SEE-6 Economic Outlook

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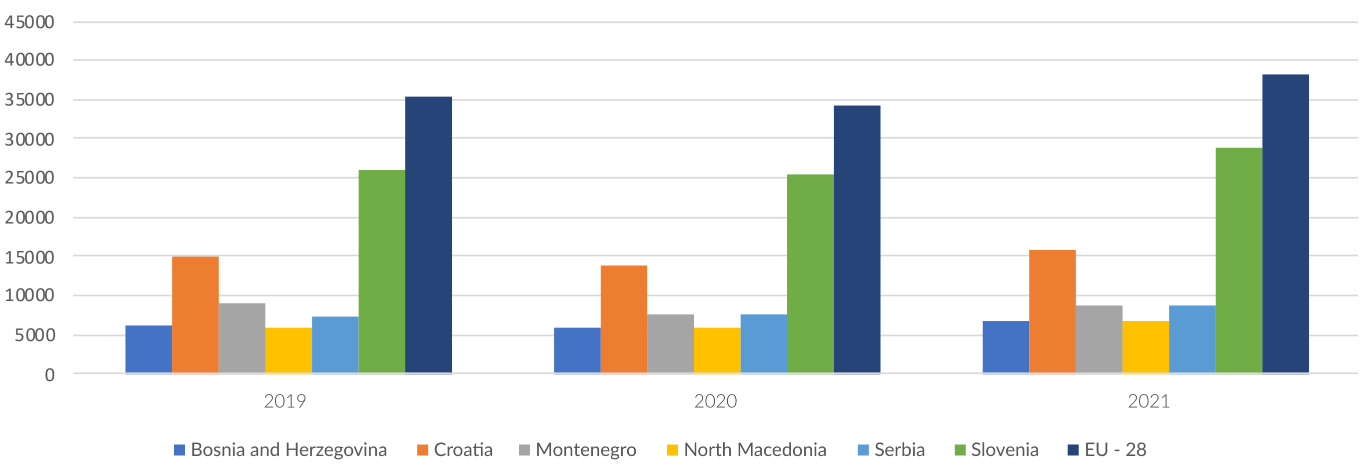
GDP PER CAPITA FOR SELECTED SEE COUNTRIES AND EU-28



Source: IMF
Note: GDP per capita, current prices (U.S. dollars per capita)

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BOSNIA AND HERZEGOVINA

Gradual economic recovery in the first half of 2021

Positive economic trends despite institutional weaknesses and delays in implementing key regional connectivity projects

In health and economic terms, 2020 is completely marked by the global pandemic of the Covid-19 virus. Accordingly, the global spread of the Covid-19 virus pandemic in 2020, accompanied by the introduction of the so-called lockdown economy, had a very negative impact on economic trends in the world, the region, and ultimately in Bosnia and Herzegovina. Nevertheless, at the beginning of 2021, a slight recovery of the economy was recorded, which is indicated by GDP, industrial production, domestic demand and, consequently, merchandise imports.

Although relatively high growth rates have been recorded, largely due to the previous year's low base (base effect), it is worth noting that these developments are quite encouraging given the presence of the Covid 19 global pandemic and delays in the vaccination process in Bosnia and Herzegovina.

The authorities have made some progress in improving the business environment and enhancing the functioning of 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.

In the first semester of 2021, a gradual recovery of the BiH economy was recorded. Namely, after the GDP growth rate for 2020 was negative (-0.3% yoy), in the first two quarters of 2021, positive growth rates of 3.2% and 1.2% were achieved, respectively. Thus, GDP growth in the first semester of 2021 was primarily due to an increase in real private consumption (2.8% yoy) and real investment (2.5% yoy).

Moderate growth as a result of the recovery of private consumption and real investment

In addition, economic growth in the first semester of 2021 was supported by the increase of the physical volume of industrial production of 4.8% compared to the same period last year. Given the global Covid 19 pandemic, this increase in the physical volume of industrial production is encouraging. Still, it is also necessary to keep in mind the effect of the low base from the previous year, which enabled such a high growth rate. In terms of sectors, the most significant contribution to the growth of industrial production during this period was made in the sector for electricity production, within which there was an increase in production of 17.0% and manufacturing of about 14.8%. This recovery is especially important within the manufacturing industry, which accounts for 2/3 of total industrial production, has a high degree of export orientation and is an important employment generator in Bosnia and Herzegovina.

A slight increase in the unemployment rate

In the first semester of 2021, there was an increase in unemployment compared to the last quarter of 2020. According to the Labor Force Survey data, the unemployment rate in the second semester was 18.1%, which is a slight increase compared to the average rate in 2020. amounted to 15.9%.

In June 2021, the number of persons in paid employment in BiH was 820,979. Compared to May 2021, the number of persons in paid employment increased by 0.5%. The number of registered unemployed persons in Bosnia and Herzegovina in June 2021 was 393.7 thousand. Compared to May 2021, the number of unemployed persons decreased by 0.6%.

From January to June 2021, the average monthly gross salary per employee in legal entities in BiH amounted to 775 euros. As a result, the average monthly gross earnings in the first half of 2021, compared to the first half of the previous year, was nominally higher by 4.8%.

Moderate inflation was recorded in the first semester of 2021

In the first two quarters of 2021, moderate inflation was recorded. The price level in the second quarter of 2021 is 1.1% higher than in the same quarter of the previous year. The average growth of prices was recorded in the sections *Food and non-alcoholic beverages by* 1.9%, *Alcoholic beverages and tobacco by* 1.9%, *Housing and overheads by* 0.9%, *Health by* 0.6%, *Transport 8.6%*, *Recreation and culture by* 0.3%, *Education by* 0.2%, *Restaurants and hotels* by 0.6% and *Other goods and services* by 0.4%. On the other hand, the average decrease in prices was recorded in the sections *Clothing and footwear* by 7.5%, *Furniture, household appliances and regular housekeeping* by 0.3% and *Communications* by 0.4%.

Significant growth in foreign trade

After the spread of the global Covid 19 virus pandemic, in 2020, Bosnia and Herzegovina recorded a decline in total trade of over 10%, a consequence of a reduction in merchandise exports of 16.5% imports of 14.3% compared to the previous year. In the last year, these negative trends in foreign trade are a direct consequence of the decline in production within the manufacturing industry in Bosnia and Herzegovina in 2020.

However, in the first semester of 2021, there was a certain improvement in foreign trade with the world. Namely, not neglecting the effect of the low base from the previous year, Bosnia and Herzegovina achieved an enviable growth rate of merchandise exports in the first semester of 2021 (19.8% yoy). On the other hand, in the first semester of 2021, there was a strong growth of imports (18.5% yoy), which indicates the recovery of domestic demand (consumption and investment) in Bosnia and Herzegovina.

Improvement in government finances due to growth in public revenues

After ending 2020 with a budget deficit, there was an improvement in government finances in the first two quarters of 2021. Due to the growth of budget revenues in the first semester of 2021, a budget surplus of 224 million BAM was realized. During the first quarter of 2021, about 3.8 billion public revenues were collected in Bosnia and Herzegovina. Compared to last year's same period, these revenues are higher by about 1.9% due to the growth of revenues from direct taxes, especially from contributions.

Table BH1 Main economic indicators

	2020				Total 2020 year	2021	
	Q1	Q2	Q3	Q4		Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	0.3	-9.0	4.6	2.8	**-0.3**	3.2	1.2
Real private consumption (% change, yoy)	-0.9	-10.1	6.3	0.9	**-1.0**	5.1	0.5
Real government consumption (% change, yoy)	0.6	0.1	0.4	0.2	**0.3**	0.5	0.6
Real investment (% change, yoy)	-0.9	-11.4	9.0	0.0	**-0.8**	-4.6	9.6
Industrial output (% change, yoy)	-4.1	-10.7	-2.6	5.3	**-2.0**	2.8	-6,8
Unemployment rate (LFS, % pa)	16.7	16.0	14.2	16.6	**15.9**	19.1	18.1
Nominal GDP (EUR million)	4,517	4,339	4,484	4,562	**17,902**	4,641	4,790
GDP per capita (EUR)	1,290	1,239	1,281	1,303	**5,114**	1,326	1,368
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	1.1	1.1	1.1	1.1	**1.1**	1.057	1.057
Consumer prices (% change, yoy, pa)	1.9	-0.3	-0.9	-0.2	**0.1**	0.7	1.1
Producer prices (% change, yoy, pa)	-1.0	-1.6	-1.3	-0.9	**-1.2**	1.0	4.0
Average gross wage (% change, yoy, pa)	4.7	3.1	3.9	3.7	**3.9**	2.8	4.8
Exchange rate (_BAM/EUR, pa)	1.96	1.96	1.96	1.96	**1.96**	1.96	1.96
Exchange rate (_BAM/USD, pa)	1.77	1.77	1.67	1.60	**1.70**	1.61	1.62
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	2,206	1,897	2,169	2,314	**8,588**	2,272	2,591
Exports of goods (EUR, % change, yoy)	-2.8	-30.2	-22.1	-7.8	**-16.5**	3.0	36.6
Imports of goods (EUR million)	2,333	2,066	2,372	2,470	**9,244**	2,366	2,800
Imports of goods (EUR, % change, yoy)	-5.7	-27.4	-14.8	-7.7	**-14,3**	1.4	35.5
Current account balance (EUR million)	-127	-168	-202	-156	**-655**	-92	-208
Current account balance (% of GDP)	-2.8	-3.8	-4.5	-3.4	**-3.7**	-2.0	-4.3
Foreign Direct Investment net inflows (EUR million)	124	106	88	22	**340**	176	214
Foreign exchange reserves (EUR million, eop)	6,357	6,644	6,808	7,076	**7,076**	6,958	7,234
Foreign debt (EUR million, eop)	4,154	4,421	4,422	4,432	**4,432**	4,515	4,677
GOVERNMENT FINANCE							
Revenues (BAM_ million)	3,081	2,815	3,236	3,419	**12,522**	3,191	3,391
Expense (BAM_ million)	2,818	3,187	3,227	3,760	**12,991**	2,928	3,167
Net = Gross operating balance	263	-372	9	-341	**-469**	263	224
Net acquisition of non-financial assets (BAM_ million)	40	102	96	231	**470**	60	93
Net lending/borrowing (BAM_ million)	223	-473	-88	-571	**-909**	203	130
Domestic government debt (EUR million, eop)	829	1,085	1,126	1,009	**1,009**	1,063	N/A
Foreign government debt (EUR million, eop)	5,109	5,382	5,390	5,387	**5,387**	5,452	N/A
Total government debt (eop. % of GDP)	N/A	N/A	N/A	N/A	**24,8**	N/A	N/A
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	12.9	11.7	11.4	13.6	**13.6**	14.5	17.2
Broad money, M4 (% change, yoy, eop)	8.8	6.9	6.3	7.3	**7.3**	8.6	11.1
Total domestic credit (% change, yoy, eop)	3.7	0.8	-0.4	-2.0	**-2.0**	-1.3	2.0
DMBs credit to households (% change, yoy, eop)	5.3	1.9	0.7	-0.8	**-0.8**	0.7	3.6
DMBs credit to enterprises (% change, yoy, eop)	0.9	-2.6	-3.2	-4.9	**-4.9**	-2.1	-5.8
Money market interest rate (%, pa)	3.1	3.0	3.1	3.1	**3.1**	3.2	3.1
DMBs credit rate for enterprises short-term (%, pa)	3.8	3.8	3.7	3,7	**3.7**	3.7	3.7
DMBs credit rate for households short-term (%, pa)	3.7	3.7	4.1	3.2	**3.7**	3.9	3.3

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., it will be overcome in the second half of 2021. Therefore, the precondition for the realization of these projections is overcoming the new circumstances in the short term, improving the international economic environment and implementing structural reforms in the country and assuming the materialization of these circumstances according to the projections in the period 2022-2023. Bosnia and Herzegovina is 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 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), total exports could be expected in 2002-2023, with annual growth rates of 5.8% and 6.7%, respectively. As a result, 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 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 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	N/A
Unemployment rate (LFS, %, 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

Economic recovery in 2021 much faster than expected

Swift economic recovery surpassed even the most optimistic forecasts

Even the most optimistic forecasts made at the beginning of 2021 did not envisage such a fast recovery of the Croatian economy that plunged as deep as -8.1% of GDP in 2020 due to COVID-19 negative economic impacts combined with the two devastating earthquakes on top of it.

According to the Croatian Bureau of Statistics, the fall of the real GDP in the first quarter of 2021 was halted at -1.0%, compared to the Q1 in 2020, however already indicating significant economic recovery by 5.4% when compared to the last quarter of 2020, thus marking the end of a trend of continuous decline generated by pandemic shock. Moreover, the impressive economic growth which followed after that in the second quarter of 2021 (Q2) recorded as high as 16.1% at y-o-y level and was made on the wings of swift rebound of private consumption, tourist sector, manufacturing, construction and exports of goods. Indeed, part of the explanation of such an unexpected swift recovery lies in the very low base of GDP compared to 2020. Nevertheless, as many other macroeconomic indicators from Q2 were very favourable and continued to go upward in the months afterwards, most domestic and international analysts were convinced to upgrade their forecasts for the whole 2021 significantly.

Components contributing to economic recovery in the first half of 2021

According to the latest European Economic Forecast from November 2021, the anticipated growth of GDP for the whole of 2021 is 8.1%, the third strongest in the EU, after Ireland and Estonia. Furthermore, the Croatian Government expects an even higher growth rate of 9.0% in their last forecasts.

Several components contributed positively to such encouraging economic results in the first half of 2021, which continued into the third quarter, paving the way to surprisingly solid economic recovery for the whole of 2021.

Very positive contribution to the pace of economic growth in the first half of the year lies in the significant rebound of the demand side of the economy, brought primarily on the wings of the solid and continuous rise of private consumption. In the first quarter of 2021 (Q1), the private consumption rate fell only slightly by -0.4% on the annual level, while in Q2, it expanded by an impressive 18.4% rate and is one of the most significant contributors to the high GDP growth rate in this quarter. The reasons behind such an increase in private consumption result from a combination of several favourable factors. Apart from the low base of comparing quarter in 2020, the rise of personal income is one of them, owing to the further personal income tax cuts effective from January 2021, which increased net wages. The other factor includes improved situation at labour market through new employment opportunities brought by expanding economic recovery.

On the other hand, the real government consumption continued to grow in the Q1 of 2021, albeit at a much lower rate of 0.2%, while in the second quarter, this consumption increased by 4.0%. That rise in government consumption in Q2 was mainly related to increased expenditures of fighting the pandemic during its third wave.

In addition, apart from the health sector, the continued need for job keeping and liquidity subsidies are directed to targeted business sectors. However, the situation for the Government somewhat eased in this period. It brought fewer uncertainties in managing it financially, both because of economic recovery and substantial EU funds available for supporting the workers of non-operating firms.

