SEE-6
Economic Outlook

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

CONTENT

2 BOSNIA AND HERZEGOVINA — Positive economic trends despite political instability

8 CROATIA — Solid economic growth sustained, albeit slowing down

14 MONTENERGRO — Biggest growth rate in the region

22 NORTH MACEDONIA — Macedonian economy on the bumpy road

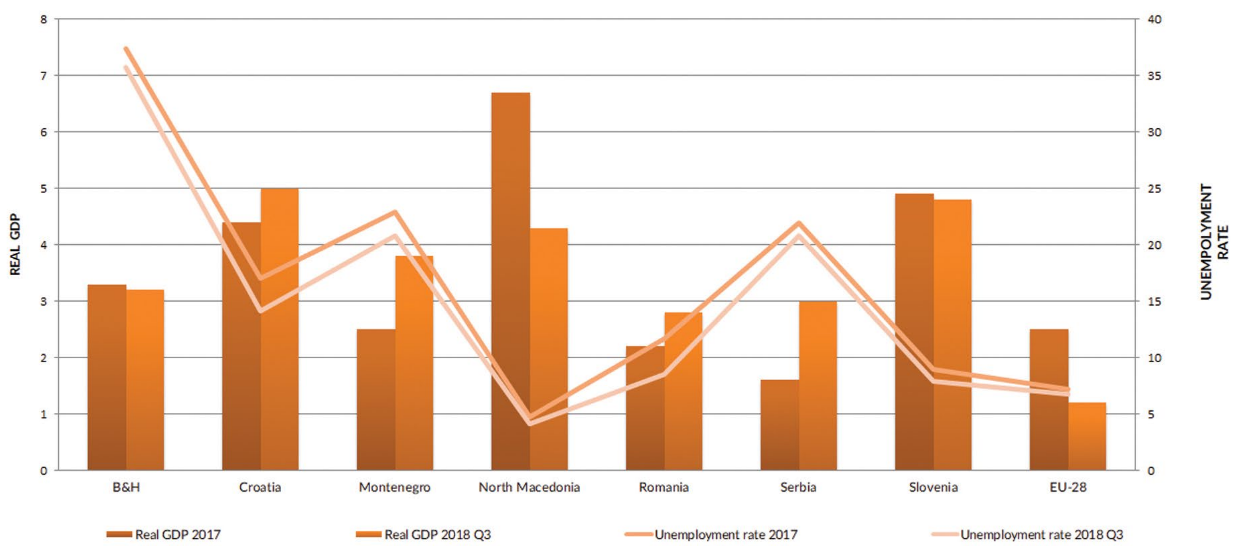
28 ROMANIA — New Challenges in the light of the Romanian Presidency of the Council of the European Union

36 SERBIA — Democratic institutions and the rule of law is of high importance for Serbia

42 SLOVENIA — Economic growth is gradually slowing, while further reforms and consolidation still need to be tackled

48 ANALYSIS — Real GDP and unemployment rate for selected SEE countries

REAL GDP AND UNEMPLOYMENT RATE FOR SELECTED SEE COUNTRIES AND EU-28



Source: Eurostat, authors for selected SEE countries and EU-28.

seea | Vol. **5** | No. **1** | June 2019 | e-ISSN **1849-8884** | ISSN **1849-8817**

BOSNIA AND HERZEGOVINA

Positive economic trends despite political instability

On the road to the EU

Several important events marked the first three quarters of 2018 in Bosnia and Herzegovina (B&H). Taking into account the foreign policy, key events are tied to the European path and the fact that in February, B&H submitted answers to 3.242 questions from the European Commission Questionnaire. However, 14 months were spent to answer these questions. The European Commission then sent an additional 655 questions, but replies to them have not yet been sent to Brussels. After B&H completes this job, the European Commission should prepare its Opinion on Bosnia and Herzegovina's application for membership in the European Union. This is especially important because B&H is the only state in the region that does not have the status of a candidate country.

General elections were held in October 2018 but the functioning of the Presidency of Bosnia and Herzegovina was affected by the expression of divergent positions by its individual members on a number of issues under its competence over foreign policy. Furthermore, the Council of Ministers adopted further country-wide strategies on areas such as environment and rural development. However, with the exception of a few reforms and the notable adoption of the excise legislation, delivery on a number of reforms

was delayed by lack of agreement within the ruling coalition members. Hence, the political situation is still unstable.

Economic growth driven by government consumption and gross capital formation

The end of 2017 and the first three quarters of 2018 were marked by a modest economic growth. In the first three quarters of 2018 Bosnia and Herzegovina achieved economic growth of about 3% as compared to the same period of the previous year. This economic growth rate is a continuation of the previous year's trend. When it comes to the structure of the achieved economic growth in B&H, increases are seen within all categories. The most significant contribution to economic growth was achieved within the gross capital formation, which increased by 11.5% during the observed period.

Employment growth and a slight decline in unemployment

At the end of the third quarter of 2018, the total number of employees in B&H amounted to 808.6 thousand and was 2% higher than in the same period of 2017. In almost all areas, the number of employed persons has increased . However, the most significant contribution to the growth of the number of employees was in the activities of industry, trade and catering. At the same time, the unemployment rate in 2018 was 18.4%. The number of registered unemployed persons in B&H in the third quarter of 2018 decreased by 8.5% compared to the same period in 2017 and amounted to 437.8 thousand.

Budget surplus and lower government public debt

In the first nine months, a total of 9.2 billion KM of public revenues was collected at the level of B&H, which is 5.7% more than in the same period of the previous year. The share of revenues from indirect and direct taxes in total public revenues is almost identical (both 50%). The highest contribution to the growth of public revenues was achieved due to the growth of VAT revenues (6.4% y/y) and customs duties (7.5% y/y), as well as income tax (8% y/y) and corporate income tax (13.2% y/y). In the same period, public expenditures amounted to about 7.9 billion KM, which is 5.4% more than in the same period of the previous year. Such trends in public finances have contributed to the reduction of public government debt by 112 million EUR.

Low inflation and a slight increase in gross wages

In the first three quarters of 2018, a slight increase in prices is continued. Inflation in B&H in the mentioned period was around 1%. The highest price increase in the first three quarters of 2018 was in the transport division (8.4% y/y). The increase in prices in the above-mentioned division was significantly determined by the rise in fuel prices on the world market. In addition, the prices were significantly increased in the alcoholic beverages and tobacco division (6.7%), which is related to tobacco and cigarette price increases during 2018. In the observed period there was a slight increase in gross wages. At the end of the third quarter of 2018, the average gross salary amounted to about EUR 703, which is an increase of 3.5% over the same period of 2017.

Growth of foreign trade and slight increase in foreign direct investments

In the first three quarters of 2018, the trend of the growth of foreign trade continued. The key drivers of this increase in foreign trade indicators were the export demand and the increase in world prices during the observed period. In the mentioned period, Bosnia and Herzegovina achieved exports of goods worth EUR 5.1 billion, which represents a nominal increase of 8.1% compared to the same period of the previous year. This increase in exports was mainly the result of the export demand and the increase in the prices of certain export products, such as metals and energy. The total foreign investments according to the data of the Central Bank of B&H for the first three quarters of 2018 amounted to 323 million EUR and are higher by 1.1% y/y.

Table BH1 Main economic indicators

	2016	2017	2018		
		Q4	Q1	Q2	Q3
ECONOMIC ACTIVITY					
Real GDP (% change, yoy)	3.1	3.3	2.0	3.6	3.2
Real private consumption (% change, yoy)	2.3	0.7	1.1	3.2	0.9
Real government consumption (% change, yoy)	0.1	0.9	1.5	2.5	3.9
Industrial output (% change, yoy)	4.6	14.1	5.2	7.7	11.0
Unemployment rate (registered, %, pa)	41.2	37.4	37.3	36.1	35.7
Nominal GDP (EUR million)	15,064	4,161	3,766	4,119	4,545
GDP per capita (EUR)	3,943	1,089	985	1,078	1,189
PRICES, WAGES, AND EXCHANGE RATES					
Implicit GDP deflator (% change, yoy)	0.7	2.6	1.8	1.9	0.9
Consumer prices (% change, yoy, pa)	-1.1	1.3	0.8	1.4	0.9
Producer prices (% change, yoy, pa)	-2.1	4.5	3.2	0.8	2.3
Average gross wage (% change, yoy, pa)	1.0	1.5	2.1	2.7	3.5
Exchange rate, BAM/EUR (pa)	1.96	1.96	1.96	1.96	1.96
Exchange rate, BAM/US$ (pa)	1.76	1.66	1.59	1.64	1.68
FOREIGN TRADE AND CAPITAL FLOWS					
Exports of goods (EUR million)	5,385	1,648	1,504	1,778	1,892
Exports of goods (EUR, % change, yoy)	6.2	13.5	10.2	10.0	4.0
Imports of goods (EUR million)	8,014	2,366	2,137	2,400	2,534
Imports of goods (EUR, % change, yoy)	2.4	10.1	9.0	4.4	6.6
Current account balance (EUR million)	-776	-202	-207	-140	-159
Current account balance (% of GDP)	-5.1	-4.8	-5.5	-3.4	-3.5
Gross foreign direct investment (EUR million)	240	65	132	76	115
Foreign exchange reserves (EUR million, eop)	4,887	5,386	5,553	5,663	5,898
Foreign debt (EUR million, eop)	4,056	4,207	N/A	N/A	N/A
GOVERNMENT FINANCE*					
Revenue (national currency)**	11,084	11,779	2,882	6,601	9,225
Expense (national currency)**	10,382	10,626	2,462	5,185	7,957
Net = Gross operating balance (BAM million)**	702	1,153	420	1,416	1,268
Net acquisition of non-financial assets (BAM million)**	364	336	31	97	189
Net lending/borrowing (national currency)**	354	816	389	778	1,079
Domestic government debt (EUR million, eop)	958	874	874	862	750
Foreign government debt (EUR million, eop)	5,257	4,904	5,030	5,175	5,133
Total government debt (% of GDP)	34.9	32.9	N/A	N/A	N/A
MONETARY INDICATORS					
Narrow money, M1 (% change, yoy, eop)	13.6	12.0	12.5	13.1	14.4
Broad money, M2 (% change, yoy, eop)	8.3	8.7	8.2	9.2	9.3
Total domestic credit (% change, yoy, eop)	1.9	6.6	5.9	6.5	6.3
DMBs credit to households (% change, yoy, eop)	3.7	6.2	6.4	6.7	6.9
DMBs credit to enterprises (% change, yoy, eop)	3.8	7.4	7.2	6.2	4.8
DMBs credit rate for enterprises, short-term, (%, pa)	6.2	3.8	4.1	3.8	3.6
DMBs credit rate for households, short-term (%, pa)	7.3	4.6	5.3	4.8	4.9

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, US$ - 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

	2019	2020	2021
Real GDP (% change)	**3.8**	**3.9**	**3.8**
Real private consumption (% change)	2.0	1.8	1.9
Real investment (% change)	10.3	11.3	11.9
Exports of goods and services (constant prices, % change)	6.0	5.8	5.0
Imports of goods and services (constant prices, % change)	3.8	3.6	3.7
Current account balance (% of GDP)	6.8	6.7	7.0
Consumer prices (% change, pa)	1.5	1.6	1.4
Exchange rate, national currency/EUR (pa)	1.96	1.96	1.96
Unemployment rate (registered, %, pa)	N/A	N/A	N/A
General government balance (ESA95 definition, % of GDP)	N/A	N/A	N/A
Broad money, M4 (% change, eop)	N/A	N/A	N/A
Total domestic credit (% change, eop)	5.5	4.0	4.0

Notes: Cut-off date for information used in the compilation of projections was December 20, 2017.
Conventional abbreviations: pa - period average, eop - end of period, EUR - euro.
Sources: B&H Directorate for Economic Planning, World Bank, IMF and author's projections.

Policy assumptions and projections summary

Continuation of economic growth, mainly through private consumption and investment

Assuming the continuation of a stable external environment, in Bosnia and Herzegovina is expected economic growth in the period 2019-2021 at average growth rates of 3.8% or 3.9%. During this period it is expected that domestic demand through private consumption and investment will be the mainstay of economic growth. On the other hand, during the observed period, stagnation of public spending is expected to result in a decrease in its share in the structure of GDP, or its contribution to the economic growth of Bosnia and Herzegovina. On the basis of macroeconomic projections of the Directorate for Economic Planning, the volume of foreign trade would continue with the growth in the period 2019-2021 with a nominal rate of import (3.6-3.8%) and a significant rate of export (5.0-6.0%), which would certainly reflect the movement of the foreign trade deficit and, consequently, the deficit in the current account of B&H. The assumption for the current account deficit in 2018 is that there could be an increase of 0.8%, while in the years 2019 and 2020, deficit growth could be expected around 6.8% and 6.7%, respectively. In 2021, there would be a negligible increase in the current account deficit compared to 2019 and 2020.

With stable food prices in the world market, the continuation of a gradual increase in the price of cigarettes in B&H and no significant changes in the price of utilities, inflation is expected to be 1.5% in 2019, 1.6% in 2020, and

1.4% in 2021. With the continuation of positive economic trends in B&H, in the countries of region and the countries that are the most important economic partners, it is expected a continuation of the growth in the total of loans. The growth rate of total loans for the period 2018 - 2019 would be around 5.5% y/y, and in the period from 2020 to 2021, around 4% y/y.

CROATIA

Solid economic growth sustained, albeit slowing down

Economic growth continued, but at a more moderate pace than expected

In 2018 the solid economic growth was sustained in Croatia, but with the trend of slowing down, which signaled that the growth "steam" is reducing after a peak reached in 2016. The growth rate of GDP in 2018 is estimated at 2.6% according to the latest release of Croatian Bureau of Statistics, what is lower than expected (2.8%) and especially when compared to 2.9% rate achieved in 2017.

The main economic development in the business sector in 2018 was marked by achieving settlement on Agrokor debts by its main creditors in July, based on special Law "Lex Agrokor", which introduced temporary state-appointed management of the company to prevent its bankruptcy and negative spillover effects on the economy. The creditors' deal was later confirmed by the High Commercial Court in Zagreb, marking the end of one and a half year of uncertainties about the survival of the largest food and retail company in the country. The extradition of Ivica Todorić, the former owner of Agrokor, from the UK to Croatia in October 2018, enabled to bring him to justice based on indictment for the various financial frauds discovered during a financial review of Agrokor.

The situation related to Agrokor has also steered a political crisis within the Government, which resulted with the resignation of Mrs. Martina Dalić, Vise-President of the Government and Minister of Economy in May 2018. Mrs. Dalić stepped down due to public and political pressures on the Government,

based on leaked emails, which indicated that people who actually wrote "Lex-Agrokor" (so called the "Borg Group") were later selected as the main consultants for the restructuring of the company. The parliamentary opposition accused Mrs. Dalić that by doing so she used her position to pave the way to the new ownership structure after restructuring of the company, what she later denied with her book "The Collapse of Crony Capitalism".

Despite the crisis in Agrokor, the economic growth yearly rate stayed solid, for the fourth year in a row. After a rather week fourth quarter of 2017 (2.2%), the growth in 2018 substantially recovered with growth rates accelerating in particularly in the second and third quarter (to 2.9 and 2.8 respectively). The main drivers of the growth in 2018 were, like in 2017 mainly attributed to the growth of domestic consumption, investments and earnings from tourism sector, while the role of exports decreased.

Private consumption continued to be the main driver of the economic growth

Private consumption continued to grow strongly in all three quarters of 2018 with rates ranging from 3.7% in the first quarter, 3.8% in the second and 3.9% in the third quarter. The reasons behind it are found in an increased disposable income of households due to further relaxation of income tax rates and increase of wages coupled with rising revenues from the tourist sector and remittances from abroad. At the same time, the government consumption has also continued to rise considerably in 2018, particular in the first quarter (2.8%) and the third quarter with growth of 3.7%, according to Ministry of Finance. Despite fiscal consolidation, the pressures on expenditures coming from public sectors (health, pensions and public administration) continue to rise albeit more slowly than the revenues.

