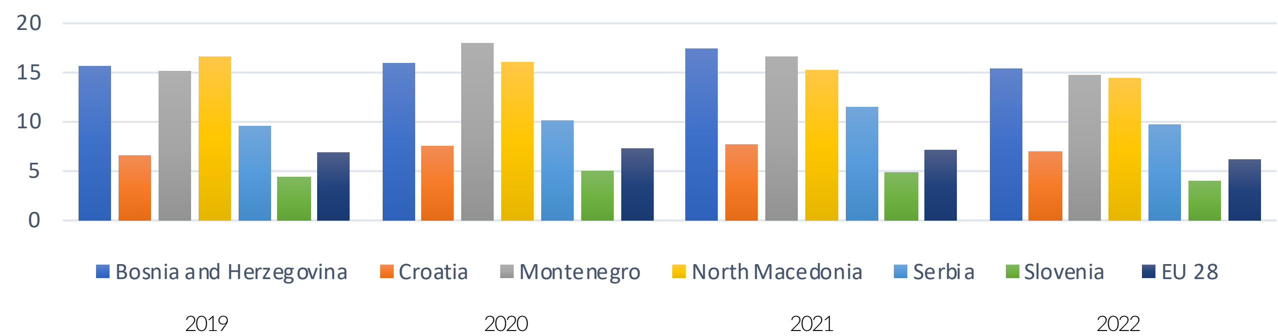
SEE-6 Economic Outlook

SEEA is an international organization with the aim to: promote economic research in Southeastern Europe; foster networking and regional cooperation among the member institutes; develop joint research programs; organize joint scientific conferences, round tables and meetings on a national level.

CONTENT

UNEMPLOYMENT RATE - ANNUAL DATA



Data: Agency for Statistics of B&H, Statistical Office of Montenegro, State Statistical Office of the Republic of North Macedonia, Statistical Office of the Republic of Serbia, Eurostat

seea | Vol. 9 | No. 1 | July 2023 | e-ISSN 1849-8884 | ISSN 1849-8817

BOSNIA AND HERZEGOVINA

B&H economy decelerated, inflation pressure softens, but prices remain elevated

The slowdown of economic activity in the second half of 2022

Global geopolitical uncertainty and pronounced inflationary pressures led to a slowdown of economic activity in the EU in the second half of 2022. As expected, this was reflected in the trajectory of Bosnia and Herzegovina's economic performance toward the end of the year. According to the available official data, in Q3 and Q4, real economic activity grew by 2.6% and 1,7%, respectively, on year-on-year basis. This is significantly lower than the growth rates registered in the first two quarters of 2022 - 5.1% and 5.8%. Although the data indicate slowing down the economy, economic activity in 2022 in B&H exceeded expectations, buoyed by a surge in investment and higher private consumption.

After record growth in 2021, industrial production grew only 1% in 2022. After a relatively good first semester (4.0% growth rate on year-on-year basis), industrial production recorded negative growth rates in the second half of the year. Negative growth rates were recorded in mining and electricity production. As industry growth was a major contributor to the improved export performance in 2021, decreasing orders from abroad are expected

to have, combined with continued inflationary pressure, negative effect economic activity in the future.

Prospects of economic activity are affected by political tensions and a lack of consensus on reforms to enhance the integration of the economy, internally and with international markets. 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.

The unemployment rate continues to decline

Labour market data show a continuation of the decreasing number of registered unemployed persons in the second half of 2022. At the end of the year, the total number of unemployed persons was 5.7% lower compared to 2021. In 2022, an additional 10 thousand persons were employed. The highest employment growth rates were recorded in the IT industry and business process outsourcing services. Although these data seem encouraging (using ILO methodology, the unemployment rate was below 15% for the first time in Q3 and Q4 of 2022), the key characteristic of the B&H labour market remains the same - low activity of the working-age population, along with high unemployment among youth and the 50+ population. Unfavorable global economic circumstances, slowdown of economic growth in the EU, unfavorable demographic trends (profound external emigration of the working-age population), and insufficient and ineffective active labour market policies raise the concern about continuing positive trends.

The trend of average salary growth continued in the second half of 2022, partly due to the increased minimum wages but also by increasing labour union pressure. The average net salary was around 14% higher in December 2022 compared to the same month of the previous year. At the same time, the extremely high inflation rate decreased the population’s real purchasing power. A decrease in real wages was recorded in seven industries, which at the end of 2022 accounted for a quarter of total employment in the country. This situation indicates serious pressure on real disposable income and private consumption.

Inflation in 2022 amounted to almost 15 percent

The most significant characteristic of the B&H economy in 2022 was mounting inflation with a disproportionate impact on the less well-off. Prices have increased by 14.7% per annum. The sharp rise was due to soaring food and transport prices that grew 22% and 26%, respectively, negatively affecting welfare, especially among the poor and vulnerable households, and creating challenges for poverty reduction. Inflation slowed down to 2,9% in the fourth quarter of 2022, but it is still higher comparing to EU and the Eurozone. As a result of growing trade union pressure, there are signs of a spiral between nominal wages and inflation in 2022.

A closer look at the CPI structure points to a significant increase in food prices, transport services and utilities, that are directly related to the changes in price of food commodities and energy on international markets, as well as current geopolitical developments. Global economic uncertainty resulted in asymmetric shocks and price changes in the most important sections of the consumer basket. Food prices were drawing the inflation surge - almost half of the total inflation was related to food and non-alcoholic beverages. Hence, the perception of inflation among the population is even higher than official numbers.

The growth of producer prices also slowed down towards the end of 2022. In the last quarter, producer prices increased by 19% on a y-o-y basis. The highest annual growth was recorded in the mining industry, followed by manufacturing.

The current account deficit reached 5.2 percent of the GDP

The trend of high growth rates in foreign trade slowed down in the last quoter of 2022. This especially applies to export growth (6,28% growth on year-on-year basis). The expansion of the external deficit was caused by investment-driven import volumes in combination with a deterioration in the terms of trade. Higher import volumes and a relatively larger increase in import than in export prices resulted in an expansion of the merchandise trade deficit to 16.5% of GDP in 2022 from 13.2% of GDP the previous year.

The growing merchandise trade deficit was in part offset by a higher services trade surplus (9.3% of GDP), due to an increase in tourism inflows and a significant inflow of remittances (9.2% of GDP). Sizably smaller investment income outflows also helped keep the current account deficit from widening further.

More than one-half of external financing requirements (4.4 % of GDP in 2022) were financed by net FDI inflows (totaled 2.9% of GDP) that were stronger compared to 2021. The remaining part was financed through foreign borrowing by the government and private sector, together with a drawdown on reserves.

Well-capitalized and profitable banking sector

At the beginning of 2022, the banking sector was exposed to a significant outflow of households deposits. Still, thanks to high liquidity and the efficient and timely reaction of entity banking agencies, the stability of the banking sector of Bosnia and Herzegovina was preserved.

The high degree of uncertainty and the business orientation of commercial banks largely determined credit dynamics during 2022. The survey on bank credit activity from the second quarter of 2022 indicated expectations regarding a moderate tightening of credit standards. This partially contributed to the relatively low credit growth rates (4.7%) in the conditions of a double-digit inflation rate. A sufficient motive for higher credit growth rates was not the high amount of excess reserves and the still negative charge on excess required reserves. On the demand side for loans, the negative effects of the reduction in households' purchasing power and the huge increase in real estate prices and durable consumer goods outweighed the effects of negative real interest rates. As usual, loans to households followed by loans to non-financial private companies contributed the most to total credit growth.

Asset quality of the banking sector has further improved compared to the previous years and pre-pandemic period, with non-performing loans to total loans declining to 4.9% at the end of the third quarter of 2022. Capital adequacy, meanwhile, remains robust. The banking sector's profitability has improved, given the rise in the higher return on equity.

Fiscal deficit of 1.0 percent of GDP in 2022

During 2022, the fiscal impact of stronger tax revenues supported by high inflation was more than offset by higher spending, which resulted in a fiscal deficit of 1.0 % of GDP in 2022. This compares to a deficit of 0.3 % of GDP in 2021 and 5.2 % of GDP in 2020. Expenditures in 2022 were driven by social measures softening the inflationary impact on households and pre-election spending, including wage and pension hikes, as well as higher capital expenditures which helped drive GDP growth. Nevertheless, public debt remains sustainable at around 30 % of GDP.

The financing of entities' government budgets was financed in an environment of increasing interest rates and yields on the financial markets. The average yield rate on the six-month treasury bills, for example, increased almost threefold, while the average yield on seven-year bonds increased for 230 b.p. and on ten-year bonds for 350 b.p..

Table BIH1 Main economic indicators

	Total 2021 year	2022				Total 2022 year
		Q1	Q2	Q3	Q4	
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**7.1**	5.9	5.8	2.6	1.7	**4.0**
Real private consumption (% change, yoy)	**4.0**	5.3	5.6	5.2	3.4	**4.9**
Real government consumption (% change, yoy)	**2.9**	2.8	0.3	1.6	1.5	**1.5**
Real investment (% change, yoy)	**22.4**	16.3	18.6	6.2	13.0	**12.7**
Industrial output (% change, yoy)	**7.3**	3.2	4.4	-0.3	-1.9	**1.7**
Unemployment rate (LFS, % pa)	**17.4**	16.7	15.7	14.8	14.3	**15.4**
Nominal GDP (EUR million)	**20,411**	4,867	6,281	6,244	5,991	**23,383**
GDP per capita (EUR)	**5,857**	1,410	1,820	1,809	1,736	**6,776**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**4.9**	3.8	10.3	10.7	16.8	**10.6**
Consumer prices (% change, yoy, pa)	**2.1**	8.4	14.5	16.9	16.1	**14.0**
Producer prices (% change, yoy, pa)	**4.5**	12.8	22.3	22.3	19.0	**19.1**
Average gross wage (% change, yoy, pa)	**4.5**	8.9	11.9	14.4	14.1	**11.7**
Exchange rate (BAM/EUR, pa)	**1.95**	1.95	1.95	1.95	1.95	**1.95**
Exchange rate (BAM/USD, pa)	**1.65**	1.74	1.83	1.93	1.92	**1.86**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**7,298**	2,196	2,452	2,269	2,274	**9,190**
Exports of goods (EUR, % change, yoy)	**35.67**	39.92	39.96	23.48	6.28	**25.92**
Imports of goods (EUR million)	**11,043**	3,222	3,784	3,822	3,814	**14,642**
Imports of goods (EUR, % change, yoy)	**27.90**	43.07	42.03	31.23	18.66	**32.59**
Current account balance (EUR million)	**-472**	-209	-340	-143	-355	**-1,046**
Current account balance (% of GDP)	**-2.32**	-4.29	-5.41	-2.28	-5.92	**-4.47**
Foreign Direct Investment net inflows (EUR million)	**459.8**	105.1	155.7	119.2	207.7	**587.7**
Foreign exchange reserves (EUR million, eop)	**8,373.0**	8,172.2	8,142.6	8,460.4	8,228.7	**8,228.7**
Foreign debt (EUR million, eop)	**8,699**	8,739	8,934	9,106	9,107	**9,107**
GOVERNMENT FINANCE						
Revenues (BAM million)	**8,209**	1,815	2,058	2,050	N/A	**N/A**
Expense (BAM million)	**7,566**	1,568	1,866	1,956	N/A	**N/A**
Net = Gross operating balance	**643**	247	193	94	N/A	**N/A**
Net acquisition of non-financial assets (BAM million)	**700**	11	42	56	N/A	**N/A**
Net lending/borrowing (BAM_million)	**-57**	236	151	38	N/A	**N/A**
Domestic government debt (EUR million, eop)	**1,967**	1,946	1,948	2,048	2,102	**2,102**
Foreign government debt (EUR million, eop)	**4,824**	4,789	4,831	4,859	4,733	**4,733**
Total government debt (eop. % of GDP)	**33.4**	32.3	31.1	30.7	29.2	**29.2**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**19.1**	15.6	14.0	13.6	10.9	**10.9**
Broad money, M4 (% change, yoy, eop)	**11.6**	7.3	6.4	6.7	5.5	**5.5**
Total domestic credit (% change, yoy, eop)	**3.6**	3.8	4.4	4.2	4.7	**4.7**
DMBs credit to households (% change, yoy, eop)	**5.1**	5.6	5.6	5.3	5.2	**5.2**
DMBs credit to enterprises (% change, yoy, eop)	**2.9**	3.1	4.4	3.9	4.3	**4.3**
Money market interest rate (%, pa)	**3.2**	N/A	N/A	N/A	N/A	**N/A**
DMBs credit rate for enterprises short-term (%, pa)	**3.7**	3.4	3.6	3.7	4.1	**3.7**
DMBs credit rate for households short-term (%, pa)	**5.4**	5.1	5.8	5.2	5.9	**5.5**

Conventional abbreviations: pa - period average, eop – end of the period, yoy – year on year, BAM – Bosnia and Herzegovina convertible mark, EUR- euro, USD – U.S. dollar, DMB – deposit money bank.
Source: Agency for Statistics of BiH, The World Bank in BiH, The Central Bank of Bosnia and Herzegovina

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 these 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 2023-2025 period, real output growth is expected to decelerate to 2.5 % in 2023 as private consumption slows due to the erosion of disposable income because of high inflation and a deterioration in net exports due to projected weak growth in the EU. By 2025, real output growth is projected to reach 3.2 %, driven largely by a recovery in private consumption supported by remittances and a tightening labour market. Investment in energy and infrastructure (such as windmills and Corridor Vc4) will add to the growth stimulus over the medium term.

Inflationary pressures are expected to continue dissipating. Nevertheless, inflation is projected to remain elevated at around 5% in 2023. Barring further external shocks, inflation is expected to stabilize in 2024–25 at rates seen prior to the pandemic, at around 2% or lower. Under the assumption of markets stabilizing, the current account deficit is expected to narrow to 4% of GDP. In 2023, higher interest payments and the pension increase will, in part, offset phased-out pre-election spending and one-off expenditures in response to the price shock. Barring any further shocks, the fiscal surplus is projected to exceed 1% of GDP in 2025. This will help keep public and publicly guaranteed debt below 35% of GDP. Downside risks dominate the outlook as an end to Russia's invasion of Ukraine is not in sight, and global, and particularly European, uncertainty, is expected to continue.

EU candidacy status received in December 2022 could serve as a catalyst for much-needed structural reforms. Following October 2022 elections, the attention of new policymakers could turn to the structural reform agenda for EU accession. Priority economic reforms include improving the business environment, concluding WTO accession, reducing tax wedge and enhancing employment policies, green economy transition, reducing the public sector, and enhancing oversight and management of State-owned enterprises (SOEs).