The total real investments also recovered significantly in the first half of the year, owing mostly to public investments into infrastructure financed by abundant EU structural and investment funds, thus playing a significant role in the overall economic recovery and swift growth of GDP in this period. The total investment rate in Q1 increased by 5.0%, reflecting the substantial recovery of private investments, which mostly halted in 2020 due to high uncertainties related to pandemic developments. According to the recent data of the Croatian Bureau of Statistics, the total investments in Q2 were even more impressive, with a growth rate of 18.1%. As such, both public and private investments in this period played a very positive role in an overall economic rebound.

Very strong rebound of both exports and imports

The significant rebound of exports of goods continued to be a very positive driving force of the overall economic recovery in the first half of 2021. Such developments were possible because of the rise of external demand due to the strong economic recovery of Croatia's main trading partners in Europe (Germany, Italy, and Austria). The swift surge of exports of goods was especially strong in Q2 of 2021 with a rate of 36.0%, partly owing to the low comparing base on annual level. However, the most surprising is that exports of goods surpassed the pre-crisis levels recorded in 2019, which is encouraging concerning its contribution to the current account balance. Namely, exports of goods were even 20.8% higher when compared to the same period in 2019, according to Croatian National Bank. Exports of chemical products, energy products and transport equipment continued to represent the dominant part of exporting goods in this period.

At the same time, the imports of goods also recovered very strongly due to a significant increase in demand for intermediate products, reflecting the rising needs of expanding domestic industry. Nevertheless, according to the Croatian Bureau of Statistics, the recovery of imports of goods was at a much lower rate than exports, especially in Q1 when it was at 2.6% y-o-y compared to the 7.4% for exports. However, its growth was very strong in the second quarter at the rate of 31.9% y-o-y, and it continued to rise strongly in the months after that.

On the other hand, the exports of services also recovered beyond expectations. They returned to their traditional role as a significant source of the overall growth of GDP and an important contributor to current account balance. Namely, the tourist season experienced quite a boom after the restrictive travel measures were lifted/decreased in the important EU tourist emitting markets and COVID-19 digital passes introduced at the beginning of June. According to the Croatian National Bank, foreign tourist spending in some summer periods was very close to or even surpassed the pre-crisis levels, resulting from a surplus at the current services account of 0.5 billion EUR at the end of the second quarter of 2021. This contributed to improvements in the overall current account level, which at the end of Q2 was -0.6 billion EUR.

Significant revival of industrial output growth

Domestic industry output also experienced a significant revival in the first half of 2021. In the first quarter of 2021, the industrial output achieved a growth rate of solid 3.1%, because of the continuous increase of demand of its products at domestic and export markets. In the second quarter (Q2), the growth rate recorded 12.4%, thus offsetting almost entirely the dramatic fall of industrial output that was most intensive in the second and third quarters of 2020. The industries that contributed the most to the impressive industrial output growth rate in Q2 are those predominantly exporting their products such as ships and other transport equipment, chemical products, electricity and other energy products.

Employment levels increased, unemployment rates further reduced

Strong economic recovery in the first half of 2021 had very positive effects on further stabilisation and improvements of labour market in Croatia. The Government job-keeping measures continued throughout this period. However, they were significantly reduced in scope and directed just towards several well-targeted services sectors, which continue to be badly affected by the pandemic (such as transport companies, travel agencies, hospitality services and event industries). Nevertheless, such measures contributed positively to preserving the current employment levels. However, on a more positive note, the number of firms that needed such governmental financial subsidies has been reducing month by month, especially in the second quarter (Q2) of 2021. According to Croatian National Bank to illustrate, by the end of May 2021, only 7.5% of total employees consumed such job-keeping support.

On the other hand, the demand for workers was very profound in the service sectors, which experienced a great expansion of their activities after the moderation or lifting of the restrictions to travel in June 2021 throughout Europe. This was particularly the case with tourist sector, a traditional source of increased seasonal employment, leading to a significant increase of such employment, especially when the summer season started to accelerate.

The situation at labour market in the first half of 2021 reflected both of the described developments above. In the first quarter of 2021, the rate of unemployment measured by Labour Force Survey (LSF), has increased to 9.9% because of the severe second wave of the pandemic and reintroduced travelling restrictions affecting again mostly the businesses in services sectors. In addition, the seasonal workers are traditionally out of work in these winter/spring months.

However, the situation significantly improved in the second quarter of 2021, when the unemployment rate dropped to 8.0%, reflecting the general swift revival of the economy and strong demand for workers in several sectors. Apart from tourism, this, in particular, includes the construction sector, agriculture and manufacturing industry. In these sectors, the demand for workers was surpassing the job-seeking potentials offered by the domestic labour market and shortages of labour force were rather profound throughout the year, despite the lifting of the quotas for foreign workers.

The fiscal deficit started to moderate

After such an enormous fiscal deficit that recorded in 2020, the public finances started their recovery path in the first half of 2021, and deficit ratio to GDP begun to slowly decline along with strong economic growth in this period, which brought a much higher increase of budget revenues than growth of expenditures.

On the Budget income side, the strong revival of economy brought along the significant increase of revenues both in Q1 and Q2 of 2021, especially when compared to the Q2 in 2020, when the Budget balance suffered the most due to a lockdown. In addition, the EU funding supporting fiscal recovery from negative impacts of pandemic also substantially contributed to an increase of budget revenues. On the other hand, on the expenditure side, costs in Q1 and Q2 experienced much weaker relative growth than revenues, reflecting the reduction of scope and better targeting of job-keeping subsidies to businesses and a decrease of interest expenditures due to refinancing of public debt at lower interest rates. These developments led towards substantial improvements in the net operating balance, especially when compared to the second quarter of the previous year when the gap between the budget revenues and expenditures was over 1.4 billion Euro just for that quarter.

Such positive trends also continued in the summer months, thus making the ground for very positive anticipations of further narrowing of fiscal deficit for the whole of 2021, both by domestic and foreign analysts.

Although the general government debt continued to increase nominally due to a strong economic growth surge, its GDP ratio reduced in the first half of 2021 and at the end of Q2 was around 87.0%. This fact is especially important as Croatia expects to join the Eurozone in 2023 and has to demonstrate a clear trend of declining public debt ratio in GDP towards the required Maastricht levels.

Consumer and producer prices on rise

The strong revival of the economy in the first half of 2021 caused a consequent rise of prices for both consumers and producers due to increased demand. This especially relates to the surge of oil and gas prices at the world market, resulting in the rise of petrol prices and another oil derivate. In addition, the food prices have continued to rise in both quarters of 2021, contributing significantly to the CPI rise. This development was partly a result of a decrease in domestic agriculture production caused by severe weather conditions (frost, floods). At the same time, the imports of food became more expensive due to increased transport costs.

Nevertheless, the rise of the CPI rate was still rather modest in the first half of 2021. In the first quarter, the CPI rate increased by only 0.4% compared to the same quarter in the previous year, while in the second quarter the rise was stronger by the rate of 2.1% on an annual basis. On the other side, the rise of producer prices in the Q2 was very strong y-o-y (6.9%), due to steep rise of energy prices as well as the increase of prices of intermediate products (especially raw materials and construction materials). However, the rise of inflation started to build up at much stronger rates in the third quarter of 2021, according to the Croatian Bureau of Statistics monthly rates, and after many years of low levels, inflation become an important source of concern for policy makers.

Table HR1 Main economic indicators

	2020				Total 2020 year	2021	
	Q1	Q2	Q3	Q4		Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	0.8	-14.6	-10.1	-6.9	**-8.1**	-1.0	16.1
Real private consumption (% change, yoy)	0.7	-14.0	-7.5	-4.5	**-6.2**	-0.4	18.4
Real government consumption (% change, yoy)	6.1	1.7	3.0	3.1	**3.4**	0.2	4.0
Real investment (% change, yoy)	-0.9	-14.9	-4.2	-3.8	**-6.1**	5.0	18.1
Industrial output (% change, yoy)	-1.9	-9.2	-1.0	-0.4	**-3.1**	3.1	12.4
Unemployment rate (LFS, % pa)	7.0	6.4	7.5	9.2	**7.5**	9.9	8.0
Nominal GDP (EUR million)	12,468	11,731	13,475	12,639	**50,245**	12,404	13,981
GDP per capita (EUR)	3,081	2,899	3,330	3,123	**12,410**	3,073	3,464
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	-0.9	0.3	0.2	0.3	**-0.1**	-0.3	-2.0
Consumer prices (% change, yoy, pa)	1.4	-0.3	-0.1	-0.3	**0.1**	0.4	2.1
Producer prices (% change, yoy, pa)	-0.2	-5.6	-4.2	-3.4	**-4.2**	0.2	6.9
Average gross wage (% change, yoy, pa)	6.2	3.9	5.1	5.3	**5.1**	3.8	4.4
Exchange rate (HRK/EUR, pa)	7.48	7.53	7.52	7.55	**7.53**	7.56	7.53
Exchange rate (HRK/USD, pa)	6.78	6.89	6.44	6.34	**6.61**	6.27	6.25
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	3,684	3,219	3,791	4,206	**14,900**	4,039	4,743
Exports of goods (EUR, % change, yoy)	1.9	-9.5	-2.3	10.7	**0.3**	7.4	36.0
Imports of goods (EUR million)	4,169	5,111	5,711	5,992	**20,983**	6,310	7,007
Imports of goods (EUR, % change, yoy)	-1.0	-23.5	-7.9	-1.8	**-8.8**	2.6	31.9
Current account balance (EUR million)	-1,359	-470	2,001	-226	**54**	1.299	802
Current account balance (% of GDP)	-3.9	-3.5	14.2	-3.0	**0.8**	0.3	0,6
Foreign Direct Investment net inflows (EUR million)	379.6	267.5	404.5	-5.6	**1,046.1**	647.6	1,048.6
Foreign exchange reserves (EUR million, eop)	16,425	17,257	18,372	19,165	**18,943**	21,084	21,586
Foreign debt (EUR million, eop)	40,268	41,376	41,041	40,083	**40,083**	43,586	44,369
GOVERNMENT FINANCE							
Revenues (HRK million)	41,821	40,746	45,866	50,025	**178,457**	45,208	48,632
Expense (HRK million)	46,170	51,593	50,294	58,251	**206,307**	49,770	53,340
Net = Gross operating balance	-4,349	-10,847	-4,428	-8,226	**-27,850**	-4,562	-4,708
Net acquisition of non-financial assets (HRK million)	1,185	-750	138	299	**274**	-835	-1,066
Net lending/borrowing (HRK million)	-3,164	-11,597	-4,290	-7,927	**-27,576**	-5,397	-5,774
Domestic government debt (EUR million, eop)	25,881	28,754	29,270	29,704	**29,783**	28,962	29,438
Foreign government debt (EUR million, eop)	13,409	15,039	14,082	14,035	**14,072**	16,080	15,822
Total government debt (eop. % of GDP)	75.2	85.3	87.2	87.7	**87.3**	87.2	87.0
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	17.2	18.0	14.9	17.0	**17.0**	18.4	16.8
Broad money, M4 (% change, yoy, eop)	8.8	8.7	6.5	9.3	**9.3**	7.4	8.1
Total domestic credit (% change, yoy, eop)	5.0	3.3	4.1	3.9	**3.9**	2.5	3.9
DMBs credit to households (% change, yoy, eop)	6.1	3.7	4.2	2.1	**2.1**	2.2	4.4
DMBs credit to enterprises (% change, yoy, eop)	4.2	4.1	5.0	6.0	**6.0**	1.2	1.5
Money market interest rate (%, pa)	0.3	0.3	0.2	N/A	**N/A**	N/A	N/A
DMBs credit rate for enterprises short-term (%, pa)	2.9	2.8	2.8	2.6	**2.6**	2.8	2.7
DMBs credit rate for households short-term (%, pa)	8.1	7.9	7.0	6.6	**7.6**	6.4	6.3

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 continuing also in the medium term

In the summer and especially in autumn of 2021, owing to the surprisingly strong economic recovery (having so-called “V” shape), both the official and international economic growth projections revised significantly upwards for the whole of 2021. The Croatian Ministry of Finance (end of October 2021) envisages GDP growth in 2021 at a rate of 9.0%, almost twice higher than April 2021 projections (5.2%). The September 2021 prognosis of the Croatian National Bank anticipates a GDP growth rate of 8.5%. In the most recent November 2021 forecast, the European Commission envisages that the Croatian GDP in 2021 will expand by 8.1% this year. On the other hand, the World Bank’s projections from October 2021 are traditionally more cautious and anticipate a growth rate of 7.6% in 2021.

The most medium-term GDP projections depend significantly on further success in managing and restraining the pandemic and its negative impacts on the economy, which also rests upon further vaccination of a vast proportion of the population. So far, only about 56% of the adult population completed vaccination with two doses, which is among the four lowest in the EU. Despite this negative risk, the growth prospects in the 2022-2024 period look very favourable. On the positive assumptions side, one of the important factors potentially contributing to this favourable outlook is the scheduled Croatia’s entry into the Euro zone in 2023, which would likely enhance investment and trade flows by further reducing the associated risks and transaction costs. In addition, the Fitch rating agency on 12th November 2021 increased Croatia investment ratings to BBB due to its significant progress in 2021 despite the pandemic shock. As a result, it gave a positive outlook for sustained economic growth in the medium term. This assessment, which offered quite a favourable perception of country risk, might also positively affect the investors’ decisions in the future.

The Government's last projections of medium-term growth at the end of October 2021 envisages the continuance of the strong growth rate of 4.4% in 2022, followed by 3.7% in 2023 and 3.1% in 2024. These projections are somewhat lower when compared to the April 2021 rates, as the Government initially expected that the year 2022 would be the main recovery year. Economic recovery prospects in the medium term rely heavily on 6.3 billion Euro of available EU funding that should come through the ambitious Program of Recovery and Resilience, which the Government submitted at the end of April 2021 and the European Commission approved before the summer. According to the EC, Croatia is among the top net beneficiaries of the planned EU investment funding within this facility for the coming period. In addition, the abundant EU funding from Solidarity Fund is at disposal for the post-earthquakes reconstruction of Zagreb and Banija region, what makes the envisaged growth rates achievable if funding use is successful. Apart from the foreseen investments, the main drivers of economic growth in the medium term would also rest upon increased tourism sector earnings, private consumption and exports of goods.

As for the important international prognosis for this period is even more optimistic than the Government projections. In its Autumn Economic Forecast 2021 (November 2021), the European Commission envisages an even stronger growth rate of 5.6% in 2022, followed by 3.4% in 2023. The World Bank in its recent fall 2021 forecasts from October 2021 anticipates growth rate of 6.0% in 2022, followed by 4.2% in 2023, what is at this time, the most optimistic.

