SEE-6
Economic Outlook

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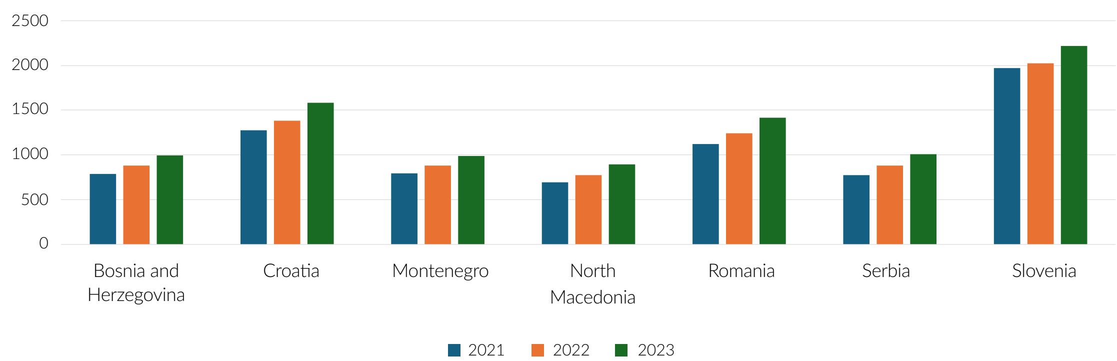
AVERAGE GROSS MONTHLY WAGES IN EUR



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BOSNIA AND HERZEGOVINA

B&H economy is slowing down, fiscal balance is deteriorating

The announcement that the EU will open accession negotiations could boost reform momentum

The announcement from March 2024 that the EU will open accession negotiations could boost reform momentum, but challenges remain amid elevated domestic tensions. In the lead-up to the announcement, B&H adopted several state-level laws, including anti-money laundering and combating the financing of terrorism, prevention of conflict of interest, freedom to access information, ombudsman for human rights, and High Judicial and Prosecutorial Council. However, before negotiations can formally start, more reforms need to be advanced, including strengthening courts and ensuring the integrity of elections. Domestic political tensions, including secessionist threats, remain, contributing to limited policy coordination at the state level.

A new EU Growth Plan for the Western Balkans could play a catalytic role in reforms. The plan, presented by the EC in November 2023, aims at boosting growth and accelerating socio-economic convergence of the six WB countries within the region and with the EU single market. It includes a EUR 6 billion facility for 2024–27. Planned allocations for

B&H are about 1.2 billion EUR, split evenly between grants and loans. Disbursements are conditional on successful reform implementation and may be redistributed to other participants after a grace period of 1–2 years. Although the financing is not sufficiently sizeable to be fully transformative, it would support the reform agenda by providing resources and by sustaining momentum.

A slowdown of economic activity continues towards the end of 2023

Economic growth decelerated to 1.6% in 2023 from 3.8% in 2022. This reflected mainly a slowdown in exports and investment amid strong tourism and resilient domestic consumption. With inflation receding and real wages rising, private consumption rose in the second half of 2023 leading to stronger growth (1.8 versus 1.5% in the first half). The labour market has tightened, with slight employment growth (below 1% year-on-year in December 2023). The unemployment rate was declining to 12.7% in the third quarter 2023 and then recovered to 13,2%.

Credit to the private sector increased by 4.5 % year-on-year in real terms in 2023 and the external current account deficit narrowed from 4.4% of GDP in 2022 to 2.6% of GDP last year, helped by lower oil prices and higher investment income and remittances. The external position is moderately stronger than the level implied by fundamentals and desirable policies. However, this trend is expected to reverse, and the current account deficit is projected to increase over 2024-25, reflecting higher interest payments on public debt and increasing domestic demand. Gross international reserves have been broadly stable in nominal terms but slowly declining in relative terms since 2021. External risks are moderate, related to continuation of capital outflows, the ability of two entities to secure budget financing, and delays in bilateral and multilateral project loans and grants disbursements. In the medium term, the external position will be affected by the introduction of the EU Carbon Border Adjustment Mechanism and the ability of B&H to secure an exemption for electricity exports and to adjust in other affected sectors.

Inflation is receding, public and minimum wages are increasing

Amid a rapid slowdown in food, transportation, and utility prices, headline inflation decelerated to 2.0% year-on-year in March 2024 from a peak of 17.4% in October 2022. Core inflation peaked at 7.2% year-on-year in March 2023 before declining to 4.2% in March 2024. Annual headline and core inflation declined to 6.1 and 6.5%, respectively, on average in 2023.

Nominal wages have been growing at a declining rate since May 2023. Both entities have relied on public and minimum wage increases to mitigate the impact of the cost-of-living crisis. Continuing on sizable public wage increases from previous years, minimum wages in 2023 were increased multiple times. Towards the end of the year, B&H entity RS adopted a decision to increase the minimum wage by 28.6% (to 68% of the average wage) effective January, while FB&H introduced a formula-based increase of 3.9% (47% of average wages). Overall, wages increase in the last two years were 27% - 8% higher in real terms, affecting competitiveness. However, minimum wages in B&H remain significantly below most European countries.

The fiscal balance in both entities is deteriorating, driven by current spending. Revenues grew by 1.2% age points of GDP, primarily reflecting wage increases and strong corporate profits. However, social spending increased by 1.8 ppt of GDP reflecting pension and social benefits increases in both entities, of which 1.3 ppt were mandated by law and 0.5 ppt discretionary. This, combined with public wage increases and higher interest costs, pushed expenditures up by 3.9 ppt of GDP. For the first time in recent years, expansionary fiscal policies led to fiscal deficits in both entities (2 and 2.4% in FB&H and RS, respectively), with an overall deficit of 1.7% in 2023, compared to a surplus of 0.9% in 2022. Both entities prioritized debt repayments and statutory payments (wage and pensions), while other payments (some subsidies and grants) were deferred.

The fiscal balance is deteriorating, and general government financing needs are raising

The increased deficits and large debt repayments, paired with limited external financing, led to a rise in general government domestic financing and a drawdown of government deposits. B&H entity RS faced particularly sizeable gross financing needs - around EUR 735 million, or 9.1% of GDP. To close the year, the authorities drew down on deposits and delayed some payments, mostly subsidies to farmers. Other entity (FB&H) also experienced rising financing pressures, together with increased borrowing costs. Gross financing needs in this entity were around EUR 560 million, 3.4% of GDP. Foreign loan disbursements for infrastructure picked up, but project implementation remains slow. Overall public debt increased to 32.2% of GDP in 2023, from 31% in 2022.

Banks are well-capitalized and liquid, but there are latent risks

Banks, on average, are well-capitalized and liquid. Profits are on record level. NPLs declined to 3.8% in 2023, partly due to still-low interest rates. The authorities have extended measures to slow the lending interest rate rise in 2024 and to limit exposure to foreign government securities through end-2024. Companies in B&H, on average, borrow at rates lower than in the euro area, which may not adequately reflect credit risk. The gap in remuneration rates has also led banks to search for higher returns abroad and increase foreign-asset holdings, particularly money-market placements. Exposure to interest rate risk may be rising, as rates for new loans (including mortgages) are mostly fixed at low levels over long maturities, while deposits are increasingly short-term and could experience upward pressures in financing costs. B&H banks have been cautioned by the US authorities of the potential risks of doing business with sanctioned individuals and companies. Finally, an incomplete regulatory framework for virtual assets continues to be a source of risk and legal uncertainty.

Table BIH1 Main economic indicators

	Total 2022 year	2023 Q1	2023 Q2	2023 Q3	2023 Q4	Total 2023 year
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**3.8**	1.7	1.2	1.9	1.7	**1.6**
Real private consumption (% change, yoy)	**1.9**	0.5	1.1	2.8	2.0	**1.6**
Real government consumption (% change, yoy)	**1.3**	2.1	1.3	1.9	1.4	**1.7**
Real investment (% change, yoy)	**2.4**	15.6	1.0	1.0	-4.4	**1.2**
Industrial output (% change, yoy)	**1.7**	-2.4	-6.4	-0.4	-6.0	**-3.8**
Unemployment rate (LFS, % pa)	**13.3**	13.1	13.6	12.7	13.2	**13.3**
Nominal GDP (EUR million)	**23,273**	5,904	6,913	7,157	6,513	**26,487**
GDP per capita (EUR)	**6,744**	1,721	2,015	2,086	1,898	**7,720**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**9.5**	13.0	10.0	13.1	12.0	**12.0**
Consumer prices (% change, yoy, pa)	**14.0**	12.4	6.4	4.3	2.0	**6.3**
Producer prices (% change, yoy, pa)	**19.1**	13.9	2.9	0.1	0.6	**4.4**
Average gross wage (% change, yoy, pa)	**11.7**	15.6	14.7	11.4	10.7	**13.0**
Exchange rate (BAM/EUR, pa)	**1.95**	1.95	1.95	1.95	1.95	**1.95**
Exchange rate (BAM/USD, pa)	**1.86**	1.82	1.80	1.80	1.82	**1.81**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**8,367**	2,083	2,025	1,966	1,925	**7,999**
Exports of goods (EUR, % change, yoy)	**25.92**	5.93	-8.46	-6.70	-7.49	**-4.4**
Imports of goods (EUR million)	**14,642**	3,116	3,350	3,414	3,344	**13,224**
Imports of goods (EUR, % change, yoy)	**32.59**	4.78	-3.80	-3.86	-6.24	**-2.5**
Current account balance (EUR million)	**-1,046**	-168	-241	-106	-183	**-698**
Current account balance (% of GDP)	**-4.47**	-2.85	-3.48	-1.48	-2.80	**-2.63**
Foreign Direct Investment net inflows (EUR million)	**688**	253	281	169	127	**830**
Foreign exchange reserves (EUR million, eop)	**8,228**	7,774	7,831	8,136	8,328	**8,328**
Foreign debt (EUR million, eop)	**9,158**	9,081	9,168	9,216	9,321	**9,321**
GOVERNMENT FINANCE						
Revenues (EUR_million)	**8,033**	2,082	2,294	2,316	N/A	**N/A**
Expense (EUR million)	**7,658**	1,881	2,126	2,228	N/A	**N/A**
Net = Gross operating balance	**375**	201	168	88	N/A	**N/A**
Net acquisition of non-financial assets (EUR million)	**248**	17	40	51	N/A	**N/A**
Net lending/borrowing (EUR_million)	**551**	184	128	37	N/A	**N/A**
Domestic government debt (EUR million, eop)	**1,030**	1,048	1,196	1,266	1,362	**1,362**
Foreign government debt (EUR million, eop)	**5,804**	5,634	5,407	5,384	5,367	**5,367**
Total government debt (eop. % of GDP)	**31.0**	N/A	N/A	N/A	N/A	**32.2**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**10.9**	10.0	10.5	9.1	8.7	**8.7**
Broad money, M4 (% change, yoy, eop)	**5.5**	7.5	8.1	7.4	7.6	**7.6**
Total domestic credit (% change, yoy, eop)	**4.7**	4.5	4.7	5.4	6.7	**6.7**
DMBs credit to households (% change, yoy, eop)	**5.2**	5.6	5.7	6.5	7.4	**7.4**
DMBs credit to enterprises (% change, yoy, eop)	**4.3**	3.7	3.3	5.2	6.7	**6.7**
Money market interest rate (%, pa)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
DMBs credit rate for enterprises short-term (%, pa)	**3.7**	4.3	4.4	4.4	4.8	**4.5**
DMBs credit rate for households short-term (%, pa)	**5.5**	6.1	6.4	6.5	6.3	**6.3**

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

Projected growth is not enough to speed up convergence with the EU

Growth is expected to increase to 2.5% in 2024, but remain subdued at around 3% in the medium term, below levels needed to speed up convergence with the EU. Demand will be helped by higher real wages, continued fiscal expansion, and recovering private investment, while EU demand for B&H exports will remain tepid. The current account deficit is expected to widen to 3.3% of GDP in 2024 and 4% in the medium term, reflecting higher interest payments on public debt and domestic demand. The fiscal deficit will further rise to 2.4% of GDP driven by current spending.

Inflation will further decelerate, but core inflation is expected to remain sticky reflecting wage pressures. Declining commodity prices, combined with regulated electricity prices, will further ease inflationary pressures. The decline in core inflation will lag headline due to wage pressures. Headline inflation is projected to decline to 3% on average in 2024 and to 2%, the euro area inflation target, by 2027; core inflation will decline but remain higher at around 5% in 2024.

Uncertainty around the outlook is high and risks are tilted to the downside. The intensification of conflicts (Ukraine, Israel-Gaza, Red Sea), an abrupt slowdown in Europe, or increased commodity price volatility could disrupt trade and raise food and energy prices, lower B&H exports and remittances, and dampen domestic demand. Rising domestic political tensions could increase economic fragmentation and weaken growth prospects.

There are also policy-induced risks. Maintaining expansionary fiscal policies could undermine fiscal and external sustainability—financing needs have risen and proven challenging to meet. Public and minimum wage increases to mitigate the impact of the cost-of-living crisis have supported domestic demand, but also fueled inflation. The materialization of financial sector risks could lead to more capital outflows and financial distress. By contrast, progress on the EU accession path could provide a reform boost, with positive spillovers.

Table BH2 Summary of projections

	2024	2025	2026
Real GDP (% change)	**2.5**	**2.8**	**3.2**
Real GDP (% change)	2.5	3.0	3.0
Real final consumption (% change)	2.9	3.4	3.7
Real investment (% change)	4.0	4.4	3.3
Exports of goods and services (constant prices, % change)	4.4	5.8	4.7
Imports of goods and services (constant prices, % change)	5.4	6.4	5.5
Current account balance (% of GDP)	-3.3	-3.9	-4.1
Consumer prices (% change, pa)	3.0	2.7	2.5
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)	-2.4	-2.4	-2.1
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

Projections for 2024 envisage a continuance of strong growth

Economic growth moderated but remained relatively strong in 2023

Despite being lower than the high recovery rates of previous years, economic growth in 2023 was still relatively strong, according to revised data from the Croatian Bureau of Statistics. With a growth rate of 3.1%, it remained one of the highest in the EU.

According to the revised data, the real growth rates in the first half of 2023 were very solid (2.9 and 3.8% respectively), however, the growth in Q3 shortly lost steam despite a very good tourist season, reaching only 1.4% year-on-year. Such a modest real growth rate in Q3 was due to a very high comparative base a year before, but also a reflection of rather high inflation levels fuelled by the significant rises in prices in the services sector. However, in the last quarter of 2023, economic activities accelerated significantly (4.4%) on the wings of increased domestic consumption, EU-funded investments, a prolonged tourist season and a recovery of exports of goods. The positive developments in the labour market and increase in wages also contributed to reviving the economic growth in the fourth quarter.

Robust growth continued also in the first quarter of 2024 reaching 3.9% according to the recently released first estimations of the Croatian Bureau

of Statistics. Contrary to most Eurozone-member states' rather sluggish growth rates, such a growth rate was among the two highest.

Grounded on a good economic performance in 2023 as well as its continuance in the first quarter of 2024, growth forecasts for 2024 were recently revised upwards by the Government and most economic analysts and international organizations. At the end of May 2024, the Ministry of Finance revised its projections of growth rate to 3.5%. The Croatian National Bank also revised growth projections upwards to 3.3%. Spring projections of the international organisations also did the same. European Commission in its Spring Economic Forecast from May 2024 for Croatia also envisages a growth rate of 3.3%. The IMF in its Global Economic Outlook (April 2024) forecasts a GDP growth of 3.0% in 2024, while the recent IMF Mission Staff Report (June 2024) anticipates 3.4%. The World Bank anticipates a more conservative growth rate of 3.0% in 2024, while the OECD envisages that Croatian GDP will grow by 3.3% in 2024.

Major factors driving growth

The largest contribution to economic growth in 2023 came from two factors driven by the growing domestic demand mostly reflected in the increase of private consumption and investments financed by generous EU funds. The other factors that significantly added to growth were traditionally high exports of services through tourism and hospitality services thanks to a prolonged tourist season. However, the total exports of goods declined significantly compared to the previous year, reflecting a significant decline in foreign demand at main export markets as well as a marked fall in domestic industrial output.

