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SEE-6
Economic Outlook

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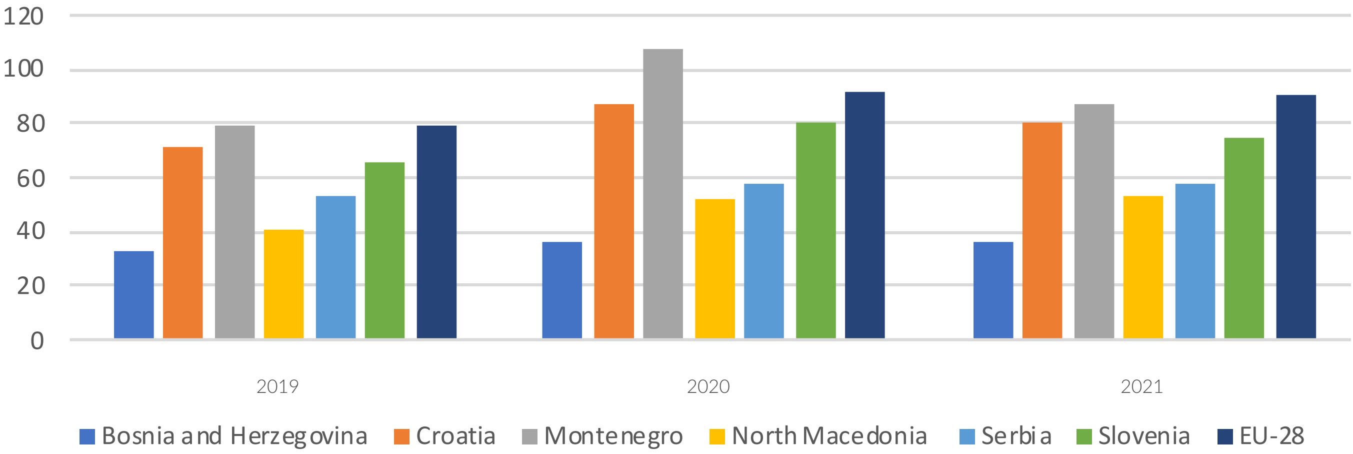

Source: IMF, 2022.
Note: General government gross debt (percent of GDP)

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BOSNIA AND HERZEGOVINA

Gradual economic recovery in 2021

Positive economic trends despite institutional weaknesses, and delays in implementing key structural reforms

Bosnia and Herzegovina's economy has recovered from the COVID-19 pandemic. Growth of 7.1% was recorded in 2021, fueled by strong external demand, pent-up domestic spending, and a rebound in tourism. Strong economic activity also reflected the authorities' COVID-19 related measures and their decision not to impose lockdowns during the Delta and Omicron variants despite a surge in cases amid vaccine hesitancy.

However, prospects for economic activity are affected by domestic tensions and a lack of consensus on reforms to enhance the integration of the economy internally and with international markets. The most immediate economic impact of the war is the large increase in food and fuel prices, which is already hitting many households and firms hard and will last for some time.

Looking ahead, structural reforms are critical to improving the business environment, stimulating private-sector employment, and tackling corruption. Work on these reforms needs to resume as soon as possible.

Bosnia and Herzegovina's economy has recovered from the COVID-19 pandemic

In 2021, Bosnia and Herzegovina achieved economic growth of 7.1%. Looking at the structure of economic trends in 2021, we can say that this GDP growth was a consequence of the simultaneous growth of both aggregate supply and aggregate demand due to improving

epidemiological and economic conditions in the country and the external environment.

GDP growth recorded in 2021 was primarily due to an increase in real private consumption (6.1% y-o-y) but also in real investment (4.4% y-o-y). In addition, economic growth in 2021 was supported by the growth in the physical volume of industrial production of 7.3% compared to the same period last year. Given the presence of the global COVID-19 pandemic, this increase in the physical volume of industrial production is encouraging, but it is necessary to keep in mind the effect of the low base from the previous year, which enabled such a high growth rate.

A slight increase in the unemployment rate

After the unemployment rate was at a record low in 2020 (15.9%), it increased slightly (17.4%) in 2021. After the unemployment rate growth in the first semester of 2021, there was a gradual stabilization of the labor market in the second semester, so that in the fourth quarter of 2021 the unemployment rate was 16.1%. The average monthly gross salary per employee in Bosnia and Herzegovina amounted to EUR 790 in 2021, representing a growth of 4.4% compared to the previous year when it ammounted to EUR 757.

Inflation accelerated in the second semester of 2021

In the second semester of 2021, there was a gradual rise in inflation. The price level in the fourth quarter of 2021 was 5.1% higher than in the same quarter of the previous year. Political instability in northern Europe and the rise in energy prices through the spillover effect have caused this rise in prices in Bosnia and Herzegovina's market. The highest average growth of prices was recorded in the sections

Food and non-alcoholic beverages (by 10.3%), Alcoholic beverages and tobacco (by 31.9%), *Housing and overheads* (by 12.5%), Health (by 7%), Transport (by 11.1%), and *Restaurants and hotels* (by 6.9%).

Significant growth in foreign trade

After the spread of the global COVID-19 virus pandemic, Bosnia and Herzegovina recorded a decline in total trade of over 10% in 2020, which is a consequence of a decline in merchandise exports of 8.5% and imports of 13.2%, compared to the previous year. These negative trends in foreign trade during the previous year are a direct consequence of the decline in production within the manufacturing industry in Bosnia and Herzegovina in 2020.

However, in 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 2021 (35.7% y-o-y). On the other hand, in the first semester of 2021, strong growth in imports (27.9% y-o-y) was recorded, which indicates the recovery in domestic demand (consumption and investment) in Bosnia and Herzegovina.

The rebound in economic activity helped restore fiscal balance

After ending 2020 with a budget deficit, there was an improvement in government finances in the first three quarters of 2021. Due to the growth of budget revenues in the first three quarters of 2021, a budget surplus of BAM 978 million was realized. Revenues collected by the Indirect Tax Authority reached a record high level, driven by strong private consumption and higher prices. Thus, revenues from indirect taxes in 2021 were over BAM 8.4 billion and are higher by about BAM 1.2 billion or 16.8% compared to the previous year, when they ammounted to about BAM 7.2 billion.

Table BIH1 Main economic indicators

	Total 2020 year	2021				Total 2021 year
		Q1	Q2	Q3	Q4	
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**-3.2**	2.6	11.6	6.9	7.6	**7.2**
Real private consumption (% change, yoy)	**-3.2**	1.3	12.8	3.4	7.6	**6.3**
Real government consumption (% change, yoy)	**1.3**	1.1	1.9	2.1	1.3	**1.6**
Real investment (% change, yoy)	**-8.4**	-8.2	11.5	7.2	8.6	**4.8**
Industrial output (% change, yoy)	**-2.0**	2.8	6.8	6.6	13.1	**7.3**
Unemployment rate (LFS, % pa)	**15.9**	19.1	18.1	16.4	16.1	**17.4**
Nominal GDP (EUR million)	**18,181**	4,810	4,776	4,901	4,969	**19,456**
GDP per capita (EUR)	**5,195**	1,374	1,365	1,400	1,420	**5,559**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**108.9**	108.2	109.2	112.9	112.7	**110.8**
Consumer prices (% change, yoy, pa)	**0.1**	0.7	1.1	1.5	5.1	**2.1**
Producer prices (% change, yoy, pa)	**3.3**	5.5	7.1	10.3	13.4	**9.1**
Average gross wage (% change, yoy, pa)	**4.0**	3.4	4.3	4.5	5.2	**4.3**
Exchange rate (BAM/EUR, pa)	**1.95**	1.95	1.95	1.95	1.95	**1.95**
Exchange rate (BAM/USD, pa)	**1.70**	1.61	1.62	1.66	1.71	**1.65**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**5,395**	1,573	1,757	1,843	2,146	**7,320**
Exports of goods (EUR, % change, yoy)	**-8.5**	16.8	47.5	36.7	42.2	**35.8**
Imports of goods (EUR million)	**8,659**	2,258	2,672	2,921	3,233	**11,084**
Imports of goods (EUR, % change, yoy)	**-13,2**	2.7	39.6	32.5	37.7	**28.1**
Current account balance (EUR million)	**-659**	-51	-173	-63	-124	**-411**
Current account balance (% of GDP)	**-3.6**	-1.1	-3.6	-1.3	-2.5	**-2.1**
Foreign Direct Investment net inflows (EUR million)	**348**	177	217	143	N/A	**N/A**
Foreign exchange reserves (EUR million, eop)	**7,112**	6,955	7,272	7,906	8,384	**8,384**
Foreign debt (EUR million, eop)	**4,475**	4,539	4,646	4,646	4,794	**4,794**
GOVERNMENT FINANCE						
Revenues (BAM_million)	**12,522**	3,191	3,391	3,728	N/A	**N/A**
Expense (BAM million)	**12,991**	2,916	3,212	3,204	N/A	**N/A**
Net = Gross operating balance	**-469**	275	179	524	N/A	**N/A**
Net acquisition of non-financial assets (BAM million)	**470**	60	93	79	N/A	**N/A**
Net lending/borrowing (BAM_million)	**-909**	216	86	445	N/A	**N/A**
Domestic government debt (EUR million, eop)	**1,015**	1,075	1,013	975	884	**884**
Foreign government debt (EUR million, eop)	**5,415**	5,452	5,482	5,774	5,909	**5,909**
Total government debt (eop. % of GDP)	**33.9**	N/A	N/A	N/A	N/A	**34.9**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**13.6**	14.5	17.2	18.9	19.1	**19.1**
Broad money, M4 (% change, yoy, eop)	**7.3**	8.6	11.1	11.9	11.6	**11.6**
Total domestic credit (% change, yoy, eop)	**-2.0**	-1.3	2.0	2.9	3.6	**3.6**
DMBs credit to households (% change, yoy, eop)	**-0.8**	0.7	3.6	4.3	5.5	**5.5**
DMBs credit to enterprises (% change, yoy, eop)	**-4.9**	-2.1	-5.8	1.4	2.2	**2.2**
Money market interest rate (%, pa)	**3.1**	3.2	3.1	3.3	3.0	**3.2**
DMBs credit rate for enterprises short-term (%, pa)	**3.7**	3.7	3.7	3.7	3.7	**3.7**
DMBs credit rate for households short-term (%, pa)	**3.7**	3.9	3.3	3.0	1.9	**3.0**

Policy assumptions and projections summary

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

A key basis for assessing economic trends in Bosnia and Herzegovina in the 2022-2024 period will represent trends in economic activity in the external environment and the development of the situation related to the war in Ukraine. In addition to this external dynamics, an important determinant in generating economic growth in Bosnia and Herzegovina during this period will be internal dynamics through the implementation of structural reforms in the country.

Considering the above factors, and according to the projections for the 2022-2024 period, Bosnia and Herzegovina is expected to continue the trend of economic growth of about 3.5% annually (2022: 3.4%, 2023: 3.5%, and 2024: 3.7%). It is assumed that the key pillar of economic growth during this period should represent domestic demand. Thus, in the 2022-2024 period, private consumption is expected to grow at an average rate of about 2% (2022: 2.0%, 2023: 1.7%, and 2024: 1.8%). An increase in total exports could be expected in the 2023-2024 period, with annual growth rates of 6.9% and 7.4%, respectively. The current account deficit (as a share of GDP) could be expected to remain at approximately the same level (in the range of -4.7% to -5.1% of GDP) for the 2022-2023 period. Assuming that food prices will rise moderately, as do prices utilities, a price increase of 3.0% could be expected in the 2022-2024 period. In 2022, there would bemoderate growth of credit activity again with a rate of 4.5% y-o-y, and in 2023 with a rate of 6.0% y-o-y.

Table BH2 Summary of projections

	2022	2023	2024
Real GDP (% change)	**3.4**	**3.5**	**3.7**
Real private consumption (% change)	2.0	1.7	1.8
Real government consumption (% change)	0.7	0.7	0.7
Real investment (% change)	7.0	6.9	7.9
Exports of goods and services (constant prices, % change)	6.7	6.9	7.4
Imports of goods and services (constant prices, % change)	4.6	4.1	4.8
Current account balance (% of GDP)	-4.7	-5.1	N/A
Consumer prices (% change, pa)	3.0	3.0	3.0
Exchange rate, national currency/EUR (pa)	1.95	1.95	1.95
Unemployment rate (LFS, %, pa)	17.0	16.5	N/A
General government balance (ESA 2010 definition, % of GDP)	-2.5	-2.6	-2.9
Total domestic credit (% change, eop)	4.5	6.0	N/A

CROATIA

Impressive economic growth achieved in 2021 is expected to slow down significantly in 2022

Economic recovery in 2022 will continue, albeit at much lower rates than expected

The Croatian economy in 2021 experienced a full "V" shaped recovery from the pandemic shock with a GDP growth rate of 10.2%, according to the o last revised estimates of the Croatian Bureau of Statistics published on 22 April 2022. The first estimate published at the end of February 2022 was slightly higher (10.4%). That is the second strongest growth in the EU, straight after Ireland, according to the latest European Economic Forecast Spring 2022 from May 2022..

Such impressive economic growth was achieved on the wings of a swift rebound of private consumption, tourist sector, construction industry, and exports of goods. Additionally, it is important to take into account a very low base of GDP in 2020, when it declined by -8.1%.

However, due to the negative impacts of the war in Ukraine on the EU economies, the growth rates envisaged for 2022 would be much lower than expected. Most forecasts therefore revised significantly downwards and the latest one by the Government released at the end of April 2022 is

3.0% (compared to 4.4% projected in November 2021). The World Bank also lowered its expectations for 2022 to 3.8%, while the IMF predicts a much lower growth rate of 2.7%.

Factors contributing to economic recovery in 2021

The dominant positive contribution to a very strong economic recovery in 2021 attributes mainly to a very quick expansion of the demand side of the economy. This relates primarily to the rebound and strong rise of private consumption, especially in the second and the third quarter of the year (18.2% and 16.0%, respectively). The rates of expansion of private consumption in that period were really beyond any optimistic expectations due to several favourable factors. The starting one was a very low comparative base in 2020. The other is the rise of personal income due to further income tax reductions, which increased net wages in 2021 and, therefore, the general purchasing power of households. Finally, the rise of employment levels due to a strong economic recovery also contributed to the high private consumption rates and consumer confidence in recovery. However, the last quarter of 2021 brought some moderation of these rates to 7.7% due to the worsening situation with the pandemic, as well as due to the rise of inflation, especially related to energy and food prices. Nevertheless, the increase in private consumption for the whole of 2021 was at a remarkable rate of 10.1%.