Table BH2 Summary of projections

	2023	2024	2025
Real GDP (% change)	**2.5**	**2.8**	**3.2**
Real final consumption (% change)	1.7	1.8	2.1
Real investment (% change)	0.8	0.7	0.6
Exports of goods and services (constant prices, % change)	2.6	2.7	2.8
Imports of goods and services (constant prices, % change)	2.6	2.1	2.0
Current account balance (% of GDP)	-4.1	-3.9	-3.7
Consumer prices (% change, pa)	5.0	2.1	1.9
Exchange rate, national currency/EUR (pa)	1.95	1.95	1.95
Unemployment rate (LFS, %, pa)	N/A	N/A	N/A
General government balance (ESA 2010 definition, % of GDP)	0.1	0.9	1.1
Total domestic credit (% change, eop)	N/A	N/A	N/A

Source: Agency for Statistics of BiH, The World Bank in BiH, The Central Bank of Bosnia and Herzegovina

CROATIA

Despite the harsh impact of high inflation, economic growth remained relatively strong in 2022

Economic growth in 2023 will reflect the global slowing down

In Croatia, like in most EU member states, the last year was a year of coping with the harsh negative macroeconomic implications of the Ukraine war. The global rise of energy and food prices had a consequent spillover on the increase of domestic inflation to above two digits (10.8%), which slowed down considerably and halved down the real economic growth rate in 2022 to 6.3%, according to the estimations of the Croatian Bureau of Statistics. Unfavorable global geo-economic circumstances inevitably affected the speed of post-COVID economic recovery, causing a considerable deceleration, especially in the second half of 2022.

Nevertheless, this relatively strong growth rate demonstrated quite a solid resilience of the Croatian economy backed up by abundant EU funding and diversified domestic energy sources, including renewable green ones. Croatia managed to avoid a technical recession, although

it experienced a significant decrease in economic activity, especially in the third quarter, compared to the strong growth rate achieved in Q2 (8.7%). The growth performance in Q3 decreased to 5.2%, while in Q4, which is also traditionally a much weaker quarter, further dropped to 4.0% compared to the same period of 2021. However, contrary to the recessionary expectations of many analysts, it nevertheless recorded slim growth compared to Q3 (0.9%), thus avoiding a technical recession. The growth also continued in the first quarter of 2023, which brought more optimism for growth projections in 2023. According to the first estimations of the Croatian Bureau of Statistics, the growth in Q1 of 2023 reached 2.8% on the annual level, which is up 1.4% compared to the last quarter of 2022.

The recent stabilization of world energy and food prices has also brought more optimism for growth prospects in 2023. Although the economy would continue to be burdened with persistent inflation causing a global slowdown, its impact is expected to be less profound than in 2022, thus making growth prospects slightly brighter than expected just a quarter of a year ago. Accordingly, the Croatian Government recently revised the growth projections for 2023 to 2.2%. The spring growth forecasts of the international organizations also reflect more optimism for 2023. The World Bank in June 2023 revised the anticipated growth rate for Croatia upwards to 1.9% in 2023. The European Commission expects that this year Croatia will grow at a rate of 1.6%. In its World Economic Outlook 2023 (April 2023), the IMF envisaged a growth rate of 1.7%, the fifth highest in the Euro area.

Major factors contributing to economic growth

A couple of factors continued to contribute the most positively to the economic growth achieved in 2022, primarily personal consumption and investments. In addition, the continuous growth of exports, especially tourism-related services, continues to exert important economic impetus, despite the negative risks due to the war in Ukraine.

Personal consumption continued to have the strongest positive contribution to economic growth in 2022 as it increased strength throughout the year, on average by 5.1%. Its contribution was particularly strong in the first half of the year, while its growth considerably decelerated in the second half of 2022, especially in Q4, when it steeply plummeted to only 1.3% as compared to the same quarter of 2021. Such a strong decline reflected the harsh impact of the increase of inflation on the deterioration of the population's purchasing power, which, combined with an increase in interest rates, had caused growing concerns about the uncertain future and consequent decrease in household consumption attitudes. These consumers' concerns were also partly fuelled by opinion polls because further increases in prices were expected due to the scheduled introduction of the Euro as of 1 January 2023, which brought fears of the practice of rounding up prices during the conversion of Kuna. To sum up, despite the increase in nominal wages, the double digits inflation eroded both households' real disposable income and consumer confidence, which substantially declined by the end of 2022.

The government consumption, on the other hand, has remained rather stable and strong throughout 2022, with an average rate of 3.0%. One of the reasons behind it is a substantial government intervention to buffer the effects of the energy crisis by limiting its volatile rise and by introducing financial support packages for the most vulnerable parts of the population. The rise of wages in the public sector in April 2022 also contributed to it.

Another pivotal growth driver was total real investments, which, throughout 2022, had a very substantial positive contribution to the growth level and expanded at the rate of 5.8%. The investments, in particular, increased in the year's second half, by 8.0% in Q3 and 9.6% in Q4, on the wings of increased absorption of abundant EU funding for large public construction and infrastructure projects. By the end of 2022, the Government complied with all the required indicators for implementation of the National Plan of Recovery and Resilience, and successfully disbursed 2.2 million euros of grants for that purpose, which accounts for 38% of total funding offered within this facility. In addition, the revival of private investments also contributed to the strong growth of total investments.

The stronger growth of imports than exports worsened the current account balance significantly

The growth of exports of both goods and services continued to have a very important contribution to the GDP growth in 2022. In the third quarter (Q3), the rise of exports of goods increased by 37.0% compared to the same quarter in the previous year, while that growth in Q4 decelerated to 13.4%, reflecting the negative impact of slowing down of foreign demand, especially in the Croatian main trading partners such as Germany and Italy. In the second half of 2022, the rise of exports was particularly strong in energy products as well as in exports of non-durable consumer goods and capital goods, reflecting the steep rise of their prices in world markets. For the whole of 2022, the total Croatian goods exports expanded at the rate of 23.6%.

Due to the same reasons, i.e., because of the impact of the rising prices at the global market, the imports of goods, especially those related to energy and food products, increased at much stronger rates than exports throughout 2022 (26.3%). Because of that, the current account balance worsened significantly, and the surplus of 1.8% of GDP achieved in 2021 plunged to -1.8% in 2022. The profound worsening of terms of trade on world markets of goods was particularly evident in the third and fourth quarters due to the mounting negative effects of the war in Ukraine.

On the other hand, the export of services was extraordinarily high despite all the negative risks associated with the war in Ukraine, primarily due to the excellent results of tourism throughout 2022. The rise in services exports exceeded even the most optimistic expectations with the record level of tourism income, which reached above 13 billion Euro, i.e., over 24% beyond the pre-pandemic level. Such a rise in income from the export of services was very beneficial for patching the negative current account balance.

The growth of industrial output significantly decelerated

The negative economic developments caused by the war in Ukraine had rather harsh implications for industrial output growth in 2022. The producer expenditures have risen beyond their control because of very volatile increases in prices of energy, raw materials, and intermediate industrial products in the world markets due to the war in Ukraine. Reflecting all these factors and slowing down of demand, especially in the second half of 2022, the industrial output grew by only 2% at the annual level as compared to the very high growth rate achieved in 2021, when it was 8.2%.

The last quarter of 2022 was especially weak in terms of industrial production, with a negative growth rate of -3.7%. The pronounced falling trend, which started in November 2022, also continued in the first quarter of 2023 for the fifth month in a row. The most profound decline related to the production of intermediate products, consumer durable and non-durable products, while the production of capital goods as well as energy products recovered and were the only ones growing in this period. Production of electricity from hydropower plants was on the rise in the first quarter of 2023, thanks to abundant rain during the winter.

Labour market reflects rising demand for workers and a trend of decline in unemployment

The labour market developments in 2022 have remained relatively favorable and resilient despite the slowing down of the economy. A relatively strong growth of the economy created an additional demand for workers, especially in the tourism-related services and construction sector but also in the other expanding sectors such as the exporting manufacturing industry and agriculture. As a result, the level of employment in 2022 increased by 2.5%, while the annual unemployment rate decreased from 7.6% in 2021 to 7.0% in 2022.

Rising demand for labour created occasional shortages throughout the year, which were eased by lifting up quotas for foreign workers. Such a trend also continued in the first quarter of 2023, when a record number of working visas were issued, and some estimations reckon that up to 10% of total workers may be of foreign origin in 2023. Most of the increase in labour demand in 2022 came from the recovery of the private sector, while the public sector experienced a slight decrease in the total number of employed.

Budget surplus instead of a planned deficit

Despite the energy crisis and high inflation rate, the public finances have experienced further significant improvements in 2022. The Budget revenues actually profited from high inflation as they have risen significantly and have a marked impact on the elimination of public deficit, achieving of a Budget surplus of 0.4% of GDP instead of a planned -1.4% deficit. The increased VAT revenues were the prime source of that increase on the wings of further recovery of personal consumption, a record tourist consumption, and the high increase in the general level of prices. The strong growth of total revenues from income tax also contributed to the general rise of Budget revenues due to a rise in nominal wages as well as in the level of employment.

On the other hand, Budget expenditures grew slower than revenues in 2022, mostly because previous intense expenditures related to coping with the pandemic, including job-preservation subsidies, significantly diminished. The capital investments financed from the Budget also declined due to abundant EU grants for infrastructure and post-earthquake reconstruction projects. Direct impact on the rise of expenditures came from the adoption of April and September packages of fiscal measures directed to mitigate the effects of the rising energy and food prices on citizens and the business sector, having direct implications on Budget expenditures due to social transfers to pensioners and other most vulnerable income categories of citizens. According to the Ministry of Finance, total fiscal effects directed to easing the inflationary pressures on the various segments of the most vulnerable population in 2022 were over 1 billion euros.

The level of general government debt also continued falling, with an enormous decline in the debt/ GDP ratio for 2022 from 78.4% to 68.4%, which is a decrease of 10 percentage points in just one year. The debt servicing costs significantly declined thanks to prudent debt management measures and refinancing based on low-interest rates in earlier periods.

High inflation started to slow down

The great instability and disruptions in the supply chains at the world oil, gas, and food and raw materials markets caused by the Russian-Ukraine conflict have also caused the highest inflation levels in Croatia in the last three decades, with an average annual rate of 10.8%. The rise of CPI prices was especially profound in the third and last quarter of the year, reaching 12.5% and 13.3%, respectively. The growth of energy and food prices contributed the most to inflation levels in the first three quarters, while the prices of industrial products and services grew the most in the last quarter of 2022, reflecting the postponed effects of rising producer expenditures. The increase in consumer prices is losing its steam since its peak in November 2022 (13.5%) and finally brought inflationary pressures on the long-awaited path of slowing down. The CPI rate is now falling for the sixth consecutive month, reaching 7.9% in May 2023 compared to the previous year. Although there were some occasional practices of rounding up the prices, mostly in services, the conversion of HRK into Euro on 1 January 2023 did not impact the rise of inflation at any significant level. According to Croatian National Bank, the impact of the introduction of the Euro on the inflation rate in January 2023 is estimated to be 0.4 percentage points.

The producer prices expanded even more significantly throughout 2022, with an average annual rise of 20.2%. However, in contrast to the rise of consumer prices, they reached their peak already in Q2 and Q3 when the impact of the war in Ukraine on global prices was the highest in terms of both world energy prices and disruptions in global energy and food supply and value chains. The producer prices have also been falling since the last quarter of 2022, and according to the State Bureau of Statistics, they reached only 2.5% in May 2023 compared to the previous year. The deceleration of growth of producer prices reflects the moderation of energy and raw material prices at the world market, as well as the normalization in the global supply chains.

It is important to mention that the levels of both consumer and producer prices would most probably explode if the Government did not intervene several times with substantial inflation-mitigating measures in 2022. Such measures encompassed introducing the price cups for electricity, gas, petrol, and the, most important basic food products through lowering the VAT and excise rates. In addition, the Government introduced further income tax reductions and increases in the minimum wage, child allowances, pensions and stipends for students, etc. The wide spectrum of intervention measures also included energy vouchers and direct money transfers to pensioners and other socially vulnerable citizens such as the unemployed and poor. The Government intervention packages introduced for coping with increased energy prices and high inflation effects in 2022 are estimated to be worth in total of 3.43 billion euros (6.3% of GDP). The new round of inflation-mitigating measures for the population and part of the public services sector are in effect from 1 April 2023 and will last until the end of March 2024. The new Government package is worth 1.7 billion Euro (2.5% BDP) and aims at the continuance of shielding both the population and parts of the business sector from the negative effects of high inflation and volatile energy prices.

The rise of interest rates to curb inflation

Following European Central Bank recommendations in July 2022, the banking sector has started to introduce gradual increases in credit interest rates to restrain new demand for household and corporate loans, thus limiting inflation. However, the interest rate increases for new loans in Croatia in 2022 were much less pronounced than in the other EU member-states due to the abundant liquidity and high capitalization of the domestic banking sector. According to Croatian National Bank, since the beginning of increases in key interest rates in July 2022, the average interest rate on new loans to the enterprise sector rose by 150 basis points and came to the level of 3.2% in January 2023. Nevertheless, the enterprise sector continued to take new loans with a total annual increase of 20.7%, mostly due to increased expenditure pressures. On the other hand, the interest rate on household new loans rose by 110 basis points in the same period, reaching 4.7% in January 2023. Households were, in that period, noticeably more hesitant to embark on new loans than the business sector, especially when it comes to long-term mortgage loans. To curb inflation, additional deterioration of financing conditions and larger increases in interest rates by the banking sector is expected in 2023; however, that rise would most likely be again lower than the introduced ECB key interest rates.

Table HR1 Main economic indicators

	Total 2021 year	2022 Q1	2022 Q2	2022 Q3	2022 Q4	Total 2022 year
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**13.1**	7.8	8.7	5.2	4.0	**6.3**
Real private consumption (% change, yoy)	**9.9**	6.4	7.8	5.6	1.3	**5.1**
Real government consumption (% change, yoy)	**3.0**	5.8	-2.2	1.3	6.8	**3.0**
Real investment (% change, yoy)	**4.7**	2.0	3.9	8.0	9.6	**5.8**
Industrial output (% change, yoy)	**8.2**	4.0	5.5	2.4	-3.7	**2.0**
Unemployment rate (LFS, % pa)	**7.6**	7.1	7.3	6.7	6.8	**7.0**
Nominal GDP (EUR million)	**57,207**	14,387	16,863	18,881	17,259	**67,390**
GDP per capita (EUR)	**15,206**	3,737	4,478	4,899	4,478	**17,486**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**3.2**	6.0	9.1	10.1	11.2	**8.9**
Consumer prices (% change, yoy, pa)	**2.7**	6.4	10.8	12.5	13.3	**10.8**
Producer prices (% change, yoy, pa)	**9.5**	17.9	23.2	22.8	16.9	**20.2**
Average gross wage (% change, yoy, pa)	**4.3**					
Exchange rate (HRK/EUR, pa)	**7.52**	7.54	7.53	7.51	7.53	**7.53**
Exchange rate (HRK/USD, pa)	**6.36**	6.71	7.06	7.45	7.40	**7.16**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**14,573**	4,038	4,751	5,284	5,193	**19,266**
Exports of goods (EUR, % change, yoy)	**20.0**	22.9	22.0	37.0	13.4	**23.6**
Imports of goods (EUR million)	**28,559**	7,709	8,425	8,885	8,102	**33,120**
Imports of goods (EUR, % change, yoy)	**14.8**	28.7	28.0	33.4	16.0	**26.3**
Current account balance (EUR million)	**1,022**	-2,757	-1,046	4,179	-1,440	**-1,064**
Current account balance (% of GDP)	**1.8**	1.3	0.2	-1.2	-1.6	**-1.8**
Foreign Direct Investment net inflows (EUR million)	**3,901.9**	904.4	768.3	1,154.1	661.9	**3,488.8**
Foreign exchange reserves (EUR million, eop)	**25,022**	24,069	25,243	26,260	27,877	**27,877**
Foreign debt (EUR million, eop)	**47,213**	48,121	49,843	48,716	49,554	**49,554**
GOVERNMENT FINANCE						
Revenues (EUR million)	**26,899.0**	6,472.9	7,362.6	8,158.9	8,471.1	**30,465.6**
Expense (EUR million)	**28,346.8**	6,566.2	7,180.5	7,153.8	9,303.1	**30,203.6**
Net = Gross operating balance	**-1,413.9**	-194	-51.9	912.1	-1,007.0	**284.2**
Net acquisition of non-financial assets (EUR million)	**34.0**	-101	-234	-93	-245	**22.3**
Net lending/borrowing (EUR million)	**-1,447.9**	-93.3	182.1	1,005.1	-832.0	**261.9**
Domestic government debt (EUR million, eop)	**30,119**	29,753	30,621	31,240	31,160	**31,160**
Foreign government debt (EUR million, eop)	**17,089**	18,254	18,440	17,924	18,752	**18,752**
Total government debt (eop. % of GDP)	**78.4**	76.7	75.8	74.6	73.5	**68.4**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**18.0**	13.6	13.0	8.5	9.4	**9.4**
Broad money, M4 (% change, yoy, eop)	**10.7**	8.6	10.7	10.4	8.4	**8.4**
Total domestic credit (% change, yoy, eop)	**3.9**	4.2	7.6	10.4	10.1	**10.1**
DMBs credit to households (% change, yoy, eop)	**4.5**	4.1	6.9	5.1	5.4	**5.4**
DMBs credit to enterprises (% change, yoy, eop)	**1.0**	5.7	12.3	21.2	20.7	**20.7**
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)	**2.7**	2.0	2.0	2.1	3.0	**2.3**
DMBs credit rate for households short-term (%, pa)	**5.1**	5.2	5.1	5.7	6.2	**5.6**

Conventional abbreviations: pa - period average, eop – end of period, yoy – year on year, HRK – Croatian kuna, EUR- Euro, USD – U.S. dollar, DMB – deposit money bank.
Source: Croatian Bureau of Statistics, Croatian National Bank and Ministry of Finance.