The growth of exports also continued to contribute to overall economic growth although it has slowed down considerably when compared to the higher rates achieved in 2017, diminishing its impact on the growth accordingly. This is especially the case with the exports of goods, which sharply dropped in the first quarter of 2018 (-3.0%), however, recovering considerably in the second and the third quarter (8.9 and 6.3% respectively). Nevertheless, the exports will continue to decrease further as the foreign demand slowly decreases in the main EU trading partners and in non-EU neighboring countries. The exports of the services in particularly related to tourism are still high, but after achieving record numbers, started to also slightly moderate in 2018. On the other hand, the growth of imports of goods was strong in all three quarters of 2018 owing to increasing demand, while imports of services on the other hand, started to slow down.

Industrial output on the path of falling

While the rise of industrial output in previous years significantly helped economic recovery, it is now on the path of falling since 2017. In the first and the second quarter of 2018, it recorded only very modest y-o-y growth

(0.3% and 0.4% respectively) but it fell especially sharply in the third quarter (-1.5%). This fall is mostly attributed to the manufacturing industry output and to the currently financially distressed shipbuilding Uljanik, which is on the brink of bankruptcy since the summer, what caused the loss of several already concluded shipbuilding contracts. The government owns close to a quarter of the company and is now seeking for the strategic foreign partners to save the company and successfully restructure it. Apart from affecting negatively an industrial output and exports, this situation is also having a negative impact on the public finances, as some of the state guarantees for the ship contracts were already activated (2.8 billion HRK). If the company goes to bankruptcy, it will activate government guarantees for Uljanik loans in excess of 1% of the GDP in total.

The unemployment rate continues to fall strongly, while employment also rises

The solid economic growth continued to impact the fall of unemployment quite strongly in 2018 reaching the lowest levels since the 2008 financial crisis. Registered unemployment fell sharply from 12.1% in the first quarter to 8.5% in the third quarter of 2018. These developments happened partly as a result of economic recovery and new jobs created, but also owing to the large outflow of unemployed, mostly younger, persons seeking work abroad. At the beginning of October 2018, there were about 140,000 persons registered as unemployed. On the other hand, the employment levels are also on a steady rise due to increased demand for workers especially in the tourist industry and construction. For the first time in many years, Croatia actually experienced the shortage of workers in these and other industrial sectors and thus had to raise quotas for foreign workers. The underlying reason for that was also the large outflow of domestic workers to other EU countries, especially from the continental areas such as Slavonia, known as a traditional source of the seasonal workforce.

Fiscal health continues to improve

Favorable developments contributing to improving the health of public finances continued in 2018, particularly in the first two quarters. The tax revenues continued rising due to economic growth and good tourist season. According to data from Ministry of Finance total government revenues were increasing at high rates: in the first two quarters they increased on average by 5.0% and continued to rise strongly in the third quarter of 2018 (6%), owing to growth of VAT and income tax revenues boosted by the relatively strong increase of the wages. Expenditures were on the other side also growing albeit at a much slower rate of 4.4% in the third quarter. All these led to a sizeable cumulative surplus of central government revenues of HRK 4.6bn in the first nine months of 2018, relative to a surplus of HRK 3.6bn recorded in the same period in 2017. As a result, according to the revised Budget, the fiscal surplus in 2018 is projected to be at 0.5% of GDP despite the pressures coming from planned expenditures linked with invoked guarantees to Uljanik shipyards. For comparison, the original 2018 Budget planned the deficit of -0.5% of GDP (ESA 2010 methodology). As for the total public debt, it continued to decrease strongly in 2018 reaching 74.5% of the GDP at the end of the third quarter of 2018, thanks to solid GDP growth and significant improvements in public debt management policy.

Consumer prices moderately increase

Comparing to 2017 when they were low, the consumer prices continued to rise slowly in all three quarters of 2018, owing to a further increase of food and energy prices, especially in the second and third quarter of 2018. Namely, energy prices (electricity and gas) stayed rather low in 2017 due to administratively regulated prices of electricity and gas, while in 2018 theses effects ceased.

Table HR1 Main economic indicators

	2016	2017	2018		
		Q4	Q1	Q2	Q3
ECONOMIC ACTIVITY					
Real GDP (% change, yoy)	3.5	2.2	2.5	2.9	2.8
Real private consumption (% change, yoy)	3.4	3.7	3.8	3.7	3.9
Real government consumption (% change, yoy)	0.7	3.4	2.8	2.5	3.7
Real investment (% change, yoy)	6.5	1.9	3.5	3.1	3,9
Industrial output (% change, yoy)	5.3	-0.6	0.3	0.4	-1.5
Unemployment rate (registered, % pa)	14.8	11.7	12.1	9.5	8.5
Nominal GDP (EUR million)	46,664	12,111	11.298	13,009	14,414
GDP per capita (EUR)	11,179	11,740	N/A	N/A	N/A
PRICES, WAGES AND EXCHANGE RATES					
Implicit GDP deflator (% change, yoy)	-0.1	1.7	0.4	0.9	1.0
Consumer prices (% change, yoy, pa)	-1.1	1.3	1.0	1.9	1.9
Producer prices (% change, yoy, pa)	-4.0	2.5	1.3	2.4	3.7
Average gross wage (% change, yoy, pa)	1.9	4.4	4.8	5.9	5.1
Exchange rate (HRK/EUR, pa)	7.53	7.53	7.44	7.39	7.41
Exchange rate (HRK/USD, pa)	6.80	6.40	6.05	6.20	6.37
FOREIGN TRADE AND CAPITAL FLOWS					
Exports of goods (EUR million)	12,317	3,813	3,299	3,644	3,701
Exports of goods (EUR, % change, yoy)	5.7	9.3	-3.0	8.9	6.3
Imports of goods (EUR million)	19,712	5,391	5,665	6,024	5,949
Imports of goods (EUR, % change, yoy)	5.5	4.7	7.8	5.7	5.1
Current account balance (EUR million)	1,204	-537	-2,003	212	4,011
Current account balance (EUR, % change, yoy)	2.6	4.0	2.9	3.0	3,2
Gross foreign direct investment (EUR million)	1,765	477	533	496	110
Foreign exchange reserves (EUR million, eop)	13,514	15,706	16,480	16,694	16,637
Foreign debt (EUR million, eop)	41,668	40,069	40,594	40,142	38,748
GOVERNMENT FINANCE*					
Revenues (HRK million)**	158,057	41,309	38,531	44,065	45,802
Expense (HRK million)**	152,715	43,241	38,621	38,747	39,124
Net = Gross operating balance **	5,342	-1,932	-594	5,318	6,678
Net acquisition of non-financial assets (HRK million)**	8,086	2,935	1,297	1, 609	2,631
Net lending/borrowing (HRK million)**	-2,744	-4,867	-1,891	3,710	4,047
Domestic government debt (EUR million, eop)	22,909	22,995	23,182	23,759	23,961
Foreign government debt (EUR million, eop)	14,369	14,712	14,622	14,727	14,001
Total government debt (eop. % of GDP)	80.2	77.5	74.7	75.4	74.1
MONETARY INDICATORS					
Narrow money, M1 (% change, yoy, eop)	18.1	19.1	23.8	22.8	20.4
Broad money, M4 (% change, yoy, eop)	4.2	2.9	5.1	5.7	5.6
Total domestic credit (% change, yoy, eop)	-6.0	-4.7	-4.7	-2.0	1.2
DMBs credit to households (% change, yoy, eop)	-5.5	1.2	2.2	3.9	4.0
DMBs credit to enterprises (% change, yoy, eop)	-2.3	-1.9	-1.4	-0.1	-0.2
Money market interest rate (%, pa)	0.5	0.4	0.3	0.3	0.3
DMBs credit rate for enterprises short-term (%, pa)***	8.0	7.3	7.1	7.0	5.9
DMBs credit rate for households short-term (%, pa)***	4.7	3.9	3.9	3.7	3.3

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

Since summer 2018, moderate pressures on the rise of inflation were also created by the rise of the oil derivate prices. Nevertheless, the inflation rate in the first nine months of 2018 is considered rather moderate, with estimates for the whole year not passing 1.5%, according to Croatian National Bank.

Policy assumptions and projections summary

The economic growth will continue to gradually slow down

Macroeconomic forecasts are prepared based on recent projections of Croatian National Bank (CNB), Ministry of Finance of Croatia and the European Commission. The latest 2018 growth estimates of the Croatian Bureau of Statistics (CBS) in February 2019 is only 2.6%, due to much lower growth than expected achieved in the fourth quarter (2.3%). Croatian National Bank at the end of January 2019 also revised back its estimates for 2018 from 2.8 to 2.7%. The European Commission, however, in February 2019 kept its original optimistic estimate for 2018 at 2.8%. As for projections of GDP growth, the European Commission forecasts gradual slowing down to the rate of 2.7% in 2019 and further down to 2.6% in 2020. This was also the forecast of CBN for 2019 and 2020, but most analysts expect that they will be revised now, based on the newest release of Croatian Bureau of Statistics for 2018. In May 2019, the European Commission revised down its forecasts of growth rates for Croatia to 2.6% in 2019 and 2.5 in 2020.

Table HR2 Summary of projections

	2018	2019	2020
Real GDP (% change)	**2.6**	**2.6**	**2.5**
Real private consumption (% change)	3.2	3.5	3.3
Real government consumption (% change)	3.3	2.6	2.0
Real investment (% change)	5.7	6.0	5.8
Exports of goods and services (constant prices, % change)	3.6	3.4	3.2
Imports of goods and services (constant prices, % change)	5.1	5.3	5.0
Current account balance (% of GDP)	2.9	2.0	1.8
Consumer prices (% change, pa)	1.5	0.9	0.9
Exchange rate, national currency/EUR (pa)	7.41	7.42	7.43
Unemployment rate (registered, %, pa)	9.5	8.8	8.5
General government balance (ESA 2010 definition, % of GDP)	0.5	-0.4	0.0
Total domestic credit (% change, eop)	-1.7	-0.9	0.1

Source: Croatian National Bank, Ministry of Finance, Institute of Economics Zagreb and European Commission.

The expansion of private consumption will remain the main driver of continued economic growth in 2019, like in the previous years, mainly due to a further increase of disposable income of households. This projection is based on the recent increase in wages of workers in both public and private sectors, increased employment levels and several changes in the taxation of income and VAT that came into effect in January 2019. Namely, the government introduced VAT reductions from 25% to 13% on several unprocessed food products such as fresh meat, fish, eggs, fruits and vegetables. In addition to that, the Government increased the upper threshold for 24% taxable income for all the salaries up to HRK 30,000 (4,000 EUR). The previous top threshold was 17,500 HRK (2,335 EUR) and incomes above it were taxable by 36% rate.

The households purchasing potential in 2019 will be additionally boosted by the sustained low interest rates and subdued inflation due to VAT reductions on various food products, which participate with around 11% in average consumer's basket. Owing to that, the inflation rate is expected to fall from 1.5% in 2018 to 0.9% in both 2019 and 2020 to 0.9%, according to the Croatian National Bank. However, the European Commission expects the inflation rate will remain at around 1.4% for both 2019 and 2020. Some Croatian economic analysts also consider that the VAT reductions will not affect significantly the level of consumer prices in 2019.

As for the tourist sector, which is Croatia's very important source of economic growth and revenues, the expectations are that it will moderate its expansion in 2019 and 2020 as the main competitive markets such as those of Turkey, Greece and Egypt continue to recover significantly. However, this situation will have a positive side, as it will give a sector an opportunity to base its future revenue expansion based more on the rise of quality of service rather than number of tourists. Nevertheless, solid growth rates of the sector will likely sustain.

The investment levels are expected to grow significantly both in 2019 and 2020 (6.0 and 5.8% respectively) thanks to several important infrastructure projects financed by the EU money, the most important and largest one being Pelješac bridge. It is expected that the rise of disbursements of the EU funds will especially boost public investment projects in energy, water, railroads and road construction sectors. Apart from that, the rise of private investments is expected especially in tourism sector, with significant investments planned in Plava laguna and Valamar Riviera's high-rated hotels.

In accordance with the anticipated slowdown of economic growth in the EU main trading countries (Italy and Germany) the expected exports from Croatia, especially of the goods, will experience lower growth rates in 2019 and 2020 than in the previous years (3.4 and 3.2% respectively). On the other hand, exports of services will continue to experience good growth rates, thanks to the sustained growth of tourism sector. Import rates will also continue to be strong especially for goods in both 2019 and 2020, owing to increased consumer demand. This will however, affect the further deterioration of current account balance in the years ahead.

The public finances balance is projected to continue to be very solid in both 2019 and 2020. Due to the situation in shipbuilding Uljanik and potential threats of activating the state guarantees given to it, the 2019 budget deficit is planned at -0.4%, while it is expected to return to full balance in 2020. The total public debt will also continue to decrease in both 2019 and 2020. The positive developments in consolidating public finances achieved in 2018, led the European Commission to declare on 27 February 2019 that after five years of monitoring procedure, Croatia is no longer experiencing excessive macroeconomic imbalances.

The situation at the labor market will also continue to improve with falling rates of registered unemployment and the rise of employment levels due to sustained economic growth in years ahead. The unemployment rate is projected to further fall to 8.8% in 2019 and 8.5% in 2020.

MONTENEGRO

Biggest growth rate in the region

Recent economic developments

Montenegro's economy has achieved dynamic growth over the period 2016-2018 due to increased investment activity and engagement of the domestic potential, primarily from the construction sector.

The tendency of growth of the Montenegrin economy remains above the expectations of domestic and foreign expert assessments. According to the final data of Directorate for statistics – MONSTAT, *GDP real growth rate* in 2017 was 4,7%, while, 1st,2nd,3rd and 4th quarter of 2018 saw growth of 4,5%, 4,9% 5% and 4,8% respectively, compared with the same period of 2017.

In the first three quarters of 2018, *consumer prices* increased, both in comparison with December of the previous year and at the annual level. At the same time, there was an improvement in the labor market with the growth in the number of employed persons and the fall in the number of unemployed persons compared to the first nine months of 2017.

Due to the increased import of goods from exports, there was an increase in imbalance in foreign trade. The high *import dependence* of the Montenegrin economy is a consequence of the narrow production base and the high correlation between the import of goods and tourism or investments. The

non-diversified Montenegrin economy significantly reduces the positive effects of investments, as there are no capacities for the production of goods necessary for the implementation of investments, and the high imports of goods and equipment that accompany the investment cycle have negative effects. It is necessary to expand the production and export base, that is, to increase industrial production, especially processing, and to make full use of the significant natural potential for the production of food and energy.

Political environment

In 2018, Montenegro remains the *frontrunner* in the process of European integration, among the Western Balkans countries. In December 2018, Montenegro opened one more negotiation chapter – Chapter 27- Environment and climate change. Montenegro now has 32/33 chapters opened and 3 chapters provisionally closed. On the path of European integration, the focus will remain on further strengthening of administrative capacities with the focus on the rule of law.

EU Commissioner Johannes Hahn paid a visit to Montenegro in February 2019. PM Markovic said on that occasion that Montenegro's ambition is to open the remaining negotiating chapter – Chapter 8 – Competition, and to fulfill the remaining obligations in chapters 23 and 24 in order to get a positive report and get closing benchmarks which would be a further milestone for the continuation of the negotiation process, in terms of faster closing of the chapters.

Commissioner Hahn thanked the PM and the Government for the strong commitment to the EU accession process and said that Montenegro enjoys great support for EU membership among the population and politicians.

Chief Negotiator Aleksandar Drljević, during the 17th session of European Union-Montenegro Stabilization and Association Parliamentary Committee, said that the acceleration of accession dynamics in the first place depends on Montenegro, but also on the factors of European politics, as well as the European public. EU support as a whole is crucial in order to maintain the motivation and continue the quality and committed fulfillment of the remaining obligations, within the interim and closing benchmarks of the negotiating chapters.

Development of GDP and its components

Positive economic developments that resulted in the real growth rate of 4,4% in 2017 were continued in the first nine months of 2018. Level of activity is increased in the sector of construction, industry, trade, most aspects of transport, tourist arrivals and overnight stays in collective accommodation. A fall in production is only noted in the forestry sector.

