SEE-6
Economic Outlook

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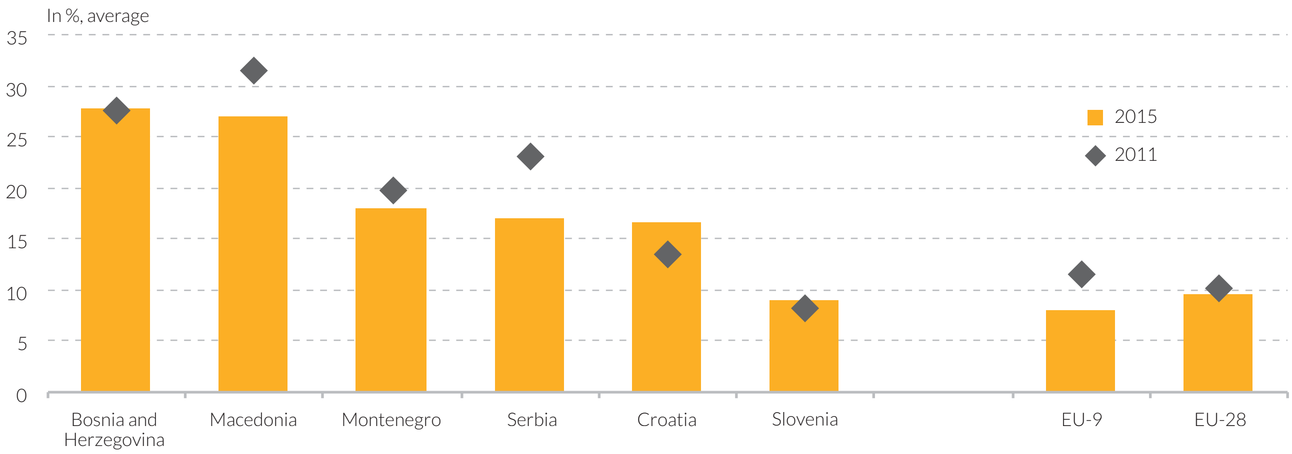
CONTENT

UNEMPLOYMENT RATE, LFS, FOR SEE-6, EU-9* AND EU-28



Source: WIIW Database for SEE-6, Eurostat for EU-9 and EU-28.
Note: * EU-9 include Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania and Slovakia.

seea | Vol. 2 | No. 1 | June 2016 | e-ISSN 1849-8884 | ISSN 1849-8817
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BOSNIA AND HERZEGOVINA

Moderate growth in spite of a lacking consensus on key political issues

Recent economic developments

Complex constitutional set-up makes consensus impossible even in most vital areas

Bosnia and Herzegovina has a complex constitutional set-up that has made it difficult to generate policy changes and implement reforms. As a result of this complex structure, main political representatives can hardly reach consensus on how political authority and administrative competencies should be arranged in order to ensure continued progress towards the EU and to create conditions for the country's sustainable economic development. Thus, although the Stabilization and Association Agreement (SAA) came into force in June 2015, the authorities in Bosnia and Herzegovina have not yet adapted the trade part of the agreement. This is a particularly important, because the adaptation of the SAA is one of the basic conditions on which the European Commission insists in order to grant candidate status for the EU membership. Furthermore, while the respective governments have coordinated a development strategy (Reform Agenda), Bosnia and Herzegovina still lacks coherent country-wide sectoral policies in strategic areas such as energy, agriculture, education, and transportation. The implications of this

are severe – from deterring foreign investment, to slowing down of the EU accession process, the latter being a key stated objective of both entities and also popular among general public.

Reform Agenda to boost economic growth

A key challenge of the Bosnia and Herzegovina economy in the coming period is to find an economic model that will increase the share of private sector in total economic activity and thus be directed towards a more dynamic economic development. This model should provide a business environment conducive to private investment, support small and medium entrepreneurship, improve export potential and productivity, reduce imbalances between supply and demand in the labor market, and generally, improve the economic infrastructure. As a first step towards such a model, in July 2015 the Bosnia and Herzegovina Council of Ministers and entity governments agreed upon the Reform Agenda. This Reform Agenda highlights many of the previously mentioned challenges and objectives related to the strengthening of economic growth, creation of new jobs, improvement of the efficiency of social assistance, and simultaneously to the assurance of fiscal consolidation and macroeconomic stability. Reform Agenda is supported by the International Labour Organization (ILO), International Monetary Fund (IMF), and the World Bank (WB).

In addition to the Reform Agenda, an Economic and Social Affairs Platform (ESAP) was launched in March 2016. ESAP is intended to strengthen regional cooperation, the investment capacity of the countries in the region (Albania, Bosnia and Herzegovina, Kosovo, Serbia, and Macedonia), and associations of employers and workers. At the same time, the project should enable countries in the region to develop and effectively implement labor market and social policy reforms in order to accelerate its EU accession process. It will be implemented jointly by the ILO and the Regional Cooperation Council (RCC) and will last 36 months.

In March 2016, Bosnia and Herzegovina has made another step towards a more efficient labor market by adopting a new Labor Law. The new Labor Law should contribute to greater labor market flexibility, and it should also enable better alignment between supply and demand, and thus, higher employment. It is also expected that the new Labor Law will have positive effects on the budget deficit by limiting public expenditure and gross wages in the public sector.

In order to support Bosnia and Herzegovina's efforts aimed at economic reforms, in May 2016, the IMF and the authorities of Bosnia and Herzegovina reached an agreement on an economic program that will be supported by approximately EUR 550 million in loans. The program will last 36 months, and its main objectives can be summarized as: a) Improving the business environment in order to attract investment, creating new jobs in the private sector and increasing the potential for economic growth; b) Mitigating the problems with public debt through fiscal consolidation and a higher quality of government spending; c) Ensuring the stability of the financial sector and the revival of credit growth.

Continuation of moderate growth

Bosnia and Herzegovina achieved a moderate GDP growth in the third and fourth quarter of 2015. In the third quarter of 2015, GDP increased by 3.7 percent, and in the fourth it increased by 2.1 percent, compared to the same quarters in 2014. The average rate of GDP growth in 2015 was 2.8 percent, representing a slight increase compared to the growth in 2013 and 2014. A rebound in economic activity can be attributed to the recovery from floods that hit the country in mid-2014 and a favorable economic situation in Bosnia and Herzegovina's major trading partners – Croatia, Serbia, and Slovenia. In 2015, the growth of industrial production in Bosnia and Herzegovina was 2.6 percent. The largest contribution to this growth was achieved through increased production in manufacturing, which is mainly export-oriented.

A slight increase in employment, but unemployment remains high

Contrary to trends in most EU member states, there was a slight increase in the survey unemployment rate in Bosnia and Herzegovina in 2015, which now stands at 27.7 percent. This is still one of the highest unemployment rates in the region. However, in 2015 there was an increase of registered employment as a result of increased activity in manufacturing and retail trade. The new Labor Law should contribute to improving the performance of the labor market in the coming period. Average nominal gross wages were increased by 1 percent compared to 2014, while the real gross wages increased by about 2 percent.

Budget deficit still unknown and a slight increase in public debt

In 2015, government expenditures grew at a slightly higher rate than revenue. According to the official data of the Department of Macroeconomic Analysis, the government recorded a modest surplus of EUR 145 million. However, the data on consolidated government budget for 2015 is not yet complete, since it excludes a significant part of public investments under the jurisdiction of the state-owned enterprise, the Roads Directorate. This enterprise has made major investments in highway construction in 2015, and therefore, the government is more likely to have recorded a deficit instead of a surplus. The trend of a slight increase in the total public debt continued in 2015, which now amounts to 41 percent of GDP. However, it should be noted that due to the significant outstanding liabilities *vis-à-vis* suppliers, as well as the contingent liabilities related to the court cases, the actual public debt is likely to be underestimated.

Inflation in Bosnia and Herzegovina is low, which is a direct result of the currency board. In 2015, the average consumer price index (CPI) fell by 1 percent compared to the CPI for 2014. Deflation is caused mainly by the decline in energy prices, i.e. oil and gas prices in the world market.

Growth in loans to households

The growing trend of bank deposits has continued, accompanied by a simultaneous increase in credit activities. Loans to households increased by 4.8 percent in 2015 as a result of the increase in private consumption due to deflation. Loans to the corporate sector have slightly decreased compared to 2014, i.e. by 0.2 percent.

Positive trends in foreign trade

In 2015, the total volume of trade maintained at last year's level. However, there are some positive changes – goods exports have risen by 3.2 percent, goods imports went down by 2.3 percent, and thus, the foreign trade deficit decreased significantly. These trends had a positive effect on reducing the current account deficit, which dropped to 5.4 percent of GDP. The main factors behind goods exports performance were the strengthening of the export demand, as well as measures implemented by the institutions of Bosnia and Herzegovina aimed at improving exports to the Republic of Turkey.

Table BH1 Main economic indicators

	2014	2015	2014	2015			
			Q4	Q1	Q2	Q3	Q4
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	1.1	2.8		2.1	4.4	3.7	2.1
Real private consumption (% change, yoy)	2.2	-	-	-	-	-	-
Real government consumption (% change, yoy)	0.9	-	-	-	-	-	-
Industrial output (% change, yoy)	6.1	2.6	1.0	1.1	4.5	3.7	3.3
Unemployment rate (registered, %, pa)	27.5	27.7	27.5	27.6	27.1	-	-
Nominal GDP (EUR million)	13,937	14,361	-	-	-	-	-
GDP per capita (EUR)	3,641	3,752	-	-	-	-	-
PRICES, WAGES, AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	-0.4	-	-	-	-	-	-
Consumer prices (% change, yoy, pa)	2.2	-1.0	-0.1	-0.6	-0.4	-1.4	-1.7
Producer prices (% change, yoy, pa)	0.4	0.6	1.0	1.4	1.6	0.9	-
Average gross wage (% change, yoy, pa)	0.1	1.0	1.0	0.5	-0.3	-	-
Exchange rate, BAM/EUR (pa)	1.96	1.96	1.96	1.96	1.96	1.96	1.96
Exchange rate, BAM/USD (pa)	1.47	1.76	1.57	1.73	1.77	1.75	1.78
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	4,439	4,585	1,157	1,083	1,157	1,183	1,176
Exports of goods (EUR, % change, yoy)	3.6	3.2	8.5	2.5	6.2	2.2	-0.6
Imports of goods (EUR million)	8,283	8,087	2,196	1,820	2,085	2,131	2,073
Imports of goods (EUR, % change, yoy)	6.8	-2.3	6.7	-0.2	1.8	2.2	-2.7
Current account balance (EUR million)	-1,091	-816	-269	-185	-283	-429	-452
Current account balance (% of GDP)	-7.7	-5.4	-	-	-	-	-
Gross foreign direct investment (EUR million)	378	241	67	62	-	-	-
Foreign exchange reserves (EUR million, eop)	4,013	4,413	4,013	3,906	4,046	-	-
Foreign debt (EUR million, eop)	7,106	8,238	-	-	-	-	-
GOVERNMENT FINANCE*							
Revenue (national currency)**	11,961	12,027	5,344	2,724	2,997	3,172	3,133
Expense (national currency)**	11,350	11,882	5,181	2,590	2,826	2,908	3,557
Net = Gross operating balance (BAM million)**	611	693	163	177	279	386	-149
Net acquisition of non-financial assets (BAM million)**	554	415	363	24	51	101	239
Net lending/borrowing (national currency)**	486	145	-44	133	171	263	-423
Domestic government debt (EUR million, eop)	1,386	1,632	1,386	1,430	1,434	-	-
Foreign government debt (EUR million, eop)	4,152	4,438	4,152	4,392	4,287	4,417	4,457
Total government debt (% of GDP)	39.7	41.0	-	-	-	-	-
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	9.1	11,2	8.9	9.3	10.2	4.7	3.2
Broad money, M2 (% change, yoy, eop)	7.5	8.0	7.5	7.1	8.3	2.8	1.9
Total domestic credit (% change, yoy, eop)	2.9	2.4	2.9	1.5	1.8	-	-
DMBs credit to households (% change, yoy, eop)	5.7	4.8	5.7	5.6	5.1	-	-
DMBs credit to enterprises (% change, yoy, eop)	-1.4	-0.2	-1.4	-2.5	1.2	-	-
DMBs credit rate for enterprises, short-term, (%, pa)	6.6	6.3	6.1	6.4	6.1	6.0	5.8
DMBs credit rate for households, short-term (%, pa)	7.3	7.4	7.2	7.4	7.2	7.5	7.0

Notes: * Data refer to consolidated general government. ** On the cash principle, cumulative from the beginning of the year.