Policy assumptions and projections summary

Further slowdown of economic growth is anticipated for 2023, followed by a mild recovery in 2024-25

A relatively strong economic growth achieved in 2022 in very uncertain and negative global macroeconomic circumstances paved the way for more optimistic growth projections in 2023. The most recent projection of the GDP growth by the Government (end of April 2023) stands at quite an optimistic 2.2% and is based on the good economic results achieved in the first quarter of 2023 especially related to generated income from tourism and exports of goods. Although this anticipated rate means a further significant slowdown of the economy and represents only one-third of a rate achieved in 2022, it is still rather solid, considering the globally unfavorable circumstances and an anticipated general slowdown of the world economy.

The Government's medium-term economic outlook anticipates further mild recovery of the growth rates in 2024 and 2025 (2.6% and 2.4%, respectively). Although positive assumptions prevail, the Government assumes that future growth would continue to be affected by the consequences of negative risks associated with prolonged high inflation and uncertain resolution of the conflict in Ukraine.

Investments are expected to be the most prominent driver of growth in the medium term thanks to the generous support of EU funding at the disposal of the Government in the form of both non-returnable grants and very favorable loans within the National Recovery and Resilience Plan. By the end of 2022, Croatia had already absorbed 2.2 billion out of 5.5 billion euros of the EU grants. The rest of the grants is planned to be used mostly for important infrastructure projects (rail, roads, water system management, LNG terminal capacity expansion, etc.) as well as for post-earthquake reconstruction of damaged hospitals, schools, and other public and private buildings. Only in 2023, the Government plans an increase in absorption of EU funds by 32.8% as it has also to spend additional funding of over 1 billion Euro that came from the EU Solidarity Fund for the post-earthquake reconstruction of Zagreb and Banija region by the end of June 2023.

The other important growth assumption is that inflation pressures would gradually diminish. Although they would most likely stubbornly persist in 2023 due to high levels of domestic core inflation, the Government anticipates inflation levels to decrease significantly in 2004 and 2025 towards the more normal target values. The core inflation in the domestic market is beside rising production expenditures caused by a high rise in profit margins in some sectors (energy and processing industry) as well as by a rise in real wages to keep workers. Therefore, the inflation rate projection in 2023 is at a rather high 6.5%, while it is expected now that it will markedly fall to 2.8% in 2024 and further down to 2.4% in 2025 and 2.2% in 2026. These expectations are backed by the recent stabilization of world crude oil, gas, raw materials, and food prices at world markets, the continuance of Government inflation-mitigating measures and extended energy cap prices and subsidies, as well as a significant fall of inflation in the Eurozone and further moderation of domestic demand due to rise of interest rates.

The positive effects on growth caused by Croatia joining the Eurozone and Schengen area are expected to be more visible in the medium term, especially relating to a potential increase in private investments and gaining benefits in sectors such as tourism and foreign trade due to the elimination of transaction costs and currency risks. Additional positive contributions, although much smaller than in 2021-2022, would come from traditional drivers of Croatian economic growth, such as tourism and recovery of private consumption, while exports of goods are likely to deteriorate due to the global economic slowdown in 2023, with more favorable recovery prospects in 2024-25.

High investment ratings given to Croatia by the most important credit rating agencies support the prognoses of solid economic growth prospects for Croatia in the medium term. In April 2023, Fitch confirmed an investment credit rating of "BBB+" with a stable outlook for Croatia. Such a positive rating reflects Fitch's expectations that the Croatian economy will remain resilient to potential external shocks due to decreasing energy prices' risks, very important improvements in fiscal and external positions, and successful adoption of the Euro. Standard & Poor's credit rating for Croatia also stands at BBB+ with a stable outlook, while Moody's credit rating for Croatia was last set at Baa2 with a stable outlook.

Recent medium-term economic growth projections for Croatia also look more optimistic to most international organizations. The European Commission forecasts that Croatia will grow in 2023 at a rate of 1.6%, followed by a rate of 2.3% in 2024. The World Bank also revised upwards its expectations already twice this year, first in its Spring Europe and Central Asia Economic Update (April 2023) to 1.3% and latest in June 2023 in its Global Economic Prospects and now anticipates a growth rate of 1.9% for 2023 followed by a stronger recovery in 2024 and 2025 with growth rates of 3.1% and 3.3% respectively. In its World Economic Outlook (April 2023), the MMF forecasts a 1.7% growth rate for 2023, followed by 2.3% of real GDP growth in 2024. Despite the general slowing down of the global economy, the international prognoses base their forecasts on demonstrated resilience of the Croatian economy to exogenous shocks so far and on prevailing positive contributions to further growth prospects in the medium term.

Table HR2 Summary of projections

	2023	2024	2025	2026
Real GDP (% change)	**2.2**	**2.6**	**2.4**	**2.2**
Real private consumption (% change)	1.3	2.4	2.3	2.1
Real government consumption (% change)	3.3	2.8	2.5	2.2
Real investment (% change)	4.6	3.7	3.3	2.9
Exports of goods and services (constant prices, % change)	2.7	2.9	3.0	2.7
Imports of goods and services (constant prices, % change)	2.8	3.0	2.9	2.6
Current account balance (% of GDP)	-1.8	-0.1	-0.5	-0.9
Consumer prices (% change, pa)	6.6	2.8	2.4	2.,2
Exchange rate, national currency/EUR (pa)*	-	-	-	-
Unemployment rate (LFS, %, pa)	6.5	5.9	5.4	5.2
General government balance (ESA 2010 definition, % of GDP)	0.7	1.5	0.8	0.6
Total domestic credit (% change, eop)	9.2	5.3	4.5	4.2

Source: Ministry of Finance of the Republic of Croatia and Croatian National Bank.
*Conversion rate of Kuna to Euro was fixed at 7.53 at the time Croatia joined Eurozone and adopted Euro on 1 January 2023.

MONTENEGRO

The road to economic recovery through the prism of (geo)political challenges

During 2022, Montenegro's economy continued its recovery that began the previous year (primarily thanks to the results achieved in the tourism and catering sector). GDP recorded positive trends and growth rates of 3.2% and 3.3% in Q3 and Q4 2022, respectively, while inflation stood out as the biggest challenge in terms of the macroeconomic performance of the economy. The balance of payments recorded an increase in the deficit, mostly due to the growth in aggregate demand and the increase in import prices. Political instability represented the biggest challenge on the domestic front, while concerns regarding the geopolitical situation and the negative repercussions of the war in Eastern Europe were not abating. In such circumstances, Montenegro continues to face numerous internal and external challenges to create the precondition for establishing a stimulating business environment that will enable long-term growth and development.

Growing political uncertainty

Growing uncertainty and insecurity were the best describers of the political situation in Montenegro in the second half of 2022. The

Government formed in April 2022 lost support in the Assembly of Montenegro only a few months later. Deviation from the principles on which the Government was formed was the main reason why certain political parties that supported the formation of the Government decided to deny it. All this was followed by a series of election cycles at the local level, as well as unsuccessful attempts to reach an agreement on the formation of a new Government within the current convocation of the Parliament. The Constitutional Court was still incomplete, which made it impossible to make numerous important decisions. As a consequence of all of the above, there was a significant slowdown in the European integration process, which was repeatedly emphasized in the speeches of European officials.

Fighting inflation

War events in Eastern Europe and disruptions in supply chains and the rest of Europe naturally negatively impacted price movements in Montenegro itself. Data from the Central Bank of Montenegro from the end of December 2022 show that inflation measured by the Consumer Price Index (CPI) was 17.2%, while inflation measured by the Harmonized Consumer Price Index (HCPI) was 15.7%. Observed on an annual basis, food and non-alcoholic beverages recorded the highest growth of 28.9% (this is the biggest cause of such a high inflation rate). In addition, high inflation was recorded in the sector of housing, water, electricity, gas, and other fuels (16.2%); in the sector of furniture, household equipment, and routine apartment maintenance (13.4%); as well as in the restaurants and hotels sector (16.8%). On the other hand, the lowest inflation growth was recorded in the communication (0.3%), education (3.1%), and recreation and culture (3.5%) sectors.

Prices of producers of industrial products grew by 12.1% annually, mostly due to growth in the manufacturing sector (18.5%), that is, the mining and stone sector (15%). There were no price changes in the electricity, gas, and steam supply sector.

Labour market and wages

According to the Administration for Statistics of Montenegro records, 227,151 persons in Montenegro were employed at the end of December 2022 (when comparing the statistics on an annual basis this represents a rise of 7.5%). When it comes to the employed persons' structural composition, there is no significant difference in terms of sectoral distribution. Wholesale and retail trade, i.e., the sale of motor vehicles and motorcycles, takes up almost 1/5 of the employees (19.6%), whilst state administration and compulsory social insurance, accommodation and food services, and education are the sectors that follow with 10%, 8.8%, and 7.3%, respectively.

The average gross salary in December 2020 was EUR 900, while the average net salary (without taxes and contributions) was EUR 727. At the annual level, earnings recorded a large increase of up to 35.4%. The primary factor in the wage increase was the tax reform, which resulted in the abolition of health insurance contributions, i.e., the minimum wage increase from EUR 250 to EUR 450. Observed on a quarterly basis, in Q4, there was a smaller growth in the amount of 1% compared to Q3. Observed by sector, the highest average earnings were traditionally achieved in the financial and insurance sector (EUR 1,201), i.e., the supply of electricity, gas, steam, and air conditioning sector (EUR 1,127). On the other hand, the lowest wages were earned in the administrative and auxiliary service sector (EUR 571) and the processing industry sector (EUR 592).

Foreign trade and capital flows

According to data published by the Directorate for Statistics of Montenegro, Montenegro's foreign trade in 2022 amounted to EUR 4,240 million. Comparative data at the annual level indicated a growth of 44% from the previous period. In the structure of foreign trade, imports dominated with EUR 3,539.8 million, while the total amount of goods exported was EUR 700.2 million. However, the structure of foreign trade is still quite unfavorable regarding coverage of imports by exports. Despite slightly better results, this indicator still represents a ballast for the development of the national economy (in the last year, it amounted to 19.8%).

As far as foreign trade is concerned, the problem is not only the unfavorable ratio regarding coverage of imports by exports but also the structure itself. Namely, in the structure of exports, products, and services of a lower level of processing are predominately represented.

According to the Standard International Trade Classification, mineral fuels and lubricants (Sector 3), amounting to EUR 209.9 million, were the most represented in the export structure (the dominant part of which was electricity with EUR 170.2 million). In the structure of imports, the dominant part was machinery and transport devices (Sector 7), amounting to EUR 709.7 million (road vehicles, which made up the majority of this sector's structure and amounted to EUR 228.4 million, were followed by electrical machines, appliances, and devices, amounting to EUR 142.2 million).

When it comes to the foreign trade partner countries, Montenegro's largest export partners in 2022 were Serbia (EUR 149.4 million), Switzerland (EUR 107.9 million), and Bosnia and Herzegovina (EUR 90.6 million); whilst its largest import partners were Serbia (EUR 614.7 million), China (EUR 330.6 million), and Greece (EUR 295.4 million). Generally speaking, foreign trade in goods is traditionally the largest with the signatories of CEFTA and the European Union.

Preliminary data from the Central Bank of Montenegro for 2022 show a net inflow of foreign direct investments of EUR 782.6 million. This represents an increase of 34.6% on an annual basis. The total inflow of foreign direct investments in absolute amounts was EUR 1,151.42 million, which is a growth of 24.1%. For the most part, the increased inflow of foreign direct investments resulted from growth in equity investments and investments based on intercompany debt.

Decomposing the foreign direct investments' structure, it can be concluded that 57.9% of the total realized inflow falls on proprietary investments. In that part, investments in companies and banks in the amount of EUR 219.4 million, that is, investments in real estate in the amount of EUR 448 million, should be especially highlighted. The total inflow in the form of intercompany debt amounted to 34.9% of the total inflow. Additionally, in both segments - equity investments and intercompany debt, there was 34.9% and 24.1% growth, respectively. The total outflow of foreign direct investments amounted to EUR 368.8 million (it is about the outflow based on investments of residents abroad in the amount of EUR 132.4 million, while the withdrawals of funds of non-residents invested in Montenegro amounted to EUR 236.4 million).

Monetary developments

A high level of liquidity and stability still characterizes the banking system of Montenegro. At the end of the previous year, according to the Central Bank of Montenegro's data, the balance sheet total of banks amounted to EUR 6,407.7 million. That is a significant growth in the ratio of even 20.2 annually. Total loans made up the dominant part of assets with almost 3/5 (57.1%), followed by cash and deposit accounts with central banks at 27.5%, i.e., securities with 14.4%. Deposits dominated when it came to liabilities, with a share of over 4/5 (81.5%). They were followed by capital (10.6%) and loans (4.8%). The Bank's total capital at the end of 2022 amounted to EUR 680.2 million.

Total approved bank loans at the end of December 2022 amounted to EUR 3,661.9 million. Observed at the annual level, this was a growth of 8.9%. The loan/deposit ratio was 0.70, a lower ratio compared to comparative data. Bank deposits amounted to EUR 5,224.3 million and recorded an intense growth of even 24.3% annually. The structure of deposits did not change much. Demand deposits continued to dominate with a share of 78.9%, followed by term deposits with 15.6% and 5.5% of the funds in the escrow account. When it comes to the structure of term deposits, most were deposits of up to 3 months (39.2%), followed by deposits of one to 3 years (37.5%). Broken by sector, the largest share was held by deposits of the non-financial sector and deposits of households, with 33.8% and 32.6%, respectively.