Table HR2 Summary of projections

	2022	2023	2024
Real GDP (% change)	**4.4**	**3.7**	**3.1**
Real private consumption (% change)	3.2	3.1	3.2
Real government consumption (% change)	2.1	2.0	1.9
Real investment (% change)	12.1	8.7	5.6
Exports of goods and services (constant prices, % change)	10.7	5.7	3.6
Imports of goods and services (constant prices, % change)	10.7	6.2	4.4
Current account balance (% of GDP)	0.8	0.3	0.2
Consumer prices (% change, pa)	2.6	2.3	2.2
Exchange rate, national currency/EUR (pa)	7.53	7.53	7.53
Unemployment rate (LFS, %, pa)	6.8	5.9	5.3
General government balance (ESA 2010 definition, % of GDP)	-2.6	-2.4	1.9
Total domestic credit (% change, eop)	3.0	3.3	3.4

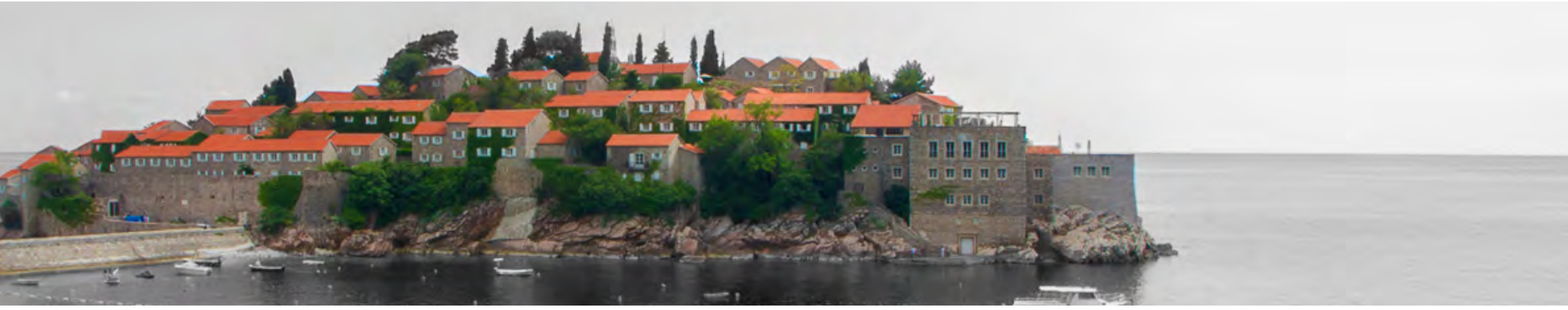
Source: Ministry of Finance of Republic of Croatia and Croatian National Bank.

MONTENEGRO

Slight recovery of economic activity in a complex socio-political environment

The first half of 2021 in Montenegro was marked by a health crisis in the fight against the Covid19 pandemic and no less significant activities in the field of the gradual recovery of the Montenegrin economy. The very poor epidemiological situation at the end of 2020 continued in the first quarter of the current year, in such a way that Montenegro occupied leading positions at the European level in the number of active cases of infection, as well as the number of deceased citizens in relation to the population. It is inevitable to mention delays in vaccine procurement, so the process of mass immunization of the population began quite late, on May 4th 2021.

In such circumstances, it is natural that the economic consequences were very pronounced. Official projections from relevant international addresses and the latest published data from the Statistical Office of Montenegro (MONSTAT) and the Central Bank of Montenegro show a decline of the Montenegrin economy by 15.3% in 2020, which according to Eurostat, is the worst result on the European



continent. The next worst affected country is Spain, with a drop in newly created value by 10.8%. To make the problem bigger, the first quarter of 2021 also brought the worst result in Europe with a drop of 6.8%. This caused significant social problems so that the unemployment rate at the end of the first quarter of the current year was 23.83%, according to the published quarterly report of the Employment Service of Montenegro. For example, compared to the previous year, the unemployment rate increased by 7%. Data published from other sources indicate negative growth rates in almost all sectors of the Montenegrin economy, except in the part of total industrial production. The balance of payments recorded a current account deficit, a foreign trade deficit and a smaller inflow of foreign direct investment. The situation was further complicated by the fact that Montenegro was in the system of temporary financing, given that due to the complex political situation, the budget was adopted at the end of June.

The second quarter brings some progress and represents the initial impulses in a certain long recovery process of the Montenegrin economy. The beginning of mass vaccination and the decision to open the borders for a better tourist season brings specific benefits at the end of the second quarter. In this period, GDP growth of 19% was recorded. There is a tendency of growth of activity in the sectors of tourism and industrial production and a somewhat smaller decline in the field of forestry. An important determinant of the Montenegrin economy in the observed period is the banking sector's stability and highly pronounced liquidity. This is especially important given the role that the banking sector should play in economic recovery in terms of supporting the economy and restarting businesses. The decision of the Assembly not to adopt the Law on Unconditional Moratorium, which could have seriously endangered the banking sector, certainly contributed to that.

In 2020, the Government of Montenegro adopted three packages of socio-economic measures to support the economy and citizens to help overcome the consequences of the pandemic and preserve the economic substance and liquidity of the real sector. January 2021 brought the fourth package of socio-economic measures, which essentially represented the continued assistance initially realized in the second and third packages.

The most important measures refer to the following: one-time support to the economy to establish electronic fiscalization; increasing the limit of turnover from 18,000 to 30,000 EUR as a condition for mandatory VAT registration; tourist vouchers for educators and health workers and support for private accommodation issuers. In addition, at the monetary policy level, the coverage of loan beneficiaries entitled to a moratorium, loan approval, and restructuring with preferential regulatory treatment has been expanded for those sectors that, based on previous analysis, have been identified as most affected by the pandemic.

The month of April also brought the adoption of the fifth package of measures, which is mainly focused on providing support for maintaining the economy's liquidity, employment levels, and the part related to supporting the tourism sector in the run-up to the tourist season. The most important segment is credit support for the corporate sector for EUR 110 million new credit funds.

Political environment

The political situation in Montenegro is characterized by rather strained relations within the parliamentary majority. The most important economic consequences of this situation are the late adoption of the budget and the delay in adopting numerous other reform laws aimed at increasing the living standards of citizens. In addition, the cohabitation process, which is currently ongoing, runs with certain problems, which slows down the decision-making process. In that sense, in the first half of this year, no progress was made on the path of joining the EU, in the way that some of the open negotiation chapters were closed. The limitation in the functioning of the system is the fact that a large number of institutions in Montenegro are not working in a full capacity as a consequence of the lack of political dialogue between key social/political actors.

Prices

At the end of the first quarter of last year, the onset of the health crisis led to a fall in consumer prices. However, this year first steps towards the economic recovery of the national, regional and world economy have brought a rise in prices. The leading cause of this phenomenon is the growth of oil prices at the world market, which directly affected the growth of prices in the transport sector in Montenegro and indirectly the growth of prices of several food products within the category of food and soft drinks. In June 2021, consumer prices increased by 0.2% compared to the previous month. The largest price increase was recorded in the category of hotels and restaurants (4.1%). When the aspect of annual inflation in June 2021 is taken into account, we come to the data that inflation measured by Consumer Prices Index amounted to 2.3%, while inflation measured by the Harmonized Index of Consumer Prices amounted to 2.8%.

Producer prices of industrial products in June 2021 increased by 1% compared to the same period of the previous year. These slight inflationary trends in the mining and quarrying sectors (3.6%) and manufacturing (0.7%) contributed to this growth. On the other hand, the electricity, gas and steam supply sector remained stable in that part, with no changes compared to the end of the second quarter of 2020.

Labor market and wages

At the end of the second quarter of the current year, according to the data of the Statistical Office, 149.371 citizens were employed in Montenegro, which is 16.2% fewer employees than the situation in June 2020. The structure of employed persons is still dominated by the services sector, ie trade and wholesale and retail, repair of motor vehicles and motorcycles (19.9%). They are followed by the sectors of state administration, defence and compulsory social insurance (12.7%), education (8.2%) and health and social protection (7.6%).

The average gross salary in Montenegro in the first half of 2021 amounted to 791 EUR, while the average net salary without taxes and contributions amounted to about 529 EUR. The highest salaries are still in the sector of financial services, ie insurance (972 EUR) and the sector of electricity, gas and steam supply, where salaries without taxes and contributions are at the level of 920 EUR. On the contrary, administrative, support and service activities and the area of providing accommodation and food services are industries in which wages are at the lowest level, taking values of 352 and 377 EUR, respectively.

Montenegro debates on ways and possibilities to increase the minimum wage and reduce the tax burden on wages within the broader economic recovery program. However, these issues will be discussed in parallel with the discussion on the budget for next year. Compared to comparation about average salaries, Montenegro ranks fourth in the region behind Slovenia, Croatia and Serbia, while it ranks better than Bosnia and Herzegovina and North Macedonia.

Foreign trade and capital flows

The trend of negative results in the current account balance continued in the first two quarters of 2021. According to data obtained by the Central Bank of Montenegro, it totalled 408.7 million or an average of 20.2% of GDP. Comparing these data with the first half of the previous year, we conclude that the deficit is lower by 235.3 million EUR.

According to the data of the Statistical Office, the total foreign trade of Montenegro for the first six months of 2021 amounted to 1289.3 million EUR. Compared to the first half of the previous year, that represents an increase of 6.8 percentage points. The growth of foreign trade is expected to keep in mind the country's gradual opening related to the summer tourist season and, consequently, the greater need for trade. The structure, however, is not much better when it comes to the import-export ratio. Montenegro remains a highly dependent import economy with only 18.6% coverage of imports by exports. It should be noted that this represents a slight improvement compared to the previous year data when this ratio was worth 16.1%.

In the structure of exports, the dominant share is occupied by the category Mineral fuels for 48.4 million EUR. Within this category, 92.35% refers to Electricity, while the remaining part falls on coal, coke and briquettes. In the import structure, the category Machines and transport devices are the most represented - the so-called Sector 7 according to the Standard International Classification, with 241.3 million EUR. The most significant part of this amount refers to road vehicles (69.2 million EUR) and electrical machinery, appliances and devices (50.5 million EUR). The largest foreign trade export partners were Serbia, Bosnia and Herzegovina and Switzerland, while in terms of imports, the largest share of trade relates to Serbia, China and Germany.

A decline in net capital inflows also characterized the first two quarters. The cause of the fall should be sought on two grounds. Smaller capital inflow on the account of foreign direct investments as well as realized net outflow on the basis of other portfolio investments. This primarily refers to the repayment of the principal based on Eurobonds issued in previous years. FDI amounted to 205.6 million in the analyzed period, a decrease of 20.7% compared to the previous year. The total inflow of foreign direct investments amounted to 349.6 million EUR, and the outflow reached the value of 144 million EUR.

Monetary developments

In the first half of the current year, the banking sector in Montenegro was characterized by high capitalization and significant liquidity indicators. Daily liquidity ratios were 1.99 at the end of the observed period, which is significantly improved compared to June 2020, when they were 1.32. Decade indicators are at approximately the same level. The growth of liquidity ratios results from the growth of liquid assets in the amount of 13% or 130.7 million EUR.

At the end of the second quarter, the total assets of banks amounted to 4815.2 million and were higher by 265.2 million EUR compared to previous data. In terms of assets, the increase was primarily due to an increase in loans in the total amount of 152.5 million EUR, i.e. securities by 40.5 million EUR. On the other hand, the structure of liabilities was determined mainly by the growth of deposits for 303.5 million EUR, which is an indicator of high confidence in the banking system of Montenegro. In summary, at the end of June, the structure of assets was dominated by loans with 68.8% and the structure of liabilities by deposits with a share of 76.4%.

At the end of June, however, it is noticeable to mention growth when it comes to the quantity of NPL loans, i.e. non-performing assets of banks. In total, this part amounted to 233.9 million EUR. For example, this is an increase of 17.6 million compared to the end of 2020 or 26.6 million, or 12.8% compared to the previous period. However, given the significant growth of assets, this did not broadly reflect in percentage, i.e. share in total assets, which increased by 0.30% points and reached 4.86% at the end of June.

The first two quarters saw a decline in weighted average nominal and effective interest rates. The Weighted Average Nominal Interest Rate (WANIR) on total bank loans at the end of June was 5.28%. For example, compared to June of the previous year, this represents a decrease of 0.13%. The Weighted Average Effective Interest Rate (WAEIR) on the total approved bank loans amounted to 5.78% and was 0.15% lower than the previous period. This slight decline is the effect of falling interest rates on long-term loans, while short-term loans oscillate. When it comes to depositing interest rates, they also recorded a slight decline in the analyzed period. The weighted average effective interest rate was 0.37% at the end of June this year and was 0.04 percentage points lower than 12 months earlier. Interest rates on demand deposits remained at the same level, while interest rates fell on deposits with 1-3 years of maturity. At the end of June, the difference between lending and deposit interest rates was 5.41%. This is a 0.11% smaller difference than the one that existed in June of the previous year.

Fiscal sector

The situation in the public finances of Montenegro in the first half of 2020 was mostly marked by the procedure of temporary financing. The Law on a budget of Montenegro for 2021 was adopted at the end of June, so its implementation started at the beginning of the seventh month. This period is also characterized by an increase in the collection of budget revenues due to a slight recovery of economic activity and the easing of epidemiological measures.

According to preliminary data from the Ministry of Finance and Social Welfare, public revenues for the first six months of the current year amounted to 891.6 million EUR or 19.2% of estimated GDP. This represents an increase of 6.5% or 54.4 million compared to the same period in 2020. The most significant increase was recorded in tax revenues (29.3 million EUR), mainly by VAT revenues. As a result, the plan was exceeded by 1.5%. Public spending in the same period amounted to 1.06 billion EUR or 22.9% of estimated GDP. Public spending is at approximately the same level as in previous years, as it is lower by 0.8%. The most significant decrease in expenditures was recorded in capital expenditures for 23.6 million EUR.

At the end of the second quarter, total government debt amounted to 4,079.4 million EUR or 87.98% GDP. Decomposing that amount, external debt amounts to 3,652.6 million EUR, and internal debt to 426.63 million EUR. In the structure of external debt, the largest share is occupied by liabilities based on Eurobonds (1.750). In contrast, in the internal debt structure, the majority is occupied by credits with commercial banks.