On the other side, the real government consumption moderated in 2021 compared to 2020 by 3% for the whole year. Its rise and fall in the second half of the year were very much dependent on the pandemic situation and the costs of its management. While in the summer months (Q3) it decreased substantially, a very significant rise of expenditures appeared in the last quarter (Q4) of 2021 with a rate of 14% y-o-y when the fourth pandemic wave built up significantly.

Another important factor contributing to overall swift economic growth in 2021 relates to the continuation of the growth of total real investments, mainly owing to public investments into infrastructure projects financed by abundant EU structural and investment funds. According to the Croatian Bureau of Statistics data, the average growth rate of real investments for the whole of 2021 was as strong as 7.6%, and also reflects the significant recovery of private investments underpinning overall economic growth in this period.

The strong revival of both exports and imports

The strong revival of exports of goods and services was one of the driving forces of the impressive economic recovery of Croatia. The most surprising was the swift growth of exports of goods due to a strong global recovery, especially in Croatia's main trading partners in the European Union. The steep rise of exports of goods reached the impressive growth rate of 20% for the whole of 2021, with especially strong expansion rates in Q2 (36.0%) and Q4 (24.7%). Indeed, part of the explanation for such a surge attributes to the low 2020 comparison base. Nevertheless, such high growth rates were very encouraging and very beneficial for the current account balance, with the overall positive contribution of the net exports to economic growth.

Along with a growth of exports of goods, the rates of imports of goods have also risen strongly, especially related to the intermediate goods on which domestic industry greatly depends upon. Still, the growth rates of imports of goods in 2021 were much slower (14.8%) than the growth rates of exports of goods (20%). However, the stronger expansion of imports of goods in the last quarter of 2021 (15.0%) also reflects the higher prices of energy and raw materials in the world markets, which also continued to rise significantly in the first quarter of 2022. This could lead to a worsening of the current account balance in months to come.

The contribution of exports of services to overall economic recovery in 2021 was beyond any expectations as the tourist sector results rebounded very close to pre-pandemic 2019 and even surpassed it in some summer periods. Mild pandemic containment measures and lifting up travel restrictions greatly contributed to very favourable results of the tourist sector. Needless to say that the abundant revenues from the tourist sector in 2021 were very beneficial for further improvements and balancing the current account. Substantial surpluses created in the current services account, especially in Q3 when the tourist season was at its peak, significantly contributed to the overall current account level, which for the whole of 2021 reached a surplus of 1,945 million Euro or 3.4% of GDP.

The remarkable growth of industrial output

Industrial output recovered significantly at the rate of 6% for the whole of 2021, reflecting a strong demand increase in both domestic and export markets. The most remarkable growth was recorded in the second and fourth quarter, 12.4% and 5.4%, respectively. The industrial output revived most strongly in those industries with a high share of exports, such as shipbuilding, transport equipment industries, capital goods industry, chemical industries, electrical equipment and appliances, durable consumer goods, and processing industry. Fortunately, due to industrial structure, disruptions in the supply chains did not play a major limiting role in the increase of the total industrial output in 2021. Industrial output growth has also continued in the first two months of 2022 and is among the strongest in the EU.

Economic recovery favourably affected labour market developments

Labour market developments in 2021 were under the very positive influence of strong economic recovery, which as a result had rising demand for workers and consequently employment levels and further reduction of unemployment rates. The LFS data indicate a decrease in unemployment rates, especially in the second half of 2021, with significantly lower unemployment rates than in the first half of 2021. Apart from the economic recovery, the government job-keeping measures contributed positively to preserving the employment levels. However, compared to 2020, these measures were much smaller in scope and better targeted to sectors badly affected by the pandemic.

At the same time, the employment levels were continuously rising as demand for workers built up during the year. This particularly relates to the construction and service sectors, most notably the tourist and hospitality sector. According to the Croatian Bureau of Statistics, the total increase in the number of employed in 2021 was close to 48,431 persons, i.e. 3.6%.

Apart from the tourist sector, the demand for workers was particularly strong in the construction sector, where shortages of labour were mounting due to high demand in the areas in need of post-earthquake reconstruction. The general shortages of the labour force were mitigated partly by lifting the quotas for foreign workers; however, despite these measures, they remained profound throughout 2021 and are likely to continue in 2022.

The fiscal deficit decreased substantially

The public finances balance improved significantly in 2021 on the wings of the swift economic recovery, which brought a much stronger rise in budget revenues than expenditures as the pandemic's impact substantially eased compared to 2020. Apart from that, a significant amount of EU funding was available that alleviated a large part of the pressures on the Budget, especially related to health sector expenses and job-support subsidies. As for the latter, job support subsidies decreased substantially in 2021 compared to 2020 (by 18.6%) as they descaled both in sectorial scope and number of users because of strong economic recovery. In addition, the decrease in interest rates on government loans due to favourable financing conditions in the world market also contributed to a lower rise in total budget expenditures in 2021. Beyond the most optimistic forecasts, the budget deficit decreased in just one year from a very high 7.3% of GDP in 2020 to 2.9% in 2021. This achievement of returning to the Maastricht reference level much faster than initially planned is very important given the Government's plan to join the Eurozone in January 2023.

At the same time, the level of general government debt also decreased significantly. At the end of 2021, it stood at 79.8% of the GDP (down from 87.3% in 2020), according to the latest Croatian Bureau of Statistics data published in April 2022. Demonstrating a declining trend of public debt toward the Maastricht convergence criteria level is yet another important indicator to be complied with within the criteria for joining the Eurozone zone. The Ministry of Finance projects that the total government debt level will further fall in 2022 to 76.2% of GDP.

As elsewhere in the EU, consumer and producer prices are on the rise

After many years of very low levels, CPI rates started to build up significantly in the third quarter (3.1%) and particularly in the fourth quarter of 2021 (4.6%) compared to the same two quarters of 2020. However, due to very low inflation rates in the first two quarters, it ended up at the rate of 2.6% for the whole of 2021, which was still rather moderate compared to other EU countries. The strong revival of the 2021 economy brought a consequent rise in prices for both consumers and producers due to the quick increase in demand and occasional shortages in global supply chains. Most of that rise (above 40%) is attributed to the increase in energy prices, especially oil and gas at the world market, which affected the prices of petrol and other derivates very much, although the government intervention in the market restrained such surge through freezing the prices of petrol for a month in November 2021. The second significant source of increase in consumer prices in the last two quarters was the prices of raw materials as well as food, partly also due to the spillover effect of fuel and energy prices.

However, producer prices have surged much more dramatically in the last two quarters of 2021 (10.9% in Q3 and 19.7% in Q4) and continued to rise even more dramatically in the first quarter of 2022. For that reason, in February 2022, the Government adopted a substantial package of anti-inflationary measures worth 4.8 billion HRK to alleviate some of the burden, both for producers and the general population. These measures included limiting the increase of electricity prices to 9.6% and gas to an average increase of 16% in effect from April 2022, lowering VAT for electricity and gas, as well as for major food product prices. In addition, the Government increased the energy vouchers value for the socially challenged and poor. It also adopted a lump sum aid to pensioners with a pension below 4,000 HRK; similarly, it did to cope with COVID-19 in 2021.

Due to the war in Ukraine and EU sanctions introduced on Russia, energy prices are likely to remain high until the situation stabilizes and will be the largest source of a surge in consumer and producer prices in 2022. Both analysts and policymakers thus expect that it would have a major impact on the growth rates' slowdown in 2022, not only in Croatia but also globally.

Table HR1 Main economic indicators

	Total 2020 year	2021 Q1	2021 Q2	2021 Q3	2021 Q4	Total 2021 year
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**-8.1**	-0.6	16.4	15.1	9.7	**10.2**
Real private consumption (% change, yoy)	**-5.3**	-0.2	18.2	16.0	7.7	**10.1**
Real government consumption (% change, yoy)	**4.1**	-5.8	8.5	-4.5	14.0	**3.0**
Real investment (% change, yoy)	**-6.1**	5.0	18.1	7.6	0.8	**7.6**
Industrial output (% change, yoy)	**-3.1**	3.1	12.4	3.5	5.4	**6.0**
Unemployment rate (LFS, % pa)	**7.5**	9.9	8.0	6.2	6.4	**7.6**
Nominal GDP (EUR million)	**50,225**	12,404	13,981	16,528	14,455	**57,342**
GDP per capita (EUR)	**12,410**	3,073	3,464	4,249	3,716	**14,747**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**-0.1**	-0.3	-2.0	3.4	4.7	**3,2**
Consumer prices (% change, yoy, pa)	**0.1**	0.4	2.2	3.1	4.6	**2.6**
Producer prices (% change, yoy, pa)	**-4.2**	0.7	6.8	10.9	19.7	**9.5**
Average gross wage (% change, yoy, pa)	**5.1**	3.8	4.4	4.0	4.9	**4.3**
Exchange rate (HRK/EUR, pa)	**7.53**	7.56	7.53	7.49	7.51	**7.52**
Exchange rate (HRK/USD, pa)	**6.61**	6.27	6.25	6.35	6.57	**6.36**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**14,832**	4,020	4,725	4,598	5,677	**19,021**
Exports of goods (EUR, % change, yoy)	**0.3**	7.4	36.0	13.1	24.7	**20.0**
Imports of goods (EUR million)	**23,133**	6,364	7,086	7,282	7,826	**28,559**
Imports of goods (EUR, % change, yoy)	**-8.8**	2.6	31.9	12.4	15.0	**14.8**
Current account balance (EUR million)	**-56**	1.299	802	4,430	-451	**1,945**
Current account balance (% of GDP)	**0.1**	0.3	0,6	3.7	-0.3	**3.4**
Foreign Direct Investment net inflows (EUR million)	**1,045.5**	617.8	1,039,3	1.520,7	598.8	**3,776.5**
Foreign exchange reserves (EUR million, eop)	**18,943**	21,084	21,586	24,366	24,373	**25,022**
Foreign debt (EUR million, eop)	**40,074**	43,517	44,246	44,305	44,610	**44,610**
GOVERNMENT FINANCE						
Revenues (HRK million)	**178,627**	45,627	47,826	54,725	51,456	**199,633**
Expense (HRK million)	**206,338**	49,604	52,772	50,936	58,760	**212,071**
Net = Gross operating balance	**-27,710**	-3,977	-4,817	3,790	-7,304	**-12.438**
Net acquisition of non-financial assets (HRK million)	**274**	-835	-1.066	-991	-3,869	**256**
Net lending/borrowing (HRK million)	**-27.576**	-5.397	-5.774	2,799	-11,173	**-12,182**
Domestic government debt (EUR million, eop)	**29,783**	28,962	29,438	30,498	30,194	**30,194**
Foreign government debt (EUR million, eop)	**14,072**	16,258	16,075	15,856	15,864	**15,864**
Total government debt (eop. % of GDP)	**87.3**	87.2	87.0	82.7	79.8	**79.8**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**17.0**	18.4	16.8	20.7	18.0	**18.0**
Broad money, M4 (% change, yoy, eop)	**9.3**	7.4	8.1	11.4	10.4	**10.7**
Total domestic credit (% change, yoy, eop)	**3.9**	2.5	3.9	4.1	3.6	**3.9**
DMBs credit to households (% change, yoy, eop)	**2.1**	2.2	4.4	4.8	4.5	**4.5**
DMBs credit to enterprises (% change, yoy, eop)	**6.0**	1.2	1.5	1.0	1.0	**1.0**
Money market interest rate (%, pa)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
DMBs credit rate for enterprises short-term (%, pa)	**2.6**	2.8	2.7	2.7	2.6	**2.7**
DMBs credit rate for households short-term (%, pa)	**7.6**	6.4	6.3	6.2	6.0	**6.2**

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

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

Policy assumptions and projections summary

Economic growth expected to moderate in the medium term

The war in Ukraine that started at the end of February 2022 and the impact of economic sanctions introduced by the EU to Russia have significantly changed the prospects of economic growth in the EU countries and globally. The most recent projections of the economic growth in 2022 therefore revised significantly downwards. The most recent forecast of the Croatian Ministry of Finance made at the end of April 2022, which takes into account the impact of this new geopolitical situation, envisages a significant slowing down of growth of Croatian GDP in 2022 to the rate of only 3.0% (compared to 10.2% in 2021). The prognoses of the Croatian National bank also lowered accordingly in April 2022 and envisaged a growth rate of 3.2%.

The international projections also followed suit in their spring 2022 outlooks. The World Bank Spring Economic Outlook in April 2022 for Croatia projects a growth rate of 3.8%, while the IMF World Economic Outlook envisages a growth rate of only 2.7%, almost twice lower than the last projections made in November 2021.

The medium-term growth projections for Croatia were lowered less significantly and still look rather solid. However, the realisation of these growth rates will very much depend on further macroeconomic consequences of the war in Ukraine and on consequent price developments in the global energy and food markets, which dominantly fuel domestic inflation rates. Another negative factor determining the prospects of growth also depends partly on managing further pandemic impacts, although this negative risk is perceived now much smaller than in the last two years. When examining possible positive impacts, the growth prospects are likely to be driven by the positive effects of Croatia joining the Eurozone, primarily through lowering the transaction costs and potential increase in investments.

Based on the plans for joining the Eurozone, the credit rating agency Standard & Poor's affirmed Croatia's BBB-/A-3 ratings in March 2022 and provided a stable outlook for medium-term economic growth, despite the rising

Table HR2 Summary of projections

	2022	2023	2024
Real GDP (% change)	**3.0**	**4.4**	**2.7**
Real private consumption (% change)	1.4	3.2	2.4
Real government consumption (% change)	3.3	1.9	2.0
Real investment (% change)	5.8	6.1	3.9
Exports of goods and services (constant prices, % change)	6.9	6.0	4.2
Imports of goods and services (constant prices, % change)	6.1	6.9	4.2
Current account balance (% of GDP)	2.0	2.4	2.6
Consumer prices (% change, pa)	7.8	3.7	2.7
Exchange rate, national currency/EUR (pa)	7.53	7.53	7.53
Unemployment rate (LFS, %, pa)	6.3	5.6	5.2
General government balance (ESA 2010 definition, % of GDP)	-2.8	-1.6	-1.6
Total domestic credit (% change, eop)	3.3	3.4	3.5

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

inflationary pressures and geopolitical uncertainties related to the conflict in Ukraine. The Fitch rating agency also confirmed the investment rating of Croatia with a positive medium-term outlook (BBB) at the beginning of May 2022. Fitch considers that Croatia is less exposed to negative risks of rising energy prices primarily due to the diversification of energy sources in which half of the needs are covered by LNG terminal. In addition, the Croatian economy is less vulnerable to direct negative impacts of war in Ukraine than other EU countries with more intensive trade links.