Monetary indicators at a stable level

Banks' liquid assets in December 2022 amounted to EUR 1,989.5 million and were higher by as much as 41.6% compared to the period a year ago. Liquidity coefficients on both daily and decadal level were above the prescribed minimums. Mandatory reserves of banks at the Central Bank amounted to EUR 263.1 million and recorded an increase of EUR 46 million annually. The biggest part (68.3%) was in the account of the Central Bank in the country, while 31.7% was allocated to the account of the Central Bank abroad. The effective reserve requirement rate was 5%, which is slightly lower compared to the period a year ago when it was 5.2%. Microcredit financial institutions had a balance sheet amounting to EUR 74.8 million, representing a decrease of 6.6% compared to a year ago.

Banks' average weighted nominal interest rate on total approved loans in December 2022 was 5.4%. At the annual level, this was an increase of 0.3 percentage points. The average weighted effective interest rate was 5.9% and was higher by 0.3% compared to the comparative data 12 months ago. When it comes to newly approved loans, there was a slightly larger increase. Namely, the projected weighted nominal interest rate on newly approved loans amounted to 6% in December 2022 and was higher by 1.7% compared to the period a year ago. The situation is similar to the average weighted effective interest rate, which was 6.5%, thus recording an increase of 1.2%. In the part of condition provided by microcredit financial institutions, the average interest rate was 20.5%, and the effective interest rate was 23.4%. In that part, no significant deviations were recorded in relation to the previous period. The average weighted effective passive interest rate was 0.3% in December 2022 (it recorded a decrease of 0.1% annually). The highest passive interest rate on time deposits over five years was 1.6%.

Regarding the capital market, a turnover of EUR 12.96 million was realized on the Montenegro Stock Exchange in December 2022 through 1,545 transactions. This is a significant increase in turnover of 19.7 times compared to the period a year ago. Almost the entire turnover (99.9%) was related to the turnover of shares, and the smaller remaining part was related to the turnover of government bonds. The MONEX stock market index value was 14,141.3 index points, which is a decrease of 43.3% compared to the previous period. The value of realized payment transactions in the RTGS system and the DNS system amounted to EUR 2,168.2 million at the end of December 2022 and recorded a growth of 22.1% compared to the same month of the previous year, i.e., an increase of 27.2% compared to the previous month. In the structure of the total realized payment transaction, 94.5% was related to the value of the payment transaction realized in the RTGS system. Looking at the share of completed orders, the dominant share of 62.8% was achieved by orders in the DNS system, with 796,948 completed orders.

Fiscal sector

The current revenues of the budget of Montenegro during the second half of the year and in December 2022 were above the planned. According to the Ministry of Finance of Montenegro estimate, they amounted to EUR 218.72 million during December, representing 3.8% of the estimated GDP. In the structure of source income, the dominant share was the income generated based on taxes (54.4%), then contributions (34.8%), and fees, donations, other income, and taxes with 5.9%, 2.6%, 1.4%, and 0.7%, respectively. The biggest contribution to the increase in tax revenue was the increased collection of VAT, which is the result of significant imports and an increase in the prices of items, i.e., the tax base. Consolidated budget expenditures in December 2022 amounted to EUR 370.7 million or 6.5% of GDP. The budget of Montenegro recorded a deficit of EUR 152 million or 2.7% of GDP in December 2022.

Total national debt (without deposits) as of 12/31/2022 was EUR 4,026.3 million or 69.5% of GDP, according to the data published by the Ministry of Finance of Montenegro in its regular report on the state of debt. State debt with deposits amounted to EUR 3,914.6 million or 67.5%. External debt amounted to 61.4% of GDP. During Q4 2022, there was an increase in debt compared to Q3 2022, mostly due to the fact that state bonds were issued in the amount of EUR 39 million. In addition, the state concluded new credit arrangements with domestic commercial banks - with Montenegro Commercial Bank (EUR 50 million), Universal Capital Bank (EUR 10 million), and Erste Bank (EUR 6 million).

During Q4 2022, the state debt was repaid based on the principal in the total amount of EUR 74.5 million, of which the largest part (EUR 61.5 million) was related to the repayment of debt to non-residents. In the same period, interest amounting to EUR 34 million was repaid. When it comes to the interest structure of the state debt, 78.5% is repaid at a fixed interest rate, while 21.5% of credit obligations are serviced at variable interest rates. In the part of the currency structure, loans in euro currency are dominant with 95.3%, followed by debts in dollars (2.5%) and the remaining currencies (2.2%).

Table MN1 Main economic indicators

	Total 2021 year	2022 Q1	2022 Q2	2022 Q3	2022 Q4	Total 2022 year
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**13.0**	7.1	12.7	3.2	3.3	**6.6**
Real private consumption (% change, yoy)	**4.0**	12.9	12.3	9.8	4.7	**9.9**
Real government consumption (% change, yoy)	**0.5**	0.4	-1.3	2.6	2.9	**1.1**
Real investment (% change, yoy)	**-12.3**	2.3	-1.5	-8.1	3.6	**-0.9**
Industrial output (% change, yoy)	**4.9**	-15.2	17.2	-6.8	-1.9	**-1.7**
Unemployment rate (LFS, % pa)	**16.6**	16.8	14.6	13.0	14.4	**14.7**
Nominal GDP (EUR million)	**4,955.1**	1,032.0	1,395.8	1,824.1	1,544.8	**5,796.7**
GDP per capita (EUR)	**8,002**	1,672	2,262	2,955	2,503	**9,392**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**4.7**	9.5	8.9	10.5	11.8	**10.2**
Consumer prices (% change, yoy, pa)	**2.4**	7.4	12.2	15.3	17.2	**13.0**
Producer prices (% change, yoy, pa)	**1.3**	6.0	11.5	14.3	13.0	**11.2**
Average gross wage (% change, yoy, pa)	**1.3**	11.3	10.5	11.5	11.8	**11.3**
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)	**525.8**	216.1	196.8	156.1	194.5	**763.5**
Exports of goods (EUR, % change, yoy)	**28.6**	99.9	47.4	20.6	25.7	**48.4**
Imports of goods (EUR million)	**2,440.1**	631.7	934.6	996.2	870.1	**3,432.6**
Imports of goods (EUR, % change, yoy)	**19.0**	46.8	47.8	38.1	25.7	**39.6**
Current account balance (EUR million)	**-455.9**	-190.0	-361.3	69.2	-283.8	**-765.9**
Current account balance (% of GDP)	**-9.2**	-18.4	-25.9	3.8	-18.4	**-14.7**
Foreign Direct Investment net inflows (EUR million)	**581.6**	168.5	194.2	243.3	176.6	**782.6**
Foreign exchange reserves (EUR million, eop)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Foreign debt (EUR million, eop)	**9,501.3**	9,448.8	9,419.9	9,444.9	9,421.3	**9,421.3**
GOVERNMENT FINANCE						
Revenues (EUR million)	**2,193.9**	463.2	558.9	626.5	650.7	**2,299.3**
Expense (EUR million)	**2,005.2**	449.1	508.8	531.7	756.0	**2,245.6**
Net = Gross operating balance	**188.8**	14.1	50.1	94.7	-105.4	**53.5**
Net acquisition of non-financial assets (EUR million)	**282.2**	49.9	97.2	72.3	133.5	**352.9**
Net lending/borrowing (EUR million)	**-93.5**	-35.8	-47.1	22.4	-238.9	**-299.4**
Domestic government debt (EUR million, eop)	**401.5**	393.2	382.5	375.2	468.8	**468.8**
Foreign government debt (EUR million, eop)	**3,688.5**	3,671.2	3,632.2	3,624.5	3,557.6	**3,557.6**
Total government debt (eop. % of GDP)	**82.5%**	70.1	69.3	69.0	69.5	**69.5**
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)	**1.5**	4.4	6.0	6.1	7.7	**7.7**
DMBs credit to households (% change, yoy, eop)	**2.7**	5.3	6.8	7.2	8.6	**8.6**
DMBs credit to enterprises (% change, yoy, eop)	**4.3**	8.3	11.9	11.2	9.0	**9.0**
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)	**4.7**	4.3	4.5	4.3	4.3	**4.3**
DMBs credit rate for households short-term (%, pa)	**6.5**	5.7	5.5	5.6	5.8	**5.6**

Conventional abbreviations: pa - period average, eop – end of the period, yoy – year on year, EUR- euro, USD – U.S. dollar, DMB – deposit money bank.
Source: Monstat, final data for 2021 (September 2022), data for GDP in 2022 are preliminary
** Authors' calculations based on Monstat data.

Policy assumptions and projections summary

Projections of the International Monetary Fund from April 2023 predict growth of the newly created value of 3.2% in the current year. Projections of the Ministry of Finance of Montenegro from the Program of Economic Reforms speak of growth rates of 4% and 3.5% in the next two years. However, these projections should be taken with a grain of salt, bearing in mind the numerous challenges the Montenegrin economy currently faces. Political instability on the internal level and growing uncertainty in the field of international political developments make the predictability of economic developments difficult, so the projections presented below must be taken with caution, considering the wider context.

Table MN2 Summary of projections

	2024	2025
Real GDP (% change)	**4.0**	**3.5**
Real private consumption (% change)	2.2	1.5
Real government consumption (% change)	0.3	0.2
Real investment (% change)	1.6	1.5
Exports of goods and services (constant prices, % change)	3.6	3.4
Imports of goods and services (constant prices, % change)	3.8	3.1
Current account balance (% of GDP)	-9.9	-8.9
Consumer prices (% change, pa)	3.0	2.5
Exchange rate, national currency/EUR (pa)*	N/A	N/A
Unemployment rate (LFS, %, pa)	13.7	12.9
General government balance (ESA 2010 definition, % of GDP)	N/A	N/A
Total domestic credit (% change, eop)	7.9	6.8

Source: Economic Program Report 2023-2025 of the Ministry of Finance of Montenegro

NORTH MACEDONIA

The fallout from war, energy crises, and rising inflation weighed heavily on the economy

Slow economic recovery with a lot of obstacles

The economic recovery after the pandemic was slower than previously expected, given the start of the war conflict and the inflation caused by the rise of energy prices. So already disturbed supply chain did not manage to regenerate the economy because the production prices of all goods and commodities went through price increments, creating severe inflation.

It greatly affected the GDP growth rate, which did not meet the previous year's projections, with only a 2.1% increase. The slowing growth was also due to the fall in private consumption and government consumption, both due to the rise of the inflation rate. The industrial output declined in Q3 and Q4 of 2022, with 1.8% and 3.4 respectively. In the last quarter of 2022, the real investment declined by 5.3%, leaving no room for realizing the planned growth. Although the macroeconomic indicators at the end of the year are not all negative, there is still a lot more to go to achieve the necessary growth for economic recovery.

Revised lfs data give more realistic knowledge of the labour market

According to the Census of Population, Households and Dwellings in the Republic of North Macedonia from 2021, the total resident population is significantly

lower than the population estimations used in the Labour Force Survey (LFS) of the previous years. The State Statistical Office published the LFS data for 2021 and 2022 (annually and by quarters) processed according to the forecasts based on the data on the number and structure of the population from the Census 2021. This data illustrates a more realistic overview of the changes in the main labour market categories. Therefore, it is necessary to observe annual data for the structure of the working-age population (15-64) for 2021 and 2022.

The analysis shows that the decrease in the working-age and active populations continues, which in 2022 amounts to 1,201,811 and 797,868 persons, respectively. At the same time, the scope of the inactive population is increasing, and in 2022 reached 403,941 persons. The activity rate is 66.4% (2022) and indicates that about one-third of the working-age population (15-64) is still inactive. It implies that a significant portion of the potential labour force is out of economic activity in circumstances of a rising lack of labour force in the country. In the observed years, a minor decrease is recorded in the number of employed (from 682,206 to 681,856 persons) and a relatively higher decline in the unemployed (from 126,174 to 116,011 persons). Consequently, the employment rate amounts to 56.4% (2021) and 56.7% (2022), while the unemployment rate has decreased from 15.6% to 14.5%, respectively.

The LFS data for Q3 and Q4 of 2021 and 2022 referring to the labour force, show that the same trend of changes is characteristic for each category as for the annual data, but with small differences in the absolute numbers and rates. In Q3/2022 compared to Q3/2021, there is a decrease in the active population by 2.8%, the employed by 1.8%, and the unemployed persons by 8.4%. Similar are the changes in Q4/2022 related to Q4/2021 when the decrease amounts to 2.8%, 1.9%, and 8.0% for the same categories. As for the activity rate and unemployment rate, there is a slight decline, and their numerical values in Q3/2022 are 66.4% and 14.4%, while in Q4/2022 are 66.1% and 14.2%. A slight increase can be noticed in the employment rate, which in the last two quarters of 2022 amounted to 56.8% and 56.7%.

Borrowing and concerns in public finances continue

According to the Budget for 2022, total revenues are increased by 11.5 % compared with 2021, and total expenditures are increased by 8.4%. The budget deficit in 2022 narrowed moderately to 4.5% of GDP from 5.4% in the previous year. The reduction of the deficit results from the further post-pandemic recovery of budget revenues and, above all, of higher tax revenues. By the end of 2022, 104.8% of public revenues were realized. Thereby, there is an overrun in taxes and contributions. There was a total realization of 101.6% of the expenditures. The budget deficit was realized at 83%.

Public debt has increased by 568 million euros, totalling 7,703 million euros at the end of 2022. The internal indebtedness of public entities, especially public enterprises, and institutions in healthcare, is of particular concern.

According to Budget 2022, all types of taxes are expected to increase in Budget 2023. Some of them are the result of high inflation, while others are the result of tax reforms. Having in mind that large borrowings for upcoming capital road projects are likely to follow, it is justified to be concerned about the sustainability of public finances.

Monetary and banking sector - tightening the monetary policy to cope with the further inflation expectation

The year 2022 was characterized by the war in Ukraine, energy crises, and the highest inflation, which took longer and had a broader scope. Hence the National Bank of the Republic of North Macedonia continued implementing restrictive monetary policy. The interest rate on CB bills increased to 4.75% at the end of 2022, signalling a lasting tightening of the monetary policy aimed at securing price stability and supporting citizens' purchasing power. Such policy shifted the banking interest rate upward, inevitably influencing the bank products.

According to the data, the banking sector remained stable and provided solid economic credit support. Credits demonstrate an increase in 2022, with a major driver in the growth of corporate loans and a smooth rise in household loans. The growth of green loans in 2022 also accelerates, demonstrating increased awareness of the domestic creditors in financing renewable energy, energy efficiency, sustainable agriculture, and technological innovations. Foreign reserves remain adequate, securing price stability and the stability of the denar exchange rate.

Solid NPLs to total loans ratio stands at 3.1%, 3.2%, 3.3%, and 2.9 % in each quarter of 2022, demonstrating enhanced asset quality. ROAA with 1.6%, 1.7%, 1.7%, and 1.5% in each quarter of 2022, respectively, showing a minor increase since 2021, whereas ROAE ranged 14%, 14.3%, 13.7%, and 12.2% for each quarter of the year 2021 respectively. The data from the banking sector indicates that the banks' capital positions are stable, with a capitalization rate of 17.7%. The loan portfolio quality is currently good, and the banks' profitability is at a solid level. The profit realized by the banks at the end of the year 2022 clearly demonstrated the solid position of the banking sector in the financial system. Citizens are increasingly using digital channels with an upward trend in E-banking.

