SEE-6 Economic Outlook

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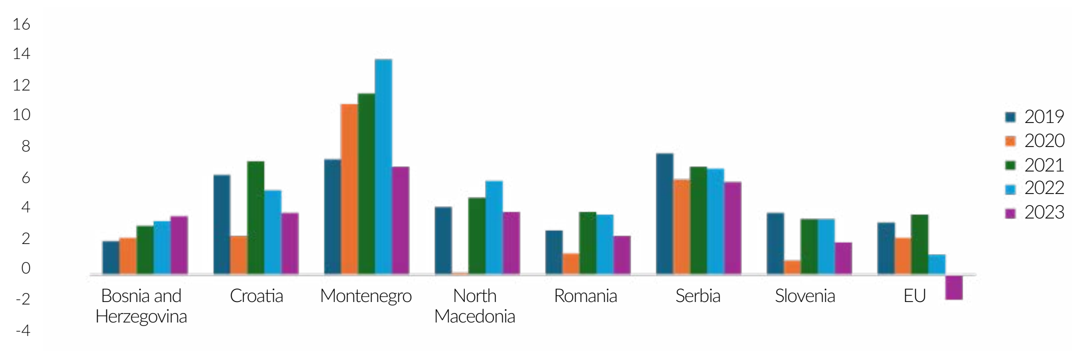
CONTENT

FOREIGN DIRECT INVESTMENT, NET INFLOWS (% OF GDP)



Source: World Bank

Vol. 10 | No. 2 | December 2024 | e-ISSN 1849-8884 | ISSN 1849-8817

BOSNIA AND HERZEGOVINA

B&H economy is slowing down; industrial production and exports have decreased significantly

B&H is losing reform momentum

The announcement from the beginning of 2024 that the EU will open accession negotiations was expected to boost reform momentum in the country. In the lead-up to the announcement, BiH adopted several state-level laws regulating money laundering and terrorism financing, conflict of interest, access to information, etc. However, before EU negotiations could formally start, more reforms were required, including judicial system strengthening and election integrity. Unfortunately, many of the planned reforms are stuck due to elevated domestic political tensions, including secessionist threats. Despite the optimism from the beginning of the year, it seems that high political risks remain, contributing to limited policy coordination at the state level and between the two entities.

It was believed that a new EU Growth Plan for the Western Balkans presented by the EC at the end of 2023 could play a catalytic role in reforms. The plan aims at boosting growth and accelerating the socio-

economic convergence of the WB region to the EU. Planned allocations for BiH in 2024-2027 were 1.2 billion EUR, conditional on successful reform implementation. After several attempts, the Reform agenda has still not been agreed upon and officially submitted to the European Commission.

The slowdown of economic activity continues towards the end of 2023

Towards the end of 2023, economic growth decelerated significantly. This was mainly due to the slowdown in exports and investment amid strong tourism and resilient domestic consumption. With inflation receding and real wages rising, private consumption rose in the second half of 2023. The labour market has tightened, with employment growth close to 1% year-on-year in December 2023. The unemployment rate stabilized around 13 % towards the end of 2023 and the first half of 2024.

In the first two quarters of 2024, slightly higher real GDP growth rates were recorded – 2,5 and 2,2 %. This was mainly due to a recovery in investment. Export contribution to GDP was negative. By activities, the largest contribution to annual growth rates, in the half of 2024, was registered in trade, and tourism-related industries. The contribution of the manufacturing industry was negative. Overall, the GDP growth rate is still below the average long-term growth rate of 3 %.

Worsening economic and industrial prospects in the EU, further aggravated by global geopolitical tensions, affected the reduction of demand in the markets of B&H's main trading partners. This is reflected in the continued decline in the volume of industrial production in the second quarter of

2024. The volume of industrial production recorded an annual decline for the eighth quarter in a row. The total decline in the volume of industrial production, for the first half of 2024, amounted to 5.7%, compared to the year before. The decline is recorded in all main activities: mining (8.3%), manufacturing (5.1%) and production and supercentage points of electricity and gas (12.4%). Within the manufacturing industry, almost all important branches recorded a decline. It was especially profound in the production of base metals (27 % in the second quarter of 2024). A modest increase in employment numbers put continuous pressure on pension systems in both entities. At the end of the year, after several rounds of negotiations, authorities in the Federation of BiH entity agreed to pay a one-time supercentage point sort to pensioners - 50 or 25 EUR, depending on the pension level.

Monetary trends in the first half of 2024 exhibit an increase in the money supercentage points. Foreign exchange reserves recorded quarterly growth. The growth trend of the required reserve continued in the second quarter of 2024, with a significant decrease in the surplus above the required reserve. High credit growth, significant growth in foreign liabilities, and a decline in foreign assets are key highlights of commercial bank's activities during the second quarter of 2024. Credit to the private sector is increasing continuously - more than 8 % year-on-year in the first half of 2024. Interest rates were slightly changed, while bank deposits continued their upward trend. Stock market traffic is still dominated by the entity's primary public debt market with unchanged yields on entity debt securities. All planned issues were realised, but there is still a higher demand for issues from both entities.

External current account deficit narrowed from 4.4 % of GDP in 2022 to 2.6 % of GDP last year, helped by lower oil prices and higher investment income and remittances. The external position is moderately stronger than the level implied by fundamentals and desirable policies. However, this trend is expected to reverse, and the current account deficit is projected to increase over 2024-25, reflecting higher interest payments on public debt and increasing domestic demand. Gross international reserves have been broadly stable in nominal terms but slowly declining in relative terms since 2021. Signes of improvement are registered in the second quarter of 2024.

External risks are moderate, related to the continuation of capital outflows, the ability of two entities to secure budget financing, and delays in bilateral and multilateral project loans and grant disbursements. In the medium term, the external position will be affected by the introduction of the EU Carbon Border Adjustment Mechanism and the ability of BiH to secure an exemption for electricity exports and to adjust in other affected sectors.

Inflation is stabilizing around 2%

Continuing the trends from the end of last year, inflation continued to decline in the first of 2024. The annual inflation rate was slightly below 2 %. Growth of consumer prices in the second quarter of 2024 was 4,5 percentage points lower compared to the same quarter of 2003. There are clear signs of alignment of movement in consumer prices in BiH and the euro area. The highest annual price growth in the second quarter was recorded in restaurant and hotel services (7.7%), other products and services (5.3%), and recreation and culture (4.3%). The price of food and non-alcoholic beverages recorded the lowest annual growth rate (0.8%) since the first quarter of 2021.

In the second quarter of 2024 producer prices recorded an annual decline, the fourth quarter in a row. An annual increase in producer prices was recorded in energy (6.4%) and durable consumer goods (3.7%), while the Intermediate Products group saw an annual decline in prices (1.1%). The decrease in prices was more pronounced in a case of non-domestic markets.

Positive labour market trends are slowing down in 2024

Somewhat positive labour market trends have slowed down in first half of 2024. Actually, labour market data seems contrasting when observing administrative and LFS data. The unemployment rate is stabilized slightly above 13 % based on LFS data. However, according to administrative data, in June of 2024 number of unemployed persons were 6,1 % lower compared to year before. Also, administrative employment data from the same month shows 0,5% increase on year-on-year basis – a total of 855 thousand of employed persons. The highest increase was recorded in service sector – mostly in retail, outsourced services, tourism related activities and public sector. Employment decrease was recorded in agriculture, mining and manufacturing, which is in a line with the downward trend in industrial production in last two years.

Increase in real wages continues, with raising pressure on competitiveness

Nominal wages have been growing at a declining rate since May 2023. Both entities have relied on public and minimum wage increases to mitigate the impact of the cost-of-living crisis. Continuing on sizable public wage increases from previous years, minimum wages in 2023 were increased multiple times. Overall, wages increase in last two years were 8 % higher in real terms, affecting competitiveness. Nominal growth of wages continued in the first half of 2024. With further stabilisation of inflationary pressures, this resulted in a significant growth of real wages. Similar trends are expected in near future, conditioned by previously signed trade union contracts, and further growth of minimum wage. The full impact of this development on economic activity is still not evident. The official inflation still is not showing signs of an increase, meaning that initial effects of input costs were absorbed by profit margins. Wage increase was recorded in all activities. The highest was recorded in Financial and insurance activities (13.3%), Professional, scientific and technical activities (11.6%), and Retail and wholesale trade (11.1%).

Table BH1 Main economic indicators

	2023				Total 2023 year	2024	
	Q1	Q2	Q3	Q4		Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	17.0	12.0	19.0	17.0	**16.0**	25.0	22.0
Real private consumption (% change, yoy)	5.0	11.0	28.0	2	**16.0**	25.0	18.0
Real government consumption (% change, yoy)	21.0	13.0	19.0	14.0	**17.0**	23.0	19.0
Real investment (% change, yoy)	156.0	1	1	-44.0	**12.0**	482.0	96.0
Industrial output (% change, yoy)	-24.0	-64.0	-4.0	-6	**-38.0**	-48.0	-64.0
Unemployment rate (LFS, % pa)	131.0	136.0	127.0	132.0	**133.0**	134.0	133.0
Nominal GDP (EUR million)	5.9	6.9	7.2	6.5	**26.5**	6.2	7.3
GDP per capita (EUR)	1.7	2.0	2.1	1.9	**7.7**	1.8	2.1
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	130.0	100.0	131.0	120.0	**120.0**	50.0	24.0
Consumer prices (% change, yoy, pa)	124.0	64.0	43.0	20.0	**63.0**	20.0	19.0
Producer prices (% change, yoy, pa)	139.0	29.0	1.0	6.0	**44.0**	-23.0	-1.0
Average gross wage (% change, yoy, pa)	156.0	147.0	114.0	107.0	**130.0**	97.0	98.0
Exchange rate (BAM/EUR, pa)	1.9	1.9	1.9	1.9	**1.9**	1.9	1.9
Exchange rate (BAM/USD, pa)	182.0	180.0	180.0	182.0	**181.0**	181.0	182.0
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	2.1	2.0	2.0	1.9	**8.0**	2.0	2.1
Exports of goods (EUR, % change, yoy)	593.0	-846.0	-670.0	-749.0	**-44.0**	-540.0	386.0
Imports of goods (EUR million)	3.1	3.4	3.4	3.3	**13.2**	3.5	3.7
Imports of goods (EUR, % change, yoy)	478.0	-380.0	-386.0	-624.0	**-25.0**	1,177.0	1,052.0
Current account balance (EUR million)	-241	-241	-241	-241	**-241**	-241	-241
Current account balance (% of GDP)	-298.0	-350.0	-151.0	-290.0	**-270.0**	-748.0	-346.0
Foreign Direct Investment net inflows (EUR million)	253	281	169	127	**830**	291	164
Foreign exchange reserves (EUR million, eop)	7.8	7.8	8.1	8.3	**8.3**	8.2	8.5
Foreign debt (EUR million, eop)	9.1	9.2	9.2	9.3	**9.3**	9.4	9.4
GOVERNMENT FINANCE							
Revenues (EUR_million)	2.1	2.3	2.3	2.4	**10.4**	2.3	2.5
Expense (EUR million)	1.9	2.1	2.2	2.6	**9.8**	2.2	2.3
Net = Gross operating balance	201	168	87	-243	**562**	171	199
Net acquisition of non-financial assets (EUR million)	17	40	51	189	**1.7**	10	52
Net lending/borrowing (EUR_million)	184	128	37	-433	**-601**	161	147
Domestic government debt (EUR million, eop)	1.0	1.2	1.3	1.4	**1.4**	1.4	1.5
Foreign government debt (EUR million, eop)	5.6	5.4	5.4	5.4	**5.4**	5.4	5.2
Total government debt (eop. % of GDP)	N/A	N/A	N/A	N/A	**322.0**	N/A	N/A
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	100.0	105.0	91.0	87.0	**87.0**	115.0	98.0
Broad money, M4 (% change, yoy, eop)	75.0	81.0	74.0	76.0	**76.0**	93.0	85.0
Total domestic credit (% change, yoy, eop)	45.0	47.0	54.0	67.0	**67.0**	83.0	92.0
DMBs credit to households (% change, yoy, eop)	56.0	57.0	65.0	74.0	**74.0**	82.0	87.0
DMBs credit to enterprises (% change, yoy, eop)	37.0	33.0	52.0	67.0	**67.0**	87.0	100.0
Money market interest rate (%, pa)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
DMBs credit rate for enterprises short-term (%, pa)	43.0	44.0	44.0	48.0	**45.0**	47.0	49.0
DMBs credit rate for households short-term (%, pa)	61.0	64.0	65.0	63.0	**63.0**	68.0	63.0