In the recent medium-term growth outlook released at the end of April 2022, despite negative risks, the Government envisages an increase of the growth to 4.4 rate already in 2023, followed by 2.7 in 2024 and 2.5% in 2025. The main components on which the Government base its prognosis relies strongly on abundant EU funding available for investments through the Recovery and Resilience Facility, out of which 6.3 billion Euro is in the form of grants. The first portion of this grant in the value of 700 million euros was disbursed on the 10th of May 2022, after the European Commission confirmed the fulfilment of 34 Croatian Recovery and Resilience Programme goals in the first year of its implementation. The total amount of available funding at disposal to Croatia within the new EU Financial Framework 2021-2027 is around 12 billion euros. Combined with additional funding from the EU Solidarity Fund (around 1 billion Euro in total) already approved for the post-earthquake reconstruction of the Zagreb and Banija region, this represents a huge potential for sustaining rather strong growth rates also in the medium term. The European Commission recently prolonged the use of such funding until summer 2023. Apart from investments, despite the negative impacts of the war in Ukraine, the tourist sector is likely to continue to be the main driver of growth in the medium term, along with further strengthening of private consumption and export of goods.

The Government bases its prognoses on the expectation that these inflationary pressures would ease considerably in the medium term. However, many independent analysts argue that this remains the highest growth averse risk factor within the current geopolitical situation, which impact is quite impossible to predict precisely at this point.

The recent projections of medium-term growth by most international organisations also corrected downwards. The European Commission in its Spring Economic Forecast 2022 (May 2022) lowered anticipation of growth rate in 2022 to 3.4%, followed by a rate of 3.0% in 2023. In its recent Spring Economic Update from April 2022, the World Bank projects a growth rate of 3.4% in 2023 and 3.1% in 2024. The IMF projections for 2023 are more optimistic and anticipate a growth rate of 4.0, while the growth rate in 2024 stands at a solid 3.0%. These prognoses also single out that the major negative risk of growth rates' realisation is associated with rising inflation caused by increased energy and food prices. These developments would likely cause worsening financial conditions due to the inevitable increase of interest rates, which in addition would affect investments and growth in general. Overall, the growth prospects for the medium-term do not look as great as just three-four months ago but are still reflecting well Croatia's solid growth potential.

MONTENEGRO

The beginning of economic recovery to meet new challenges

The second half of 2021 was marked by a gradual economic recovery in Montenegro, following a recession caused by the Covid 19 pandemic in 2020. In summary, in the third and fourth quarters, the value of GDP increased by 25.8% and 8.2%, respectively. Positive economic trends in the tourism sector contributed the most to this growth. The better health situation, encouraged by intensifying the vaccination process and easing restrictive measures, has led to a significant increase in the number of tourist arrivals and the number of overnight stays. It is also important to note that in the midst of the summer tourist season, Montenegro has fully opened its boundaries, allowing foreign tourists to enter without a vaccination certificate or a negative PCR test. In addition to tourism, the observed period is characterized by positive results in the industrial production sector, while in the forestry sector, there was a certain decline.

The whole process of opening the borders in the later stages of the third, as well as during the fourth quarter, inevitably brought problems in terms of controlling the spread of the virus. Therefore, the end of the year brought negative records in the number of new cases and

the number of deceased citizens. The return to restrictive measures has naturally contributed to the percentage of GDP growth in the last quarter being below the expected level. The fourth quarter also brings growth in inflation measured by the GDP deflator and the Consumer Price Index, while the banking system is characterized by a high level of stability and liquidity. All banking indicators monitored by the Central Bank of Montenegro show an improvement compared to the comparable period last year.

Foreign direct investment recorded an increase differentiate from the previous period, while better results were achieved in the balance of payments, which is reflected in the reduction of the deficit. The deficit on the services account realized on the basis of higher revenues from tourism, i.e. growth on the accounts of primary and secondary income, contributed the most to the reduction of the deficit. The labor market is characterised by better indicators compared to the first two quarters of the current year, i.e. the end of the previous year. The second half of the year also brought the continuation of the implementation of a package of measures to support the economy and citizens, including one-time support to educators and health workers through the issuance of tourist vouchers worth 200 EUR. In this way, the Government of Montenegro wanted to make an adequate connection between the need to reward health and education workers who have borne the heavy burden of the pandemic, as well as strengthening the tourism sector, especially the part related to private accommodation.

Although the budget for 2021 was adopted only in June, the good tourist season enabled the achievement of the largest number of set goals. Furthermore, the "Evropa sad" program was presented, which began its implementation on January 1, 2022. The essence of the program is tax reform, which aims to contribute to the growth of net wages and, consequently, the population's living standard. Some of the most important measures envisaged by the tax reform include an increase in the minimum wage from EUR 250 to EUR 450, and an increase in average wages in Montenegro by approximately 17%. The increase in salaries has its sources in reducing the tax burden, by introducing a non-taxable part on gross salaries up to 750 EUR, while the contributions to health insurance are replaced with other state revenues. In this way, the tax burden on the minimum wage is reduced from 39% to 20.4%.

In order to increase the salaries of the population, i.e. to implement the tax reform in an adequate way, it was necessary to adopt amendments to a number of laws, which were related to the draft budget of the Government of Montenegro for 2022. Accompanying changes to the law include an increase in excise duties on tobacco and tobacco products, alcohol and alcoholic beverages, sweetened beverages as well as products with high sugar content.

There were many doubts about the sustainability of the measures proposed by the program, which were highlighted by a large number of participants in public life. When it comes to economic analysts, divided opinions prevailed regarding the need to improve the living standard of citizens on the one hand, and on the other hand the need to maintain the stability of the public finance system in very challenging times. The abolition of health insurance contributions has emerged as an issue of particular importance in terms of the sustainability of health care financing. To this should be added the complexity of the political situation in Montenegro, and the numerous problems that existed between the Government of Montenegro and the parliamentary majority. Despite all the above challenges, after the discussion in the plenum, on December 29, 2021, the Law on the Budget for 2022 was adopted. How sustainable are the measures envisaged by the program, will be shown by the time ahead.

Political hiatus between policy makers

The internal political situation in Montenegro was characterized by marked instability in terms of relations between the legislature and the executive. Noises in the communication that existed resulted in the Parliament of Montenegro working to a lesser extent than anticipated, which resulted in delays in the adoption of a large number of laws. No less significant consequence of such a situation is the fact that a large number of institutions within the judiciary and the prosecutor's office are in an acting state, as a result of the lack of consensus of parliamentary parties, especially in situations where decisions need to be made by qualified majority.

The beginning of price growth

In the third and fourth quarters of 2021, Montenegro had a noticeable increase in consumer prices compared to the previous period and 2020. This may not come as a surprise if we keep in mind that this is a year of gradual recovery after the great recession, and having in mind the global economic trends. The end of the previous year, i.e. December 2021, brings a growth of consumer prices by 0.3% compared to the previous month. The largest increase in prices was recorded in the category of food and non-alcoholic beverages (1.4%) as a result of an increase in prices of milk, dairy products, and eggs by 2%, and vegetables by 3.4%. Slightly lower price growth was recorded in the categories of housing, water, electricity, gas, and other fuels (0.7%), hotels and restaurants (0.6%), as well as in the category of alcoholic beverages and tobacco (0.1%). On the other hand, price falls were recorded in the categories of clothing and footwear (-1.8%), transport (-1.6%), furniture and other household equipment (-0.6%). The annual inflation rate measured by the Consumer Price Index is 4.6%, while inflation measured by the harmonized consumer price index is 4.5%. Data from the Statistical Office and the Central Bank of Montenegro show that in the second half of the year, observed by quarters, consumer prices increased by 3.1 and 4.3%, respectively.

Labor market on the road to recovery and return to pre-pandemic state

Data from the Statistical Office from the end of 2021 show that 211,302 people were employed, which is an increase of as much as 31.3% compared to the end of the previous year, i.e. in absolute terms, more than 50,324 people were employed. Observed by sectors, there were no major changes differentiate to comparative data. Consequently, the wholesale and retail trade sector, repair of motor vehicles and motorcycles (19.8%), i.e. the state administration and defense sector, and compulsory social security (12.5%) still dominate. In addition to the above, the education sector (7.8%), the accommodation and food services sector (7.3%), the health and social care sector (7.2%), as well as the manufacturing sector have a more significant share in the structure of employed persons.

Monstat data shows that the average gross salary at the end of 2021 was 802 EUR, while the net salary without taxes and contributions was 537 EUR. Observed on a monthly basis, this represents a growth of net earnings of 0.4%, while observed in a period of 12 months, earnings increased by 1.9% compared to December 2020. If we look at the summary of 2021, we come to the conclusion that due to the growth of consumer prices that occurred, essentially, real wages recorded a decline of 0.9%.

In the part of the sector analysis of salaries, the employees in the sector of financial activities and insurance activities (EUR 970) still have the best conditions, followed by the sector of electricity, gas, steam and air conditioning (EUR 924), and the information and communication sector (EUR 694). The lowest earnings were recorded in the accommodation and food services sector and the processing industry (EUR 391).

Coverage of imports by exports remains low

Montenegro's foreign trade is at a significantly higher level in 2021 compared to 2020. According to the data of the Statistical Office, the total foreign trade amounted to 2,942.2 million EUR, which is an increase of 19.1% compared to the previous year. However, it should be noted that the extremely negative foreign trade balance remains a significant limiting factor for the Montenegrin economy. Exports of goods amounted to EUR 437.1 million and imports to EUR 2,505.1 million. This means that the coverage of imports by exports is still very low and ranges at the level of 17-18%.

The structure of exports, observed by the standards of the international trade classification, did not change significantly in relation to the first two quarters of 2021, and in relation to the comparative data in 2020. Consequently, the most represented sector is 6, i.e. products classified in the category of materials in the total amount of 101.6 million EUR. Within this sector, non-ferrous metals (EUR 81.8 million) dominate, followed by iron and steel (EUR 6.7 million) and others. The structure of imports is predominantly made up of machinery and transport equipment in the amount of EUR 513.4 million. Within this sector, road vehicles account for the most, amounting to EUR 147.8 million. When it comes to countries that are the most important foreign trade partners, in terms of exports, they are Serbia, Switzerland, and Bosnia and Herzegovina. On the other hand, in terms of imports, the most important partners are Serbia, China, and Germany. In summary, Montenegro has the largest foreign trade exchange with CEFTA member state countries and EU member states.

Preliminary data for 2021 support the growing net inflow of foreign direct investment. During 2021, the total inflow of FDI amounted to 552 million EUR, an increase of 18.1% compared to 2020. The total inflow of foreign direct investment amounted to 898.4 EUR million, which is a result of the growth of equity investments. In the area of equity investments, an inflow of 493.3 million EUR was realized, which is 54.9% of the total inflow. In the structure of equity investments, investments in companies and banks amounted to 215 million EUR. The inflow in the form of intercompany debt amounted to 293.8 million EUR.

The banking sector maintains stability

The banking sector of Montenegro in the second half of 2021 was characterized by a high degree of liquidity. Liquid assets of banks amounted to 1,404.8 million EUR, which is an increase of as much as 388.8 million EUR, compared to December 2020. Observed by the level of daily and decadal liquidity indicators, in the whole period, values were above the prescribed minimum were recorded. At the end of December, commercial banks had reserves with the Central Bank of Montenegro in the total amount of 217.1 million EUR, which is 37.6 million EUR or 21% more than in the previous year. In terms of the effective reserve requirement rate, it amounted to 5.25% at the end of 2021 and is at approximately the same level as at the end of 2020. When it comes to microcredit financial institutions, their total balance sheet amounted to 80.1 million EUR at the end of the fourth quarter, which is slightly lower compared to the comparable period in the previous year.

When it comes to interest rates, the total weighted average nominal interest rate (WANIR) in December 2021 was 5.16%, while the weighted average effective interest rate (WAEIR) was 5.66%. Comparing these data with the previous period, we come to the conclusion that observed in the time interval of 12 months, the average nominal and effective interest rate decreased by 0.17% and 0.18%, respectively. If we would extract only the newly approved ones from the total observed amount of loans, we would notice that the interest rates are somewhat lower. Namely, the WANIR at the end of the last quarter of 2021 was 4.31%, and the WAEIR was 4.83%. This is a decrease of 0.34% on average compared to 12 months ago. Passive interest rates were at an approximately stable level in the second half of the previous year. At the end of December, the weighted average effective interest rate was 0.35%.

In December 2021, the Montenegro Stock Exchange generated a turnover of 656,817 thousand EUR, thanks to a volume of 113 transactions. This turnover is significantly lower than in the comparable month of the previous year by 70%. The value of the MONEX stock exchange index at the end of December amounted to 9,867 index points and decreased by 6.6% compared to the previous month, or 4.5% observed on an annual basis.

Continuation of fiscal consolidation

During 2021, the original budget revenues amounted to 1,910.01 million EUR. If we compare these data with 2020, there was an increase of 272 million EUR. The better result was mostly due to the increase in revenues from value-added tax (VAT), from 529 to 691 million euros, as well as the increase in the collection of corporate income tax, i.e. in the part of fees and other revenues. Total revenues at the end of 2021 amounted to 2,194 million EUR. In terms of expenditures, the largest increase was recorded in the categories of gross wages and contributions borne by the employer, and in total, total expenditures at the end of the previous year amounted to 2,449 million EUR.

The state of public debt speaks in favor of positive tendencies in terms of the state in the structure of public finances of Montenegro, due to a significant debt decrease both in the total amount and in relation to the observed value of GDP. According to the Report of the Ministry of Finance and Social Welfare of Montenegro, the total debt on 31.12.2021. amounted to 4,162.79 million EUR, or 83.27% of GDP. This represents a decrease of 20 percentage points compared to the beginning of the year. An overview of the debt situation by creditors shows that Eurobond has by far the largest share with 47.45%, followed by Exim Bank with 18.73%.

In July, Montenegro concluded a cross-currency swap arrangement with four renowned world banks related to a loan from Exim Bank, which was a major partner in financing the construction of a priority section of the Bar-Boljare highway. On that occasion, a debt amounting to 818 million EUR in US dollars was converted, according to the agreed EUR / USD exchange rate of 1.18, and a fixed average weighted interest rate of 0.88% was agreed to be paid on the outstanding part of the debt converted into euros. As a result of this arrangement, 96% of Montenegro's debt is now paid in euros. The interest rate structure of the debt is also positive, if we keep in mind that almost 3/4, i.e. 74.7% of the total debt is serviced at a fixed interest rate. In the part of the average debt maturity, at the end of 2021 it was 5.6 years.