High inflation equals high uncertainty

In 2022, inflation soared throughout Europe, and North Macedonia was not left behind. The year started with the inflation rate being 3.2% and reached a historical high of 19.4% in Q4 of 2022. The average inflation rate for the same year was 14.2%, which unfortunately remains one of the highest in history. Facing increasing inflation, eroding purchasing power, and business confidence, the government tried to suppress the roaring inflation with measures directed toward the most vulnerable groups of the population.

The initial increase in the inflation rate observed in the previous years was primarily a result of the increased prices of food products, mainly because of the supply chain disruption due to the pandemic. However, according to the data, the more fuel to the already fired-up inflation was the substantial increase in energy prices initially caused by the war conflict in Ukraine.

The measures imposed at first targeted the trade margin of the retailers and wholesalers. Still, after the rise in production and consumer prices, the government decided to freeze the prices of basic and necessary products. Combined with the increase of the basic interest rate of the National Bank and the fall in government spending, this did take effect and slowed the rising inflation. Additional measures to help the population were also put in place. One of them was a direct subsidizing by the government for the part of electricity that households were using, leading to even more effective stabilization of the prices. Nevertheless, inflation still disrupts the normal living conditions of many people. Further measures are considered to reduce the prices of food and electricity and consequently reduce the possible inflation shocks in the future.

Significant expansion of the current account deficit

In 2022, further disruptions in global supply chains, the emergence of the Russian-Ukrainian military conflict, and disruptions in the markets of primary products (especially energy) led to a significant expansion of the current account deficit in the balance of payments, reaching a level of 6% of GDP, which is 2.9 p.p. greater compared to the previous year. This is entirely due to the increased trade deficit, i.e., the higher growth of imports than exports of goods, for the most part resulting from the expanded energy deficit in conditions of global price shocks among energy producers, the high energy dependence of the domestic economy on imports, as well as the high growth of food stock prices, particularly in the first half of the year. Other components of the current account have a positive contribution, especially the increased surplus in services and the surplus in secondary income (due to the growth of private transfers due to the complete lifting of restrictive measures related to travel).

Solid positive flows were also achieved in the financial account of the balance of payments, especially in the second half of 2022. It is due to realized net inflows in almost all components except the "currencies and deposits" category. The inflows mostly come from direct investments, which in 2022 amount to 670.2 million euros and show particular growth compared to the previous year.

Positive flows in the financial account enabled the full financing of the current account deficit and the simultaneous growth of foreign exchange reserves. The growth of foreign exchange reserves was also supported by transactions for the account of the state, i.e., the borrowing of the state on the international market through a bond for the German financial market and the withdrawal of the first tranche of the Instrument for Prudence and Liquidity (PLL) approved by the International Monetary Fund. This way, foreign exchange reserves are kept in a safe zone during the year.

Gross foreign debt in 2022 is 80.7% of GDP, almost identical to 2021 (80.8% of GDP). This realization aligns with reducing public debt by 3.0 pp of GDP, with simultaneous private debt growth by 3.0 pp of GDP. According to this data, the indebtedness of the domestic economy is still in a safe zone.

Table NM1 Main economic indicators

	Total 2021 year	2022 Q1	2022 Q2	2022 Q3	2022 Q4	Total 2022 year
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**3.9**	2.2	4.0	2.0	0.6	**2.1**
Real private consumption (% change, yoy)	**8.1**	2.5	1.5	5.4	3.0	**3.1**
Real government consumption (% change, yoy)	**-0.4**	2.7	-5.2	-4.7	-2.8	**-2.6**
Real investment (% change, yoy)	**0.9**	31.8	41.5	9.0	-5.3	**15.0**
Industrial output (% change, yoy)	**1.4**	3.5	1.9	-1.8	-3.4	**-0.3**
Unemployment rate (LFS, % pa)	**15.4**	14.7	14.5	14.3	14.0	**14.4**
Nominal GDP (EUR million)	**11,690**	2,765.1	3,089.1	3,283.9	3,761.0	**12,898**
GDP per capita (EUR)	**6,385**	1,511.0	1,688.0	1,794.0	2,055.0	**7,048**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**3.6**	1.3	3.7	9.4	16.3	**8.0**
Consumer prices (% change, yoy, pa)	**3.2**	7.7	12.3	17.2	19.4	**14.2**
Producer prices (% change, yoy, pa)	**8.5**	19.6	21.7	25.2	21.2	**21.9**
Average gross wage (% change, yoy, pa)	**2.4**	0.0	-1.6	-4.4	-4.4	**-2.7**
Exchange rate (MKD/EUR, pa)	**61.63**	61.69	61.66	61.51	61.62	**61.62**
Exchange rate (MKD/USD, pa)	**52.11**	54.98	57.80	61.01	60.52	**58.60**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**6,000.43**	1,667.14	1,886.87	1,845.03	1,946.83	**7,345.87**
Exports of goods (EUR, % change, yoy)	**24.5**	18.9	23.9	21.4	25.3	**22.4**
Imports of goods (EUR million)	**8,370.76**	2,517.41	2,786.23	2,726.48	2,768.53	**10,798.65**
Imports of goods (EUR, % change, yoy)	**26.4**	32.0	33.5	34.7	17.7	**29.0**
Current account balance (EUR million)	**-366.4**	-388.8	-234.0	96.6	-246.2	**-772.4**
Current account balance (% of GDP)	**-3.1**	-14.1	-7.6	2.9	-6.5	**-6.0**
Foreign Direct Investment net inflows (EUR million)	**387.5**	111.7	137.7	181.8	239.0	**670.2**
Foreign exchange reserves (EUR million, eop)	**3,643.3**	3,272.5	3,116.1	3,753.8	3,862.9	**3,862.9**
Foreign debt (EUR million, eop)	**9,576.6**	9,980.9	10,361.9	11,096.6	10,855.8	**10,855.8**
GOVERNMENT FINANCE						
Revenues (MKD million)	**218,021**	57,106	59,207	62,200	64,520	**243,033**
Expense (MKD million)	**256,906**	63,775	62,882	67,912	83,947	**278,518**
Net = Gross operating balance	**-38,885**	-6,669	-3,675	-5,712	-19,427	**-35,485**
Net acquisition of non-financial assets (MKD million)	**-21,480**	-4,636	-3,108	-3,221	-15,400	**-26,364**
Net lending/borrowing (MKD million)	**-17,405**	-2,033	-567	-2,491	-4,027	**-9,121**
Domestic government debt (EUR million, eop)	**2,431.4**	2,466	2,465.5	2,602.4	2,597.4	**2,597.4**
Foreign government debt (EUR million, eop)	**3,648.9**	3,647.4	3,631.3	3,895.1	3,983.7	**3,983.7**
Total government debt (eop. % of GDP)	**52.0**	47.4	47.3	50.4	51.0	**51.0**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**8.7**	0.3	-0.4	2.3	6.0	**6.0**
Broad money, M4 (% change, yoy, eop)	**7.0**	2.8	1.4	2.9	5.1	**5.1**
Total domestic credit (% change, yoy, eop)	**8.3**	9.8	10.0	9.9	9.4	**9.4**
DMBs credit to households (% change, yoy, eop)	**7.8**	7.9	7.7	7.6	7.3	**7.3**
DMBs credit to enterprises (% change, yoy, eop)	**8.7**	11.9	12.4	12.6	11.5	**11.5**
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)	**3.2**	3.1	4.0	4.4	4.5	**4.2**
DMBs credit rate for households short-term (%, pa)	**4.2**	3.3	3.3	3.4	3.1	**3.3**

Conventional abbreviations: pa - period average, eop – end of the period, yoy – year on year, MKD-Macedonian denar, EUR- euro, USD – U.S. dollar, DMB – deposit money bank.

Source: Ministry of Finance of the Republic of North Macedonia, National Bank of the Republic of North Macedonia,
State Statistical Office of the Republic of North Macedonia and https://www.ceicdata.com/en/indicator/macedonia/gdp-deflator-growth

Policy assumptions and projections summary

The future of the economic recovery is still unclear, mainly because of the recession in the EU region. This also impacts the possibility of the macroeconomic stability of the country. However, due to certain measures, inflation is expected to fall, reaching 9.2% by the end of this year and stabilizing even further in 2024. The inflation and the possibility of a recession in the region did and will impact the growth, expected to be only 2.4 in 2023, mainly driven by the change in real investment, projected to be 10% at the end of 2023.

The growth dynamic will not be created with the support of private consumption or government expenditures because of the lingering effects of inflation that may further complicate the macroeconomic stability.

Considering the current situation in the age structure of the population, identified with the Census data from 2021, a further intensified decrease in the working-age population (15-64)

and higher participation of the population aged 50-64 can be expected. Due to the lower inflow of new working-age generations in the labour market, unemployment will decrease also. As for the changes in employment, they will depend on the economic situation in North Macedonia, particularly on the new investments in the real sector and on the mitigation of the current labour market supply and demand mismatch.

Permanent adjustment in the monetary policy instruments closely monitored by the National Bank of the Republic of North Macedonia will ensure the country's price and financial stability, considering the ongoing wage growth trend and correlation with productivity growth. Further monetary tightening is expected due to the conditions in the international markets, where central banks implement a more intense cycle of monetary tightening and permanent increase of interest rates.

External sector negative contribution is expected to decrease during the forecast period. This is in accordance with the foreign demand increase and reduced import growth. Such conditions are expected to lead to a narrowing of the current account deficit, which will be due to a significant improvement in the merchandise trade balance likely to occur as a result of lower commodity prices, as well as stronger external demand, supported by the reduction of pressures in the supply chain.

Table NM2 Summary of projections

	2023	2024	2025
Real GDP (% change)	**2.4**	**2.7**	**2.9**
Real private consumption (% change)	3.3	2.1	3.7
Real government consumption (% change)	0.3	0.2	0.2
Real investment (% change)	10.0	5.5	3.0
Exports of goods and services (constant prices, % change)	6.0	5.5	5.0
Imports of goods and services (constant prices, % change)	5.8	4.5	4.5
Current account balance (% of GDP)	-4.2	-3.7	-3.2
Consumer prices (% change, pa)	9.2	3.0	2.0
Exchange rate, national currency/EUR (pa)	N/A	N/A	N/A
Unemployment rate (LFS, %, pa)	14.2	13.9	N/A
General government balance (ESA 2010 definition, % of GDP)	-4.8	-4.2	-3.3
Total domestic credit (% change, eop)	N/A	N/A	N/A

Sources: International Bank for Reconstruction and Development / The World Bank, The Macro Poverty Outlook (MPO), April, 2023, available at: https://thedocs.worldbank.org/en/doc/d5f32ef28464d01f195827b7e020a3e8-0500022021/related/mpo-mkd.pdf and European Commission, Directorate-General for Economic and Financial Affairs, European Economic Forecast, Spring 2023, EUROPEAN ECONOMY, Institutional Paper 200, May 2023

S E R B I A

Serbia's economy faced significant inflationary pressures during 2022

The health, financial, and geopolitical challenges the world has faced over the past few years reshaped the global economic landscape from the inside out and generated massive disruptions to which Serbia, as a developing country, has not remained immune. Namely, these disruptions placed pressure on Serbia's economic prospects, threatened national financial stability, and brought the economy's fragilities to light. Serbia's economy experienced a remarkable increase in inflation, i.e., reached "multi-decade inflation highs", as representatives of the Chamber of Commerce and Industry of Serbia argue.

Domestic demand was a major driver of real GDP growth in 2022

The latest available data on the economy's prime health indicator - real GDP, confirm that the efforts Serbia made in order to maintain macroeconomic stability in the 2022 twelve-month interval were quite futile. Namely, Serbia's real GDP growth decreased from 7.5% in 2021 to 2.3% in 2022. The second half of 2022 saw a particularly significant decline in economic activity growth (the real GDP value declined by 80.8% compared to the first half of 2022). Factors contributing

to the aforementioned state of affairs were the intensification of cost pressures, the declining external demand tendency, the flawed summer agricultural season, and the genuine drop in the construction industry sector activity. On the contrary, as National Bank of Serbia representatives claim, domestic demand was the primary driver of the real GDP growth recorded in 2022. As for 2023, domestic demand will likely remain the major generator of economic growth throughout the year (private consumption primarily, due to the preserved labour market), whilst net exports will likely emerge as a major generator of the slowdown in economic activity (due to the still expected high volume imports of the most important energy sources - gas and oil, and the expected slowdown in the economic growth of Serbia's main trading partners). When it comes to real private consumption and real government consumption, the National Bank of Serbia's data indicates that these indicators' values fell sharply in 2022 (from 7.8% in 2021 to 3.8% in 2022, and from 4.2% in 2021 to 0.4% in 2022, respectively). A similar scenario applies regarding the real investment value - national statistical data provide evidence of a strong decrease in real investment volume in 2022 (from 12.8% in 2021 to -0.4% in 2022).

2022 saw a decline in Serbia's unemployment rate

Serbian statistics on unemployment for 2022 still exhibit some consequences of the crisis and the upheavals that affected the labour market. However, the Labour Force Survey's data indicate a decline in the unemployment rate in 2022, mirroring the gradual stabilization of the national labour market (the unemployment rate in 2022 amounted to 9.6%, representing a drop of 1.5 percentage points compared to the 2021 rate value). The data worth noting indicate that the unemployment rate in the national male population increased in 2022 compared to 2021 (by 0.5 percentage points), whilst the unemployment rate in the national female population decreased during the same interval (by 2.1 percentage points). Additionally, the latest available country-specific data from Serbian National Employment Service indicate that at the end of the 2022 second six-month interval, the number of unemployed persons (actively seeking employment) amounted to 291,100, while the number of employed persons totaled 2,888,700. Observed region-specific data unveil that the most significant year-on-year (2021-on-2022) increase in employment was recorded in Belgrade region (12,600 persons), whilst the most considerable decrease in employment was recorded in the Vojvodina region (28,100 persons).

Serbia's economic output per person rose in 2022

Observing the nominal GDP values, Serbia reached EUR 16,775 million in the last quarter of 2022, which is an increase of 11.4% and 22.7% compared to the same interval of the preceding year and the first quarter of 2022, respectively. Regarding the country's average prosperity and well-being indicator (GDP per capita) value for the last quarter of 2022 (EUR 2,489), it is noticeable that economic output per person rose considerably, recording a 2021-on-2022 change of 12.1% and the 2022 Q1-on-Q4 change of 22.9%.

Prices, wages, and exchange rates

During the previous year, strong inflationary pressures were recorded in the Republic of Serbia. At the end of 2022, the annual inflation rate was 15.1%, while the average was 11.9%. The inflation rate would certainly have been higher if the Government had not tried to keep inflation under control through administrative measures, freezing and limiting the prices of certain food products and some energy

products. In response to high inflationary pressures, the National Bank of Serbia (NBS) increased the key interest rate from 0.5% to 5.0% in 2022. The deposit facility interest rate and lending facility interest rate were raised to the same extent, from 0.5% to 4.0% and 2.5% to 6.0%, respectively. Observed by main groups according to the destination of consumption and their participation in total consumption, the highest price growth during the previous year was recorded in the groups of Food and non-alcoholic beverages (23.4%), Housing, water, electricity, gas, and other fuels (19.3%). %) and Transport (9.2%). High inflation is primarily a consequence of the increase in the world price of energy, primary agricultural products, and other industrial raw materials due to war conflicts in Ukraine and disruptions in global supply chains. This led to an increase in the producer price by 13.3%. The cause of high inflation is the excessive expansionary fiscal and monetary policy implemented by the state in 2020 and 2021, which led to faster growth in demand than production. Regarding core inflation (excluding energy, food, alcohol, and cigarettes), it amounted to 10.1% in 2022. On the foreign exchange market, due to strong foreign exchange inflows and interbank foreign exchange market interventions by NBS, the relative stability of the national currency was maintained. During 2022, the dinar appreciated nominally against the euro by 0.2%, while against the dollar, it depreciated nominally by 6.0%, primarily due to the euro's depreciation on the international market. In the same period, the year-on-year nominal growth of gross wage was 13.8%, while the real increase was 1.7%. The average gross wage at the end of 2022 amounted to RSD 115,315. High inflation and strong growth in nominal wages in conditions of an unchanged exchange rate of the dinar against the euro increase the costs of our economy, which is becoming less and less competitive among our largest trading partners.