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

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

Policy assumptions and projections summary

Projected growth not enough to speed up convergence with the EU

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

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

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

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

Table BH2 Summary of projections

	2024	2025	2026
Real GDP (% change)	**2.5**	**3.0**	**3.0**
Real final consumption (% change)	2.9	3.4	3.7
Real investment (% change)	4.0	4.4	3.3
Exports of goods and services (constant prices, % change)	4.4	5.8	4.7
Imports of goods and services (constant prices, % change)	5.4	6.4	5.5
Current account balance (% of GDP)	-3.3	-3.9	-4.1
Consumer prices (% change, pa)	3.0	2.7	2.5
Exchange rate, national currency/EUR (pa)	1.9	1.9	1.9
Unemployment rate (LFS, %, pa)	N/A	N/A	N/A
General government balance (ESA 2010 definition, % of GDP)	-2.4	-2.4	-2.1
Total domestic credit (% change, eop)	N/A	N/A	N/a
Total domestic credit (% change, eop)	N/A	N/A	N/A

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

CROATIA

Strong economic growth continues throughout 2024

The economy continued to expand in 2024

Croatia's economic growth rate further picked up in 2024, especially compared to the rest of the Euro area member states, which continued to struggle with rather sluggish growth rates and recessionary pressures. In the first quarter of the year, the real growth rate of GDP reached 4.0% and continued to expand by a further 3.5% yearly in the second quarter. The first estimate for the third quarter of 2024 by the Croatian Bureau of Statistics is as high as 3.9% because of contributions of propelled private consumption due to increased wages earlier in the year and increased employment levels, growing EU-funded investments, and increased revenues from a tourist season.

These strong growth trends indicated that the projected growth rate in 2024 would likely be higher than planned in May, which led the Ministry of Finance to revise it to 3.6% in November 2024. The Croatian National Bank (CNB) envisages an even slightly higher 3.7% growth rate for 2024. Only Malta has the stronger growth projections among the EU member states, while Croatia shares second place with Cyprus.

International organizations' autumn projections of 2024 growth were also revised upwards. In its autumn economic forecasts, the European Commission projects a 3.6% growth rate in 2024. In its World Economic Outlook from

October 2024, the IMF also revised its growth anticipation for Croatia to 3.4%. The World Bank, in its Fall 2024 Europe and Central Asia Economic Update released in October 2024, envisages a growth rate of 3.5%, which is significantly higher than its earlier forecasts.

Significant factors driving economic growth

The key factors driving the expansion of economic growth in Croatia in 2024 have continued to be attributed to growing domestic demand. First and foremost, this is related to the significant increases in consumption, primarily private but also government consumption. A considerable increase in wages backs a rise in private consumption, mainly referring to the substantial rise of those in the public sector this year. The other crucial growth drivers are investments financed by the EU funds into public infrastructure and post-earthquake reconstruction, which have also continued to pick up strongly. On the other hand, the contribution from foreign demand traditionally related to tourist and hospitality services moderated and lost its steam. However, total revenues were solid due to higher prices. That came because of a weakening in foreign demand and a marked decline in tourist arrivals compared to the previous year, primarily due to increased prices compared to the recovered competitive Mediterranean markets. Furthermore, the contribution of the export of goods could have been more adequate as such exports only slightly recovered compared to a year before, primarily due to declining demand at the main export markets and further decreases in domestic industrial production.

Like in previous years, a rise in personal consumption continued to contribute dominantly to growth. In the first half of 2024, its rates significantly accelerated and reached 5.2% in Q1 and 5.9% in Q2 on the wings of increases in total employment and significant rises in nominal wages, particularly in the public sector as of March 2024. The falling inflation rates also contributed to increases in households' disposable income and consequently strengthened households' purchasing power. In addition, further expansion of consumer optimism and a steep rise in short-term household bank loans also fuelled total private consumption. The Croatian National Bank recently expressed concerns over growth strongly driven by private consumption as potentially risky for economic prosperity in the longer run. Besides that, in 2024, especially worrisome is a continuous decline of total industrial output and sluggish recovery of exports of goods, which, combined with a decrease in exports of services, especially in tourism, might jeopardize future macroeconomic balances and the performance of the economy.

Compared to 2023, government consumption decelerated substantially, especially in the first quarter of 2024, when it reached 1.4%. However, it picked up strongly in Q2 with a rate of 3.8% and will likely continue growing until the end of the year. Government projections for 2024 are as high as 4.0%, while CNB envisages 4.3%. The primary source of the growth in government consumption is attributed to a substantial increase in wages of the whole public sector in effect from March 2024. The other significant contributor to government consumption increase is the continuation of government fiscal intervention measures to mitigate the impact of high energy prices and buffer the effects of high inflation affecting the most vulnerable parts of the population. Although these measures were not as high this year as in the previous pre-election year, they remained relatively high, and international organizations often repeated the need for their fading out. The other sources of this year's increase in government consumption are attributed to the pressing demands for post-earthquake reconstruction.

An increase in total real investments, mainly backed by abundant EU funding, continued to be the second-largest driving factor of growth throughout 2024. Therefore, the growth rates of real total investments were as high as 9.2% in the first quarter and continued to increase to 11.7% in the second quarter. The estimate for the third quarter is 9.3%. The government projections for 2024 envisage that real investments will remain at a high 10.5% rate, while the analysts at the CNB project project it at 11.9%. Most of the total real investments are attributed to large construction projects financed by the EU funding in the public sector, such as public infrastructure, post-earthquake reconstruction of public buildings, and other essential construction projects (railway, roads). Such financing is what the Government has at its disposal within the National Plan of Recovery and Resilience (NPRR), both in the form of grants and very favourable loans. According to the Ministry of Finance, Croatia has disbursed 67% of grant funding and 19% in favourable EU loans within NPRR. Regarding withdrawing EU funding in 2024, Croatia has maintained its position among the leading countries in the EU.

However, EU funding has crowded out private real investments, which is a source of concern regarding future investment levels, especially after 2027, when such abundant funding is likely to decline. It is, therefore, of the utmost importance to substantially revive the levels of private investments and their contribution to total investments in Croatia to ensure future growth dynamics.

Faster recovery of imports than export of goods

After a significant contraction in 2023, exports and imports of goods partially recovered in 2024. However, this recovery has worked more in favour of the import of goods, which recovered faster and more significantly.

The recovery of imports of goods was driven by rising domestic demand, mainly related to consumption goods such as food products, home appliances, and vehicles, reflecting the increase in household purchasing power. In Q1, the import of goods increased by a modest 0.5%, while in Q2, it reached 9.8%. At the same time, the exports of goods continued to fall in Q1 by -6.8%, while a more marked recovery started in the second quarter with a growth rate of 5.6%. The growth also continued in Q3, according to first estimates. Capital goods and machinery, chemicals, and pharmaceuticals dominated the exports of goods. A more significant recovery of exports of goods in 2024 was challenged by a continuous decline in domestic industrial output and the recessionary trends at the main export markets in the EU, most prominently in Germany, Italy, and Austria, which consequently contracted the level of foreign demand for Croatian exports. For that reason, the Croatian exporters of goods have been putting extra effort into shifting their exports to other markets globally and regionally.

The value of service exports continued to increase, mainly reflecting notable increases in the prices of tourist-related services. However, the number of tourist arrivals declined compared to the previous year, signalling the limitations for further volume expansion. Nevertheless, tourist revenues in 2024 will continue to be beneficial for patching the growing negative current account balance from the international trade of goods.

The current account balance shifted from a slight surplus in 2023 to a negative zone in the first half of 2024. Reflecting a considerable gap in trade goods revenues, it had cumulatively grown to 3.7 billion EUR at the end of the first half of 2024. According to the Croatian National Bank, this is up 1.2 billion EUR compared to the same period last year. The Government projects a negative current account balance of 0.4 % for 2024.

The industrial output further declines

Industrial production is one of the sectors that was affected the most by all the cumulative negative consequences of disruptions and realignments in global supply and value chains, high inflation, particularly related to energy and raw material prices, and high interest rates causing a rise in producer's expenditures. Furthermore, the recessionary developments in the markets of leading trade partners, especially in the EU, reflected notable decreases in foreign demand for its products. On top of it, old structural weaknesses and low productivity issues surfaced and affected the performance and competitiveness of the industrial sector in the domestic market, mainly related to the manufacturing industry in Croatia.

All these resulted in a further decline in both volumes and values of industrial production in 2024 for the second year. In the first quarter, its value only slightly recovered by 0.8% compared to the same quarter of the previous year, thanking mainly for positive developments in energy production and the construction industry's recovery. However, in the second quarter, it decreased by 2.0%, according to the Croatian Bureau of Statistics. The negative trends also continued in the third quarter, likely leading to a negative growth rate for 2024.

According to Eurostat, Croatia's industrial output fell among the highest in the EU for most of 2024, with the highest monthly fall in June, when the rate reached -8.2% compared to the year before. After seven months of continuous fall, short episodes of subdued industrial growth were achieved only in July and September 2024, with rates of 1.6% and 1.0%, respectively. That short recovery was mainly attributed to a growth in capital goods and energy production due to increased demand in these specific months.