Conventional abbreviations: pa - period average; eop - end of period; yoy - year on year; EUR - euro, USD - US dollar; BAM - Bosnia-Herzegovina convertible mark; DMB – deposit money bank.

Sources: Agency for Statistics of Bosnia and Herzegovina, Bosnia and Herzegovina Directorate for Economic Planning, Bosnia and Herzegovina Indirect Taxation Authority, Central Bank of Bosnia and Herzegovina.

Table BH2 Summary of projections

	2016	2017
Real GDP (% change)	**3.0**	**3.2**
Real private consumption (% change)	1.8	2.1
Real investment (% change)	10.4	7.6
Exports of goods and services (constant prices, % change)	7.9	6.7
Imports of goods and services (constant prices, % change)	7	4.5
Current account balance (% of GDP)	-7.8	-8.0
Consumer prices (% change, pa)	1.0	1.2
Exchange rate, national currency/EUR (pa)	1.96	1.96
Unemployment rate (registered, %, pa)	26.5	24.8
General government balance (ESA95 definition, % of GDP)	-2.8	-
Broad money, M4 (% change, eop)	5.9	-
Total domestic credit (% change, eop)	14.6	-

Notes: Cut-off date for information used in the compilation of projections was May 20, 2016.
Conventional abbreviations: pa - period average; eop - end of period; EUR - euro.
Sources: Bosnia and Herzegovina Directorate for Economic Planning, World Bank, IMF, and author's projections.

Policy assumptions and projections summary

Higher growth in 2016 and 2017 supported by both domestic and external demand

Projections for 2016 and 2017 are based on the assumptions of positive trends in the economies of the region and the stability of the domestic economy. Stable growth rates of around 3 percent are projected for the aforementioned years. This growth should primarily rest on domestic demand, and to a lesser extent, significantly slower growth of foreign trade deficit. Better external environment should lead to the strengthening of export demand, but also to the improvements of foreign cash inflows used to finance domestic demand. This should also induce real growth of final consumption by 1.8 percent in 2016 and 2.1 percent in 2017. In addition, in 2016, a significant growth of investment by 10.4 percent is expected, with a somewhat more moderate growth by 7.6 percent in 2017. Export growth should be higher than import growth, which would further reduce the foreign trade deficit in 2016 and 2017. Good economic prospects should have a positive impact on job creation and the increase of average net salary. A reduction of unemployment is also foreseen – the unemployment rate is projected to amount up to 24.8 percent in 2017. After deflation in 2015, moderate inflation of around 1 percent is projected for 2016 and 2017. ■

C R O A T I A

Economic recovery in spite of political instability

Recent economic developments

Second parliamentary elections in only ten months

At the end of 2015 and the beginning of 2016, a political drama full of plots and conflicts has dominated over any other topic in the Croatian society. Following the parliamentary elections in November last year, it took almost three months for the government to be established. The formation of the government that had a rather slim majority in the Parliament was backed by an agreement between the right-wing Patriotic Coalition with HDZ on the forefront and Most. The government was headed by a non-partisan Prime Minister Tomislav Orešković and two vice presidents, one being Tomislav Karamarko, the leader of HDZ, and the other being Božo Petrov, the leader of Most. Both the government and the Parliament have never succeeded to function smoothly and ended up in a political crisis triggered by Karamarko's conflict of interest. After the three key players, Orešković, Petrov and Karamarko, lost confidence in each other, the government fell. HDZ and the opposition voted against the Prime Minister and passed a no-confidence motion in the Parliament. Subsequent to the fall of the Prime Minister, the majority of the members voted for the Parliament dissolution. The new elections will be held on September 11, 2016.

The government was in power for less than six months and left behind no legacy worth mentioning. Structural reforms that have been advocated by Most in the pre-election campaign have not even been prepared, while the educational reform inherited from the previous government was halted, provoking unexpectedly massive protests. No new legislation has been passed in the Parliament. Generally, reasonable government budget for 2016 is the only decision of importance reached by this government and the Parliament.

Economic performance better than expected

Economic recovery which started in the last quarter of 2014 continued in 2015, even speeding up at the beginning of 2016, in spite of the unprecedented political instability. 2015 was the first year measuring economic growth after 2008 – the economy grew by 1.6 percent. Foreign trade was the most dynamic component of the GDP. In 2015, exports of goods and services rose by 9.2 percent compared to 2015, still slightly more than imports, which went up by 8.6 percent. The other components of GDP grew as well, but at much more moderate rates. It is encouraging to see the investment activity growing by 1.6 percent in 2015 since that was an element of economic activity that was mostly hit by economic recession and also was the last to show signs of recovery. In the first quarter of 2016, the growth of exports remained strong, while real investment and private consumption increased by 4.3 and 3.1-percent rates respectively, y-o-y. Such high growth rates will probably not be sustained in the remaining part of 2016, but they brought along a wind of so much needed optimism into a gloomy economic atmosphere.

Unemployment going down, but employment not rising equivalently

There have been some evident changes on the labor market in the last couple of years. On one hand, the number of jobless individuals is going down quite impressively. It stood at 219 thousand at the end of June 2016, which is 15.6 percent or 40.5 thousand individuals less than in June 2015. On the other hand, this positive development regarding unemployment is not reflected in the equivalent change of the number of employed. In the first quarter of 2016, the number of employed was only marginally, i.e. by 10 thousand individuals higher than in the same quarter last year. Since the number of unemployed went down by 60 thousand, the data recorded a fall in labor force by 50 thousand individuals. It can be speculated that this loss of labor force can be partly attributed to increased emigration, partly to a slippage of workers into the informal economy, and partly to non-appearance of the discouraged workers in the Register. Unfortunately, there are no hard data that would give us a more accurate indication on the size of all three effects.

Deficit in 2015 below 3 percent of GDP

Throughout the six-year recession, governments were reluctant to cut expenditures in order to stabilize public finances. In the same manner, for 2015, the expenditure cuts were not envisaged, therefore, there was a high risk that the deficit target of 3.5 would be exceeded. However, quite unexpectedly, general government deficit dropped to only 3.2 percent in 2015. The main reason for a surprisingly good fiscal outturn was an increase in tax collection spurred by revived consumption and public investments that were much lower than planned. As a consequence, public debt was stabilized at some 86.5 percent of GDP, whereas its projected level was as high as 90 percent.

The government, led by Mr Orešković, proposed the government budget for 2016 which was not very ambitious, but still in line with the fiscal consolidation recommendations by the European Commission. According to this budget, general government deficit is expected to fall below 3 percent of GDP in 2016. There are good chances to believe that the deficit in 2016 will not exceed 2.7 percent of the GDP which was planned for this year. Firstly, the year started with the temporary financing which sets the strict limits to government expenditures. Secondly, after the fall of the government, the technical government can engage in only basic activities. Consequently, in spite of the fact that the fall of the government will cause unplanned expenditures for the new elections, the overall government spending will most probably stay within the boundaries set by the budget. The new fiscal developments mean that Croatia might soon exit the Excessive Deficit Procedure (EDP). This would be a positive sign that rating agencies would hopefully appreciate, and might consequently improve the mood of the capital markets towards Croatian debt. However, it is now the political stability that started to worry the investors more than the fiscal position of the country.

Deleveraging of the household and enterprise sector continues

Last year was yet another year with a contraction of credits both to the household and enterprise sector. Total domestic credits shrunk by 2 percent compared to 2014 in spite of the abundance of liquidity in the banking sector. However, hope remains that the conversion of Swiss franc loans will result in the reversal of such a trend. After the bank wrote off a total of HRK 5.4 billion of loans, the share of nonperforming loans in total loans went down and reached 16.1 percent by the end of March 2016.

Table HR1 Main economic indicators

	2014	2015	2014	2015			
			Q4	Q1	Q2	Q3	Q4
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	-0.4	1.6	0.2	0.5	1.2	2.8	1.9
Real private consumption (% change, yoy)	-0.7	1.2	-0.5	0.3	0.6	1.4	2.4
Real government consumption (% change, yoy)	-1.9	0.6	-0.5	0.6	0.4	0.6	0.8
Real investment (% change, yoy)	-3.6	1.6	-4.1	-0.4	0.8	2.2	3.7
Industrial output (% change, yoy)	1.2	2.7	4.1	-0.1	2.4	4.6	3.9
Unemployment rate (registered, %, pa)	19.6	17.4	19.0	20.1	16.9	15.7	13.
Nominal GDP (EUR million)	43,045	43,921	10,728	9,835	10,969	12,154	10,979
GDP per capita (EUR)	10,156	10,363	-	-	-	-	-
PRICES, WAGES, AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	0.0	0.1	0.4	0.3	0.4	0.0	-0.1
Consumer prices (% change, yoy, pa)	-0.2	-0.5	0.0	-0.4	0.0	-0.6	-0.8
Producer prices (% change, yoy, pa)	-2.8	-3.8	-2.6	-4.1	-2.8	-4.1	-4.3
Average gross wage (% change, yoy, pa)	0.2	1.3	0.6	0.7	1.5	1.5	1.4
Exchange rate, HRK/EUR (pa)	7.63	7.61	7.66	7.68	7.57	7.57	7.62
Exchange rate, HRK/USD (pa)	5.75	6.86	6.13	6.81	6.86	6.80	6.96
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	10,369	11,528	2,755	2,573	2,933	2,967	3,055
Exports of goods (EUR, % change, yoy)	8.1	11.2	5.0	9.2	15.4	9.2	10.9
Imports of goods (EUR million)	17,129	18,483	4,123	4,268	4,785	4,845	4,621
Imports of goods (EUR, % change, yoy)	3.6	7.9	0.9	7.1	6.1	6.7	12.1
Current account balance (EUR million)	898	2,260	-787	-1,483	-316	2,841	-143
Current account balance (% of GDP)	0.9	5.2	-	-	-	-	-
Gross foreign direct investment (EUR million)	2,910	128	96	394	111	170	-548
Foreign exchange reserves (EUR million, eop)	12,688	13,707	12,688	14,158	13,734	13,437	13,707
Foreign debt (EUR million, eop)	46,664	45,534	46,664	49,120	48,793	46,918	45,534
GOVERNMENT FINANCE*							
Revenue (HRK million)**	131,917	150,089	33,179	33,232	37,291	39,283	40,283
Expense (HRK million)**	139,532	150,559	36,860	37,248	36,527	36,093	40,691
Net = Gross operating balance (HRK million)**	-7,615	-470	-3,681	-4,016	763	3,189	-407
Net acquisition of non-financial assets (HRK million)**	4,855	7,850	1,951	927	1,566	1,985	3,371
Net lending/borrowing (HRK million)**	-12,470	-8,320	-5,632	-4,943	-802	1,205	-3,778
Domestic government debt (EUR million, eop)	21,650	22,457	21,630	22,161	21,935	22,555	22,457
Foreign government debt (EUR million, eop)	15,443	15,482	14,861	16,179	15,977	15,485	15,482
Total government debt (eop, % of GDP)	86.5	86.7	-	-	-	-	-
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	9.6	11.4	9.6	8.3	11.6	10.4	11.4
Broad money, M4 (% change, yoy, eop)	3.2	5.1	3.2	2.8	4.8	4.6	5.1
Total domestic credit (% change, yoy, eop)	-2.3	-2.0	-2.3	-0.6	-0.7	1.4	-2.0
DMBs credit to households (% change, yoy, eop)	-0.8	-1.5	-0.8	0.9	0.9	-0.5	-1.5
DMBs credit to enterprises (% change, yoy, eop)	-3.7	-5.2	-3.7	-2.3	-2.6	-2.9	-5.2
Money market interest rate (%, pa)	0.5	0.8	0.5	0.5	0.4	1.2	0.9
DMBs credit rate for enterprises, short-term, (%, pa)***	5.7	5.4	5.7	5.6	5.6	5.5	5.3
DMBs credit rate for households, short-term (%, pa)***	7.4	8.9	7.3	7.3	7.2	8.8	8.4

Notes: * Data refer to consolidated general government. ** On the cash principle. *** The weighted average interest rate on new loan agreements, revised data.
Conventional abbreviations: pa - period average; eop - end of period; yoy - year on year; HRK - Croatian kuna; EUR - euro; USD - US dollar; DMB – deposit money bank.
Sources: Croatian Bureau of Statistics, Croatian National Bank and Ministry of Finance.