Personal consumption increase remained the strongest contributor to growth throughout 2023. Its rates significantly accelerated particularly in the second half of 2023, to 3.0% in Q3 and 5.3% in O4, propelled by favourable labour market developments, the rise of nominal wages especially in the private sector, the significant rise of workers' remittances from abroad and falling inflation.

All of that led to a significant increase in real disposable household income which combined with a rise in consumer optimism led to a robust increase in total private consumption. Analysts, however, often express concern over growth propelled mainly by private consumption which combined with the fall of exports and industrial production is potentially unhealthy for the economy in the longer run. Especially worrisome is the decline of net exports of goods and its diminishing and even negative impact on the total economic activity which indicates low competitive capacities of the economy.

The total domestic consumption also increased due to acceleration of the government consumption especially in the first half of 2023, with a record rate of 10.1 in the second quarter. Relatively high quarterly rates also continued in the second half of the year, leading to a very high yearly rate of 6.6%. The important source of such an increase is the continuation of government fiscal intervention measures to mitigate the impact of high energy prices and buffer the effects of high inflation affecting the most vulnerable parts of the population. The increase in government consumption levels is also attributed to the post-earthquake reconstruction demands and an increase in wages in the public sector, some of which were forced by strikes (in the health and judiciary sectors).

The second largest source of growth in 2023 was an increase in total real investments propelled by abundant EU funding. The Government has at its disposal a generous amount of EU funding directed especially toward large public construction and infrastructure projects as well as post-earthquake reconstruction. The growth rates of total real investments accelerated especially in the second half of 2023, reaching 6.1% in Q3 and and 6.0% in Q4, which led to a high yearly rate of 4.2%. After managing to successfully spend the EU funding assigned for post-earthquake reconstruction in Zagreb and Banija region by the end of June 2023, the public infrastructure and other big construction projects had at disposal the funding within National Plan of Recovery and Resilience (NPRR) both in the form of grants and very favourable loans. The Governemnt has so far disbursed more than half of EU funding coming from this facility (3.67 million EUR).

The independent analysts also express concern over the high dependency of the economy on EU funding and wonder how economic growth would look after that funding ceases by the end of 2027. For that reason, it is important to revive the currently modest levels of private investments and their contribution to total investments and the economic growth of Croatia.

The significant fall in both exports and imports

The export and import flows have experienced a significant contraction of both volume and values throughout 2023, especially when it comes to the trade of goods. The main reason behind this was a contraction of foreign and domestic demand due to the negative influence of high energy prices, disruptions in global value and supply chains as well as recessionary pressures in Croatia's main export markets. All of this came as an impact of the negative economic consequences of the exogenous shocks caused by wars in Ukraine and the Gaza region.

The exports of goods decreased yearly by 9.6% in 2023 with the highest fall in the third quarter when it contracted by 20.4% mainly due to a sharp fall of foreign demand in the key export markets, particularly in Germany, but also due to a general slowdown of economic activities both in Europe and globally. The fall in exports of goods negatively contributed to the total economic growth in 2023.

The moderation of domestic economic activities and a contraction of industrial production have at the same time brought the decline in imports of goods in 2023 by 7.3%, however, this was slower than the fall in exports.

On the other hand, the exports of services which are dominated by the tourism sector further expanded throughout 2023 which was very beneficial to eliminating the gap in the negative current account balance. The tourist revenues increased significantly partly due to a substantial rise in prices of accommodation, travel, restaurants as well as in other hospitality support services. In addition, the number of arrivals of foreign tourists as well as the days of their stay extended, having a favourable impact on total revenues and surpassing the pre-pandemic indicators.

On the wings of extraordinary tourist revenues due to prices increase, the negative current account balance in the trade of goods was completely offset and even bounced back to a small surplus of 825 million EUR (1.1% of the GDP) by the end of 2023.

The industrial output contraction

Throughout 2023 except for the last quarter when it increased mildly by 0.8%, industrial production in Croatia experienced significant contraction rates as a result of the decrease in foreign demand and rising producers' expenditures due to the increase of prices in raw materials and intermediate products, as well as rising wages to keep qualified workers. Some of the industrial sectors, such as construction and mining also experienced a shortage of workers. All this led to the contraction of industrial output by -2.0% in 2023.

The industrial sector, much more than the other economic sectors was exposed to mounting negative effects of geopolitical instabilities as well as disruptions in global value and supply chains. When you add to it the old problems of its competitiveness due to low productivity levels, in general, the Croatian industrial sector had a rather hard time in 2023.

The fall in industrial production was recorded practically in most of the industrial sectors, with the largest declines attributed to the production of non-durable and durable manufacturing products, while the fall in the production of capital goods was smaller. This has also been reflected in the decline of exports of industrial products with the largest declines in exports of wood and metal manufacturing products. On the other hand, due to an increased demand, the production of energy increased.

The decline of industrial output also continued in the first quarter of 2023, and according to Eurostat, in March 2024, it was among the highest in the EU (-5.0%).

Favourable developments in the labour market

The developments in the labour market in 2023 have been relatively favourable, with the continuance of an increase in employment by 2.7% and a decrease in unemployment to 6.0%, reflecting an increase in demand for workers due to rising economic activities. The strongest growth in total employment is attributed to tourism-related activities as well as to the construction sector.

Demand for workers exceeded the domestic supply, which led to a significant increase in the participation of foreign workers in the labour market, which in 2023 reached a record level and significantly helped to offset occasional labour supply shortages. Foreign workers are mostly employed in the tourist-related services, retail trade and construction industry.

The LFS unemployment levels continued to fall throughout 2023 and were especially low in Q2 and Q3 (5.6% and 5.5% respectively) and stayed below 6% in Q4, which traditionally increases due to seasonal workers in tourism-related services. Unemployment continued to gradually decrease also in the first five months of 2024 reaching record low levels by the end of May 2024 of only 88,327 registered unemployed persons according to the Croatian Bureau of Employment. The LFS unemployment rate for May 2024 is estimated at 5%.

Public finances remained relatively rational

Public finances in 2023 tried hard to remain rational in spending despite the substantial intervention measures to help citizens and businesses cope with the negative impacts of inflation and high energy prices as well as despite the increased pressures on expenditures due to scheduled elections in April 2024.

The total Budget deficit in 2023 is estimated at 0.7% of the GDP, which is still quite a solid fiscal balance within the circumstances but also compared to most of the Euro area member states. This was primarily enabled by the extraordinary growth of Budget revenues mostly attributed to VAT revenues growth on the wings of high inflation as well as high growth in personal consumption. The rise in nominal wages also contributed towards this end through an increase in income tax revenues.

Budget expenditures, on the other hand, although rising were kept under relative control despite the negative economic impacts caused by high inflation and still high but decreasing prices of energy. The fiscal intervention measures were prolonged in 2023 by two generous government support packages in effect from April and October 2023. They intended to ease coping with the negative effects of high energy prices for citizens and the business sector as well as for the poor and other most vulnerable parts of the population. This also included social transfers with vouchers similar to those during the pandemic. Such support measures were again prolonged in April 2024, despite the recommendation from the European Commission to withdraw such measures already in 2023 as they considerably distort the energy and other market prices. Most recently, the IMF Article IV

Consultation Mission in June 2024 also expressed concern about the continuation of intervention measures and recommended the Government abolish such measures as they hurt the achieved fiscal credibility, distort competitiveness and hinder more efficient reduction of inflation. According to the IMF Mission Report from June 2024, the Government should start to think about fiscal sustainability by building a fiscal space for demanding big reforms such as digitalisation and greening of the economy. Also, contrary to expanding the fiscal deficit in times of strong growth, it might be prudent to build fiscal reserves for harsh times that could buffer the possible future global shocks. The Government plans to widen the Budget deficit for 2024 to - 2.6%, which is a significant deterioration of fiscal balance. One of the reasons is the increase in expenditures due to the substantial rise of wages in the public sector in March 2024 (17%) as well as due to ongoing public infrastructure reconstruction projects.

The general government debt however kept significantly decreasing during 2023 and its ratio to GDP reached 63%, on the wings of a substantial reduction of foreign government debt and its prudent management during a period of very low interest rates. This is quite a significant decrease compared to 2022 when it was 67.8% of GDP. The Government's demand for new loans was reoriented more to the domestic market through the offer of treasury bills to citizens, which resulted in a slight increase in domestic government debt. However, the Ministry of Finance announced that the total government debt in 2024 is projected to continue falling to below 60% of GDP (59.2%), reaching compliance with Maastricht's fiscal criteria for the first time since joining the EU.

Inflation is declining, but still rather high

Inflation levels have been gradually declining throughout 2023, however remaining still at a relatively high level of 8.4%. It was higher than the Government planned, despite the extensive array of inflation mitigating measures that were in force throughout 2023 (fixing prices for electricity, gas and petrol, and for the increased number of selected basic food products through lowering the VAT and excise rates). A more significant fall in CPI rates was recorded in the second half of the year reaching 5.0% in the last quarter. Nevertheless, the CPI rate is among the highest in the Euro area. The sources of relatively stubborn inflation could be attributed to the postponed effects of the falling food and energy prices at the world markets especially in the first half of the year. The other source of inflation is a continuous increase in consumer spending due to the rise of wages and other disposable income including remittances, as well as due to an overall increase in consumer optimism.

Substantial sources of prolonged levels of relatively high inflation have now moved from product prices to consumer prices of services. This is particularly evidenced in the tourist-related services (accommodation, hospitality and travel services), which experienced a very high growth of prices due to a significant increase in demand, especially by foreign tourists.

A more substantial fall in CPI rates was achieved in the first five months of 2024, when the consumer inflation rate reached 3.3% (May 2024), which is the lowest level since September 2021. For the whole of 2024, the Government expects that the inflation rate will be 3.1%, again higher than in the most of Eurozone member countries. This projected rate reflects the impact of the strong rise in wages in the public sector in effect from March 2024 and the rising domestic demand and consumer spending, which impede a stronger fall in inflation.

The producer prices in 2023, on the other hand, have been falling continuously and more profoundly, especially in the last two quarters, reaching a yearly rate of 4.2%, which is twice less than the CPI yearly rate. In the last quarter of 2023, it even recorded a negative rate of 0.7%, according to the Croatian Bureau of Statistics. The fall in producer prices especially in the second half of 2023 reflected a substantial fall in energy and raw material prices, as well as prices of intermediate products at the world market and positive effects of stabilization of global supply chains. For that reason and as opposed to developments in 2022, the contribution of producer prices to the core inflation has been continuously diminishing in 2023, while the services sector's contribution to the core inflation has been rising, reflecting the significant increase in prices especially in tourism-related services.

The moderate rise in interest rates

Contrary to other Euro area members, the rise of interest rates on the new loans as a measure of restraining rising inflation levels was rather moderate in Croatia. High banking liquidity, good capitalisation and relatively low exposure to external risks enabled the expansion of new loans despite the inflation crisis and enabled the total domestic loans to increase by 10.1%. The strong demand for loans in 2023 especially coming from the household sector (9.5%), was also the main reason for the steep rise in profitability of the banking sector. As the interest rates on deposits have risen very mildly and conservatively as well as with a considerable time leg, this has also contributed to the rising profitability of the banking sector, which reached a historically high level in 2023.

According to the Croatian National Bank, the strong rise in new long-term loans to households was attributed to the new round of government-subsidised real-estate loans. At the same time, high growth in short-term cash loans to households was driven by revived consumer optimism encouraging spending in 2023 thanks to the rise in wages as well as the total disposable income of households.

However, the enterprise sector was much more cautious when taking new loans under worsening financial conditions and rising geopolitical uncertainties, which was reflected in the deceleration of growth rates for new loans in 2023, especially in the second half of the year. Nevertheless, although the lending growth rate to the enterprise sector was reduced from a very high 15.2% in Q1 to a moderate 6.3% in Q4, the yearly growth rate of new loans in 2023 was still as high as 10.7%.

Table HR1 Main economic indicators

	2023				Total 2023 year
	Q1	Q2	Q3	Q4	
ECONOMIC ACTIVITY					
Real GDP (% change, yoy)	2.9	3.8	1.4	4.4	**3.1**
Real private consumption (% change, yoy)	1.9	2.1	3.0	5.3	**3.1**
Real government consumption (% change, yoy)	6.1	10.1	6.0	4.6	**6.6**
Real investment (% change, yoy)	0.7	4.2	6.1	6.0	**4.2**
Industrial output (% change, yoy)	-1.4	-1.3	-5.8	0.8	**-2.0**
Unemployment rate (LFS, % pa)	7.3	5.6	5.5	5.9	**6.0**
Nominal GDP (EUR million)	16,422	19,146	22,085	18,818	**76,472**
GDP per capita (EUR)	4,265	4,972	5,736	4,888	**19,863**
PRICES, WAGES AND EXCHANGE RATES					
Implicit GDP deflator (% change, yoy)	10.9	8.0	7.4	4.9	**8.3**
Consumer prices (% change, yoy, pa)	11.8	8.1	7.3	5.0	**8.4**
Producer prices (% change, yoy, pa)	12.0	3.7	1.9	-0,7	**4.2**
Average gross wage (% change, yoy, pa)	13.3	13.5	16.0	15.8	**14.6**
Exchange rate (HRK/EUR, pa)*	N/A	N/A	N/A	N/A	**N/A**
Exchange rate (USD/EUR pa)*	1.08	1.09	1.09	1.07	**1.08**
FOREIGN TRADE AND CAPITAL FLOWS					
Exports of goods (EUR million)	4,764	4,700	4,613	5,039	**19,116**
Exports of goods (EUR, % change, yoy)	3.2	-9.3	-20.4	-8.7	**-9.6**
Imports of goods (EUR million)	9,128	9,416	8,894	8,690	**36,129**
Imports of goods (EUR, % change, yoy)	-0.2	-4.3	-14.8	-9.0	**-7.3**
Current account balance (EUR million)	-2,290	-542	-55	-1,064	**825**
Current account balance (% of GDP)	-0.9	-1.1	-0.1	1.1	**1.1**
Foreign Direct Investment net inflows (EUR million)	570.3	215.4	822.8	-155.4	**1,453.1**
Foreign exchange reserves (EUR million, eop)	3,127	2,890	1,039	-1,018	**2,880**
Foreign debt (EUR million, eop)	56,848	56,648	62,532	63,998	**63,998**
GOVERNMENT FINANCE					
Revenues (EUR million)	7,471.1	9,074.8	9,381.3	9,788.3	**35,715.5**
Expense (EUR million)	7,657.8	8,900.4	8,384.4	11,301.3	**36,244.0**
Net = Gross operating balance	-175.4	687.2	777.3	-431.4	**-434.3**
Net acquisition of non-financial assets (EUR million)	11.3	512.8	-219.5	1,082.4	**94.2**
Net lending/borrowing (EUR million)	-186.7	174.4	996.8	-1,513.8	**-528.5**
Domestic government debt (EUR million, eop)	33,724	33,136	33,575	33,973	**33,973**
Foreign government debt (EUR million, eop)	14,685	14,737	14,323	14,218	**14,218**
Total government debt (eop. % of GDP)	69.1	66.5	64.4	63.9	**63.0**
MONETARY INDICATORS					
Narrow money, M1 (% change, yoy, eop)	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**
Total domestic credit (% change, yoy, eop)	9.3	9.1	8.0	7.9	**10.1**
DMBs credit to households (% change, yoy, eop)	6.3	6.6	8.1	9.5	**9.5**
DMBs credit to enterprises (% change, yoy, eop)	15.2	13.5	7.8	6.3	**10.7**
Money market interest rate (%, pa)	N/A	N/A	N/A	N/A	**N/A**
DMBs credit rate for enterprises short-term (%, pa)	3.6	4.4	4.6	5.1	**4.4**
DMBs credit rate for households short-term (%, pa)	5.3	5.9	6.3	6.5	**6.0**

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

The continuance of rather strong growth in 2024-2026

At the end of May 2024, the Government revised upwards the projections of GDP growth for 2024 from an initial 2.8% to 3.5%, based on the very good growth achieved in the first quarter of the year (3.9%). After an acceleration in 2004, the growth rate in 2025-26 will moderate to 2.8% in 2025 and 2.7% in 2026, given the uncertainties associated with the settlement of current geo-political conflicts as well as the slow recovery in the main EU trading markets,

The anticipated growth rates are much stronger than those projected for the Euro area member states, where the average recovery growth rate in 2024 is expected to be rather slim (0.8%), followed by 1.4% in 2025, according to Spring European Economic Forecasts from May 2024.