Table MN1 Main economic indicators

	Total 2020 year	2021 Q1	2021 Q2	2021 Q3	2021 Q4	Total 2021 year
ECONOMIC ACTIVITY*						
Real GDP (% change, yoy)	**-15.3**	-6.5	19.0	25.8	8.2	**12.4**
Real private consumption (% change, yoy)**	**-4.6**	-8.2	15.4	4.8	5.6	**4.3**
Real government consumption (% change, yoy)**	**0.8**	1.8	0.8	2.3	1.2	**1.5**
Real investment (% change, yoy)**	**-12.0**	-19.1	3.5	-9.5	-15.6	**-10.3**
Industrial output (% change, yoy)	**-0.9**	11.8	8.7	0.4	0.0	**4.9**
Unemployment rate (LFS, % pa)	**17.9**	19.4	17.1	14.8	15.4	**16.6**
Nominal GDP (EUR million)	**4,185.6**	875.3	1,128.7	1,583.2	1,324.4	**4,911.6**
GDP per capita (EUR)**	**6,737**	1,410	1,818	2,551	2,134	**7,913**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)**	**-0.2**	2.1	5.3	3.9	5.7	**4.4**
Consumer prices (% change, yoy, pa)	**-0.3**	0.0	2.3	3.1	4.3	**2.4**
Producer prices (% change, yoy, pa)**	**-0.1**	0.8	1.8	0.1	2.5	**1.3**
Average gross wage (% change, yoy, pa)	**1.3**	0.3	1.5	1.7	1.9	**1.3**
Exchange rate (______/EUR, pa)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Exchange rate (______/USD, pa)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**409.0**	108.1	133.5	129.5	155.2	**526.2**
Exports of goods (EUR, % change, yoy)	**-12.2**	13.1	53.6	32.9	20.2	**28.7**
Imports of goods (EUR million)	**2,051.0**	430.2	632.2	720.8	656.9	**2,440.2**
Imports of goods (EUR, % change, yoy)	**-19.0**	-17.4	28.8	40.9	24.5	**19.0**
Current account balance (EUR million)	**-1,090.4**	-162.7	-249.7	162.0	-203.0	**-453.4**
Current account balance (% of GDP)	**-26.1**	-18.6	-22.1	10.2	-15.3	**-9.2**
Foreign Direct Investment net inflows (EUR million)	**467.5**	83.7	122.0	146.6	200.0	**552.0**
Foreign exchange reserves (EUR million, eop)	**206.6**	191.8	192.5	179.3	189.8	**189.8**
Foreign debt (EUR million, eop)	**9,381.1**	N/A	N/A	N/A	N/A	**N/A**
GOVERNMENT FINANCE						
Revenues (EUR million)	**1,868.7**	390.6	501.0	643.7	658.7	**2,194.0**
Expense (EUR million)	**2,018.3**	466.2	507.8	467.3	563.9	**2,005.2**
Net = Gross operating balance	**-149.6**	-75.6	-6.8	176.4	94.8	**188.8**
Net acquisition of non-financial assets (EUR million)	**315.0**	36.6	52.4	64.0	129.2	**282.3**
Net lending/borrowing (EUR million)	**-464.6**	-112.2	-59.2	112.3	-34.5	**-93.5**
Domestic government debt (EUR million, eop)	**495.56**	454.76	426.63	417.36	401.54	**401.54**
Foreign government debt (EUR million, eop)	**3,835.27**	3,642.68	3,652.60	3,658.88	3,688.48	**3,688.48**
Total government debt (eop. % of GDP)	**103.47**	83.42	83.05	82.99	83.27	**83.27**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Broad money, M4 (% change, yoy, eop)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Total domestic credit (% change, yoy, eop)	**N/A**	3.31	6.79	8.98	6.37	**N/A**
DMBs credit to households (% change, yoy, eop)	**N/A**	1.52	1.79	2.04	2.68	**N/A**
DMBs credit to enterprises (% change, yoy, eop)	**N/A**	1.90	2.99	0.71	4.35	**N/A**
Money market interest rate (%, pa)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
DMBs credit rate for enterprises short-term (%, pa)	**N/A**	4.53	4.65	4.45	4.69	**N/A**
DMBs credit rate for households short-term (%, pa)	**N/A**	6.01	6.34	6.86	6.54	**N/A**

*** Source:** Monstat, data for GDP in 2021 are preliminary.

**** Authors:** calculations based on Monstat data.

Policy assumptions and projections summary

According to the data from the Ministry of Finance and Social Welfare, the economy of Montenegro in 2021 grew by 13.4%. This shows that Montenegro has made significant progress over the past year, but this is only the beginning of a gradual economic recovery after very poor results, which was a consequence of the health crisis caused by the Covid19 pandemic. The latest projections by the European institutions say about further progress in the field of recovery of economic activities next year. However, it should be noted that making of projections is extremely difficult, taking into account the current events caused by the conflicts in Eastern Europe, which represent a new type of external shock for economies around the world, including Montenegro.

A detailed overview of the projections for 2022 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)	**3.8**	**3.4**	**N/A**
Real private consumption (% change)	2.9	3.3	N/A
Real government consumption (% change)	2.1	1.1	N/A
Real investment (% change)	N/A	N/A	N/A
Exports of goods and services (constant prices, % change)	3.8	6.3	N/A
Imports of goods and services (constant prices, % change)	1.4	4.8	N/A
Current account balance (% of GDP)	-12.1	-12.5	N/A
Consumer prices (% change, pa)	6.5	2.9	N/A
Exchange rate, national currency/EUR (pa)	N/A	N/A	N/A
Unemployment rate (LFS, %, pa)	15.2	14.7	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

*European Commission: European Economic Forecasts

NORTH MACEDONIA

Following a rebound in the economy, the new economic crisis brings new challenges

A new dawn and a new crisis

As 2021 ended, all the hopes for economic recovery passed to 2022, which again began with high expectations for overcoming the effects of the Covid-19 pandemic. However, the expectations and projections were not achieved yet again due to the lingering effects of the Covid-19 pandemic and the new form of crisis coming because of the war between Ukraine and Russia. In economic terms, the chain of supply and distribution of inputs for production as well as final products remains unconsolidated. This comes as a cumulative effect and as a direct consequence of the pandemic and the war, leading to the rise of the prices of primary goods for consumption. Adding to the fire, the prices of electricity, gas and other fuels went higher, leading to a sloppy economic recovery.

Economic activity in Q1 2021 dropped by 1.8% on an annual basis. However, it has risen in Q2 of 2021 by 13.8%. This is mainly due to increased private consumption and real investment, as well as industrial output. Nevertheless, this increased economic activity lasted only for a quarter. In Q3, there was a decrease in industrial output, which happened

again in Q4, leading to a decrease in the real GDP growth rate. Q3 and Q4, respectively, show also lower growth rates of real investment and private consumption.

New measures in accordance with previously taken ones from the Central Government aimed to keep the aggregate consumption on a steady level and to ensure the quality of life for the people and steady budget income through the taxes. This also ensured and maintained the PPP and GDP per capita on the same level since before the pandemic.

Minor changes in the macedonian labour market

In the second half of 2021, the Macedonian labour market noticed slightly different changes than in the first half. In Q3/2021, compared to Q3/2020, the total labour force has increased by more than 4,000 persons, while in the fourth quarter, there was a decrease for the same number. It was reflected in the activity rate, which increased in Q3 (from 55.8% in 2020 to 56.2% in 2021), while in Q4 remained almost equal (55.9% and 55.7%, respectively). Employment in the country was increasing, and the total number of employed persons in Q3/2021 was higher for 11,120 persons and in Q4/2021 for 5,724 persons, related to Q3 and Q4 of 2020. It resulted in an increase in the employment rate, which in the last two quarters of 2021 reached about 47%. The total number of unemployed was significantly decreasing (for 7,098 in Q3/2021 and 9,766 persons in Q4/2021) compared to the same quarters of 2020. At the same time, the unemployment rate was following the decrease and in 2021 amounted to 15.7% and 15.2%, respectively. In terms of equal employment increase and unemployment decrease (for about 16,800 persons each) in the second half of 2021, North Macedonia continues to face the problem of a low employment rate, high unemployment rate, and relatively high share of the inactive working-age population.

The employment rate of the young population (15-24) in Q3/2021 was lower, while in Q4/2021 remained almost identical compared to both quarters of 2020. The unemployment rate noticed a minor increase in the third and a relatively higher increase in the fourth quarter. These changes resulted in the decline of the young population activity rate. Opposite are the movements of these indicators for the population aged 25-49. They are manifested in the increase of the activity and employment rates and the unemployment rate decrease, but with more emphasized intensity in the third quarter. Similar are the changes of the abovementioned indicators for the population aged 50-64, but they are more accentuated in the fourth quarter. The LFS data for labour force by education show that the decline of those with a lower level of education continues in the second half of 2021. Related to the labour force with four years of secondary education, Q3 and Q4 of 2021, there was an increase in the number of active and employed persons and a decrease in the unemployed. The labour force with a high level of education noticed an increase in the active and employed population in Q3/2021 and a decrease in Q4/2021. At the same time, there was a decline in their unemployment.

Fiscal consolidation is needed

With the Budget for 2021, according to the Budget for 2020, total revenues have increased by 6.15 %, expenditures have decreased by 3%, the budget deficit as a percent of GDP has also increased by 2%, and public debt is over 60% of GDP (over 7 billion euros). Due to the pandemic mitigation in Q2, the Budget for 2021 was amended, increasing all the main fiscal indicators. So, total revenues are increased by 4.7%, total expenditures by 8.56%, the budget deficit (it grows throughout all quarters, especially in the last), and public debt by 5%.

By the end of 2021, public revenues were realized by 97.97%. Thereby, there is an overrun in taxes and contributions. So, taxes revenues are realized by 101.98% (VAT with 107.33% and import duties 131.11%) and contributions by 102.07%. There is a shortfall in non-tax revenues (78.94%), capital revenues (60.50%), and foreign donations (67.74%).

The total expenditures are realized at 95.59%. There is an overrun only at interest rates (102.61%) and a shortfall at all other types of expenditures (goods and services with 89.23% and capital expenditures with 78.36%). The planned budget deficit was realized at 84.11%.

The public debt is absolutely increased by 648 million euros. At the end of 2021, it amounted to 7.135 million euros. Relatively (from 61.0% to 60.8%) it decreased by 0.2 pp.

Monetary and banking sector–stable and solid in light of new challenges

Despite the Covid-19 pandemic situation and other pressures, foreign exchange reserves remained appropriate in the safe zone with EUR 3.5 billion, or about 30% of the GDP, enabling a stable exchange rate and national currency, whereas the banking sector persisted solid and healthy.

The key interest rate in 2021 was set on the history lower level at 1.25%. However, the pressure of inflation expectations and increased key interest rates at international markets pushed the increment to 0.25 percent points, which should give a further signal to the banking sector. After smooth stabilization in 2020, credits trends indicated an increase in 2021 with a major driver of the growth to the corporate loans, particularly in the Q4 of 2021, and a smooth increase of household loans.

Remittances, which during the first pandemic year had a substantial decline by about 24%, in the year 2021 returned to pre-crisis levels with 44% growth. The citizens' habits which have been dramatically changed in the Covid-19 pandemic period, continued in 2021, contributing to high annual growth of payment cards utilization and pushing further the process of digitalization in banking.

Solid NPLs to total loans ratio stands at 3.4%, 3.45%, 3.5%, and 3.1% in each quarter of the year 2021, demonstrating enhanced assets quality. ROAA with 1.3%, 1.5%, 1.6%, and 1.5% in each quarter of 2021 respectively, demonstrated minor increase since 2020, whereas ROAE was ranged 11.3%, 12.6%, 13.4% and 12.9% for each quarter of the year 2021, respectively. Profits of the banks at the end of the year 2021 clearly demonstrated the solid position of the banking sector in the financial system.

In the shadow of creeping inflation

The Consumer price index continued to increase through 2021 and is still doing so in Q1 of 2022. This is mainly the result of the increased price of housing, electricity, gas and other fuel. Considering the disruption in the supply chain, it can be noticed that it led to an increase in the prices of the primary goods and other consumables. The prices for health care played a significant role in the increased consumer price index in the previous period. However, the most concerning fact comes from the production side, which saw an increase in the prices of 14,8% in Q4 2021. The central government has reacted to this, leading to a measure that limits the retailers' profit margin and traders selling primary goods.

External sector recovery continues at a moderate pace

The recovery of the export sector and the increasingly active functioning of the production chains, which started in the second half of 2020, continued during 2021. This contributed to keeping the current account deficit approximately at the previous year's level. The higher secondary income surplus, with higher private and official transfers, and the increased surplus in the exchange of services positively contributed to the current account. On the other hand, the commodity balance contributed to widening its deficit due to the faster growth of imports than exports. In addition, data on exports and imports in Q3 indicate a slight slowdown in their annual growth over the summer. This can be explained by the decrease in the effect of the low comparative base from the previous year, unlike the previous quarter (Q2), when high growth was registered due to the low comparative basis.

Within the financial account (except for the Q1), foreign direct investments realized net inflows in all three quarters of 2021. In terms of FDI components, inflows in all three quarters are mainly achieved through reinvested profit, and the presence of other components changes depending on the respective quarter.

Gross foreign exchange reserves in 2021 achieved higher growth than expected. They are still at the appropriate level and in a safe zone. The increase in foreign reserves is largely due to borrowing in the international market, including the IMF allocation of special drawing rights.

The external debt indicators of the domestic economy remain in the safe zone.