The energy import prices fluctuations reflected in the significant movements in the current account deficit

According to the National Bank of Serbia's data, Serbia's current account deficit significantly widened in 2022, reaching EUR 4,139 million (or 6.9% of the country's GDP), representing an 83% increase compared to 2021. However, over half of the entire value was mainly realized in the first four months of the year due to the deterioration in the goods trade balance driven by sharp rises in energy import prices and the worsening of the primary income balance. With a decrease in energy prices, the current account deficit growth was moderated, while the improvement of the balance of secondary incomes and the trade in the services balance also favorably influenced the current account deficit. On the other side, despite the substantial deterioration of the current account deficit, it was fully covered by foreign direct investments (FDIs), of which net inflows amounted to EUR 4,306 million (or 7.1% of the country's GDP) in 2022. The bulk of FDI inflows, which in 2022 increased by 18.7% year-on-year, originated from China with a remarkable EUR 1,399 million (more than double year-on-year increase), followed by Great Britain (EUR

363 million) and the Russian Federation (EUR 320 million). When it comes to EU member states, the main investors were Germany (EUR 286 million), Austria (EUR 274 million), and the Netherlands (EUR 222 million).

The trade growth continued in 2022, along with the widening of the trade deficit

Considering foreign trade performance based on the NBS data, a positive trend of total merchandise trade growth recorded in the previous period also continued in 2022 but was more pronounced. Namely, total trade increased by 31.5% year-on-year, reaching EUR 63,180 million. The manufacturing and mining sectors experienced robust export growth in 2022, which resulted in an intense rise in goods exports of 28%. Imports of goods rose by 34.1% in 2022, led by intermediate products (around 60% of total imports), of which growth in energy imports contributed a third. Due to the pronounced growth in imports outpaced surging exports, the trade deficit widened by 55.4% compared to 2021 and amounted to EUR 9,353 million. The coverage of imports by exports was 74.2% and is lower than the coverage in the same period of 2021 when it reached 77.8%.

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, showed that in 2022, in terms of exports, *Machinery and transport equipment and Manufactured goods classified chiefly by material* were the main sections, with a share of 26.5% and 21.1%, respectively, in total exports of goods. On the imports side, the main sections were *Machinery and transport equipment* (22% of total imports of goods), *Manufactured goods classified chiefly by material* (17.5%), and *Mineral fuels, lubricants, and related materials* (17.5%). The share of the section *Mineral fuels, lubricants, and related materials* increased almost twice compared to 2021, primarily due to higher energy import prices.

The EU countries traditionally were Serbian main trade partners, with a share of 65.7% in exports and 55.7% in imports. By country, the five-top exporters of Serbian goods were Germany (13.7%), Bosnia and Hercegovina (7.5%), Italy (7.2%), Hungary (5.4%), and Romania (4.4%). The leading position in Serbian imports had China (12.1%), followed by Germany (11.4%), the Russian Federation (7.5%), Italy (6.6%), and Hungary (5.5%).

China remains the largest contributor to the trade deficit in 2022

China has been recording a continuously growing presence, both in terms of exports and imports, during the last few years. However, the key challenges in trade cooperation with this Asian country persist. The trade balance remains strongly in favor of China, i.e., trade deficit with China was the largest compared to other countries in 2022, accounting for 32% of Serbia's total trade deficit. At the same time, Serbian export is poorly diversified, comprising products with low-added value. Moreover, the alarming fact is that copper and copper ores represent 80% of total Serbian exports to China in 2022.

It became apparent that the Serbian authorities' more active and comprehensive strategic approach toward creating conditions for more balanced bilateral trade development between the two countries is necessary. In this regard, the Serbian Government announced the signing of the free trade agreement by the end of 2022, declaring that this is an incredible opportunity to gain favorable access to one of the world's largest markets. However, the sign was postponed to the end of 2023, so, when it comes to bilateral trade between Serbia and China, one can hardly expect substantial changes in the forthcoming period.

The government continued practices of taking discretionary fiscal policy measures

At the end of 2022, the Serbian fiscal deficit accounted 3.2% of GDP, which is 0.6% of GDP better than planned, given that the budget rebalances adopted at the end of 2022 envisaged a deficit of 3.8% of GDP. The bulk of the fiscal deficit (around 2.7% of GDP) was generated by the appropriations covering the losses of public companies from the energy sector (Srbijagas and Elektroprivreda Srbije), while the remaining basic budget flows were almost balanced (deficit of 0.5% of GDP). Overall, from autumn 2021 to May 2023, the Government intervened with as much as 3 billion euros (2.1 billion EUR of direct budget support, 0.9 billion EUR of state guarantees on loans for liquidity) to cover losses that occurred by the poor performance of non-reformed public companies from the energy sector.

It is envisaged that the situation with companies from the energy sector will considerably improve in 2023, mainly following the cut in prices of imported energy from the global markets and the increase in the price of energy on the domestic market. However, these expectations are not reflected in the latest Fiscal Strategy draft since the targeted deficit in 2023 has been set at 3% of GDP. According to the estimates of the Fiscal Council, the 2023 projection of the fiscal deficit is most likely overestimated for 1% of GDP, following the practice of the Government to overestimate public expenditures in order to secure fiscal space for discretionary spending apart from the adopted budget.

Indeed, in 2023, the Government continued taking discretionary fiscal policy measures, which increased during the pandemic. While budget planning and execution in Serbia has been legally well-established, in recent years, the Government made a couple of decisions on ad hoc spending (not imposed by the emergency situations) ruling out the adopted budget. For instance, in 2022, only one month after the Parliament adopted the 2022 budget, the fiscal authorities decided to pay out one-off aid of 100 EUR to youth aged 16-29. Unfortunately, such practice continued in 2023, as the Government recently announced plans to make an ad hoc increase in pensions and

salaries in the public sector for 5.5%, as well as to pay out one-off aid (around 85 EUR) to approximately 1.1 million children up to 16 years age. While these particular discretionary measures will not endanger fiscal solvency, continuing such practices in governing fiscal policy is very dangerous and, in the long run, may seriously undermine the credibility of the budget system and destabilize the overall process of mid-term fiscal planning.

Credit activities have plummeted following the increase in interest rates

Following the global tightening of the monetary policy and persistent domestic inflation, the National Bank of Serbia has continuously increased key policy rates in the second half of 2022 and the first half of 2023. The increase in key policy rate has translated on the other domestic interest rates; when Q1 in 2022 is compared to Q1 in 2023, the average money market rate increased by 3.4 percentage points (from 1.27% to 4.67%), the average short-term rate on new loans to enterprises more than doubled (from 2.38% to 5.23%), while the average short-term interest rate on new loans to households increased from 6.34% to 9.15%. Subsequently, credit activity slowed down. The plummet in credit activities is mostly pronounced in the case of enterprises, as yoy increase in credit to enterprises in Q1 2023 was only 1.8% (in the case of households, it was 4.2%). Since the inflation in the first half of 2023 is still high and persistent, the NBS will most likely keep the key policy rate high through the rest of 2023. Therefore, it is reasonable to expect that the domestic interest rate will also remain high and credit activities will not recover at least by the end of 2023.

Table SRB1 Main economic indicators

	Total 2021 year	2022 Q1	Q2	Q3	Q4	Total 2022 year
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**7.5**	4.0	3.8	1.0	0.5	**2.3**
Real private consumption (% change, yoy)	**7.8**	6.8	3.8	3.0	1.5	**3.8**
Real government consumption (% change, yoy)	**4.2**	2.7	4.9	-3.8	-2.4	**0.4**
Real investment (% change, yoy)	**12.8**	1.1	2.1	-1.9	-2.7	**-0.4**
Industrial output (% change, yoy)	**0.0**	0.6	3.8	-2.8	-1.5	**0.0**
Unemployment rate (LFS, % pa)	**11.1**	10.9	8.9	9.0	9.4	**9.6**
Nominal GDP (EUR million)	**53,329**	12,968	14,928	15,699	16,775	**60,370**
GDP per capita (EUR)	**7,800**	1,910	2,200	2,320	2,480	**8,910**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**5.9**	1.3	9.9	13.1	17.2	**10.6**
Consumer prices (% change, yoy, pa)	**7.9**	9.1	11.9	14.0	15.1	**15.1**
Producer prices (% change, yoy, pa)	**14.7**	17.0	19.7	16.9	13.3	**13.3**
Average gross wage (% change, yoy, pa)	**9.4**	14.3	14.2	15.0	12.8	**13.8**
Exchange rate (RSD/EUR, pa)	**117.58**	117.75	117.41	117.32	117.32	**117.32**
Exchange rate (RSD/USD, pa)	**103.93**	112.26	112.26	119.55	110.15	**110.15**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**21,018**	6,150	6,822	6,816	7,126	**26,913**
Exports of goods (EUR, % change, yoy)	**30.7**	31.7	34.6	25.9	21.5	**28.0**
Imports of goods (EUR million)	**27,038**	8,728	9,560	8,700	9,278	**36,266**
Imports of goods (EUR, % change, yoy)	**27.1**	55.2	43.3	26.2	18.2	**34.1**
Current account balance (EUR million)	**-2,266**	-1,532	-1,366	-404.3	-837	**-4,139**
Current account balance (% of GDP)	**-4.2**	-11.8	-8.7	-2.6	-5.0	**-6.9**
Foreign Direct Investment net inflows (EUR million)	**3,657**	559	938	1,286	1,520	**4,306**
Foreign exchange reserves (EUR million, eop)	**16,455**	14,296	14,776	16,502	19,416	**19,416**
Foreign debt (EUR million, eop)	**36,488**	36,921	38,260	39,964	41,885	**41,885**
GOVERNMENT FINANCE						
Revenues (RSD million)	**2,712**	685	809	780	830	**3,103**
Expense (RSD million)	**2,502**	683	626	625	868	**2,802**
Net = Gross operating balance	**210**	2	184	154	-38	**301**
Net acquisition of non-financial assets (RSD million)	**468**	81	125	98	222	**526**
Net lending/borrowing (RSD million)	**-257**	-79	58	56	-260	**-225**
Domestic government debt (EUR million, eop)	**11,607**	11,191	11,359	11,667	11,760	**11,760**
Foreign government debt (EUR million, eop)	**18,527**	19,406	19,956	20,753	21,566	**21,566**
Total government debt (eop. % of GDP)	**57.13**	56.55	55.93	55.94	55.68	**55.68**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**14.84**	8.05	1.23	-0.88	2.47	**2.47**
Broad money, M4 (% change, yoy, eop)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Total domestic credit (% change, yoy, eop)	**8.29**	7.54	7.32	7.31	4.46	**4.46**
DMBs credit to households (% change, yoy, eop)	**10.55**	10.53	9.56	8.07	6.06	**6.06**
DMBs credit to enterprises (% change, yoy, eop)	**7.06**	8.02	8.98	8.89	4.14	**4.14**
Money market interest rate (%, pa)	**0.16**	0.75	1.27	2.16	3.53	**1.93**
DMBs credit rate for enterprises short-term (%, pa)	**2.39**	2.38	2.55	3.32	4.49	**3.19**
DMBs credit rate for households short-term (%, pa)	**6.57**	6.34	6.51	7.62	8.02	**7.12**

Conventional abbreviations: pa - period average, eop – end of the period, yoy – year on year, RSD - Serbian dinar, EUR- euro, USD – U.S. dollar, DMB – deposit money bank.

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

Policy assumptions and projections summary

The draft of the Fiscal Strategy for 2024-2026 envisages solid and steady economic growth with gradually increasing rates in the mid-run, starting from 2.5% in 2023 up to 4.3% in 2026. As usual, an increase in private consumption is projected to be the main driver of the growth, followed by investments. On the other hand, join contribution of the government expenditure and net export to GDP growth over the same period is expected to be low, up to 0.3 percentage points. Inflation is expected to remain high in 2023 and is projected at 12.5%, while over 2024-2026, inflation is expected to decline sharply from 5% to 3%. On the external side, projections on the current account deficit are much more favorable than they were in 2022, which is underpinned by the positive developments in the foreign trade flows in the first half of 2023; the current account balance is projected to around 5% of GDP over the whole period. Eventually, the Fiscal Strategy envisaged a mid-term decline in fiscal deficit down to 1.5% in 2025, followed by the gradual decline of gross government debt from 54% in 2023 to 52% in 2026.

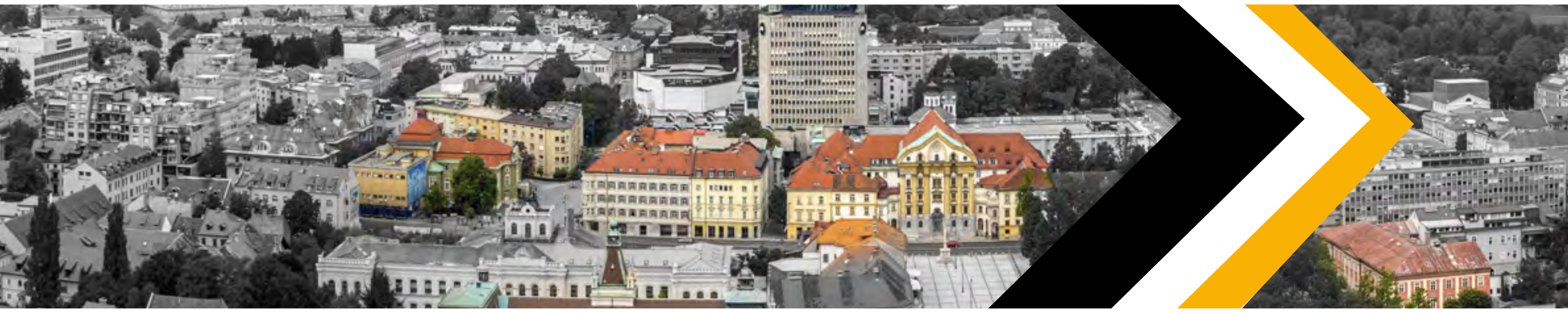
Regarding the realism of the Fiscal Strategy projections, the mid-term projections over the period 2024-2026 are realistic and in line with mid-term expectations on global macroeconomic developments. Nevertheless, the achievements of the predictions for 2023 are under a question mark, especially regarding real growth and inflation. The yoy inflation in May 2023 was 14.8%, which implies that in the rest of 2023, the rise in prices has to considerably slow down so that the average inflation rate in 2023 achieves the forecasted value. The plummet in credit activities and expectations on harsh monetary policy in 2023, combined with persistent inflation, is a major threat to households' consumption and investments. On the positive side, foreign trade flows in Q1 2023, which characterize significantly

higher real growth of exports of goods and services than imports (export has recovered, import of energy declined), are significantly more favorable than expected. In addition, the agricultural sector in 2023 will most likely perform much better relative to 2022 regarding weather conditions. The skepticism on the 2.5% projected growth rate has already been reflected in the international organizations' forecast, which varies from 1.9% (European Commission) up to 2.3% (World Bank). We agree that a projected growth rate of 2.5% will be hard to achieve. However, we are optimistic (mostly due to positive developments in the external sector) that the growth rate will not be significantly lower than projected; our estimates projects growth in 2023 at 2.3%.