Strong growth expectations are based on the continuance of robust growth of domestic demand on the wings of further growth of personal consumption which is fuelled by a substantial increase of wages in the public sector in March 2024 before the April Parliamentary elections as well as by an increase in total employment. Apart from personal consumption, government consumption is also anticipated to rise combined with the substantial EU-funded investment increase although somewhat slower than in 2023.

An additional positive policy assumption is a continuous decline of inflation towards the 2% target values in the medium term, i.e. by 2026, which would further add to the health of the economy. The government envisages CPI to moderate to 3.1% in 2024 and 2.6% in 2025, which is a significant decrease compared to 8.4% in 2023. However, the core inflation in Croatia will continue to be somewhat more resilient than in the most of Euro area member states where restraining inflation measures were more profound. According to the Croatian National Bank, it is now much more driven by service prices than by industry prices and is presently significantly higher than in the other Euro area members. The other sources of resilient inflation are attributed to the substantial increase in wages, most recently in March 2024, which fuels domestic demand and creates rising price pressures. Furthermore, lower interest rates on new loans than in the Euro area also encourage consumer spending.

Negative global risks to projected growth are mostly related to uncertainties of future geo-political developments (Ukraine, Israel-Gaza conflict, US-China trade relations) and their impact on Croatia's main trading partners in the EU and their slow recovery from a recent substantial slowdown. Nevertheless, the economic growth in the medium term is expected to be supported by the gradual recovery of exports of goods, while the exports of services especially in the tourism sector would likely experience a moderation of growth rates which were exceptionally high in post-pandemic 2022 and 2023. Notwithstanding this, tourism-related services will remain an important source of growth also in 2024-2026.

Strong growth rates in the medium term will continue to be supported by further absorption of EU grants and loans within the National Recovery and Resilience Plan (NRRP). Good progress in planned NRRP reforms and complying with scheduled indicators, has enabled Croatia to receive so far 2.9 billion

EUR (3.5% of GDP), which is about half of the total EU grants allocation. If we add to grants the favourable loans so far disbursed, according to the Government, Croatia so far received 3.67 billion EUR of total EU funding within the NRRP facility and together with Italy is leading in the absorption of such funds in the EU.

Further moderation of interest rates on new loans announced recently by the European Central Bank, will facilitate the potential revival of private investments and FDI that were rather modest in previous years, which might positively impact the projected growth in the medium term. Croatia being now in the Eurozone and Schengen area will additionally ease that possibility.

International organisations have also positive growth projections for Croatia in the medium term, according to their spring economic forecasts. European Commission for Croatia anticipates a growth rate of 3.3% in 2024 and 2.9% in 2025. The IMF Mission Report for Croatia forecasts GDP growth of 3.4% in 2024, followed by 2.9% in 2025 and 2.7% in 2026. The OECD envisages that Croatian GDP will grow by 3.3% in 2024 and remain robust in 2025 with a growth of 2.8%. The World Bank anticipates a growth rate of 3.0% in 2024, followed by moderation to 2.8% in 2025 and 2.7 in 2026.

Credit rating agencies also seem to be unanimous concerning a very positive view of Croatia's medium-term economic outlook. On April 5, 2024, Fitch confirmed its 'BBB+' investment rating of Croatia with a positive outlook. On May 10, 2024, Moodys also confirmed its credit rating for Croatia of 'Baa2' with a positive outlook, while Standard and Poors although without new re-evaluation has kept its estimated credit rating at 'BBB+/A-2'. In its elaboration of a positive outlook, Moody announced that if the favourable economic trends continue as projected, they might consider an even more favourable grade of investment rating for Croatia in the second half of 2024. Both Fitch and Moodys expect a strong 3.3% growth in 2024 and a continuation of fiscal consolidation by a further fall of total government debt to 59% of GDP. If favourable trends continue, it is reasonable to expect an increase in investment grade by the end of a year by all three credit rating agencies.

Table HR2 Summary of projections

	2024	2025	2026
Real GDP (% change)	**3.5**	**2.8**	**2.7**
Real private consumption (% change)	4.9	2.9	2.7
Real government consumption (% change)	3.0	2.7	2.2
Real investment (% change)	2.4	2.4	3.1
Exports of goods and services (constant prices, % change)	2.5	2.4	2.4
Imports of goods and services (constant prices, % change)	3.6	2.6	2.5
Current account balance (% of GDP)	1.4	0.7	0.1
Consumer prices (% change, pa)	3.1	2.6	2.,1
Exchange rate, national currency/EUR (pa)*	N/A	N/A	N/A
Unemployment rate (LFS, %, pa)	5.8	5.5	5.3
General government balance (ESA 2010 definition, % of GDP)	-2.6	-1.6	-1.5
Total domestic credit (% change, eop)	5.3	4.5	4.2

Source: Ministry of Finance of the Republic of Croatia and Croatian National Bank.
*Croatia joined the Euro area and adopted the Euro on 1 January 2023.

MONTENEGRO

Price stabilization and economic recovery

Price stabilization is one of the important characteristics of Montenegro's economy in the second half of 2023. There is a recovery of macroeconomic indicators and a return to regular values typical of peacetime periods. Positive results are recorded in the tourism sector and partially in forestry and industrial production. The level of foreign direct investments shows a negative trend compared to previous years. The banking system is stable and liquid.

Political environment

Early parliamentary elections were held at the beginning of June (June 11). Following the elections, the 44th Government of Montenegro was formed at the end of October 2023. The second half of the year did not see concrete results in terms of progress in the accession negotiations with the European Union. The issue of the population census captured the attention of the entire public, which was completed during December after reaching an agreement between the ruling and opposition parties.

Prices

Official data from the Central Bank of Montenegro indicate that the inflation rate in December 2023 was 4.3%, measured by the consumer price index, and 4.9%, measured by the harmonized consumer price index. Although the values are not yet fully satisfactory, positive trends are present. During December, there was a 2.3% decrease in transportation prices compared

to the previous month, as well as a slight reduction in the prices of clothing and footwear (0.5%) and food and non-alcoholic beverages (0.4%).

On the other hand, there is a price increase in the producer prices of industrial products. When observed on an annual level, this increase totals 5.5%, with the most significant contribution to the price growth coming from the sectors of mining and quarrying, which saw a rise of as much as 28.2%. This price growth is also present on a monthly level, with prices in these sectors being 10.4% higher compared to November.

Labour market and wages

According to data from the Statistical Office of Montenegro, in December 2023, the number of employed persons was 246,499. When compared to an annual level, this represents an increase in employment of 8.50%.

An analysis of the educational structure of the population, based on data from the Statistical Office, shows that the active population is predominantly comprised of individuals with secondary education (59.7%), followed by those with higher education (33.6%), and those with primary education or lower (6.7%).

The employment structure within the Montenegrin economy has remained fairly constant without significant changes in recent years. Specifically, wholesale and retail trade, and repair of motor vehicles and motorcycles remain the dominant activity, accounting for almost one-fifth of total employment (19.57%). This is followed by public administration and compulsory social security (9.34%), and the accommodation and food service sector (9.25%).

At the end of 2023, the average gross salary in Montenegro was 1,018 EUR, while the average net salary was 814 EUR. When comparing data over twelve months, net salaries increased by 12% compared to the same period last year. However, considering that consumer prices in 2023 (especially in the first part of the year) rose significantly, reports from the Statistical Office indicate that the real wage growth was 2.4%.

Just as there were no changes in the employment structure, there were also no changes in the sectors that are the most attractive in terms of salary levels. The highest salaries are in the financial and insurance activities sector, with an average salary of 1,285 EUR at the end of the previous year. This is followed by the electricity, gas, steam, and air conditioning supply sectors with an average salary of 1,187 EUR and the mining and quarrying sector with an average salary of 1,049 EUR.

Foreign trade and capital flows

The total foreign trade in goods of Montenegro during 2023 amounted to 4,484.4 million EUR. On an annual level, this represents an increase of 5.9% compared to the previous year's data. Of the total foreign trade in goods, the largest portion predominantly pertains to imports, totalling 3,810.1 million EUR or 84.96% of the total foreign trade in goods. The coverage of imports by exports, a parameter that continuously shows weaker results and highlights one of the shortcomings of the Montenegrin economy, was 17.7% at the end of the previous year. This represents a decline compared to 2021 when the coverage of imports by exports was 19.8%.

The structure of foreign trade in goods also did not undergo any significant changes. In the export structure according to the Standard International Trade Classification, based on MONSTAT data available on their official website, the most represented category is 3 - Mineral fuels and lubricants, amounting to 244.9 million EUR. An integral part of this category is electricity, with a dominant share of 206.9 million EUR.

In the import structure according to the Standard International Trade Classification, sector 7, which relates to machinery and transport equipment, dominates. The total amount allocated to this sector is 885.2 million EUR, with road vehicles having a dominant share of 330 million EUR.

According to data from the Central Bank of Montenegro at the end of 2023, the net inflow of foreign direct investments totaled 428.67 million EUR. This represents a significant annual decrease of 45.23 million EUR. The main reasons for this decline are the drop in investments based on intercompany debt and investments in companies and banks in Montenegro. Additionally, there was also a withdrawal of certain foreign investments.

Regarding the structure of the total inflow of foreign direct investments, 65.16% of the total inflow resulted from equity investments in companies, banks, and real estate, amounting to 463.18 million EUR. On the other hand, equity investments in companies and banks decreased by as much as

56.58%. The inflow of foreign direct investments in the form of intercompany debt also decreased by 34.09% compared to 2022, according to the latest available data from the Central Bank of Montenegro.

Monetary developments

As mentioned in the introductory section, the stability of the banking sector was not threatened during 2023. The total balance sheet sum of commercial banks in Montenegro at the end of the fourth quarter of 2023 amounted to 6,734.26 million EUR. Compared to the twelve months, this represents a growth of the banks' balance sheet sum by 5.15%, or 0.07% on a monthly level. The structure of bank assets is predominantly determined by total loans, which make up 60.81%. This is followed by securities with almost one-fifth shares (19.48%) and cash and deposit accounts with central banks at 18.49%. On the liability side of the balance, deposits continuously constitute over four-fifths of the total value, specifically 81.27%, according to the latest data from the Central Bank of Montenegro. The remaining part consists of capital at 12.18% and other balance sheet items with less than 5% share.

The credit structure is as follows. Total approved loans at the end of 2023 amounted to 4,095.21 million EUR. On an annual level, total loans recorded an intense growth of 11.89%, indicating a significant increase in the credit activity of banks. This can have positive implications for supporting economic activities, but a higher amount of money in circulation often triggers inflationary tendencies. This significant credit growth also resulted in a slightly lower loan/deposit ratio compared to comparable data. Most of the loans pertain to banks' claims in the non-financial sector and the household sector.

Household deposits also recorded growth in the previous calendar year, although this growth was smaller than the credit growth. They totalled 5,473.18 million EUR, an increase of 4.76% on an annual level. The deposit structure is predominantly determined by sight deposits, amounting to more than four-fifths (82.67%). This is followed by term deposits amounting to 15.04% and funds held in escrow accounts at 2.29%, according to the latest available data from the Central Bank of Montenegro. It is important to note that within the structure of term deposits, the largest part pertains to short-term deposits with a maturity of three to twelve months (two-fifths) and deposits with a maturity of one to three years (33.47%). Furthermore, household deposits constituted a little over one-third of total deposits (34.73%), followed by deposits from the non-financial sector with a share of 32.10%.

Regarding the liquidity of banks, the total liquid assets amounted to 1,597.62 million EUR at the end of December 2023. This represents a decrease in liquid assets by almost 20% compared to comparable data from a year earlier. Liquidity ratios, both on a daily level and within decades, were above the prescribed minimums.

The mandatory reserve of commercial banks with the Central Bank of Montenegro at the end of the fourth quarter of the previous year amounted to 290.63 million EUR. Of the total amount of the mandatory reserve, 71.33% is allocated to domestic accounts, while the remaining part is on accounts with the Central Bank abroad. The effective mandatory reserve rate was 5.31% at the end of 2024, higher than at the end of 2022 when it was 5.04%. As for microcredit financial institutions, their total balance sheet sum amounted to 90 million EUR.

Regarding average weighted interest rates, it is important to distinguish between interest rates on total approved and newly approved loans. The average weighted nominal interest rate on total approved loans according to the Central Bank of Montenegro data in December amounted to 6.11%, an increase of 0.66% on an annual level. The average weighted effective interest rate on total approved loans in the same period was 6.59%. For newly approved loans, the situation is slightly different, with the nominal interest rate being 6.09% and the effective interest rate 6.51%. Interest rates for microcredit institutions are naturally higher compared to the banking sector, with average nominal and effective interest rates on total approved loans being 19.65% and 22.19%, respectively. On the other hand, the average weighted effective passive interest rate was 0.21% in December 2023, lower by 0.05% compared to the same period a year earlier. Finally, in terms of the capital market, the total turnover on the Montenegro Stock Exchange in December was 2.18 million EUR, realized through 75 transactions. The value of the stock index MONEX was 15,583.12 index points, a 10% increase on an annual level.

Fiscal sector

According to data from the Ministry of Finance of the Government of Montenegro, preliminary budget revenues in 2023 amounted to 2,656.3 million EUR or 38.7% of the estimated GDP. This represents a budget revenue increase of 142.6 million EUR or 5.9% compared to the amount planned by the revised budget. The most significant revenue growth was recorded from value-added tax, corporate income tax, and contributions for mandatory social insurance. VAT revenues were 3% higher than planned, primarily due to increased revenues during the tourist season, higher tax revenue collection, price increases, and inflationary trends. Excise revenues grew by 9%, mainly from excises on mineral oils and their derivatives, as well as tobacco and tobacco products.

On the expenditure side of the budget, total expenditures amounted to 2,555.4 million EUR or 38.6% of the estimated GDP. Expenditures were 83.7 million EUR higher than planned and 13.8% higher compared to 2022. The current budget was executed at 93% of total spending, while the capital budget was at 7%. Delving into the expenditure structure, the highest outlays were for gross wages and employer contributions (643 million EUR), service expenses (64 million EUR), and subsidies (74.4 million

EUR). Transfers for social protection were particularly significant, amounting to 825.1 million EUR.

Public debt of Montenegro, according to the Ministry of Finance report, amounted to 4,126.82 million EUR at the end of 2023. In relative terms, this public debt was 60.27% of GDP. In absolute terms, public debt increased by 24.61 million EUR compared to 2022. The increase in debt resulted from state borrowing on one hand and regular repayment of exchange rate differences on the other. Relative to GDP, public debt significantly decreased by 10 percentage points due to the fact that GDP increased by about 900 million EUR in 2023. The largest percentage of public debt is attributed to EUROBOND, accounting for 42.38%.