Labor market developments

The average number of employees in 2018 was 190.132 and was 4,3% higher than in the same period of the previous year. This marks the continued trend of increase in the average number of employees in the last seven years. Fourteen out of the total of nineteen sectors recorded an increase in the number of employees. According to the data of the Employment Bureau, the unemployment rate in September amounted to 17.20% and was lower by 4.85 pp. than the unemployment rate from December 2017.

In the first nine months of 2018, the average salary in Montenegro amounted to 765 euros, while the average salary without taxes and contributions amounted to 510 euros, and did not change compared to the average for the same period in 2017. Amongst the ex-Yugoslav republics, Montenegro ranks third in terms of the net salary.

Fiscal stance

Continued implementation of fiscal adjustment measures has marked public finances and in the third quarter of 2018, they resulted in a deficit reduction of EUR 64.5 million compared to January-September of 2017. This was mainly due to a better collection of revenues from VAT and contributions.

According to the Ministry of Finance estimates, in the nine months of 2018, public revenues amounted to 1.43 billion, or 31.2% of the estimated GDP for 2018, which is in line with the plan. Compared to the same period of 2017, public revenues were higher by 13.3%, representing a nominal increase of EUR 168.6 million, largely as a result of an increase in tax revenues by EUR 98.9 million, or by 12.2%. VAT revenues (58 million euros) were the highest in this category. In the structure of public revenues, tax revenues are dominant (63.5%), then revenues from contributions (24.5%), while all other revenues account for 12% of public revenues.

Budget deficit at the end of the third quarter amounted to EUR 25.3 million or 0.6% of GDP. According to the Ministry of Finance, at the end of September 2018, *government debt (gross)* amounted to 3,093.9 million euros or 67.2% of GDP. Out of this amount EUR 2,700.5 million or 87.3% was related to external debt, while the remaining 393.4 million euros or 12.7% were related to domestic debt. If we include deposits from the Ministry of Finance together with 38,477 ounces of gold, the net state debt of Montenegro at the end of September 2018 amounted to EUR 2,719.5 million or 59.1% of GDP which, compared to the end of 2017, increased by 6.4%.

Gross debt compared to the end of 2017 was higher by 466.1 million euros or 17.7%. The increase in government debt, during the nine months of 2018, was largely influenced by the issuance of Eurobonds in the amount of EUR 500 million, as well as the withdrawal of syndicated loan funds with a World Bank guarantee in the amount of EUR 250 million.

The total debt repayment in the period January-September 2018 amounted to EUR 318.8 million or 6.9% of the estimated GDP. The largest amount relates to repayment of the principal debt to residents and non-residents in the amount of 230.4 million euros. The repayment of interest amounted to 70.6 million euros, with 17.9 million euros of debt from the previous period also repaid.

Monetary developments

The banking sector during the first three quarters of 2018 is characterized by security and stability, with profitable operations, high liquidity and solvency. The main indicators of liquidity at the aggregate level were above the prescribed minimum.

The banks' balance sheet had a tendency of growth in the observed period and at the end of September it reached an amount of 5.5% higher compared to the end of 2017. Growth on the assets side is the dominant result of credit growth, while on the side of liabilities, deposits in banks recorded the most significant growth. First three quarters of 2018 saw a more intensive banks' lending activity and total loans at the end of September recorded an increase of EUR 289.1 million or 10.7% compared to the end of the previous year. Total deposits with banks recorded an increase of EUR 192.1 million or 5.9% compared to the end of the previous year.

Total bank loans, during the three quarters of 2018, had a positive trend, and grew on average monthly at a rate of 1.2%. At the end of the observed period, banks' loans amounted to EUR 2,989.6 million, which is EUR 289.1 million or 10.7% more than at the end of the previous year, or EUR 289.9 million or 10.7% more than at the end of September of the previous year. Eleven banks recorded annual growth of loans, while four banks recorded a decline.

At the end of September 2018, non-performing loans of banks amounted to EUR 200.6 million or 6.71% of total loans, and their share in total loans decreased by 0.59 pp. in relation to the end of 2017 and by 0.69 pp on an annual basis. Observed by banks, one bank did not have NPLs, with two banks having a significantly higher level. NPLs, according to credit risk indicators, represent individual banks' risk rather than systemic risk.

At the end of the first three quarters, deposits in banks amounted to EUR 3,459.3 million, which is EUR 192.1 million or 5.9% more compared to the end of 2017, ie by EUR 321.9 million or 10.3% more than a year earlier. The average weighted *nominal* and effective interest rates on total bank loans continued the downward trend from 2017, and at the end of the third quarter of 2018 reached their historical minimum values. The average weighted nominal interest rate on total bank loans amounted to 5.80% in September 2018 and recorded a decline of 0.36 pp. compared to the end of the previous year and a drop of 0.51 pp. on an annual basis. The average weighted *effective* interest rate on total bank loans granted has also declined steadily during the first nine months of 2018 - 6,40% in September and was 0,41 pp. lower than in December 2017, while it is lower by 0.58 pp on an annual basis.

The *average weighted effective interest rate on deposits* continued to decline in the third quarter of 2018. In September 2018, this rate was 0.58% and was lower in relation to December and September of the previous year by 0.12 pp. and 0.17 p.p. respectively.

Prices

Inflation in Montenegro, measured by the consumer price index (CPI), was positive in September 2018 compared to the same month of the previous year, amounting to 1.9%. In September 2018, consumer prices recorded a growth of 2.2% in relation to December 2017.

Positive annual inflation rates were a common phenomenon in all countries in the region and most of the EU countries in the first nine months of 2018, so this trend did not bypass Montenegro. The price increase was largely the result of the price increase in hotels and restaurants (6.9%), alcoholic beverages and tobacco (6.2%), transport (5.1%) and food and non-alcoholic beverages (1.4%).

Foreign trade and capital flows

According to preliminary data, in the first nine months of 2018, the current account deficit was EUR 416.6 million and was 32.2% higher than in the same period of 2017. This is the result of an increase in the deficit on the account of goods and a lower surplus in the primary income account. The deficit on account of goods was EUR 1.5 billion or 12.6% more than in the previous year due to the faster growth of imports than the export of goods.

Total *export* of goods amounted to EUR 312.7 million, an increase of 11.3%. The biggest impact on export growth had an increase in exports of electricity and medical and pharmaceutical products. Total *import* of goods amounted to EUR 1.8 billion and was 12.4% higher than in the same period of 2017 as a result of the increase in imports of machinery and transport equipment as well as oil and oil derivatives.

According to preliminary data, the net inflow of FDI was 218.4 million euros, which is 29.9% less compared to the same period of 2017. The total inflow of FDI amounted to EUR 588.8 million, while at the same time an outflow of EUR 370.4 million was realized. This movement is the result of a significantly larger outflow from the repayment of intercompany debt, as well as the withdrawal of equity investments of a large company in comparison with the same period of 2017. The total outflow is significantly higher than in the same period of 2017 (98.1 million euros). Total FDI inflow was increased by 43.7%, which significantly reduced the decrease in the FDI net inflow. The total inflow of FDI amounted to EUR 588.8 million.

In the following table are presented changes in main economic indicators for Montenegro, for 2016, 4th quarter of 2017 and 1st, 2nd, 3rd and 4th quarter of 2018.

Table MN1 Main economic indicators

	2016	2017	2018			
		Q4	Q1	Q2	Q3	Q4
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	2.9	4.4	4.5	4.9	5.0	4.8
Real private consumption (% change, yoy)	5.4	3.9	4.9	8.2	6.0	6.0
Real government consumption (% change, yoy)	0.8	-1.4	2.6	16.0	0.7	14.9
Industrial output (% change, yoy)	-4.4	2.7	40.2	24.4	12.2	17.5
Unemployment rate (LFS, %)	17.7	17.0	16.1	14.4	14.1	16.1
Nominal GDP (EUR million)	3,954.2	1,090.7	839.8	1,094.8	1,525.0	1,159.5
GDP per capita (EUR)*	6,354.0	1,753.0	1,349.3	1,759.2	2,450.3	1,863
PRICES, WAGES, AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	5.1	3.8	-1.6	-0.3	-1.5	-1.6
Consumer prices (% change, annual change: end month/end month-12)	1.0	1.9	2.9	3.4	1.9	1.6
Producer prices (% change, annual change: end month/end month-12)	-0.3	0.1	1.2	2.1	2.4	2.4
Average gross wage (% change, yoy, average of monthly data)	3.6	1.3	-0.1	0.0	0.3	0.1
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	350.8	101.6	99.5	111.3	104.7	120.4
Exports of goods (EUR, % change, yoy)**	6.2	-5.0	20.3	32.8	-8.5	18.5
Imports of goods (EUR million)	2,008.5	605.7	488.8	684.4	667.0	645.6
Imports of goods (EUR, % change, yoy)**	12.0	22.5	9.9	15.4	11.4	6.6
Current account balance (EUR million)	-642.0	-376.4	-303.6	-315.0	200.2	-374.6
Current account balance (% of GDP)	-16.2	-34.5	-36.2	-28.8	13.1	18.1
Gross foreign direct investment (EUR million)	687.2	249.5	138.4	265.2	184.6	254.9
Foreign exchange reserves (EUR million, eop)	803.0	897.7	784.4	1,020.0	1,110.3	1,100.9
GOVERNMENT FINANCE**						
Revenue (EUR million)	1,487.1	450.2	327.5	436.4	509.2	473.1
Expense (EUR million)****	1,544.7	433.6	380.3	391.7	377.9	491.0
Net operating balance (EUR million)*****	-57.7	16.6	-52.8	44.7	131.3	-17.9
Capital expenses (EUR million)	77.3	150.8	17.3	66.4	71.3	109.7
Net lending/borrowing (EUR million) ******	-122.3	-134.2	-70.1	-21.7	60.0	-127.6
Domestic government debt (EUR million, eop), national methodology	400.2	413.9	469.2	460.7	393.4	392.98
Foreign government debt (EUR million, eop), national methodology	2,002.8	2,214.0	2,196.1	2,644.4	2,700.5	2,760.0
Total government debt (% of GDP), national methodology	60.8	61.1	57.9	67.4	67.2	68.26
MONETARY INDICATORS						
Total domestic credit (% change, yoy, eop)	6.2	10.3	7.4	10.4	12.2	10.2
DMBs credit to households (% change, yoy, eop)*******	10.9	10.5	10.1	10.4	10.7	11.9
DMBs credit to enterprises (% change, yoy, eop)********	0.1	4.6	4.1	6.3	9.7	5.9
DMBs credit rate for enterprises, shortterm, (%, pa)*********	5.8	5.4	5.1	5.2	5.07	5.1
DMBs credit rate for households, shortterm (%, pa)**********	8.9	9.0	8.6	8.1	7.64	8.8

Notes: * Population data for 2018 are Monstat estimates on 1/01/2018

** QoQ % change for quarterly data

*** Quarterly budget data based on a monthly budget data. Debt data exclude local governments. Source: Ministry of Finance

**** Data refer to current expenses only, and exclude capital expenses.

***** Calculated as a difference between revenues and current expenses.

****** Calculated as a difference between net operating balance and capital expenses. Net lending/borrowing for 2016 include net increase/decrease in liabilities in accordance with the Law on the final budget for 2016

******* Households include resident natural persons and entrepreneurs
******** Enterprises include state owned companies and privately owned companies
********* Enterprises include state owned companies, privately owned companies and enterpreneurs
********** Households include resident and nonresident natural persons

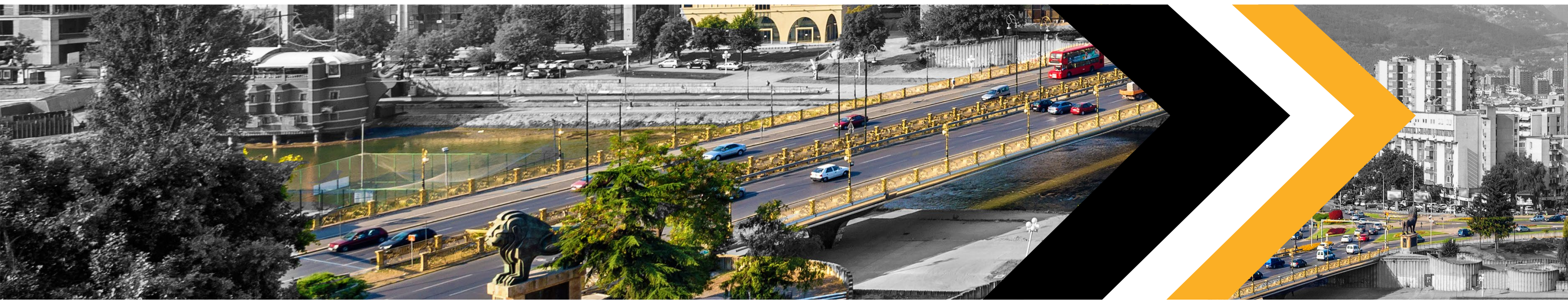
Projections

Projections in table MN2 reflect the official projections of the Government of Montenegro presented in the **"Montenegro Economic Reform Programme 2019 - 2021"**. The following table presents core macro-economic and fiscal aggregates, precisely their projections over the next three-year period:

Table MN2 Summary of projections

	2018	2019	2020	2021
Real GDP (% change)	**4.1**	**2.8**	**2.3**	**2.4**
Real private consumption (% change, yoy)	1.6	1.4	1.3	0.8
Real government consumption (% change, yoy)	0.3	-0.5	-0.5	-0.5
Nominal GDP, EUR million	4,604.50	4,788.60	4,956.80	5,138.30
Exports of goods and services (constant prices, % change)	6.9	4.3	3.9	3.9
Imports of goods and services (constant prices, % change)	8.6	1.5	1	-2.4
Current account balance (% of GDP)	18.1	17	15.9	12.5
Consumer prices (% change, pa)	2.9	1.8	1.8	1.9
GDP deflator	2.9	1.2	1.2	1.8
Unemployment rate (LFS, %)	14.8	14.5	14	13.8

Conventional abbreviations: pa - period average, eop - end of period, EUR - euro.
[1]"Montenegro Economic Reform Programme 2019 - 2021", Jan 2019
Sources: Central Bank of Montenegro,Monistat, Ministry of Finance of the Government of Montenegro



NORTH MACEDONIA

Macedonian economy on the bumpy road

Economic recovery?

The resolution of the countries' name dispute was in focus of the political problems in the third quartile of 2018. Hopes of ending a Balkan conflict that has dragged on for almost three decades, relay on this. Now, after the ratification, the focus should be on measures and activities that will intensify the process of EU accession.

Signs of economic recovery

Real GDP increase and it is 3% in the third quarter of 2018, the same as in the previous quarter period, remaining the strongest pace of expansion since the economy shrank 1.9 percent in the first quarter of 2018. Employment growth, as well as wage increase and increased household lending, fuelled household consumption. Government consumption (9.6 percent from 7.7 percent in the second quarter and 3 percent in the first quarter) rose faster than household consumption (3 percent from the 1.9 percent in the second quarter and 2 percent in the first quarter in 2018). Investment is negative in 2018, starting from -9.3 in the first quarter, continued to contract -16.4 in second and -8.5 in the third quarter.

The GDP growth arises from the positive performance in the service, industrial and agricultural sectors in the first half of 2018. Agricultural sector evident negative achievements in the third quarter. Considering that in the

past period government investment was a driving force behind economic growth, there low turnover in the construction in the analyzed quarters led to negative gross investments.

Increased number of job vacancies and lack of labor force

In the last years, despite the continuous decrease of the unemployment rate in the Republic of Macedonia, the absolute number of unemployed remains high (about 199 thousand according to LFS and around 183 thousand according to the Employment agency). At the same time, the number of job vacancies has increased from 6200 in Q3/2016 to 8549 in Q3/2018 i.e. for 36.4 percent, while the job vacancy rate rose from 1.3 to 1.7 percent, respectively.