Price inflation below zero, exchange rate stable

In 2015, consumer prices decreased by 0.5 percent on average and the same trend will probably be continued in 2016. The highest contribution to such price development comes from the transport prices and is directly linked to the movement of prices of oil on the global market. Recent reduction of administratively set gas tariffs gave additional boost to the price decrease. As a consequence, consumer prices in the first quarter of 2016 were 1.3 lower than in the same quarter last year.

Double-digit rise in exports in 2015

Exports of goods were rising at substantial rates ever since Croatia joined the EU. Still, an 11.2 percent growth of goods exports in 2015 overshot the most optimistic projections. It seems that there are parts of the Croatian economy that are ready to reap the dividend of free entrance on the EU market and that are also competitive on this market. Growth of goods exports was particularly high in exports of food products, chemicals and chemical products, pharmaceutical products, metal products, but also in exports of computers and motor vehicles. By the end of 2015 and at the beginning of 2016, some slowdown of exports has been observed, but it seems that the export base has improved so that solid rates of growth in goods exports can be sustained in 2016. Imports of goods grew at a lower rate than exports in 2015, i.e. 7.9 percent; therefore, the coverage of imports by exports grew by almost 2 percentage points in comparison with 2014 and exceeded 62 percent.

Policy assumptions and projections summary

Prolonged political instability might jeopardize otherwise improved economic prospects

In this issue, we present the macroeconomic forecast for 2016 and 2017 prepared by the Institute of Economics, Zagreb (EIZ) and presented in the *Croatian Economic Outlook Quarterly*, issued in June 2016. Due to the data that have become available for the end of 2015 and the first quarter of 2016, which show a robust growth of all GDP components, EIZ forecast for GDP has been revised upwards. GDP forecast for 2016 and 2017 now stands at 1.9 and 2.1 percent, respectively.

It is assumed that the economic activity in the world and in the euro zone will stay relatively stable, the economic activity regarding Croatian main trading partners will improve, positive economic trends in Croatia regarding the industrial production, construction and retail trade will continue in the rest of 2016 and in 2017, tourism scores will be good, and investments will grow. However, such projections are coupled with a high risk whose origins are located primarily in the political domain. Since the country will be run by an acting government, necessary reforms aimed at improving the investment climate will be delayed, consumer optimism might be ruined due to rising uncertainties, and the risk premium of the country as a whole could go up. Those downward risks were not accounted for in the EIZ forecast, but have to be taken into consideration as well.

Table HR2 Summary of projections

	2016	2017
Real GDP (% change)	**1.9**	**2.1**
Real private consumption (% change)	1.5	1.6
Real government consumption (% change)	0.6	0.9
Real investment (% change)	2.5	3.3
Exports of goods and services (constant prices, % change)	5.2	4.2
Imports of goods and services (constant prices, % change)	4.8	4.4
Current account balance (% of GDP)	3.9	2.8
Consumer prices (% change, pa)	-0.4	0.8
Exchange rate, national currency/EUR (pa)	7.52	7.50
Unemployment rate (registered, %, pa)	16.5	16.1
General government balance (ESA2010 definition, % of GDP)	-2.9	-2.5
Broad money, M4 (% change, eop)	4.0	4.2
Total domestic credit (% change, eop)	-1.1	1.5

Notes: Cut-off date for information used in the compilation of projections was June 8, 2016.
Conventional abbreviations: pa - period average; eop - end of period; EUR - euro.
Source: The Institute of Economics, Zagreb.

Positive trends prevail; growth might even speed up in 2017

EIZ foresees positive growth rates of all the GDP components in 2016, and also predicts that the growth of domestic demand might speed up in 2017. Despite some increase in government consumption, further improvement of fiscal balance is projected. Current account balance might go down from 5.2 percent of GDP in 2015 to 3.9 in 2016 and 2.8 percent in 2017, but will stay in the positive zone due to an increase in surplus in secondary incomes resulting from the EU funds absorption. The rate of unemployment will probably go down to 16.5 percent in 2016 and 16.2 percent in 2017.

After yet another year of deflation in 2016, EIZ projects consumer prices to increase at 0.8-percent rate in 2017 as a consequence of labor market recovery and oil prices adjustment. The exchange rate will remain stable. ■

MACEDONIA

Resolving the political crisis – a precondition for economic recovery

Recent economic developments

On the verge of political crisis

In the past months the Republic of Macedonia has been confronted with a serious challenge which beckons a political crisis. The date for the upcoming parliamentary elections, which were delayed twice due to different irregularities, has not yet been set. The elections are postponed due to a series of affairs concerning the wiretapping of a large number of people, mainly the elected politicians, judges, professors, and journalists. This has cast doubt on fair and free elections. More so, the ongoing problems such as rising politicization, bulky and inefficient public administration and rising public debt are not addressed and they add more steam to the complicated political situation in the Republic of Macedonia. This could lead to a slowdown in economic activity and economic growth of the country. The announced sanctions of the international community, which may follow if the country abandons the path towards European integration, imply that the Republic of Macedonia could witness a further broadening of the political crisis. Macedonia already fails to implement and complete the mandatory reforms imposed by the European Union which is the obvious proof of departure from the EU accession path. This was also confirmed by Fitch Ratings who affirmed the country's long-

term issue rating at BB+, with a negative outlook on account of risks from political instability, potential fiscal slippages, and external imbalances.

Economic growth - result of increased indebtedness?

GDP growth has increased, mainly due to the increase of the government consumption, especially due to the investments in physical infrastructure that gave a boost to the construction sector. Growth has continued in the third and fourth quarter of 2015 (3.6 percent and 3.9 percent, respectively, y-o-y). Therefore, the overall annual growth rate in 2015 stood at 3.7 percent. The investment went up as well. After a slight decrease in the third quarter, investments grew by 5.5 percent in the last quarter. However, for the 2015 as a whole, real investment increased only marginally in comparison with 2014. Industrial output growth was quite strong in the second half of 2015, leading to an annual growth of 4.9 percent. Government consumption, which was heavily debt-financed, increased due to both an increase in wage bill and especially in capital spending that grew by roughly 20 percent in the second half of 2015, compared to the same period in 2014. In the third and fourth quarter of 2015 the growth in construction sector was around 30 percent which was a result of the completion of some construction works for the public sector. It is evident that the growth experienced in 2015, as well as the one of 4 percent that is projected for 2016, cannot be sustained since it leads to a significant rise in both public and foreign debt.

Rising inactivity and unemployment among the highly educated

Macedonia has been facing challenging developments on the labor market in the last years. On the positive side, employment is going up and unemployment is going down. Positive trends seen on the labor market in Macedonia in the last years are accompanied by a rise of employment in the informal sector and an increased inactivity and unemployment of the highly educated individuals.

The informal employment is one of the factors contributing negatively to the business climate, restricting competition and the development of the private sector in the Republic of Macedonia. The share of the informally employed in total employment has decreased from 28.6 percent in 2008 to 22.5 percent in 2012. However, from 2012 to 2014, it increased again and stood at some 156 thousand individuals at the end of 2014 with no improvement in 2015. This is confirmed by the results from the EU-funded project, "Support to the Fight Against Undeclared Work".

Since 2011, the number of the unemployed and inactive individuals with university education has significantly increased. In 2015, it amounted up to approximately 75 thousand individuals, i.e. 33.2 percent of the total working age population with university education. More than half of them are young adults, aged 20–34. In the last years, more than 40 percent of the population aged 20–34 with university education has been unemployed and inactive. This should obviously be a reason for concern since it implies serious underutilization of human resources as a significant factor of the socio-economic development.

Intense deficit spending at the beginning of 2016

Overall government revenue in 2015 was 10.5 percent above the level attained in 2014. This is mainly a consequence of a surge in profit tax collection at the beginning of the year resulting from the abolition of tax exemptions for reinvested profits. Total government expenditure in 2015 was some 7 percent higher, and the general government deficit was reduced to 3.5 percent of the estimated GDP. Compared to 2014, deficit went down by 0.7 percentage points. Spending on goods and services, spending on wages and social transfers contributed mostly to the rise in government expenditures and provided a sizeable stimulus to the economy. High government spending continued in 2016 as well. The deficit in the first three months of the year amounted up to some 35 percent of the total projected balance, or 1.1 percent of the projected GDP.

Public debt level rose in the fourth quarter and was financed through government's Eurobond issue in November in the amount of EUR 270 million, over-compensating the repayment of a 2005 Eurobond in December.

Tightening monetary policy to offset deteriorating expectations of economic agents

Prolonged political crises at the beginning of May 2016 forced the National Bank of the Republic of Macedonia (NBRM) to tighten the monetary policy by deploying several instruments such as an increase in interest rate on CB bills and an increase in policy rate by 0.75 percentage points, from 3.25 percent to 4 percent. It was an expected reaction of NBRM on an increased demand for foreign currency and pressures on banks' deposit base originating entirely from deteriorated expectations caused by factors of non-economic nature and the unstable political situation in the country. The MKD deposit withdrawal in April 2016 reached 1.6 percent of households' deposits, or EUR 58 million. The NBRM responded by supplying the banking sector with foreign currency liquidity amounting up to EUR 77 million.

In the first quarter of 2016 the banking sector remained stable, liquid, and highly capitalized, followed by a solid deposit and credit growth. Moreover, foreign reserves' indicators continuously show their adequate level, sufficient to cope with further shocks. At the end of 2015, the NBRM adopted a package of measures aimed at slowing down the growth of long-term consumer loans and facilitating access to finance for the corporate sector as well as supporting the lending to net exporters and domestic producers of electricity. The share of NPL in total loans remains stable at around 10.8 percent at the end of 2015. Capital adequacy ratio stands at 15.5 percent at the end of 2015, with 14.9 percent, 16.3 percent, and 18.7 percent for the large, medium-sized and small-sized banks, respectively.

Consumer price and production price indices continue to decline in the second half of 2015. The price decrease was mainly triggered by the decline in electricity prices and the lower price of transport services resulting from falling oil prices.

Minor fluctuations in the balance of payments

The current account deficit of the balance of payments in 2015 remained at a moderate level, without major imbalances in the external sector. However, compared to the previous year, the current account gap increased slightly and reached 1.4 percent of GDP. Deterioration was registered in all components of the current account, with the exception of the trade deficit. Trade deficit remained stable due to stronger goods exports as opposed to weaker goods imports. Such developments result from increasing net exports of new industrial plants in the free trade zones and reduced energy imports brought about by sharp decline in world oil prices.

In the financial account, foreign direct investments remain the main source of financial flows, but were lower compared to the previous year. At the end of 2015, the gross foreign debt reached 69.9 percent of GDP, therefore Macedonia entered a group of highly indebted countries, but is still considered to be in a reasonably safe zone.