Table MN1 Main economic indicators

	Total 2022 year	2023 Q1	2023 Q2	2023 Q3	2023 Q4	Total 2023 year
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**6.4**	6.2	6.9	6.6	4.3	**6.9**
Real private consumption (% change, yoy)	**9.7**	15.5	6.4	13.9	12.7	**12.12**
Real government consumption (% change, yoy)	**1.5**	3.0	3.0	9.4	17.7	**8.27**
Real investment (% change, yoy)	**0.1**	12.6	-2.7	16.0	18.3	**13.2**
Industrial output (% change, yoy)	**-3.3**	9.5	-1.0	9.1	7.4	**6.25**
Unemployment rate (LFS, % pa)	**14.7**	15.5	12.9	11.8	12.2	**13.1**
Nominal GDP (EUR million)	**5,924.0**	1,232.2	1,689.4	2,171.6	1,753.8	**6.889.0**
GDP per capita (EUR)	**9,598**	1,998	2,739	3,491	2,819	**11,047**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**12.4**	10.9	11.0	13.2	11.4	**12.7**
Consumer prices (% change, yoy, pa)	**13.0**	13.9	8.2	7.5	4.9	**4.3**
Producer prices (% change, yoy, pa)	**11.2**	12.0	4.9	4.0	5.5	**6.6**
Average gross wage (% change, yoy, pa)	**11.3**	9.0	12.8	12.5	13.1	**12.2**
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)	**763.46**	226.81	170.38	122.7	180.9	**674.3**
Exports of goods (EUR, % change, yoy)	**45.20**	4.96	-13.43	-49.2	0.5	**-3.8**
Imports of goods (EUR million)	**3,433.56**	796.10	962.43	1,032.2	965.7	**3,807.6**
Imports of goods (EUR, % change, yoy)	**40.66**	26.02	2.97	0.3	7.2	**7.5**
Current account balance (EUR million)	**-766.03**	-259.87	-279.10	-211.10	-454.3	**- 278.9**
Current account balance (% of GDP)	**12.93**	N/A	N/A	N/A	N/A	**3,7**
Foreign Direct Investment net inflows (EUR million)	**782.62**	117.82	148.52	53.3	108.3	**428.67**
Foreign exchange reserves (EUR million, eop)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Foreign debt (EUR million, eop)	**N/A**	9,289.00	9,167.79	9,380.69	9,245.23	**9,284.65**
GOVERNMENT FINANCE						
Revenues (EUR million)	**2,299.23**	606.87	775.45	667.35	661.6	**2,565.3**
Expense (EUR million)	**2,245.70**	516.70	621.70	660.20	828.1	**2,555.4**
Net = Gross operating balance	**53.53**	90.17	153.75	94.72	-106.97	**231.56**
Net acquisition of non-financial assets (EUR million)	**352.97**	27.39	43.65	72.31	133.53	**275.56**
Net lending/borrowing (EUR million)	**-299.44**	62.78	110.10	37.31	- 73.75	**-33.59**
Domestic government debt (EUR million, eop)	**468.77**	461.00	411.07	393,14	542,62	**542,62**
Foreign government debt (EUR million, eop)	**3,557.56**	3,619.56	3,613.40	3,593.62	3,517.29	**3,517.29**
Total government debt (eop. % of GDP)	**67.97%**	61.60%	60.75%	60,18%	60,27%	**60,27%**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Broad money, M4 (% change, yoy, eop)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Total domestic credit (% change, yoy, eop)	**7.74**	6.44	5.70	8.92	10.84	**11.9**
DMBs credit to households (% change, yoy, eop)	**8.63**	7.93	7.09	7.92	8.53	**8.67**
DMBs credit to enterprises (% change, yoy, eop)	**8.99**	4.84	2.10	1.39	3.46	**3.89**
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)	**4.34**	4.69	4.92	5.03	5.37	**5.00**
DMBs credit rate for households short-term (%, pa)	**5.82**	6.55	4.53	7.14	7.28	**6.37**

** Authors' calculations based on Monstat data.

Policy assumptions and projections summary

International institutions such as the International Monetary Fund (IMF) and the World Bank have provided economic projections for Montenegro, forecasting various macroeconomic indicators for the coming years. These projections indicate a moderate but steady growth in GDP, driven by tourism and infrastructure development. Inflation rates are expected to remain stable, though external economic pressures could pose risks. The unemployment rate is projected to decrease gradually, reflecting improvements in the labour market. Additionally, efforts to maintain fiscal discipline are anticipated to stabilize public debt levels, promoting a more sustainable economic environment for Montenegro. Below is an overview of the projections of the basic macroeconomic indicators.

Table MN2 Summary of projections

	2024	2025	2026
Real GDP (% change)	**4.0**	**3.5**	**5.8**
Real private consumption (% change)	2.2	1.5	5.8
Real government consumption (% change)	0.3	0.2	0.5
Real investment (% change)	1.6	1.5	1.4
Exports of goods and services (constant prices, % change)	3.6	3.4	3.7
Imports of goods and services (constant prices, % change)	3.8	3.1	3.5
Current account balance (% of GDP)	-9.9	-8.9	-12
Consumer prices (% change, pa)	3.0	2.5	3.2
Exchange rate, national currency/EUR (pa)*	N/A	N/A	N/A
Unemployment rate (LFS, %, pa)	13.7	12.9	11.9
General government balance (ESA 2010 definition, % of GDP)	N/A	N/A	N/A
Total domestic credit (% change, eop)	7.9	6.8	4.0

Source: Economic programme report 2023/2025 – 2024/2026. Ministry of Finance / Authors calculation

NORTH MACEDONIA

The Macedonian economy: navigating crosscurrents

Economic recovery: overestimated projections

The anticipated economic recovery for 2023 fell short of expectations. North Macedonia experienced a GDP growth rate of just 1.0%, significantly lower than the forecasted 2.3%. The journey toward achieving stable and sustainable growth remains fraught with challenges. The war in Ukraine and the ensuing European energy crisis disrupted the global economic recovery post-pandemic and destabilized Europe. Although GDP declined across Europe, the drop was slightly less severe than predicted. Inflation in the Eurozone is on a downward trend, yet disparities in food, beverage, tobacco, services, and energy prices maintain high inflation rates across Europe, including North Macedonia.

In the first quarter of 2023, North Macedonia's GDP grew by 1.4%, but in the second quarter, this growth slowed to 0.9%. This represents a significant decrease of approximately 1/3 compared to the same period in 2022. Private consumption mirrored the trends seen in 2022, registering 0.7% in Q1 and 2.8% in Q2 of 2023. Public consumption saw notable changes, with a decline of 4.3% in Q1 and 1.1% in Q2. Despite these declines, government consumption in the second quarter was a key driver of GDP growth. Both exports and imports decreased in the first half

of 2023, with the reduction in imports outpacing that of exports. This dynamic positively impacted net exports and, consequently, economic growth. Industrial output remained stagnant at 0.1% in Q1 but improved to 2.7% in Q2. Driven by growth in both buildings and civil engineering, construction activity surged by 12.7%.

In the third quarter of 2023, GDP growth slightly improved to 1.0%, maintaining stability in the face of ongoing economic challenges. Private consumption remained steady at 2.8%, reflecting consistent consumer confidence and spending. However, government consumption saw a notable increase of 5.6%, indicating significant fiscal intervention to support the economy. Industrial output experienced a minor setback, with a decrease of 0.8%, likely due to fluctuations in manufacturing activities. Despite this, construction continued to thrive, contributing positively to overall economic activity. By the fourth quarter of 2023, GDP growth held steady at 1.0%. Private consumption increased to 3.3%, boosting consumer spending likely fueled by seasonal factors and end-of-year economic activities. Government consumption slightly decreased to -0.6%, reflecting a return to more conservative fiscal policies after the earlier stimulus. Industrial output showed resilience with a 0.6% growth, and the construction sector maintained its momentum, underscoring the importance of infrastructure projects in driving economic stability.

In general, a decrease in private consumption is evident, with rates of 3.8% in 2022 and 2.4% in 2023. While public consumption shows an increase, it still stands at -0.6% in 2023. The most noticeable change in the analysed period is the decrease in investments, from 9.4% in 2022 to -16.7% in 2023.

Population projections indicate imminent labour market problems

Due to the application of the new EU Regulation related to Labour Force Survey (LFS) No. 2019/1700 and No. 2019/2240, the annual data of the labour market indicators for 2022 and 2023 is not comparable. Therefore, the analysis is separate for each year and only for the indicators related to the population 15-64 years.

In 2022, the total working-age population was 1.201.809 persons, the number of employed 681.856 persons and the unemployed 116.011 persons. Consequently, the activity rate reached 66.4%, the employment rate 56.7% and the unemployment rate 14.5%. The annual LFS data for 2023 shows that the number of the working-age population reached 1.198.386 persons; there were 680.174 employed and 103.270 unemployed persons. Because of such numbers, the activity rate amounted for 65.4%, the employment rate 56.8% and the unemployment rate 13.2%. The quarterly data for 2023 indicate that the total number of the working-age population increased up to Q3 (1.200.648 persons) and in Q4 decreased to 1.198.730 persons or for 0.2%. The same situation refers to the number of employed persons. The increase in their number was constant until the third quarter (686.110 persons). In Q4, it declined to 678.684 persons or by 1.1%. Regarding the unemployed persons, there was a significant decrease in their number from 104.403 (Q1) to 102.980 persons (Q4), which is a decline of 1.4%. Consequently, the number of inactive population rose from 415.801 (Q1) to 417.066 persons (Q4). The activity rate remained the same at 65.2% (Q1 and Q4), the employment rate slightly increased from 56.5% (Q1) to 56.6% (Q4), while the unemployment rate decreased from 13.4% to 13.2%, respectively. These rates had different changes for men and women. The activity and unemployment rates increased for men, while the employment rate for women.

New fiscal policy, concerns about public debt

By the end of 2022, the public revenues have been achieved by 104.85%. At the same time, there is an overrun in taxes and contributions. Total expenses were realized at 101.60%. The planned budget deficit was achieved at 83%. The public debt absolutely increased by 568 million EUR and at the end of 2022 it amounted to 7.703 million EUR. The internal indebtedness of public entities, especially public enterprises and healthcare institutions, is of particular concern.

According to the Budget for 2023, total revenues are increased by 14.8% in comparison with 2022 and total expenditures are increased by 12.6%. The budget deficit is planned as 4.6 of GDP. The Budget 2023 projects an increase in all types of taxes compared to Budget 2022. Some of these increases result from high inflation, while others are due to the implementation of tax reforms.

By the end of 2023, almost all the planned revenues with the Budget and the II amendment of the Budget and 98.08% of the expenditures have been realized. The budget deficit was achieved with 96.87% (of the planned 4.6% of GDP) as a result of the weak realization of expenditures for goods and services and capital expenditures. As of Q4, the public debt has increased by 774 million EUR and amounts to 8.477 million EUR. The public debt amounts to 62.1% of GDP.

Further restrictive monetary policy and a stable banking sector

Banking sector remains stable and solid with adequate level of capitalization and solid liquidity. The restrictive monetary policy continued to be implemented in 2023. Namely, the interest rate on CB bills from 4.75% at the end of 2022, reached 6.3% at the end of 2023, signalling further tightening of the monetary policy and securing price stabilization.

ROAA, with 1.5% at the end of 2022 and 2% at the end of 2023, and ROAE, with 12.2% at the end of 2022 and 16.1% at the end of 2023 demonstrate a high level of profitability in the banking sector. The deposit potential of the banks is growing at a rate of 9.1% at the end of 2023, which is higher than expected, whilst credit support to the private sector continues to grow moderately at 5.1%. The deposit base continuously increases, focusing on long-term deposits and deposits in MKD.

The share of "green" loans in total bank loans at the end of 2023 was 4.5%, marking a trend of growth. Such growth of the loans almost entirely results from the corporate sector. The foreign exchange market is stable. At the beginning of the energy crisis, foreign reserves decreased. However, by the end of 2023, they had grown by 40% compared to the pre-crisis period, successfully maintaining the stability of the MKD. At the end of December 2023, the foreign reserves reached 4,538.5 million EUR. Such a level of foreign reserves recorded stable growth despite the permanent interventions of the National Bank in the last 2 years for the net purchase of excess foreign currency assets from the banking sector.

Inflation: a persistent challenge

Inflation remains a volatile issue. The annual inflation rate, measured by the CPI Index, was 16.1% in Q1 2023 and reduced to 11.2% in Q2. Consumer prices began to decline gradually in the first quarter of 2023 after peaking at 14.2% in Q4 2022, primarily due to falling global prices for food and energy. This downward trend continued into the second quarter and so forth reaching 3.4% in Q4. Producer prices also saw a reduction, from 10.6% in Q1 to -2.8% in Q4. The National Bank of North Macedonia has taken steps to curb inflation by tightening monetary policy and raising the policy rate multiple times over the past two years. These measures have slowed credit growth, leading to reduced domestic consumption and lower inflation rates. The result is a decreased annual inflation rate. In 2023, it is 9.4% compared to 14.2% in 2022. However, sustained high nominal wage growth, from -2,7% in 2022 to 5,4% in 2023, poses a risk of reigniting inflation.

The current account in 2023 ends in surplus for the second time in the last 20 years

The current account reported a positive value of 0.7% of GDP in 2023, the second time in the past 20 years (the first time was in 2018, 0.1% of GDP). A narrowing trade deficit and substantial remittances and income from abroad contribute to this. The narrowing of the trade deficit is mainly contributed by the decrease in imports, and it is followed by the smaller decline in exports. As a result of improved international exchange conditions and higher raw material stocks in the previous period, import pressures have decreased. Additionally, reducing the energy import component also contributed to reducing the import component, because of both the lower import prices and the smaller import volume. The main reason for the weaker export results is the unfavourable world metal market situation, resulting in weaker achievements in the metal processing industry and mining sector in several consecutive quarters. Similar but smaller impacts were associated with reduced energy exports.

Compared to the previous year, the financial account of the balance in 2023 records lower net inflows. Direct investments and loans accounted for most of the net inflows. FDI is lower than last year, but it remains above the average of the past two decades. The state concluded loan agreements with several institutions to provide financial support for overcoming economic difficulties resulting from successive crises in the past period, while private debt is primarily caused by higher intercompany debt of capital-related entities. As a result of this increase in public debt, along with a small increase in private debt, gross external debt increased in 2023. Foreign exchange reserves increased significantly during this period of realized surpluses in the current account and net inflows in the financial account.

Table NM1 Main economic indicators

	Total 2022 year	2023 Q1	2023 Q2	2023 Q3	2023 Q4	Total 2023 year
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**2.2**	1.4	0.9	1.0	0.9	**1.0**
Real private consumption (% change, yoy)	**3.8**	0.7	2.8	2.8	3.3	**2.4**
Real government consumption (% change, yoy)	**-5.0**	-4.3	-1.1	-3.0	5.6	**-0.6**
Real investment (% change, yoy)	**9.4**	-22.3	-4.8	-18.7	-20.5	**-16.7**
Industrial output (% change, yoy)	**-0.3**	0.1	2.7	-0.8	0.6	**0.7**
Unemployment rate (LFS, % pa)	**14.4**	13.3	13.1	12.8	13.0	**13.1**
Nominal GDP (EUR million)	**13,034**	3,038.2	3,177.9	3,288.9	3,529.1	**13,655**
GDP per capita (EUR)	**7,122**	1,660.2	1,736.6	1,797.2	1,928.5	**7,462**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**7.7**	N/A	N/A	N/A	N/A	**3.6**
Consumer prices (% change, yoy, pa)	**14.2**	16.1	11.2	7.7	3.4	**9.4**
Producer prices (% change, yoy, pa)	**21.9**	10.6	5.6	-1.7	-2.8	**2.7**
Average gross wage (% change, yoy, pa)	**-2.7**	-2.5	3.8	6.9	13.1	**5.4**
Exchange rate (MKD/EUR, pa)	**61.62**	61.67	61.56	61.51	61.50	**61.56**
Exchange rate (MKD/USD, pa)	**58.60**	57.52	56.55	56.51	57.19	**56.94**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**7,320.29**	1,839.74	1,864.43	1,768.57	1,819.22	**7,291.96**
Exports of goods (EUR, % change, yoy)	**21.2**	10.4	-1.4	-4.6	-4.7	**-0.4**
Imports of goods (EUR million)	**10,801.29**	2,440.78	2,457.05	2,389.08	2,581.40	**9,868.31**
Imports of goods (EUR, % change, yoy)	**28.9**	-3.1	-11.8	-12.4	-6.8	**-8.6**
Current account balance (EUR million)	**-797.4**	92.8	-124.9	239.2	-111.7	**95.3**
Current account balance (% of GDP)	**-6.1**	0.7	-0.9	1.8	-0.8	**0.7**
Foreign Direct Investment net inflows (EUR million)	**654.2**	143.3	122.4	51.2	206.2	**523.1**
Foreign exchange reserves (EUR million, eop)	**3,862.9**	4,159.2	4,189.7	3,901.7	4,538.4	**4,538.4**
Foreign debt (EUR million, eop)	**10,790.0**	11,057.2	11,393.0	11,076.2	11,462.7	**11,462.7**
GOVERNMENT FINANCE						
Revenues (MKD million)	**243,085**	66,009	65,142	66,329	N/A	**N/A**
Expense (MKD million)	**278,518**	69,532	85,200	70,312	N/A	**N/A**
Net = Gross operating balance	**-35,433**	-3,523	-20,058	-3,983	N/A	**N/A**
Net acquisition of non-financial assets (MKD million)	**-26,364**	-5,131	-16,413	-4,774	N/A	**N/A**
Net lending/borrowing (MKD million)	**-9,069**	1,608	-3,645	791	N/A	**N/A**
Domestic government debt (EUR million, eop)	**2,597.4**	2,726.9	2,804.2	2,957.8	3,085.1	**3,085.1**
Foreign government debt (EUR million, eop)	**3,983.7**	4,475.0	4,450.0	3,978.6	4,171.0	**4,171.0**
Total government debt (eop. % of GDP)	**50.5**	49.6	50.0	47.8	50.0	**50.0**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**6.0**	9.5	14.5	8.0	11.0	**11.0**
Broad money, M4 (% change, yoy, eop)	**5.1**	6.9	13.9	9.6	11.1	**11.1**
Total domestic credit (% change, yoy, eop)	**9.4**	6.6	6.5	5.8	5.1	**5.1**
DMBs credit to households (% change, yoy, eop)	**7.3**	6.8	6.4	6.4	6.7	**6.7**
DMBs credit to enterprises (% change, yoy, eop)	**11.5**	6.2	6.5	5.1	3.3	**3.3**
Money market interest rate (%, pa)	**1.1**	N/A	N/A	3.7	4.0	**3.9**
DMBs credit rate for enterprises short-term (%, pa)	**4.2**	5.2	5.5	5.5	5.1	**5.4**
DMBs credit rate for households short-term (%, pa)	**3.2**	3.0	3.0	3.6	3.6	**3.5**