Table NM1 Main economic indicators

	Total 2020 year	2021				Total 2021 year
		Q1	Q2	Q3	Q4	
ECONOMIC ACTIVITY*						
Real GDP (% change, yoy)	**-6.1**	-1.8	13.8	3.0	2.3	**4.0**
Real private consumption (% change, yoy)	**-4.6**	-0.3	12.4	2.4	5.7	**5.0**
Real government consumption (% change, yoy)	**6.4**	-0.1	5.2	4.9	6.5	**4.1**
Real investment (% change, yoy)	**-16.1**	-15.3	40.7	0.4	21.2	**9.2**
Industrial output (% change, yoy)	**-9.5**	-6.1	24.0	-3.3	-2.2	**1.4**
Unemployment rate (LFS, % pa)	**16.4**	16.0	15.9	15.7	15.2	**15.7**
Nominal GDP (EUR million)	**10,635**	2,603.3	2,797.2	2,967.0	3,367.9	**11,736**
GDP per capita (EUR)	**5,132**	1,256	1,350	1,432	1,625	**5,693**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Consumer prices (% change, yoy, pa)	**1.2**	2.0	2.8	3.5	4.6	**3.2**
Producer prices (% change, yoy, pa)	**0.8**	3.3	6.2	10.1	14.8	**8.5**
Average gross wage (% change, yoy, pa)	**7.0**	2.0	5.7	1.2	0.7	**2.4**
Exchange rate (MKD/EUR, pa)	**61.67**	61.66	61.61	61.55	61.69	**61.63**
Exchange rate (MKD/USD, pa)	**54.13**	51.13	51.15	52.19	53.93	**52.11**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**4,816.90**	1,401.84	1,522.52	1,518.91	1,522.70	**5,995.97**
Exports of goods (EUR, % change, yoy)	**-9.9**	23.6	73.0	12.3	5.0	**24.5**
Imports of goods (EUR million)	**6,621.55**	1,907.0	2,087.54	2,024.41	2,351.61	**8,370.57**
Imports of goods (EUR, % change, yoy)	**-9.2**	13.6	69.5	15.3	20.3	**26.4**
Current account balance (EUR million)	**-366.2**	-53.0	-115.3	99.1	-346.5	**-415.7**
Current account balance (% of GDP)	**-3.4**	-0.5	-1.0	0.8	-3.0	**-3.5**
Foreign Direct Investment net inflows (EUR million)	**154.7**	-3.5	217.0	24.6	197.1	**435.2**
Foreign exchange reserves (EUR million, eop)	**3,359.9**	3,939.2	4,031.1	3,690.7	3,643.3	**3,643.3**
Foreign debt (EUR million, eop)	**8,536.1**	9,809.7	10,171.6	9,870.4	9,547.3	**9,547.3**
GOVERNMENT FINANCE						
Revenues (MKD million)	**189,770**	48,918	52,491	56,719	60,377	**218,505**
Expense (MKD million)	**243,636**	55,815	61,273	65,612	74,588	**257,288**
Net = Gross operating balance	**-53,866**	-6,897	-8,782	-8,893	-14,211	**-38,783**
Net acquisition of non-financial assets (MKD million)	**-14,269**	-3,787	-2,343	-5,551	-9,799	**-21,480**
Net lending/borrowing (MKD million)	**-39,597**	-3,110	-6,439	-3,342	-4,412	**-17,303**
Domestic government debt (EUR million, eop)	**2,133.4**	2,120.9	2,257.3	2,320.3	2,413.4	**2,431.4**
Foreign government debt (EUR million, eop)	**3,382.5**	4,086.8	4,153.9	3,666.7	3,684.9	**3,684.9**
Total government debt (eop. % of GDP)	**51.9**	52.9	54.6	51.0	51.8	**51.8**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**16.4**	17.8	14.3	13.1	8.7	**8.7**
Broad money, M4 (% change, yoy, eop)	**6.9**	7.1	6.7	8.2	7.0	**7.0**
Total domestic credit (% change, yoy, eop)	**4.7**	5.2	5.1	6.3	8.3	**8.3**
DMBs credit to households (% change, yoy, eop)	**8.0**	8.1	8.7	7.5	7.8	**7.8**
DMBs credit to enterprises (% change, yoy, eop)	**1.1**	2.1	1.2	4.7	8.7	**8.7**
Money market interest rate (%, pa)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
DMBs credit rate for enterprises short-term (%, pa)	**3.6**	3.3	3.3	3.3	3.1	**3.2**
DMBs credit rate for households short-term (%, pa)	**4.8**	4.6	n.a.	3.6	3.4	**4.2**

Source: Ministry of Finance of the Republic of North Macedonia, National Bank of the Republic of North Macedonia and State Statistical Office of the Republic of North Macedonia.

Policy assumptions and projections summary

The energy crisis and the war in Ukraine have brought new challenges to the Macedonian economy, which is barely recovering.

As a result of the new conditions, growth is projected to slow to 3.2 percent in 2022. According to the projections, the real investment will be the booster of economic growth as well as the expectation of increased private consumption. Inflationary pressures (especially food and energy prices) will increase the cost of living. The inflation rate in 2022 is expected to reach an extremely high level of 6.9%. According to the optimistic scenario, this value would decrease in the coming years (2023 and 2024), reaching a level before the crisis.

In the following years, it is expected that the pressure of inflation expectations and increased key interest rate in international markets would make a compression on the key interest rate, with further implications on shifting the deposit and credit interest rates upward. The international financial market has already passed a signal for the rising trend on the interest rates, which would inevitably be one of the following challenges for our country.

The fiscal deficit will remain elevated in 2022. The new conditions would also reduce external demand and result in investment delays. Given the new situation with the war in Ukraine, the previously anticipated improvements in conditions in the external sector are losing their course. Namely, the prolonged disruption of the supply chains will have a negative impact, especially on the expectations for exports and hence on the current account as a whole. In 2022, the current account deficit is expected to deepen to -5.8% of GDP.

The prospects for the following period are that the problems of still-high unemployment and relatively low employment will remain, accompanied by even more emphasized labour supply and demand mismatch due to a lack of skilled workers. All these expectations should be seen in terms of further working-age population and labour force aging, as well as of the global economic crisis that considerably affects the Macedonian economy.

The further challenges will remain in light of finalizing the pandemic situation and new challenges arising from the crises in Ukraine. If the war in Ukraine is prolonged, the projections shown in Table NM2 will be further aggravated.

Table NM2 Summary of projections

	2022	2023	2024
Real GDP (% change)	**3.2**	**2.7**	**3.7**
Real private consumption (% change)	2.8	2.5	3.3
Real government consumption (% change)	1.0	0.3	0.2
Real investment (% change)	6.0	8.0	8.0
Exports of goods and services (constant prices, % change)	7.2	7.0	6.0
Imports of goods and services (constant prices, % change)	6.5	6.2	6.0
Current account balance (% of GDP)	-5.8	-3.6	-2.9
Consumer prices (% change, pa)	6.9	3.6	1.9
Exchange rate, national currency/EUR (pa)	N/A	N/A	N/A
Unemployment rate (LFS, %, pa)	15.7	15.1	14.7
General government balance (ESA 2010 definition, % of GDP)	-6.3	-4.4	-3.8
Total domestic credit (% change, eop)	N/A	N/A	N/A

Sources: https://www.imf.org/en/Countries/MKD; https://thedocs.worldbank.org/en/doc/d5f32ef28464d01f195827b7e020a3e8-0500022021/related/mpo-mkd.pdf

S E R B I A

Economic recovery undermined by the rising inflation

Real GDP growth in 2021 was driven by the growing activity in the industry, construction, and service sectors

The latest statistical data on Serbia's economic activity illustrate an increased resilience and economic recovery. Namely, relatively preserved macroeconomic and financial stability, accompanied by a comprehensive package of economic measures, led to Serbia's real GDP cumulative growth of 6.4% throughout the "pandemic years". Considering only 2021, the latest National Bank of Serbia's data evidenced real GDP growth of 7.4%, related primarily to growing activity in the industry, construction, and service sectors. When it comes to nominal values, Eurostat's data showed that Serbia's GDP reached EUR 53,317 million in 2021, which is an increase of 13.9% compared to the preceding year. Regarding the country's GDP per capita values, it is possible to notice that economic output per person remained high in 2021 (and even increased by 14.7%). Additionally, the value attained in the fourth trimester of 2021 contributed the most to this growth.

Real private consumption rose sharply in 2021

According to the National Bank of Serbia's data, real private consumption rose sharply in 2021, while real government consumption recorded a modest decline. The observed strong increase in private consumption (from -1.8% to 7.6%) was mainly driven by popularized consumer

loans and changed wage levels. Rebound in real investment volume occurred in the second trimester of 2021 when investments of this type went up - from 8.0% in the first quarter to 21.4% in the second quarter. On a sectoral basis, the Statistical Office of the Republic of Serbia's data suggested that industrial output increased from 0.4% in 2020 to 1.3% in 2021, whereby the second quarter of 2021 stood out due to unprecedented growth (9.3%).

Regarding the labor market's dynamics in 2021, insight into the Labor market survey's data revealed an increase in the unemployment rate, which rose to 11.1%. This was expected due to the fact that the health and resulting economic crisis led to a large wave of layoffs and negligible labor market pressures which maintained instability. In that context, the survey's data for 2021 showed that Serbia generated 352,400 unemployed, i.e. 2,848,800 employed persons.

Serbia faced strong inflationary pressures in 2021

During the previous year, strong inflationary pressures were recorded in the Republic of Serbia. At the end of 2021, the annual inflation rate was 7.9%, its highest level since 2008. The high inflation rate was influenced primarily by the global growth of prices of oil products, primary agricultural products, as well as disruptions in the global supply chain. Also, we must not forget that inflation had a low base value in the previous year. In response to high inflationary pressures, the National Bank of Serbia decided to tighten monetary policy in the last quarter of 2021 by increasing the weighted average interest rate on reverse repo auctions. The most significant inflationary pressures are still on the supply side, which monetary policy cannot influence much, confirming the core inflation movement (3.5 year-on-year at the end of 2021). As a result of the disruptions in the supply chain and the increase in import prices of production inputs, producer prices recorded a year-on-year growth of 14.7%.

The average gross wage in 2021 amounted to 1,089,408 representing year-on-year nominal growth of 9.4%. Due to the impact of inflation, the real increase in gross wage was 1.5 percentage points. In 2021, the relative stability of the dinar exchange rate was maintained. In 2021, the dinar depreciated nominally against the dollar by 8.7%, while it remained unchanged in relation to the euro. To prevent excessive short-term fluctuations last year, the National Bank of Serbia was a net buyer of foreign exchange on the interbank foreign exchange market of 645 million euros. In the following period, the dinar exchange rate will slightly depreciate. The intensity of depreciation will largely depend on the implemented monetary policy of major central banks worldwide and the movement of key domestic macroeconomic indicators, primarily the balance of payments deficit.

Serbia's foreign trade records a strong recovery in the post-COVID-19 era

According to the National Bank of Serbia's data, total trade in goods in 2021 bounced back from a pandemic-related drop recorded in the previous year. Amounting to EUR 47,441 million, total trade in 2021 increased by 27% compared to 2020, whereby both exports and imports saw a robust recovery (29.1% and 25.4%, respectively). The increase in exports was largely due to the recovery of exports of the manufacturing industry, while the imports growth was driven

by the imports of intermediate goods. Although exports rose faster than imports, the trade deficit went up 14% y-o-y, to EUR 5,929 million. Despite the increase in the trade deficit, the export results in 2021 were far more significant than expected as major exporters resumed operations, and thus exports. In addition, as the World Bank Western Balkan Regular Economic Report's findings show, a more extensive rise in export prices (by 6.4%), compounded with a less pronounced rise in import prices (by 2.4%), also contributed to better export performances.

Analysis of the trade structure by Standard International Trade Classification (SITC), in accordance with the data of the Statistical Office of the Republic of Serbia, suggests neither the structure of Serbian exports nor imports has remarkably changed in the last two years. In 2021, in terms of exports, *Machinery and transport equipment* and *Miscellaneous manufactured articles* remained the main sections, with a share of 26.7% and 22.4%, respectively, in total exports of goods. At the same time, on the imports side, the main sections were *Machinery and transport equipment* (25.3% of total imports of goods), *Manufactured goods classified chiefly by material* (19.1%), and *Chemicals and related products, not elsewhere specified* (15.2%). However, some changes were recorded at lower levels of aggregation. Namely, the first five divisions with the largest share in export structure in 2021 were *Electrical machinery, apparatus and appliances, n.e.s.* (23% y-o-y increase), *Vegetables and fruit* (25.4%), *Iron and steel* (80.3%), *Metalliferous ores and metal scrap* (276.4%), and *Cereals and cereal preparations* (10.6%). On the other side, the first five divisions with the largest share in imports structure in 2021 were *Unclassified goods* (21.3% y-o-y increase), *Electrical machinery, apparatus and appliances, n.e.s.* (29.1%), *Road vehicles* (21.9%), *Petroleum, petroleum products and related materials* (61%), and *Medicinal and pharmaceutical products* (15.2%).

Regarding Serbia's leading trade partners, the highest percentage of goods exports in 2021 went to Germany (12.7% of total exports), Italy (8.5%), Bosnia and Herzegovina (7.2%), Romania (5.5%), and Hungary (5.0%); while the main importers were Germany (13.2% of total imports), China (12.8%), Italy (8.1%), the Russian Federation (5.4%), and Turkey (5.0%).

It should be mentioned that despite the remarkable increase in exports to China (from 1.9% in 2020 to 3.8% in 2021), this Asian country remained the largest contributor to Serbia's trade deficit, making up 47.7% of the total. Moreover, the trade deficit with China is continuously growing, which implies the necessity of a more active and comprehensive approach of the Serbian authorities regarding this issue.

The nation's current account slight increase was covered by the FDI inflows in 2021

Concerning the external sector statistics, it could be noticed that Serbia's current account deficit remained relatively high in 2021, totaling EUR 2,340 million (or -4.4% of the country's GDP), and is primarily a consequence of the significantly growing imports of energy products. Nevertheless, of great importance in this concern is the fact that the current account deficit is fully covered by foreign direct investments (FDIs), which net inflows amounted to EUR 3,625 million (or 6.8% of the country's GDP) in 2021. The bulk of FDI inflows, which in 2021 increased by 23.4% y-o-y, originated from the EU member states, led by investments from the Netherlands (EUR 683 million), Switzerland (EUR 654 million), and Germany (EUR 420 million). Outside the EU countries, the main investors were China (EUR 569 million) and Great Britain (EUR 335 million).

The foreign exchange market remained stable in 2021, while the external debt was steadily rising

The foreign exchange market of Serbia is characterized by a continuously stable exchange rate. According to the National Bank of Serbia's data, foreign exchange reserves in 2021 were higher by 24.4% compared to 2020, amounting to EUR 19,350 million, which further strengthened the domestic financial system's resilience to external shocks pressures. As the National Bank of Serbia declares, such a level of reserves provides coverage of the money supply M1 of 137.8%, i.e. up to six months of imports of goods and services. This coverage is twice the standard considered the adequate level of coverage of imports of goods and services by foreign exchange reserves.