Table MK1 Main economic indicators

	2014	2015	2014 Q4	2015 Q1	2015 Q2	2015 Q3	2015 Q4
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	3.5	3.7	4.6	3.8	3.4	3.6	3.9
Real private consumption (% change, yoy)	2.1	3.2	3.1	2.1	2.7	4.3	3.6
Real government consumption (% change, yoy)	1.0	4.6	-5.8	-5.6	0.7	15.4	9.7
Real investment (% change, yoy)	13.1	0.1	2.2	11	-14.9	-1.1	5.5
Industrial output (% change, yoy)	4.8	4.9	4.7	1.6	0.2	6.2	11.7
Unemployment rate (registered, %, pa)	28.0	26.1	27.6	27.3	26.8	25.5	24.6
Nominal GDP (EUR million)	8,530	9,092	-	-	-	-	-
GDP per capita (EUR)	4,126	4,392	-	-	-	-	-
PRICES, WAGES, AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	1.2	2.8	-	-	-	-	-
Consumer prices (% change, yoy, pa)	-0.3	-0.3	-0.5	-0.9	0.3	-0.2	-0.4
Producer prices (% change, yoy, pa)	-1.5	-4.1	-3.8	-4.5	-4.1	-4.6	-3.1
Average gross wage (% change, yoy, pa)	1.4	3.0	3.2	3.1	3.0	3.5	2.4
Exchange rate, MKD/EUR (pa)	61.62	61.61	61.65	61.55	61.63	61.61	61.65
Exchange rate, MKD/USD (pa)	46.44	55.5	49.35	54.59	55.71	55.41	56.26
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	2,780	3,042	762	666	784	771	821
Exports of goods (EUR, % change, yoy)	17.0	9.4	16.6	13.2	12.0	5.6	7.9
Imports of goods (EUR million)	4,635	4,867	1,245	1,093	1,224	1,189	1,362
Imports of goods (EUR, % change, yoy)	9.4	5.0	9.7	3.1	6.7	0.5	9.4
Current account balance (EUR million)	-69	-127	4	-47	-82	131	-123
Current account balance (% of GDP)	-0.8	-1.4	-	-0.5	-0.9	1.4	-1.4
Gross foreign direct investment (EUR million)	37	172	-84	36	78	19	39
Foreign exchange reserves (EUR million, eop)	2,437	2,262	2,437	2,355	2,255	2,187	2,262
Foreign debt (EUR million, eop)	5,992	6,354	5,992	6,252	6,360	6,240	6,354
GOVERNMENT FINANCE*							
Revenue (national currency)**	145,929	161,207	41,365	37,779	40,352	39,314	43,762
Expense (national currency)**	168,063	180,632	46,045	44,080	43,572	43,667	49,313
Net = Gross operating balance (MKD million)**	-22,134	-19,425	-4,680	-6,301	-3,220	-4,353	-5,551
Net acquisition of non-financial assets (MKD million)**	-15,742	-16,402	-5,718	-3,827	-2,180	-3,416	-7,012
Net lending/borrowing (national currency)**	-6,392	-3,023	1,038	-2,474	-1,040	-937	1,461
Domestic government debt (EUR million, eop)	1,170	1,357	1,170	1,256	1,281	1,263	1,357
Foreign government debt (EUR million, eop)	2,092	2,094	2,092	1,975	1,957	1,971	2,094
Total government debt (% of GDP)	38.2	38.4	-	-	-	-	-
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	22.2	18.4	22.2	16.4	23.0	18.7	18.4
Broad money, M4 (% change, yoy, eop)	10.5	6.8	10.5	8.8	9.2	6.2	6.8
Total domestic credit (% change, yoy, eop)	10.0	9.5	10.0	9.2	9.0	8.8	9.5
DMBs credit to households (% change, yoy, eop)	12.5	13.9	12.5	12.7	13.1	13.5	13.9
DMBs credit to enterprises (% change, yoy, eop)	8.4	7.3	8.4	5.6	6.8	6.3	7.3
Money market interest rate (%, pa)	1.8	1.1	1.6	1.5	1.0	0.9	0.9
DMBs credit rate for enterprises, short-term, (%, pa)	7.2	6.8	7.0	7.1	6.9	6.6	6.4
DMBs credit rate for households, short-term (%, pa)	5.0	4.9	5.1	5.3	4.8	4.7	4.7

Notes: * Data refer to consolidated general government. ** On the cash principle, cumulative from the beginning of the year.

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

Sources: Ministry of Finance of the Republic of Macedonia, National Bank of the Republic of Macedonia, State Statistical Office of the Republic of Macedonia.

Policy assumptions and projections summary

For 2016, we expect a solid macroeconomic performance, but these expectations are burdened by existing risks from the external and domestic environment. Growth will mainly be driven by exports and investments. Moderate rise in private consumption will support growth as well. It is expected that the external sector developments will be favorable in the next two years, despite a moderate expansion of the current account deficit which will be caused by the strengthening of economic activity. The LFS data show that the unemployment rate in the first quarter of 2016 was 24.5 percent. However, in the current circumstances it can be expected that the unemployment rate will remain around 25 percent.

Public debt is expected to continue to expand in 2016 partly due to the increasing government's borrowing requirement and partly due to the financing of sizable investments by the state-owned enterprises. Inflation will stay within a 2 percent limit. The monetary policy in 2016 will remain focused on maintaining the price stability and a stable exchange rate and on the maintenance of financial and macroeconomic stability. ■

Table MK2 Summary of projections

	2016	2017
Real GDP (% change)	**3.5**	**3.5**
Real private consumption (% change)	2.5	2.7
Real government consumption (% change)	1.6	1.2
Real investment (% change)	5.2	10.0
Exports of goods and services (constant prices, % change)	6.8	7.0
Imports of goods and services (constant prices, % change)	5.3	5.5
Current account balance (% of GDP)	-1.7	-2.2
Consumer prices (% change, pa)	1.1	1.4
Exchange rate, national currency/EUR (pa)	61.5	-
Unemployment rate (registered, %, pa)	24.7	23.5
General government balance (ESA95 definition, % of GDP)	-3.4	-2.9
Broad money, M4 (% change, eop)	9.3	-
Total domestic credit (% change, eop)	-	-

Notes: Cut-off date for information used in the compilation of projections was June 20, 2016.

Conventional abbreviations: pa - period average; eop - end of period; EUR - euro.

Sources: Ministry of Finance of the Republic of Macedonia, National Bank of the Republic of Macedonia, State Statistical Office of the Republic of Macedonia, http://country.eiu.com/macedonia, and the European Economic Forecast (Spring 2016), European Commission Directorate-General for Economic and Financial Affairs, Institutional Paper 025, May 2016.

MONTENEGRO

Lively economic activity expected to continue in the years to come

Recent economic developments

Off-route, but ready for refugees

Intense activity in the field of Euro-Atlantic integration and the invitation for Montenegro to join the NATO alliance marked the year 2015. The implementation of economic policy measures aimed at improving the living standards of the citizens of Montenegro is proclaimed as a strategic goal of the country's economic policy. This goal should have been achieved through ensuring fiscal sustainability, strengthening economic competitiveness and creating conditions for dynamic economic growth and development. However, so far the fiscal policy was not successful in fulfilling the fiscal sustainability which has even deteriorated in the recent past.

Montenegro has not been on the main Balkan refugee route, but the country thoroughly observed the situation, regularly exchanged information with other countries and adjusted institutional mechanisms in order to accept migrants. The aim was to make preparations for keeping all the citizens secure and to provide humanitarian aid to those coming from the areas endangered by the war in Syria. Coordination was made, and the UNHCR was involved. Montenegro has the capacity to accept 2.000 migrants daily.

All sectors had a positive impact on Montenegrin GDP

According to the Statistical Office of Montenegro's preliminary data, the real growth rate in 2015 was 3.2 percent. Growth has thus significantly accelerated from 1.8 percent attained in 2014. There were several factors contributing positively to the overall economic performance, such as the beginning of the main highway construction, record growth rates in tourism, growth in industrial production, especially manufacturing and forestry production, and a high inflow of foreign direct investment. A continuation of lively economic activity can be expected in 2016 and onwards. For 2016, GDP is projected to rise by 4.1 percent, and then to grow at a somewhat slower pace in 2017 and 2018, i.e. by 4 and 3 percent, respectively.

Construction of Bar-Boljare highway started in May 2016

Bar-Boljare highway project is currently the most important infrastructural project in Montenegro. Its construction started in May 2015 and is planned to be completed in 4 years. The 176-km-long highway will connect the main Montenegrin seaport Bar with Serbia. Currently, only the costs of the first 40 km segment have been assessed and they amount up to EUR 809 million, i.e. almost one quarter of the 2014 GDP. 85 percent of the first section of the highway will be financed through a 20-year, dollar-denominated China's Exim Bank loan with a fixed 2 percent interest rate and a six-year grace period. The remaining 15 percent of the project will be financed through a combination of offsetting spending cuts, concessions and tolls. The main part of the construction has been contracted to the China Road and Bridge Corporation, but 30 percent of the investment is to be subcontracted to domestic companies. The investment should therefore give boost to the domestic economy, but other benefits from the project are also being emphasized, such as enhanced regional integration, strengthened trade and better road safety.

Real estate business sector leading by an average number of employees

The number of employed people in 2015 was 175.617 and it increased by 3.6 percent compared to the same period last year. Employment in real estate business, arts, entertainment and recreation and other service sectors experienced the highest growth of 5 percent and more. All other service sectors observed some growth in employment as well. On the other side, all the manufacturing sectors recorded a decline in the average number of employees. Job loss was the highest in manufacturing, agriculture, forestry, and fishing, where the number of employed individuals went down by 5 percent or more.

The general government deficit 8.1 percent of GDP

The general government deficit in 2015 amounted up to EUR 291.3 million, which is almost three times as high as in 2014. Although in 2015 the Montenegrin government continued with the implementation of fiscal adjustment measures, fiscal discipline was far from satisfactory and the year ended up with a fiscal deficit of 8.1 percent of the GDP.

Consolidated budget expenditures reached 45 percent of GDP in 2015 and recorded an increase of 10.8 percent compared to 2014. Expenditures for other personal income, services, interest and subsidies contributed to that increase.

In its Staff Report prepared under Article IV Consultation of the IMF's Articles of Agreement, the IMF has examined the Montenegrin growth strategy based on new infrastructure projects and fiscal incentives and the implications of such policy on fiscal sustainability. The IMF projects that fiscal deficit will remain in the vicinity of 8 percent of the GDP over the next three year, due to the lax fiscal policy. Therefore, public debt which stood at 60 percent at the end of 2014 might reach 80 percent of GDP by the end of 2014. The Staff has indicated that the foreseeable fiscal developments might put pressure on sovereign interest rates and could also lead to a considerable worsening of country's foreign debt position. Additional risks could also come from shocks related to the highway project, such as cost overruns and delays. Consequently, the Staff recommended immediate and durable fiscal consolidation measures that would limit risks to the public finances and insure favorable funding conditions.

Liquidity in the banking sector and illiquidity in the rest of the economy

The Montenegrin banking sector was stable and liquid throughout 2015. Still, banks were somewhat cautious regarding the extension of new credits due to the already high indebtedness of the so-called real sector. In contrast to the banking sector, real sector is facing constant rise in illiquidity. According to the central bank data, at the end of December 2015 the accounts of 14.870 legal and physical individuals conducting business operations were blocked, and their total debt amounted up to more than half a billion EUR. Compared to the previous year, the number of entities with arrears increased by 5 percent and the amount of their debt rose by 10.5 percent. The concentration of debt is relatively high, so that the fifty entities with the highest unsettled debt accounted for more than one third of the total amount of debt due. There are currently some 3,500 entities whose accounts are blocked for more than 30 days due and have more than EUR 10,000 of unpaid debts. The share of such debtors' debt in the total amount of unpaid debt is 95 percent.

Inflation turned positive

Average annual inflation in 2015 measured by HICP was 1.5 percent. A modest rise in consumer prices appeared after a two-year period of price stagnation – in 2013 the inflation stood at negligible 0.3 percent, while in 2014 it even entered a negative zone with the price level falling by 0.3 percent. Slight price increase in 2015 can be attributed to a somewhat stronger demand and improved consumer sentiments.