The sectors with the most significant fall in industrial output in the first two quarters of 2024 are related to the production of consumption durables and industrial intermediates facing harsher competitive pressures from imports. The total contraction of industrial output across all economic sectors for the first seven months compared to the year before is estimated at -3.4 %. Such a substantial decline was also reflected in a decline in manufacturing exports, especially in the first quarter of 2024, as well as in a slower recovery of exports than imports in the following quarters of 2024.

Positive trends in the labour market continue

The positive trends in the labour market have continued throughout 2024 reflecting the rise of demand for workers due to strong economic growth. Such a growing demand was particularly profound in tourism and related sectors, retail trade, and the booming construction sector due to high infrastructure investments and post-earthquake reconstruction. That was reflected in the continuance of growth in employment rates by 2.7% in Q1 and 3.4% in Q2. Initial estimates for the Q3 are at 3.7%. The rise of employment in public sectors such as health, education, social care, and public administration also contributed to it.

At the same time, that has led to further decreases in unemployment towards the lowest historical levels of 5.6% in Q1 and 4.6% in Q2 of 2024, according to Labour Force survey. As in previous years, the domestic supply of unemployed workers could not meet the growing demand for workers in particularly related sectors such as construction, tourism, hospitality services, and retail trade. For that reason, a significant increase in employment of foreign workers also continued in 2024 to offset the pronounced labour shortages in the most growing sectors. Recent estimates of CNB say that in 2024, about 130.000 foreign workers found a job in Croatia out of 200,000 short-term labour permits issued so far to help companies in their urgent need for workers. However, most foreign workers employed prevailingly have lower labour skills. In contrast, sectors requiring high labour skills, such as health, education, and social care, are less successful in patching their occasional labour shortages, mainly caused by the emigration of their workers to the more developed EU countries.

Other problems that surfaced are that the integration, treatment at work, and living conditions of foreign workers do not always meet the required domestic labour standards, which prompted the need for the adoption of additional regulative measures for better protection of their rights and integration into society.

Public finances expansionary stance

Compared to the very modest deficit achieved in the previous year, the fiscal balance deteriorated in the first half of 2024, reflecting mostly rising budget expenditures.

The November revision of the Budget for 2024 has shown that the initially projected deficit of 1.6% will be substantially surpassed, reaching 2.1% by the end of the year. Three sources of expenditures substantially contributed to the deterioration of the fiscal balance. The first is related to significant increases in wages of the public sector's employees in effect in March 2024. The second is related to higher investments in public infrastructure and housing post-earthquake reconstruction coming directly from the budget. The third source is the continuance of government mitigating measures for high energy prices, although they are smaller in scale than in previous years.

Budget revenues have also been rising above the projected levels in 2024, especially reflecting the increases in VAT revenues due to increased private consumption and foreign tourists' consumption due to high prices in the tourism sector. The rise in wages also contributed to increases in income tax revenues. In addition, the withdrawal of EU funding continued to expand significantly throughout the year.

The European Commission and international organizations such as the IMF and OECD expressed concerns about present expansionary public spending and recommended using increased revenues to build reasonable reserves, which could support transformative economic reforms such as the greening of the economy and digitalization. Furthermore, the present global geopolitical situation calls for prudent macroeconomic behaviour concerning the sustainability of high public spending in times of exposure to potential global shocks.

Nevertheless, the fiscal balance has been kept within the framework of Maastricht criteria. The most positive development is related to bringing down the general government debt ratio to GDP, which has been continuously declining in the first three quarters of 2024 and is projected to reach 57.4% by the end of the year, down from 61.8% % in 2023. This would be the first time Croatia has complied fully with those Maastricht fiscal criteria since joining the EU in 2013.

Inflation pressures continue easing

The decline in inflation pressures in 2024 has been continuous and notable; however, it is still much slower than in other Euro area member states. The CPI rates in the first half of 2024 decelerated to 4.8% in the first quarter and 4.2% in the second quarter. The Government projects a 3.0 CPI rate for the whole of 2024. The harmonized index of consumer prices (HIPC) rate, however, would be as high as 4.0%, according to the latest estimation of analysts of the Croatian National Bank. Most international organizations and analysts also believe it would be close to 4.0%. The continuous rise of services and food prices throughout the year has the largest share in the total increase of CPI. In contrast, energy prices have been regulated, and their contribution continues to decline, reflecting the global market developments.

There are several reasons for the relatively gradual decline in inflation. The most important is increasing demand in the domestic market, fuelled by significant increases in wages and other disposable household income, which impede a steeper fall in CPI rates. The other source of higher inflation levels than desired is the rise in prices of tourist and hospitality-related services. In general, the increase in the contribution of service prices to the CPI level has also been among the dominant driving factors of inflation in 2024.

Conversely, producer prices have been falling much steeper throughout 2024, reflecting the more profound price declines on global markets that started in the last quarter of 2023. Producer prices experienced negative growth rates in the first half of the year, with 1.7% in Q1 and 2.9% in Q2, according to the Croatian Bureau of Statistics. Such developments are reflecting further significant fall in market prices of energy as well as in raw materials and other primary commodities. Furthermore, prices of intermediate products in the world market also benefited from stabilizing global supply chains.

The interest rates declining mildly

Like in the other EU member states, as inflationary pressures continue declining, the bank interest rates fell mildly in 2024. This has stimulated further growth in the traditionally strong demand for a short-term cash loan from the household sector, propelled by increases in wages earlier in the year and by other sources of disposable household income. According to data from the Croatian National Bank, by August 2024, the new short-term cash loans to the household sector in 2024 were three times higher than the previous year's period. Such developments have led the CNB to express their concerns as that trend may lead towards over-indebtedness in the household sector, prompting the need to improve general citizens' financial literacy.

Conversely, demand for household long-term loans has remained subdued due to very high prices in real-estate sector, making such loans unaffordable for most of younger population. Demand was also limited due to the cessation of government subventions for interest rates on such loans directed to young people under 45 years of age.

The new enterprise sector loans also rose more cautiously in the first half of 2024 due to the weaker demand for financing through such loans and relatively high interest rates. Namely, despite falling in the average short-term bank lending interest rates for the enterprise sector to 5.1% in June 2024, this rate still needed to be more attractive for most of them. However, the demand for the enterprise sector's new corporate loans has gradually risen in the year's second half, reflecting expanding businesses and further declines in interest rate levels.

Table HR1 Main economic indicators

	2023				Total 2023 year	2024	
	Q1	Q2	Q3	Q4		Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	2.2	3.9	2.0	5.3	**3.3**	4.0	3.5
Real private consumption (% change, yoy)	2.3	2.2	2.7	4.9	**3.0**	5.2	5.9
Real government consumption (% change, yoy)	6.1	10.1	6.0	4.6	**7.1**	1.4	3.8
Real investment (% change, yoy)	8.7	10.6	11.4	9.9	**10.1**	9.2	11.7
Industrial output (% change, yoy)	-1.4	-1.3	-5.8	0.8	**-2.0**	-3.8	-4.5
Unemployment rate (LFS, % pa)	7.4	5.6	5.5	6.0	**6.0**	5.2	4.7
Nominal GDP (EUR million)	16,483	19,389	22,672	19,504	**78,048**	18,371	21,259
GDP per capita (EUR)	4,270	5,023	5,873	5,052	**20,239**	4,771	5,552.1
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	10.9	9.0	7.8	6.9	**8.7**	6.8	6.5
Consumer prices (% change, yoy, pa)	11.8	8.1	7.3	5.0	**8.4**	4.8	4.2
Producer prices (% change, yoy, pa)	12.0	3.7	1.9	-0,7	**4.2**	-1.7	-2.9
Average gross wage (% change, yoy, pa)	13.3	13.5	16.0	15.8	**14.6**	10.0	13.1
Exchange rate (EUR/USD, pa	1.08	1.09	1.09	1.07	**1.08**	1.08	1.07
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	4,764	4,700	4,613	5,039	**19,116**	5,525	5,952
Exports of goods (EUR, % change, yoy)	3.2	-9.3	-20.4	-8.7	**-9.6**	-6.8	5.6
Imports of goods (EUR million)	9,128	9,416	8,894	8,690	**36,129**	9,931	11,203
Imports of goods (EUR, % change, yoy)	-0.2	-4.3	-14.8	-9.0	**-7.3**	0.5	9.8
Current account balance (EUR million)	-2,816	-850	5,037	-1,051	**321**	-3,068	--1,197
Current account balance (% of GDP)	-0.9	-1.1	-0.1	1.1	**0.4**	-0.9	-0.3
Foreign Direct Investment net inflows (EUR million)	570.3	215.4	822.8	-155.4	**-1,824**	-1,584	-1,636
Foreign exchange reserves (EUR million, eop)	3,127	2,890	1,039	-1,018	**-1,018**	2,527	2,,732
Foreign debt (EUR million, eop)	56,848	56,648	62,532	63,998	**63,998**	62,096	63,281
GOVERNMENT FINANCE							
Revenues (EUR million)	7,515.5	9,055.2	9,405,1	9,739.6	**35,715.4**	8,402.2	9,460.4
Expense (EUR million)	7,753.4	8,891.2	8,423.0	11,315.2	**36,382.8**	8,616.2	10,050.9
Net = Gross operating balance	-238.1	164.0	982.1	-575.6	**-667.4**	-214.0	-590.5
Net acquisition of non-financial assets (EUR million)	11.3	512.8	-219.5	1,082.4	**94.2**	443.2	73.2
Net lending/borrowing (EUR million)	-186.7	174.4	996.8	-1,513.8	**-573.2**	-229.2	-417.3
Domestic government debt (EUR million, eop)	33,854	33,309	33,719	34,136	**34,136**	34,768	34,405
Foreign government debt (EUR million, eop)	14,555	14,631	14,250	14,126	**14,126**	14,821	14,744
Total government debt (eop. % of GDP)	69.1	66.5	64.4	61.8	**61.8**	61.0	60.1
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
Broad money, M4 (% change, yoy, eop)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
Total domestic credit (% change, yoy, eop)	9.3	9.1	8.0	7.9	**10.1**	4.8	6.0
DMBs credit to households (% change, yoy, eop)	6.3	6.6	8.1	9.5	**9.5**	10.9	11.1
DMBs credit to enterprises (% change, yoy, eop)	15.2	13.5	7.8	6.3	**10.7**	4.0	4.9
Money market interest rate (%, pa)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
DMBs credit rate for enterprises short-term (%, pa)	3.6	4.4	4.6	5.1	**4.4**	5.9	5.1
DMBs credit rate for households short-term (%, pa)	5.3	5.9	6.3	6.5	**6.0**	6.0	6.1

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

Policy assumptions and projections summary

Solid growth rates are also anticipated for 2025-2027

The official mid-term economic growth projections in 2025-2027 were corrected upwards in November 2024, while a new Fiscal Plan for 2005-2028 was adopted. The Government anticipates that the GDP growth rate will remain relatively strong in 2025, although it will slightly moderate to 3.2%, with further deceleration to 2.8% in 2026 and 2.6% in 2027.

