactions. A significant number of individuals from Serbia stated that there is no need for financial services or that they lack documentation. Serbia and North Macedonia are the only two countries that reported this factor in a more significant percentage. Therefore, we can conclude that the procedures in these two countries are somewhat more rigorous and complicated. Financial services are perceived as the most expensive in Bulgaria and Romania, while religious reasons are mentioned in a small percentage in Bulgaria, North Macedonia and Montenegro.

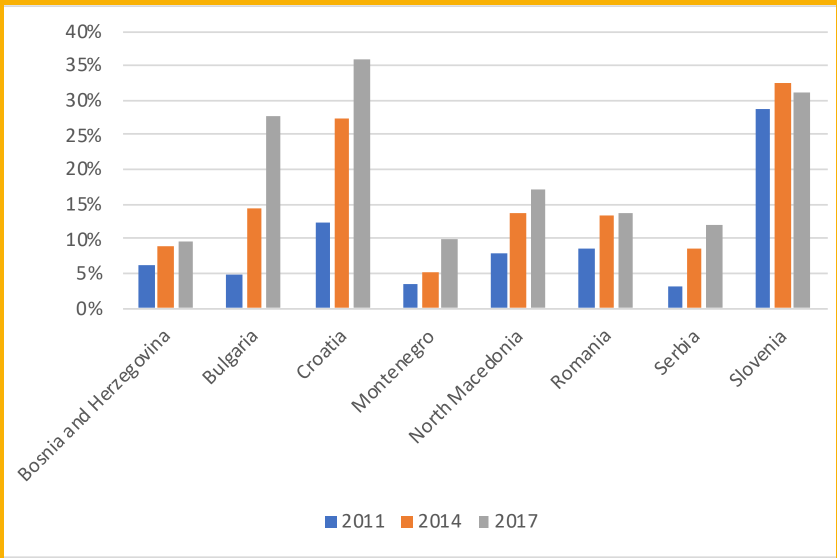
Chart 2: Reasons why respondents do not possess a financial institution account (%)



Source: Demirgüç-Kunt et al., 2018, based on the authors' calculation
Note: Data for Slovenia is missing

Savings and borrowing are mainly limited by the specific economic situation and the earnings of individuals. Data from the Chart 3 show low levels of savings through the formal financial system. In the number of financial accounts, Croatia and Slovenia have the highest percentage of individuals who reported saving at a financial institution. Opposite to this, the saving levels are below 20% for all observed countries, except Bulgaria. Nevertheless, there is a rapid increase in the percentage of individual saving in the observed period, ranging from 4% in Bosnia and Herzegovina to 24% in Croatia, besides Slovenia, with a slight decline in 2017. Again, the percentage of saving is lower in all analyzed economies than in the Eurozone, reaching 49% in 2017. Domestic savings increases the lending potential available for financing profitable business opportunities that can lead to economic growth.

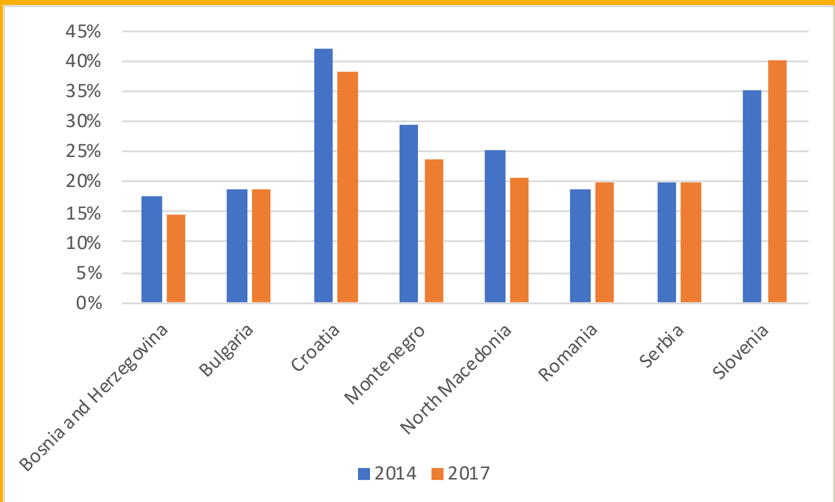
Chart 3: The percentage of respondents who report saving or setting aside any money at a bank or another type of financial institution



Source: Demirgüç-Kunt et al., 2018, based on the authors' calculation

Chart 4 shows that trends in borrowing, including ownership of a credit card, are more constant. They do not point to an improvement in the percentage of individuals borrowing from the formal financial system or improved lending condition that can increase the borrowing capacity. As in the other cases, Croatia and Slovenia have the highest number of individuals who reported borrowing from formal financial institutions or owning a credit card. There is a general trend of stagnation or a decrease of borrowers/credit card owners compared to 2014, except in Slovenia, with a slight rise. Compared to the Euro area, there are similar patterns as in other analysis. Only Slovenia and Croatia are close to the Euro level, that was, for 2017, at the level of 46%.

Chart 4: The percentage of respondents who report borrowing any money from a bank or another type of financial institution or using a credit card



Source: Demirgüç-Kunt et al., 2018, based on the authors' calculation
Note: Data for 2011 are not available

The observed countries within this analysis have not achieved the same level of financial inclusion. Indicators related to the number of account holders, savings and borrowing through the formal financial system in analyzed countries are below the Eurozone's average. Slovenia and Croatia are significantly closer to the average compared to other observed countries. However, a positive fact is the increasing financial inclusion observed along with the majority of analyzed parameters. As the following survey is planned for 2020, we can expect results soon to point to further improvement concerning financial inclusion.

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