The lowest current account deficit in the last ten years

The current account of balance of payments is characterized by negative trends in goods exchange leading to a rising goods exchange deficit, by means of services account surplus growth and primary income account growth. Preliminary data show that the current account deficit in 2015 amounted to EUR 481.9 million and decreased by 8.4 percent compared to the previous year. Thus, it was the lowest current account deficit in the last ten years, which resulted from the rise in revenues from services by 17.7 percent and primary income being over two times higher than in the previous year.

Even though being a small economy, Montenegro has attracted a substantial inflow of FDI, due to its geographical location and natural endowments. Until 2005, Montenegro was not an attractive location for foreign investors, but as of 2005 it became one of the most attractive European destinations after an economic boom caused by the privatization process and regulations which opened the Montenegrin economy to foreign investors. From 2009 onwards, Montenegro records significant FDI inflows. A predominant part of FDI inflow is related to the privatization process, while green field investments are still very low. Tourism, energy sector, real estate, banking and telecommunications attracted the highest amounts of foreign investments. The biggest investors of the Montenegrin economy originate, in general, from Switzerland, Norway, Austria, and Russia, while the tourism and energy sector also attracts investors from Italy and Egypt. In 2015, net FDI flows to Montenegro amounted up to EUR 619.3 million, which represented an increase of nearly 75 percent compared to the same period last year.

Table MN1 Main economic indicators

	2014	2015	2014	2015			
			Q4	Q1	Q2	Q3	Q4
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	1.8	3.2	2.6	3.2	3.4	4.2	1.4
Real private consumption (% change, yoy)	2.8	1.9	-	4.5	0.9	-0.8	8.5
Real government consumption (% change, yoy)	-1.5	1.3	-	3.6	-4.8	1.8	23.3
Real investment (% change, yoy)	0.9		-	6.8	32.3	9.5	6.2
Industrial output (% change, yoy)	-11.4	-10.9	-7.3	7.1	12.8	16.5	17.9
Unemployment rate (%, ILO definition)	18,0	17.6	18.1	18.2	17.7	14.5	16.3
Nominal GDP (EUR million)	3,425	3,595	855	667	834	1,172	881
GDP per capita (EUR)	5,450	5,720	-	-	-	-	-
PRICES AND WAGES							
Implicit GDP deflator (% change, yoy)	-1.0	-	-	-1.6	1.4	1.0	1.0
Consumer prices (% change, yoy, pa)	-0.7	1.5	-0.3	0.8	2.1	1.8	1.4
Producer prices (% change, yoy, pa)	0.2	0.3	1.0	0.6	0.4	0.2	0.0
Average gross wage (% change, yoy, pa)	-0.4	0.3	-0.3	0.4	0.1	0.1	0.2
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	357	317	101	76	72	75	98
Exports of goods (EUR, % change, yoy)	-9.7	-4.8	5.2	3	-5.3	3.4	31.8
Imports of goods (EUR million)	1,733	1,841	438	346	489	522	457
Imports of goods (EUR, % change, yoy)	0.6	3.2	1.9	4.4	41.0	6.7	-12.4
Current account balance (EUR million)	-525	-747	-242	-197	-293	-448	-358
Current account balance (% of GDP)	15.3	-13.4	-3.5	-3.4	-3.8	-2.6	-2.4
Gross foreign direct investment (EUR million)	498	757	92	100	-	340	-
Foreign exchange reserves (EUR million, eop)	544	674	544	938	818	703	674
Foreign debt (EUR million, eop)	1,562	-	1,562	2,048	2,160	1,975	-
GOVERNMENT FINANCE*							
Revenue (EUR million)**	1,354	1,327	414	258	330	376	363
Expense (EUR million)**	635	662	183	144	172	170	176
Net = Gross operating balance (EUR million)**	719	665	230	115	157	206	187
Net acquisition of non-financial assets (EUR million)**	826	955	280	173	359	199	223
Net lending/borrowing (EUR million)**	-107	-290	-49	-59	-202	7	-37
Domestic government debt (EUR million, eop)	381	320	381	396	372	329	320
Foreign government debt (EUR million, eop)	1,561	1,956	1,562	2,048	2,160	1,975	1,956
Total government debt (% of GDP)	56.2	63.3	56.2	68.0	70.4	64.1	63.3
MONETARY INDICATORS							
Total domestic credit (% change, yoy, eop)	-1.9	0.8	-1.9	-2.7	0.2	4.1	0.8
DMBs credit to households (% change, yoy, eop)	1.4	3.1	1.4	2.0	2.8	2.4	3.1
DMBs credit to enterprises (% change, yoy, eop)	-3.4	2.0	-3.4	-1.0	0.8	3.4	2.0
Money market interest rate (%, pa)	1.4	0.5	0.4	0.5	-	0.4	-
DMBs credit rate for enterprises, short-term, (%, pa)	9.4	8.4	9.1	8.9	8.6	8.3	8.0
DMBs credit rate for households, short-term (%, pa)	11.1	11.5	12.1	12.2	12.0	11.2	10.5

Notes: * Data refer to consolidated general government. ** On the cash principle, cumulative from the beginning of the year.
Conventional abbreviations: pa - period average; eop - end of period; yoy - year on year; EUR - euro; DMB – deposit money bank.
Sources: Central Bank of Montenegro and the Ministry of Finance of the Republic of Montenegro, Statistical Office of Montenegro - Montstat.

Policy assumptions and projections summary

Projections in Table MN2 fully reflect the official projections of the Montenegrin Ministry of Finance, presented in its document "Montenegro Economic Reform Programme 2015–2018". The macroeconomic projections for the period 2015–2018 forecast 3.8 percent real GDP growth in 2016 and 4 percent in 2017. ■

Table MN2 Summary of projections

	2016	2017
Real GDP (% change)	**3.8**	**4.0**
Real private consumption (% change)	2.6	2.3
Real government consumption (% change)	1.5	0.0
Real investment (% change)	12.1	9.6
Exports of goods and services (constant prices, % change)	3.5	3.4
Imports of goods and services (constant prices, % change)	4.0	2.3
Current account balance (% of GDP)	-13.8	-
Consumer prices (% change, pa)	1.5	2.0
Unemployment rate (ILO definition, %, pa)	17.6	16.7
General government balance (ESA95 definition, % of GDP)	-5.4	-
Total domestic credit (% change, eop)	4.6	5.2

Notes: Cut-off date for information used in the compilation of projections was July, 2016.
Conventional abbreviations: pa - period average; eop - end of period; EUR - euro.
Source: The Projections of Macroeconomics and Fiscal Indicators over the 2015-2018 period, The Ministry of Finance of Montenegro, Podgorica, September 2015.

S E R B I A

Modest economic recovery in 2016

Recent economic developments

Challenges abound in both political and economic sphere

Prolonged refugee crisis, combined with the current economic crisis and early elections on April 24, 2016, are expected to have a significant impact on the Serbian economy. Elections could slow down the started reform. Aside from the mentioned problems, Serbia is waiting for the outcomes of court cases concerning the controversial privatization of companies. Additionally, the restructuring of certain state-owned enterprises is underway as well (such as “Smederevo Steel Works”, “Srbijagas”, “Serbian Railways”, “Serbian Power Utility”, “JP PEU Resavica”, “Mining-melting complex Bor”). As part of the reforms and austerity measures required by the IMF, the privatization and reform of the remaining state-owned enterprises have to be implemented as well. In order to curb the mounting public debt and ease the debt repayment, state officials have announced layoffs across the public sector. Although inevitable from a pure economic point of view, such measures could lead to a deterioration of the living standard of the Serbian population.

Accelerated recovery in early 2016

Throughout 2015 and the first quarter of 2016, Serbian economy has continued to grow. In 2015, GDP increased by 0.7 percent, while the first indicators suggest accelerated recovery in early 2016. Slow but accelerating growth tendencies are encouraging as IES forecasts also speak in favor of further improvement of the economic activity in the following quarters. However, it

is clear that the recorded growth has to be taken with a grain of salt, keeping in mind the low base, i.e. the low initial GDP.

Economic recovery has been primarily influenced by the increase in industrial production, recovery of the international trade characterized by a gradual increase of both imports and exports, as well as an increase in the investment activity. Particularly encouraging trends were observed in the last two quarters of 2015. If the production side of GDP is considered, industrial production had the largest impact on growth. In 2015 its physical volume increased by 8.3 percent in comparison with 2014. The growth was additionally fueled by the recovery of service sectors such as domestic trade and tourism, while slight recovery has also been recorded in both construction and agriculture. When taking into consideration the expenditure side of the GDP, final private consumption is still decreasing. In the last two quarters it has declined by 0.6 and 0.7 percent, respectively. However, in the last two quarters of 2015 an increase in investment activity has been recorded with gross fixed capital formation increasing by 11.5 and 7.8 percent respectively, y-o-y. In addition, government final consumption increased slightly as well.

Positive trends are expected to continue in the following period. The latest estimations of the IES team and the revised projections of the European Commission suggest that the GDP will grow by some 2 percent in 2016. However, it should be noted that GDP growth in the previous years and future growth projections still remain substantially lower compared to some neighboring countries such as Romania, Montenegro, and Bosnia and Herzegovina. Whether such optimistic projections will materialize depends largely on the economic situation of the main trade partners in the region and the economic recovery in the EU. Further implementation of economic reforms that should provide a sustainable fiscal position and a favorable climate for further investments is necessary in order to ensure good economic perspectives in years to come.

Labor market development shows slight improvement

Both administrative and LFS data indicate some improvements in the labor market. After several years of continuous increase, unemployment has finally stabilized and turned towards a decreasing trend. In 2015, the survey-based rate of unemployment was 17.7 percent down from 19.2 percent in 2014, while the registered rate of unemployment amounted up to 27.1 percent or 2.2 percentage points lower than in 2014. At the same time, employment follows a mildly increasing trend, while activity of the labor force has slightly declined. Registered employment continued to grow in the first three months of 2016 showing an increase of 0.1 percent compared to the same period in 2015. The rise in employment came mainly from the private sector. Informal employment continues to be high, but there are some improvements with regard to that. According to LFS data, the share of those employed in the informal sector out of total employment was 20.4 percent in 2015 or 0.8 percentage points lower than in 2014.

Positive developments on the labor market should probably not be attributed to the new Labor Law which came into force in 2014. It seems more likely that the awakening of economy after years of recession is the main reason behind the slow recovery of the labor market. In the first quarter of 2016, the rise in employment went hand in hand with positive economic development, indicating good prospects for labor market indicators to reach their pre-crisis level. We suppose that the new investment cycle will keep unemployment stable for a while in spite of the ongoing reduction of the public sector employment.

Public sector wages were cut in November 2014 as part of the fiscal consolidation package under the IMF agreement. In spite of some growth in the private sector wages, this cut induced a fall in real wages in 2015 by 2.4 percent in comparison with 2014. However, an increase in both gross and net wages is observed in the first quarter of 2016. It is reasonable to expect that real wages will somewhat increase in 2016 due to stable inflation and a probability of minimum wage increase which will affect wages at the lower end.

Government deficit under control

Despite the unexpected expenditure of the snap elections, government deficit in the first quarter of 2016 has been significantly lower than it has been planned. Fiscal consolidation plan has been smoothly implemented, as Serbia reduced the planned deficit of the general government to RSD 16 billion relative to 54 billion, which was the maximum level of the deficit agreed with the IMF. The main sources of the unexpected cut in deficit originate from a better tax collection. Success of fiscal consolidation plan has been confirmed by the IMF and the World Bank, and also by Moody's Ratings which improved the Serbian outlook on a sovereign rating from stable to positive. Nevertheless, budget deficit is still under threat of the main fiscal risks originating from contingent liabilities of the state-owned enterprises, prolonged reduction of employees in the public sector and interest payment on government debt, which is very sensitive to the fluctuations of the exchange rate.