The main uncertainty risks for realizing projected growth rates in the medium term are associated with the global geopolitical situation and its negative impacts on the worldwide economy. First of all, this is related to the prolongation of war in Ukraine as well as the escalation of further instabilities in the Middle East caused by the current Israel-Gaza conflict. Additional complications of US-China and US-Europe trade relations due to the announced introduction of heavy import duties and other protectionist measures in the US after President Trump takes office in January 2025 would significantly affect Europe's terms of trade, with a negative spillover on Croatian trade relations. The very slow recovery of the main Euro area trade partners such as Germany, Austria, and Italy anticipated for 2025 and 2026 would add to the potential risks to Croatia's projected economic growth. All these could cause protracted, sluggish recovery and intensification of recessionary pressures in the main EU trading markets, negatively impacting the Croatian economy.

Nevertheless, the projected growth rates are significantly more potent than those anticipated by the European Commission for the Euro area in November 2024. According to its Autumn Economic Forecasts, the Euro area members will grow in 2024 below expectations with an average rate of only 0.8%, followed by a more substantial recovery to a 1.3% growth rate in 2025. The European Central Bank most recently (December 2024) projected even slower growth, only 0.7% in 2024 and 1.1% in 2025. The projected average EU members' growth rate in 2024 and 2025 is only slightly higher: 0.9% and 1.5%, respectively, primarily due to better recovery in the EU member states in CEE.

The main positive policy assumptions behind the Croatian strong growth rate expectations in 2024 and 2025 are grounded in further increases in private consumption and government consumption. The Government expects that positive contribution would also come from continuously falling inflation. It envisages that in 2024, it will be at the level of 3.0%, followed by further moderation to 2.7% in 2025 and reaching 2.1% in 2026, which would be an acceptable level for the economy's health. However, high levels of consumer spending underpinned by increasing wages, which are not matched by rises in productivity, are slowing down steeper moderation of CPI levels.

Successful absorption of the available EU grants and loans within the National Recovery and Resilience Plan (NRRP) will continue to be among the dominant factors behind the substantial growth in 2025-2027. Achieving scheduled progress in reforms and investments and complying with performance indicators, Croatia reimbursed about 67% of available EU grants allocation within that funding facility and close to 20% of available loans. In short, total EU funding was a crucial factor contributing to growth, estimated to be about 6% of GDP in 2024. However, this, presently favourable situation, is also a source of serious concerns predominantly expressed by independent analysts. Namely, this generous financial source ends in 2027, and such a scale of EU funding will not likely continue in the next EU financial envelope. Therefore, future growth would need to rely more on the inner economic strength and dynamics. However, this situation is worrisome as EU funding has to a large extent crowded out private investments in the last four years.

Official forecasts predict the gradual recovery of Croatian exports of goods from a significant fall, especially in 2023, which continued on a smaller scale in 2024. Such a forecast is based on the current increase in the export of goods to the global market (including the US), which partly compensates for the fall in the main EU trading markets. However, in the medium term, the exports of goods remain limited by the potential of industrial production recovery, which is presently not encouraging and looks quite grim, reflecting the more profound structural weaknesses of the economy. At the same time, the notable moderation in exports of services in 2024 related mainly to the tourism sector signalled a new stage of potential decline of the contribution of this sector to the economic growth in 2025-2026. Several factors would likely contribute to this trend, affected mainly by declining foreign demand in the leading EU emitting markets, caused by higher prices in Croatia than at the main competitors in the Mediterranean and by the government policy efforts to reduce the number of tourists in the following years. However, notwithstanding this fact, tourism will remain an important growth driver in the next medium term.

The revival of private sector investments may increase in the medium term via FDI due to the positive impact of lowering transaction costs due to being part of the European Monetary Union and Schengen. FDI would be particularly beneficial in changing the economy's structure towards sectors like ICT, with higher value-added and better positioning in the global value chains. The Government plans to join the OECD in 2026, which may additionally ease both domestic and foreign investments, as it has a special focus on further improvements in corporate governance practices and reform of state-owned enterprises.

Furthermore, the recent upgrades in investment and credit rating of Croatia in autumn 2024 by three major credit rating agencies may also benefit the increase of private investments in the medium term. Namely, in September 2024, the Fitch rating agency increased Croatia's investment rating from 'BBB+' to 'A-,' giving it the highest investment rating for the first time and signalling a favourable investment climate to potential investors in the Croatian economy. The Fitch considers that the Croatian economy will continue to grow strongly, with an average of 3.1% in 2024-2026. Standard and Poor's rating agency followed suit in September 2024 and increased Croatia's investment and credit rating to an A- level with a positive economic outlook. Moody's agency also released a very positive view on the medium-term economic outlook for Croatia and, on that ground, in November 2024, upgraded investment and credit rating even for two places, from 'Baa2' to 'A3'. Especially positive are their views on the significant progress achieved in the decline of the public debt ratio to GDP and keeping the budget deficit within the EU Maastricht criteria, thus signalling a low credit risk to potential investors.

Based on the promising economic developments throughout 2024, international organizations envisaged the continuance of relatively strong growth and revised their growth projections upwards. The European Commission increased expectations for the Croatian growth rate in 2024 to 3.6%, followed by a slight moderation in 2025 to 3.3% and 2.9% in 2026. The World Bank projects a GDP growth rate of 3.5% in 2024 and 3.0% in 2025, slightly moderating to 2.8% in 2026. The IMF anticipates a growth rate of 3.4% in 2024, followed by a deceleration to 2.9% in 2025 and 2.6% in 2026. The OECD envisages a growth rate of 3.7% in 2024, with a slowing down to a rate of 3.0% in 2025 and 2.8% in 2026.

Table HR2 Summary of projections

	2024	2025	2026
2027Real GDP (% change)	**3.6**	**3.2**	**2.8**
Real private consumption (% change)	6.0	4.9	3.5
Real government consumption (% change)	4.3	3.2	2.4
Real investment (% change)	10.5	4.3	3.1
Exports of goods and services (constant prices, % change)	-1.2	2.0	2.5
Imports of goods and services (constant prices, % change)	4.6	4.1	2.8
Current account balance (% of GDP)	-0.4	-1.2	-1.5
Consumer prices (% change, pa)	3.0	2.7	2.1
Exchange rate, national currency/EUR (pa)*	-	-	-
Unemployment rate (LFS, %, pa)	4.9	4.7	4.5
General government balance (ESA 2010 definition, % of GDP)	-2.1	-2.3	-1.9
Total domestic credit (% change, eop)	5.3	4.5	4.2

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

MONTENEGRO

Montenegro's Economy in 2024: Insights from the First Two Quarters

The beginning and first half of the current year were marked by moderately positive economic trends. GDP increased in both quarters compared to the previous year, alongside a reduction in the inflation rate measured by the Consumer Price Index (CPI). Slight improvements were also recorded in the labour market, while the banking system maintained a notably high level of stability. In public finance, the groundwork was laid for a new fiscal reform planned for the second half of the year. On the path to European Union accession, progress was made, but political instability remains a challenge.

Political environment

The political situation in Montenegro can be characterized as highly dynamic. During the first quarter of the current year, the President of Montenegro resigned from all positions within his former party, which is currently the largest force in the Montenegrin Parliament, thereby reigniting the process of political cohabitation. On the other hand, the Government of Montenegro formally enjoys the support of more than three-fifths of the Montenegrin Parliament. However, this support comes from forces with different ideological profiles, which, in certain segments, complicates the political landscape.

In terms of European integration, the most significant progress was made at the end of June when Montenegro received a positive IBAR — a positive report on the fulfilment of interim benchmarks in the area of the rule of law. Generally speaking, there remains a very strong social and political consensus regarding EU membership. According to research, around four-fifths of Montenegrin citizens support the accession

Fighting inflation

After two fairly challenging years in terms of combating rising prices, the first two quarters of the current year have seen a lower inflation rate and gradual stabilization. On an annual basis, the end of the second quarter of the current year recorded an inflation rate of 4.1%, measured by the Consumer Price Index (CPI), and 3.9%, measured by the Harmonized Index of Consumer Prices (HICP). Since the beginning of the year, monthly, there have been slight fluctuations, with the inflation rate moving between 4% and 5%.

Compared to the corresponding data from 2023, the highest increase of 10.9% was recorded in the category of clothing and footwear, followed by housing, water, electricity, gas, and other fuels, with a 6.7% increase. On the other hand, certain stabilization was observed in the prices of food and non-alcoholic beverages, according to official data from the Statistical Office of Montenegro (MONSTAT). Producer prices of industrial products also show a degree of stabilization. According to data from the end of the second quarter, the price increase amounted to 4.1%. The mining and quarrying sector remains the dominant sector influencing these performances, with an annual growth of 1.8%.

Labour market and wages

According to data from the Statistical Office of Montenegro (MONSTAT), as of the end of June, 265,257 people were employed in absolute terms. When this figure is compared with the corresponding data from the end of the second quarter of the previous year, a decline of 5.06% in total employment is evident.

The structure of employed persons in Montenegro, viewed from the perspective of sectoral categorization, shows stable trends over a longer period. Nearly one-fifth (19.48%) of the total number of employed persons work in the wholesale and retail trade sector, as well as in the repair of motor vehicles and motorcycles. Additionally, 12.15% are employed in the accommodation and food service activities sector.

It is also noteworthy that, according to MONSTAT data, the population outside the labour force totalled 179.79 thousand people, marking an increase of 1.2% on an annual basis. In terms of gender distribution, 56.4% of the employed population are men, while 43.6% are women.

In June 2024, the average gross salary in Montenegro amounted to 1,050 EUR, while the average net salary was 838 EUR. When compared to the same period in 2023, the net salary recorded an increase of 5.4%, while a monthly increase of 0.7% was observed.

A sectoral analysis of wages shows that the highest average salaries are achieved in the financial and insurance activities sector, amounting to 1,293 EUR, as well as in the electricity, gas, steam, and air conditioning supply sector, where the average salary was 1,253 EUR. On the other hand, the lowest wages are still traditionally recorded in the administrative and support service activities sector, with an average salary of 679 EUR, and in the manufacturing sector, with an average salary of 681 EUR.

Labour market and wages

The total foreign trade of goods between Montenegro and foreign countries, according to preliminary data from MONSTAT, amounted to €2,220.00 million in the first two quarters of the current year. This volume of foreign trade did not experience significant changes, especially considering that trade increased by 0.9% compared to the previous year's corresponding period. However, the persistent and significantly negative trade balance remains an issue. During the first two quarters, merchandise exports recorded a decrease of 24.5%, while imports increased by 5.9%. Analysis of comparative data implies that the export-to-import coverage ratio was only 14.9%, representing a notable decline compared to the previous year when it stood at 20.9%.

The structure of imports and exports shows trends similar to those in previous periods. According to the Standard International Trade Classification (SITC) and data from the Statistical Office, mineral fuels and lubricants (Section 3) were the most represented in exports, amounting to €61.9 million, of which €50 million consisted of electricity exports. In terms of imports, Section 7—machinery and transport equipment—continues to dominate, amounting to a total of €493.1 million, primarily driven by road vehicle imports, which alone accounted for nearly €200 million.