Table MN1 Main economic indicators

	2020				Total 2020 year	2021	
	Q1	Q2	Q3	Q4		Q1	Q2
ECONOMIC ACTIVITY*							
Real GDP (% change, yoy)	2.5	-20.5	-27.1	-7.7	**-15.3**	-6.5	19.0
Real private consumption (% change, yoy) **	3.3	-15.2	0.3	-5.7	**-4.6**	-8.2	15.4
Real government consumption (% change, yoy) **	1.8	2.3	2.4	-2.1	**0.8**	1.8	0.8
Real investment (% change, yoy)**	-0.1	-25.9	-7.1	-11.0	**-12.0**	-19.1	3.5
Industrial output (% change, yoy)	12.9	-15.9	-2.8	0.6	**-0.9**	11.8	8.7
Unemployment rate (LFS, % pa)	16.3	15.2	19.0	21.2	**17.9**	23.8	N/A
Nominal GDP (EUR million)	916.4	900.9	1,210.9	1,157.4	**4,185.6**	875.3	1,128.7
GDP per capita (EUR)**	1,475	1,450	1,949	1,863	**6,737**	1,410	1,818
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)**	0.4	-2.4	0.8	0.1	**-0.2**	2.1	5.3
Consumer prices (% change, yoy, pa)	0.8	-0.7	-0.3	-0.8	**-0.3**	0.0	2.3
Producer prices (% change, yoy, pa)**	1.3	-0.4	-0.5	-0.6	**-0.1**	0.8	1.8
Average gross wage (% change, yoy, pa)	2.2	1.2	1.1	0.8	**1.3**	0.3	1.5
Exchange rate (RSD/EUR, pa)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
Exchange rate (RSD/USD, pa)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	95.6	86.9	97.4	129.1	**409.0**	108.1	133.3
Exports of goods (EUR, % change, yoy)	-5.6	-23.9	-19.4	-0.2	**-12.2**	13.1	53.4
Imports of goods (EUR million)	520.9	491.0	511.5	527.5	**2,051.0**	430.2	631.5
Imports of goods (EUR, % change, yoy)	2.1	-29.5	-25.9	-16.7	**-19.0**	-17.4	28.6
Current account balance (EUR million)	-321.9	-322.1	-217.8	-228.6	**-1,090.4**	-161.9	-246.8
Current account balance (% of GDP)	-35.1	-35.8	-18.0	-19.7	**-26.1**	-18.5	-21.9
Foreign Direct Investment net inflows (EUR million)	134.2	125.0	86.2	122.1	**467.5**	83.7	122.0
Foreign exchange reserves (EUR million, eop)	N/A	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	N/A
GOVERNMENT FINANCE							
Revenues (EUR million)	423.5	413.6	482.5	549.0	**1,868.7**	390.6	501.0
Expense (EUR million)	469.6	489.2	471.6	587.9	**2,018.3**	466.2	507.8
Net = Gross operating balance	-46.1	-75.6	11.0	-38.9	**-149.6**	-75.6	-6.8
Net acquisition of non-financial assets (EUR million)	38.9	73.6	89.5	113.0	**315.0**	36.6	52.4
Net lending/borrowing (EUR million)	-85.0	-149.2	-78.5	-151.8	**-464.6**	-112.2	-59.2
Domestic government debt (EUR million, eop)	535.6	559.4	570.5	495.6	**495.6**	454.8	426.6
Foreign government debt (EUR million, eop)	2,807.8	3,105.2	3,089.8	3,835.3	**3,835.3**	3,642.7	3,652.6
Total government debt (eop. % of GDP)	79.9	87.6	87.5	103.5	**103.5**	88.4	88.0
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
Broad money, M4 (% change, yoy, eop)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
Total domestic credit (% change, yoy, eop)	4.26	5.11	5.74	3.18	**N/A**	3.31	6.79
DMBs credit to households (% change, yoy, eop)	6.46	7.39	5.82	2.68	**N/A**	1.52	1.79
DMBs credit to enterprises (% change, yoy, eop)	4.06	6.46	8.38	3.22	**N/A**	1.90	2.99
Money market interest rate (%, pa)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
DMBs credit rate for enterprises short-term (%, pa)	4.48	4.60	4.44	4.51	**N/A**	4.53	4.65
DMBs credit rate for households short-term (%, pa)	7.70	7.19	6.54	6.43	**N/A**	6.01	6.34

Policy assumptions and projections summary

Table MN2 shows the preliminary forecast of the Central Bank of Montenegro for 2021-2023.

According to the projections of all domestic and international institutions, the current year should be the beginning of the recovery of the Montenegrin economy. However, how significant that recovery will mostly depend on the success of the tourist season. A larger number of tourist arrivals is noticeable. Due to the current restrictions for travel at the European level during this season, Montenegro is more focused on regional markets. How much this will affect the budget's revenue will be more apparent by the end of the year.

A detailed overview of the projections for 2021 and the upcoming two years, in terms of estimating economic growth and the form of individual macroeconomic and fiscal aggregates is given in the following table.

Table MN2 Summary of projections

	2022*	2023*	2024*
Real GDP (% change)	**6.5**	**3.5**	**N/A**
Real private consumption (% change)	4.0	2.7	N/A
Real government consumption (% change)	2.0	0.5	N/A
Real investment (% change)	1.0	3.5	N/A
Exports of goods and services (constant prices, % change)	24.7	5.7	N/A
Imports of goods and services (constant prices, % change)	6.7	3.0	N/A
Current account balance (% of GDP)	-13.5	-12.8	N/A
Consumer prices (% change, pa)	2.2	1.8	N/A
Exchange rate, national currency/EUR (pa)	N/A	N/A	N/A
Unemployment rate (LFS, %, pa)	17.3	16.0	N/A
General government balance (ESA 2010 definition, % of GDP)	N/A	N/A	N/A
Total domestic credit (% change, eop)	N/A	N/A	N/A

*Preliminary forecasts of Central bank of Montenegro

NORTH MACEDONIA

Economic recovery looking for solid ground

Signs of economic recovery

The new 2021 began with high expectations for overcoming the effects of the pandemic. The data about economic activity in the second half of the previous year (2020) gave promising sign of recovery. Expectations, however, were higher than actually achievable. The only thing that was certain was the continuation of the pandemic.

Economic activity in Q1 2021 dropped by 1.9% on an annual basis. Compared to the 0.9 in Q1 2020, before the Covid-19 crises, it is obvious decrease. This is mainly the result of decreased activity of the industry, from -3.9 (Q1-2020) to -6.7 (Q1-2021). Also, the service sector dropped by 1% and mainly the decrease was mainly seen at the arts, entertainment and recreation sector by 3.8%. This was expected due to the taken measures and health protocols to prevent the spread of the virus.

Signs of economic recovery, that will boost economic activity appeared with the arrival of spring. Manufacturing in March 2021 showed growth of 6.2% and 64.3% in April 2021. Manufacture of textile, food products, motor vehicles etc. shifted to the positive zone. Industrial production index in this quarter increased to 24. Construction with 1.7% and agricultural sector with 0.3% are also confirming the positive trends of recovery.

Due to the previously taken measures of the Central Government to assure the aggregate consumption in high level, the private consumption was increased (0.4 in Q1-2021). The government consumption in the first quarter of 2021 showed negative -2.2%. The decline of public consumption was partially due to the high comparative basis, as well as the real drop of public expenditures for wages and allowances.

Decrease of unemployment in terms of inactive population increase

The LFS data for the first two quarters of 2021 is confirming the expectations on the labour market developments in North Macedonia. Noticeable are the changes in the employment and unemployment, accompanied with decrease of the total labour force. The number of employed in Q1/2021 compared to Q1/2020 decreased for almost 18 thousand persons, while of the unemployed for nearly 6 thousand persons. The changes in Q2/2021 compared to 2020 are manifested in increase of the employed for 1855 persons and further decline of the unemployment for around 9500 persons. At the same time the employment rate decreased from 48.1% (Q1/2020) to 47.1% (Q1/2021) and increased from 47.1% to 47.3% in Q2 respectively by years. The unemployment rate is noticing a declining trend from 16.2% to 16.0% (Q1) and from 16.7% to 15.9% (Q2). These figures shows that the decrease of the employment doesn't result with increase of the unemployment.

These changes should be seen in context of the total labour force decrease, amounting almost 24 thousand persons in Q1 and more than 7600 persons in Q2 of 2021, compared to the same quarters of 2020, as well as of the inactive population increase. The LFS data by age show that in Q1/2021 compared to 2020 the number of the inactive young and middle age population (25-49) has increased for more than 15 thousand persons, while in Q2 has decreased for around 4300 persons. It means that almost 11 thousand persons from this age group has remained inactive. It raises the question whether these persons decided to stay inactive (which is less likely due to their age), they are informally employed or have emigrated abroad. The LFS data for labour force by education show that the greatest part of the labour force decline is characteristic for those with 3 years of secondary education, as well as of the persons with primary and lower secondary education.

Worrying growth of public debt

The Macedonian economy during 2020 was affected by the COVOD-19 pandemic. Despite spending restrictions, servicing the highest priority liabilities, as well as 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 60% of GDP (for 483 million euros). Therefore, 2 amendments were made to the Budget of the Republic of Northern Macedonia for 2020, with which the total revenues are reduced by 12% (422 million euros), total expenditures increased by 5.2% (213.7 million euros). As of December 31, 2020, the realization of budget revenues exceeded by 2.1%, expenditures were realized according to the plan.

The Budget for 2021 compared to the Budget for 2020, indicates total revenues are increased by 6,15%, expenditures are reduced for 3%, budget deficit is also decreased for 2% of GDP and public debt rised to over 60% of GDP (over 7 billion euros). At the beginning of 2021, Government of North Macedonia adopted the fifth set of anti-crisis measures aimed at revitalizing and developing the economy. This set is worth EUR 160 million, including a total of 29 measures systematized in 4 main pillars. Due to the easing of the pandemic in the Q2, was made amendment of the Budget for 2021, increasing all main fiscal indicators. So, total revenues are increased by 4,7%, total expenditures by 8,56 %, and budget deficit and public debt by 5%.

Total revenues for the seven months of 2021 are realized by 54,5% of the planned, which is higher than the same period last year and due to VAT growth and import duties. Expenditures are less realized, especially capital expenditures which are realized with only 31.3%, and the deficit is realized in 41% of the planned dynamics, provided in the Budget for 2021. However, the public debt in absolute value has increased by 900 million euros, on 30.06.2021 it is 64.4% of GDP with a tendency to grow rapidly.

Monetary and banking sector – pandemic reboot

Pandemic reboot in field of the monetary policy continued with further relaxation by setting the key interest rate on the history lower level at 1.25%. The monetary relaxation with all instruments has supported credit flows in the economy and increased banking liquidity.

Despite the pandemic situation, foreign exchange reserves remain appropriate in the safe zone, resulting in solid level of foreign reserves and absence of inflationary pressures. On cumulative basis, the growth of foreign reserves since the beginning of the 2021 is slightly higher than expected. Solid NPLs to total loans ratio stands to 5%, 4.7%, 3.4% and 3.4% in each quarter of the year 2020, and 3.5% in the first two quarters of 2021 demonstrating enhanced assets quality.

After smooth stabilization in 2020, credits trends indicated mild increase in first half of 2021. Analyzing by the type of credits, household loans represent the main driver of the growth of the loans, whereas minor contribution belongs to the corporate credits. In terms of household's lending, the analysis indicate the dominate share of housing loans, with minor growth of consumer loans. Interest rates on loans and deposits demonstrates decreasing trend. Citizens continued to utilize the benefits of digitalization in banking services.

Prices are still increasing

The Consumer price index is increased and it is 2 in Q1 (2021) and 2.8 in Q2 (2021). This is the result mainly of the increased price of alcoholic beverages and tobacco in the second half of the 2021, then increased prices for restaurant and hotel services, housing, water, electricity, gas and other fuel. The prices for the health care have a significant role in the increased consumer price index in the previous period.

The consumer price index is also increased as a result of the increased prices of food, especially fruit and vegetables, as well as the prices of oil and cereals.

Most concerning fact is that the index of the producer prices in the first half of 2021 increased to 3.3 in the first quarter and 6.2 in the second quarter of the year.

Positive impulses in external sector

The recovery of foreign demand, especially from Germany and China, supported by the restoration of supply chains, leads to a recovery of the export sector. This is confirmed by the data indicating that starting from the third quarter in 2020 onwards, there is not only a significant slowdown in the decline in exports of goods, but also its accelerated recovery in Q1 and especially Q2 in 2021. Exports on annual basis increased by 23.7% and 73.1%, respectively. It is similar on the import side of goods where the recovery is also expressed in the first two quarters of 2021 with an annual percentage change of 13.6% in Q1 and 69.3% in Q2. Hence, in Q1 and Q2 in 2021, the deficit in foreign trade is narrowing due to the higher growth of exports than imports. In addition to the improved balance in the exchange of goods with foreign countries, also the higher surplus in the secondary income realized in conditions of growth of private transfers and the higher transfers of the country lead to a lower deficit in the current account. Confirmation is the data from the analysis on an annual basis, indicating that the current account deficit in Q1/2021 is 0.9 pp. of GDP lower than in Q1 the previous year. In Q2/2021 it is almost at the same level as the previous year. This indicates that the moderate deficit in the current account balance during 2020, continues in the first two quarters of 2021.

The recovery of the economy, especially in the Q2/2021, has also positive impact on FDI, recording net inflows of EUR 207.4 million, as a result of growth in all sub-components, as opposed to their continuous decline in the last three quarters of 2020 (as a result of reinvested earnings and debt instruments) and Q1/2021 (as result of intercompany debt and equity).

The positive changes are also reflected in the foreign reserves. Namely, in the first two quarters of 2021, they recorded growth, unlike 2020, when mainly in three quarters of the year, negative changes were registered. Mostly the change in the foreign reserves in both quarters of 2021 arises from the transactions on behalf of the government, and in the second quarter that change also arises from the transactions for management of the foreign reserves.

During 2021, the gross external debt continues to grow and at the end of the first quarter amounted to 9,833.4 million euros. In this period, it fully arises from the growth of public external debt, which is due to the borrowing of the country abroad by issuing a Eurobond.