Credit activity is slowly recovering

Although the key policy rate of the National Bank is on hold, credit activity has been recovering in the first quarter of 2016. Monetary easing results mainly from a cut in foreign exchange reserve requirement, which was reduced by 6 percentage points in the last quarter of 2015. Consequently, bank's credit potential went up and the NBS foreign exchange reserves have declined. Low interest rates on global financial markets combined with a lax monetary policy of the NBS contributed to the fall of the landing interest rates. In the first quarter of 2016, lending rates on new households and corporate loans, both RSD and EUR-indexed, have achieved the lowest levels since 2000. As the NBS remained committed to the policy of monetary easing, a trend of the recovery of credit activity is most likely to continue in 2016. The main source of threat for the credit activity of the banking sector is a high level of nonperforming loans. The share of nonperforming corporate loans is hovering around 23 percent for the last three years.

Keeping the exchange rate stable

Inflationary pressures remained low during the last two quarters of 2015 and much lower compared to the previous years. Serbia is one of the few countries in the region that has managed to avoid deflation. Still, the actual consumer prices growth of 1.5 percent in 2015 is below the inflation target adopted by the National Bank of Serbia. Low inflationary pressures resulted primarily from low aggregate demand, low imported inflation and continuous price decrease of oil and primary agricultural products at the international market. In the following period, an increase of the inflation rate could be expected due to the expected rise of oil product prices, the rebound of domestic demand, as well as the acceleration of the price increase at the international level. During 2015, RSD depreciation trend was observed. The weakening of the effective exchange rate of domestic currency was mostly influenced by the fall of EUR when compared to the major global currencies. The average rate of the RSD depreciation against the EUR in 2015 was 4.5 percent, while in relation to the USD, RSD depreciation was much higher, amounting up to 23.1 percent. At the inter-bank foreign currency market, the National Bank of Serbia purchased a total of EUR 970 million and sold EUR 450 million in order to prevent high daily fluctuations and to ensure stability at the foreign exchange market. The RSD exchange rate in the next period will follow a slight depreciation trend. The intensity of depreciation will largely depend on the implemented monetary policy of major central banks worldwide but also on the movement of key domestic macroeconomic indicators.

Current account deficit down in 2015

Serbia's current account deficit decreased in 2015. This improvement was due to an increase in net inflow of remittances and higher services' surplus, mainly due to a surge in exports of computer services and passenger transport services.

Table RS1 Main economic indicators

	2014	2015	2014	2015			
			Q4	Q1	Q2	Q3	Q4
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	-1.8	0.7	-2.0	-1.8	1.1	2.3	1.2
Real private consumption (% change, yoy)	-0.9	-0.6	-1.0	-0.2	-1.2	-0.6	-0.3
Real government consumption (% change, yoy)	0.1	-1.2	1.6	-3.8	-2.8	0.7	0.8
Industrial output (% change, yoy)	-6.5	8.3	-13.3	-1.6	11.7	13.5	9.7
Unemployment rate (registered, %, pa)	29.3	27.1	28.4	27.7	27.5	26.9	26.4
Nominal GDP (EUR million)	33,318	32,908	-	7,241	8,200	8,613	8,857
GDP per capita (EUR)	4,635	4,626	-	-	-	-	-
GDP per capita (EUR)	4,783	4,635	-	-	-	-	-
PRICES, WAGES, AND EXCHANGE RATES							
Consumer prices (% change, yoy, pa)	1.7	1.5	-0.6	1.4	0.7	-0.1	-0.5
Producer prices (% change, yoy, pa)	0.2	0.7	-1.5	1.2	1.0	-1.7	0.2
Average gross wage (% change, yoy, pa)	-1.7	-2.4	-1.7	-1.4	-2.7	-2.3	-1.0
Exchange rate, RSD/EUR (pa)	117.3	122.6	121.0	121.5	120.4	120.2	120.8
Exchange rate, RSD/USD (pa)	88.5	108.9	99.5	108.2	108.7	108.1	110.3
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	11,158	12,028	2,860	2,775	3,183	3,032	3,033
Exports of goods (EUR, % change, yoy)	1.5	7.8	-3.2	5.2	10.7	8.8	6.0
Imports of goods (EUR million)	15,497	16,393	4,052	3,875	4,155	4,015	4,322
Imports of goods (EUR, % change, yoy)	0.2	5.8	-4.2	8.7	5.1	2.2	6.7
Current account balance (EUR million)	-1,985	-1,578	-563	-511	-279	-344	-445
Current account balance (% of GDP)	-6.0	-4.8	-6.4	-7.1	-3.4	-4.0	-5.0
Gross foreign direct investment (EUR million)	1,500	2,115	347	405	527	594	589
Foreign exchange reserves (EUR million, eop)	11,643	11,813	11,643	12,169	11,977	11,995	11,813
Foreign debt (EUR million, eop)	25,741	26,358	25,741	26,689	26,494	26,292	26,358
GOVERNMENT FINANCE*							
Revenue (RSD billion)**	1,621	1,695	457	381	425	433	457
Expense (RSD billion)**	1,782	1,729	528	391	415	419	505
Net = Gross operating balance (RSD billion)**	-161	-35	-72	-11	10	14	-47
Net acquisition of non-financial assets (RSD billion)**	97	115	34	10	24	30	51
Net lending/borrowing (RSD billion)**	-258	-149	-105	-21	-14	-16	-98
Domestic government debt (EUR million, eop), national methodology***	8,912	9,420	8,912	9,113	9,343	9,658	9,420
Foreign government debt (EUR million, eop), national methodology***	13,849	14,773	13,849	14,663	14,721	15,152	14,773
Total government debt (% of GDP), national methodology	71.8	74.5	-	-	-	-	-
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	11.0	17.1	11.0	10.5	6.3	9.1	17.1
Broad money, M2 (% change, yoy, eop)	12.2	14.4	12.2	8.5	7.8	4.1	14.4
Total domestic credit (% change, yoy, eop)	8.0	5.7	8.0	8.1	6.1	4.1	5.7
DMBs credit to households (% change, yoy, eop)	7.5	4.7	7.5	8.5	7.8	4.3	4.7
DMBs credit to enterprises (% change, yoy, eop)	-4.2	2.2	-4.2	-2.3	-6.0	-6.9	2.2
DMBs credit rate for enterprises, short-term, (%, pa)****	8.1	6.4	7.9	7.5	6.7	6.3	5.4
DMBs credit rate for households, short-term (%, pa)*****	14.1	13.3	14.3	16.0	13.2	12.0	10.8

Notes: * Data refer to consolidated general government unless stated otherwise. ** On the cash principle, cumulative from the beginning of the year. *** Central government debt only. **** New loans. ***** New loans, weighted average interest rates on consumer, cash, and other loans.

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

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

Trade deficit remained unchanged in relation to the previous year because the increase in merchandise exports was slightly stronger than the increase in imports. The composition of trade remained broadly stable: exports were dominated by machinery products, metals, and agricultural products (fruits and cereals), while imports were driven by machinery products as well, and also by petroleum and chemicals. It is interesting to observe that trade growth was attained even though some of the major product groups recorded year-on-year declines: exports of motor vehicles and cereals decreased, as well as imports of petroleum, gas, and motor vehicles. Financial account of the balance of payments improved as well, due to an increase in FDI and a decrease in the borrowing of the general government.

Policy assumptions and projections summary

Projections for the Republic of Serbia are based on projections presented in the Fiscal Strategy of the Republic of Serbia for 2016 with projections for 2017 and 2018 and the IMF's World Economic Outlook, as well as projections by the European Commission, expert estimates, and ARIMA modeling.

Table RS2 Summary of projections

	2016	2017
Real GDP (% change)	**2.0**	**2.5**
Exports of goods and services (constant prices, % change)	7.7	7.0
Imports of goods and services (constant prices, % change)	5.8	4.4
Current account balance (% of GDP)	-4.6	-4.3
Consumer prices (% change, pa)	2.2	3.4
Exchange rate, national currency/EUR (pa)	125.3	127.8
Unemployment rate (registered, %, pa)	27.2	27.1
General government balance (ESA 2010 definition, % of GDP)	-4.0	2.8
Broad money, M4* (% change, eop)	8.0	7.5
Total domestic credit (% change, eop)	7.5	7.0

Notes: Cut-off date for information used in the compilation of projections was June 29, 2016. * Data on M3, the broadest category of money for which the statistics is compiled by the NBS (according to national methodology).

Conventional abbreviations: pa - period average; eop - end of period; EUR - euro.

Sources: Authors' projections, Fiscal strategy of the Republic of Serbia for 2016 with projections for 2017 and 2018, the IMF WEO.

SLOVENIA

Improved economic outlook and restored short-term fiscal stability

Recent economic developments

First refugees from the solidarity scheme entering Slovenia

After the number of migrants transiting through the country increased considerably in the final quarter of 2015, their number moderated at the beginning of 2016. All along, Slovenia has been striving for a common European solution to the refugee-migrant crisis. In January 2016, Slovenia addressed the European Union leaders and the leaders of the countries in the Balkan migration route with a proposal of halting irregular migration flow on the Balkan route. Its initiative has been supported by the key Western Balkan countries (Croatia, Serbia, and Macedonia) and the Visegrad countries (Czech Republic, Hungary, Poland, and Slovakia). Positive signals also came from Brussels and some other EU member states. In May 2016, Slovenia accepted the first refugees under the scheme of solidarity redistribution of immigrants in the EU and plans to accept additional 567 refugees in 2016 and 2017.

Strong exports support further GDP growth

With regard to the Transatlantic Trade and Investment Partnership (TTIP), Slovenia continues to support the negotiation of a balanced TTIP, but calls for

caution and transparency in the negotiations and gives absolute precedence to content of the agreement over the rapid conclusion of the negotiations.

Among domestic political-economic issues, rules mandating the use of certified cash registers entered into force in Slovenia on January 1, 2016. The new system is designed to curb tax evasion and the government expects to collect between additional EUR 50 million and 100 million in tax receipts per year. However, during the first two months, the number of cash registers' users was still far behind the target.

Solid economic growth continues

In the third and fourth quarter of 2015, economic activity continued to grow and its growth even strengthened in the last quarter driven by a greater domestic demand. Altogether, GDP rose by 2.9 percent in 2015, continuing the solid performance from 2014 when it grew by 3 percent. Exports remained the key driver of growth, but were less strong when compared to 2014. On the other hand, private consumption strengthened in 2015 as a result of rising employment, increasing wages and consumer confidence. Economic growth was further spurred by strong public infrastructure investment related to the closure of the EU funding for 2007–2013. Most recent data for the first months of 2016 suggest economic activity increased further, particularly merchandise exports and manufacturing production.

Labor market improves further

Consistent with higher economic activity, the number of employed individuals continued to grow in the second half of 2015 up to November. After a temporary halt in the rise in employment in December, the number of individuals employed increased further at the beginning of 2016. Employment has been rising in most private sector activities and, since mid-2015, a slight increase in public service employment has been recorded as well. The registered unemployment rate was declining throughout 2015. On a yearly basis, it stood at 12.3 percent and was 0.8 percentage points lower than in 2014. In the first four months of 2016, the number of registered unemployed dropped by 6.2 percent compared to the same period in 2015. Despite significant improvements in the labor market, Slovenia needs to tackle labor market structural imbalances such as long-term unemployment, low employment among older workers and the less educated. Following solid economic growth, average gross monthly earnings rose in 2015 both in nominal and real terms. The average monthly net earnings were higher by 0.8 percent in the public sector and by 0.3 percent in the private sector. The rise in average monthly earnings continued in the first two months of 2016.

The general government deficit dropped below 3 percent of GDP

In 2015, the general government deficit dropped below 3 percent of GDP for the first time since the onset of the crisis. This was mainly due to the continued implementation of consolidation measures and the non-recurrence of several one-off factors which were in place in 2014. With a significant improvement in financing conditions, the expenditure on interest also fell in 2015, which should be welcomed in view of the necessary reduction in general government debt. The latter increased further in 2015 and reached 83.2 percent of GDP, which is up by 2.2 percentage points compared to 2014. The increase was the result of the continued accumulation of cash buffers due to favorable market conditions. To ensure medium- and long-term fiscal sustainability, fiscal consolidation should focus on structural fiscal reforms including pension scheme reform, healthcare reform, and long-term care reform.