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 and State Statistical Office of the Republic of North Macedonia

Policy assumptions and projections summary

North Macedonia's economy is expected to continue its recovery in 2024, with projected growth remaining modest at 2.5%. Inflation control measures will impact household consumption, with private consumption expected to increase modestly by 1.4% in 2024. The primary objective will be to maintain current spending at sustainable levels ahead of elections, ensuring that wage increases align with those agreed upon in the general collective agreement. A positive development is the anticipated increase in public investment, particularly with the Corridor 8/10 project, which aims to enhance public investment management and prioritize projects more effectively. Inflation will probably gradually decrease due to tighter monetary policies and the stabilization of global energy and food prices. Temporary administrative price-control measures have provided some relief but are not seen as a long-term solution to inflationary pressures. The central bank must remain vigilant and ready to implement further tightening if inflationary risks resurface.

Based on the Population Projections of the Republic of North Macedonia until 2070, made by the State Statistical Office, in the next three years (2024-2026) the working-age population (15-64 years) will decrease by 3.4%. This decline will continue in the following decades as well, and we can expect a significant reduction in the inflow of younger generations of the working-age population.

Consequently, in the longer term, under the influence of the demographic ageing process and continuous intensive emigration abroad, a growing problem of providing a young and appropriate professional and educated labour force, which will be able to respond to the challenges of the global technological development, will be inevitable on the Macedonian labour market.

For 2024, the largest budget is planned so far, and for the next mid-term period, given the change of government expected in the second half of 2024, the development of the fiscal context is unpredictable. From the pre-election programs of the party that won the recent elections, it can be felt that there will be no fiscal consolidation (reduction of taxes and increase of expenditures), but the current trend will continue (new borrowing of 1 billion EUR).

Future steps in monetary policy should continue to ensure and prioritize price and financial stability. Moreover, further challenges in implementing green finance should also be part of the banking sector's role in mitigating climate change and energy efficiency projects. The process of digitalization will further continue to improve efficiency and services for the bank clients. It is expected that the credit activities of the banks will rise toward increased credit growth for businesses and households. North Macedonia's export and import performance will depend heavily on global trade dynamics, commodity prices, and the economic health of its major trading partners. The slight increase in energy prices (gas and electricity) in the next two to three years, as well as the increase in the import of raw materials and investments for the industry in the coming years, are expected to contribute to a slight deficit in the current account with the gradual increase in trade and normalization of import dynamics.

Table NM2 Summary of projections

	2024	2025	2025
Real GDP (% change)	**2.5**	**2.9**	**3**
Real private consumption (% change)	1.4	2.5	2.5
Real government consumption (% change)	1.5	3.3	2.7
Real investment (% change)	2.7	3.1	2.8
Exports of goods and services (constant prices, % change)	5.1	5.6	5.6
Imports of goods and services (constant prices, % change)	5.1	4.5	4.3
Current account balance (% of GDP)	-1.8	-2.1	-2.1
Consumer prices (% change, pa)	3.0	2.0	2.0
Exchange rate, national currency/EUR (pa)	N/A	N/A	N/A
Unemployment rate (LFS, %, pa)	12.9	12.8	N/A
General government balance (ESA 2010 definition, % of GDP)	-3.7	-3.0	N/A
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

ROMANIA

Romania's economic growth was resilient but mild

Romania's gross domestic product rose 2.1% in 2023, below the expectations and the 4.1% growth in 2022

Romania's gross domestic product rose 2.1% in 2023, being mainly underpinned by an expansionary fiscal impulse and, despite a peak in the key interest rate, by favourable monetary conditions. The fiscal stance supported both government consumption and, along with the contribution of European funds, public investment growth. Real interest rates remained negative and fuelled household consumption, while excess liquidity in the money market ensured easy access to finance for both the public and private sectors. These favourable effects were dampened by subdued external demand, as economic growth in the euro area, Romania's main trading partner, was marginal. In addition, geopolitical tensions, the war in Ukraine, as well as the significant exceeding of the budget deficit target created uncertainty in investor's sentiment

Household consumption decelerated compared to 2022, while government consumption and gross fixed capital formation rose strongly

Despite the positive path, the economic growth was below the domestic and external forecasts and below the 4.1% growth in 2022. Compared to the previous year, the deceleration of economic activity was driven by a lower contribution of household consumption to GDP growth and to the negative contribution of inventories. The decline in household consumption was more pronounced in the first half of the year, partly offset by an increase in the contribution of public consumption to GDP.

Specifically, household and government consumption grew by 2.8% and, respectively, 6.0% in 2023, compared to 5.8% and, respectively, -3.3% in 2022. The gross fixed capital formation rose by 14.4%, up from 5.9% in 2022. Both exports and imports of goods and services went down by around 1.4%, and, considering the negative trade balance, the net exports had a marginal positive contribution of 0.1% to GDP growth. The positive contributions of consumption and gross fixed capital formation to GDP growth were partially offset by the negative impact of the change in inventories (-4.3 percentage points).

On the output side, the decline in economic activity was mainly driven by an increase in the gross value added of the services sector of only 2.1%, compared to 10% in 2022. Notwithstanding the disinflationary trend, the inflation rate in the services sector remained high and the disinflationary movement was dampened. Moreover, the IT sector, which benefited from a strong push of digitisation, moderated its advance from 23% to 5% in 2023. The slowdown in services was mitigated by an increase in agriculture, forestry, and fishing gross value added of around 10%, compared to the previous year's decline, and an improvement in construction gross value added from 3% in 2022 to 11% in 2023. The industry remained in a contraction territory.

Significant disparities between capital remuneration and labour compensation persist despite some mirror improvements

The income method, which reveals how the output was distributed, shows a growth in the compensation of labour of 16.6%, up from 15.1% in the previous year, and an increase in the remuneration of capital by 11.6%, down from 22.1% in 2022. The wider increase of the former slightly narrowed the gap between the distribution of labour and capital, which remains, however, among the highest among the EU countries: in 2023, 37.6% of the gross value added was distributed to labour compensation (vs. 37% in 2022), while 53.3% was distributed to capital remuneration (vs. 54.7% in 2022).

The labour market was resilient, as the average number of employees increased and the real wage growth was positive.

In 2023, the labour market was resilient. The average number of employees increased by about 1.1%, compared to the previous year and the number of registered unemployed went down by about 2.9% in December 2023 compared to the same month in 2022, while the job vacancies dropped. The unemployment rate remained unchanged, at 5.8%, according to the last quarter of 2023 data. Positively, excepting February, in every month of 2023, the net wage growth was above the rate of inflation. Moreover, the gap widened in the second half of the year. For instance, the annual net wage growth rate was 15.4% in December 2023, while the inflation rate was about 6.6%. This dynamic kept the growth rate of household consumption in positive territory.

From a peak in inflation in December 2022, the disinflationary trend was steady throughout 2023. Thus, from 16.4% at the end of 2022, the annual inflation rate fell to 6.6% in December 2023. However, this disinflationary pattern contains some nuances. Firstly, it was moderate in the case of core inflation, with the base inflation index falling only to 8.4% in December 2023, compared to 14.7% in December 2022. Secondly, differences can also be seen between the components of core inflation. Specifically, the annualised change in the food price index was 0.8% in December 2023, while the increase in non-food and services prices was 9.2% and, respectively, 8.4%.

In 2023, the GDP deflator fell marginally to 12.2% from 13.2% in 2022. The breakdown of the GDP deflator into components shows a relatively equal contribution of labour and profit cost. Specifically, unit labour cost increased by around 14.2% compared to the previous year, while unit profit cost went up by 9.3%. Under these circumstances, considering the share of capital remuneration in the output distribution, unit labour cost accounted for 5.2 percentage points of the deflator, up from 4 percentage points in 2022, and unit profits contributed 5.1 percentage points to the value of the deflator, up from 9.2 percentage points in 2022. The difference of 1.9 percentage points corresponds to the unit taxes.

The interest rate hawkish cycle ended in 2023. The central bank opted for higher for longer interest rates to consolidate the disinflationary trend

In the first month of 2023, the central bank ended the tightening of key interest rates, which was quite ample in 2022, when the benchmark rate was raised by 500 basis points. As such, in January 2023, the central bank raised the key interest rate by another 25 basis points to 7%. Afterwards, the central bank kept interest rates higher for longer to strengthen the disinflationary trend. Money market conditions remained accommodative. Excess liquidity was high, peaking especially in the second part of the year when the daily average of the central bank's deposit facility was around 45 billion lei. On the secondary market, the central bank intervened only once, in March 2023, when it purchased government bonds worth about 1.3 billion lei.

The banking system remained highly resilient. The liquidity and capitalisation of the banking sector improved, while banks have shown the capacity to absorb possible adverse conditions or shocks. The solvency ratio increased from 23.4% in 2022 to 23.6% in 2023. The loan-to-deposit ratio declined from 71.5% in 2022 to 67.8% in 2023, as deposits rose by 11.8% and credit to the private sector by 6.4%. In terms of profitability, 2023 was a good year for banks, supported by high interest rates, with implications in maintaining a high spread between lending and deposit rates. Return on equity increased from 16.4% in 2022 to 20.1% in 2023. The quality of the bank asset portfolio continued its improving trend, with the non-performing loan ratio falling from 2.65% to 2.3%. It should be underlined that this performance was achieved in the context of a low financial intermediation.

Fiscal policy was dominated by tensions, as below-target budget execution was the main narrative of macroeconomic developments. 2023 brought a major deviation from the fiscal consolidation timetable agreed with the European Commission in the excessive deficit procedure opened against Romania. The high inflation rate in 2022 put pressure on the budget execution in 2023. These pressures materialised, notably, on the expenses related to labour, goods, and services, while budget revenues were below the targets. Despite some expense restraint measures adopted in the last quarter of the year, the budget deficit was around 6.6% of GDP, about 220 basis points above the authorities' target and 30 basis points above the deficit of the previous year. The structural budget balance was -6.00% of GDP, up from -5.90% of GDP in 2022, corresponding to a mildly stimulative fiscal impulse. On the positive side, the share of public investment in GDP reached 6.2% of GDP, up from the previous year. More than half of this share was supported by the European Multiannual Financial Framework 2014-2020.

Financial markets outperformed in 2023. The Bucharest stock exchange index had an annual return of around 35% in dollar terms. However, in regional context, the performance is more nuanced: above Prague (19%) and Sofia (31%), but below Budapest (49%) and Warsaw (52%). The positive momentum was also helped by the Hidroelectrica IPO, which was the largest IPO in Europe and the fourth largest globally.

The sovereign bond market performed against a backdrop of an annual decline in yields of around 200 basis points, which corresponds to an increase in bond prices. The disinflationary trend, the end of the hawkish interest rate cycle, and the high demand for Romanian bonds, both on the domestic and foreign markets, supported this development. For example, in 2023, the domestic sovereign bond bid-to-cover ratio was 1.5, which reflects a significantly higher demand than supply. Romania performed well in the region. However, the sovereign yield still remained the highest among the EU Member States.

As in the previous year, in 2023, the foreign exchange market was stable, being also backed-up by the foreign currency funds coming from the Recovery and Resilience Facility pre-financing of the National Recovery and Resilience Plan. The exchange rate between the national currency and the euro fluctuated within a narrow range, between 4.8858 lei and 4.9783 lei. Compared with the previous year, the average annual exchange rate of the national currency depreciated by around 0.30% against the euro.

The current account deficit narrowed in 2023 by around 3.3 billion euros, equivalent to 12.8%, to 22.69 billion euros in 2023. The share of the current account deficit in GDP declined from 9.2% to 7.0% in 2023. As the trade balance is the main determinant of the current account balance, the reduction of the trade deficit by around 3 billion euros supported the narrowing of the current account deficit. In addition, the services balance recorded a surplus of around 0.2 billion euros higher than in the previous year.

Exports of goods expanded by 1.3% in 2023, while imports of goods fell by 3.2%. The top five countries to which Romania's exports of goods were directed were Germany (21%), Italy (10.1%), France (6.3%), Hungary (5.7%) and Bulgaria (4.2%). The top five countries from which Romania imported goods were Germany (19.4%), Italy (8.7%), Hungary (6.5%), Poland (6.3%) and China (5.5%).