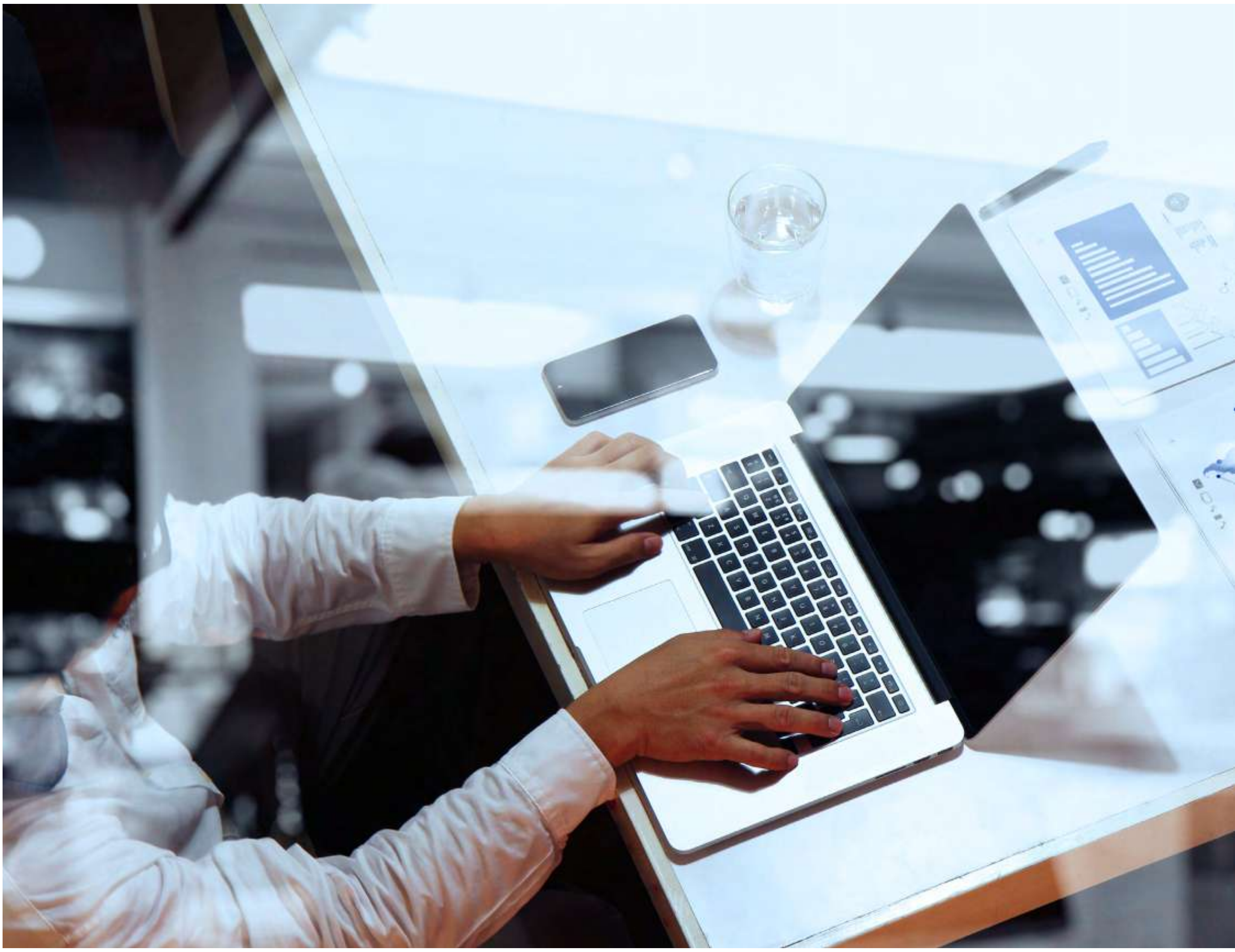
In order to mitigate excessive daily oscillations, the National Bank of Serbia intervened in the interbank foreign exchange market in 2021 with a net purchase of EUR 645 million. The appreciation pressures were additionally reduced due to favorable movements in the balance of payments. On the other side, due to the increased energy imports, some depreciation pressures appeared at the end of 2021, forcing the National Bank of Serbia to sell EUR 205 million on the interbank market in December.

The external debt of Serbia in 2021 amounted to EUR 36,536 million, which is an almost 19% y-o-y increase. In terms of medium and long-term debt, Serbia relied on international, state, and private creditors' funds. Serbia borrowed primarily from *Other creditors, i.e. other commercial banks, financial organizations and suppliers* (EUR 13,930.3 million), *International financial organizations* (EUR 8,034.2 million), and *Governments and their agencies* (EUR 5,619.2 million); while EUR 7,061.9 million of debt represented the debt based on government securities (*euro-bonds*) issued on the foreign financial markets. The share of euro-bonds debt in the total external debt increased the most (from 15.5% in 2020 to 19.3% in 2021) compared to other types of borrowings. Short-term debt amounted to EUR 1,761.8 million, or 4.8% of the total external debt.

Fiscal stabilization was endangered by the (geo)political risks and structural problems

In 2020 and 2021, the Serbian government provided a large fiscal support package to businesses, households, and the health sector, similar to other European countries. According to the analysis of the Fiscal Council, Serbian cumulative anti-crisis spending in 2020 and 2021 is estimated at 10.4% of GDP, being the highest support package compared to peer countries in Central and Eastern Europe. The package was effective as main goals were achieved: employment was preserved, and GDP bounced back to the pre-crisis level already in the first quarter of 2021. However, the efficiency of spending has been heavily criticized, particularly the non-selective approach in distributing direct financial support to households and businesses.

The large fiscal support resulted in large deficits, around 8% in 2020 and 4.1% in 2021. The fiscal result in 2021 was even better than expected (fiscal balance was initially projected at 6.9%, then revised to 4.9%), primarily due to stronger economic growth and lower government spending. The large cumulative deficit didn't damage fiscal solvency since economic growth offsets the rise in public debt. Eventually, public debt to GDP in 2021 was around 57.1%, safely below the Maastricht threshold.



Nevertheless, by the end of 2021, the new risks stemming from structural problems and political factors have become a threat to fiscal stabilization. The long-term incompetent management and postponement of the reforms in the state-owned electric power company “Elektroprivreda Srbije” resulted in a collapse of electricity production. Since then, “Elektroprivreda Srbije” has already imported electricity worth around EUR 530 million, mainly funded by borrowing, which increased contingent liability risks. After the sharp increase in gas prices following the conflict between Russia and Ukraine, the Serbian Government has frozen gas prices in the domestic market, taking responsibility for paying the difference between import and domestic prices. In addition, due to elections, the Government continue in 2022 with inefficient spending of budget resources to provide non-selective “anti-crisis” financial assistance to households. While inefficient spending and high inflation of energy prices at this point do not severely affect government finance, further escalation could endanger fiscal stabilization, especially regarding squeezed fiscal space due to the counter-pandemic measures.

In 2021 the degree of monetary policy expansion was lower compared to the previous year due to the increased inflationary pressures

In 2021 basic monetary aggregate (M1) increased by 14.84% (y/y) and, at the end of December, accounted for more than 1,401 billion dinars. Nevertheless, the degree of monetary policy expansion was lower compared to the previous year, mainly due to the increased inflationary pressures that proved to be stronger than anticipated.

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

By providing favourable financing conditions, NBS has enabled credit activity to continue to be a significant source of financing for investment and consumption in 2021, as evidenced by the year-on-year total domestic credit increase (8,29%). A larger contribution to the total credit activity at the end of 2021 came from DMBs credit to households (10.55%) than DMBs credit to enterprises (7.06%).

Despite the tightening of monetary conditions in 2021, the borrowing conditions for the corporate and household sector remained favourable

In response to the challenges from the international environment, NBS took steps to gradually tighten the monetary policy stance, using the flexibility provided by the existing monetary policy framework. The weighted average rate on repo sales auctions has been gradually increasing since the last quarter of 2021. Nevertheless, despite the tightening of monetary conditions in the last quarter of 2021, the borrowing conditions for the corporate and household sector remained favourable.

Table SRB1 Main economic indicators

	Total 2020 year	2021 Q1	2021 Q2	2021 Q3	2021 Q4	Total 2021 year
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**-0.8**	1.5	13.7	7.6	7.0	**7.4**
Real private consumption (% change, yoy)	**-1.8**	-1.9	17.1	8.1	7.3	**7.6**
Real government consumption (% change, yoy)	**3.0**	0.2	-2.9	7.8	5.8	**2.7**
Real investment (% change, yoy)	**-1.2**	8.0	21.4	12.2	9.8	**12.8**
Industrial output (% change, yoy)	**0.4**	1.9	9.3	-3.6	-2.5	**1.3**
Unemployment rate (LFS, % pa)	**9.7**	12.8	11.1	10.5	9.8	**11.1**
Nominal GDP (EUR million)	**46,796**	11,607	13,033	13,817	14,860	**53,317**
GDP per capita (EUR)	**6,780**	1,690	1,900	2,020	2,170	**7,780**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**2.4**	0.0	5.6	6.9	11.0	**6.1**
Consumer prices (% change, yoy, pa)	**1.3**	1.4	3.2	4.4	7.3	**7.9**
Producer prices (% change, yoy, pa)	**-1.8**	0.8	8.8	11.3	15.5	**14.7**
Average gross wage (% change, yoy, pa)	**9.5**	7.1	9.6	9.0	11.8	**9.4**
Exchange rate (RSD/EUR, pa)	**117.58**	117.58	117.57	117.57	117.58	**117.58**
Exchange rate (RSD/USD, pa)	**95.66**	97.60	97.59	99.71	102.83	**103.93**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**16,079**	4,609	5,013	5,355	5,779	**20,756**
Exports of goods (EUR, % change, yoy)	**-12.5**	16.5	48.1	28.7	26.3	**29.1**
Imports of goods (EUR million)	**21,280**	5,581	6,631	6,813	7,660	**26,685**
Imports of goods (EUR, % change, yoy)	**-13.7**	0.9	51.0	26.6	28.2	**25.4**
Current account balance (EUR million)	**-2,034**	83	-656	-766	-1,001	**-2,340**
Current account balance (% of GDP)	**-4.3**	0.7	-5.0	-5.5	-6.7	**-4.4**
Foreign Direct Investment net inflows (EUR million)	**2,938**	852	747	1,164	863	**3,625**
Foreign exchange reserves (EUR million, eop)	**15,550**	17,018	17,014	19,726	19,350	**19,350**
Foreign debt (EUR million, eop)	**30,787**	32,303	32,272	35,258	36,536	**36,536**
GOVERNMENT FINANCE						
Revenues (RSD million)	**2,255**	594	691	684	743	**2,712**
Expense (RSD million)	**2,405**	545	647	579	732	**2,502**
Net = Gross operating balance	**-150**	50	45	105	11	**210**
Net acquisition of non-financial assets (RSD million)	**293**	63	71	132	202	**468**
Net lending/borrowing (RSD million)	**-443**	-13	-26	-27	-191	**-257**
Domestic government debt (EUR million, eop)	**11,434**	11,595	11,722	11,670	11,607	**11,607**
Foreign government debt (EUR million, eop)	**15,235**	16,549	16,540	17,925	18,527	**18,527**
Total government debt (eop. % of GDP)	**57.8**	60.4	57.9	58.5	57.1	**57.1**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**35.02**	27.24	12.38	17.49	14.84	**14.84**
Broad money, M4 (% change, yoy, eop)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Total domestic credit (% change, yoy, eop)	**14.5**	12.08	8.05	5.68	8.29	**8.29**
DMBs credit to households (% change, yoy, eop)	**11.8**	11.91	10.60	8.91	10.55	**10.55**
DMBs credit to enterprises (% change, yoy, eop)	**8.3**	4.77	3.32	3.68	7.06	**7.06**
Money market interest rate (%, pa)	**0.49**	0.11	0.11	0.11	0.31	**0.16**
DMBs credit rate for enterprises short-term (%, pa)	**2.76**	2.29	2.58	2.30	2.41	**2.40**
DMBs credit rate for households short-term (%, pa)	**5.67**	6.85	6.77	6.27	6.40	**6.57**

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

Policy assumptions and projections summary

The Serbian economy recovered well from a mild recession in 2020, and the economy recorded a strong rebound, growing by 7.4 % in 2021. The economic recovery in 2021 was primarily attributed to expansive fiscal and monetary policy, which boosted private consumption, income levels, consumer loans, and investments. On the supply side, growth was driven by the recovery of services, construction, and industry.

The revised Fiscal Strategy, adopted by the end of 2021, envisaged the continuation of strong growth of around 5% in the mid-run, boosted by an increase in domestic absorption. The Strategy foresaw a balanced contribution of private consumption and investment growth to GDP growth, as before the pandemic, but with a minor contribution of government consumption and net export. In addition, baseline forecasts were grounded on the assumption that rising inflation in Serbia and Europe was transitory at the end of 2021, so annual average inflation in 2022 was projected at only 3.7%. Following the assumption of low inflation, the current account deficit was forecasted at only 4.2%. The Strategy also envisaged the continuation of fiscal stabilization, projecting the fiscal balance in 2022 and 2023 at -3% and 1.5%, respectively. At that time, forecasts of the leading international institutions were chiefly in compliance with conjectures from the Fiscal Strategy.

However, the war in Ukraine and subsequent shocks in energy and food prices have diminished Serbian growth prospects. As of April 2022, the Serbian Government still hasn't rebalanced the budget, but it is likely to happen in the second half of 2022. On the other hand, international institutions have already revised downward economic growth forecasts for 2022 (3.2% World Bank, 3.4% EC, 3.5% IMF). The expected contraction of economic growth in 2022 will be caused by the lower growth of private consumption and private investment than initially expected due to the high uncertainty caused by global shocks.

Table SRB2 Summary of projections

	2022	2023	2024
Real GDP (% change)	**3.6**	**4**	**4.5**
Real private consumption (% change)	3.8	3.9	4.0
Real government consumption (% change)	0.1	0.5	0.5
Real investment (% change)	4.5	5.0	5.5
Exports of goods and services (constant prices, % change)	3.0	4.0	5.0
Imports of goods and services (constant prices, % change)	3.5	5.0	6.0
Current account balance (% of GDP)	6.2	5.5	5.0
Consumer prices (% change, pa)	8.0	4.0	3.5
Exchange rate, national currency/EUR (pa)	117.8	118	118.2
Unemployment rate (LFS, %, pa)	9.8	9.6	9.4
General government balance (ESA 2010 definition, % of GDP)	3.0	1.5	1.0
Total domestic credit (% change, eop)	N/A	N/A	N/A

Source: EC Spring 2022 Economic Forecast, IMF WEO April 2022, IES estimates

Since Serbia is a net importer of energy, the April 2022 forecast of annual inflation doubled relative to 3.7% expected by the end of 2021, which translated into the downward revision of the current balance deficit below 6%. Inflationary pressures will be persistent in the coming period, especially during the first half of 2022. The slowdown in inflation and return to the target tolerance band are expected from the year's second half. The uncertainty of inflation is mostly coming from the international environment. Its further movement will mostly depend on resolving the Ukrainian crisis and the monetary policies of the major central banks in the world. In 2022, the National Bank has already increased the key policy rate from 1% to 2%, and restrictive monetary policy is further expected to relax inflationary pressures. On the fiscal policy side, deficit and debt targets set by the Fiscal Strategy most likely will not change.