Lending activity continues to contract

Lending activity continued to contract in 2015 as a result of limited corporate demand and the persistent risk aversion of banks, but the decline slowed in 2015 due to the increase in household loans and a smaller decline in corporate and non-financial institutions loans. Although the non-financial institutions deleveraged further in 2015, their equity capital has not increased. Given the high reliance of enterprises, especially SMEs on bank funding owing to the poor development of other segments of the financial system, this makes it very difficult for them to secure financing. Lending activity declined further in the first months of 2016, with a significant drop taking place in February as a consequence of the liquidation of two smaller banks. The trend of low and decreasing interest rates continues and the gaps between domestic and foreign interest rates narrow gradually. The share of nonperforming loans stood at 11.5 percent in 2015 and was only marginally down compared to the end of 2014.

Inflation turned negative

Following the historically low annual inflation of 0.2 percent in 2014, Slovenia recorded a deflation of 0.5 percent in 2015. This was mainly a result of a decrease in energy prices by 6.7 percent. With a slow recovery in household consumption, prices of non-energy goods were also lower year-on-year, while the prices of food and services went up in 2015. In the first quarter of 2016, prices remained down year-on-year by 0.7 percent. The decline was still largely due to lower oil and other energy prices.

Table SI1 Main economic indicators

	2014	2015	2014	2015			
			Q4	Q1	Q2	Q3	Q4
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	3.0	2.9	2.8	2.8	2.7	2.6	3.3
Real private consumption (% change, yoy)	0.6	1.7	-0.2	0.6	1.1	2.5	2.6
Real government consumption (% change, yoy)	-0.1	0.7	0.8	-1.2	0.2	0.8	3.0
Real investment (% change, yoy)	5.7	4.4	-3.6	10.9	0.8	-0.6	8.1
Gross-fixed capital formation (% change, yoy)	3.2	0.5	-4.1	1.5	-0.6	-2.0	3.4
Industrial output (% change, yoy)	2.2	5.6	2.6	6.6	5.0	5.7	5.1
Unemployment rate (registered, %, pa)	13.1	12.3	12.7	13.2	12.3	11.7	11.9
Nominal GDP (EUR million)	37,303	38,543	9,410	8,950	9,869	9,904	9,820
GDP per capita (EUR)	18,093	18,680	-	-	-	-	-
PRICES AND WAGES							
Implicit GDP deflator (% change, yoy)	0.8	0.4	0.6	0.5	0.2	0.1	1.0
Consumer prices (% change, yoy, pa)	0.2	-0.5	-0.1	-0.4	-0.6	-0.4	-0.6
Producer prices (% change, yoy, pa)	-0.6	-0.2	-0.1	0.1	0.6	-0.4	-1.2
Average gross wage (% change, yoy, pa)	1.1	0.7	1.2	0.5	0.6	0.4	1.3
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	22,989	24,035	5,928	5,887	6,078	5,943	6,127
Exports of goods (EUR, % change, yoy)	6.4	5.1	8.5	6.8	6.2	4.8	2.9
Imports of goods (EUR million)	21,755	22,423	5,534	5,530	5,660	5,460	5,774
Imports of goods (EUR, % change, yoy)	3.7	4.9	3.9	7.5	4.6	2.9	4.6
Current account balance (EUR million)	2,607	2,828	733	443	816	896	673
Current account balance (percent of GDP)	7.0	7.3	7.8	5.0	8.3	9.0	6.9
Gross foreign direct investment (EUR million)	746	944	-173	430	117	81	317
Foreign exchange reserves (EUR million, eop)	837	787	837	900	893	841	787
Foreign debt (EUR million, eop)	47,184	44,765	46,314	47,287	45,319	45,437	44,765
GOVERNMENT FINANCE*							
Revenue (EUR million)**	16,766	17,384	4,551	3,923	4,332	4,418	4,712
Expense (EUR million)**	18,621	18,516	5,371	4,288	4,603	4,523	5,101
Net lending/borrowing (EUR million)**	-1,855	-1,131	-820	-365	-272	-105	-390
Domestic government debt (EUR million, eop)	15,988	17,256	15,988	15,660	15,606	17,258	17,256
Foreign government debt (EUR million, eop)	10,027	10,023	10,027	10,025	10,026	10,023	10,023
Total government debt (% of GDP)	81.0	83.2	-	-	-	-	-
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)***	18.5	24.9	18.5	19.8	21.2	22.1	25.0
Broad money, M3 (% change, yoy, eop)***	6.1	4.6	6.1	4.7	4.1	3.1	3.9
Total domestic credit (% change, yoy, eop)	-12.6	-5.0	-12.6	-11.9	-11.6	-12.2	-5.0
DMBs credit to households (% change, yoy, eop)	-1.7	1.1	-1.7	-0.2	0.3	0.1	1.1
DMBs credit to enterprises (% change, yoy, eop)	-21.1	-10.8	-21.1	-20.6	-21.0	-21.9	-10.8
3 months EURIBOR (%, pa)	0.2	0.0	0.1	0.0	0.0	0.0	-0.1
6 months EURIBOR (%, pa)	0.3	0.1	0.2	0.1	0.1	0.0	0.0
DMBs credit rate for enterprises, short-term, (%, pa)	4.3	3.0	3.8	3.3	3.1	3.1	2.6
DMBs credit rate for households, short-term (%, pa)	4.3	3.4	4.0	3.7	3.5	3.4	3.3

Notes: * Data refer to consolidated general government. ** ESA 2010, cumulative from the beginning of the year. *** Contribution of Slovenia to the euro area monetary aggregates.

Conventional abbreviations: pa - period average; eop - end of period; yoy - year on year; EUR – euro; DMB – deposit money bank.

Sources: Statistical Office of the Republic of Slovenia, Ministry of Finance, Bank of Slovenia, and calculations by IER.

Current account surplus remains high

The current account surplus widened further in 2015 reaching 7.3 percent of GDP. Increase was a result of a larger surplus in international trade in goods and services, which was impacted not only by favorable export developments, but also by low import prices.

FDI inflow continued to increase in 2015

Most of the increase was due to equity capital inflows totaling EUR 1.4 billion while net claims abroad in the amount of EUR 421 million decreased the FDI inflow. The largest transactions in equity capital took place in March and August as a result of the conversion of debt into equity capital. Despite the increase in FDI in the last two years, Slovenia still needs to improve its attractiveness by tackling factors such as high labor taxation, lengthy procedures for obtaining building licenses, high land prices, and an inefficient judicial system.

Policy assumptions and projections summary

The projected values of the main macroeconomic aggregates for Slovenia are those presented in the Spring Forecast 2016 of the Institute for Macroeconomic Analysis and Development (IMAD), except the projected value of the general government deficit, which is based on the Spring 2016 Economic Forecast of the European Commission.

Compared to the IMAD's Autumn Forecast, the forecast of GDP growth for 2016 was subject to a downward revision. The latest forecast projects GDP growth to moderate to 1.7 percent in 2016. Weaker growth will be mainly attributable to lower public investment after the expiry of access to EU funds under the previous financial perspective, but also to lower contribution of net exports. The latter will be the result of a moderation in exports growth accompanied by increased imports growth fueled by stronger domestic demand. Growth in government consumption will continue this year. In 2017, GDP growth is expected to accelerate up to 2.4 percent. In addition to exports, which will follow the expected increase in foreign demand and further growth in private consumption, investment consumption is envisaged to again make a more significant contribution to GDP growth. The rise in investment will come from both the anticipated increase in government investment and strong anticipated growth in private investment indicated by the high capacity utilization levels and rising domestic consumption.

In line with the continued economic growth, a further increase in employment and a decline in unemployment are expected in 2016 and 2017. The rise in employment will be somewhat weaker this year compared to 2015 due to lower GDP growth and stronger wage pressure. The unemployment rate is forecasted to drop to 11.7 percent in 2016 and then to 11.0 percent in 2017. The decline will come from both fewer job losses and fewer first-time jobseekers.

This year's inflation is again projected to be negative. However, assuming an increase in import prices and higher economic growth, a renewed overall consumer price growth is expected in 2017 starting already towards the end of 2016. Nevertheless, inflation will remain relatively low. Thanks to favorable macroeconomic conditions, the general government deficit is projected to decrease to 2.4 percent in 2016 and further down to 2.1 percent in 2017. ■

Table SI2 Summary of projections

	2016	2017
Real GDP (% change)	**1.7**	**2.4**
Real private consumption (% change)	2.1	1.7
Real government consumption (% change)	0.9	0.2
Gross fixed capital formation (% change)	-3.0	6.0
Exports of goods and services (constant prices, % change)	3.7	4.8
Imports of goods and services (constant prices, % change)	3.0	5.1
Current account balance (% of GDP)	7.5	6.8
Consumer prices (% change, pa)	-0.3	1.3
Exchange rate, national currency/USD (pa)	1,111	1,114
Unemployment rate (registered, %, pa)	11.7	11,0
General government balance (ESA95 definition, % of GDP)	-2.4	-1.9

Notes: Cut-off date for information used in the IMAD's projections was March 3, 2016.
Conventional abbreviations: pa - period average; eop - end of period; USD - US dollar.
Sources: Institute for Macroeconomic Analysis and Development (Spring Forecast of Economic Trends 2016) and European Commission (Spring 2016 Economic Forecast).

ANALYSES

Economic aspects of the refugee crisis in SEE-6 countries

The largest inflow of refugees into Europe since World War II

The persistence of the war in Syria and the deepening of the refugee crisis have prompted the largest inflow of refugees and migrants into Europe since World War II. Therefore, according to some authors, year 2015 may become known as the year of Europe's migration crisis[1]. Macedonia, Serbia, Croatia, and Slovenia are on the transit route to West European countries, and refugees are mainly originating from Syria, Afghanistan, and Iraq. There were more than one million registered refugees reaching developed EU countries in 2015. Rather than welcoming, settling, and integrating the new arrivals, many EU member states have tried to drive them away from their borders through an escalation of restrictive migration policies designed to stop people entering in the first place.

The rising number of asylum seekers in SEE-6 countries

The arrival of refugees has increased, especially in the second half of 2015. As Macedonia, Serbia, Croatia, and Slovenia are on a transit route, according to some estimation, 30–40 times more refugees passed through these countries in 2015 in comparison to 2014. Since the SEE-6 countries are themselves facing a relatively difficult economic and political situation, and mainly due

1 Hagen-Zanker, J. and R. Mallett, 2016, "Journeys to Europe. The Role of Policy in Migrant Decision-Making", ODI Insights. URL: http://www.odi.org/publications/10317-journeys-europe-role-policy-migrant-decision-making, (accessed March 2016).

to rather high rates of unemployment in those countries, refugee population is predominantly just transiting those countries, without the intention of settling. However, a proportion of refugees is seeking asylum in spite of the meager labor market situation in SEE-6 countries. Data on asylum seekers are quite scarce and incomplete. UNHCR Regional Office for South-East Europe provides data for the asylum seekers only in the first half of 2015 and for 2014, but does not cover Croatia and Slovenia. According to this data source, the number of asylum seekers in Serbia and Macedonia in the first half of 2015 outpaced the number of asylum seekers in the entire 2014(see Table A1).

Slovenia – the best ranked among SEE-6 countries according to the political risk

Business Monitor International assessed the short-term political risk index for five South-East European countries. According to the assessment, political risk in 2015 seems to be the highest in Croatia, followed by Slovenia, Macedonia, and Serbia. However, the emergence of the refugee crisis along with the indigenous political instabilities in SEE countries, have totally changed the ranking in 2016 (see Table A2). In 2016, Bosnia and Herzegovina was attributed the highest level of political risk, followed by Kosovo and Macedonia.