The largest foreign trade partners for exports were Serbia (€86 million), Bosnia and Herzegovina (€18 million), and Switzerland (€17 million). On the import side, Montenegro primarily imported goods from Serbia (€325 million), followed by China (€229 million) and Germany (€199 million). Overall, Montenegro's foreign trade remains overwhelmingly concentrated with countries that are signatories to the CEFTA agreement.

Capital flow trends indicate that net foreign direct investment (FDI) inflows in Montenegro amounted to €245.39 million in the first two quarters of 2024. A year-on-year comparison shows a decrease of 4.69%. A 6.71% decline in the total level of foreign direct investment was also recorded. The structure of total FDI inflows maintains the previously established dynamics. More than three-fifths of the inflows relate to equity investments. Within equity investments, investments in companies and banks amounted to €59 million, investments in real estate were close to €200 million, while intercompany debt investments totalled €156 million or 37.02% of total inflows.

FDI outflows amounted to €176 million, representing a 9.38% decrease compared to the corresponding period of the previous year. Direct outflows based on investments by Montenegrin residents abroad amounted to €42.46 million.

Monetary developments

The banking system indicators continued to be characterized by a notably high level of stability and liquidity. The total balance sheet value of banks at the end of 2024 amounted to €6,707.03 million, representing an annual growth of slightly over 3% and an increase of 0.8% compared to the previous month. The primary determinant on the asset side, as expected, relates to loans, which accounted for 64.82% of total assets, followed by securities at 18.43%. On the liability side, deposits constituted 80% of the total, followed by capital at just over 12%.

In mid-year reviews of monetary indicators, special attention is always given to credit dynamics. According to official data from the Central Bank of Montenegro from June, total approved loans recorded an annual growth of 12.52%. The credit-to-deposit ratio also rose to 0.83 compared to 0.76 in June 2023. Deposits, on the other hand, also showed a slight increase of a few percentage points. The maturity structure of deposits is predominantly driven by demand deposits, which accounted for more than 83.8%. Among term deposits, the largest share is held by those with the shortest maturity period, ranging from three months to one year.

The average weighted interest rate of commercial banks in Montenegro on the total volume of approved loans was 6.12%, reflecting an increase of 0.30% compared to the previous year. In June 2024, the average weighted interest rate stood at 6.61%. The causes of this growth can be traced to an increase in the average weighted nominal and effective interest rates on newly approved corporate loans by 0.35% and 0.97%, respectively, as well as a rise in nominal and effective rates for new loans to households by 0.21% and 0.45%. However, it is worth noting that there was a slight decrease in interest rates on new loans to individuals during the year, driven by promotional loan offerings for individuals initiated by the Central Bank of Montenegro, according to officially available data.

Interest rates in microcredit financial institutions remain significantly higher. The active interest rate on total approved loans in June 2024 was 19.25%, slightly higher than in the corresponding period of the previous year. On the other hand, the average effective passive interest rate stood at 0.25%, marking a decline of 0.03% compared to June of the previous year. Comparing active and passive interest rates, the spread observed in June of this year was 6.36%, representing an increase of 0.3% over the past 12 months.

The capital market, as observed through the turnover of the Montenegro Stock Exchange, recorded a turnover of €1.64 million in June, encompassing 100 transactions and reflecting a 58% increase compared to the same period last year. Stock trading dominated the market, accounting for 93.60% of total turnover, while 6.40% was attributed to corporate bond trading. The value of the MONEX stock exchange index rose by 3.45% at the end of the second quarter compared to the same period in 2023.

Fiscal sector

Public revenues of the State of Montenegro for the period from January to June 2024 amounted to 1,497.5 million EUR, which represents 21.3% of the estimated GDP. These revenues are 90 million EUR or 6.3% higher than planned. There was also an 8.3% increase in public revenues compared to the same period of the previous year.

On the other hand, public expenditure amounted to 1,457 million EUR, representing 20.7% of GDP. It is noteworthy that public expenditure was lower than planned for this year, by 6.7%, but it was 20% higher compared to the corresponding period of the previous year. By simply comparing revenues and expenditures in the current year, a slight surplus of 42.8 million EUR was achieved. It is also important to emphasize that, excluding one-time revenues in this and the previous year, revenue growth in the current study period was 17.5% higher than in the same period of the previous year. The primary driver of revenue growth can be found in the increase in revenues from corporate income tax, which is 35% higher than planned. Growth was also recorded in personal income tax revenue, with a smaller increase in excise taxes.

As of June 30, 2024, Montenegro's total public debt amounted to 4,540.45 million EUR, representing 62.37% of GDP. Taking into account the deposits of the Ministry of Finance (including 38,477 ounces of gold), Montenegro's net public debt on June 30, 2024, amounted to 3,906.89 million EUR, or 53.67% of GDP. The total state debt (excluding deposits) as of June 30, 2024, amounted to 4,478.03 million EUR, or 61.51% of GDP. Considering the deposits, the total net state debt as of June 30, 2024, was 3,844.47 million EUR, representing 52.81% of GDP.

According to the Ministry of Finance, the debt of local self-governments as of June 30, 2024, amounted to 62.42 million EUR, or 0.86% of GDP.

The following table provides a detailed overview of the key macroeconomic indicators of the Montenegrin economy.

Table MN1 Main economic indicators

	2023				Total 2023 year	2024	
	Q1	Q2	Q3	Q4		Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	6.2	6.9	6.6	4.3	**6.9**	4.4	2.7
Real private consumption (% change, yoy)	15.5	6.4	13.9	12.7	**12.12**	7.3	12.8
Real government consumption (% change, yoy)	3.0	3.0	9.4	17.7	**8.27**	12.7	7.6
Real investment (% change, yoy)	12.6	-2.7	16.0	18.3	**13.2**	8.9	11.1
Industrial output (% change, yoy)	9.5	-1.0	9.1	7.4	**6.25**	4.2	3.8
Unemployment rate (LFS, % pa)	15.5	12.9	11.8	12.2	**13.1**		
Nominal GDP (EUR million)	1,232.2	1,689.4	2,171.6	1,753.8	**6,889.0**	1,354	1,847
GDP per capita (EUR)	1,998	2,739	3,491	2,819	**11,047**	2,173	2,964
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	10.9	11.0	13.2	11,4	**12.7**	5.3	2.8
Consumer prices (% change, yoy, pa)	13.9	8.2	7.5	4.9	**4.3**	5.5	4.1
Producer prices (% change, yoy, pa)	12.0	4.9	4.0	5.5	**6.6**	4.2	3.9
Average gross wage (% change, yoy, pa)	9.0	12.8	12.5	13.1	**12.2**	5.6	5.4
Exchange rate (BAM/EUR, pa)							
Exchange rate (BAM/USD, pa)							
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	226.81	170.38	122.7	180.9	**674.3**	150,8	287,9
Exports of goods (EUR, % change, yoy)	4.96	-13.43	-49.2	0.5	**-3.8**	31,2	24,5
Imports of goods (EUR million)	796.10	962.43	1,032.2	965.7	**3,807.6**	858,8	1,932.0
Imports of goods (EUR, % change, yoy)	26.02	2.97	0.3	7.2	**7.5**	3,9	5,9
Current account balance (EUR million)							
Current account balance (% of GDP)							
Foreign Direct Investment net inflows (EUR million)	117.82	148.52	54.03	113.24	**433.61**	117.55	127.84
Foreign exchange reserves (EUR million, eop)							
Foreign debt (EUR million, eop)							
GOVERNMENT FINANCE							
Revenues (EUR_million)	606.87	725.45	637.35	641.23	**2,609,4**	902,8	922,8
Expense (EUR million)	516.70	621.70	665.6	545.8	**2,347.1**	875,25	875,25
Net = Gross operating balance							
Net acquisition of non-financial assets (EUR million)							
Net lending/borrowing (EUR_million)							
Domestic government debt (EUR million, eop)	461.00	411.07	393,14	542,62	**542,62**	511,29	386.70
Foreign government debt (EUR million, eop)	3,619.56	3,613.40	3,593.62	3,517.29	**3,517.29**	4,156.65	4,091.32
Total government debt (eop. % of GDP)	61.60%	60.75%	60,18%	60,27%	**60,27%**	66.36%	61.51%
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
Broad money, M4 (% change, yoy, eop)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
Total domestic credit (% change, yoy, eop)	6.44	5.70	8.92	10.84	**11.9**	7.6	12.5
DMBs credit to households (% change, yoy, eop)	7.93	7.09	7.92	8.53	**8.67**	8.01	7.12
DMBs credit to enterprises (% change, yoy, eop)	4.84	2.10	1,39	3,46	**3,89**	4.43	2.10
Money market interest rate (%, pa)	N/A	N/A	N/A	N/A	**N/A**	N/A	N/A
DMBs credit rate for enterprises short-term (%, pa)	4.69	4.92	5.03	5.37	**5.00**	4.73	4.94
DMBs credit rate for households short-term (%, pa)	6.55	4.53	7.14	7.28	**6.37**	6.42	5.11

Source: Authors'calculations based on Monstat and CBCG data.

Policy assumptions and projections summary

Global geopolitical trends and internal political and economic challenges significantly complicate the implementation of economic projections. In such circumstances, the question arises as to how feasible and realistic it is to provide precise data on the movement of key macroeconomic indicators. The following table provides an overview of Montenegro's macroeconomic future, based on current data from relevant institutions.

Table MN2 Summary of projections

	2024	2025	2026
Real GDP (% change)	**3.8**	**3.0**	**2.9**
Real private consumption (% change)	2.2	1.5	1.7
Real government consumption (% change)	0.3	0.2	0.3
Real investment (% change)	1.6	1.5	1.3
Exports of goods and services (constant prices, % change)	3.6	3.4	3.1
Imports of goods and services (constant prices, % change)	3.8	3.1	3.2
Current account balance (% of GDP)	-9.9	-8.9	-10.2
Consumer prices (% change, pa) (average)	3.0	2.5	2.5
Exchange rate, national currency/EUR (pa)	N/A	N/A	N/A
Unemployment rate (LFS, %, pa)	13.7	12.9	12.0
General government balance (ESA 2010 definition, % of GDP)	N/A	N/A	N/A
Total domestic credit (% change, eop)	7.9	6.8	7.3

NORTH MACEDONIA

Balancing inflationary pressures and economic recovery: North Macedonia's path forward

Economic growth challenges

The ongoing consequences of the Ukraine war were largely responsible for the major political issues in Europe in 2023. In addition, challenges associated with migration, the cost of living, the fight against climate change, and the emergence of populism and nationalism also influenced the political landscape. The EU's internal cohesion, the task of managing diverse political and cultural tensions, as well as the ongoing effects of Brexit, had a significant impact on shaping the political discourse across Europe.