The highest job vacancy rate is characteristic for five sectors: Manufacturing; Construction; Transportation and storage; Accommodation and food service activities; Administrative and support service activities. In the observed period the number of job vacancies in these sectors has increased by 35.7 percent. As for the occupations, with increase and highest participation in the job vacancies are distinguished: Technicians and associate professionals; Service and sales workers; Plant and machine operators, and assemblers. Their common share in the total number of vacancies increased from 60.3 percent (Q3/2016) to 66.9 percent (Q3/2018). Majority of these job vacancies require the employment of persons with a secondary level of education. No less emphasized is the lack of labor force with a high level of education, particularly of engineers in different areas and doctors/specialists in the health sector. Regarding the size of the enterprises, the number of job vacancies has increased in the small enterprises, a decrease in the medium ones and remains the same in the large enterprises.

Strengthening of the public finance is needed

For 2018, the lower deficit (2.7%) relative to the planed (above from 4%) is driven by exceptionally weak public spending execution on the capital spending (65.29%), goods and services (82.58%) and transfers (84.07%). This formally is explained with high political uncertainty in the pre-referendum period and the decision to scrutinize existing portfolio of construction projects, but it is obvious that there is no sufficient capacity to manage capital projects. In mid-2018, the government introduced financial incentives to support investment and employment, subject to extensive qualification criteria which have had a low uptake compared to the budgeted amount. Public debt continues to grow. On the end of 2018 it amounted 48.75 (1 p. p more than the end of 2017).

There is significant underperformance on the revenue side, although collections of corporate income tax and social security contributions exceeded expectations as exemptions, previously granted to companies in the Technological and Industrial Development Zones (TIDZ).

A gradual and sustained fiscal consolidation is needed to put public debt firmly on a downward path. This should be underpinned by the steady implementation of recent measures to reduce the pension deficit and improve targeting of social assistance spending, as well as additional measures to improve tax efficiency and compliance and rationalize untargeted subsidies.

Easing monetary policy and focus to companies credits by the banking sector

Further decreased rate on CB bills on 2.75% by 0.25 percentage points in August 2018 provides a signal for a lasting lessening in the monetary policy. Having in mind that in May 2016 the CB bills rate stood at 4%, it clearly opens the room for easing the monetary policy, strongly supported by the future decrease of the CB bills rate to 2.5% in 2019.

Credit growth registered a major increase in terms of credit to enterprises, whilst credits to households indicated moderate growth. It evidently represents a positive signal in fostering economic growth, apart from the trend in previous years, when credit growth was basically reproduced in households. NPLs to gross loans determine further decrease and stands to 4.9% in all three quarters of 2018 demonstrating increased bank assets quality and enhanced risk assessment in the banks. Capital adequacy ratios remain stable around 16% (regulatory capital/risk weighted assets) for 2018 whereas earnings are quite solid measured by ROAA ranging 3.1 to 2.2% and ROAE from 28% and 19.5% for the first 3 quarters of 2018.

Decline product prices

Consumer prices in 2018 are stable. After the cutback from 2.2 in the last quarter in 2018 to 1.5 in the first half of the 2018, they are stable at 1.6 in the third quarter of the 2018. Growth of consumer prices in the third quarter was a result mainly of the higher transportation prices (10.3%), also the prices of alcoholic beverages and tobacco by 4.9%. The trend of decreasing production price mark this period. Starting from 0.8 in the first quarter, then negative -0.2 and -0.8, respectively in the second and third quarter.

The faster growth of exports than imports contributed to a slight reduction in the foreign trade deficit. Such movements are mostly due to the growth of the export of foreign industrial capacities, but the majority of traditional export sectors also have a positive contribution. The growth of import was mainly due to the increased import of the raw material component for the new industrial facilities, equipment and machinery, as well as non-ferrous metals and non-metallic minerals.

Narrowing of the current account balance deficit

The current account of the balance of payments registered a surplus of EUR 20.5 million in Q2-2018 and EUR 202.2 million in Q3-2018, due to the better balance of goods, as well as the surplus of services and secondary income. While in Q4-2017 and Q1-2018 the current account registered a deficit due to the increased deficit of primary income and goods. Most of the FDI in the analyzed period is based on debt instruments and reinvested profits, while the rest is based on equity. In Q3-2018, FDI recorded a significant reduction, mainly arising from debt instruments, through which net outflows were made, while inflows were registered on the basis of reinvestment of profits and equity.

The increase in the foreign exchange reserves during almost the entire analyzed period is mostly due to the NBRM interventions on the foreign exchange market, and in Q1-2018 it is a result of the issued sixth Eurobond on the international financial markets. The decrease in the foreign exchange reserves in Q4-2017 compared to that period in 2016 is mainly a result of the regular repayment of external debt.

The indicators of the external indebtedness of the domestic economy, in general, continue to indicate that gross external debt is in the "safe zone". However, according to the indicator gross external debt as % of GDP, the economy is still classified in the group of highly indebted countries.

Policy assumptions and projections summary

Stabilization and positive economic growth in the coming period

The GDP growth is expected and the positive economic growth is predictions in 2019 (2.8%) and in 2020 (3.1%). The forecast is increasing in consumer prices, also the Inflation rate. Consumer price will increase by 2.0 in 2019 and 2.1 in 2020.

Over the medium-term, the public debt is projected to stay above 50% percent of GDP with public debt rising to 54.25% percent of GDP by end-2020. Since the beginning of 2019 according to the newly adopted Law on Personal Income the income tax is paid at a progressive rate of 10% for the generated income up to 1.080.000 MKD per year and from 18% for the realized income above this threshold, for each earned income from labor. The Law also implements an increase in the amount of tax reductions applied

Table MK1 Main economic indicators

	2016	2017	2018		
		Q4	Q1	Q2	Q3
ECONOMIC ACTIVITY					
Real GDP (% change, yoy)	2.8	1.6	0.9	3.0	3.0
Real private consumption (% change, yoy)	3.1	0.0	2.0	1.9	3.0
Real government consumption (% change, yoy)	1.9	-2.8	3.0	7.7	9.6
Real investment (% change, yoy)	13.3	11	-9.3	-16.4	-8.5
Industrial output (% change, yoy)	3.4	0.9	5.4	4.9	5.0
Unemployment rate (registered, %, pa)	23.7	21.9	21.6	21.1	20.8
Nominal GDP (EUR million)	9,657	2,710	2,394	2,621	2,798
GDP per capita (EUR)	4,659	N/A	N/A	N/A	N/A
PRICES, WAGES, AND EXCHANGE RATES					
Implicit GDP deflator (% change, yoy)	6.3	N/A	N/A	N/A	N/A
Consumer prices (% change, yoy, pa)	-0.2	2.2	1.5	1.5	1.6
Producer prices (% change, yoy, pa)	-0.1	1.4	0.8	-0.2	-0.8
Average gross wage (% change, yoy, pa)	2.2	0.9	3.1	4.6	3.9
Exchange rate, MKD/EUR (pa)	61.6	61.52	61.56	61.5	61.49
Exchange rate, MKD/US$ (pa)	55.69	52.23	50.1	51.55	52.9
FOREIGN TRADE AND CAPITAL FLOWS					
Exports of goods (EUR million)	3,529.4	1,088.9	1,058.3	1,202.3	1,232.3
Exports of goods (EUR, % change, yoy)	15.8	14.4	14.7	16.2	20.0
Imports of goods (EUR million)	5,342.3	1,592.3	1,521.3	1,608.5	1,628
Imports of goods (EUR, % change, yoy)	9.7	10.4	9.9	10.7	13.7
Current account balance (EUR million)	-275.5	-66.1	-140.7	29.6	202.2
Current account balance (% of GDP)	-2.9	-0.7	-5.9	1.1	7.2
Gross foreign direct investment (EUR million)	495.4	106.9	299.6	131.4	43.9
Foreign exchange reserves (EUR million, eop)	2,613.4	2,336.3	2,577.1	2,642.2	2,709.1
Foreign debt (EUR million, eop)	7,216.6	7,372.5	8,258.6	8,425.7	8,399.8
GOVERNMENT FINANCE*					
Revenue (million Denars)**	169,356	48,714	43,369	47,279	46,006
Expense (million Denars)**	185,407	54,559	46,502	48,684	48,476
Net = Gross operating balance (million Denars)**	-16,051	-5,845	-3,133	-1,405	-2,470
Net acquisition of non-financial assets (million Denars)**	-14,997	-8,122	-1,338	-1,872	-1,649
Net lending/borrowing (million Denars)**	-1,054	2,277	-1,795	467	-821
Domestic government debt (EUR million, eop)	1,404.9	1,581.7	1,588.4	1,607.6	1,616.4
Foreign government debt (EUR million, eop)	2,446.6	2,376.8	2,682.3	2,692.8	2,685.9
Total government debt (% of GDP)	39.9	39.5	40	40.3	40.3
MONETARY INDICATORS					
Narrow money, M1 (% change, yoy, eop)	10	9.9	14.8	13.8	17.1
Broad money, M4 (% change, yoy, eop)	6.2	5.1	7.5	10.1	11.7
Total domestic credit (% change, yoy, eop)	-0.1	5.4	5.7	6.2	7.9
DMBs credit to households (% change, yoy, eop)	11.04	9.5	9.6	9.9	10.4
DMBs credit to enterprises (% change, yoy, eop)	2.1	2.8	4.8	6.4	9.2
Money market interest rate (%, pa)	1.0	1.0	1.0	1.0	1.0
DMBs credit rate for enterprises, short-term, (%, pa)	6	5	4.8	4.5	4.5
DMBs credit rate for households, short-term (%, pa)	4.3	4.2	4.1	4	3.8

Notes: * Data refer to consolidated general government, unless stated otherwise ** 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, US$ - US dollar, MKD - Macedonian denar, 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.

Table MK2 Summary of projections

	2018	2019	2020
Real GDP (% change)	**2.1**	**2.8**	**3.1**
Exports of goods and services (constant prices, % change)	11.2	9.7	9.7
Imports of goods and services (constant prices, % change)	7.9	8.6	9.3
Current account balance (% of GDP)	-0.7	-0.9	-0.5
Consumer prices (% change, pa)	1.6	2.0	2.1
Exchange rate, national currency/EUR (pa)	61.6	61.6	-
Unemployment rate (registered, %, pa)	21.3	20.6	20.1
General government balance (ESA 2010 definition, % of GDP)	-2.8	-2.6	-2.3
Broad money, M4* (% change, eop)	-	-	-
Total domestic credit (% change, eop)	6.7	-	-

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, and the European Economic Forecast, Autumn 2018, European Commission Directorate - General for Economic and Financial Affairs, Institutional Paper 038, November 2018.

to salaries and pensions. Income tax is paid at a flat rate of 15% for income earned from capital. These measures will have a net positive impact on the fiscal balance by 0.2 percent of GDP in 2019.

The monetary policy goals in 2019 will remain focused on maintaining price stability and stable exchange rate, maintaining financial stability and supporting macroeconomic stability. In 2019 the positive trends are expected in terms of sustaining price stability and deposit and credit growths, particularly credits fostering company development and further economic development.

The increase in the number of job vacancies implicates the rising problem of the lack of labor force that in the next years will be one of the main challenges of the Macedonian economy. It is mainly determined by the incompatibility of the educational programs with the labor market needs and high emigration abroad. In 2017 the implementation of the system of dual education (supported by the Delegation of the German economy in Macedonia) has started and is expected to help in mitigating the lack of labor force with specific skills. The activities concerning the lack of highly educated labor force remain modest, especially for the decrease of the brain drain emigration abroad.

In the next few years it is expected to continue the stable external position, with further faster growth of exports than imports, the lower deficit in the current account balance and maintaining of an adequate level of foreign exchange reserves. ■

ROMANIA

New Challenges in the light of the Romanian Presidency of the Council of the European Union

Contraction of economic growth

The key factors driving the Romanian economy in 2018 were associated with: a) various shocks both on demand and supply side; b) uncertainty about the external environment; c) changes in economic policies (especially in the fiscal one); d) decline in private investments.

The expansion of the Romanian economy started in 2017 slowed down during 2018. Real GDP growth eased from 7% in 2017 to 4.3% annualized in the first three quarters of 2018 and it is predicted, in European Commission Winter 2019 Economic Forecast, to reach 4%. The main cause is a change in private consumption, as the impact of 2017 tax cuts faded away. In the meantime, the persistence of inflation tensions affects real disposable income. Still, private consumption remains a key factor in the economic dynamics, due to rising wages and labor market tightening conditions.

The industrial output fell 1.0 percent year-on-year in December 2018 (first period with a decline since May 2016; significant contractions occurring in mining and quarrying sectors). This reflects the uncertainty surrounding the economic environment and the design of economic policies. In detail, the influence of external evolutions was particularly reflected by sectors which are highly integrated into the global production networks, i.e. the automotive industry and the manufacture of electrical equipment.

Overall, the 2018 evolutions should be interpreted in an uncertain European environment linked to the European Union's economic deceleration after the 2017 peak. In addition, there was a quite significant contraction of investments in the second and in the third quarter of the year, especially in the private sector (jointly with a large build-up of inventories in this sector). As World Bank Systematic Country Diagnostic- Background note: Productivity for Romania (June 2018: page 7) notes: "the composition of investment in Romania (gross fixed capital formation as a proxy of net investment) is biased in favor of non-tradable sectors, rather than tradable sectors that are more likely to enhance productivity".

The decline in both exports and imports

The external unbalances were, at a certain extent, attenuated. The commercial deficit was evolving with a decline in both exports and imports (with consumption goods as the main determinant of imports; and exports' deceleration being determined inter alia by an appreciation of the real effective exchange rate). Still, net exports had a larger negative contribution to GDP dynamics and a further widening of the current account deficit can be expected (with the trade deficit in October 2018 at EUR 1,788 million, up by more than 40% versus October 2017). The capital account shows a surplus of EUR 2.6 billion as of September 2018 (annualized value) (almost an increase with 17% versus the end-2017). Nevertheless, this was a decline compared with its developments in previous years.

Increase in FDI inward flows

The direct investments by non-residents increased between January and October 2018 by 9.74 compared to the same period of 2017. Still, during this period, around 21% of inflows was represented by intra-group loans and the number of newly established foreign capital companies decreased by 3.62%. For the meantime, there was an important decline of the outward flows of foreign direct investments, with these flows reaching their lowest levels in the third quarter of 2018.

Inflation perspectives worsen

The annual headline inflation, reached 4.5% in September 2018, the five years highest level since 2013, and averaged 4.1% in 2018 overall. The downward path from Q4 of 2018 was associated with the decrease in international prices of oil as well as with the decreases in some prices at European level (especially for fruits and vegetables) and was mainly driven by developments in all consumer basket components. Among inflation mechanisms, the growth of unit wage costs (and the absolute levels of the unit labor cost) had played an important role jointly with their effects leading to adverse pressures on the economy's competitive position and raised obstacles in the business expansion. Most likely, the persistent excess demand in the economy, and advance in unit labor costs will continue to exercise latent pressures on prices in the next periods.

BNR continues to keep the reins of a tight monetary policy

The National Bank of Romania (BNR) kept a tight monetary policy (with the monetary policy rate at 2.5% per year and with minimum reserve requirement ratios on both RON- and foreign currency-denominated liabilities of credit institutions at 8%) in order to anchor inflation expectations and to safeguard the financial stability. Besides the risks sourcing outside Romania, the changes in lending prudential standards and the tendencies of interest rates to move worldwide from their historical lows (with the Romanian money market interest rate being in Q3 almost double that of Q1) contribute to an increase in default risk for loans, especially for households. Further, the relatively low financial intermediation level is associated with a widespread between lending and deposit rates (particularly for households) and the financial system was, as in previous years, dominated by the commercial banks' system.

The volume of non-performing loans in domestic currency expanded by 7.8% (September 2018 versus September 2017) and the relative preference for granting loans mainly in domestic currency was visible during the whole year. In the third quarter of 2018, the households sector consolidated its net creditor position vis-à-vis the banking sector, reaching 50.5 billion RON, after an annual increase of 21%. Their net foreign currency position was almost double in September 2018 compared to September 2017. The levels of banking loans to households had increased by around 9% between September 2017 and September 2018 (at a faster pace than the previous year).