Table RO1 Main economic indicators

	Total 2022 year	2023 Q1	2023 Q2	2023 Q3	2023 Q4	Total 2023 year
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**4.1**	1.1	2.8	3.5	1.1	**2.1**
Real private consumption (% change, yoy)	**5.8**	1.3	5.3	1.5	3.3	**2.8**
Real government consumption (% change, yoy)	**-3.3**	2.5	4.3	8.8	8.1	**6.0**
Real investment (% change, yoy)	**5.9**	14.7	15.4	11.4	17.1	**14.4**
Industrial output (% change, yoy)	**-1.8**	-3.8	-4.8	-5.1	-4.9	**-4.9**
Unemployment rate (LFS, % pa)	**5.6**	5.5	5.7	5.6	5.6	**5.6**
Nominal GDP (EUR million)	**284,279**	64,299	75,420	87,807	96,874	**324,399**
GDP per capita (EUR)	**14,920**	3,370	3,960	4,610	5,080	**17,030**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**13.2**	15.8	9.8	8.6	13.1	**12.2**
Consumer prices (% change, yoy, pa)	**13.8**	15.3	14.2	12.6	10.4	**10.4**
Producer prices (% change, yoy, pa)	**43.8**	38.1	29.0	16.2	5.4	**5.3**
Average gross wage (% change, yoy, pa)	**11.2**	12.1	12.8	13.4	14.5	**14.5**
Exchange rate (RSD/EUR, pa)	**4.9315**	4.9189	4.9481	4.9493	4.9696	**4.9465**
Exchange rate (RSD/USD, pa)	**4.6885**	4.5839	4.5435	4.5484	4.6214	**4.5743**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**91,945**	23,821	23,607	22,862	22,809	**93,098**
Exports of goods (EUR, % change, yoy)	**23.1**	8.1	3.8	-5.1	-1.2	**1.3**
Imports of goods (EUR million)	**126,034**	30,623	30,130	29,935	31,357	**122,046**
Imports of goods (EUR, % change, yoy)	**28.1**	4.8	-2.8	-10.9	-2.6	**-3.2**
Current account balance (EUR million)	**-26,040**	-5,004	-4,822	-6,225	-6,643	**-22,694**
Current account balance (% of GDP)	**-9.2**	-7.8	-6.4	-7.1	-6.9	**-7.0**
Foreign Direct Investment net inflows (EUR million)	**8,807**	2,226	566	2,717	1,035	**6,544**
Foreign exchange reserves (EUR million, eop)	**52,305**	59,289	59,266	65,117	65,983	**65,983**
Foreign debt (EUR million, eop)	**98,638**	108,551	114,448	117,015	121,758	**121,758**
GOVERNMENT FINANCE						
Revenues (RSD million)	**95,715**	21,957	27,774	26,555	32,583	**108,868**
Expense (RSD million)	**113,697**	27,404	31,488	30,851	40,657	**130,399**
Net = Gross operating balance	**-17,982**	-5,447	-3,714	-4,296	-8,074	**-21,531**
Net acquisition of non-financial assets (RSD million)	**67,774**	69,123	69,240	72,940	77,410	**77,410**
Net lending/borrowing (RSD million)	**66,739**	75,432	76,782	79,697	80,096	**80,096**
Domestic government debt (EUR million, eop)	**47.5**	49.2	49.2	49.0	48.8	**48.8**
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)	**-2.1**	-6.0	-4.5	-2.5	2.8	**2.8**
Broad money, M4 (% change, yoy, eop)	**6.9**	8.2	9.7	10.1	10.7	**10.7**
Total domestic credit (% change, yoy, eop)	**12.1**	10.2	5.5	4.5	6.4	**6.4**
DMBs credit to households (% change, yoy, eop)	**4.3**	2.1	0.1	0.0	1.4	**1.4**
DMBs credit to enterprises (% change, yoy, eop)	**18.8**	16.9	11.6	7.8	10.3	**10.3**
Money market interest rate (%, pa)	**6.20**	7.1	6.6	6.4	6.3	**6.6**
DMBs credit rate for enterprises short-term (%, pa)	**7.8**	8.8	9.3	9.3	9.0	**9.0**
DMBs credit rate for households short-term (%, pa)	**13.2**	14.2	15.0	15.4	15.5	**15.5**

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: Eurostat, Statistical Office of Romania, National Bank of Romania, Ministry of Finance

Policy assumptions and projections summary

Both international and domestic institutions forecast a slight acceleration of economic growth in 2024. The spring forecast of the IMF foresees an economic growth of 2.8% in 2024, while the European Commission projects a GDP growth of 3.3% in 2024. In addition, the spring forecast of the Romania's National Commission for Strategy and Prognosis estimates an economic growth of 3.4%. The acceleration in real growth considers several favourable assumptions, but with a high degree of uncertainty.

Household consumption is expected to remain in positive territory, helped by real wage growth. Data for the first months of 2024 supports this hypothesis. In addition, the authorities adopted measures to increase public sector wages and the minimum wage, while most of the public sector pensions will grow one more time in September 2024, after the January 2024 increase.

Public investment is expected to remain at a high level, at around 7% of GDP, sustained by both national funds, but especially by European funds, related to the Multiannual Financial Framework 2021 - 2027 and the National Recovery and Resilience Plan. Investor sentiment towards Romania remains in an optimistic area, with the trend of the economic sentiment index being positive, both in 2023 and in the first half of 2024. Furthermore, an additional boost of foreign investment inflows is expected, considering some patterns of investment relocation, the opening of the European Union to the East, and a possible favourable decision on Romania's access to Schengen zone. Under these circumstances, gross fixed capital formation is expected to make at least a similar contribution to GDP growth as in 2023. Finally, although 2024 is a super election year, with local, European, parliamentary, and presidential election cycles, political stability is expected to be maintained for most of the year.

However, some risk factors also prevail. European Commission data indicate that the budget deficit remains high, at around 7%, significantly above the 5% target of the Romanian authorities. Most likely, 2025 will bring a tax reform that should restart fiscal consolidation. The way in which the possible tax reform will affect the revenue and expenditure structure may create tensions and uncertainties in the economy. Currently, demand for sovereign bonds is high, but the tightening of financial markets could lead to additional risks. In 2024, the current account deficit is estimated to be above 7% of GDP. The high twin deficits have negative consequences for public and private debt and create an external vulnerability risk. The European funds under the National Recovery and Resilience Plan are an important pillar of public investment. However, by the end of the first quarter of 2024, only 8% of the funds under Romania's Recovery and Resilience Plan had been accessed. With the Recovery and Resilience Facility implementation ending in 2026, there is a high risk of losing funds.

Table RO2 Summary of projections

	2024	2025	2026
Real GDP (% change)	**3.4**	**4.0**	**4.4**
Real private consumption (% change)	3.8	4.0	4.3
Real government consumption (% change)	5.0	1.2	1.5
Real investment (% change)	6.1	8.3	8.1
Exports of goods and services (constant prices, % change)	2.6	3.9	4.9
Imports of goods and services (constant prices, % change)	4.6	4.8	5.6
Current account balance (% of GDP)	-7.0	-6.6	-6.3
Consumer prices (% change, pa)	5.6	4.0	2.9
Exchange rate, national currency/EUR (pa)	5.00	5.06	5.12
Unemployment rate (LFS, %, pa)	5.5	5.2	4.9
General government balance (ESA 2010 definition, % of GDP)	-4.9	-4.6	-4.2
Total domestic credit (% change, eop)	N/A	N/A	N/A

Source: National Commission for Strategy and Prognosis – Spring Forecast, Ministry of Finance

S E R B I A

Serbia’s economy regained strength in the latter half of 2023 and overcame subdued growth prospects

Serbia’s 2023 economic outlook was profoundly influenced by global geopolitical tensions, trade fragmentations, monetary policy tightenings, and drifts in inflation. The country’s unexpected resilience to these challenges ultimately resulted in a smaller than initially anticipated impact on the national economy. Despite lacklustre economic growth recorded in the initial six months of 2023 (0.9% and 1.6% year-on-year growth in Q1 and Q2, respectively), Serbia achieved a robust upswing by year-end (3.6% and 3.8% year-on-year growth in Q3 and Q4, respectively). As a result, as the Statistical Office of the Republic of Serbia’s representatives claim, the overall real GDP growth for the year stood at 2.5%. According to the National Bank of Serbia’s estimation, the 2023 initial six-months’ economic growth was primarily driven by net exports (rising exports of goods and services, coupled with the decline in imports); whilst the latter six-months’ economic expansion was largely fueled by the boost in investments and private consumption. Additionally, the country’s

nominal GDP, according to the Serbian central bank's data, reached EUR 69,514 million in 2023 (reflecting a 13.1% increase compared to the previous year). Finally, concerning the country's GDP per capita, it is noteworthy that economic output per person remained robust in 2023 (it grew by 14.2% year-on-year and amounted to EUR 2,890 in the last quarter of 2023).

By the end of 2023, both real private consumption and real government consumption recorded significant year-on-year growth (2.5% and 5.9% in Q4 2023, respectively). Upon examining the origins of private consumption, the National Bank of Serbia's representatives indicated that the increase in household consumption during Q4 was primarily fueled by mass of earnings, and by consumption loans. On the other hand, government consumption was mainly influenced by the rise in public sector salary expenditures and the goods and services procurements.

Serbia's industrial production recorded 2.6% year-on-year growth in 2023

Real investment volume recorded its record-high in the fourth trimester of 2023 (5.2% year-on-year growth), resulting in cumulative year-on-year growth of 3.8%. Industrial output's cumulative year-on-year growth amounted to 2.6%, and as the Chamber of Commerce and Industry of Serbia's representatives claim, the main boost was owed to the impressive growth of 12.7% in the Electricity, gas, steam, and air conditioning supply sector, which contributed 2.1 percentage points to the overall industrial production growth.

Serbia's unemployment rate in 2023 was 9.4%

The latest available country-specific data from the Labour Force Survey revealed that the unemployment rate amounted to 9.4% in 2023 (0.2 percentage points decrease compared to 2022), i.e., that the employment rate amounted to 50.2% (0.7 percentage points increase

The investment plan "Leap into the Future – Serbia EXPO 2027" was announced

compared to 2022). In 2023, the number of employed individuals reached 2,842,000, reflecting a 0.8% increase from the previous year. On the other hand, the unemployed population experienced a slight decline of 0.2%, totalling 295,800 individuals. Employment expansion has been witnessed across various sectors – healthcare, professional and scientific endeavours, ICT, and construction sector. Finally, the 2023 average nominal net wage was RSD 94,979 (EUR 810), with the private sector's average wage of RSD 92,889 (EUR 793), and the public sector's average wage of RSD 100,149 (EUR 855).

In 2023, a fiscal deficit of 181 RSD billion (2.2% of GDP) was realized, 0.6 percentage points lower than forecasted 2.8% of GDP. The overestimation of the fiscal deficit over recent years became a modus operandi of the government, stemming from the practice of conservative estimation of the revenues and overestimation of the expenditures. The "savings" from the overestimated expenditures usually end up in the current budget reserves, which are further reallocated to budget beneficiaries on a discretionary basis. The practice of fiscal deficit overestimation is also visible in the first quarter of 2024; according to the statement of the Ministry of Finance, the budget deficit in Q1 2024 amounted to 19.7 RSD billion, which is better than the budget plan by 43.7 RSD billion since deficit was planned at 63.4 RSD billion. The main drivers of the favorable fiscal trends in 2024 were strong growth in revenues from value-added tax and social security contributions, due to the continued growth of wages and the recovery of private consumption.

The continuous practice of the government to act in a non-transparent manner, outside its own laws, remains a major concern that undermines the credibility of the budgetary process. The most recent example of this practice is the announcement of the program “Leap into the Future – Serbia EXPO 2027”, which envisages an investment plan worth 17.8 EUR billion in the next 4 years to fund infrastructural projects, including EXPO 2027. In July 2024, the controversial “Law on Special Procedures for the Implementation of Construction and Reconstruction Projects of Line Infrastructure Facilities of Special Importance for the Republic of Serbia”, which stipulated exemptions from the Public Procurement Law for big infrastructural projects, was abolished. Nevertheless, a few months later. the “Law on Special Procedures for the Implementation of the International Specialized Exhibition EXPO BELGRADE 2027” was adopted, which also provides for exemptions from the Public Procurement Law for the infrastructural projects related to the EXPO. Following the adoption of this law, the government has already borrowed around 1.3 EUR billion in four emissions of the 8-year bonds at a 7% coupon rate, with an estimated 700 EUR million interest payments. Due to the non-transparent acting of the government, the economic and financial benefits of this investment plan remain dubious and widely criticized by the public, including the Fiscal Council. On the other hand, the new borrowings have not endangered fiscal solvency in the short run, as the public debt relative to GDP continues to decline reaching around 51.5% in the first quarter of 2024.

Restrictive monetary policy is about to relax

After the prolonged period of continuous increase in the key policy rate (stretching from mid-2022 to mid-2023), the National Bank of Serbia has kept the key policy rate at 6.5% from July 2023 to June 2024. Subsequently, for most of the second half of 2023 and at the beginning of 2024, interest rates remained high but stable or slightly increasing. By the end of 2024 Q1, the money market interest rate was around 5.56%, only 0.1 percentage points above its value in 2023 Q3. A similar trend can also be observed in the average short-term interest rate on new loans to enterprises, which stabilized at 7.2% in 2024 Q1. The only exception is the short-term interest rate on new loans to households, which reached a peak in 2023 Q3 at around 10% and already showed a downward trend in Q4. The interest rate hikes in the second half of 2023 led to a contraction in total domestic credit, as well as in contraction in credit to enterprises, while credit to households increased but at sluggish growth rates. Nevertheless, developments in 2024 Q1 have indicated that credit activities are slowly recovering since the trend of declining loans to households and enterprises observed during most of 2022 has reversed. Indeed, in June 2024, the NBS Executive Board decided to decrease the key rate slightly to 6.25%, indicating that through the rest of 2024, a gradual easing of monetary policy can be expected, following the stabilization of global and domestic inflation.

Prices, wages, and exchange rates

A downward trend in inflation was observed throughout 2023. At the end of the year, inflation was only half as high compared to the end of the previous year, reaching 7.6%, while the average inflation rate was 12.1%. Observed by main groups according to the destination of consumption and their share in total consumption, the most significant contributors were dairy products, vegetables, meat, household electricity, bread, and cereals. The reduction in inflationary pressures was influenced by lower cost pressures, the effect of a high base of food prices, and the tightening of monetary policy. These factors also contributed to the reduction in core inflation (excluding energy, food, alcohol, and cigarettes), which amounted to 6.5% at the end of 2023. The slowdown in inflation was also supported by a decline in short-term inflation expectations in the financial and corporate sectors. Producer prices of industrial products increased by 1.6% in 2023, mainly due to higher costs for the supply of electricity and gas. During 2023, the dinar exchange rate remained relatively stable against the euro, with almost no change. On an annual basis, the dinar appreciated against the euro by 0.1% in nominal terms. At the same time, the dinar appreciated by 4.0 in nominal terms against the dollar due to the strengthening of the euro on the international market. Average gross wages amounted to RSD 118,599 at the end of 2023, while the average net wage was RSD 86,007. Compared to the previous year, the calculated average wage excluding taxes and contributions was 14.8% higher in nominal terms and 2.4% higher in real terms.

The current account gap significantly narrowed as imports slipped and exports continued to grow

According to the National Bank of Serbia's data, Serbia's current account deficit shrank by 56.5% to EUR 1,810 million in 2023. Consequently, the share of the current account deficit in the country's GDP fell from 6.9% in 2022 to 2.6% in 2023. The improvement was primarily due to the growth in exports and a decline in imports. In addition, the current account deficit was entirely covered by foreign direct investments (FDIs) - net FDI inflows amounted to EUR 4,220 million in 2023 (or 6.1% of the country's GDP). The majority of net FDI inflows, which decreased by 2.5% year-on-year in 2023, originated from EU member states (EUR 2,044 million), led by investments from the Netherlands (EUR 742 million), followed by Austria (EUR 302 million), Germany (EUR 170 million) and Slovenia (EUR 168 million). Outside the EU countries, the most important investors were China (with a remarkable EUR 1,372 million) and Great Britain (EUR 374 million). Significant investments also came from the Russian Federation (EUR 170 million). However, there was an almost threefold decrease compared to 2022.

Total trade slowed down, while a significant reduction in the trade deficit was recorded

According to data retrieved from the National Bank of Serbia, total trade in goods in 2023 experienced a slight decline of 1.20% compared to the previous year and amounted to EUR 62,464 million. While exports continued to rise (3.7% year-on-year), imports fell by 4.8% compared to 2022. The increase in exports was largely driven by manufacturing exports. On the other hand, lower energy imports and imports of intermediary goods contributed to the decline in total imports. The growth in exports combined with the decline in imports led to a significant reduction in the trade deficit. Namely, the trade deficit shrank considerably (29.5% year-on-year), and reached a value of EUR 6,604 million in 2023 (EUR 9,364 million in 2022). The coverage of imports by exports improved from 74.2% in 2022 to 80.9% in 2023.

The 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, shows that in 2023, the sections Machinery and transport equipment and Miscellaneous manufactured articles remain the most important in terms of exports, with a share of 30.3% and 19.9%, respectively. On the imports side, the main sections were Machinery and transport equipment (23.9% of total imports of goods), Manufactured goods classified chiefly by material (17.2%), Mineral fuels, lubricants, and related materials (14.0%) and Chemicals and related products, n.e.s. (13.7%).

The EU countries, CEFTA and China remain leading trade partners of Serbia

Serbia's exports were resilient in 2023 despite the declining demand from the EU and the region. The EU's share in Serbian exports reached 64.6%, while the CEFTA's share amounted to 15.4%. In terms of imports, the EU and CEFTA accounted for 57.8% and 4.6%, respectively. Broken down by country, Germany (15.1%), Bosnia and Herzegovina (6.9%), Italy (6.2%), Hungary (5.5%), and Romania (5.0%) took the lead in Serbian exports of goods. The top five importers were Germany (13.1%), followed by China (12.2%), Italy (7.3%), Turkey (4.7%) and the Russian Federation (4.3%).