This period was also demanding and challenging for North Macedonia, not only politically but also economically. The political stage was marked by preparations for the 2024 presidential elections, heated political debates over EU integration, economic difficulties, and ongoing disputes with Bulgaria. The agreement reached in 2022 with Bulgaria to overcome

historical disputes and enable the start of negotiations for EU accession remained a contentious issue.

In 2023, North Macedonia was predicted to have a GDP growth rate of around 2.4%. This was lower than in previous years, largely due to the economic headwinds faced by the country, such as inflation, energy price hikes, and slower global economic growth. Despite this, the actual growth rate in 2023 was less than what was predicted, ending up at just 1%.

Private consumption remains a key contributor to economic growth, though it has been influenced by the high cost of living and inflation. Private consumption in 2023 grew by 2.4%, despite inflation being 9.4%, as measured by the consumer price index. A positive trend in private consumption continued in the first half of 2024.

Government consumption grew by 0.6% overall in 2023 due to the negative trend in the first three quarters of the year (Q1:-4.3%, Q2:-1.1%, and Q3:-3%). In the fourth quarter, government consumption increased by 5.6%, marking a positive trend that persisted into the first half of 2024 (Q1/2024: 2.4% and Q2/2024: 3.5%). This development was expected, considering the political circumstances, including the one hundred days of the administrative government before the elections and the constitution of the new government afterward.

Investments in 2023 showed negative growth, with -22.3% (year-on-year) in Q1 and -20.5% in Q4. The remarkable increase of 23.6% in the first quarter of 2024 was a result of the government's prioritization of infrastructure development, including roads, energy projects, and public buildings. These large-scale investments drove overall growth in fixed capital formation. Unfortunately, this boost was not enough to sustain the positive trend, and investments dropped by 1.7% year-on-year in the second quarter of 2024.

North Macedonia's industrial sector, which is heavily reliant on exports, experienced mixed performance. Global supply chain disruptions, combined with energy constraints, affected industrial output in certain sectors such as automotive and textiles. Industrial output in Q1/2024 decreased by 3.1% year-on-year and the most concerning issue is that it continued to decline in the second quarter of the year, dropping by 6.9% year-on-year.

The services sector, particularly trade, finance, and telecommunications, showed resilience and contributed positively to GDP growth. The agricultural sector faced challenges due to climate conditions and inflation but remained a significant part of the economy, especially in rural areas.

Sectoral restructuring of the employment

The LFS data on the labour market in the Republic of North Macedonia shows that in 2023, the activity rate of the working-age population (15-64) marginally increased from 65.2% in Q1 to 65.6% in Q3, before dropping back to 65.2% in Q4. A similar trend is evident for the employment rate (15-64), which rose from 56.5% to 57.1% in Q3, only to decrease to 56.6% in the last quarter of 2023. The unemployment rate declined from 13.4% (Q1) to 12.9% (Q3), while slightly increased to 13.2% in Q4. After these slightly unfavourable changes in the last quarter of 2023, the situation began to improve in 2024. By Q2, the activity and employment rates had risen to 65.7% and 57.4%, respectively, while the unemployment rate decreased to 12.6%. A similar dynamic of changes was observed for both men and women.

In the first quarter of 2024 compared to the same period in 2023, significant employment growth was evident in the Agriculture, Forestry, and Fishing sector (34.5%), driven by a notable rise in informal employment, particularly among self-employed persons (63.6%) and unpaid family workers (49%). Employment in the Accommodation and Food Service sector grew by 11%, influenced by increased post-pandemic recovery and tourism activities. Similarly, employment in the Administrative and Support Service Activities sector rose by 14.7%, potentially linked to outsourcing trends and a recovery in business operations. In contrast, there was a significant decline in employment in the Electricity, Gas, Steam, and Air Conditioning Supply sector (-23.9%), mostly due to shifts in energy demand or increased automation. Employment in the Information and Communications sector also dropped significantly (-21.5%), potentially reflecting slowing momentum in the tech industry or layoffs.

These changes suggest a shift in employment dynamics, with growth concentrated in sectors offering informal or flexible employment opportunities, while traditional or formalized industries face challenges. This pattern highlights the importance of monitoring informal labour trends and their implications for economic stability and workers' protection.

Navigating fiscal challenges: expanding spending amid rising debt

In the 2023 Budget, total revenues were realized at 98.25% of projections, while total expenditures reached 98.08%. The budget deficit, initially projected at 4.6% of GDP, was realized at 4.45%. Public debt showed a slight reduction by the end of the year, standing at 58.15% of GDP.

For 2024, total revenues are projected to reach 6 billion euros, reflecting a 10% increase compared to 2023. Expenditures are planned at 6.6 billion euros, representing an approximate increase of 5.8% compared to the previous year. Consequently, the planned budget deficit is set at 3.4% of projected GDP. Following the formation of the new government in June, budget revisions were introduced, resulting in increased revenues, expenditures, and a rise in the deficit by more than 1%.

As of October, public revenues had been realized at 78.94%, expenditures at 75.84%, and the deficit at 53.76%. Public debt stood at 56.9% of GDP, largely due to underachievement in capital expenditures, which amounted to only 41.97% of planned levels. However, with new borrowing exceeding 500 million euros, public debt is expected to surpass 60% of GDP by the end of the year.

Financial resilience and green financing trends in banking sector

The banking sector in North Macedonia remained stable and well-capitalized in 2023, maintaining solid liquidity levels. A restrictive monetary policy was consistently applied throughout the previous years. The interest rate on Central Bank bills increased from 4.75% at the end of 2022 to 6.3% by the end of 2023. However, by the year 2024, the rate began to decline, reaching 5.8%, signalling a gradual easing of monetary policy aimed at securing price stability.

Profitability indicators showed a positive trend, with Return on Average Assets (ROAA) reaching 2% at the end of 2023 and rising to 2.5% by mid-2024. Return on Average Equity (ROAE) also demonstrated growth, increasing from 16.1% at the end of 2023 to 19.8% by mid-2024, reflecting the banking sector's continued strong profitability.

As of the first two quarters of 2024, the share of "green" loans in total bank loans in North Macedonia stood at 4.5%, marking a notable increase from 2.5% in 2020. This growth in green financing has been primarily driven by the corporate sector, with the Central Bank actively supporting its development within the banking industry.

The Non-Performing Loans (NPLs) to total loans ratio remained stable throughout 2023, standing at 2.8% and 2.7% in the respective quarters. In the first two quarters of 2024, the ratio slightly increased to 2.9% and 3%, indicating a modest rise but still reflecting solid asset quality. Data from the banking sector further indicates that banks' capital positions remain stable, with a capitalization ratio of 19% in mid-2024. The quality of the loan portfolio is currently assessed as favourable, while profitability levels remain robust. These indicators point to a well-capitalized and financially stable banking sector, maintaining strong asset quality and profitability.

Inflation trends: challenges and recovery

North Macedonia experienced high inflation throughout 2023, which reached 9.4%, primarily driven by energy prices and food costs, similar to trends in other European countries. This inflationary pressure reduced consumer spending and business activity, thereby limiting overall economic growth.

The energy crisis, exacerbated by the war in Ukraine, continued to affect North Macedonia, particularly with increasing electricity and fuel prices. While the country made efforts to mitigate the impact, energy costs remained a substantial burden on both businesses and households, restricting growth potential. Despite these challenges, domestic consumption remained a key driver of the economy, though it was influenced by the high cost of living and inflation. The government introduced support measures to ease the economic strain on households, but their effectiveness was constrained by the broader external economic environment. Inflation began to ease in the first half of 2024, dropping to 3.4% and 3.9% in the first and second quarters, respectively.

Current account moved back into deficit

In 2023, economic stability in the external sector was demonstrated by a rare surplus in the current account (0.7% of GDP), driven by a reduced trade deficit and significant inflows from secondary income. However, the first half of 2024 indicated a weakening of these positive trends, with a current account deficit emerging. In the first quarter of 2024, the current account deficit amounted to EUR 185 million (-1.3% of GDP), primarily due to a significant drop in exports, particularly in the automotive and metal processing industries, as well as reduced private transfers. The second quarter recorded an improvement, with the deficit narrowing to EUR 111.7 million (-0.8% of GDP), supported by better performance in the services sector. Significant contributions came from construction services, which shifted from a deficit to a surplus, as well as from telecommunications and IT services, which show consistent structural growth. However, the trade deficit continued to rise, driven by decreased exports in key industries.

The financial account in 2023 reflected stable net inflows, particularly from direct investments and loan arrangements. By contrast, the first half of 2024 presented mixed results in the financial account. While direct investments maintained a positive contribution, outflows were noted in other areas, such as portfolio investments and trade credits. These developments highlight the need for careful management to mitigate risks associated with external financing, despite the stability of foreign exchange reserves.