Despite depreciation pressures stemming from the rising trade and current account deficits, the exchange rate will most likely remain stable (at least in 2022) due to the high foreign exchange reserves of the National Bank and the severe effects that sharp RSD depreciation may have on the businesses and households' income. However, slight depreciation of the exchange rate in the mid-run is also a possible option, depending on the implemented monetary policy of major central banks worldwide and the movement of key domestic macroeconomic indicators, primarily the balance of payments deficit.

Despite downward growth revisions in 2022, mid-term prospects of the Serbian economy have remained solid but highly exposed to uncertainty regarding future economic and political development in Europe. Apart from the macroeconomic risks from the further escalation of the energy crisis and distortions in supply change, Serbia also faces huge political risks related to the war in Ukraine. As of April 2022, Serbia is the only country among EU member states and candidates that didn't impose any sanctions on Russia. Further hesitation of the Serbian Government to introduce sanctions on Russia may worsen the political relations with the EU, which would severely impact the Serbian economy. On the other side, Serbia is fully dependent on gas imports from Russia, and worsening relations with Russia may also damage the Serbian economy. Therefore, mid-term economic development is still highly uncertain.

SLOVENIA

Strong and broad-based economic recovery

High gross domestic product growth

In addition to growth in the export-oriented part of the economy, which began to strengthen in the second part of 2020, service activities also began to recover in 2021. Service sector recovery was significantly influenced by the release of containment measures during the spring and summer months and the enforcement of the recovered-vaccinated-tested rule in the operation of the most exposed activities during severe epidemic conditions in the autumn and winter months. Most activities exceeded their pre-crisis levels in 2021 except tourism, catering and accommodation services, entertainment, sports, recreational and personal services.

In each quarter of 2021, the year-on-year increase in the gross domestic product was higher than its decline in the previous year. At the annual level, the gross domestic product growth stood at 8.1% and was well above the EU average (5.2%). The gross domestic product surpassed its pre-COVID level in the year's third quarter. The driving forces of economic growth in 2021 were consumption, investment, and foreign demand.

Rebound in real investment

After plummeting 8.2% in 2020, the gross fixed capital formation was 12.3% higher at the annual level in 2021. It exceeded the pre-COVID level already in the first quarter of 2021. The rise was mainly due to the increase in gross

fixed capital formation in machinery and equipment. On the other hand, the increase in construction investment was only modest in 2021. Construction investment was still down year-on-year in the first quarter and later slowly resumed growth spurred by investment in other buildings and structures in the second quarter. Investment in residential buildings picked up in the second part of the year and contributed most to construction investment growth in the last quarter of the year.

In addition to growth in gross fixed capital formation, change in inventories also contributed to an increase in real investment, which was 15.5% higher at the annual level in 2021.

Private consumption picked up substantially

After a 6.6% decline in 2020 due to strict containment measures amid the COVID-19 pandemic, real private consumption increased by 11.6% in 2021. While it was still slightly down year-on-year in the first quarter, it picked up substantially in the second quarter with the gradual release of containment measures and the re-opening of service activities. The rising total disposable income resulting from the labour market's recovery and government intervention measures further supported the resumption of consumption. Private consumption growth continued in the second part of 2021 and was particularly high year-on-year in the last quarter, partly due to the low base caused by the restrictions in the retail sector and contact-intensive services in the final quarter of 2020. In addition, strong private consumption in 2021 was enabled by savings accumulated during the pandemic and the redemption of vouchers.

Government consumption continued to increase in 2021 (3.9%). The rise in expenditure was due to rising employment, particularly in the health sector, an increase in investment, and expenditure on measures to mitigate the consequences of the COVID-19 pandemic, especially in the service sector.

The rise in industrial production was driven by manufacturing growth

The year-on-year growth in industrial production value, which turned positive already in the last quarter of 2020, gained speed in 2021. At the annual level, the value of industrial production was 10.2% higher than in 2020. It was higher in manufacturing (by 11.7%) but lower in mining and quarrying as well as electricity, gas, steam and air conditioning supply (by 6.5% and 4.4%, respectively). The increase was observed across all industrial groupings, namely intermediate goods, capital goods, and consumer goods. The rise in consumer goods industries was mostly driven by growth in the production of durable consumer goods.

After recording a decline in 2020, production in medium- and low-technology intensive industries increased by over ten per cent in 2021. On the other hand, the increase in industrial production of high-technology intensive industries was only modest (3.0%) due to the high 2020'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 in 2021 and have considerably exceeded their pre-pandemic levels. Compared to 2020, exports of goods were higher by 12.3% and imports of goods by 17.4%, leading to a decrease in the external trade balance.

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 activity level in the same period in 2020. At the annual level, services exports and imports were both higher by 17% compared to 2020. The value of services exports in 2021 still slightly falls behind the pre-pandemic level, mainly because of the lower volume of trade in travel services.

Due to higher growth of imports than exports and worse terms of trade in the three quarters of 2021, the contribution of the external trade balance to gross domestic product growth was negative.

The current account surplus halved

In 2021, the current account surplus amounted to EUR 1.7 billion and was reduced by almost half compared to 2020. The decline resulted from a decrease in the surplus in trade in goods (-EUR 1.9 million), while the surplus in trade in services increased. The highest increase in surplus was recorded in travelling, which was severely limited in 2020. The surplus in trade in goods amounted to EUR 438 million, and the surplus in trade in services to EUR 2.4 billion. Half of the surplus in trade in services resulted from the surplus in transportation services, followed by travelling and construction services.

After a severe year-on-year decline in FDI inflow in 2020, related primarily to the COVID-19 health crisis, Slovenia recorded an inflow of FDI in the amount of EUR 1.6 billion in 2021. Debt instruments made up about two-thirds of the FDI inflow. According to the directional principle, inward foreign direct investment in Slovenia increased by EUR 1.3 billion in 2021. Over half of the increase came from net liabilities to foreign investors, followed by reinvested earnings and equity capital.

Employment reached a record high

Labour market conditions improved in 2021, and the number of employed reached the highest level measured to date in the third quarter of the year. According to the Labour Force Survey, year-on-year growth was especially high for the self-employed and unpaid family workers. In the last quarter of the year, there was a slight year-on-year decrease in employment, entirely due to a decline in the number of employees. Regarding the sector of activity, employment growth in 2021 was most prominent in professional, scientific and technical activities, real estate activities, other service activities, arts, entertainment and recreation, and administrative and support service activities. Employment increased in the public sector as well, most notably in the health sector in connection with the pandemic and the public administration due to Slovenia's EU presidency.

According to the Labour Force Survey, unemployment started to decline in the second quarter of 2021 due to the gradual relaxation of containment measures and seasonal influences. It dropped to 4.3%, a level comparable to the second quarter of 2019 (4.2%), and remained stable in the third and fourth quarters of 2021 (4.5%). At the annual level, unemployment stood at 4.7% and was 0.3 p.p. lower than in the previous year but 0.2 p.p. higher than in 2019.

Wage growth remained high

Wage growth remained high in 2021, both in the public (6.5%) and private sectors (6.1%). In the public sector, wage growth was high in the first two quarters due to the payments of performance bonuses and allowances related to the COVID-19 pandemic. With the cessation of these payments in the second part of the year, wage growth turned negative in the last quarter of 2021. In the private sector, the factors behind wage growth were the minimum wage increase that came into effect at the beginning of the year, the return to employment of workers who had participated in job-retention measures, and the payment of 13th salaries and Christmas bonuses in the last quarter of the year.

General government deficit slightly down year-on-year

The general government balance continued to be in deficit in 2021. At the annual level, the deficit amounted to EUR 2.7 billion and was EUR 961 million lower than in 2020. As a per cent of gross domestic product, the deficit stood at 5.2% and was 3.0 p.p. lower than in 2020. Amid a more broad-based economic recovery, the revenue in 2021 was higher by 11.9% compared to the previous year. It was spurred primarily by a high increase in tax revenues, but social security contributions increased as well. Total expenditure was higher by 6.1% compared to 2020, driven by the rise in intermediate consumption, compensation of employees, and social transfers, while expenditure on subsidies decreased.

At the end of the fourth quarter, consolidated general government gross debt stood at 74.7% of gross domestic product and was lower by 5.1 p.p. compared to 2020.

Housing loans primarily drove total loans growth

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 from quarter to quarter, reaching 5.1% in the last quarter of the year. Growth was driven by the increase in housing loans, which accelerated year-on-year from 4.3% in the first quarter to 9.0% in the last quarter. On the other hand, a year-on-year contraction was observed in consumer loans throughout 2021, albeit at a decreasing rate due to repayments of loans from previous years, when consumer lending was well above average.

The year-on-year contraction in loans to non-financial corporations continued in the first half of 2021, albeit at a decreasing rate. In the third quarter of the year, the year-on-year growth in loans to non-financial corporations turned positive and strengthened to 5.2% in the last quarter.

Inflation set-in

A deflation that set in with the outbreak of the COVID-19 pandemic was still observed in the first quarter of 2021. Since then, inflation picked up and accelerated from 1.9% in the second quarter to 4.2% in the last quarter of the year. Average annual inflation stood at 1.9% in 2021. Looking at its main components, average annual growth rates were the highest for energy prices, particularly the prices of petroleum products and, consequently, the prices of transport services. These were followed by increases in alcoholic beverages and tobacco prices, and the prices of services in restaurants and hotels. Only the prices of recreation and culture, communications, and food and non-alcoholic beverages were down year-on-year.

Producer prices exhibited even more prominent growth in 2021. Average annual growth stood at 5.5% and was driven mainly by the rise in the prices of intermediate goods, followed by capital goods and energy. The increase in producer prices was partially spilled over to consumer prices amid the recovery of household spending.

Table SL1 Main economic indicators

	Total 2020 year	2021 Q1	2021 Q2	2021 Q3	2021 Q4	Total 2021 year
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**-4.2**	1.5	16.1	5.0	10.4	**8.1**
Real private consumption (% change, yoy)	**-6.6**	-1.1	17.9	7.2	22.9	**11.6**
Real government consumption (% change, yoy)	**4.2**	1.2	4.4	3.2	7.0	**3.9**
Real investment (% change, yoy)	**-7.3**	5.6	36.3	24.5	0.8	**15.5**
Gross fixed capital formation (% change)	**-8.2**	8.0	20.4	10.5	11.0	**12.3**
Industrial output (% change, yoy)	**-5.2**	3.3	25.5	6.3	8.2	**10.2**
Unemployment rate (LFS, % pa)	**5.0**	5.6	4.3	4.5	4.5	**4.7**
Nominal GDP (EUR million)	**46,918**	11,667	13,027	13,359	13,967	**52,020**
GDP per capita (EUR)	**22,312**	5,532	6,182	6,340	6,624	**24,678**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**1.2**	0.0	2.8	3.5	3.6	**2.6**
Consumer prices (% change, yoy, pa)	**-0.1**	-0.5	1.9	2.2	4.2	**1.9**
Producer prices (% change, yoy, pa)	**-0.2**	1.2	3.6	7.5	9.9	**5.5**
Average gross wage (% change, yoy, pa)	**5.8**	10.6	5.7	5.4	2.9	**6.1**
Exchange rate (EUR/EUR, pa)	**NA**	NA	NA	NA	NA	**NA**
Exchange rate (EUR/USD, pa)	**1.14**	1.20	1.21	1.18	1.14	**1.18**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**29,656**	8,237	8,770	8,504	9,738	**35,248**
Exports of goods (EUR, % change, yoy)	**-5.5**	4.6	30.9	7.2	9.5	**12.3**
Imports of goods (EUR million)	**27,290**	7,709	8,572	8,564	9,965	**34,810**
Imports of goods (EUR, % change, yoy)	**-8.6**	4.2	37.2	16.3	15.6	**17.4**
Current account balance (EUR million)	**3,462**	755	469	368	144	**1,736**
Current account balance (% of GDP)	**7.4**	6.5	3.6	2.8	1.0	**3.3**
Foreign Direct Investment net inflows (EUR million)	**431**	491	600	538	-60	**1,569**
Foreign exchange reserves (EUR million, eop)	**507**	542	557	600	646	**646**
Foreign debt (EUR million, eop)	**47,792**	50,281	50,046	51,925	50,477	**50,477**
GOVERNMENT FINANCE						
Revenues (EUR million)	**20,413**	5,215	5,820	5,739	6,069	**22,843**
Expense (EUR million)	**24,079**	6,134	6,637	6,060	6,717	**25,548**
Net = Gross operating balance	**NA**	NA	NA	NA	NA	**NA**
Net acquisition of non-financial assets (EUR million)	**NA**	NA	NA	NA	NA	**NA**
Net lending/borrowing (EUR million)	**-3,666**	-919	-817	-322	-648	**-2,705**
Domestic government debt (EUR million, eop)	**32,258**	34,154	33,537	34,269	32,921	**32,921**
Foreign government debt (EUR million, eop)	**2,061**	2,973	2,964	2,963	2,954	**2,954**
Total government debt (eop. % of GDP)	**79.8**	85.0	80.1	79.7	74.7	**74.7**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**NA**	NA	NA	NA	NA	**NA**
Broad money, M4 (% change, yoy, eop)	**NA**	NA	NA	NA	NA	**NA**
Total domestic credit (% change, yoy, eop)	**8.4**	10.3	10.8	11.1	12.2	**12.2**
DMBs credit to households (% change, yoy, eop)	**0.1**	0.7	2.9	3.6	5.1	**5.1**
DMBs credit to enterprises (% change, yoy, eop)	**-2.1**	-4.3	-1.7	0.2	5.2	**5.2**
Money market interest rate (%, pa)	**-0.55**	-0.56	-0.56	-0.57	-0.57	**-0.57**
DMBs credit rate for enterprises short-term (%, pa)	**1.9**	1.5	1.8	1.7	1.7	**1.7**
DMBs credit rate for households short-term (%, pa)	**2.9**	2.9	2.7	2.9	3.0	**2.9**

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

Policy assumptions and summary of projections

Economic outlook projections significantly worsened amid Russia's invasion of Ukraine

Following Russia's invasion of Ukraine and the corresponding global sanctions to stop the aggression, economic outlook projections have worsened globally and in Slovenia. In addition to disruption in the supply chains and increasing price pressures caused by the pandemic, war has caused shortages in the supply of energy and agricultural products, deteriorated export expectations, and aggravated economic prospects while also setting pressure on inflation.