The number of companies with outstanding loans from banks and non-banking financial institutions rose to a significant 16.1% of total active firms. From a structural point of view, there is a higher indebtedness for companies in low-tech and medium low-tech industries. Their debts had accounted for about 66% of total liabilities and owners' equity. The total number of companies undergoing insolvency proceedings remained relatively unchanged in the first three quarters of 2018 (as compared with the end-2017), but newly-insolvent companies had significantly higher importance to the economy, as compared with those undergoing insolvency in the same year-ago period.

The banking sector's total exposure to the commercial real estate market was adjusted down from 66 billion RON in September 2017 to 61.5 billion RON in September 2018; however some risks remain with lower growth rates of asking prices for residential properties, due to volatility on the demand side.

Relaxed fiscal policy

Conversely, during 2018 the fiscal policy was relaxed with Romania's general consolidated budget (fiscal and social budgets of the government) after the first eight months of this year, reaching a deficit of RON 14.56 billion (EUR 3.1 billion) (1.54% of GDP). This was more than two times larger than the one in the same period of 2017, as public expenses overwhelm revenues' increase. The general budget in the first eight months of 2018 closed with a deficit of RON 14.56 billion (1.54 %of GDP), while in the same period of 2017 the deficit was RON 6.5 billion.

Among the lowest external debt-to-GDP ratios in the region

The vulnerabilities for financial stability arising from external debt dynamics have remained low. In the regional context, Romania displays one of the lowest external debt-to-GDP ratios (around 51%). Long-term external debt service ratio, i.e. ratio of long-term external debt service to exports of goods and services, had decreased to 20.8% in September 2018 compared to 25% in 2017, while coverage of short-term external debt has followed a similar downward trend. All the same, Romania is the EU Member State which pays the highest interest rates for its debt (3.96% per year in 2017).

The long-term unemployment rate remains mainly unchanged

While the long-term unemployment rate remains unchanged during the first three quarters of 2018, and the global unemployment rate reached a record low of 4.10% in September 2018 (the ninth place among the EU Member States with the lowest unemployment rate), there are some structural unbalances of the labor market that had impacted its evolution during 2018. First, the percentage of Romanian young people (aged 20 to 34) in 2017 which are neither in employment, nor in education is still among the highest between the European Union countries. Second, there are some substantial unemployment regional disparities. Third, non-educated persons and those with only primary education have the highest shares in the total unemployment. Fourth, gender differences in unemployment are reaching in 2018 a level around 3%. Fifth, the income inequalities are substantial and the redistributive power of fiscal policies remains below the European Union levels.

Table RO1 Main economic indicators

	2016	2017	2018		
		Q4*	Q1	Q2	Q3*
ECONOMIC ACTIVITY					
Real GDP (% change, yoy)	4.8	6.7	4.0	4.1	4.3
Real private consumption (% change, yoy)	8	8.2*	N/A	N/A	5.5*
Real government consumption (% change, yoy)	-3.8	9.6*	N/A	N/A	4.0*
Real investment (% change, yoy)	-3.3	3.6	5.8	-0.2	-1.5
Gross-fixed capital formation (% change, yoy)	-1.7	2.7	5.6	5.8	5.3
Industrial output (% change, yoy)	1.7	7.9	4.9	4.6	4.0
Unemployment rate (registered, percent, pa)	5.9	4.7	4.5	4.2	4.1
Nominal GDP (EUR million)	170,393.6	48,060.6	48,696.0	50,154.2	51,844.2
GDP per capita (EUR)	8,671	9,596*	N/A	N/A	10,435*
PRICES AND WAGES					
Implicit GDP deflator (% change, yoy)	1.4	2.6	2.4	3.6	4.9
Consumer prices (% change, yoy, pa)	-1.55	1.34	3.73	4.53	4.56
Producer prices (% change, yoy, pa)	0.2	3.1	3.5	6.1	6.4
Average gross wage (% change, yoy, pa)	9.9	15.9	8.7	0.7	1.1
Average gross earnings (RON)	2,886.92	3,473	4,253	4,511	4,480.33
Exchange rate (RON/Euro, pa)	4.4904	4.6189	4.6553	4.6532	4.6471
FOREIGN TRADE AND CAPITAL FLOWS					
Exports of goods (EUR million)	57,392.4	62,615.6*	N/A	N/A	68,090*
Exports of goods (% change, yoy, pa)	5.1	9.1*	N/A	N/A	8.7*
Imports of goods (EUR million)	67,363.1	75,567.5*	N/A	N/A	82705*
Imports of goods (% change, yoy, pa)	7.0	12.2*	N/A	N/A	9.4*
Exports of goods and services (EUR million)	70,177.6	20,018.6	20,720.4	20,962.1	21,056.8
Exports of goods and services (%GDP)	41.2	41.7	42.6	41.8	40.6
Imports of goods and services (EUR million)	71,756.8	21,422.5	21,874.5	22,400.4	22,815.3
Imports of goods and services (%GDP)	42.1	44.6	44.9	44.7	44.0
Current account balance (EUR million)	-3,549	-6,295	N/A	N/A	-6,280
Current account balance (% of GDP)	-2.1	-3.3	N/A	N/A	-3.1
Gross foreign direct investment (EUR million, transactions, directional principle)	1,128.3	1,092.7	1,516.6	221.96	2,400.0
Gross foreign direct investment (EUR million, stocks, directional principle)	-66,096.1	-75,218.7	-77,064.2	-77,606.1	-79,925.5
Gross foreign direct investment (EUR million, net values)	N/A	4.883	4.937	N/A	N/A
Foreign direct investment (inward) (national currency million)	6,350.5	3,471.0	9,687.0	1,597.0	10,883.0
Foreign direct investment (inward) (% of GDP)	3.3	2.9	5.4	0.7	4.1
Foreign direct investment (outward) (national currency million)	1,283.5	-226.0	2,626.0	564.0	-270.0
Foreign direct investment (outward) (% of GDP)	0.65	1.0	1.5	0.3	-0.1
Foreign exchange reserves (EUR million, eop)	32,638	33,494	34,725	31,766	31,421
Foreign debt (EUR million, eop)	68,723.5	68,161.7	67,684.4	66,199.1	65,730.6
GOVERNMENT FINANCE					
Revenue (national currency million)	61,098.2	76,665	64,668	74,067	77,549
Expense (national currency million)	66,680.5	89,213	72,332	77,364	80,992
Net = Gross operating balance (national currency million)	-5,582.3	-12,548	-7,664	-3,297	-3,443
Net acquisition of non-financialassets (EUR million)	5.044	4.335	N/A	N/A	2.349
Net lending/borrowing (national currency million)	3,395.0	-158.0	-3,628.0	-10,486.0	-12,498.0
Domestic government debt (EUR million, eop)	62,911.0	64,647.1	64,804.5	65,590.1	67,201.0
Foreign government debt (EUR million, eop)	32,024.8	33,764.6	34,860.0	33,054.9	32,971.1
Total government debt (% of GDP)	36.7	35.1	34.5	34.1	33.9

MONETARY INDICATORS					
Narrow money, M1 (% change, yoy, eop)	20.3	17.0	14.9	14.3	11.4
Broad money, M3 (% change, yoy, eop)	9.8	11.5	11.7	12.9	10.2
Total domestic credit (% change, yoy, eop)	N/A	5.52	5.05	4.34	N/A
DMBs credit to households (% change, yoy, eop)	4.7	7.8	9.4	10	9.4
DMBs credit to enterprises (% change, yoy, eop)	17.5	22.2	13.7	0.5	1.1
3 months EURIBOR (percent, pa)	-0.132	-0.318	-0.328	-0.326	-0.319
6 months EURIBOR (percent, pa)	-0.041	-0.220	-0.273	-0.269	-0.268
Money market interest rate (%, pa)	0.580	1.776	1.846	2.45	3.11
DMBs credit rate for enterprises, short-term (percent, pa)	1.11	1.05	1.21	1.78	2.21
DMBs credit rate for households, short-term (percent, pa)	0.52	0.90	0.94	1.00	1.14

Notes: * someindicators are captured for the entire 2017 or 2018 period, not only on Q4-2017 and/orQ3-2018, according to the availability of data from official sources.

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

Sources: National Institute of Statistics Romania, The National Bank of Romania, National Commission for Strategy and Prognosis Romania (Spring and Summer 2018),Amecoand Eurostat Databases (European Commission), European Central Bank (EUROSYSTEM), Euribor-rates.eu

Table RO2 Summary of projections

	2019	2020
Real GDP (% change)	**5.6***	**5.7***
Real private consumption (% change)	5.8	5.6
Real government consumption (% change)	4.0	3.0
Gross fixed capital formation (% change)	8.4	8.6
Imports of goods and services (constant prices, % change)	8.0	7.9
Exports of goods and services (constant prices, % change)	6.9	7.1
Current account balance (% of GDP)	-2.8	-2.6
Consumer prices (% change, pa)	2.8	2.6
Exchange rate, national currency/EUR (pa)	4.67	4.62
Exchange rate, national currency/USD (pa)	4.03	3.98
Unemployment rate (registered, percent, pa)	4.6	4.5
General government balance (ESA95 definition, % of GDP)	-3.4	-4.6
GDP deflator (% change, yoy)	2.1	1.9

Notes:* estimates published by theNational Commission for Strategy and Prognosis (Romania), Summer 2018 edition; the European Commission forecasts for Romania areal GDP growth (%, yoy) of 3.8% in 2019 and 3.6% in 2020, while the IMF forecasts 3.4% in 2019 and 3.2% in 2020.

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

Sources:National Commission for Strategy and Prognosis Romania (Summer 2018), National Institute of Statistics Romania, National Bank of Romania, Ameco Database.

The annualized dynamics of economy-wide unit labor costs was fast in the third quarter of 2018 (14.6%), while decreasing by only 1% from the first two quarters. Public wages and old-age pensions had been placed on an upward trend started in 2017 and their evolution mirror the lax wage policy in the public sector.

Policy assumptions and projections summary

Different international bodies are forecasting a downward trend of Romanian real GDP in the upcoming two years, but the expected amplitude of economic output's decrease varies among them. For instance, while the expected growth rate of real GDP in 2019 is 3.8% for the European Commission, and 3.4% for IMF, this rate is 3.6% for The European Bank for Reconstruction and Development. Yet, all these forecasts share some common assumption: a) a weakening of the private consumption; b) a moderate growth of nominal wages; c) an inflation process that will continue to weigh on real disposable income; d) labor market conditions that will remain tight; e) a worsening of the trade deficit. The inflation figures actually projected by the National Bank of Romania lay between 3% in the first quarter of 2019 and 3.1% in the last quarter of 2020, with a certain decrease in second and third quarters of both 2019 and 2020. Still, uncertainty intervals for such projections exceed 1.5% and all the figures stay above the target inflation of 2.5%. Most plausible, the main sources of systemic risks may include those identified by the largest banks in BNR's *Quarterly Systemic Risk Survey, September 2018*, Year II, No.4 (page 5): "(1) the fast deterioration of investors' sentiment towards emerging economies in the context of external developments, (2) the uncertain and unpredictable legislative framework governing the banking and financial field, with implications for banking sector solvency and (3) higher financing costs following an interest rate hike and/or a weaker leu exchange rate, with a negative impact on the debt servicing capacity of borrowers, especially households and SMEs". To these, other risk determinants can be added (with a potential impact on short and medium-term): a) structural domestic macroeconomic disequilibrium; b) the evolutions of the real estate market; c) uncertain and unpredictable legislative framework; d) higher financing costs; e) modest growth of lending to non-financial corporations and lower levels of internal investments; f) a procyclical fiscal policy and g) a widening current account deficit. However, for the labor market, the Romanian National Commission for Strategy and Prognosis does not foresee a significant change in unemployment rates, with these rates evolving around 4.5% in the next two years.

Most likely, a particularly important role will be played by the changes in fiscal policy starting with December 2018. Among these changes: banks are to be required to pay tax on their financial assets when the average quarterly Romanian Interbank Offer Rate (ROBOR) exceeds the 2% threshold; gross national minimum wage to increase to 2.080 RON; 2% tax on holders of energy licenses; special provisions for employers and employees working in the construction sector. Such changes will impact the entire system of interest rates, the costs of borrowing, the energy prices and the dynamics of nominal wages.

Accounting for all of the above, at least two possible scenarios may be considered. In the first one, the Romanian economy will continue to grow at a moderate rate in the next two years. This growth will be driven mainly by internal consumption and imports (with a widening of the trade deficit). Inflation will remain in the projected boundaries and the growth of interest rates will follow a relatively moderate upward trend. No major changes in residents and non-residents investments are to be expected in this scenario. The unbalances from the labor markets will not worsen, nor will see major corrections. No severe depreciation of national currency will occur and no major shocks from the European Union or international environment will frappe the economy. In a second scenario, the cost-push mechanisms of inflation will be triggered at higher amplitude by the increase in labor costs and expansionary fiscal policies (jointly with some possible shocks in energy prices). This will severely compress the real income and domestic demand leading to a more significant slowdown in growth. Possible advances in the decrease of foreign direct investments and higher costs of borrowing from international markets will further worsen the macroeconomic environment. Losses in international competitiveness and acceleration in public expenditures and government consumption (jointly with a lowering in tax collection efficiency) will make more acute the presence of 'twin deficits' (government budget balance and current account balance). The labor market will suffer some major corrections and the unemployment rate will be higher than expected. Of course, it is difficult to assess the likelihood of scenarios. Nevertheless, the emergence of at least some of the mentioned sources of systemic risks is highly possible.

S E R B I A

Democratic institutions and the rule of law is of high importance for Serbia

Strengthening democratic institutions and the rule of law is of high importance for Serbia, to join the European Union. However, the latest reports of the European Union and the assessment of the state of democracy in the region of various monitoring organizations such as Freedom House, the International Institute for Democracy and Electoral Assistance and the Economist, estimate that in Serbia the rule of law stagnates or "falls" over the past few years. According to the Freedom House report, Serbia lost the status of "free state" for the first time in last fifteen years namely, Serbia no longer belongs to the category of free countries, but fell into the category of "partially free states". For the first time, Serbia is among the four countries (Nicaragua, Tanzania, and Venezuela) where the index of freedom had the most significant decrease. Serbia is the worst-rated country in the Western Balkans, as no progress has been made in any field. Also, in Serbia, to ensure the stability of democratic institutions and the rule of law, a decisive fight against corruption is necessary. The Republic of Serbia opened negotiating chapters 23 (judiciary and fundamental rights) and 24 (justice, freedom and security) at the third EU-Serbia Intergovernmental Conference held in Brussels on 18 July 2016. Serbia will have a job not only to harmonize many

laws with the law of the European Union but also to implement them. The European Commission stressed that the time it takes for Serbia to become a full member of the EU would determine chapter 35 on Kosovo and chapters 23 and 24 on the rule of law.

Respectable economic growth is slightly slowing down in the second half of 2018

After relatively high growth rates recorded over the first two quarters of 2018, economic activity has shown slightly slowing down trends in the second half of the year. Although initial forecasts of GDP growth in the amount of 3.5% for 2018 has been significantly surpassed, it could be noticed that such a dynamics of the economic activity will be hard to maintain in the following quarters. This is particularly true if we consider the fact that recorded growth has been, apart from doubtless rise in many sectors, the consequence of relatively modest growth rates recorded in the first quarters of 2017.

If the production side of the GDP is considered, main factors behind relatively high growth rates in the first half of 2018 were related to the awakening of the agricultural production and construction industry that recorded respectable growth contributing the overall increase of the economic activity. Although still having the largest growth impact, activity of the services sector has been in the third quarter significantly amended by agriculture that accounted for almost one third of the growth recorded in the third quarter of 2018. In the observed period, agricultural production and construction recorded growth of 15.9% and 7.0% respectively. Unfortunately, after encouraging signs of recovery in the first half of the year industrial production recorded a decrease of 1.4% in the third quarter. Recent data obtained from the national statistics indicate the continuation of the negative trends in January 2019. Industrial production in January 2019 has been lower by the 5.5% if compared with the same month last year.