Table NM1 Main economic indicators

	2023				Total 2023 year	2024	
	Q1	Q2	Q3	Q4		Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	1.4	0.9	1.0	0.9	**1.0**	1.2	2.3
Real private consumption (% change, yoy)	0.7	2.8	2.8	3.3	**2.4**	2.0	1.3
Real government consumption (% change, yoy)	-4.3	-1.1	-3.0	5.6	**-0.6**	2.4	3.5
Real investment (% change, yoy)	-22.3	-4.8	-18.7	-20.5	**-16.7**	23.6	-1.7
Industrial output (% change, yoy)	0.1	2.7	-0.8	0.6	**0.7**	-3.1	-6.9
Unemployment rate (LFS, % pa)	13.3	13.1	12.8	13.0	**13.1**	12.9	12.5
Nominal GDP (EUR million)	3038.2	3177.9	3288.9	3529.1	**13655**	3241.4	3493.9
GDP per capita (EUR)	1660.2	1736.6	1797.2	1928.5	**7462**	1771.3	1909.0
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	N/A	N/A	N/A	N/A	**3.6**	N/A	N/A
Consumer prices (% change, yoy, pa)	16.1	11.2	7.7	3.4	**9.4**	3.4	3.9
Producer prices (% change, yoy, pa)	10.6	5.6	-1.7	-2.8	**2.7**	-1.4	1.2
Average gross wage (% change, yoy, pa)	-2.5	3.8	6.9	13.1	**5.4**	12.8	9.9
Exchange rate (BAM/EUR, pa)	61.67	61.56	61.51	61.50	**61.56**	61.62	61.52
Exchange rate (BAM/USD, pa)	57.52	56.55	56.51	57.19	**56.94**	56.74	57.15
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	1822.34	1860.69	1755.13	1798.30	**7236.47**	1613.68	1742.53
Exports of goods (EUR, % change, yoy)	9.4	-1.6	-5.4	-5.8	**-1.1**	-11.5	-6.4
Imports of goods (EUR million)	2442.83	2457.09	2389.15	2581.50	**9870.57**	2430.58	2486.24
Imports of goods (EUR, % change, yoy)	-3.0	-11.8	-12.4	-6.9	**-8.6**	-0.5	1.2
Current account balance (EUR million)	78.6	-126.7	229.1	-125.4	**55.6**	-195.1	-111.7
Current account balance (% of GDP)	0.6	-0.9	1.7	-0.9	**0.4**	-1.3	-0.8
Foreign Direct Investment net inflows (EUR million)	129.5	119.7	40.1	198.8	**488.1**	251.6	204.4
Foreign exchange reserves (EUR million, eop)	4159.2	4189.7	3901.7	4538.4	**4538.4**	4287.1	4337.5
Foreign debt (EUR million, eop)	11051.8	11383.9	11068.5	11356.1	**11356.1**	11799.0	11875.0
GOVERNMENT FINANCE							
Revenues (EUR_million)	66009	65140	66326	79669	**277127**	69418	74882
Expense (EUR million)	69533	85199	70313	93521	**318574**	84085	84068
Net = Gross operating balance	-3524	-20059	-3987	-13852	**-41447**	-14667	-9186
Net acquisition of non-financial assets (EUR million)	-5131	-16413	-4774	-15135	**-41453**	-6809	-5768
Net lending/borrowing (EUR_million)	1607	-3646	787	1283	**6**	-7858	-3418
Domestic government debt (EUR million, eop)	2726.9	2804.2	2957.8	3085.1	**3085.1**	3300.5	3391.3
Foreign government debt (EUR million, eop)	4475.0	4450.0	3978.6	4171.0	**4171.0**	4243.4	4250.8
Total government debt (eop. % of GDP)	49.6	50.0	47.8	53.1	**53.1**	51.5	52.1
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	9.5	14.5	8.0	11.0	**11.0**	10.8	8.6
Broad money, M4 (% change, yoy, eop)	6.9	13.9	9.6	11.1	**11.1**	12.1	10.0
Total domestic credit (% change, yoy, eop)	6.6	6.5	5.8	5.1	**5.1**	6.1	6.4
DMBs credit to households (% change, yoy, eop)	6.8	6.4	6.4	6.7	**6.7**	6.8	7.1
DMBs credit to enterprises (% change, yoy, eop)	6.2	6.5	5.1	3.3	**3.3**	5.4	5.8
Money market interest rate (%, pa)	N/A	N/A	3.7	4.0	**3.9**	4.1	N/A
DMBs credit rate for enterprises short-term (%, pa)	5.2	5.5	5.5	5.1	**5.4**	4.4	4.3
DMBs credit rate for households short-term (%, pa)	3.0	3.0	3.6	3.6	**3.5**	3.9	4.0

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

Policy assumptions and projections summary

North Macedonia's economic projections reflect expectations of moderate recovery and growth acceleration, supported by structural reforms and investment initiatives. The average growth rate is forecasted to reach 1.8% in 2024, with projections increasing to 2.5% in 2025 and 3% in 2026. Meanwhile, inflation is expected to rise to 3.5% in 2024, before gradually decreasing to 2.8% in 2025 and 2% in 2026. These figures highlight a cautiously optimistic outlook for the country's economic trajectory following recent challenges.

Growth is anticipated to be driven by public investment projects, such as infrastructure development under the Corridor 8 and 10d initiatives, along with improvements in domestic consumption and export performance. These projections, however, depend on successful management of challenges such as inflation, labor market issues and regional political uncertainties. Enhanced fiscal discipline and policy support are expected to further stabilize and boost the economy.

According to available employment projections[1], in 2027 the labour force participation rate is expected to reach 60%, while the unemployment rate (15-64 age group) is predicted to drop to 11%. At the same time, the employment rate of young people (15-24) should rise to 22%, with the unemployment rate falling to 26%. One of the prerequisites for achieving the above-mentioned positive changes in the labour market is maintaining a favourable fiscal position for job creation. It is also necessary to align the employment policy with the educational, macroeconomic, investment and social policies, in order to improve the employment both in terms of quantity and quality.

The new fiscal strategy for the period 2025-2029 anticipates a fiscal policy aimed at fostering the conditions for a new cycle of economic growth, through significant public capital investments, gradual fiscal consolidation, and maintaining a moderate debt level. Total revenues are projected to reach around 36% of GDP, with expenditures at 39%. The deficit is expected to increase gradually starting next year, while public debt is forecast to rise from 66.4% of GDP in 2024, before steadily decreasing and falling below 60% of GDP by 2029.

In the coming years, North Macedonia's monetary policy will further focus on maintaining price and financial stability, with inflation expected to slow down. The banking sector will face challenges in promoting green finance to support climate change mitigation and energy efficiency projects. Digitalization will continue to enhance banking efficiency and customer service. Additionally, an increase in credit growth is anticipated for both businesses and households, with banks expected to support this demand while managing credit risk.

During the forecast period, net exports are unlikely to play a significant role in driving economic growth. This outlook reflects slow economic recovery

1 National Employment strategy 2021-2027, Ministry of Labour and Social Policy of the Republic of North Macedonia, p. 72

in key export destinations, particularly Germany, coupled with rising import levels required to support the anticipated expansion in investment activities.

The current account, which has recently shifted to a deficit, is expected to face increased pressure. This is attributed to a worsening merchandise trade deficit and a slow-paced recovery in remittance inflows, consistent with modest economic growth in major remittance-sending countries. However, these challenges are expected to be partially mitigated by a projected rise in the surplus from services, particularly boosted by growth in tourism and IT-related sectors.

Table NM2 Summary of projections

	2024	2025	2025
Real GDP (% change)	**1.8**	**2.5**	**3.0**
Real private consumption (% change)	1.2	1.4	2.6
Real government consumption (% change)	8.4	1.8	0.5
Real investment (% change)	5.1	5.1	5.2
Exports of goods and services (constant prices, % change)	3.0	5.2	5.6
Imports of goods and services (constant prices, % change)	3.2	4.0	4.6
Current account balance (% of GDP)	-1.8	-2.0	-2.0
Consumer prices (% change, pa)	3.5	2.8	2.0
Exchange rate, national currency/EUR (pa)	N/A	N/A	N/A
Unemployment rate (LFS, %, pa)	13.0	12.1	11.8
General government balance (ESA 2010 definition, % of GDP)	-4.8	-4.1	-3.4
Total domestic credit (% change, eop)	N/A	N/A	N/A

Sources: International Bank for Reconstruction and Development / The World Bank, The Macro Poverty Outlook (MPO), October, 2024, available at: https://documents1.worldbank.org/curated/en/099159410152416219/pdf/IDU179a996931951814a7118f441949e95955ac6.pdf and European Commission, Directorate-General for Economic and Financial Affairs, European Economic Forecast, Autumn 2024, EUROPEAN ECONOMY, Institutional Paper 296, November 2024

ROMANIA

Romania's economic growth decelerates in early 2024, while fiscal and political risks rise

Weaker Economic Activity in the First Half of 2024 Continues Downward Trend

Romania ended 2023 with moderate economic growth of 2.4%, decelerating from 4.0% in 2022, according to the latest revised data. At the beginning of 2024, expectations for economic growth ranged between 3.0% and 4.0%, signalling a potential rebound. The IMF forecasted an economic growth of 3.8%, while the European Commission advanced a pessimistic figure of 2.9%. The Romanian authorities estimated growth at 3.4%, positioning themselves in the middle of the range.

In the first half of 2024, the dynamics of economic activity fell below expectations, continuing the downward trend of the previous year. GDP grew by approximately 0.7% compared to the same period of the previous year. Granularly, the first and second quarters of 2024 brought annual growth rates of about 0.5% and 0.9%, respectively. Factors influencing economic growth included expansionary fiscal policy, a less accommodative monetary policy, weak external demand, and a widening gap between exports and imports.

Demand-Side Drivers of Economic Activity: Positive Consumption vs. Negative Trade and Inventory Impacts

On the demand side, economic activity was supported by the positive contribution of final consumption, with significant differences between household and government consumption, as well as gross fixed capital formation. Changes in inventories and net exports exerted a negative influence. These trends were visible in both quarters. In the first quarter, household consumption contributed 2.5 percentage points (pps) to economic growth. This trend accelerated significantly in the second quarter, with a contribution reaching 4.4 pps. The impact of government consumption was mixed and variable, detracting from -0.8 pps in the first quarter, but rebounding to +0.3 pps in the second. Gross fixed capital formation contributed positively to economic growth, adding 1.4 pps points and 0.8 pps in the first and second quarters, respectively. However, compared to 2023, the contribution of gross fixed capital formation to economic growth is slowing down. If this trend continues, the decline in investment may indicate a contraction in economic activity in the coming quarters. The change in inventories made a minor negative contribution of 0.1 pps. Net exports were the main factor dampening the positive momentum of consumption and investments. In the first quarter, net exports negatively contributed by approximately 2.5 pps to economic growth. This contractionary impulse intensified in the second quarter, reaching 4.5 pps. In both quarters, the positive contribution of household consumption to economic growth was practically cancelled out by the negative impact of net exports.

Supply-Side Insights: Modest Contribution of Gross Value Added and Key Role of Net Taxes on Products

On the supply side, the data show that gross value added made a minor contribution to economic growth, with net taxes on products playing a more significant role. In the first quarter, the contribution of gross value added was zero. The IT sector and the entertainment, culture, recreation, repair of household goods, and other services sectors were standout performers, each contributing with 0.2 pps to economic growth. The positive effect was cancelled out by industry (-0.2 pps) and the sector of professional, scientific and technical activities, administrative and support service activities. In the second quarter, gross value added contributed with 0.5 pps to the GDP growth of 0.9%. Agriculture, forestry and fishing and professional, scientific and technical activities individually contributed 0.3 pps to growth. Conversely, industry, IT and real estate transactions reduced this effect. The IT and construction sectors, which were pillars of economic growth in previous years, entered contractionary territory.

Favorable Labor Market Conditions Highlighted by Real Wage Growth in Early 2024

Labour market conditions remained generally favourable during the first half of 2024. At the end of June, the average number of employees had increased by 0.5% compared to the same period in the previous year, while job vacancies declined by approximately 12%. The unemployment rate fell, reaching 5.0%, down from 5.6% a year earlier. Notably, the most positive indicator was real wage growth. Throughout the first half of the year, the annual wage growth consistently outpaced the annual inflation rate, nearly doubling it each month. On average, net wages rose by approximately 13.6%, while the average inflation rate stood at 6.2%. This significant real wage growth emerged as a key driver of economic expansion, primarily through its positive impact on household consumption.

Disinflationary Trend Resumes in 2024, Bringing Annual Inflation Down to 4.9%

In December 2023, the annual inflation rate decreased to 6.6%, continuing the disinflationary trend observed throughout the year. However, the first part of 2024 saw a reversal of this trend, with the annual inflation rate rising to 7.4% in January and remaining above the year-end level during the first quarter. This increase was primarily driven by an upward revision of some reduced VAT rates, higher fuel excise duties, and a positive annual change in crude oil prices. In the second quarter of 2024, the disinflationary trend resumed. As a result, the annual inflation rate fell to 4.9% at the end of June, largely due to favourable developments in utilities prices.