In its April 2022 World Economic Forecast, the IMF estimates that gross domestic product growth in Slovenia will stand at 3.7% this year and moderate to 3.0% in 2023. It represents a downward correction of 0.9 p.p. and 0.7 p.p. compared to the IMF's Autumn 2021 forecast. The Spring Forecast 2022 of the Slovenian Institute for Macroeconomic Analysis and Development (IMAD) is slightly more optimistic for this year. It estimates that gross domestic product growth will stand at 4.2% in 2022 and moderate to 3.0% in 2023 (a downward correction of 0.5 p.p. and 0.3 p.p. compared to its Autumn 2021 Forecast).

On the other hand, the high employment level, wage growth, and accumulated savings are expected to support private consumption growth over the projection horizon, but growth will moderate under the impact of higher inflation. Investment growth is projected to remain high as well, also due to public investments supported by the EU funds and the Recovery and Resilience Facility. The speed of economic recovery will depend on the effectiveness of the policy and the efficiency of RRF-funded public investment targeted towards a greener economy, digital transformation, and the accompanied retooling and reskilling of workers, as well as social-economic cohesion and resilience.

Growth in foreign demand is estimated to slow down over the projection horizon amid aggravated economic prospects in the main trading partners. Combined with a sharp decline in exports to Russia, it will lead to a slowdown in the growth of the export part of the economy. The contribution of net exports to economic growth will remain negative in 2022 but is expected to turn positive again in the following years.

Employment growth is expected to strengthen over the projection horizon. According to the IMF, the unemployment rate will decline to the pre-pandemic level (4.5%) in 2022, while IMAD projects that it will drop slightly below that level (4.3%). Managing shortages in the labour market accompanied by wage pressures and challenges in filling vacancies will become an increasing challenge over the projection horizon as the population ageing progresses.

War-induced fuel and food price increases and broadening price pressures have led to a significant upward revision of inflation projections. A sharp rise in consumer prices was observed already in the last quarter of 2021, and a relatively high level of inflation is forecasted to persist also this year. According to the forecasts of IMAD and IMF, inflation will stand at 6.4% and 6.7%, respectively, in 2022, representing a 4.4 p.p. and 4.9 p.p. upward revision compared to the respective autumn forecasts of IMAD and IMF. In 2023 and 2024, inflation is projected to decline, but there seems to be high uncertainty about its level. According to the IMF, inflation in Slovenia will moderate to 5.1% in 2023 and 3.9% in 2024. On the other hand, IMAD projects a more substantial decline, with consumer price growth standing at 3.2% and 2.3% in the next two years.

Table SL2 Summary of projections

	2022	2023	2024
Real GDP (% change)	4.2	3.0	2.8
Real private consumption (% change)	4.3	1.4	1.6
Real government consumption (% change)	0.6	1.3	1.5
Real investment (% change)	N/A	N/A	N/A
Gross fixed capital formation (% change)	6.5	5.0	5.0
Exports of goods and services (constant prices, % change)	7.1	5.5	5.0
Imports of goods and services (constant prices, % change)	7.2	4.9	4.6
Current account balance (% of GDP)	2.1	2.5	2.6
Consumer prices (% change, pa)	6.4	3.2	2.3
Exchange rate, national currency/EUR (pa)	N/A	N/A	N/A
Unemployment rate (LFS, %. pa)	4.3	4.1	3.9
General government balance (ESA 2010 definition, % of GDP)	-4.8	-4.2	-3.4
Total domestic credit (% change, eop)	N/A	N/A	N/A

Source: IMAD - Spring Forecast of Economic Trends 2022, IMF – World Economic Outlook, April 2022.

ANALYSIS

Analysis of the public debt in the selected countries - SEE-6

SEE-6 countries have faced different public debt levels in the last ten years. Some countries are recording an increase in public debt across the border, which places them in highly indebted countries. Some countries, however, manage to control public debt within the borders of indebted countries. Tables 1 and 2 show the public debt of SEE-6 countries in millions of euros and its share in GDP (%).

		2010	2011	2012	2013	2014	2015
Bosnia and Herzegovina	In mil. euros	4,852.7	5,100.5	5,362.4	5,331.5	5,888.3	6,109.6
	Share in GDP%	41%	46%	49%	46%	41%	40%
Croatia	In mil. euros	24,300.3	27,546.7	30,362.5	35,209.3	36,943.8	37,645.7
	Share in GDP%	58%	64%	70%	81%	85%	84%
Montenegro	In mil. euros	1,270.7	1,483.5	1,699.5	1,893.0	2,022.2	2,361.6
	Share in GDP%	42%	45%	54%	57%	58%	65%
North Macedonia	In mil. euros	1,710.8	2,092.9	2,554.5	2,771.6	3,262.5	3,453.3
	Share in GDP%	26%	28%	34%	34%	38%	38%
Serbia	In mil. euros	12,156.9	14,788.8	17,717.0	20,141.3	22,761.6	24,818.6
	Share in GDP%	40%	43%	53%	56%	66%	70%
Slovenia	In mil. euros	13,916.2	17,216.6	19,417.7	25,520.1	30,219.9	32,087.4
	Share in GDP%	38%	47%	54%	70%	80%	83%

Table 1. Public debt in SEE-6 countries (2010-2015)

		2016	2017	2018	2019	2020	2021
Bosnia and Herzegovina	In mil. euros	6,185.8	5,628.2	5,678.8	5,732.3	6,214.6	6,552.8
	Share in GDP%	39%	34%	32%	31%	35%	36%
Croatia	In mil. euros	37,579.9	37,039.6	37,197.9	38,092.6	42,858.9	45,486.0
	Share in GDP%	81%	78%	74%	73%	89%	N/A
Montenegro	In mil. euros	2,498.7	2,758.8	3,268.2	3,789.3	4,409.0	4,162.8
	Share in GDP%	63%	64%	70%	77%	105%	85%
North Macedonia	In mil. euros	3,851.5	3,958.5	4,344.4	4,556.8	5,516.0	7,170.5
	Share in GDP%	40%	39%	40%	41%	51%	57%
Serbia	In mil. euros	24,820.2	23,221.5	23,014.6	23,944.0	26,669.3	30,130
	Share in GDP%	68%	58%	54%	52%	57%	57%
Slovenia	In mil. euros	31,756.0	31,893.0	32,245.0	31,751.0	37,422.9	38,857.8
	Share in GDP%	79%	74%	70%	66%	80%	75%

Table 2. Public debt in SEE-6 countries (2016-2021)

In the **Republic of Serbia**, in the period from 2014 to 2019, thanks to the implemented fiscal consolidation measures, the economic indicators improved. There was a fiscal surplus in the period from 2017 to 2019; a reduced debt-to-GDP ratio, which amounted to 70% in 2015; and the downward trend continued in the following period until 2020 when the coronavirus outbreak began. Due to the drastic increase in the costs of health care and assistance to the national economy, additional borrowing was necessary in order to mitigate the negative effects of the COVID-19 pandemic, which affected the entire economic system. The crisis affected the increase of the public debt, which was EUR 26.7 billion in 2020, and in 2021 it rose to EUR 30.1 billion, that is, 57% of GDP.

Efficient public debt servicing is very important for Serbia, as well as implementing methods that imply more efficient use of foreign funds, reduction of interest rates, or significant retained foreign earnings. If the public debt continues to rise, it is doubtful whether Serbia, like many other countries, will be able to service the debts regularly. In order to service the public debt as efficiently as possible, the strategy of the Republic of Serbia is based on funding the deficit and the principal of debt by issuing government securities in the domestic and international capital markets. Special attention will be paid to the choice of the market when it comes to borrowing, the currency of the debt, and financing instruments. In the following period, the aim is to perform financing primarily by issuing dinar securities in the domestic market, along with realizing a part of the financing in the international financial market in the medium term.

Due to the specific limitations of the monetary policy of **Montenegro**, as a euroized economy, the most important instrument for conducting macroeconomic policy is a fiscal policy. Additionally, Montenegro's economy is facing the problem of excessive reliance of its economic activities on foreign direct investments rather than on its production, export, and competitiveness of national products and services. At the same time, the use of the public debt for financing the deficit slows down economic growth. Furthermore, Montenegro's public debt at the end of 2020 amounted to as much as 105% of GDP.

Expectedly, the current crisis caused by the coronavirus significantly contributed to this situation. However, special attention needs to be paid to Montenegro's debt due to China's participation in major energy and infrastructure projects. The loan taken to finance the Bar-Boljare highway infrastructure project led to an increase in the public debt to over 70%. This problem made the Government of Montenegro adopt demanding fiscal consolidation measures in 2017 in order to reduce the public debt and return it to an acceptable level. Unfortunately, the coronavirus pandemic made the situation worse.

The public debt at the end of 2021, compared to the end of 2020, is characterized by a significant reduction, both in absolute terms and in the debt-to-GDP ratio. Namely, the total public debt of Montenegro at the end of 2021 amounted to EUR 4,162.79 million, or 84.75% of GDP. In mid-2021, the Republic of Montenegro entered a cross-currency swap related to the credit arrangement with Exim China Bank, converting the dollar debt with Exim China Bank, approximately USD 818 million, which had a significant impact on the currency structure of the debt. Namely, compared to the end of 2020, when the share of euro debt amounted to 82.6% of the total debt, it also significantly increased at the end of 2021, and 96.7% of the debt was in domestic currency, i.e. in euros. The debt management strategy is based on the strategy that each subsequent borrowing should be aimed at improving the quality of the debt portfolio from the point of borrowing price and repayment profile, which would be aimed at reducing the annual budget for debt repayment.

As a transition country facing a lack of domestic investment accumulation, **Bosnia and Herzegovina** is forced to borrow. It is essential to outline that the public debt of Bosnia and Herzegovina is within the Maastricht criteria, up to 60% of GDP, meaning that it does not belong to a group of heavily indebted countries, but to a group of medium-indebted countries since the debt-to-GDP ratio amounts to approximately 40%.

However, one of the major limits in Bosnia and Herzegovina is the lack of adequate analysis of the most important fiscal risks. Key public debt indicators need to be adequately monitored, analyzed, and assessed in the future so that appropriate strategies and policies can be implemented that will contribute to maintaining the public debt level on a stable basis. Since 2017, Bosnia and Herzegovina has managed to reduce its public debt thanks to a larger primary fiscal surplus and output growth. However, in terms of its public debt, there is a significant difference in the borrowing levels between the two entities in Bosnia and Herzegovina. The Republic of Srpska faces far higher public debt rates than the Federation of Bosnia and Herzegovina. As a consequence of the COVID-19 pandemic on its economy, the total public debt increased by 4 percentage points in 2020 compared to the previous year, and in 2021 the public debt slightly increased to 36% of GDP.

In the **Republic of Croatia**, having taken measures to control and prevent the coronavirus, the economic indicators started declining in 2020. Along with the problems caused by the coronavirus, Croatia also suffered the consequences of devastating earthquakes. All of this resulted in by far the most significant drop in real GDP in the history of Croatia (8%). The significant increase in financial expenditures kept burdening the public finances, challenging the sustainability of meeting the financial obligations, that is, servicing the public debt.

The negative consequences of the coronavirus pandemic in 2020 caused a significant drop in tax revenue and social contributions but also a sharp increase in the expenditure due to financing the measures for maintaining jobs and securing the health of citizens. With a share of the public debt of 89% in 2020, Croatia ranked in a group of highly indebted countries. After several years of decline, this negative trend of the public debt is a consequence of the fall in economic activities caused by the coronavirus pandemic and numerous generous fiscal policy measures implemented by the Government of the Republic of Croatia to support the entire economy and population. Croatia's current fiscal position demonstrates the need to choose adequate fiscal consolidation measures, a more successful public debt management, i.e. its restructuring in order to sustain the public finances, and thus break the vicious circle where increasing deficits lead to a rise in public debt and vice versa. The fiscal policy in the following period should be aimed at strengthening fiscal sustainability, recovery, competitiveness, and resilience of the economy; as well as ensuring adequate protection of all segments of the population. The Croatian government expects a return to the fiscal balance within the Maastricht criteria in 2022, with a gradual reduction of the debt-to-GDP ratio.

The public debt of **North Macedonia** is growing gradually as the current spending increases due to rising wages, pensions, and subsidies in relation to moderate revenue growth. The lowest debt-to-GDP ratio of Northern Macedonia was at the beginning of the analyzed period, amounting to 24%. In the following years, the debt-to-GDP ratio increased.

The structure of the public debt was dominated by short-term government securities sold in international markets, which exposed the economy to the volatility of foreign markets. Despite the fact that the public debt of North Macedonia increased significantly in the period from 2008 to the end of 2016, its structure became more favourable. The average maturity of the government securities increased from less than 12 months in 2011 to more than 5 years in 2016. The public debt and the debt guaranteed by the state increased in 2020 because the government had to increase borrowing due to financing the growing deficit and the repayment of the due obligations. Low economic growth rate, declining foreign direct investments, decreasing output, and high public debt point to certain serious structural problems in the Macedonian economy.

According to static indicators, **Slovenia's** gross public debt amounted to EUR 38.85 billion at the end of last year, or 74.7% of GDP, and compared to the end of 2020, it was 5.1% lower in real terms, while it nominally increased by EUR 1.43 billion. The central government's debt amounted to EUR 38.11 billion or 73.3% of GDP, while the local governments' debt amounted to EUR 943 million or 1.8% of GDP.

At the end of December 2021, Slovenia's gross foreign debt amounted to EUR 50.8 billion. In the current prices, it is 108.3% of GDP, while the gross foreign receivables amounted to EUR 51.2 billion. To compare, Serbia's public debt at the end of last year amounted to just under 57% of GDP. As a part of the country's total debt on borrowing from foreign creditors, gross external debt increased by EUR 3.0 billion last year compared to the same month in 2020. Furthermore, the government's external debt was reduced by EUR 2 billion. Slightly less than half of the external debt was general public debt, and slightly more than a fifth (21.5%) was the debt of commercial banks and the central bank, according to a report by the Bank of Slovenia. The external receivables of EUR 51.2 billion increased by EUR 3.2 billion compared to the end of 2020. Slovenia's current account surplus in 2021 amounted to EUR 1.7 billion, which is slightly below half of the surplus in the previous year.

The global financial crisis and the crisis caused by the COVID-19 pandemic led to the increase in indebtedness of almost all countries worldwide (including the Balkan countries). The increase in public debt in the analyzed countries was mainly due to the high costs intended for combating the pandemic and helping the economies and the population.

The limitation of this analysis is the impossibility of presenting the data for 2022. The current crisis, which the Ukraine and Russia armed conflict caused, will significantly change the structure and level of the public debt of many countries.

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