Table SRB2 Summary of projections

	2023	2024	2025
Real GDP (% change)	**2.3**	**3.5**	**4.0**
Real private consumption (% change)	2.0	3.5	3.6
Real government consumption (% change)	0.0	1.0	0.8
Real investment (% change)	2.0	3.2	5.8
Exports of goods and services (constant prices, % change)	5.3	8.6	10.6
Imports of goods and services (constant prices, % change)	3.8	7.2	8.9
Current account balance (% of GDP)	-5.5	-5.2	-5.1
Consumer prices (% change, pa)	13.5	4.9	3.5
Exchange rate, national currency/EUR (pa)	117.3	117.3	117.3
Unemployment rate (LFS, %, pa)	9.0	8.7	8.2
General government balance (ESA 2010 definition, % of GDP)	2.8	-2.0	-1.3
Total domestic credit (% change, eop)	N/A	N/A	N/A

Source: Fiscal strategy for 2024, authors' estimates



SLOVENIA

War in Ukraine and the fight against inflation weigh on economic growth

A sharp slowdown in economic growth in the second half of 2022

Slovenia's gross domestic product expanded by 5.4% in 2022, with strong growth in the first half of the year before slowing in the second half due to Russia's war of aggression in Ukraine and the resulting severe energy crisis in Europe, coupled with rising inflation and increases in central bank interest rates. On a quarterly basis, year-on-year growth fell from 10.2% in the first quarter to 3.3% in the third quarter and almost came to a standstill in the last quarter (0.2% y-o-y) as manufacturing activity and growth in the export-oriented sectors weakened further. In early 2023, however, some positive momentum in domestic economic growth could be observed as government support to households and businesses hit by the energy crisis started to take effect.

Throughout 2022, domestic private consumption and gross investment positively impacted economic growth. Domestic demand played a more important role in the year's first half, and gross fixed capital formation in the second half. Exports, and thus industrial production, slowed down in the second half of the year and turned negative year-on-year in the last quarter

amid a slowdown in economic growth in Slovenia's main trading partners, a reduction in energy consumption, and tighter monetary conditions.

Private consumption - a key driver of gross domestic product growth

Domestic private consumption was the dominant contributor to economic growth in 2022, growing by 9.1%. In the first half of the year, it recorded double-digit year-on-year growth, boosted by the lifting of COVID-19 restrictions, the redemption of tourism vouchers and high employment levels. In the second half of the year, private consumption growth slowed significantly amid rising inflation and accelerated monetary tightening, eroding household purchasing power and consumer confidence. An even sharper decline in private consumption was cushioned by Government measures to control inflation and transfers to vulnerable groups.

Growth in government consumption slowed significantly from 5.8% in 2021 to 0.9% in 2022. The slowdown in growth was mainly due to the decline in expenditure on COVID-19 mitigation measures, including a reduction in the wage bill and a decline in financial transfers and subsidies to individuals and businesses.

Building construction drives growth in gross fixed capital formation

Investment activity remained strong in 2022, with annual growth in gross fixed capital formation at 7.8%. Growth was mainly driven by the increase in investment in buildings and structures, while year-on-year growth in investment in machinery and equipment came to a halt in the last quarter of the year (and turned negative in the first quarter of 2023) due to the decline in capacity utilization in manufacturing. In addition to growth in gross fixed capital formation, changes in inventories also contributed to growth in real investment, which was 12.4% higher in 2022 than in the previous year.

Decline in industrial output

Against the background of rising prices for capital goods and raw materials, a decline in external demand and tighter financial conditions, industrial production growth fell sharply in 2022 compared to 2021 and turned negative in the last quarter of the year. Annual growth was 1.3%, driven by increases in mining and quarrying (12.9%) and manufacturing (3.8%), while production of electricity, gas, steam and air conditioning fell (-26.4%).

Production growth in the manufacturing sector was volatile last year before slowing in the final quarter. It was mainly driven by high-technology industries, including the pharmaceutical industry and the manufacture of ICT equipment, and by the manufacture of electrical equipment and the manufacture of other transport equipment. On the other hand, production volumes fell in the automotive industry due to supply chain bottlenecks and restructuring towards electric vehicles and in the more energy-intensive industries.

The current account turns negative on weaker goods exports

Amid high uncertainty in the international environment, growth in exports of goods in 2022 was much weaker than in the previous year and turned negative in the last quarter of the year. At the annual level, growth in exports of goods was 2.4%, significantly lower than growth in services exports (23.8%), the latter being boosted by pent-up demand, particularly on tourism-related services.

Growth in imports of goods outpaced that of exports in 2022, resulting in a negative balance of trade in goods, while the surplus in the balance of services continued to increase, driven by tourism. After being in surplus for ten years, the current account balance turned negative in 2022 (-0.4% of gross domestic product).

Record low unemployment level

Labour market conditions continued to improve in 2022. According to the Labour Force Survey, the unemployment rate fell to a record low of 3.5% in the last quarter of 2022 and stood at 4.0% on an annual basis, 0.7 percentage points lower than in 2021.

The number of persons in employment increased by 1.5% compared to 2021. In terms of economic activity, year-on-year growth was the highest in accommodation and food service activities (largely due to the very low 2021 base) and in water supply, sewerage and waste management. Strong year-on-year growth in employment was also observed in administrative and support service activities in arts, entertainment and recreation, agriculture and construction. The employment of foreign workers has increasingly contributed to employment growth due to domestic labour shortages.

Real wages fall

The nominal growth of the average gross wage in 2022 was moderate (2.8%) due to the decrease in the average nominal gross wage in the public sector (-2.5%). The decline in the public sector gross wage was observed in the year's first quarter and resulted from the cessation of most COVID-19 bonuses. Since autumn 2022, it has picked up again as a result of the agreement with the public sector unions, which regulates measures relating to salaries and other labour costs for 2022 and 2023. On the other hand, the average gross wage in the private sector increased by 6.2% in nominal terms last year amid ongoing labour shortages and the increase in the minimum wage. In real terms, however, the average gross wage fell due to high inflation.

2022 was marked by high inflation

In 2022, the average annual price increase was 8.8%. In the early months of 2022, the most significant year-on-year increase was observed in energy prices due to Russia's invasion of Ukraine, followed by an increase in food and transport services prices. In the following months, the increase in the prices of these products and services, combined with the recovery in demand after COVID-19, supply chain bottlenecks and wage growth, also affected the price growth of non-energy industrial goods and services. The contribution of services prices and food prices to inflation increased towards the end of last year, while the contribution of energy prices declined as a result of the slowdown in economic activity and government measures to curb rising energy prices.

Under the impact of supply-side constraints and energy prices, producer prices increased even more markedly last year. The producer price index peaked at 22.5% in May and declined only slightly to 19.3% in December. Growth was mainly driven by the rise in energy prices, but prices of goods, especially intermediate goods, also increased.

Strong growth in loans to non-financial corporations and households

Year-on-year growth in the volume of bank loans to non-financial corporations rose sharply in the first three quarters of 2022, reaching 16.9% in the third quarter before slowing to 12.5% in the final quarter. Overall, the annual growth rate was well above the long-term average. Growth in loans to households was lower but still solid and accelerated in the first nine months of the year. It was entirely driven by growth in housing loans. On the other hand, the year-on-year contraction in consumer loans, which had already begun in 2021, continued in the first three quarters of 2022, albeit at a slower pace. In October, consumer loans resumed slow but steady growth.

General government deficit down

The general government balance remained in deficit in 2022, but the government deficit-to-gross domestic product ratio fell from 4.6% in 2021 to 3.0% in 2022, thanks to strong gross domestic product growth in the first three quarters of the year and the phasing out of pandemic-related support. The improved general government balance was the result of higher revenue growth than expenditure growth. Total general government revenue was 6.8% higher in 2022 than in the previous year. Despite new measures to mitigate the impact of rising energy prices on households and businesses, general government expenditure increased by 3.6%, much less than in 2021, due to lower spending on subsidies to the corporate sector and public sector wages.

In 2022, consolidated general government gross debt stood at 69.9% of gross domestic product, 4.6 percentage points lower than in the previous year.

Table SLO1 Main economic indicators

	Total 2021 year	2022 Q1	2022 Q2	2022 Q3	2022 Q4	Total 2022 year
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**8.2**	10.2	8.6	3.3	0.2	**5.4**
Real private consumption (% change, yoy)	**9.4**	20.3	13.2	3.3	2.6	**9.1**
Real government consumption (% change, yoy)	**5.8**	4.8	0.8	-0.6	-1.0	**0.9**
Real investment (% change, yoy)	**15.1**	26.3	16.7	7.6	0.5	**12.4**
Gross fixed capital formation (% change)	**13.7**	9.4	7.3	8.7	5.9	**7.8**
Industrial output (% change, yoy)	**10.2**	6.3	2.9	2.1	-5.7	**1.3**
Unemployment rate (LFS, % pa)	**4.7**	4.3	4.2	4.0	3.5	**4.0**
Nominal GDP (EUR million)	**52,208**	13,313	15,017	15,309	15,349	**58,989**
GDP per capita (EUR)	**24,770**	6,318	7,130	7,260	7,273	**27,975**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**2.6**	0.3	6.4	11.7	10.2	**7.2**
Consumer prices (% change, yoy, pa)	**1.9**	6.0	8.5	10.7	10.1	**8.8**
Producer prices (% change, yoy, pa)	**5.5**	15.6	21.7	21.1	19.9	**19.6**
Average gross wage (% change, yoy, pa)	**6.1**	-1.2	0.8	5.0	6.5	**2.8**
Exchange rate (EUR/USD)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Exchange rate (EUR/USD)	**1.18**	1.12	1.06	1.01	1.02	**1.05**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**35,255**	9,988	10,933	10,780	10,650	**42,350**
Exports of goods (EUR, % change, yoy)	**13.4**	4.0	3.2	8.5	-5.3	**2.4**
Imports of goods (EUR million)	**34,373**	10,551	11,667	11,230	11,440	**44,889**
Imports of goods (EUR, % change, yoy)	**17.2**	15.0	9.4	11.9	-2.1	**8.2**
Current account balance (EUR million)	**1,986**	-254	-95	180	-79	**-247**
Current account balance (% of GDP)	**3.8**	-1.9	-0.6	1.2	-0.5	**-0.4**
Foreign Direct Investment net inflows (EUR million)	**1,795**	644	593	472	-68	**1,642**
Foreign exchange reserves (EUR million, eop)	**646**	709	742	781	757	**757**
Foreign debt (EUR million, eop)	**50,818**	51,845	51,792	52,183	51,885	**51,885**
GOVERNMENT FINANCE						
Revenues (RSD million)	**23,448**	5,783	6,350	6,353	6,563	**25,049**
Expense (RSD million)	**25,858**	6,199	6,916	6,511	7,203	**26,828**
Net = Gross operating balance	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Net acquisition of non-financial assets (RSD million)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Net lending/borrowing (RSD million)	**-2,410**	-417	-566	-158	-639	**-1,779**
Domestic government debt (EUR million, eop)	**32,921**	35,228	35,283	35,607	35,546	**35,546**
Foreign government debt (EUR million, eop)	**2,954**	2,526	2,517	2,517	2,299	**2,299**
Total government debt (eop. % of GDP)	**74.5**	74.6	73.5	72.4	69.9	**69.9**
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)	**12.2**	9.7	2.3	5.0	3.2	**3.2**
DMBs credit to households (% change, yoy, eop)	**5.1**	6.8	8.1	8.5	7.6	**7.6**
DMBs credit to enterprises (% change, yoy, eop)	**5.2**	7.7	12.4	16.9	12.5	**12.5**
Money market interest rate (%, pa)	**-0.57**	-0.58	-0.58	-0.08	1.20	**-0.01**
DMBs credit rate for enterprises short-term (%, pa)	**1.7**	1.9	1.4	2.0	3.3	**2.2**
DMBs credit rate for households short-term (%, pa)	**2.9**	3.1	3.0	3.5	5.0	**3.6**

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

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

Policy assumptions and projections summary

Weak medium-term economic growth

In its Spring 2023 Economic Forecast, the European Commission estimates that Slovenia's gross domestic product growth will decline sharply from 5.4% in 2022 to 1.2% in 2023 before rising to 2.2% in 2024. The spring forecast of the national Institute for Macroeconomic Analysis and Development (IMAD) is slightly more optimistic. It expects economic growth to slow to 1.8% this year and to pick up to around 2.5% in the medium term. The downside risks to the forecast are somewhat more pronounced than the upside risks and relate to a possible persistence of high inflation, which would lead to a further tightening of financing conditions, an escalation of Russia's war in Ukraine and a pandemic situation. On the upside, a stronger recovery in domestic and foreign demand or a faster fall in inflation are plausible.

The projected slowdown in economic growth this year is mainly due to a significant decline in private consumption growth compared to 2022, and a decline in private investment. According to IMAD's forecast, private consumption growth will fall to 1.2% as inflation and tighter credit conditions continue to erode household purchasing power and consumer confidence. Over the medium term, private consumption is projected to increase only moderately (1.8% in 2024 and 2025).

Growth in gross fixed capital formation is projected to decline to 2.8% in 2023 and further to 2.2% in 2024 as a result of a decline in business investment amid a worsening macroeconomic outlook in the international environment, less favourable financing conditions, high prices of investment goods, and a decline in real revenues and profits. Growth in gross fixed capital formation is expected to be driven mainly by public investment related to the absorption of RRF-financed measures and of EU Cohesion Policy Funds. Growth in government consumption is also expected to play a more prominent rule in gross domestic product growth in 2023 and 2024 compared to last year. It is projected to grow by 1.2% this year and to strengthen to 1.8-1.9% in the next two years, mainly driven by the increase in health expenditure. The general government deficit is projected to widen to 3.7% of gross domestic product in 2023 before narrowing to 2.9% in 2024 as subsidies to the corporate sector to mitigate the economic impact of high energy prices phase out and public investment declines following the end of the 2014-2020 EU multiannual financial framework.

Growth in exports of goods and services is projected to weaken significantly in 2023, mainly as a result of slower growth in external demand, but also due to cost pressures. However, growth in imports of goods and services is projected to decline even more sharply amid weaker domestic demand, so that the contribution of net exports to gross domestic product growth will turn positive in 2023 and strengthen further in 2024 as a result of the recovery in global demand and an improvement in the terms of trade.

The current account balance is also projected to turn positive this year (0.3% of gross domestic product) and its surplus to increase slightly but stay below 1% over the medium term. The surplus will mainly result from an increase in the services surplus, but also from a reduction in the goods trade deficit in 2023.

Employment growth is expected to slow this year amid the economic slowdown and to increase only moderately over the next two years due to already high employment levels and labour supply bottlenecks. The unemployment rate is expected to decline from 4.0% in 2022 to 3.8% in 2024. In a context of historically low unemployment and an ageing population, managing shortages in the labour market will become an increasing challenge over the projection horizon.