Table NM1 Main economic indicators

	2020				Total 2020 year	2021	
	Q1	Q2	Q3	Q4		Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	0.9	-14.9	-3.3	-0.7	**-4.5**	-1.9	13.1
Real private consumption (% change, yoy)	-0.3	-13.0	-4.1	-4.3	**-5.6**	0.4	12.9
Real government consumption (% change, yoy)	10.7	9.8	13.5	6.6	**10.1**	-2.2	2.9
Real investment (% change, yoy)	1.0	-34.4	4.2	-13.0	**-10.2**	-16.6	38.4
Industrial output (% change, yoy)	-3.7	-25.2	-7.6	-2.2	**-9.5**	-6.1	24
Unemployment rate (LFS, % pa)	16.2	16.7	16.5	16.1	**16.4**	16.0	15.9
Nominal GDP (EUR million)	2,608.0	2,332.9	2,781.1	3,044.0	**10,766**	N/A	N/A
GDP per capita (EUR)	1256	1123	1339	1466	**5187**	N/A	N/A
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	1.9	-1.0	0.4	2.0	**N/A**	N/A	N/A
Consumer prices (% change, yoy, pa)	0.6	0.5	1.5	2.2	**1.2**	2	2.8
Producer prices (% change, yoy, pa)	0.4	0.4	0.8	1.5	**0.8**	3.3	6.2
Average gross wage (% change, yoy, pa)	10.6	5.1	7.5	5.1	**7.0**	2.0	5.7
Exchange rate (MKD/EUR, pa)	61.61	61.69	61.70	61.70	**61.67**	61.66	61.61
Exchange rate (MKD/USD, pa)	55.89	56.09	52.84	51.75	**54.13**	51.13	51.15
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	1,132.84	879.49	1351.65	1,448.58	**4,812.55**	1,401.84	1,522.5
Exports of goods (EUR, % change, yoy)	-9.0	-34.5	-0.7	5.5	**-9.6**	23.7	73.1
Imports of goods (EUR million)	1,679.15	1,231.88	1,755.10	1,955.21	**6,621.34**	1,907.0	2,085.48
Imports of goods (EUR, % change, yoy)	-2.4	-31.1	-2.4	-1.6	**-9.2**	13.6	69.3
Current account balance (EUR million)	-156.1	-91.9	-52.7	-72.4	**-373.0**	-54.7	-120.0
Current account balance (% of GDP)	-1.4	-0.9	-0.5	-0.7	**-3.5**	-0.5	-1.0
Foreign Direct Investment net inflows (EUR million)	135.9	-6.7	-7.8	84.3	**205.7**	-13.9	204.0
Foreign exchange reserves (EUR million, eop)	3,017.3	3,639.7	3,480.2	3,359.9	**3,359.9**	3,939.2	4,031.1
Foreign debt (EUR million, eop)	8,295.5	8,770.9	9,068.8	8,536.1	**8,536.1**	9,805.5	10,158.8
GOVERNMENT FINANCE							
Revenues (MKD million)	46,484	40,953	48,600	53,735	**189,770**	48,545	52,524
Expense (MKD million)	53,894	59,486	58,527	71,731	**243,636**	55,444	61,322
Net = Gross operating balance	-7,410	-18,533	-9,927	-17,996	**-53,866**	-6,899	-8,798
Net acquisition of non-financial assets (MKD million)	-1,633	-2,280	-3,175	-7,181	**-14,269**	-3,787	-2,343
Net lending/borrowing (MKD million)	-5,777	-16,253	-6,752	-10,815	**-39,597**	-3,112	-6,455
Domestic government debt (EUR million, eop)	1,971.3	2,090.4	2,102.8	2,133.4	**2,133.4**	2,120.9	2,257.3
Foreign government debt (EUR million, eop)	2,608.1	3,471	3,470.3	3,382.5	**3,382.5**	4,086.8	4,153.9
Total government debt (eop. % of GDP)	42.5	51.7	51.8	51.2	**51.2**	54.1	55.9
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	19.9	21.3	17.8	16.4	**16.4**	17.8	14.3
Broad money, M4 (% change, yoy, eop)	8.9	9.8	6.9	6.9	**6.9**	7.1	6.7
Total domestic credit (% change, yoy, eop)	5.8	6.6	7.3	4.7	**4.7**	5.2	5.1
DMBs credit to households (% change, yoy, eop)	10.1	8.8	9.5	8.0	**8.0**	8.1	8.7
DMBs credit to enterprises (% change, yoy, eop)	1.8	4.6	5.2	1.1	**1.1**	2.1	1.2
Money market interest rate (%, pa)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
DMBs credit rate for enterprises short-term (%, pa)	3.8	3.6	3.5	3.5	**3.6**	3.3	3.3
DMBs credit rate for households short-term (%, pa)	3.6	4.0	4.2	3.8	**3.9**	3.9	3.4

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 Covid-19 pandemic is still ongoing, with no clear prediction of its ending. Beside its impact on the health of the world population, this pandemic has and will have enormous impact on the economies.

The projections for the real GDP are optimistic. It is expected positive and stable growth rate in the future three years. Therefore, the projections for the real GDP growth in 2022 is 3.8%, that eventually will decrease to 3.7% in 2023 and the 3.5% in 2024.

According to the projections, real investment will be the booster of economic growth.

Inflation rate in 2021 is projected at 2.1%, which represents a certain intensification of inflation compared to 2020 and has been revised upwards compared to the initial projection (1.5%), a mid upward revision of the commodity prices forecast on world markets, such as oil, wheat and maize, and upward movement of foreign effective inflation.

The projections of the inflation are also optimistic. The inflation will not increase, the consumer prices will be stable and the consumer price index will be with projections ranging from 1.5 in 2022 to 1.9 in 2024.

Many indications show that the inactive population rise coincides with the increase of the emigration abroad in the first half of 2021. In terms of further liberation of the circular migration in the receiving countries, this trend of labour market changes in North Macedonia is expected to continue. It will implicate even more emphasized lack of the labour force and increase of the job vacancies.

It is expected 2021 to be a year of reboot and a year of gradual confidence and mobility recovery. In the future period the monetary policy will be still conducted in uncertain circumstance, having in mind the endured risks related to the duration of the pandemic, vaccination process and further measures. Hence, the consequences of the crisis will be felt in 2021, while full recovery and compensation of economic losses is expected in 2022. The credit and deposit trends are expected to continue to upsurge in the following period supporting the companies and the citizens to digests all resources in order to support overall economy.

The recovery of export and import activity will continue until the end of 2021, and of course in 2022, but at a slightly moderate pace. The narrowing of the trade deficit under the influence of stable export performance and mild moderate import pressures, as well as the better position of the balance of services and expectations for further improvement of secondary income will lead to further reduction of current account deficit in the next two years (2022-2023).

However, the main risk for North Macedonia is that a prolonged pandemic, could make difficult to handle the economic crisis.

Table NM2 Summary of projections

	2022	2023	2024
Real GDP (% change)	**3.8**	**3.7**	**3.5**
Real private consumption (% change)	3.5	N/A	N/A
Real government consumption (% change)	-1.6	N/A	N/A
Real investment (% change)	8.9	N/A	N/A
Exports of goods and services (constant prices, % change)	10.9	N/A	N/A
Imports of goods and services (constant prices, % change)	9.9	N/A	N/A
Current account balance (% of GDP)	-2.8	-2.5	-2.3
Consumer prices (% change, pa)	1.5	1.6	1.9
Exchange rate, national currency/EUR (pa)	N/A	N/A	N/A
Unemployment rate (LFS, %, pa)	16.4	16.1	16.0
General government balance (ESA 2010 definition, % of GDP)	-3.4	N/A	N/A
Total domestic credit (% change, eop)	7.0	7.0	N/A

Sources: https://ec.europa.eu/info/sites/default/files/economy-finance/ip149_en.pdf, https://www.imf.org/en/Countries/MKD

SERBIA

Economic activity bounced back, but rising inflation became a new threat

Economic activity has already started to recover in 2020 despite the COVID-19 crisis

In 2020 economic activity decreased only 1%, which is one of the best results recorded in Europe. The worst-case scenario (5% drop in economic activity) of large GDP contraction induced by the COVID-19 pandemic spreading was avoided due to the comprehensive program of support measures to business and households, which was timely adopted and implemented by the Government of the Republic of Serbia and the National Bank of Serbia. However, statistical data on economic activity for the first six months of 2021 clearly illustrate the remnants of the COVID-19 crisis' impact on the market of the Republic of Serbia, primarily in terms of increasing inflation, whose decline is not expected before the second quarter of 2022. This impact was rightly expected, mainly since the faster global economic recovery reflected on inflation movements in almost all countries.

Real GDP growth in the second quarter of 2021 was entirely driven by domestic demand

The latest available country-specific data from the Statistical Office of the Republic of Serbia indicate that real GDP growth in the first quarter of 2021 was 1.8%, while in the second quarter of the same year amounted to, remarkably, 13.7% (year-on-year). Viewed from the

production side, a positive contribution to GDP in the first trimester of 2021 was made "on the wings" of trade and construction segments (0.9 and 0.8 percentage points, respectively), as well as industry and water supply component (0.7 percentage points); while in the second quarter of 2021 aforementioned contribution was mostly influenced by the service sector (excluding trade), with 4.9 percentage points, but also by trade, and industry and water supply sections (with 2.6 percentage points each). Summarized, in the first half of 2021, real GDP grew by 7.7%. Observed by aggregates of use, real GDP growth in the second quarter of 2021 was entirely driven by domestic demand due to growth in private consumption and investment. The real wages and employment growth, along with the increased citizens' spending propensity due to a better epidemiological situation, triggered a strong increase in real private consumption (17.6%) and its contribution to GDP growth.

On the other hand, real government consumption fell by -3.8% in the second quarter of 2021. Real investments in the second quarter of 2021 have risen tremendously and reached a level of 22.5%. In July 2021, industrial output increased by 3.2%, with an escalation in the physical volume of all three industry sectors. Compared with the same month of the previous year, the most significant influence on industrial production performed production of electrical equipment, rubber and plastic products, motor vehicles and trailers, and production of non-metallic minerals.

Regarding the labor market, the situation can be expected to remain stable, primarily due to wage growth, consistent economic growth, and general economic stability. Labor market basic indicators analysis

The average net salary in the Republic of Serbia has increased in June 2021

conducted through the “refreshed” Labor Force Survey methodology - suggests that the unemployment rate in the second quarter of 2021 amounted to 11.1% (representing a drop of 1.7 percentage points compared to the first quarter of 2021, and an increase of 0.4 percentage points compared to the previous year’s same quarter); while the employment rate has reached 48.3%. As reported by National Employment Service, the number of unemployed persons actively seeking employment exceeded 541,000 in June 2021, which is an increase of 2.8% compared to the same month of the previous year. According to representatives of the Macroeconomic and Fiscal Analyses and Projections Department of the Ministry of Finance of the Republic of Serbia, in June 2021, the average net salary in the Republic of Serbia has increased by 8.9% year-on-year (i.e. 5.4% in real terms) and amounted to approximately EUR 550 (RSD 65,070).

Nominal GDP in the second quarter of 2021 was EUR 12,958 million, which is a 19.7% increase regarding the corresponding quarter of 2020 (EUR 10,824 million). Thus, in the second trimester of 2021, the Republic of Serbia’s GDP per capita amounted to EUR 1,886 million, which is 20.2%, i.e. EUR 317 million more compared to the value recorded in corresponding trimester of the previous year (EUR 1,569 million). However, the difference in observed value (EUR 1,886 million) and value recorded in the fourth quarter of 2020 (EUR 1,834 million) is almost negligible (2.8%).

Consumer prices went lower in the first quarter of 2021 (1.4%) compared to the total of 2020 (1.6%), but in the second quarter of 2021 (2.9%) increased by about 81.25 p.p compared to the total of 2020 (1.6%).

The COVID-19 led to increasing prices of Communication for more than 81 percentage points in the second quarter 2021 compared to the total of 2020

In the first two quarters of 2021, the average year-on-year growth of consumer prices, observed by the purpose, was primarily driven by the prices in services and industrial products, excluding food and energy prices. As in previous years, the largest contribution to the basic consumption groups was given by the growth of group prices of Housing, water, electrical energy, gas, and other fuels; Alcoholic beverages and tobacco; and Communication. On the other hand, the smallest contribution was given by Transport prices.

The growth of Communication prices resulted from the higher demand for communication services and global increase in raw materials and energy prices (transportation cost of the imported services and devices went high), which led to increasing the mobile equipment prices (mainly mobile devices).

The average increase in the prices of industrial products is about 7.6%. The biggest growth is recorded in the prices of industrial products for the domestic market (about 8% higher on an annual level). Looking at the purpose of consumption, the most expensive products were in the segment of the oil and natural gas exploitation - as much as 42.8% annually, followed by the production of coke and oil derivatives (36.8%) %, as well as the production of basic metals (38.1%).

Average gross wage (almost) stable despite the consequences of the COVID-19

Average earnings without taxes and contributions calculated for the second quarter of 2021 amounted to RSD 72,987 in the public sector and RSD 61,638 in the private sector. On several occasions, there has been successive growth of earnings in the public sector which influenced the growth in the private sector and total earnings. Therefore, from the beginning of 2021, earnings in the public sector were generally on a higher level than those in the private sector.

The Republic of Serbia realized the largest deficit in trade with China

Observing the Statistical Office of the Republic of Serbia's data on the Serbian foreign trade exchange in the context of the partner countries offers several important findings. In the first six months of 2021, the main "backbone" of Serbian trade were the countries with which the Republic of Serbia has signed free trade agreements (EU and CEFTA countries). As expected, EU member states led the way in this area with total trade amounted to approximately 62% (66.0% of total exports and 59.5% of total imports). When it comes to export, the top five destinations for Serbia in the reference period were Germany, Italy, Bosnia and Herzegovina, Romania, and Hungary (export values of EUR 1,252 million, EUR 881 million, EUR 698 million, EUR 649 million, and EUR 528 million, respectively). On the other hand, the most goods and services Republic of Serbia imported from Germany, China, Italy, Turkey, and Hungary (import values of EUR 1,728 million, EUR 1,569 million, EUR 1,111 million, EUR 622 million, and EUR 586 million, respectively). After considering these tendencies, it is important to highlight the fact that the Republic of

Serbia realized the largest deficit - of almost EUR 1,500 million - in trade with China (export to this eastern state is symbolic, whilst an import is extremely high - primarily due to increased import of IT resources), which is an issue that the state should address in the near future. Additionally, compared to 2020, the total volume of exports and imports has decreased for most of the partner countries, and the largest decrease in the share of trade was recorded in terms of export and import to Germany (a drop of 43% and 44%, respectively). Analysis in line with Standard International Trade Classification, performed by Statistical Office of the Republic of Serbia, suggests that at the end of the first half of 2021 the first five sections with the largest share in the structure of export are electrical machines and apparatus (EUR 1,702 million), cereals and produces thereof (EUR 664 million), fruits and vegetables (EUR 641 million), power engines and motors (EUR 626 million), and iron and steel (EUR 587 million). On the other side, concerning import, the first five sections with the largest share in its structure are electrical machines and apparatus (EUR 1,315 million), oil and oil derivatives (EUR 1,010 million), road vehicles (EUR 849 million), other general-purpose machinery (EUR 793 million), and - absolutely expected - medical and pharmaceutical products (EUR 778 million). Finally, the National Bank of Serbia's data for the first six months of 2021 indicates a total export of goods worth EUR 5,013 million and total import of goods worth EUR 6,627 million (export and import of goods' changes concerning the previous year amount to 48.1% and 50.9%, respectively), with the increased coverage of imports by exports compared to the same period of the previous year.

The highest value of the nation's current account was recorded in the second quarter of 2021

Observing the current account balance segment for 2020, i.e. the data released by Eurostat, it is possible to notice the deficit of EUR -2,034 million (-4.4% of GDP). Additionally, when it comes to trends regarding the same indicator during the first half of 2021, the deficit recorded a value of EUR -656 million at the end of June. During the observed eighteen-month period, the highest value of the nation's current account was recorded in the second quarter of 2021 (EUR 95 million), while the lowest value was registered in the first quarter of 2020 (EUR -984 million).

Regarding capital flows, it is noticeable that after the increase at the end of 2020 (EUR 1,221 million), foreign direct investment net inflows in the first two trimesters of 2021 narrowed almost to the levels that characterized them throughout the previous year (for example, EUR 795 million in the first quarter of 2020). Thus, the total inflow of foreign direct investments in the first half of 2021 amounted to EUR 1,589 million. Of that amount, even EUR 922 million were foreign direct investment net inflows from EU member states. However, the leaders in this context are China, the Netherlands, and Russia, whose investments in the Republic of Serbia amounted to EUR 394 million, EUR 301 million, and EUR 156 million, respectively.