In terms of expenditures, the main drivers of GDP growth remained private consumption and investments. If the third quarter is considered, around 2.3 percentage points of the recorded growth refer to private consumption, while 1.3 points have been the contribution of the investments. Given the increase of wages in the public sector since January 2019, it can be expected that private consumption continues its positive impact on economic growth. Although having minor impact on the overall growth, Government consumption continued to rise at a relatively high pace in the amount of 4.8% and 4% over the second and third quarter respectively.

Economic activity in overall is expected to rise, mainly due to relatively positive external environment and rise of private consumption. However, it still needs to be analyzed whether relatively favorable fiscal situation is to be followed by the increase of investments and exports as important determinants of the future growth perspectives and sustainability.

Expectations in the developments in the labor market

According to the Labor Force Survey (LFS) data the unemployment rate of the population aged 15 years and over fell to 13.5% while the employment reached a rate of 46.7% in 2017. Both rates depicted further improvement of the labor market performance compared with 2016. However, those improvements are accomplished together with a drop in the total population older than 15 years by more than 32 thousand people. Similar labor market developments continued in 2018. The LFS employment rate recorded in 2018 was 47.6% showing an increase of 0.9 percentage points compared with 2017. The LFS unemployment rate was 12.7% in 2018. Relative changes in the employment, throughout all the quarters of 2018, were somewhat slower when compared with the rates of real GDP growth. This will probably induce further employment growth in the upcoming period which is in accordance with our forecasts.

The registered employment continued to grow at a slightly higher pace in 2018 than in 2017. The growth of registered employment exceeded three percent in 2018. The number of self-employed increased faster than the employment in companies and organizations, while the number of registered farmers who regularly pay social security contributions continuously decreased. Likewise, the number of job seekers registered by the National Employment Service followed a decreasing trend. This induced the expected decrease in the registered unemployment rate. If the present developments in the labor market continue, our forecasts suggest that registered unemployment rate will fall below 20% till the end of 2019.

The growth of real gross wages recorded in 2017 continued during 2018. In the second and third quarter the growth rates of real gross wages amounted to four percent on average. Given the stable macroeconomic environment and correction of the compulsory minimum wage as of January 2019 it is expected further growth of real wages will continue.

The gradual shift in the fiscal policy stance

The fiscal balance in 2018 is expected to be in surplus for the second consecutive year, despite gradual relaxation of harsh fiscal consolidation measures undertook in 2015. Following the increase of wages in the public sector and pensions at the beginning of 2018, the real y-o-y growth of public expenditures in 2018 Q3 reached almost 10%. Yet, it didn't considerably worsen fiscal balance due to the elastic reaction of income taxes and social contributions to increase in respective tax bases, in line with elastic reaction of VAT to growth in consumption. Eventually, the annualized fiscal surplus in Q3 was 0.6% of GDP, still quite above projected deficit of 0.7% for 2018 (by 2017 Fiscal Strategy), but twice as low as it was by the end of 2017. The gradual introduction of expansionary fiscal measures and discontinuation in RSD appreciation trends have reduced the pace of decline in public debt to GDP ratio; it decreased for 2 p.p in the first three quarters of 2018, far lower when compared to the prominent two-digit drop observed in 2017.

The Serbian Government envisaged continuation of the expansionary measures in 2019, striving to stimulate the growth of investment and consumption.

Three main measures include further growth in public sector wages (9% nominal average), modest growth in capital expenditures (up to 4% of GDP) and a modest decrease in the tax burden on wages (from 63% to 62%). Nevertheless, the effectiveness of these measures is arguably suspicious. A significant amount of capital expenditures is envisaged for military and police spending instead of productive investment in infrastructural projects, while the real growth of public sector wages above the real GDP growth may further deteriorate external imbalances. In addition, the Government continued to struggle with the implementation of public sector reforms agenda, since the progress in 2018 was disappointing. The implementation of major reform issues, most notable reform of public sector wages system, reform of state-owned companies and improvement in critical areas of public financial management (like tax administration and mid-term budgeting), were either postponed or modestly accomplished.

Monetary easing helps boosting credit growth

In 2018, the National Bank of Serbia remained on the course of monetary easing policy, following the low domestic inflation and low interest rates of the ECB. The key policy rate was reduced twice in the first half of 2018 for 0.25 percentage points, reaching the historical minimum of 3%, which is four times lower relative to its peak in 2011. The interest rates on the households and corporate loans adjusted to the key policy rates, reaching historical minimums in the 2018 Q3, too. In the first three quarters of 2018, trend of credit activities growth continued as a reaction to the low interest rates, stability of the financial markets and other favorable economic conditions on the side of the real economy. The y-o-y growth of total loans accelerated up to 6.3% in 2018 Q3, driven by the two-digit growth of households loans. Excluding the effects of the exchange rate fluctuation, growth rate of total loans in Q3 was even higher – 7.7% relative to the same period of the previous year. In terms of purpose, loans for financing working capital still have the dominant share in the structure of loans to the business (49.0%), followed by investment loans with a share of 31.4%. For the households, cash loans (including refinancing credits) and housing loans prevail in the structure of loans, with shares of 59.9%, and 16.2%, respectively.

The growth of credit activities was achieved despite the further efforts in struggling to solve the NPL, whose share in total loans was 6.4% at the end of the third quarter of 2018. In the next period, the chances of further decrease in key policy rate are slight, in the light of expected increase in ECB interest rates and rising uncertainty on the international markets. Yet, credit activities to corporate sector are likely to continue to grow, due to expected loosening of credit standards.

Low inflationary pressures and stable exchange rate

In the first three quarters of 2018, inflation was low and stable and ranged within the target range of 3.0 ± 1.5%. At the end of September annual inflation amounted to 2.1%. Growth in prices of fruits and vegetables as well as oil products contributed to half of its value over the observed period. Inflationary pressure s stay low, which has been also confirmed by the trend of core inflation after excluding energy, food, alcohol and cigarettes, which decreased in September to 1.5%. In the following period we do not expect a significant increase in consumer prices. The main risks might arise from the external environment mainly depending on the trends in international

Table SRB1 Main economic indicators

	2016	2017	2018		
		Q4	Q1	Q2	Q3
ECONOMIC ACTIVITY					
Real GDP (% change, yoy)	3.3	2.5	4.8	4.9	3.8
Real private consumption (% change, yoy)	0.8	1.9	3.1	3.4	3.3
Real government consumption (% change, yoy)	2.3	1.1	2.2	4.8	4.0
Industrial output (% change, yoy)	2.5	4.3	5.9	3.1	-1.4
Unemployment rate (registered, %, pa)	26.2	22.9	22.9	21.8	20.8
Nominal GDP (EUR million)	36,723	10,805	9,714	10,660	11,026
GDP per capita (EUR)	5,203	N/A	N/A	N/A	N/A
PRICES, WAGES, AND EXCHANGE RATES					
Implicit GDP deflator (% change, yoy)	N/A	N/A	N/A	N/A	N/A
Consumer prices (% change, yoy, pa)	3.3	0.2	1.4	2.3	2.1
Producer prices (% change, yoy, pa)	-0.6	2.6	0.8	3.0	3.6
Average gross wage (% change, yoy, pa)	2.6	0.1	3.4	4.0	3.7
Exchange rate, RSD/EUR (pa)	123.12	119.11	118.43	118.17	118.14
Exchange rate, RSD/US$ (pa)	111.29	101.13	96.34	99.22	101.59
FOREIGN TRADE AND CAPITAL FLOWS					
Exports of goods (EUR million)	13,432	3,800	3,829	4,211	4,091
Exports of goods (EUR, % change, yoy) ******	11.6	8.2	8.9	6.6	8.1
Imports of goods (EUR million)	17,068	5,262	5,076	5,458	5,419
Imports of goods (EUR, % change, yoy) ******	6.1	15.4	12.6	11.0	15.1
Current account balance (EUR million)	-1,075	-742	-724	-354	-556
Current account balance (% of GDP) ******	-2.9	-6.9	-7.5	-3.3	-5.1
Gross foreign direct investment (EUR million)	2,127	648	753	723	691
Foreign exchange reserves (EUR million, eop)	11,761	11,072	11,623	12,164	12,302
Foreign debt (EUR million, eop)	26,494	25,588	25,401	26,110	26,517
GOVERNMENT FINANCE*					
Revenue (RSD billion)**	1,843	522	474	527	537
Expense (RSD billion)**	1,757	495	441	457	462
Net = Gross operating balance (RSD billion)**	85	27	33	70	75
Net acquisition of non-financial assets (RSD billion)**	139	57	29	40	54
Net lending/borrowing (RSD billion))**	-54	-30	4	30	21
Domestic government debt (EUR million, eop), national methodology***	9,149	9,298	9,919	9,887	9,923
Foreign government debt (EUR million, eop), national methodology***	15,671	13,923	13,802	14,151	14,035
Total government debt (% of GDP), national methodology	69	59	56	57	57
MONETARY INDICATORS					
Narrow money, M1 (% change, yoy, eop)	20.5	10.2	9.4	13.5	15.1
Broad money, M2)5 (% change, yoy, eop)	11.6	3.6	3.3	7.9	8.2
Total domestic credit (% change, yoy, eop)	6.0	1.2	2.0	3.9	6.3
DMBs credit to households (% change, yoy, eop)	10.5	7.8	6.9	8.9	11.7
DMBs credit to enterprises (% change, yoy, eop)	1.8	0.2	0.6	2.9	4.1
DMBs credit rate for enterprises, short-term, (%, pa)****	5.3	3.7	3.4	3.6	3.2
DMBs credit rate for households, short-term (%, pa)*****	9.4	8.2	8.1	7.9	7.8

Notes: The registered unemployment rate is calculated based on the registered number of unemployed and the registered employment. The data about registered unemployment and employment are taken from the periodicals of the National Employment Service and the Statistical Office of the Republic of Serbia. * Data refer to consolidated general government, unless stated otherwise ** On the cash principle (public sector does not prepare financial reports according to accrual accounting IPSAS standards) *** Approximated by the capital expenditures **** 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, US$ - US dollar, RSD - dinar, DMB – deposit money bank.

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

Table SRB2 Summary of projections

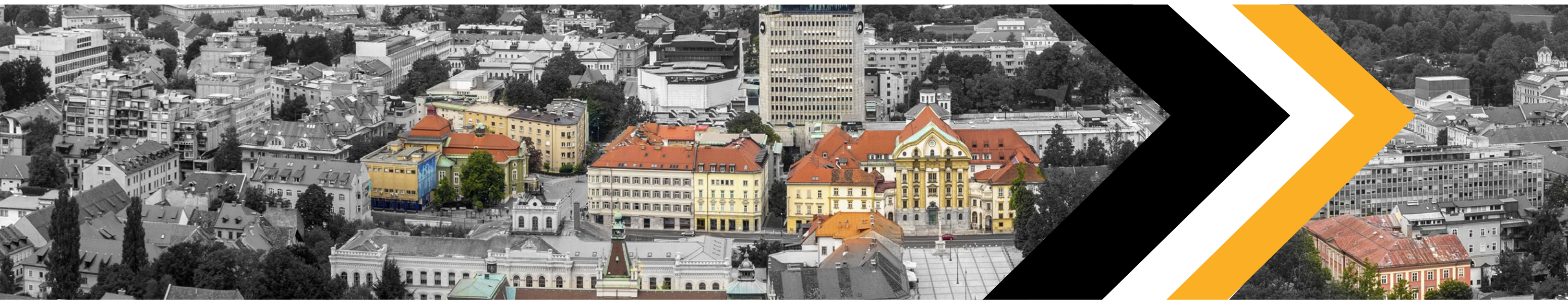
	2018	2019	2020
Real GDP (% change)	**4.2**	**3.5**	**3.5**
Exports of goods and services (constant prices, % change)	8.0	9.0	8.0
Imports of goods and services (constant prices, % change)	13.0	12.0	10.0
Current account balance (% of GDP)	-5.2	-5.5	-5.5
Consumer prices (% change, pa)	2.0	2.5	2.8
Exchange rate, national currency/EUR (pa)	118.27	118.40	118.64
Unemployment rate (registered, %, pa)	21.5	19.8	19.0
General government balance (ESA 2010 definition, % of GDP)	0.6	-0.5	-0.7
Broad money, M4* (% change, eop)	N/A	N/A	N/A
Total domestic credit (% change, eop)	7%	6%	6%

Notes: * Statistics on M4 is not available for Serbia
Conventional abbreviations: pa - period average, eop - end of period, EUR - euro.
Sources: Authors' projections, Fiscal strategy of the Republic of Serbia for 2019 with projections for 2020 and 2021, the IMF WEO.

commodity and financial markets and future monetary policies of leading central banks, as well as the movement of administered prices. During the observed period, RSD exchange rate appreciation trend has been continued. The average rate of the dinar appreciation against the euro in the first three quarters of 2018 was 0.1%, while in relation to the US dollar, dinar appreciation amount to 3.6%. The appreciation pressures were influenced by the high inflow of foreign direct investments, dynamic increase of exports and growth in FX-indexed bank assets. In the following period the exchange rate of RSD is expected to remain stable and will largely depend on the monetary policy which is to be implemented by the major central banks worldwide.

Deterioration of the trade balance

Serbia's current account deterioration continued in 2018 due to the worsening of the trade balance, despite the increase in inflows of services and remittances. However, this deterioration was largely offset by the steady y-o-y increase in the FDI inflow. As regards the commodity trade, substantial increase in imports led to the worsening of trade deficit by nearly a third in comparison to the same period of 2017. On the positive side, however, one should note that increase in trade deficit was mainly affected by an increase in imports of crude petroleum and various machinery, whereas growth in imports of consumer goods was modest. As regards the growth in exports, it was mainly driven by steel, electrical apparatus, and also petroleum products, while decline in exports of cars and agricultural products (in particular cereals and fruits) negatively affected the overall commodity exports growth. Over the observed period, the composition of a commodity trade by major product groups remained pretty much unchanged in comparison to the previous year: machinery, metals and agricultural products dominated on the export side, while imports were largely driven by fuels and machinery, as well as by various intermediate goods. The surplus in trade in services recorded a y-o-y increase, mostly due to an increase in inflows related to the IT, consultancy and construction services. ■



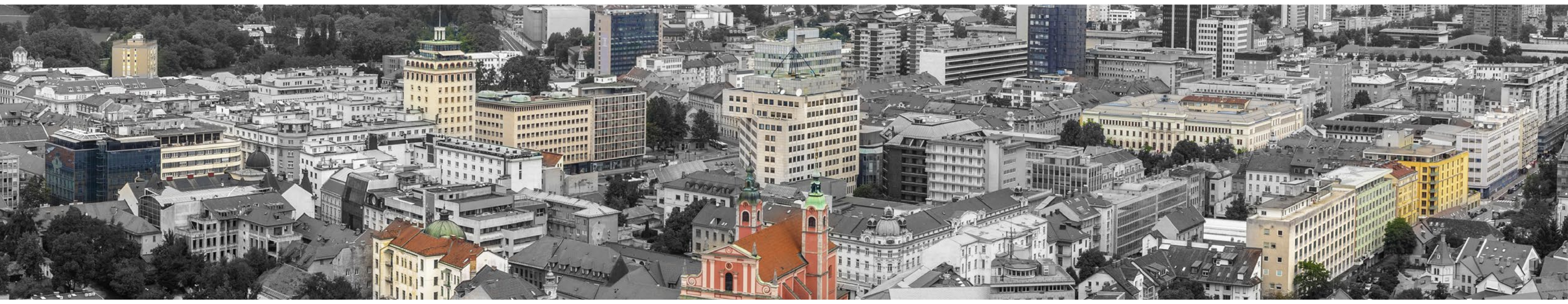
SLOVENIA

Economic growth is gradually slowing, while further reforms and consolidation still need to be tackled

Priorities of the new government

The year 2018 was marked in Slovenia by parliamentary elections in June as well as local elections in late autumn. The former Prime Minister Miro Cerar offered an early resignation less than three months ahead of the general election following the Supreme Court's decision to annul the result of a referendum that approved a 1-billion-euro railway project, the center-left government's biggest investment programme. The resignation also came amid growing pressure from public sector workers demanding an increase in wages and back pay. The government had said joint public sector trade union demands were not justified by productivity and GDP growth and would threaten the planned fiscal consolidation. After the winner of the parliamentary elections, a center-right Slovenian Democratic Party failed to draw up a new government, the coalition government was set up by a center-left List of Marjan Šarec in early September.