The Republic of Serbia's Finance Ministry estimates that in 2023, the 15 largest exporters' combined export value was EUR 7.0 billion. The Chinese companies Serbia Zijin Mining, Serbia Zijin Copper, and HBIS Group were the top three exporters. The Customs Administration's data show that in 2023, exports totaling EUR 1,152 million were made by the companies Serbia Zijin Mining, EUR 746.3 million by Serbia Zijin Bor Copper, and EUR 549.1 million by HBIS Group Serbia Iron & Steel.

Regarding Serbia's trade relations with key partners, it is also worth mentioning that bilateral trade between Serbia and China will most likely intensify in the forthcoming period, considering that the Serbia-China Free Trade Agreement (FTA) was signed on October 17, 2023. With the signing of the FTA, Serbia became China's 29th free trade partner; and this agreement was the first of its kind between China and a country in Central and Eastern Europe. The FTA aims to facilitate bilateral trade primarily by reducing or eliminating tariffs on goods and opening up new opportunities for Serbian exporters.

Table SRB1 Main economic indicators

	Total 2022 year	2023 Q1	2023 Q2	2023 Q3	2023 Q4	Total 2023 year
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**2.6**	0.9	1.6	3.6	3.8	**2.5**
Real private consumption (% change, yoy)	**4.1**	-0.1	-0.6	1.5	2.5	**0.8**
Real government consumption (% change, yoy)	**0.5**	-5.1	-1.6	1.8	5.9	**0.3**
Real investment (% change, yoy)	**2.1**	1.9	3.9	4.1	5.2	**3.8**
Industrial output (% change, yoy)	**1.8**	2.8	0.9	3.8	2.8	**2.6**
Unemployment rate (LFS, % pa)	**9.6**	10.0	9.6	9.0	9.1	**9.4**
Nominal GDP (EUR million)	**60,429**	15,239	17,260	17,879	19,136	**69,514**
GDP per capita (EUR)	**9,070**	2,300	2,610	2,700	2,890	**10,500**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**10.6**	6.2	12.8	12.2	16.1	**12.0**
Consumer prices (% change, yoy, pa)	**15.1**	16.2	13.7	10.2	7.6	**7.6**
Producer prices (% change, yoy, pa)	**13.3**	5.5	1.2	2.2	1.6	**1.6**
Average gross wage (% change, yoy, pa)	**13.8**	9.2	16.1	14.9	-4.9	**14.8**
Exchange rate (RSD/EUR, pa)	**117.32**	117.29	117.23	117.20	117.17	**117.17**
Exchange rate (RSD/USD, pa)	**110.15**	107.56	107.82	110,75	105.87	**105.87**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**26,928**	7,088	7,102	6,759	6,980	**27,930**
Exports of goods (EUR, % change, yoy)	**28.1**	15.3	4.1	-0.9	-2.3	**3.7**
Imports of goods (EUR million)	**36,292**	8,847	8,622	8,003	9,062	**34,534**
Imports of goods (EUR, % change, yoy)	**34.2**	1.3	-9.8	-8.1	-2.4	**-4.8**
Current account balance (EUR million)	**-4,162**	-162	-404	-208	-1,037	**-1,810**
Current account balance (% of GDP)	**-6.9**	-1.1%	-2.3%	-1.2%	-5.4%	**-2.6**
Foreign Direct Investment net inflows (EUR million)	**4,328**	781	1,245	965	1,228	**-4,220**
Foreign exchange reserves (EUR million, eop)	**22,086**	23,782	24,840	26,275	27,863	**27,863**
Foreign debt (EUR million, eop)	**41,895**	43,528	44,318	44,763	45,3778	**45,377**
GOVERNMENT FINANCE						
Revenues (RSD million)	**3,103**	773	904	839	957	**3,473**
Expense (RSD million)	**2,802**	705	731	751	898	**3,086**
Net = Gross operating balance	**301**	68	173	88	58	**388**
Net acquisition of non-financial assets (RSD million)	**526**	93	103	117	255	**569**
Net lending/borrowing (RSD million)	**-225**	-25	70	-29	-197	**-181**
Domestic government debt (EUR million, eop)	**11,760**	11,125	11,204	10,283	10,791	**10,791**
Foreign government debt (EUR million, eop)	**21,566**	24,127	24,541	25,178	25,362	**25,362**
Total government debt (eop. % of GDP)	**55.63**	56.68	55.45	53.23	52.45	**52.45**
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	**2.47**	10.8	15.9	19.4	22.0	**22.0**
Broad money, M4 (% change, yoy, eop)	**N/A**	N/A	N/A	N/A	N/A	**N/A**
Total domestic credit (% change, yoy, eop)	**4.46**	3.26	2.00	-1.96	-0.14	**-0.14**
DMBs credit to households (% change, yoy, eop)	**6.06**	4.19	2.60	1.60	1.12	**1.12**
DMBs credit to enterprises (% change, yoy, eop)	**4.14**	1.79	0.25	-0.31	2.41	**2.41**
Money market interest rate (%, pa)	**1.93**	4.67	5.22	5.46	5.54	**5.23**
DMBs credit rate for enterprises short-term (%, pa)	**3.19**	6.26	6.81	7.16	7.45	**6.92**
DMBs credit rate for households short-term (%, pa)	**7.12**	9.15	9.77	10.00	9.09	**9.50**

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

Policy assumptions and projections summary

Despite the legal obligation (imposed by the Law on Fiscal System) to announce fiscal strategy in the first half of the year, by the conclusion of this issue of Outlook the new fiscal strategy that set mid-term budgetary framework for the period 2025-2027, was not yet publicly available. Regarding the mid-term framework set by the revised Fiscal Strategy for 2024-2026 (adopted in October 2023), some of the assumptions and forecasts appear to remain valid. More specifically, the forecast of GDP growth from 3.5% in 2024 to 4.3% in 2026 seems to be realistic. The recovery of private consumption will boost GDP growth in 2024, and the high growth rates in private consumption of around 4% will continue to be the main driver of the economic growth beyond 2024. Also, investments will continue to increase, driven by the high level of public investments and FDI.

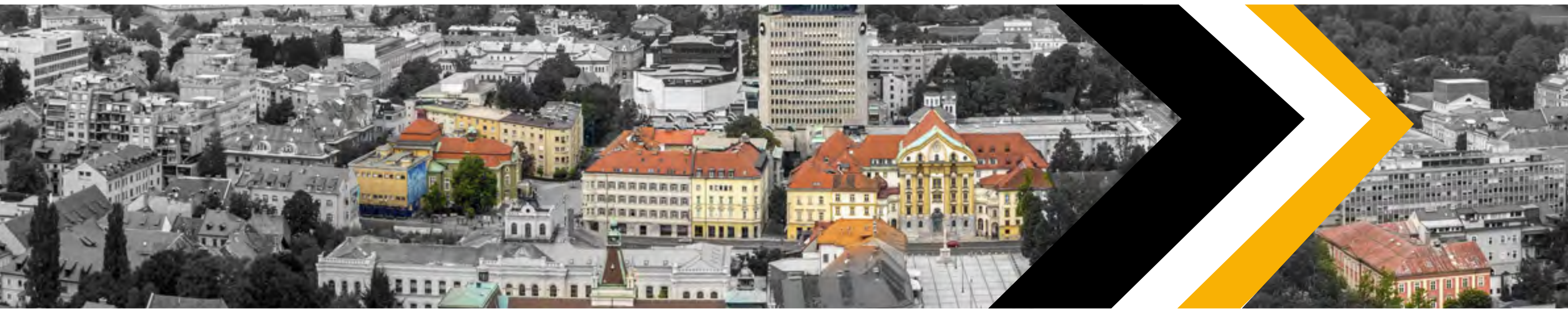
On the other hand, the growth rates of exports and imports as envisaged by the Fiscal Strategy for 2024-2026 are not realistic. The sluggish global recovery will most likely impede the high growth rates of export and import observed before pandemic and in the aftermath of the pandemic. Anyway, the current account deficit is expected to remain stable at around 4% over the period 2024-2026. Subsequently, the exchange rate EUR/RSD should also remain stable, as the expected inflow of foreign investments is sufficient to maintain the exchange rate without jeopardizing foreign exchange reserves.

On the monetary side, we expect inflationary pressures to ease in the upcoming period due to the effects of the previous monetary policy tightening, a slowdown in imported inflation, easing global cost pressures, weak external demand, and the expected further decline in inflation expectations. Disinflationary effects will also come from lower projected inflation in the Eurozone (our largest trading partner) and the expected lower growth of regulated prices due to a slower increase in utility service prices. On the fiscal side, we are expecting that the government will continue with the usual practice of conservative planning of the revenues, therefore, fiscal deficits in the period 2024-2026 will most likely be even lower than those forecasted by the revised Fiscal Strategy for 2024-2026.

Table SRB2 Summary of projections

	2024	2025	2026
Real GDP (% change)	**3.5**	**3.8**	**4.0**
Real private consumption (% change)	3.7	3.6	2.9
Real government consumption (% change)	2.8	1.6	4.0
Real investment (% change)	2.9	7.0	7.0
Exports of goods and services (constant prices, % change)	4.0	6.5	6.1
Imports of goods and services (constant prices, % change)	4.7	6.3	6.0
Current account balance (% of GDP)	-3.6	-3.9	-4.1
Consumer prices (% change, pa)	4.8	3.4	3.0
Exchange rate, national currency/EUR (pa)	117.1	117.1	117.1
Unemployment rate (LFS, %, pa)	9	8.5	8.5
General government balance (ESA 2010 definition, % of GDP)	-1.8	-1.2	-1
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

Economic growth slows further in 2023, with some signs of a recovery towards the end of the year

After a strong post-COVID-19 economic recovery in 2021 (8.2%), GDP growth slowed significantly in 2022 (2.5%) and remained subdued in 2023 (1.6%). The slowdown in 2022 was due to the outbreak of war in Ukraine and the resulting severe energy crisis in Europe, coupled with rising inflation and increases in central bank interest rates. In 2023, economic growth decelerated further, especially in the export-oriented part of the economy, amid a collapse in foreign demand and a deterioration in Slovenia's cost and price competitiveness, as the Bank of Slovenia reported. However, the last quarter of 2023 brought a slight recovery, with GDP rising by 2.2 % compared to the same quarter of the previous year. Amid improved economic sentiment, GDP grew by 2.1% year-on-year in the first quarter of 2024. However, a stronger recovery is still not in sight, as neither trade in goods nor industrial production is expected to improve significantly soon.

The main driver of GDP growth in 2023 was the strong growth in investment, mainly driven by strong growth in construction investment. On the other hand, the contribution of total gross investment was negative due to the

significant negative contribution of inventories. GDP growth was also boosted by a positive trade balance, resulting from a much stronger decline in imports of goods than in exports of goods. In addition, household and government final consumption expenditure also contributed to the growth of overall economic activity.

Strong investment growth driven by construction

Investment growth rebounded strongly last year. On an annual basis it stood at 9.5%, a strong rebound from 3.5% in 2022. Growth was mainly driven by buoyant construction investment, which was particularly strong in the segment of other buildings and structures, but residential construction also accelerated. Construction investment was largely driven by government investment and EU funds and was further boosted by reconstruction after the major floods that hit Slovenia in August 2023. On the other hand, investment in machinery and equipment was lower year-on-year in all four quarters of 2023, as capacity utilisation in the manufacturing sector fell amid weak external demand and uncertain economic conditions.

Despite strong investment growth, gross capital formation growth fell sharply last year (-9.8%) due to the large negative contribution from inventories, which was particularly strong in the first half of the year. The decline in gross capital formation growth weighed heavily on economic growth in 2023.

Household consumption growth decelerates as purchasing power falls

Growth in household final consumption decelerated from 3.3% in 2022 to 1.3% in 2023 as inflation eroded households' purchasing power. While year-on-year growth in household consumption was still robust in the first quarter and made an important contribution to GDP growth, it almost came to a halt in the second and third quarters. As inflationary pressures eased towards the end of the year, household consumption gradually picked up in the final quarter. According to the Institute for Macroeconomic Analysis and Development, households spent more on the purchase of new vehicles and tourist services abroad and less on food, non-food products and overnight stays in Slovenia last year. Although very low, growth in household final consumption remained positive on a year-on-year basis in all quarters of the year, supported by high employment, renewed real wage growth and government measures to mitigate high energy costs.

Government consumption picks-up

On the other hand, government consumption picked up markedly in 2023 (2.4%), after falling year-on-year in 2022 (-0.5%). While in the first quarter, it was still below the previous year's level due to lower COVID-related expenditure, in the rest of the year it was above the previous year's level. The increase in government consumption was driven by growth in employment and health expenditure, as well as the continuation of measures aimed at mitigating high energy prices. Towards the end of the year, government consumption was further boosted by expenditures related to the elimination of the consequences of the floods.

Sharp fall in industrial production

Industrial production, which turned negative in the last quarter of 2022, continued to decline in 2023 amid low domestic and foreign demand and concerns about the energy outlook. Compared to 2022, industrial production fell by 5.6%, similar to the contraction observed in the pandemic year of 2020. Businesses faced reduced production and declining orders, the latter becoming more unpredictable and unreliable. The largest year-on-year decline was observed in electricity, gas, steam and air conditioning supply (-32%), followed by mining and quarrying (-15%), but manufacturing also contracted and was 4.5% lower than in 2022. Production increased slightly only in high-technology manufacturing, while it decreased in medium- and low-technology manufacturing. The largest declines were observed in the energy-intensive chemical and paper industries, but also in the manufacture of basic metals and other non-metallic mineral products. The decline in output was also significant in some low-technology manufacturing industries, notably wood, but also furniture and textiles. On the other hand, industrial production rose in some sectors, notably the manufacture of computers, electronic and optical products and the manufacture of other machinery and equipment.

According to the latest PMI results, the decline in manufacturing activity continued in the first months of this year. Prospects for a concrete recovery are bleak, as the German economy, one of Slovenia's main trading partners has contracted slightly again in the first quarter of 2024.

International trade deteriorates

Activity in the export-oriented part of the economy weakened substantially in 2023, reflecting the slowdown in economic activity in Slovenia's main trading partners, the intensification of geopolitical tensions and the deterioration in the international price competitiveness of Slovenian exporters. Year-on-year growth in goods exports turned negative in the second quarter of 2023 (-0.5%) and plummeted in the third quarter (-9.7%). In the last quarter of the year, exports of goods increased compared with the previous quarter, but year-on-year growth remained negative (-2.5%). On an annual basis, exports of goods were -2.5% lower than in 2022, and exporters' expectations for the first quarter of this year remain low.

According to the Bank of Slovenia, Slovenia's international price competitiveness deteriorated significantly in 2022 and in the first half of 2023, especially under the influence of higher price growth in Slovenia compared to its trading partners. The gap between domestic inflation and the euro area average (the euro area being Slovenia's largest export market) was increasingly reinforced by the faster increase in domestic labour costs. Although the situation improved in the second half of the year, the international competitive price position of Slovenian manufacturing exporters remained unfavourable.

The decline in imports of goods was even more pronounced last year, with a year-on-year contraction of -6.0%. The sharp decline was the combined result of the slowdown in final consumption, the ongoing contraction in industrial production and a substantial drawdown in inventories. In line with developments in trade in goods, exports of transport services were also lower in 2023 than in the previous year. As regards total services exports, they were slightly higher (0.3%) in 2023 than in the previous year, mainly due to higher exports of tourism-related services.

The current account moves into surplus

Amid improved terms of trade and a significant decline in imports, the current account balance moved into surplus in 2023. It amounted to more than EUR 2.8 billion or 4.5% of GDP. The main contributor to the turnaround was the surplus in the goods trade balance, which amounted to EUR 461 million, due to a much larger fall in imports than in exports. The high surplus in services, already observed in 2022, continued in 2023, mainly due to the high trade surpluses in transport services (amid falling imports) and construction services (amid significant increases in exports). Primary and secondary income also supported the current account surplus.

Unemployment rate declines further, but demand for new jobs down

According to the Labour Force Survey, the unemployment rate continued to fall in 2023. It was at a historically low level of 3.7%, 0.3 p.p. lower than in 2022. In the last quarter of the year, it fell to 3.4%, a level similar to the same quarter of 2022 (3.5%). Long-term unemployment also continued to fall. The long-term unemployment rate (12 months or more) was 1.5%, 0.2 p.p. lower than in 2022.