Tendencies in the foreign exchange market of the Republic of Serbia are characterized by the relative stability of the exchange rate, despite the negative effects and inevitable influence of the COVID-19 pandemic. According to the National Bank of Serbia's data, foreign exchange reserves in July 2021 were higher by 9.4% compared to the same month of the previous year and amounted to EUR 17,014 million. Thereby, it is important to note that the National Bank of Serbia intervened in the interbank foreign exchange market during June 2021 with a net purchase of EUR 325 million, all to mitigate excessive daily oscillations. Registered changes in foreign debt, as an important component of the total government debt, are not enormous. At the end of the first half of 2021, the total foreign debt of the Republic of Serbia amounted to EUR 32,291 million, which is EUR 1,504 million, or 4.9%, more than at the end of 2020.

The Republic of Serbia intervened in the interbank foreign exchange market in June 2021

In 2020 the government provided a massive bailout package to the private sector at the cost of a record-high 8.1% fiscal deficit. At the end of 2020, the government adopted a debt-stabilizing fiscal strategy, which envisaged a sharp decrease in fiscal deficit in 2021 to 3% of GDP. However, at the beginning of 2021 the government has announced that fiscal stabilization would be postponed to 2022 due to a new package of support to businesses and households. This was formalized by adopting a rebalanced budget and new fiscal strategy that projected a large fiscal deficit in 2021 at 6.9% of GDP.

Large fiscal deficit in 2021 will not jeopardize mid-term debt sustainability

According to the data available for the period January-August 2021, there are no indications that recent fiscal developments have diverged from what was planned by the rebalanced budget and new fiscal strategy. Following the recovery of economic activity, fiscal revenues bounced back, especially social contributions. Relative to the same period in 2020, real growth in public revenues was around 21%, whereas public expenditures slightly declined by around 1%. Realization of the public revenues in the first eight months of 2021 was around 70% of the projected total in 2021. Since the collection of revenues in the second half of the year is traditionally higher relative to the first half, the realization of revenues in 2021 would be most likely above the projection from the fiscal strategy. Public expenditures were at only 62% of the 2021 projection, but it is too early to make conclusions about potential government underspending, as expenditures usually explode in December. Overall, current fiscal developments imply that the fiscal deficit in 2021 will likely be lower than the 6.9% projected value.

Public debt continues to grow in 2021, getting close to the 60% year-end projection set in the fiscal strategy. However, according to the official data, gross government debt counted only 55.7% of GDP at the end of the first half of 2021, which is 2.5 percentage points lower than at the end of 2020. This implies a false conclusion that public debt fell in 2021, stemming from the government practice to count debt over the year as a percentage of GDP forecast rather than a rolling sum of the actual quarterly values realized in the last four quarters. When the latter approach is applied, debt-to-GDP seems to be already slightly above 60%. However, debt-to-GDP will likely remain close to 60% of GDP until the end of 2021, especially if revised conjectures on the somewhat lower deficit and stronger growth than initially projected eventually fulfill.

Despite two consecutive years of large deficits, there are no indications that mid-term fiscal sustainability has been jeopardized. In June 2021, the IMF approved a 30-month policy coordination instrument in favour of the credibility of government plans to reduce deficits and debt beyond 2021 without the financial assistance of the IMF. In addition, Fitch and S&P have recently confirmed Serbian credit rating at BB+ with a stable outlook.

Basic monetary aggregate (M1) increased in 2020 as a consequence of the state's response to the crisis. On the other side in the second quarter of 2021 it recorded a huge drop compared to the first quarter 2021

The money supply M1, as the basic monetary aggregate, which includes short-term dinar funds - cash in circulation and demand deposits of the economy and households, increased in Serbia in the first five months of 2020 by 17.8% or 160.5 billion. That was a consequence of the state's response to the crisis caused by the coronavirus pandemic. As explained, about one-fifth of that amount refers to the increase of cash in circulation, while the largest part refers to the increase of deposits of the non-financial sector.

The total domestic credit decreased in the first quarter and the second quarter 2021 (12.08% and 8.05%, respectively) compared to the total of 2020 (14.5%). This can result from better performance of the country in 2020 than in 2021, payments of the credit or/ and exchange rates.

The Executive Board of the National Bank of Serbia decided to keep the reference interest rate at 1.0% in the second quarter 2021 (as in the first quarter 2021). In making such a decision, the Executive Board primarily had in mind that the effects of the adopted monetary and fiscal measures can be expected in the coming period. Therefore, the conditions for financing the economy and citizens will remain favourable, contributing to disposable income growth. That decision had led to lowering DMBs credit rate for enterprises on a short term (% pa) in Q1,Q2 2021 when it was 2.3% and 2.6% respectively (compared to the total of 2020 when it was 2.8%). On the other side, DMBs credit rate for households short-term (%, pa) in the first quarter 2021 was 2.3% but had a small increase in the second quarter 2021, and it was 3.63% compared to total 2020 (4.7%).

Total domestic credit has dropped in the first two quarters of 2021 in comparison to all quarters of 2020

Money market interest rate influenced the dropping of other rates (DMBs credit rates for short-term for enterprises and households)

Table SRB1 Main economic indicators

	2020				Total 2020 year	2021	
	Q1	Q2	Q3	Q4		Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	5.2	-6.3	-1.4	-1.0	**-1.0**	1.8	13.7
Real private consumption (% change, yoy)	2.8	-8.4	-1.1	-2.6	**-2.5**	-1.7	17.6
Real government consumption (% change, yoy)	11.2	8.4	-1.1	4.6	**5.6**	-0.6	-3.8
Real investment (% change, yoy)	12.0	-11.8	-4.5	-4.1	**-2.8**	9.0	22.5
Industrial output (% change, yoy)	-1.7	-9.9	3.4	9.5	**0.4**	1.8	3.2
Unemployment rate (LFS, % pa)	10.5	7.9	9.8	10.7	**9.7**	12.8	11.1
Nominal GDP (EUR million)	11,087	10,824	11,906	12,652	**46,469**	11,577	12,958
GDP per capita (EUR)	1,607	1,569	1,726	1,834	**6,735**	1,685	1,886
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	2.5	1.1	1.2	1.1	**1.8**	N/A	N/A
Consumer prices (% change, yoy, pa)	1.8	1.0	1.9	1.6	**1.6**	1.4	2.9
Producer prices (% change, yoy, pa)	0.4	-3.3	-2.0	-2.1	**-1.8**	0.8	8.8
Average gross wage (% change, yoy, pa)	10.36	8.66	9.53	8.84	**9.34**	7.08	9.6
Exchange rate* (RSD/EUR, pa)	117.56	117.59	117.58	117.58	**117.58**	117.58	117.57
Exchange rate* (RSD/USD, pa)	106.12	104.45	99.68	96.60	**101.71**	98.74	97.54
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	3,957	3,386	4,161	4,577	**16,079**	4,607	5,013
Exports of goods (EUR, % change, yoy)	-8.7	-28.6	-9.6	-2.4	**-12.5**	16.4	48.1
Imports of goods (EUR million)	5,532	4,391	5,382	5,974	**21,280**	5,595	6,627
Imports of goods (EUR, % change, yoy)	-4.3	-28.5	-10.8	-11.0	**-13.7**	1.1	50.9
Current account balance (EUR million)	-984	-331	-486	-233	**-2,034**	95	-656
Current account balance (% of GDP)	-8.9	-3.1	-4.1	-1.8	**-4.4**	0.8	-5.1
Foreign Direct Investment net inflows (EUR million)	795	635	298	1,221	**2,938**	845	744
Foreign exchange reserves (EUR million, eop)	14,476	15,654	14,964	15,550	**15,550**	17,018	17,014
Foreign debt (EUR million, eop)	28,655	30,959	30,719	30,787	**30,787**	32,334	32,291
GOVERNMENT FINANCE							
Revenues (RSD million)	537	476	588	655	**2,255**	594	691
Expense (RSD million)	534	673	579	618	**2,405**	545	647
Net = Gross operating balance	3	-197	8	36	**-150**	50	45
Net acquisition of non-financial assets (RSD million)	55	61	59	118	**293**	63	71
Net lending/borrowing (RSD million)	-52	-258	-51	-82	**-443**	-13	-26
Domestic government debt (EUR million, eop)	10,457	11,085	11,216	11,434	**11,434**	11,594	11,721
Foreign government debt (EUR million, eop)	13,852	15,742	15,388	15,235	**15,235**	16,548	16,540
Total government debt (eop. % of GDP)	52.7	58.7	58.3	58.2	**58.2**	60.7	58.3
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	26.59	44.26	35.87	35.02	**35.02**	27.24	12.38
Broad money, M4 (% change, yoy, eop)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
Total domestic credit (% change, yoy, eop)	10.6	16.00	17.74	14.49	**14.5**	12.08	8.05
DMBs credit to households (% change, yoy, eop)	9.04	12.58	14.29	11.84	**11.8**	11.91	10.6
DMBs credit to enterprises (% change, yoy, eop)	11.20	12.34	11.81	8.35	**8.4**	4.77	3.32
Money market interest rate (%, pa)	0.99	0.49	0.24	0.23	**0.49**	0.11	0.11
DMBs credit rate for enterprises short-term (%, pa)	2.6	3.1	2.6	2.8	**2.8**	2.3	2.6
DMBs credit rate for households short-term (%, pa)	5.4	5.99	5.7	1.8	**4.7**	2.3	3.63

*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, Ministry of Finance, Eurostat

Policy assumptions and projections summary

The mid-term macroeconomic framework presented in the Fiscal Strategy 2022-2024 seems to be quite realistic. The key policy assumption of the economic outlook is that recovery of economic activity in 2021 will be sustained in the mid-run, based on expectations that the health crisis caused by the COVID-19 pandemic will gradually fade. This will further recover public finance from large deficits in 2020 and 2021 created by the supportive measures to businesses and citizens. Stabilization of public finance and economic recovery will open fiscal space to reduce public debt and boost public investments necessary to accelerate economic growth.

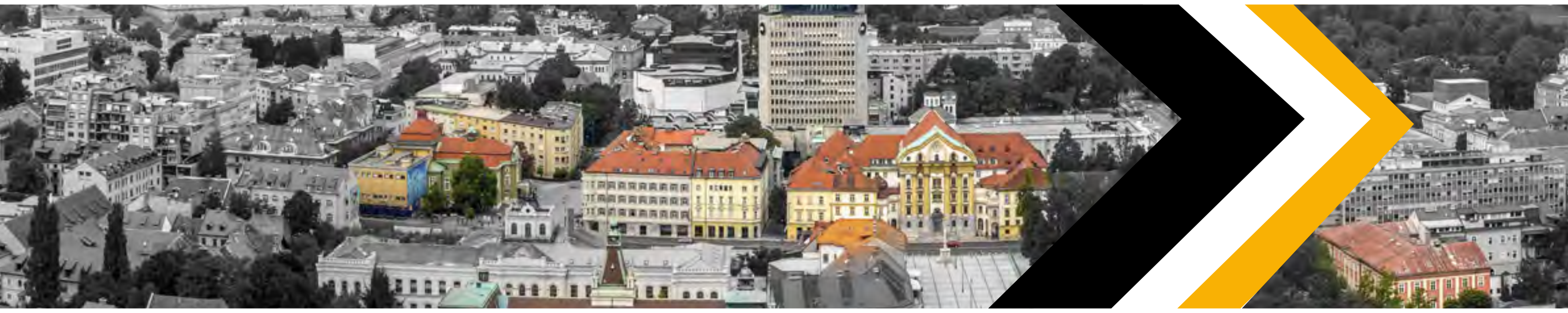
The baseline macroeconomic scenario in the Fiscal Strategy is conservative and prudent. Respective mid-term projections of key variables stemming from baseline scenario are deemed achievable by the Fiscal Council and mostly in line with forecasts of the IMF. Mid-term growth is expected to be export and investment-led and cautiously projected at a potential rate of 4% (the IMF forecast of growth in 2022 and 2023 is 4.5%). The strong growth of export at a higher rate than import is expected to continue, turning traditionally negative net export contributions to GDP to slightly positive contributions. Moreover, export growth will contribute to a gradual decline in current account deficit which is expected to be fully covered by the FDI.

Table SRB2 Summary of projections

	2022	2023	2024
Real GDP (% change)	**4.0**	**4.0**	**4.0**
Real private consumption (% change)	3.2	3.0	2.2
Real government consumption (% change)	1.1	0.3	0.3
Real investment (% change)	6.0	6.7	8.1
Exports of goods and services (constant prices, % change)	9.5	9.9	10.0
Imports of goods and services (constant prices, % change)	7.4	7.8	7.8
Current account balance (% of GDP)	-5.3	-4.9	-4.4
Consumer prices (% change, pa)	3.5	3.0	3.0
Exchange rate, national currency/EUR (pa)	118	118	118
Unemployment rate (LFS, %, pa)	11	10.5	10.0
General government balance (ESA 2010 definition, % of GDP)	-2.5	1.2	0.5
Total domestic credit (% change, eop)	N/A	N/A	N/A

Source: International Monetary Fund, the Fiscal Strategy 2022-2024, our estimates

Despite sound macroeconomic stance, the Serbian economy is still exposed to the COVID-19 health crisis that remains main threat for the mid-term growth prospects. The other major threat is prolonged period of rising inflation, if concerns about the permanent effects of recent price shocks materialize. On the other hand, the mid-term fiscal stance may improve even at a faster pace than expected if the government remains committed to the comprehensive reforms of public financial management that started in 2015.



SLOVENIA

Economic recovery is becoming more broad-based

Gross domestic product resumed growth

Economic activity in Slovenia recovered in the first half of 2021, and the outlook for economic growth remains favourable. The gross domestic product growth turned positive in the first quarter of 2021 (1.7% year-on-year) and accelerated in the second one, with year-on-year growth reaching 16.3%. The high year-on-year growth in the second quarter was primarily the result of last year's low base when gross domestic product shrunk substantially due to the economic lockdown during the first wave of COVID-19 pandemic. The driving forces of economic growth in the first half of 2021 were consumption, investment and foreign demand amid the gradual removal of restrictions and improved confidence indicators, both in Slovenia and in the trading partner economies. Economic recovery continued to be most prominent in the export-oriented part of the economy, which resumed growth already in the second part of 2020. However, service activities also began to recover thanks to the reopening of the economy. While the turnover in trade was higher year-on-year already in the first quarter, other service activities resumed year-on-year growth in the second quarter of the year. Overall, gross domestic product growth was higher than on average in the EU, both in the first and second quarters of 2021.

Real investment increased in the first half of 2021

After picking up in the last quarter of 2020, real investment was a major component of gross domestic product growth in the first half of 2021 and is expected to strengthen further. Gross fixed capital formation was up year-on-year by 7.8% and 19.2% in the first and second quarters, respectively. The year-on-year increase was higher than the corresponding decrease in 2020. The rise in gross fixed capital formation was mainly due to increased gross fixed capital formation in machinery and equipment (by 22.6% in the first quarter and 42.1% in the second quarter). While construction investment was still down year-on-year in the first quarter (-6.4%), it increased in the second quarter (4.0% year-on-year). However, the increase was modest compared to the slump in the second quarter of 2020 (-16.6% year-on-year).