The priority over the projection horizon is to achieve sustained disinflation. Inflation reached 8.8% in 2022 and is expected to ease in the second half of 2023. However, according to the European Commission and IMAD forecasts, it will remain relatively high on average this year – 7.0% and 7.1%, respectively. It will be driven by higher prices for services, while the contribution of food and energy prices is expected to decline gradually. According to the EC and IMAD, inflation is expected to fall to 3.8% and 4.2% respectively in 2024, thus, remaining above pre-pandemic levels.

Table SLO 2 Summary of projections

	2023	2024	2025
Real GDP (% change)	**1.8**	**2.5**	**2.6**
Real private consumption (% change)	1.2	1.8	1.8
Real government consumption (% change)	1.2	1.8	1.9
Real investment (% change)	N/A	N/A	N/A
Gross fixed capital formation (% change)	2.8	2.2	5.0
Exports of goods and services (constant prices, % change)	2.7	4.1	4.2
Imports of goods and services (constant prices, % change)	1.8	3.6	4.3
Current account balance (% of GDP)	0.3	0.7	0.9
Consumer prices (% change, pa)	7.1	4.2	2.4
Exchange rate, national currency/EUR (pa)	N/A	N/A	N/A
Unemployment rate (LFS, %. pa)	4.0	3.8	3.7
General government balance (ESA 2010 definition, % of GDP)	-3.7	-2.9	na
Total domestic credit (% change, eop)	N/A	N/A	N/A

Source: Institute for Macroeconomic Analysis and Development – Spring Forecast of Economic Trends 2023, European Commission – Spring 2023 Economic Forecast.

ANALYSIS

Environment and GDP: Environmental protection in SEE countries

This issue of the SEE-6 Economic Outlook focuses on a brief analysis of the environmental protection in SEE countries, specifically the relationship between the GDP of these countries and environmental protection, as well as the level of achieved decarbonization in terms of the use of renewable energy. In general, environmental protection is no longer just a debate but an issue that affects everyday life. Over time, this issue has gained importance in SEE countries since they are home to exceptional natural environments, such as the Adriatic Sea, Nature Reserve Uvac, Perućica Forest Reserve, Bled and Ohrid lake, and share common concerns related to environmental degradation and the need for effective conservation measures.

Although these countries made progress in recognizing the importance of environmental protection by adopting policies and initiatives that align with European Union standards and mitigate environmental challenges, such as improving waste management systems, introducing non-financial disclosure about environmental effects, and promoting renewable energy, some of them still face big challenges. They are mainly addressed to pollution, primarily air pollution, as well as economic losses caused by climate changes, which in this region are mainly expressed through floods. In that aspect, the analysis of environmental protection in SEE countries is important for several reasons.

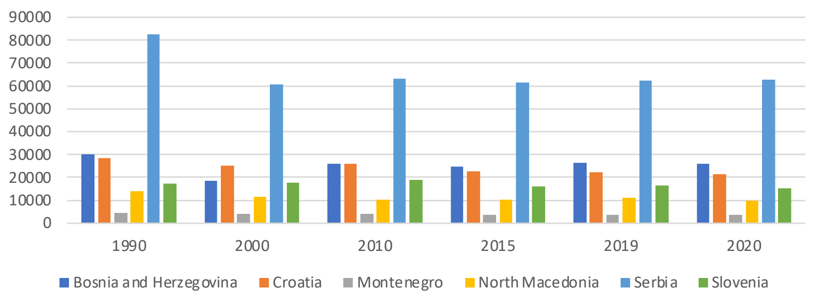
First, all observed SEE countries were part of former Yugoslavia, and although within the socialist system, the degree of representation of

industries, especially heavy ones as the most significant source of pollution, differed significantly, all observed SEE countries had a similar starting point regarding their relationship with the environment. Also, all countries faced a transition process after the breakup of former Yugoslavia, which had a different connotation in the environmental domain, especially referring to the aspirations of the observed countries for membership in the EU. As known, the EU is very committed to promoting sustainable development and environmental protection through various initiatives and policies. Such an example is European Green Deal, which aims to make the EU climate-neutral by 2050. As a result of these processes, SEE countries started to increase their expenditures of GDP on environmental protection. For instance, in 2021, on the EU level, Croatia had the biggest percentage of GDP expenditures on environmental protection, accounting for 1,5%. Slovenia devoted 0,7% of its GDP to environmental protection, Serbia 1%, and Bosnia and Herzegovina 0,5%. In the case of North Macedonia, the total environmental protection expenditures in 2021 amounted to 7.239.404 thousand MKD. Data for Montenegro were not available.

Second, all SEE countries have signed international agreements and protocols with an obligation to reduce CO_2 emissions by 2030 to achieve carbon neutrality. Third, scientific research shows that in the majority of SEE countries, higher GDP values are associated with higher CO_2 emissions meaning that economic growth has harmed the environment in these countries. Fourth, the war in Ukraine had a significant effect on this issue since we witnessed a deep energy crisis at the beginning of 2022 that greatly affected this idea of making the economy climate neutral. In that aspect, in 2022, the population in SEE countries had to cope with very high inflation while the economy faced the enormous challenge of ensuring sufficient energy supply to sustain the production processes. The pressure was especially pronounced in the electricity sector since there was a significant change in the price of natural gas. In SEE countries such as Serbia, North Macedonia, and Bosnia and Herzegovina, electricity is mainly obtained from coal. This led to higher emissions of harmful gases.

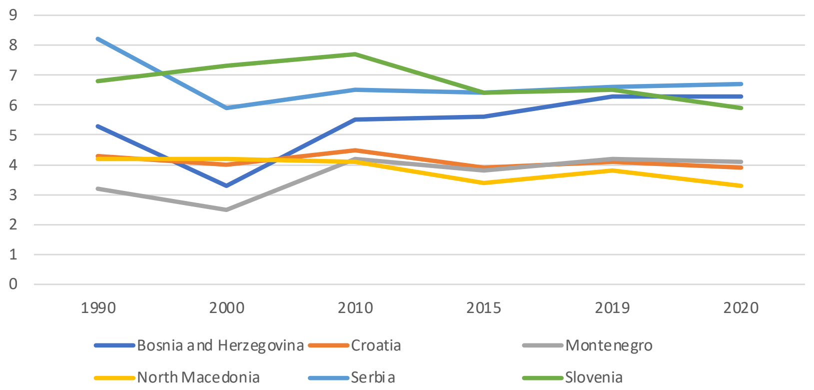
Specifically, thermal power plants in Serbia, Bosnia and Herzegovina, and North Macedonia witnessed an increase in the emission of harmful gases related to coal. These gases include sulfur dioxide (SO2), floating particles, and nitrogen oxides (NOX). For the first time, the total allowed values for NOX were exceeded. According to the "Comply or Close" report published in early 2023, sulfur dioxide emissions in Serbia, Bosnia and Herzegovina, and North Macedonia were 5.6 times higher than the permitted levels. Although Montenegro has a single large combustion plant, a coal (lignite) thermal power plant, sulfur dioxide emissions were higher in 2022 compared to 2021 but also lower than the levels recorded in 2020. In 2021, Croatia and Slovenia announced a plan to stop using coal by 2033. Both countries have only one thermal power plant operating on coal still active, while the degree of coal use in Slovenia, predominantly brown coal, is at a higher level compared to Croatia. This stems from the fact that only 9 EU member states produce brown coal, and Croatia is not among them.

Chart 1: Total GHG emissions (kt of CO2 equivalent) for SEE countries from 1990



Source: World Bank

Chart 2: CO2 emissions (metric tons per capita) for SEE countries from 1990



Source: World Bank

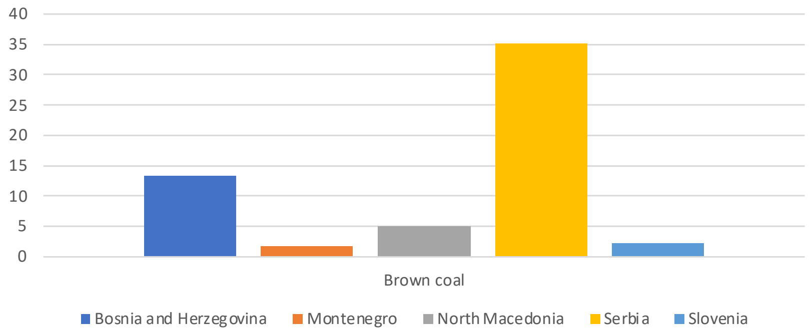


Chart 3: Production of brown coal in SEE countries in 2022 (in million tones)

Source: Eurostat

However, in response to the newly emerged situation and the dramatic increase in natural gas prices, some European countries resorted to using coal again, despite previous efforts to eliminate it as a significant source of pollution. This was done to secure a reliable electricity supply and address the crisis at hand. The decision posed a dilemma for these countries, considering their prior commitment to reducing coal usage. At the same time, it highlighted the complex dynamics between energy choices, economic processes, and environmental sustainability. As a result, according to Eurostat, in 2022, in the EU, there was an increase in coal production and consumption by +5 % compared to 2021.

Nevertheless, although the use of fossil fuels in SEE countries is still present, it is essential to note that using renewable energy sources is on the rise and plays a vital role in decarbonization efforts. Although this transition is ongoing, significant changes are happening since SEE countries have abundant renewable energy resources, such as solar, wind, hydro, and biomass. SEE countries have been investing in developing renewable energy infrastructure and implementing support mechanisms to encourage the growth of renewable energy generation. For instance, in the case of Slovenia, the country made significant progress in renewable energy, especially in hydropower and wind energy. In Croatia, renewable energy sources, such as hydro, solar and wind, have gained momentum in recent years. Bosnia and Herzegovina heavily relies on coal for its energy needs, but there have been efforts to diversify the energy mix. The country has significant hydropower potential. Also, the use of solar energy, especially among big companies in B&H is on the rise. North Macedonia has achieved significant progress regarding energy transition, where solar installations have increased, supported by government incentives and favorable feed-in tariffs. Montenegro made significant progress in renewable energy, particularly in hydropower and wind energy. The country has a significant number of hydropower plants, contributing to its electricity production. Montenegro has also been developing wind farms, with a focus on coastal areas. Serbia has been gradually diversifying its energy mix to include renewable sources. The country has notable potential for wind and solar energy, and efforts are underway to tap into these resources.

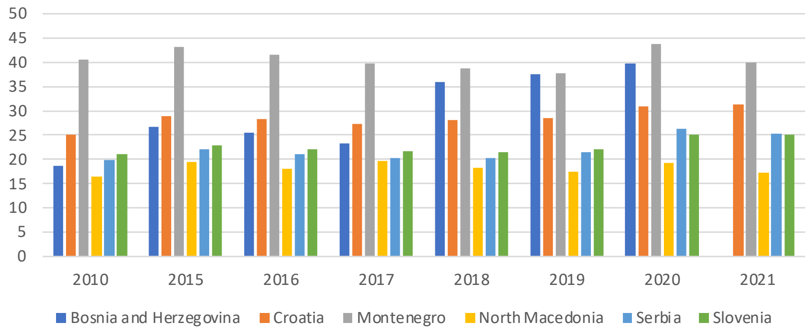


Chart 4: Share of energy from renewable sources for SEE countries

Considering this brief analysis, the environmental protection status in SEE countries is characterized by a combination of challenges and prospects. Despite recent advancements, notable deficiencies and disparities persist in the region's environmental policies and practices. As one of the crucial actions that need to be prioritized includes strengthening environmental governance and institutions, investing in sustainable infrastructure, promoting circular economy principles, and fostering regional cooperation. Additionally, while varying in developmental stages, it remains imperative to bolster environmental monitoring and enforcement capabilities and allocate adequate resources to support initiatives aimed at safeguarding the environment.

The matter of environmental protection has evolved into a significant macroeconomic concern, primarily due to the profound influence of climate change on economic patterns. This particularly relates to the economic losses incurred as a result of climate change. For instance, according to the European Environment Agency, only from 2021 EU Member States experienced economic losses amounting to 56.6 billion euro. In practice, this means that SEE countries are not immune to such losses, especially considering the unprecedented floods in 2014, when Croatia, Serbia, and Bosnia and Herzegovina were directly affected, but indirectly also the other analyzed SEE countries. Thus, proactive measures are essential to mitigate the economic challenges of climate change and safeguard the sustainability of SEE countries.

PUBLISHER INFORMATION

This publication has been prepared by:

Editor: Aida Hanić,
Institute of Economic Sciences, Belgrade

Bosnia and Herzegovina: Muamer Halilbašić, Armin Avdić, The Institute of Economics Sarajevo

Croatia: Nevenka Čučković, The Institute for Development and International Relations, Zagreb

Montenegro: Nikola Milović, Nikola Martinović, The University of Montenegro, Faculty of Economics Podgorica

North Macedonia: Zoran Janevski (team leader), Iskra Stancheva–Gigov (coordinator), Biljana Angelova, Verica Janeska, Snezana Kostadinoska-Miloseska, Klimentina Poposka, Elizabeta Dzambaska, Aleksandra Lozanoska, Vladimir Petkovski, The Institute of Economics – Skopje, University "SS. Cyril and Methodius"

Serbia: Aleksandar Zdravković, Elena Jovičić, Nevena Jolović, Duško Bodroža, Institute of Economic Sciences, Belgrade

Slovenia: Sonja Uršič, Institute for Economic Research, Ljubljana

Analysis: Aida Hanić, Institute of Economic Sciences, Belgrade

Publishers:

Institute of Economic Sciences, Belgrade
Zmaj Jovina 12, 11000 Belgrade, Serbia

The Institute of Economics Sarajevo
Branilaca Sarajeva 47,
71000 Sarajevo, Bosnia and Herzegovina

The Institute for Development and International Relations, Zagreb
Ljudevita Farkaša Vukotinovića 2,
10000 Zagreb, Croatia

The University of Montenegro, Faculty of Economics Podgorica
Jovana Tomaševića 37,
81000 Podgorica, Montenegro

The Institute of Economics – Skopje, University "SS. Cyril and Methodius"
Prolet 1, 1000 Skopje, Republic of North Macedonia

Institute for Economic Research, Ljubljana
Kardeljeva ploščad 17,
1000 Ljubljana, Slovenia

For the publishers:
Jovan Zubović
Muamer Halilbašić
Nikola Milović
Sanja Tišma
Zoran Janevski
Damjan Kavaš

E-mail: SEE-6@ien.bg.ac.rs

Technical editor: Villa Hills d.o.o

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

CIP - Каталогизација у публикацији
Народна библиотека Србије, Београд

33

SEE-6 economic outlook / editor Aida Hanić. - Vol. 1, no. 1 (2015)- . - Belgrade : Institute of Economic Sciences ; Sarajevo : The Institute of Economics ; Zagreb : The Institute for Development and International Relations ; Podgorica : The University of Montenegro, Faculty of Economics ; Skopje : The Institute of Economics, University "S. S. Cyril and Methodius" ; Ljubljana : Institute for Economic Research, 2015- (Beograd : Donat graf). - 25 cm

Polugodišnje. - Drugo izdanje na drugom medijumu: SEE-6 economic outlook (Online) = ISSN 1849-8884
ISSN 1849-8817 = SEE-6 economic outlook

COBISS.SR-ID 28100873

Institut ekonomskih nauka · EI Sarajevo · IRMO · Univerzitet Crne Gore Ekonomski fakultet Podgorica · Универзитет "Св. Кирил и Методиј" Економски институт · IER Inštitut za ekonomska raziskovanja Institute for Economic Research