In 2023, the number of unemployed fell and the number of employed rose further by 0.3% to 989,000 people, the highest level since 2009. The continued rise in employment was driven by positive developments in construction, followed by administrative and support services and trade. In contrast, real estate activities recorded the largest decline in the number of people employed, followed by several sectors including information & communication, financial & insurance activities, entertainment & recreation, electricity, gas & air conditioning, and public administration & education. Despite a further increase in the number of persons employed, the employment rate fell slightly last year (by 0.2 p.p. to 56.4 %).

The year-on-year comparison shows a decline in the demand for new jobs in 2023. Between Q4 2022 and Q4 2023, the average vacancy rate decreased by 0.3 p.p. to 2.5% (seasonally adjusted). The activity with the highest vacancy rate continued to be construction, followed by hotels and restaurants and administrative and support services.

Inflation decelerates markedly

Consumer price growth has decelerated markedly during the past year, falling from 10.0% to 4.2% between January and December 2023. In the first quarter of 2024, inflation eased further, reaching 3.4%. The average inflation rate in 2023 was 7.4%, representing a 1.4 percentage point decline from the previous year. The deceleration in inflation was largely driven by a moderation in price increases in the food and non-alcoholic beverages group. The prices of energy products contributed further to the CPI slowdown, reflecting a continuation of government measures related to the price regulation for electricity, lower taxation on certain energy products and a better situation with energy prices in the world market. Consumer price growth moderated also in all other main groups of consumer products last year. Despite signs of easing, core inflation remained rather high in 2023, driven mainly by services price inflation. There has been a notable increase in the prices of services since the post-COVID-19 recovery, driven by a combination of factors including higher demand, labour shortages, particularly in certain service activities, and cost pressures related to rising wages and the costs of goods. According to the Statistical Office of Slovenia, services prices increased by 6.0% on average last year, while goods prices rose by 3.3%. Given that inflation has recently been driven primarily by rising prices in services and rents, the government has announced plans to shift its measures aimed at curbing inflation from energy and food prices to services prices.

Concerning producer prices, these have also declined significantly over the past year due to the slowdown in prices on commodity markets and the moderation of economic activity. In December 2023, the average level of producer prices remained unchanged year-on-year, while they had grown by 18.2% year-on-year in January 2023. According to the Statistical Office of Slovenia, the decline was largely attributable to the intermediate goods group, for which prices had already fallen year-on-year since August of the previous year, and the energy group for which inflation fell from 79% to 4.2% between January and December 2023. Price growth has also been weakening in the consumer goods sector and less so in the capital goods group.

Amid a slowdown in inflation, real wages increase

The average wage growth has remained high over the past year, due to inflation compensation and a shortage of workers. The average gross wage was EUR 2,221 (net wage EUR 1,445), representing a 9.7% increase compared to 2022. The increase in the average gross wage was comparable in the public (10.3%) and private (9.4%) sectors. In addition to the effects of inflation and a shortage of labour, the rise in public sector wages can be attributed to the agreement reached in the autumn of 2022 with public sector unions on wage increases. The increase in the private sector was also the result of increases in the minimum wage. With the slowdown in inflation, real wages increased as well. According to the Statistical Office of Slovenia, real wages increased by 2.1% in 2023, following a decline of 6.6% in 2022.

An analysis by the Bank of Slovenia revealed that wage growth in Slovenia exceeded that in the euro area by approximately 2.5 percentage points in 2022, with the gap widening to 6.3 percentage points in 2023. The primary drivers of higher wage growth in Slovenia were tighter labour market conditions and more backward-looking wage dynamics. The phenomenon of high wage growth, which outpaces productivity growth, has the effect of deteriorating the international price competitiveness of Slovenia's exporters. Furthermore, it is the main factor in the service price inflation that could further widen the gap between domestic and euro area core inflation.

Demand for credit plums

The European Central Bank (ECB) has continued to tighten its monetary policy in the first nine months of 2023. This is evidenced by the marginal lending and deposit facility increasing to a record high of 4.75% and 4.00%, respectively, in September 2023. The ECB's interest rate increases have been reflected in domestic interest rates. The interest rates on loans have risen significantly in the twelve-month period up to June 2023, especially those for new (short-term) credit to enterprises, which have increased by approximately three and a half times. Similarly, (short-term) credit rates for households have also doubled. In the second half of 2023, the year-on-year increase in credit rates slowed down, reflecting the European Central Bank's decision to maintain the three key ECB interest rates unchanged since September 2023.

The increase in the cost of borrowing, coupled with the slowdown in economic activity, has markedly reduced the level of demand for credit, especially among enterprises. The year-on-year growth in the volume of bank loans to enterprises has slowed from 16.9% in September 2022 to 0.8% in July 2023 and subsequently turned negative. In December 2023, the volume of bank loans to enterprises was down year-on-year by 5.3%. The decline in household loans was less pronounced. The year-on-year growth declined from 8.5% in September 2022 to 3.2% in September 2023 and subsequently increased slightly towards the end of the year. The decline was entirely driven by a rapid slowdown in the growth of housing loans amid a significant increase in the interest rate for new loans for house purchases. The year-on-year growth in housing loans fell from just below 10% at the end of 2022 to 0.7% in December 2023. Conversely, the year-on-year growth in consumer loans, which commenced in October 2022, accelerated throughout 2023, thereby driving the overall increase in the year-on-year growth rate of household loans in the final quarter of the year.

General government deficit down

The general government deficit declined to 2.5% of GDP in 2023 from 3.0% in 2022. This decline in the government deficit was attributed to a higher year-on-year increase in general government revenue (10.7%) than expenditure (9.5%). The rise in general government revenue was primarily driven by higher social contributions, reflecting both strong wage growth and higher employment in the economy as a whole. While tax revenue also increased, its year-on-year growth slowed, particularly in the case of taxes on consumption, which were dampened by the temporary government measures to mitigate energy price rises (reduced VAT, excise duties and CO2 emission tax on energy products) in the first five months of last year. In December, general government revenue was further augmented by the disbursement of the second payment of EUR 536 million under the EU's Recovery and Resilience Facility.

On the expenditure side, the increase was related to the higher compensation of employees affected by the public sector wage agreement and to the measures implemented to mitigate the impact of high energy prices. In the second part of the year, general government expenditure was further affected by the first costs related to the reconstruction after the floods that hit Slovenia in August.

The trajectory of the general government debt as a ratio to GDP continued to improve as a result of the high increase in nominal GDP. By the end of 2023, general government gross debt had decreased to 69.2% of GDP, representing a 3.3 percentage point drop compared to the end of 2022.

Table SLO1 Main economic indicators

	Total 2022 year	2022 Q1	2022 Q2	2022 Q3	2022 Q4	Total 2023 year
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	**2.5**	1.1	1.7	1.3	2.2	**1.6**
Real private consumption (% change, yoy)	**3.3**	3.4	0.4	0.3	1.2	**1.3**
Real government consumption (% change, yoy)	**-0.5**	-1.0	3.2	2.4	4.8	**2.4**
Gross fixed capital formation (% change, yoy)	**3.5**	7.7	11.2	9.9	9.1	**9.5**
Industrial output (% change, yoy)	**1.2**	-3.4	-4.1	-10.1	-5.1	**-5.6**
Unemployment rate (LFS, % pa)	**4.0**	3.8	3.6	3.9	3.4	**3.7**
Nominal GDP (EUR million)	**57,038**	14,402	16,073	16,158	16,457	**63,090**
GDP per capita (EUR)	**27,040**	6,803	7,590	7,618	7,751	**29,753**
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	**6.5**	11.2	9.1	7.0	8.5	**8.9**
Consumer prices (% change, yoy, pa)	**8.8**	9.9	8.2	6.6	5.3	**7.4**
Producer prices (% change, yoy, pa)	**19.6**	15.5	7.1	2.4	0.4	**6.4**
Average gross wage (% change, yoy, pa)	**2.8**	10.4	9.9	10.0	8.7	**9.7**
Exchange rate (EUR/USD, pa)	**0.95**	0.93	0.92	0.92	0.93	**0.92**
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	**42,628**	10,858	10,819	9,466	10,149	**41,292**
Exports of goods (EUR, % change, yoy)	**2.9**	2.0	-0.5	-9.1	-2.5	**-2.5**
Imports of goods (EUR million)	**44,802**	10,824	10,337	9,492	10,179	**40,831**
Imports of goods (EUR, % change, yoy)	**7.7**	-1.6	-6.0	-12.2	-4.0	**-6.0**
Current account balance (EUR million)	**-578**	544	1,087	550	643	**2,824**
Current account balance (% of GDP)	**-1.0**	3.8	6.8	3.4	3.9	**4.5**
Foreign Direct Investment net inflows (EUR million)	**2,051**	567	395	106	-11	**1,056**
Foreign exchange reserves (EUR million, eop)	**757**	804	814	826	797	**797**
Foreign debt (EUR million, eop)	**51,825**	54,935	55,780	57,273	57,940	**57,940**
GOVERNMENT FINANCE						
Revenues (EUR million)	**25,209**	6,336	6,975	7,014	7,589	**27,913**
Expense (EUR million)	**26,911**	6,783	7,463	7,210	8,008	**29,465**
Net lending/borrowing (EUR million)	**-1,701**	-448	-488	-196	-420	**-1,552**
Domestic government debt (EUR million, eop)	**35,546**	36,267	36,537	36,621	36,404	**36,404**
Foreign government debt (EUR million, eop)	**2,299**	2,299	2,193	3,125	3,424	**3,424**
Total government debt (eop, % of GDP)	**72.5**	72.2	70.7	71.8	69.2	**69.2**
MONETARY INDICATORS						
Total domestic credit (% change, yoy, eop)	**3.2**	3.0	8.0	5.2	4.0	**4.0**
DMBs credit to households (% change, yoy, eop)	**7.6**	6.1	4.0	3.2	3.6	**3.6**
DMBs credit to enterprises (% change, yoy, eop)	**12.5**	5.0	3.8	-1.9	-5.3	**-5.3**
Money market interest rate (%, pa)	**0.0**	2.2	3.1	3.6	3.9	**3.2**
DMBs credit rate for enterprises short-term (%, pa)	**2.2**	4.2	5.0	5.1	5.5	**5.5**
DMBs credit rate for households short-term (%, pa)	**3.6**	6.0	6.2	6.6	6.4	**6.4**

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 of the Republic of Slovenia, the Institute for Macroeconomic Analysis and Development of the Republic of Slovenia, and Eurostat.

Policy assumptions and projections summary

Economic growth is forecast to accelerate, but downside risks present

It is projected that economic growth will accelerate in 2024 in comparison to the previous year. However, this acceleration is expected to be less pronounced than previously anticipated. The IMF's April 2024 forecast indicates that GDP will expand by 2.0% in 2024, before accelerating to 2.5% in the following year. In contrast, the Institute for Macroeconomic Analysis and Development of the Republic of Slovenia (IMAD) projects that GDP growth will accelerate to 2.4% and 2.5% in 2024 and 2025, respectively. The most recent forecasts indicate a downward revision of 0.2 p.p. and 0.4 p.p. in GDP growth for 2024 compared to the autumn 2023 projections of the IMF and IMAD, respectively. In accordance with the projections of the IMF and IMAD, the European Commission anticipates that GDP will expand by 2.3% this year and 2.6% next year. Despite the anticipated acceleration in economic growth, several potential risks could have an adverse impact on the outlook. These include the possibility of an adverse shift in the international economic environment, which could impact the anticipated recovery of Slovenia's trading partners, the pace of inflation moderation, and the impact of deteriorating cost competitiveness on the export-oriented part of the economy.

Due to a systemic change in the financing of the healthcare system, a compulsory health contribution was introduced in 2024 that replaced the previous supplementary (private) health insurance. As a result, public consumption will accelerate more (by 6.8%) and private consumption less (by 1.6%) than previously projected. Private consumption growth will be supported by high employment levels, rising wages and increased household purchasing power. Public consumption, on the other hand, will continue to grow, driven by further growth in public employment and the gradual implementation of a long-term care system. In 2025, both private and government consumption are projected to expand year-on-year by around 2.0%. Investment growth is projected to remain strong over the projection horizon, driven by continued strong government investment activity. Strong growth in government investment will be supported by the expected deployment of Recovery and Resilience Plan financed measures and reconstruction works after last year's floods. Furthermore, investment in machinery and equipment is also expected to recover, as a result of the projected increase in goods exports. Nevertheless, the recovery of investment in machinery and equipment may be less pronounced than initially anticipated, given that foreign demand has been recovering more slowly than previously expected during the initial months of 2024. Regarding imports, these are projected to recover more strongly than exports, resulting in a negative contribution to GDP growth from net exports.

Despite the projected increase in economic growth, employment is not expected to significantly increase over the next two years. This is due to the already high employment levels, shortages in the domestic labour supply amid the ageing of the labour force, and the mismatch between demand and supply of certain skills. Consequently, employment growth will continue to rely on the inflow of foreign workers. In line with these developments, the unemployment rate will remain stable and low. In the current year, the unemployment rate is projected to remain at the same level as last year (3.7%), while projections for 2025 diverge somewhat. In the next year, the European Commission projects a further slight decline in unemployment (by 0.1 p.p.), while the IMAD expects the unemployment rate to remain unchanged and the IMF forecasts a slight increase (by 0.1 p.p.).

Following a notable deceleration in the rate of inflation during the previous year, which reached 4.2% in December 2023, inflation is projected to decline further this year and average 2.7%. This year's decline is expected to be driven by a slowdown in the growth of services prices and food prices. Nevertheless, service price inflation is expected to be the dominant contributor to inflation over the forecast horizon, given the tight labour market and wage growth. The IMF and EC project a further decline in inflation in 2025 to 2.4% and 2.0%, respectively. IMAD, on the other hand, forecasts that inflation will moderate towards 2.2% only in 2026, while it expects a temporary rise in inflation in 2025 (3.4%) due to the base effect and the expiry of temporary measures to mitigate high energy prices.

The European Commission has forecast that the general government deficit will increase by 0.3 percentage points to 2.8% of GDP this year, before declining to 2.2% of GDP the following year. This year, the deficit is projected to increase due to a higher growth in expenditure than revenue. The increase in expenditure is attributable to higher spending on health, the indexation of social benefits, including pensions, and costs related to the reconstruction following the floods. Regarding revenue growth, this is anticipated to be driven by the withdrawal of revenue-reducing measures targeted at mitigating the impact of high energy prices (reduced VAT rates, excise duties, CO2 duty).

Table SLO2 Summary of projections

	2024	2025	2026
Real GDP (% change)	**2.4**	**2.5**	**2.6**
Real private consumption (% change)	1.6	2.0	1.9
Real government consumption (% change)	6.8	1.9	3.8
Gross fixed capital formation (% change)	4.2	4.0	3.5
Exports of goods and services (constant prices, % change)	1.5	3.2	4.2
Imports of goods and services (constant prices, % change)	3.7	4.0	4.2
Current account balance (% of GDP)	2.3	1.6	1.5
Consumer prices (% change, pa)	2.7	3.4	2.2
Exchange rate, /EUR (pa)	0.919	0.919	0.919
Unemployment rate (LFS, %. pa)	3.8	3.8	3.7
General government balance (ESA 2010 definition, % of GDP)	-2.8	-2.2	N/A

Source: Institute for Macroeconomic Analysis and Development of the Republic of Slovenia, and European Commission.

PUBLISHER INFORMATION

This publication has been prepared by:

Editor: Aida Hanić,
Institute of Economic Sciences, Belgrade

Bosnia and Herzegovina: Muamer Halilbašić, 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"

Romania: George Georgescu, Luminița Chivu, Mihai Nițoi, Dorina Clichici, Andrei-Jean Vasile, National Institute of Economic Research, Romanian Academy

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

Slovenia: Sonja Uršič, Institute for Economic Research, Ljubljana

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

National Institute of Economic Research, Romanian Academy,
Calea 13 Septembrie 13, 050711 Bucharest

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

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

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