The main government priorities are to implement the long-awaited systemic solutions in key areas such as healthcare and long-term care, and defence and



security; establishing of the demographic fund to improve pension financing, recasting national legislation in the area of research in order to enable a modern system of science and innovation, as well as the arrangement of the labor market and education system to ensure the necessary personnel for the continued development of the economy amid worsening demographic situation.

Stable and solid economic growth continues

Economic growth reached 4.9% in 2017 and also continued in 2018 though at a slightly slower pace. In the first, second and third quarter of the year, gross domestic product increased by 4.7%, 4.0% and 4.8% on a year-on-year basis respectively and is expected to total 4.4% in 2018. The growth in private consumption declined from quarter to quarter and was somewhat weaker than in 2017 despite relatively strong growth in wages and social transfers, a further increase in consumer loans and continued decline in unemployment. On the other hand, investment remained strong. The growth of gross fixed capital formation remained high, over 10% throughout the first three quarters of the year, primarily as a result of continued growth momentum in construction investment, but also the investment in machinery and equipment grew. Government consumption was also higher than in the same period last year. Due to lower growth in foreign demand, the growth of the export part of the economy moderated in 2018, while activity continued to expand in sectors that mainly rely on domestic demand. Growth in industrial output remained strong in the first two quarters of 2018, while in the second half of 2018 output growth was more modest than in the same period of 2017 largely reflecting weaker growth in foreign demand and a standstill of production growth in the European car industry.

Labor market conditions

In the first three quarters of 2018, the number of employed persons continued to rise relatively rapidly. Due to shortages of appropriately skilled workers on the domestic market, foreign nationals accounted for more than one-half of the growth in the total number of employed persons. Labor supply shortages were further alleviated through rising labor market participation. The number of registered unemployed persons continued to decline in 2018. A total of 78,534 persons were registered as unemployed at the end of December and 78,474 in 2018 as a whole, 7.7% and 11.5% less respectively than one year before. The registered unemployment rate is expected to decline to 8.2% in 2018.

Wage growth averaged 3.4% over the first ten months of last year, up to one percentage point in year-on-year terms. Due to the tightening labor market wage pressures are expected to increase further.

General government balance with a surplus

In 2017, the general government balance recorded a surplus that stood at 0.1% of GDP. Favorable trends in public finance also continued in the first three quarters of 2018 and were mainly the result of high revenues and a sharp decline in interest expenditure driven by active public debt management and the continuation of favorable conditions for borrowing on the financial markets. Year-on-year growth in general government revenue was driven by the increase in tax revenues and social contributions that were the result of favorable economic developments, including labor market conditions and improvement in business results. In the third quarter of 2018, the general government balance was further strengthened by increased absorption of EU funds. The general government surplus is expected to stand at 0.5% of GDP in 2018.

After peaking at 82.6% in 2015, the debt-to-GDP ratio decreased further in 2017. Supported by economic growth and active public debt management it stood at 74.1% and was 4.6 percentage points down compared to 2016. However, to ensure the sustainability of public finance in the long-term, the government needs to address the challenges of demographic change, which are particularly noticeable for Slovenia. It would be expected that the required structural reforms, in the healthcare and long-term care, in particular, are finally adopted.

Lending activity continues to strengthen at a moderate pace

The situation in the banking system remains stable, and the quality of banks' assets is steadily improving. In 2018, loans to domestic non-banking sectors continued to strengthen at a moderate pace. Loan growth was mainly driven by household borrowing, for both housing and consumer loans as well as for other purposes. Year-on-year growth in household loans equaled or surpassed 6% throughout the year. On the other hand, the volume of corporate and NFI loans fell in 2018. The decrease in corporate loans is related to somewhat higher loan repayments, as the volume of newly extended loans increased slightly.

Inflation expected to remain moderate

The average inflation stood at 1.4% in 2017 and is expected to rise to around 2% in 2018. In the first three quarters of 2018, year-on-year consumer price growth was mainly driven by higher prices of fuels and energy. An increase was also recorded in food and services prices, while prices of semi-durable and durable goods were down year-on-year. Core inflation remained low at around 1%.

Moderation of goods exports and imports growth

After a substantial increase in 2016 and 2017, exports of goods were increasing somewhat more modestly over the first three quarters of 2018 amid the slowdown in Slovenia's main export markets, Germany in particular. Year-on-year growth in goods exports moderated to below 9% in the first two quarters of the year and slowed down to 4.3% in the third quarter. Growth was mostly driven by exports of motor vehicles. Growth in goods imports declined even more, namely from 10.8% in the first quarter of 2018 to 5% in the third quarter. The growth of exports and imports of services was also lower than in 2017.

The surplus of the current account reached 8.7% of GDP in the third quarter of 2018 and was the highest thus far. The high surplus was mostly the result of a high surplus in international trade in goods and services, which reflects relatively favorable export movements and moderate growth in domestic consumption.

FDI inflow increasing further

Slovenian direct investment abroad remains modest, while foreign direct investment in Slovenia has been rising since 2014. The stock of inward FDI in Slovenia amounted to EUR 13.7 billion at the end of 2017 and was up EUR 704.3 million or 5.4% on the end of 2016. The most significant investments were in manufacturing, financial and insurance activities, and the sale of motor vehicles. In the first three quarters of 2018, the stock of inward FDI in Slovenia increased to 14.5 billion. Inflows were mainly in the form of equity transactions and reinvested earnings.

Policy assumptions and summary of projections

Growth is projected to continue at a slightly slower pace

The projected values of the main macroeconomic aggregates for Slovenia are those presented in the Autumn Forecast 2018 of the Institute for Macroeconomic Analysis and Development (IMAD). The projected value of the general government deficit is based on the autumn 2018 Economic Forecast of the European Commission.

Economic growth is forecast to slow down to 4.4% in 2018, 3.7% in 2019 and 3.4% in 2020. The contributions of domestic and foreign consumption to economic growth in 2018–2020 will be even more balanced than in 2017 as domestic consumption will increase further supported by a significant increase in private consumption as well as rising investment. Private consumption is expected to stay strong until 2019 boosted by growing employment and rising wages. Later, the growth in private consumption is anticipated to somewhat slow down due to the projected weaker growth in employment. Investment activity will increase sharply in 2018 and is projected to remain robust over the entire forecast period. It will be broad-based and driven by high capacity utilization rates, rising demand, and strong business performance. The growth in government consumption is expected to somewhat slowdown in 2019 and

Table SI1 Main economic indicators

	2016	2017	2018		
		Q4	Q1	Q2	Q3
ECONOMIC ACTIVITY					
Real GDP (percent change, yoy)	3.1	6.3	4.7	4.0	4.8
Real private consumption (percent change, yoy)	4.0	3.2	3.7	1.5	0.0
Real government consumption (percent change, yoy)	2.7	1.3	1.2	4.9	2.5
Real investment (percent change, yoy)	0.0	15.3	16.4	7.2	13.4
Gross-fixed capital formation (percent change, yoy)	-3.7	12	10.7	10.7	12
Industrial output (percent change, yoy)	7.1	9.8	7.5	5.3	3.5
Unemployment rate (registered, percent, pa)	11.2	8.9	9.0	8.1	7.9
Nominal GDP (EUR million)	40,357	11,201	10,589	11,679	11,813
GDP per capita (EUR)	19,547	5,422	5,123	5,650	5,706
PRICES AND WAGES					
Implicit GDP deflator (percent change, yoy)	0.8	3.0	0.0	2.6	3.4
Consumer prices (percent change, yoy, pa)	-0.1	1.3	1.3	1.9	1.9
Producer prices (percent change, yoy, pa)	-1.4	2.3	2.2	2.1	2.4
Average gross wage (percent change, yoy, pa)	1.8	3.9	3.6	3.6	3.0
Exchange rate, EUR/USD (pa)	1.11	1.18	1.23	1.19	1.16
FOREIGN TRADE AND CAPITAL FLOWS					
Exports of goods (EUR million)	24,991	7,428	7,541	7,938	7,627
Exports of goods (EUR, percent change, yoy)	6.2	13.8	8.6	8.7	4.3
Imports of goods (EUR million)	23,454	7,128	7,210	7,496	7,196
Imports of goods (EUR, percent change, yoy)	7.0	12.8	10.8	9.1	5.0
Current account balance (EUR million)	2,224	660	679	968	1,027
Current account balance (percent of GDP)	5.5	5.9	6.4	8.3	8.7
Gross foreign direct investment (EUR million)	1,298	226	364	82	508
Foreign exchange reserves (EUR million, eop)	705	743	716	715	781
Foreign debt (EUR million, eop)	44,810	43,813	43,525	43,552	42,680
GOVERNMENT FINANCE*					
Revenue (EUR million)**	17,510	4,876	4,614	5,016	4,983
Expense (EUR million)**	18,292	4,817	4,547	4,867	4,941
Net = Gross operating balance (EUR million)**	N/A	N/A	N/A	N/A	N/A
Net acquisition of non-financial assets (EUR million)**	N/A	N/A	N/A	N/A	N/A
Net lending/borrowing (EUR million)**	-781	59	67	150	42
Domestic government debt (EUR million, eop)	20,500	23,615	26,355	26,356	26,255
Foreign government debt (EUR million, eop)	6,629	5,125	3,785	3,013	3,011
Total government debt (percent of GDP)	78.7	N/A	N/A	N/A	N/A
MONETARY INDICATORS					
Total domestic credit (percent change, yoy, eop)	0.5	5.3	2.3	4.7	5.6
DMBs credit to households (percent change, yoy, eop)	3.4	6.4	6.0	6.2	6.5
DMBs credit to enterprises (percent change, yoy, eop)	-7.3	0.0	-0.3	-1.1	-1.0
3 months EURIBOR (percent, pa)	-0.26	-0.33	-0.33	-0.33	-0.32
6 months EURIBOR (percent, pa)	-0.17	-0.27	-0.27	-0.27	-0.27
DMBs credit rate for enterprises, short-term, (percent, pa)	2.4	2.4	2.1	2.1	2.3
DMBs credit rate for households, short-term (percent, pa)	3.1	3.3	3.5	3.3	3.2

Notes: * Data refer to consolidated general government, ** ESA 2010,

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, Bank of Slovenia, Ministry of Finance, Institute for Macroeconomic Analysis and Development - IMAD and calculations by IER.

Table SI2 Summary of projections

	2018	2019	2020
Real GDP (percent change)	**4.4**	**3.7**	**3.4**
Real private consumption (percent change)	2.7	2.6	2.2
Real government consumption (percent change)	2.7	2	1.5
Gross fixed capital formation (percent change)	9.0	8.5	7.5
Exports of goods and services (constant prices, percent change)	8.2	6.6	7.1
Imports of goods and services (constant prices, percent change)	8	7.1	7.3
Current account balance (percent of GDP)	6.8	6.4	6.7
Consumer prices (percent change, pa)	1.8	2.1	2.3
Exchange rate, national currency/USD (pa)	1.18	1.15	1.15
Unemployment rate (registered, percent, pa)	8.2	7.7	7.2
General government balance (ESA95 definition, percent of GDP)	0.5	0.4	0.2

Notes: Cut-off date for information used in the IMAD's compilation of projections was September 7, 2018.
Conventional abbreviations: pa - period average; eop - end of period; USD - US dollar.
Sources: Institute for Macroeconomic Analysis and Development - IMAD (Autumn Forecast of Economic Trends 2018) and European Commission (Autumn 2018 Economic Forecast).

2020 compared to 2018 due to more moderate growth in employment and general government sector's expenditure on goods and services. Taking into account some expected slowdown in Slovenia's main export markets coupled with anticipated growth of unit labor costs, the steady growth of exports is expected to slacken over the forecast period gradually. The positive contribution of net exports to GDP growth is likely to diminish as imports are forecast to grow faster than exports due to the strengthening of domestic demand. Slovenia's current account surplus is projected to stay high over the forecast period.

Employment will continue to rise, but given the increasingly limited pool of labor, its growth will gradually slow down despite the inflow of foreign workers and a rising participation rate. The unemployment rate is expected to fall further, reaching 7.2% in 2020. Amid further growth in economic activity and employment, this will also be the result of demographic factors, namely the decline in the numbers of the working-age population. Inflation is expected to rise moderately over the forecast period, from 1.8% in 2018 to 2.3% in 2020 driven by further growth in demand and the strengthening of cost pressures.

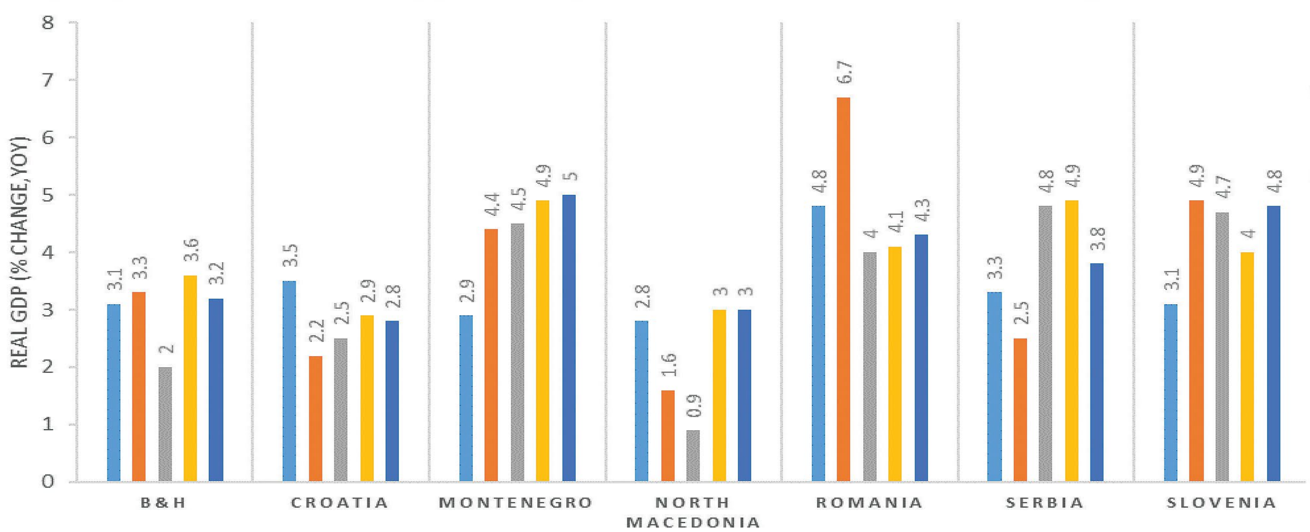
Under a no-policy-change budget, the general government surplus is forecast to slightly decrease to 0.4% of GDP in 2019 and further down to 0.2% of GDP in 2020. The surplus will slack as the government expenditure is expected to outpace the revenue growth due to the expected increase in compensation of employees and social benefits. ■

A N A L Y S I S

Real GDP and unemployment rate for selected SEE countries

In the previous numbers of the publication in the part *Analysis*, we analysed actual current themes at that moment. In this number of the publication, in the part analysis, for the first time, we will compare some of the main economic indicators for countries Bosnia and Herzegovina, Croatia, Montenegro, Republic of North Macedonia, Romania, Serbia and Slovenia. First, we will show charts with real GDP compared between countries in 2016y, 2017y, and in Q1 Q2 Q3 of 2018y. and then chart with unemployment rate for the same period of time. Chosen indicators for comparing are, as we mentioned,