Private consumption picked up substantially in the second quarter

After plummeting in 2020 due to the adoption of strict containment measures amid the first and second wave of the COVID-19 pandemic, household final consumption expenditure was still slightly down year-on-year in the first quarter of 2021. The decrease mainly resulted from the lower spending for services, while spending on durable goods (cars in particular) increased. With the gradual release of containment measures and the re-opening of service activities in the second quarter of 2021, private consumption picked up substantially. As a result, an increase was observed in all types of household consumption. Year-on-year increase reached 18.8% and was by 5.7 percentage points more prominent than the decrease in the same period of 2020. The resumption in consumption was supported by rising total disposable income, which increased in 2020 (by 3.8%) and continued to grow year-on-year in the first half of 2021. The increase in disposable income resulted from the recovery in the labour market and government intervention measures.

In addition, the rise in household consumption has been enabled by last year's build-up of excess household savings.

Government consumption continued to increase in the first half of 2021 due to rising employment and the continuation of measures to support faster economic recovery and alleviate the negative consequences of the COVID-19 pandemic, especially in the service sector, where specific containment measures were still in place.

Industrial production up in the first half of 2021

In the first half of 2021, the value of industrial production was 13.7% higher than in the same period last year (and 2.0% higher than in the first half of 2019). Production value increased year-on-year in the first six months in manufacturing (by 15.0% year-on-year). On the other hand, it decreased in mining and quarrying and in electricity, gas, steam and air conditioning supply (by 1.5% and 0.8% year-on-year, respectively). In the observed period, industrial production value increased year-on-year in medium-technology and low technology manufacturing (by 21.8% and 13.0%, respectively), which recorded a decrease in industrial production value in the first half of 2020. On the other hand, the value of industrial production in high technology manufacturing declined year-on-year in the first six months of 2021 upon high last year's base.

High trade in goods

Exports and imports of goods, which started to increase year-on-year in the last quarter of 2020, continued to rise year-on-year in the first half of 2021. While the year-on-year increase was only moderate in the first quarter, exports and imports of goods demonstrated a considerable year-on-year increase in the second quarter (by 30.6% and 35.8%, respectively), partly due to the very weak activity in the second quarter of 2020. As a result, real exports and imports of goods from and into the EU Member States have reached pre-pandemic levels.

The year-on-year growth in the exports and imports of services turned positive only in the second quarter of 2021 with the gradual relaxation of travelling. Still, the increase partly reflects the very low level of activity in the same period last year. As a result, the value of trade in services remains well below pre-pandemic levels, mainly because of the lower volume of trade in travelling.

The contribution of net exports to gross domestic product growth was positive in the first quarter (0.5 percentage point) but turned slightly negative in the second quarter (-0.3 percentage point).

The current account surplus slightly down

In the first six months of 2021, the current account surplus amounted to EUR 1.4 billion, a EUR 326 million decline compared to the first half of 2020. The decline resulted from a decrease in the trade in goods surplus, while the surplus in trade in services increased, mainly on account of a higher surplus in transportation and construction services. The primary income deficit increased primarily due to an increase in expenditure, while the secondary income deficit shrunk mainly due to higher receipts in the government sector. As a percentage of the gross domestic product, the current account surplus declined to 4.4% in the second quarter of 2021, representing a 3.4 percentage point decrease over the last quarter of 2020.

The unemployment rate dropped to pre-pandemic levels

With further economic recovery, labour market conditions have been improving in the first half of 2021. According to Labour Force Survey, the number of employed persons in the first quarter of 2021 dropped year-on-year by 5.5%. The decrease was primarily a consequence of the change in methodology; persons whose duration of the layoff was (expected to be) longer than three months were excluded from the total number of employed persons. In the second quarter, the number of employed persons increased year-on-year by 1.1%. However, employment growth was uneven across activities. It increased most prominently in professional, scientific and technical activities and other service activities; these sectors saw employment growth already in the first quarter of the year. Employment also increased in the public sector, most notably in the health sector and the public administration.

The unemployment rate, which started to increase with the outbreak of the pandemic, increased further in the first quarter of 2021. According to the Labour Force Survey, it was higher year-on-year by one percentage point and stood at 5.6%. However, the gradual relaxation of containment measures and seasonal influences led to a decrease in unemployment to 4.3% in the second quarter of 2021, a level comparable to the second quarter of 2019 (4.2%) and 0.9 percentage points lower than in the same quarter of 2020.

Wages continued to rise in the first half of 2021

Wage growth accelerated in the first quarter (10.6% year-on-year) and slowed down in the second quarter (5.7% year-on-year) of 2021. Wage growth was especially high in the public sector (16.4% and 9.2% year-on-year, respectively) due to the performance bonus introduced in the middle of 2020, higher payments of allowances related to the COVID-19 pandemic and a higher amount of overdue payments at the beginning of the year.

General government deficit slightly down year-on-year

The general government balance continued to be in deficit in the first half of 2021, with a slight year-on-year decrease compared to the first half of 2020. In the first quarter of 2021, the year-on-year increase in general government expenditure (11.1%) surpassed the growth in general government revenue (8.6%) amid the second wave of the pandemic, with the general government deficit standing at 8.3% of gross domestic product. An increase was recorded across all expenditure categories, with subsidies and compensation of employees increasing the most due to payments for the implementation of containment measures. With economic recovery becoming more broad-based in the second quarter, general government revenue recorded a strong year-on-year growth (15.3%) spurred by a high increase in tax revenues. On the expenditure side, this quarter was marked by a substantial decrease in expenditure for subsidies and a decline in interest expenditures. As a result, the general government deficit dropped to 5.8% of the gross domestic product. The general government debt stood at 80.0% at the end of June 2021, a level comparable to the end of 2020.

Household loans growth strengthened in the second quarter while corporate loans continued to fall year-on-year

After a slight year-on-year decline in the first two months of 2021, year-on-year growth in household loans turned positive in March (0.7%) and strengthened thereafter, reaching 2.9% in June. Growth was driven primarily by the increase in housing loans (which were up 6.5% year-on-year in June), while the contraction in consumer loans that has been observed since May 2020 continued throughout the first half of 2021, albeit at a decreasing rate (-5.7% year-on-year in June 2021). In addition, the year-on-year contraction in loans to non-financial corporations continued in the first half of 2021, but the decrease slowed down in the second quarter (from -4.3% year-on-year in the first quarter to -1.7% year-on-year in the second quarter).

Inflation recorded in the second quarter of 2021

A deflation that set in with the outbreak of the COVID-19 pandemic was still observed in the first two months of 2021. Since then, however, inflation has picked up, rising to 1.9% in the second quarter of the year. Looking at the main components of inflation, energy prices, particularly the prices of petroleum products, contributed the most to the rise in consumer prices in the first half of 2021. As a result, prices of transport increased year-on-year in the second quarter as well. Furthermore, electricity prices rose year-on-year in April and May 2021 due to the very low base last year when the government reduced electricity bills for households and small businesses during the lockdown period. In addition, alcoholic beverages and tobacco prices also contributed to inflation in the first half of 2021. In the second quarter of 2021, only food and non-alcoholic beverages and recreation and culture prices were still down year-on-year. In contrast to consumer prices, producer prices exhibited more prominent growth in the first two quarters of the year, driven by the rise in capital goods, intermediate goods and energy prices. It is expected that the rise in producer prices will be partially spilt over to consumer prices in the coming months amid further recovery of household spending.

Table SL1 Main economic indicators

	2020				Total 2020 year	2021	
	Q1	Q2	Q3	Q4		Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	-1.3	-11.0	-1.4	-3.1	**-4.2**	1.7	16.3
Real private consumption (% change, yoy)	-3.1	-13.1	1.4	-11.2	**-6.6**	-0.6	18.8
Real government consumption (% change, yoy)	5.3	3.2	5.0	3.5	**4.2**	0.5	1.4
Real investment (% change, yoy)	-4.3	-13.3	-21.7	12.0	**-7.3**	6.0	35.9
Real gross-fixed capital formation (% change, yoy)	-6.6	-17.6	-5.7	-2.7	**-8.2**	7.8	19.2
Industrial output (% change, yoy)	-1.6	-17.5	-2.9	1.4	**-5.2**	3.7	26.7
Unemployment rate (LFS, % pa)	4.6	5.2	5.1	5.1	**5.0**	5.6	4.3
Nominal GDP (EUR million)	11,349	10,987	12,308	12,275	**46,918**	11,699	13,070
GDP per capita (EUR)	5,415	5,239	5,860	5,813	**22,312**	5,547	6,203
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	-0.1	1.9	1.3	1.8	**1.2**	0.0	2.9
Consumer prices (% change, yoy, pa)	1.5	-0.9	0.0	-0.7	**-0.1**	-0.5	1.9
Producer prices (% change, yoy, pa)	-0.1	-0.6	-0.3	-0.1	**-0.2**	1.2	3.6
Average gross wage (% change, yoy, pa)	3.2	8.8	4.8	6.7	**5.8**	10.6	5.7
Exchange rate (EUR, pa)	NA	NA	NA	NA	**NA**	NA	NA
Exchange rate (EUR/USD, pa)	1.10	1.10	1.17	1.19	**1.14**	1.20	1.21
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	7,857	6,431	7,368	8,001	**29,656**	8,235	8,736
Exports of goods (EUR, % change, yoy)	-0.3	-20.6	-4.1	3.8	**-5.5**	4.6	30.6
Imports of goods (EUR million)	7,289	5,862	6,668	7,471	**27,290**	7,687	8,495
Imports of goods (EUR, % change, yoy)	-1.3	-23.1	-10.5	1.1	**-8.6**	3.8	35.8
Current account balance (EUR million)	986	716	798	963	**3,462**	796	580
Current account balance (% of GDP)	8.7	6.5	6.5	7.8	**7.4**	6.8	4.4
Foreign Direct Investment net inflows (EUR million)	34	229	155	14	**431**	488	840
Foreign exchange reserves (EUR million, eop)	446	459	477	507	**507**	542	557
Foreign debt (EUR million, eop)	46,108	48,183	47,760	47,792	**47,792**	50,213	50,011
GOVERNMENT FINANCE							
Revenues (EUR million)	4,788	4,995	5,278	5,400	**20,461**	5,190	5,759
Expense (EUR million)	5,450	6,471	5,563	6,596	**24,079**	6,108	6,516
Net = Gross operating balance	NA	NA	NA	NA	**NA**	NA	NA
Net acquisition of non-financial assets (EUR million)	NA	NA	NA	NA	**NA**	NA	NA
Net lending/borrowing (EUR million)	-661	-1,476	-285	-1,196	**-3,618**	-918	-757
Domestic government debt (EUR million, eop)	28,857	31,713	31,617	32,258	**32,258**	34,154	33,537
Foreign government debt (EUR million, eop)	1,879	1,870	1,870	2,061	**2,061**	2,973	2,964
Total government debt (eop. % of GDP)	68.9	77.9	77.8	79.8	**79.8**	84.9	80.0
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	NA	NA	NA	NA	**NA**	NA	NA
Broad money, M4 (% change, yoy, eop)	NA	NA	NA	NA	**NA**	NA	NA
Total domestic credit (% change, yoy, eop)	6.4	11.0	11.4	8.4	**8.4**	10.3	10.8
DMBs credit to households (% change, yoy, eop)	4.2	1.7	1.3	0.1	**0.1**	0.7	2.9
DMBs credit to enterprises (% change, yoy, eop)	4.5	-0.5	-2.9	-2.1	**-2.1**	-4.3	-1.7
Money market interest rate (%, pa)	-0.54	-0.54	-0.55	-0.56	**-0.55**	-0.56	-0.56
DMBs credit rate for enterprises short-term (%, pa)	1.6	2.0	2.1	1.9	**1.9**	1.5	1.8
DMBs credit rate for households short-term (%, pa)	3.1	2.9	2.9	2.8	**2.9**	2.9	2.7

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

Policy assumptions and projections summary

Economic growth, exports and investment are expected to reach pre-crisis levels this year

The economic outlook projections for 2021 were generally revised upwards mainly due to faster growth in activity in the first half of the year, expected further normalization in the second half of 2021 as vaccination proceeds, and additional fiscal support. In its Autumn Forecast 2021, the Institute for Macroeconomic Analysis and Development (IMAD) from Slovenia predicts that gross domestic product growth will stand at 6.1% this year and moderate to 4.7% in 2022 and 3.3% in 2023. The European Commission Summer 2021 Forecast for Slovenia is slightly more cautious in estimating this year's growth and projects a 5.7% increase in the gross domestic product. At the same time, its forecast for 2022 is somewhat more optimistic and projects a 5.0% rise in the gross domestic product.

According to IMAD, economic growth, exports and investment are expected to reach pre-crisis levels this year. On the other hand, private consumption and turnover from the sale of services (excluding tourism and travelling where recovery will be lengthier) will only exceed this level next year. The future recovery will largely depend on the epidemiological situation and related containment measures. Furthermore, it will be spurred by the release of excess household savings and investment growth. In addition, the speed of recovery will depend on the effectiveness of the policy, the efficient use of NextGenerationEU funds, and economic recovery in the main trading partners.

Private consumption is projected to grow year-on-year also in the second half of 2021. Besides high purchasing power of households due to increase in disposable income and excess savings accumulated over the last year, household consumption will also be supported by new tourism vouchers that can be redeemed for services in the areas of gastronomy, tourism, sports and culture until the end of the year. However, there are still certain restrictions that will hinder private consumption in 2021, like the recovered-vaccinated-tested rule. Overall, the year-on-year increase is estimated to reach 5.6% in 2021. A more pronounced increase in private consumption is projected for 2022 (by 6.0% year-on-year), when labour market conditions and the epidemiological situation improve further, and new possibilities are open-up for travelling and tourism. With the gradual opening of the tourism sector, services exports are also projected to improve in the second half of 2021.

Government consumption will increase again in 2021 (by 1.8% year-on-year), albeit at a lower rate than in 2020, mainly due to expenditure related to epidemic management, especially in healthcare (equipment, tests, vaccines, etc.). Also, employment in the general government sector is projected to increase in 2021 at a similar pace as last year driven by additional employment in health and social care due to the pandemic, and, in addition, by the EU presidency. In 2022 and 2023, growth in government consumption is estimated to slow down to 1.5% and 1.0% respectively.

Gross fixed capital formation is projected to jump by 10.0% this year, and high growth is expected in the next two years (8.0% and 6.0%, respectively).

In the second half of 2021, investment growth will be driven by public investment in railway infrastructure and environmental projects. In 2022 and 2023, public investments will be driven by the continued absorption of EU funds and the Recovery and Resilience Plan implementation. Private investment is projected to increase as well due to low levels of businesses indebtedness.

According to IMAD, employment growth will strenghten over the projection horizon as the economic recovery gains momentum. At the same time, activity rate is expected to increase in age groups 15–29 and 55–64, as well as on account of those persons that dropped-out from the labour market during the pandemic. The survey unemployment rate is projected to decline to 4.7% this year and drop below the pre-crisis level in 2022 (4.3%).