Persistent economic problems and greater instability in SEE-6 countries

Generally, Business Monitor International concludes that SEE countries face the risk of greater instability and unrest in 2016 due to the new refugee crisis, as well as the specific problems connected to each of SEE-6 countries, such as: unstable government in Macedonia, the snap election and IMF-mandated austerity measures in Serbia, protests against the Prime Minister and parliamentary election in the Fall of 2016 in Montenegro, weak recovery of economy and urgently needed fiscal reforms in Croatia, and problematic governance in Bosnia and Herzegovina. Therefore, unemployment rose dramatically in all SEE-6 countries and affected young people in particular. However, the Business Monitor International pointed out that the region's

Table A1 **Asylum seekers in selected SEE-6 countries in 2014 and in January–June 2015**

	B&H	Macedonia	Montenegro	Serbia
2014	45	1,289	2,312	16,490
2015, I–VI	20	1,427	1,526	37,391

Source: UNHCR, 2014 and 2015.

Table A2 **Rank of SEE countries according to the level of political risk**

	B&H	Croatia	Macedonia	Montenegro	Serbia	Slovenia
2015	5	1	3	-	4	2
2016	1	4	2	4	3	6

Note: 1 - the highest political risk; 6 - the lowest political risk.
Source: BMI Research, 2015 and 2016.

historic fault-lines remain easily susceptible to pressure points in the form of the migration influx and radicalization, which could bring the Balkans into greater prominence in the coming year[2].

Possible costs and benefits of refugee crises for SEE-6 countries

We can assume that some SEE-6 countries can benefit from the transit of refugees over its territory, but only in the short run. A longer retention period of refugees in SEE-6 countries would probably be followed by a decrease in their personal consumption on the one hand, and by an increasing government's consumption of each country in the SEE-6 region on the other hand. The International Monetary Fund researchers discovered that the immediate fiscal costs of asylum seekers for Croatia are 0.002, 0.09, and 0.11 percent of GDP, while for Serbia they amount up to 0.00, 0.06, and 0.1 percent of GDP, in the period 2014–2016, respectively[3]. In the longer run, the economic effects of the asylum seekers will depend on the speed and scope of their integration into the labor markets of the recipient countries.

Rights of asylum seekers equal to the rights of citizens in Croatia, Macedonia, and Serbia

In order to fully comprehend the economic aspects of the possible stay by some of the refugee population in the SEE-6 countries territory, it is necessary to start from the Asylum Law in these countries. In Croatia and Serbia, Asylum Laws are in force since 2007. Similar Asylum Laws have also been applied in Montenegro and Slovenia since 2006, in Macedonia since 2013, and in Bosnia

2 BMI Research, 2016, "Political Risk Analysis - Balkans to Face Rising Instability in 2016 - APR 2016", Business Monitor International. URL: http://www.emergingeuropemonitor.com/political-risk-analysis-balkans-face-rising-instability-2016-apr-2016 (accessed March 2016).

3 Aiyar, S. et al., 2016, "The Refugee Surge in Europe: Economic Challenges", International Monetary Fund (IMF). URL: https://www.imf.org/external/pubs/ft/sdn/2016/sdn1602.pdf (accessed February 2016).

and Herzegovina since 2016. There are a number of convergent areas in the Asylum Laws of the SEE countries addressing the basic needs of the asylum seekers, refugees, and individuals enjoying subsidiary protection. Those areas cover accommodation, work, health care, elementary and secondary education, free legal aid; social welfare, except in Macedonia and Slovenia; financial support, except in Bosnia and Herzegovina; freedom of religion and religious education for children, except in Bosnia and Herzegovina, Macedonia, and Slovenia; family reunification, except in Slovenia; and preservation of family unity and assistance with integration into society, except in Macedonia.

Asylum Laws of SEE-6 countries, with minor differences from one country to another, guarantee the right to the previously stated basic needs. In addition, in Croatia, Macedonia, and Serbia the rights of refugees are equal to the rights of the citizens of those countries.

Economic aspects and challenges of refugee crises

Closure of the borders of the West European countries for refugees is opening up new economic possibilities as well as challenges for South-East European countries. Therefore, it is important to understand all the relevant economic aspects of a possible retention of a part of the refugee population in the Balkans region. Considerations on economic aspects of the increased residue of refugees in SEE-6 countries would have to examine the availability of accommodation facilities, the integration of refugees into the social environment, the possible impact migration could have on the labor market, the impact on the "grey" economy, the impact on the health system and social welfare, and the impact on the educational system. When high political risk in all the SEE-6 countries and accumulated economic problems are also taken into account, it becomes obvious that further development of the refugee crisis should be carefully monitored. Also, governments of all the SEE-6 countries should be considered responsible for finding a proper political and economic answer for the challenges posed by the crisis.

Limited opportunities in SEE-6 countries

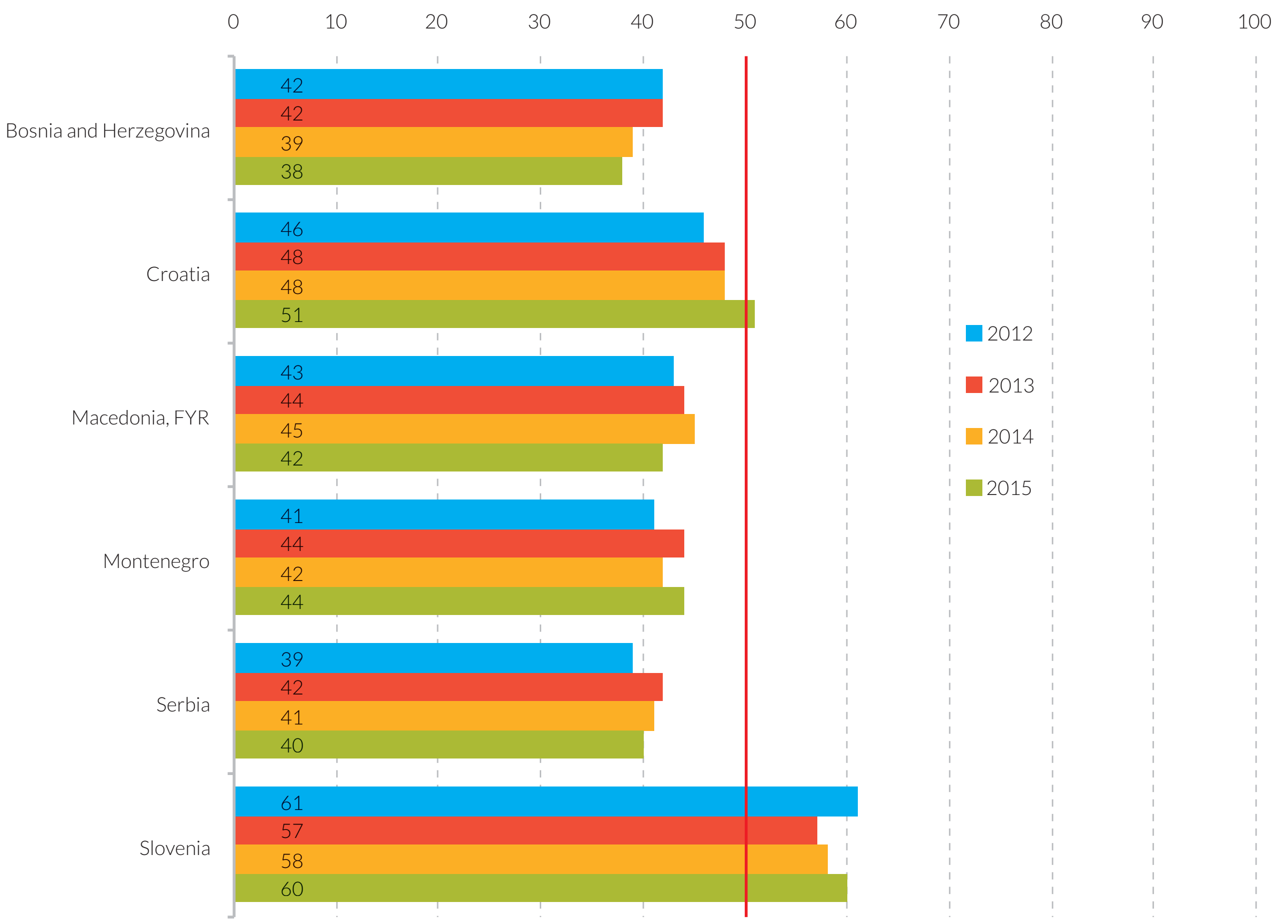
SEE-6 countries have been exhausted by the 1990s war, years of transition and refugees. Economies of these countries are small and still weak. According to the Forced Migration Review, there are still some 361.000 internally displaced individuals and around 100.000 refugees in Serbia, Croatia, Bosnia and Herzegovina, and Montenegro, of whom around 96.000 are in Serbia alone[4]. As a result, these countries are already facing problems of returnee integration according to the Readmission Agreement, an extended refugee crisis and problems with the forced migration. Hence, it is to be concluded that that the possibility of SEE-6 countries taking over any substantial part of the refugee population is quite limited.

4 Forced Migration Review (FMR), 2009, "Protracted displacement", Refugee Studies Centre, Oxford Department of International Development, University of Oxford, Issue 33. URL: http://www.refworld.org/pdfid/4c68e12d2.pdf (accessed March, 2016).

Corruption perceptions in SEE-6 countries

Corruption is recognized as a major issue in the region and seizing corruption, at least in the case of Croatia, proved to be the key criteria in the accession process to the European Union. The Transparency International's Corruption Perceptions Index (CPI) ranks countries and territories based on how corrupt their public sector is perceived to be. Recent developments in CPI scores for SEE-6 countries reveal that no major changes in corruption perception are recorded in the last four-year period (Figure A1).

Figure A1 Corruption Perception Index in SEE-6, 2012–2015



Source: Transparency International, https://www.transparency.org/.

Country score indicates the perceived level of public sector corruption on a scale of 0–100, where 0 means that a country is perceived as highly corrupt and 100 means it is perceived as very clean. In the observed period, only Slovenia was in the "clean" area with the CPI score above 50. However, its CPI score of 60 indicates that the corruption among public institutions and employees is still common. In 2015, Croatia was for the first time positioned in the less corrupted group of countries with the CPI score of 51. The improvement of the CPI should only be interpreted as slightly more optimistic according to the expert views on the public sector corruption in Croatia, rather than endorsing the scenario of "Croatia finally becoming a corruption-free country" proposed by the local media in their comments on recent CPI developments in Croatia. Other SEE-6 countries have to intensify their efforts in fighting corruption as it seems there is still a long way ahead to cross the psychological line of CPI above 50. Montenegro improved its latest CPI score to 44, while Bosnia and Herzegovina, Serbia, and Macedonia fared worse in 2015 in comparison to the previous year.

Table A3 Country rankings

Country	2012	2013	2014	2015
Bosnia and Herzegovina	72	72	80	76
Croatia	62	57	61	50
Serbia	80	72	78	71
Macedonia	69	67	64	66
Slovenia	37	43	39	35
Montenegro	75	67	76	61
Total number of countries	*174*	*177*	*168*	*168*

Source: Transparency International, https://www.transparency.org/.

Coming to comparisons, CPI scores prove to be the most useful measure of how a country fares if ranked with other nations worldwide. A country's rank indicates its position relative to other countries and territories included in the index (Table A3). Among SEE-6, Slovenia is ranked 35th and it is the only country positioned in the top quartile of 168 countries on the CPI 2015 list. All othe SEE-6 countries are clustered in the second quartile, where Croatia is the best positioned at the 50th place, followed by Montenegro (61st) and Macedonia (66th). Serbia and Bosnia and Herzegovina are clustered below, around the 70th position.

The process of accession to the EU will strengthen the anticorruption initiatives; however, the corruption risk pertains among the EU member states as well. In their recent research paper "The Cost of Non-Europe in the Area of Corruption", RAND Europe estimated the annual economic, social, and political costs of corruption in the EU-28 between EUR 179 billion and 990 billion and pointed out the major corruption risk in the public procurement sector.

Governments in the SEE-6 countries have to prove strong commitment to seize corruption and to lower the gap dividing the region from North European top ranked countries. Fighting corruption is a mandatory achievement not only in the EU accession process but a strong positive signal for investors indicating that a national economy is operating in a stable and a business-friendly environment.

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Print: GRAFOKOR d.o.o., Zagreb

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