Figure 1 **Real GDP for selected SEE countries, 2016 – Q3 2018.**

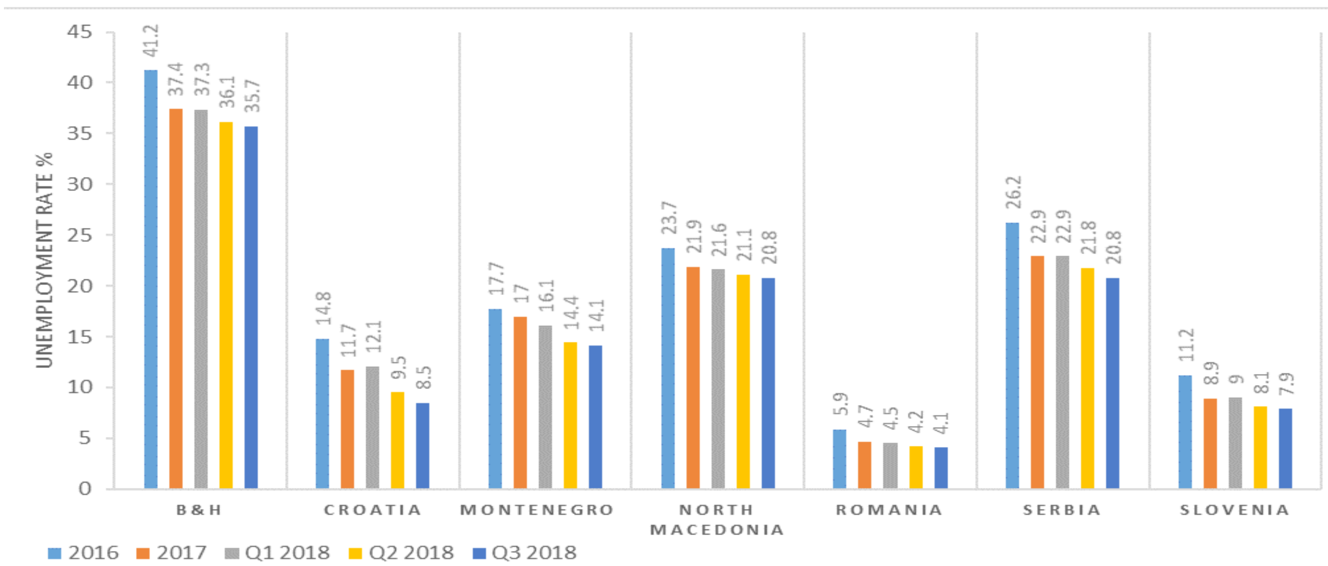


real GDP (% change year on year) and *unemployment rate* (registered, % period average). Those two indicators have been chosen because we wanted to compare relation between real GDP and unemployment rate. It is proven that they have inversely proportional relation. Which means, when real GDP goes up, unemployment rate will probably go down. The effect of real GDP sometimes comes later, because it is needed more time to have real effect on unemployment rate, and that we will see in graphs of both indicators specially for all countries.

In the displayed figures we see unemployment rate between countries, in the same period of time, 2016y-Q3 2018y.

As mentioned before, B&H growth was marked as modest economic growth. The gross capital formation had significant contribution to it. Comparing to Montenegro, which achieved dynamic growth because of increasing investment activity, construction sector and tourist arrivals, it had lower real

Figure 2 Unemployment rate for selected SEE countries, 2016 – Q3 2018.



GDP, except in 2016y. In Serbia, main factors behind high growth (Q1 2018. and Q2 2018) were agricultural production and construction industry, which influenced on economic activity in this period of time. Although, real GDP in Q3 2018y was decreased, private consumption and investment stayed its main drivers. Romania had the highest real GDP in 2017y resulted after raising private consumption stimulated with tax cuts. After fading tax cuts in that year, in Q1 2018y it fell down to 4%, but private consumption remained a key factor in the economic dynamics due to rising wages and tightening labour market conditions. Croatia reached a peak in 2016y with real GDP of 3.5%. After that year, it fell down, and the economic growth slowed down. The main drivers in 2017y and 2018y were domestic consumption, investments and tourist sector. Private consumption grew due to relaxation of income tax rates and increasing wages. In Macedonia main drivers for economic growth were service, industry, agricultural sector and government investment. In Slovenia after reaching a peak in 2017y, there was a slightly slower pace in Q1 2018 and also Q3 2018y. Private consumption, as in other countries, was one of the main drivers for ecnomic growth. It had small decline, even though wages had relatively strong growth. On the other side, another driver, investments, remained strong. Almost all countries mentioned, expect private consumption and investment as mainstay of economic growth.

In the next figures we will show countries' unemployment rate and real GDP rate especially for all countries.

Serbia's unemployment rate, from year to year, had slow decrease. This was resulted due to improvement of the labour market performance. The number of self-employed increased faster than the employment in companies, and the farmers who pay social security contributions continuously decreased. The decrease trend was also in the number of job seekers registered by

Figure 3. Real GDP and Unemployment rate in Bosnia and Herzegovina, 2016 - Q3 2018.

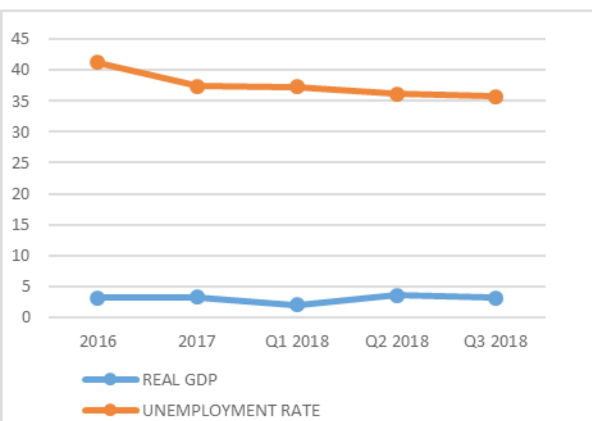


Figure 4. Real GDP and Unemployment rate in Croatia, 2016 - Q3 2018.

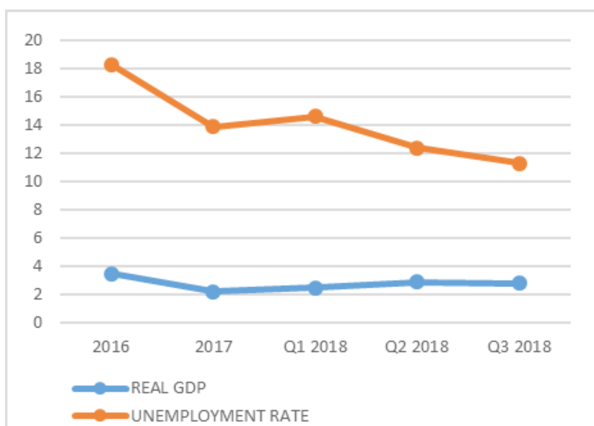


Figure 5. Real GDP and Unemployment rate in Montenegro, 2016 - Q3 2018.

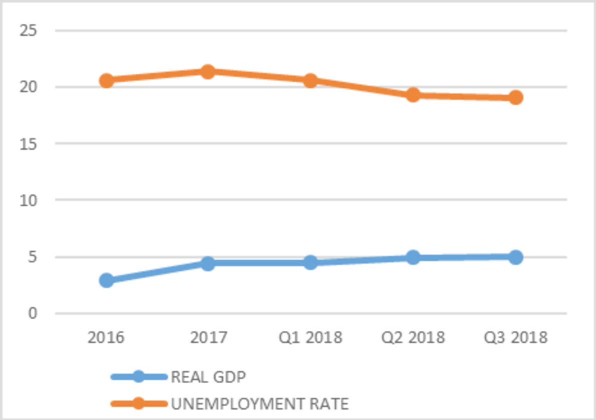


Figure 6. Real GDP and Unemployment rate in North Macedonia, 2016 - Q3 2018

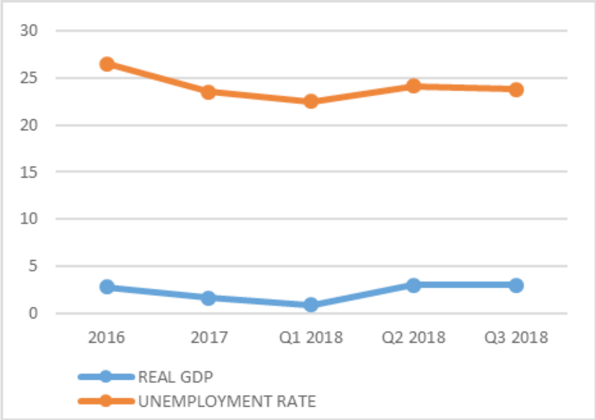


Figure 7. Real GDP and Unemployment rate in Romania, 2016 - Q3 2018.

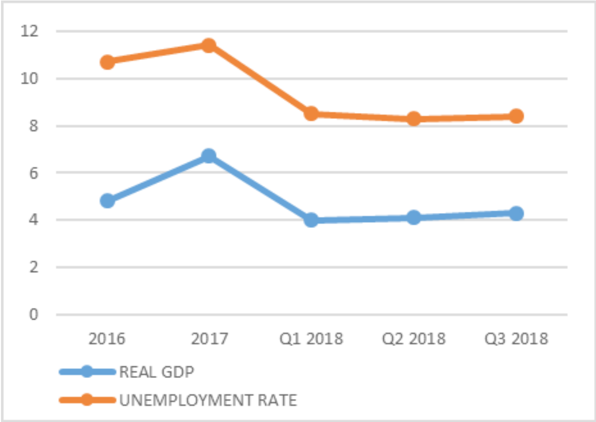


Figure 8. Real GDP and Unemployment rate in Serbia, 2016 - Q3 2018.

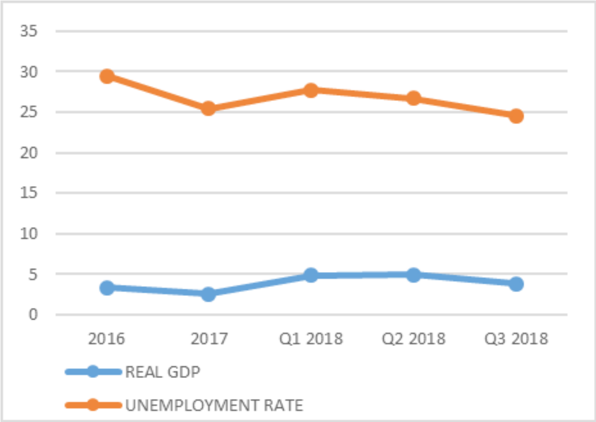
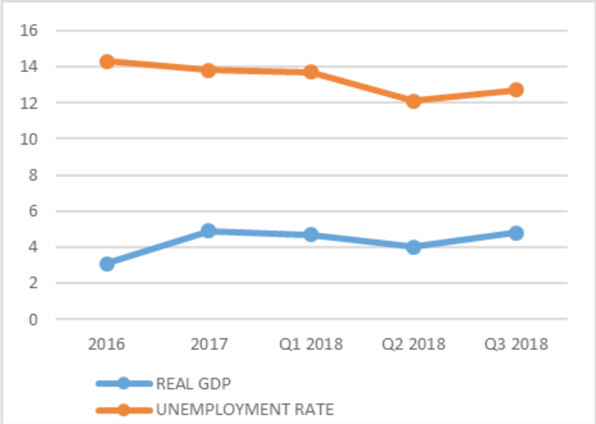


Figure 9. Real GDP and Unemployment rate in Slovenia, 2016 - Q3 2018.



the National Employment Service. When we compare countries, we see that Romania had the lowest unemployment rate. This country took ninth place in September 2018y among the EU Member States with the lowest unemployment rate. Croatia had decrease in unemployment rate between quarters in 2018y, as a result of economic recovery and new jobs created and also due to outflow of unemployed, younger persons seeking work abroad. Because of that outflow, Croatia experienced shortage of workers in construction and tourist industry. In Macedonia, which had almost the same trend of unemployed rate as Serbia, the highest job vacancy rate was in sectors of manufacturing, construction, transportation and storage; accommodation and food services; and administrative and support service activities. The high lack of employees is with high and secondary education. Slovenia's unemployment rate slowly decreased from year to year, even though it had shortage of appropriately skilled workers on the domestic market. B&H had the highest unemployment rate in all periods comparing to other countries, but when we compare their rate between years in B&H, we see that in Q3 2018. they had decrease.

In 2017y comparing to 2016y in **B&H** real GDP increased and also unemployment rate dropped. When we compare Q3 2018y to Q1 2018y we see that in first quarter real GDP was lower than in Q3 2018y and also unemployment rate was higher in Q1 2018y because lower real GDP means lower standard and because of that they had more unemployed people than in Q3 2018y.

Croatia's situation with real GDP and unemployment rate through time in 2017y comparing to 2016y was – real GDP dropped, unemployment rate dropped, effect of dropped real GDP came in Q1 2018y when unemployment rate grew comparing to 2017y. In the last period through 2018y, real GDP had almost stagnation and unemployment rate dropped. One reason behind growing real GDP was like in B&H, increased private consumption. But in B&H second reason were investments, and in Croatia were exports of goods.

In **Montenegro** in 2017y comparing to 2016y wasn't the same situation like in other mentioned countries, because when real GDP grew (2017) the unemployment rate also grew, but in the last period of time, real GDP grew and unemployment rate dropped because the effect of real GDP came faster, as it should because unemployment rate is countercyclical to real GDP.

North Macedonia had small differences between years in both indicators. Real GDP was slowly dropping from 2016y to Q1 2018y, and then it started slowly growing. Unemployment rate had the same way as real GDP.

In **Romania** we had stagnation in last quarters of 2018y. A main cause like in Croatia and B&H, is the change in private consumption, as the impact of 2017 tax cuts faded away. In September 2018 Romania was on the ninth place among the EU Member States with the lowest unemployment rate.

Looking to Figure 8. (**Serbia**), we see also different situation where real GDP in 2017y dropped, and unemployment rate dropped, comparing to 2016y. When we compare Q2 and Q3 in 2018y, we see that real GDP dropped and the last quarter, and unemployment rate also dropped. The reason for these situations is in slowing effect of the growth of real GDP. When real GDP grows, it is needed more time to have effect on unemployment rate. Awakening of the agricultural production and construction industry is the main cause of real GDP growth.

Slovenia had clear situation, where real GDP grew in 2017y comparing to 2016y, and unemployment rate in that period of time slowly dropped. Between Q1 2018y and also 2017y we have almost stagnation for both indicators. In Q2 2018y real GDP dropped from Q1 2018y and also unemployment rate dropped. Effect of dropped real GDP in Q2 2018y had effect on unemployment rate in Q3 2018y when that rate grew because of lower standard in the previous quarter.

This analysis is as mentioned on the beginning, with focus on two indicators in 7 countries, with different economies but with influence on each other. Results of these figures can be commented as retroactive effect of real GDP on unemployment rate. As we saw, in all countries the main reason on economic growth was consumption mostly private. Other reasons were exports, investments, outflow of unemployed and etc.

* All figures are compiled by authors for selected SEE countries.

PUBLISHER INFORMATION

This publication has been prepared by:

Editor: Darko Marjanović, Institute of Economic Sciences, Belgrade

Bosnia and Herzegovina: Mirza Huskić, The Institute of Economics Sarajevo

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

Montenegro: Nikola Milović, Milica Muhadinović, The University of Montenegro, Faculty of Economics in Montenegro

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

Romania: Nicoleta Sirghi (coordinator), Laura Mariana Cismas, Bogdan Dima, Gratiela Georgiana Noja, Stefana Maria Dima, Ruxandra Ioana Curea-Pitorac, ECREB - Faculty of Economics and Business Administration, West University of Timişoara

Serbia: Jelena Minović, Aleksandar Zdravković, Kosovka Ognjenović, Duško Bodroža, Aleksandra Branković, Mihajlo Đukić, Institute of Economic Sciences, Belgrade

Slovenia: Sonja Uršič, Institute for Economic Research, Ljubljana

Analysis: Đina Ivanović, Institute of Economic Sciences, Belgrade

Publishers:

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

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

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

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

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

East European Center for Research in Economics and Business (ECREB), Faculty of Economics and Business Administration, West University of Timişoara
16 J.H. Pestalozzi Street, Romania
300115, Timişoara, România

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

For the publishers:

Jovan Zubović
Muamer Halilbašić
Sanja Tišma
Zoran Janevski
Petru Ştefea
Nikola Milović
Boris Majcen

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

Technical editor: Larisa Malić

Print: Donat graf d.o.o, Grocka, Serbia

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