The epidemiological situation and the related containment measures will continue to play a significant role on labour market movements, but the impact of demographic factors, namely population ageing, which had been in place before the outbreak of coronavirus, will strengthen over the projection horizon.

According to IMAD, inflation will stand at 1.4% in 2021 and approach 2% in the next two years. This year, inflation will be driven by higher energy prices as well as an increase in the prices of final products due to higher consumer demand, higher non-energy commodity prices and production bottlenecks. In the next two years, inflation pressures are expected to intensify due to higher services prices amid service sector recovery. The European Commission also projects a 1.4% increase in consumer prices this year while the respective estimate for 2022 is somewhat lower: 1.7%.

Table SL2 Summary of projections

	2022	2023	2024
Real GDP (% change)	**4.7**	**3.3**	**N/A**
Real private consumption (% change)	6.0	3.1	N/A
Real government consumption (% change)	1.5	1.0	N/A
Real gross-fixed capital formation (% change)	8.0	6.0	N/A
Exports of goods and services (constant prices, % change)	8.2	5.6	N/A
Imports of goods and services (constant prices, % change)	8.8	5.8	N/A
Current account balance (% of GDP)	4.0	3.8	N/A
Consumer prices (% change, pa)	2.0	1.9	N/A
Exchange rate, national currency/EUR (pa)	1.180	1.180	N/A
Unemployment rate (LFS, %, pa)	4.3	4.2	N/A
General government balance (ESA 2010 definition, % of GDP)	-4.2	-3.4	N/A
Total domestic credit (% change, eop)	N/A	NA	N/A

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

ANALYSIS

Growth of economic activity in 2022: The level of real GDP from the period before the COVID-19 pandemic

In the modern conditions of globalization of the world economy, one of the important factors influencing the growth and development of any economy is macroeconomic stability. The key macroeconomic goals pursued by all economies and increasing production include achieving long-term equilibrium, stability of the general price level, and employment growth. In order to establish macroeconomic stability as well as sustainable economic growth, it is very important to pursue a rational economic policy and carry out accelerated structural reforms.

A stable macroeconomic environment is very important for any company's business, and thus for the development of the competitiveness of an economy. Therefore, it is extremely important to ensure the highest possible economic growth with price stability and reduction of unemployment and avoid the balance of payments deficit.

This issue of the SEE-6 Economic Outlook is focused on analyzing real GDP growth in selected economies. The Gros domestic product (GDP) measures national income and output for a given country's economy. The gross domestic product (GDP) is equal to the total expenditures for all final goods and services produced within the country in a stipulated period of time. Data for this analysis were collected from the IMF database for the period 2011-2020. Table 1 shows the percentage of real GDP growth in the countries subject to this analysis.

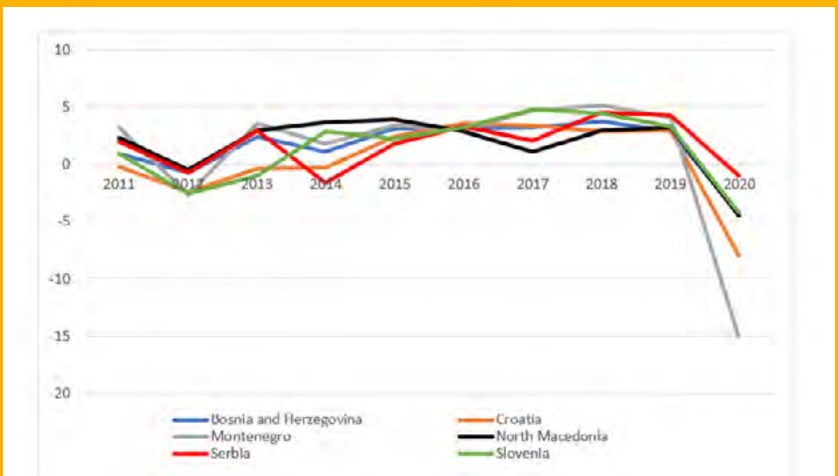
Based on the presented results, it is clear that real GDP during the crisis in 2012 had a negative value and a drastic decline during 2020, which was caused by the COVID-19 pandemic.

Country	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Bosnia and Herzegovina	0.9	-0.7	2.4	1.1	3.1	3.1	3.2	3.7	2.8	-4.3
Croatia	-0.2	-2.4	-0.4	-0.3	2.4	3.5	3.4	2.8	2.9	-8.0
Montenegro	3.2	-2.7	3.5	1.8	3.4	2.9	4.7	5.1	4.1	-15.2
North Macedonia	2.3	-0.5	2.9	3.6	3.9	2.8	1.1	2.9	3.2	-4.5
Serbia	2.0	-0.7	2.9	-1.6	1.8	3.3	2.1	4.5	4.2	-1.0
Slovenia	0.9	-2.6	-1.0	2.8	2.2	3.2	4.8	4.4	3.3	-4.2

Table 1. Real GDP growth, 2011-2020 (%)
Source: IMF, 2021.

Given the increasing integration, especially of the Western Balkan countries, into European economic flows, the public debt crisis in the European Union in 2012 led to a recession in almost all observed countries. Also, the pandemic of the COVID-19 virus, which occurred at the end of the first quarter of 2020, caused a recession in the whole world. This situation was a big and unexpected external shock for all economies in 2020, which continued in 2021.

Chart 1. Real GDP growth (Annual percent change)



Source: author, based on IMF (2021)

After a slight recovery from the effects of the 2009 crisis, Bosnia and Herzegovina's real GDP declined in 2012. This is a consequence of the public debt crisis in the EU and insufficient preparation of this economy for external shocks. Despite the fact that the economy recorded stable growth in the next few years, the insufficiently efficient public sector and the lack of reforms were the main obstacles to increasing competitiveness. Due to excessive administrative regulations, taxes, and local taxes, starting a private business continued to be a major problem, negatively impacting real GDP growth. The main driver of growth in this period was private consumption, thanks to the growing inflow of remittances from abroad, which amounted to about 8% of GDP and low inflation. According to the World Bank forecast, the economy of Bosnia and Herzegovina will grow by 2.8 percent in 2021, after a drop of over 4 percent due to the crisis caused by the COVID-19 pandemic. The decline in a gross domestic product that occurred in 2020 is a consequence of the slowdown in most manufacturing sectors, a weaker external environment, and high political uncertainty. One of the problems is the underdeveloped foundation for sustainable economic growth; the economy is driven by consumption rather than production, investment is low, and the economy is turned inward. In the coming period, the implementation of structural reforms in the country and domestic demand through an increase in private consumption and investment will play an essential role in the economic growth of BiH.

Since 2009, the Croatian economy has been in recession, with GDP falling by about 13% by 2012. In 2012, Croatia had a decline in real GDP of over 2%, a consequence of the then economic crisis, which manifested itself in almost all economies, with the difference being in a downward trend. The most negative trends were recorded in fixed capital investment, given that high rates of decline were recorded throughout the period. The real value of these investments in 2012 was as much as 34.9% lower than in 2008. Nevertheless, the Croatian economy has shown signs of recovery since 2015, when it achieved three consecutive GDP growth (in quarters). In 2018, solid economic growth was sustained in Croatia, but the trend of slowing down signalled that the growth "steam" is reducing after a peak reached in 2016. After considerable moderation in 2018, especially in the last quarter when it was only 2.3%, the GDP in Croatia reached the record level of 3.9% in the first quarter of 2019, the highest since the post-recession recovery. Thus, the Croatian economy has recovered, with GDP growth in 2021 currently estimated at around 6.3%. The consequence of this situation is an increase in exports due to an increase in activity in the euro area, with a strengthening of domestic demand. GDP growth in Croatia is a consequence of milder social distancing measures, higher external demand, and better conditions in the labor market. Strong economic activity continued in the third quarter of 2021, primarily due to the faster recovery of the tourism sector.

At the beginning of the observed period, the Montenegrin economy recorded a high growth rate of real GDP of 3.2%. However, the following year, Montenegro had the most significant decline of all the observed countries. The main reason for this recession was the extremely serious weather disasters that hit the economy and the sharp decline in aluminium production in the second half of that year. However, the recovery of the Montenegrin economy starts next year. It is maintained at a stable level. In 2018 Montenegro achieved the highest economic growth rate of 5.1%, which is the highest growth rate achieved by one of the observed economies in the observed ten-year period. This record growth was achieved thanks to investments in infrastructure and private investments in energy and tourism. Very good performance in this period, at least when it comes to economic growth, for Montenegro was spoiled by the COVID-19 virus pandemic in 2020 when this economy had a decline in real GDP of as much as 15.2%. This is explained by the fact that tourism, as the main branch of the Montenegrin economy, was most affected by the pandemic. According to IMF projections, the Montenegrin economy will grow by about 7% in 2021, the most significant growth compared to all analyzed economies. The gross domestic product of Montenegro in the second quarter of 2021 amounted to about EUR 1,100 million, while in the same period last year it was about EUR 900 million. Great credit for such a thing lies in the recovery of the tourism sector, given that this sector is of great importance for national GDP.

Northern Macedonia is a middle-income country with solid results in terms of macroeconomic stability, which, however, did not affect significant economic growth. Nevertheless, in 2015, Northern Macedonia recorded the highest real GDP growth of all observed economies, its best result in the analyzed period. This result was primarily achieved thanks to investments in public infrastructure, an increase in foreign direct investment, and better conditions in the labor market. On the other hand, the growing political instability

that negatively affected investment and private consumption led to the economic growth of only 1.1% in 2017. Economic growth accelerated in 2019 thanks to investment growth, but as early as April 2020, the COVID-19 crisis halted these positive trends. In 2021, the economy recovered, which was confirmed by the Central Bureau of Statistics with the announcement that a gross domestic product growth of 13.1 percent was registered in the second quarter of this year. According to IMF projections, real annual GDP growth ranges from 3.6 to 4.2% over the next five years.

The Serbian economy recorded a 1.6% drop in real GDP in 2014. This result is a consequence of natural disasters (floods) that hit Serbia and the beginning of fiscal consolidation in the second half of the year (reduction of pensions and salaries in the public sector). However, in 2016, Serbia achieved one of the highest rates of economic growth of the observed economies. Real GDP growth was achieved primarily due to stronger export growth, recovery of industrial production, and higher investments. In 2019, Serbia achieved the highest growth rate concerning the analyzed countries. The main driver of real GDP growth is the consequence of the extremely high level of foreign direct investment and growth in the construction sector. Although the COVID-19 virus pandemic has negatively impacted all Western Balkan economies, Serbia has experienced the smallest decline in real GDP (-1.0%), the main reason being the structure of the Serbian economy itself which has a smaller share of hard-hit sectors. Crisis.

According to IMF projections, Serbia can expect an improvement in economic parameters in the next five-year period, reflected in the growth of real incomes (salaries and pensions), i.e. living standards.

Therefore, domestic economic activity will be strongly supported by additional government health expenditures, wage subsidies, and one-time payments to retirees and other population categories. The total commitment of the Serbian authorities to the implementation of the planned structural reforms will support the potential for economic growth, which will be reflected in the next five years through high GDP growth rates ranging from 4.0 to 4.5%.

The global economic crisis of 2008 contributed to a sharp drop in Slovenia's GDP in 2009 by close to 8%. As a result of this decrease, there was a drop in exports and a low level of investment. Despite a weak short-term recovery in 2010 and 2011, economic activity declined again in 2012 and 2013. A stronger recovery with an actual GDP increase of 2.8% was recorded in 2014. Slovenia's economic growth rate in 2017 was 4.8%, which is the highest since the beginning of the recovery after the economic crisis, but also twice as high as the average growth in the EU and the eurozone. Slovenia's GDP in the second quarter of 2021 was close to the real level from 2019, which is a consequence of the positive revision of data for previous quarters and the growth of domestic consumption in this quarter. Thus, the economic outlook has improved, and its expected GDP growth of 6.3% this year. This is mainly due to higher forecasts in the international environment, faster-than-expected activity growth, especially in the second quarter and the summer months, and the constant adjustment of businesses and consumers to the changed conditions.

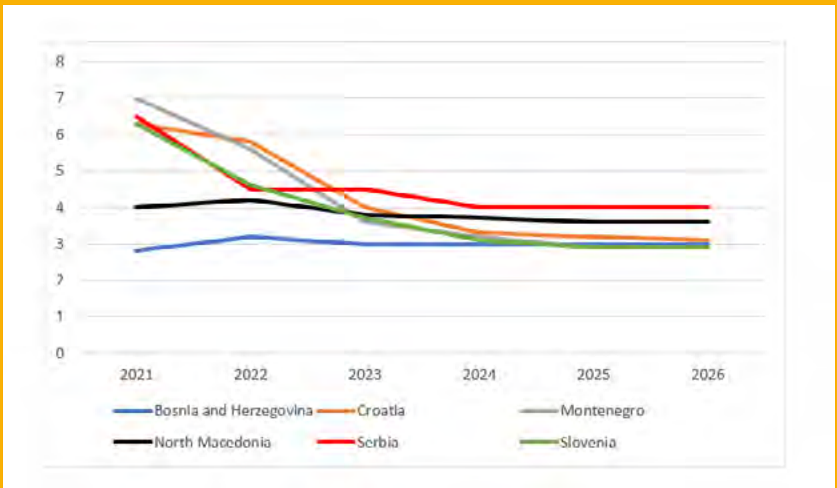
When it comes to indicators that mostly show the level and growth of the living standard of a country, such as the growth of real GDP and the unemployment rate, in the past ten years, the observed countries have generally not achieved the desired results. When it comes to real GDP growth, these economies grew at an average annual rate of about 1.5% in the observed period, while the average unemployment rate was about 20%.

Country	2021	2022	2023	2024	2025	2026
Bosnia and Herzegovina	2.8	3.2	3.0	3.0	3.0	3.0
Croatia	6.3	5.8	4.0	3.3	3.2	3.1
Montenegro	7.0	5.6	3.6	3.2	2.9	2.9
North Macedonia	4.0	4.2	3.8	3.7	3.6	3.6
Serbia	6.5	4.5	4.5	4.0	4.0	4.0
Slovenia	6.3	4.6	3.7	3.1	2.9	2.9

Table 2. Real GDP growth projections, 2021-2026 (%)
Source: IMF, 2021.

According to certain forecasts, the recovery of these economies is expected in the next period, which can be seen in Table 2. It is expected that the growth of real GDP in almost all economies in 2022 will be in the range of 4-7%. This is the period when these economies will begin to recover from the consequences caused by the COVID-19 crisis. Starting in 2023, growth will be somewhat milder, with around 3.5% expected on an annual basis. In the years to come, it is crucial that countries pursue a rational economic policy, accelerate structural reforms, and provide favourable conditions for the arrival of foreign investors, which will lead to the growth of the economy and thus its competitiveness.

Chart 2. Real GDP growth projections (%)



Source: author, based on IMF (2021)

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