Despite a decline in the first quarter of 2024, the GDP deflator remained elevated. By the end of the second quarter, the GDP deflator had reached 11.3%, 0.8 pps lower than at the end of 2023. In the first half of the year, the primary driver of the deflator's increase was labour costs, with a smaller contribution from taxation. The persistent positive gap between the GDP deflator and the inflation rate can be attributed to a stronger rise in the prices of domestic products compared to imported goods.

Stable Interest Rates and Increased Liquidity Mark the First Half of 2024

In the first half of 2024, the central bank maintained the reference interest rate, which had last been adjusted in January 2023. This status-quo strategy aims to support the disinflationary trend by keeping interest rates elevated for a prolonged period. Notably, Romania is the only EU Member State in the region that has not yet initiated a cycle of interest rate cuts. This decision was driven by the persistently high inflation rate. Money market conditions remained accommodative. Additionally, compared to December 2023, the liquidity excess increased. In the first quarter of 2024, the average daily balance of the central bank's deposit facility was approximately 50.1 billion RON, up from 45 billion RON in

December 2023. Similar levels were maintained in the second quarter of 2024, with the daily average reaching 50 billion RON in June.

Stable Banking System Amid Low Financial Intermediation in Romania

The banking system remains stable. The liquidity coverage ratio reached 286% at the end of the first quarter, significantly exceeding the EU average of approximately 167%. Similarly, the solvency ratio, although slightly lower by 0.7 pps compared to 2023, remained at a healthy level of 22.9% at the end of the first quarter. This is around 3.0 pps above the EU average and about 6.0 pps higher than the overall capital requirement. These liquidity and capital adequacy figures indicate a strong capacity to absorb negative shocks. From a profitability standpoint, the first-quarter 2024 data show continued solid performance. In the first quarter, the return on assets remained around 2%, while the return on equity was approximately 20%. The quality of the loan portfolio remained favourable, with the non-performing loan ratio standing at 2.4% at the end of the first quarter of 2024, 0.3 pps lower than at the end of 2023. It is important to note that these strong indicators are achieved in the context of low financial intermediation—Romania has one of the lowest ratios of banking assets to GDP among EU Member States. Moreover, the dynamics of non-government credit were aligned with the inflation rate, suggesting, from a real perspective, stagnation.

Fiscal Policy Challenges: Budget Deficit Reaches 3.6% of GDP Mid-2024

Fiscal policy has been a key source of economic uncertainty. Budget execution in the first half of the year continued to show a large budget deficit, deviating from the forecasts of both the European Commission and the Ministry of Finance. At the end of the first half, the budget deficit reached 3.6% of GDP, approximately 70% of the deficit projected by the Ministry of Finance for 2024. This unfavourable outcome is expected to worsen in the second half of the year, influenced by uncertainties regarding social assistance spending. The 2024 electoral cycle, which includes European, local, parliamentary, and presidential elections, adds further pressure on public spending. Under the new EU governance framework and Romania's excessive deficit procedure, closing 2024 with a high deficit will necessitate a larger downward adjustment path in the following years. This could lead to political noise and social tensions, negatively affecting economic activity.

The equity market has maintained its upward trajectory since 2023, when it posted an annual return of approximately 35% in dollar terms. At the end of the first half of 2024, the annual return stood at around 15%, outperforming markets in Prague (5%), Sofia (7.5%), Warsaw (10.5%), and Budapest (12%). This strong performance was primarily driven by favourable developments in the energy, utilities, and financial sectors.

In contrast, the sovereign bond market underperformed. By the end of the first half of the year, sovereign bond yields had risen by 66 basis points compared to the end of 2023, indicating a decline in bond prices. Key factors contributing to this performance include the slower disinflationary trend, the maintenance of the benchmark interest rate, and the higher-than-expected budget deficit. On a positive note, demand for sovereign bonds in the domestic market remained robust. For instance, in the first half of 2024, the bid-to-cover ratio for domestic bond issuances was 1.4, reflecting demand that outpaced supply. Although the bid-to-cover ratio slightly declined compared to the previous year, Romania still had the highest sovereign yield among EU Member States, standing at 6.96% at the end of the first semester.

As in previous years, the currency market remained stable. In the first half of the year, the exchange rate between the national currency and the euro fluctuated within a narrow range, from a low of 4.9665 in March to a high of 4.9773 in February. The central bank's informal commitment to maintaining exchange rate stability served as the key factor anchoring this limited variation.

Rising Current Account Deficit: From 7.1% to 8.9% in Mid-2024

In the first half of 2024, the current account deficit widened by approximately EUR 3.1 billion compared to the same period in 2023, reaching EUR 12.2 billion. Consequently, the current account deficit as a share of GDP increased from 7.1% at the end of the first half of 2023 to 8.9% in the first half of 2024. Both the goods and services balances contributed to this trend. The goods balance deficit widened by around EUR 2 billion, as exports declined while imports rose. The unfavourable export performance was also influenced by economic stagnation in Germany, Romania's main trading partner. Although the services balance remained positive, the surplus decreased by about EUR 1 billion.

Table RO1 Main economic indicators

	2023				Total 2023 year	2024	
	Q1	Q2	Q3	Q4		Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	1.5	2.7	3.2	2.1	**2.4**	2.0	0.8
Real private consumption (% change, yoy)	2.5	3.8	2.7	3.0	**3.0**	5.7	7.6
Real government consumption (% change, yoy)	6.5	4.7	8.6	5.5	**6.3**	-3.4	0.3
Real investment (% change, yoy)	15.3	14.7	11.2	17.0	**14.5**	9.0	1.5
Industrial output (% change, yoy)	-3.8	-4.8	-5.1	-4.9	**-4.9**	-2.7	-2.1
Unemployment rate (LFS, % pa)	5.7	5.6	5.5	5.5	**5.6**	5.3	5.3
Nominal GDP (EUR million)	64,522	75,472	86,843	97,353	**324,189**	70,386	84,569
GDP per capita (EUR)	3,390	3,960	4,560	5,100	**17,010**	3,690	4,440
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	15.6	10.6	10.9	14.1	**12.8**	8.1	11.3
Consumer prices (% change, yoy, pa)	15.0	10.7	9.2	7.1	**10.4**	7.1	5.3
Producer prices (% change, yoy, pa)	20.7	7.9	-2.3	-4.8	**5.4**	-6.7	-1.3
Average gross wage (% change, yoy, pa)	12.1	12.8	13.4	14.5	**13.2**	16.7	15.8
Exchange rate (BAM/EUR, pa)	4.9189	4.9481	4.9493	4.9696	**4.9465**	4.9735	4.9751
Exchange rate (BAM/USD, pa)	4.5839	4.5435	4.5484	4.6214	**4.5743**	4.5824	4.6192
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	23,820	23,606	22,860	22,807	**93,093**	22,990	23,277
Exports of goods (EUR, % change, yoy)	8.1	3.8	-5.1	-1.2	**1.3**	-3.5	-1.4
Imports of goods (EUR million)	30,624	30,134	29,947	31,357	**122,042**	29,653	31,708
Imports of goods (EUR, % change, yoy)	4.8	-2.8	-10.9	-2.5	**-3.2**	-3.2	5.2
Current account balance (EUR million)	-4,040	-5,365	-6,658	-6,540	**-22,603**	-4,347	-7,566
Current account balance (% of GDP)	-6.3	-7.1	-7.7	-6.7	**-7.0**	-6.2	-8.9
Foreign Direct Investment net inflows (EUR million)	2,587	1,343	1,130	1,527	**6,587**	2,095	1,124
Foreign exchange reserves (EUR million, eop)	53,229	53,418	59,238	59,770	**59,770**	64,279	64,392
Foreign debt (EUR million, eop)	108,611	113,780	116,584	121,026	**121,026**	128,664	131,773
GOVERNMENT FINANCE							
Revenues (EUR_million)	22,194	27,702	26,249	33,189	**109,334**	25,456	31,928
Expense (EUR million)	27,648	31,442	30,525	40,904	**130,519**	33,364	36,139
Net = Gross operating balance	N/A	N/A	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**	N/A	N/A
Net lending/borrowing (EUR_million)	-5,454	-3,740	-4,277	-7,715	**-21,186**	-7,908	-4,211
Domestic government debt (EUR million, eop)	69,123	69,240	72,940	77,410	**77,410**	82,733	83,402
Foreign government debt (EUR million, eop)	75,432	76,782	79,697	80,096	**80,096**	87,273	89,542
Total government debt (eop. % of GDP)	49.2	49.2	49.0	48.8	**48.8**	51.6	51.1
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	-6.0	-4.5	-2.5	2.8	**2.8**	5.5	6.7
Broad money, M4 (% change, yoy, eop)	8.2	9.7	10.1	10.5	**10.5**	10.6	9.7
Total domestic credit (% change, yoy, eop)	10.2	6.4	4.5	6.4	**6.4**	4.7	6.7
DMBs credit to households (% change, yoy, eop)	2.1	0.1	0.0	1.4	**1.4**	3.3	5.9
DMBs credit to enterprises (% change, yoy, eop)	16.9	11.6	7.8	10.3	**10.3**	5.1	5.7
Money market interest rate (%, pa)	7.1	6.6	6.4	6.3	**6.6**	6.1	6.0
DMBs credit rate for enterprises short-term (%, pa)	8.4	7.6	7.7	7.7	**7.8**	7.6	7.1
DMBs credit rate for households short-term (%, pa)	17.8	13.5	10.1	12.2	**13.4**	12.5	10.4

Conventional abbreviations: pa - period average, eop – end of the period, yoy – year on year, EUR- euro, RON - Romanian leu, DMB – deposit money bank.

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

Policy assumptions and projections summary

Economic Slowdown in 2024 with Growth Acceleration Expected in 2025-2026

Data for 2024 confirm a slowdown in economic activity. According to the European Commission's Autumn Forecast, GDP growth is projected at 1.4%, approximately 1.0 pps lower than in 2023 and below initial expectations for the year. Provisional data indicate that GDP growth for the first three quarters of 2024 was 0.8% compared to the same period in 2023. Additionally, data for Q3 revealed a contraction of 0.1% compared to the previous quarter. Considering these developments and the heightened uncertainty in Romania in the final months of 2024, the balance of risks leans towards a GDP growth rate falling short of the European Commission's forecast of 1.4%. Looking ahead, both international institutions and Romanian authorities foresee an acceleration in economic growth for 2025 and 2026. The European Commission forecasts GDP growth of 2.5% for 2025. This expected acceleration is underpinned by robust investment growth, moderate advances in private consumption, and a return of export growth to positive territory. However, several risks, coming also from an international adverse environment, could undermine these positive assumptions.

Economic Growth Forecasts at Risk from European Funds, Fiscal Stance, and Political Uncertainty

Public investment is expected to remain high, at around 7% of GDP, heavily reliant on European funds from the Multiannual Financial Framework (MFF) 2021-2027 and the Recovery and Resilience Facility. However, challenges persist. For the MFF, the absorption rate was nil in the first 10 months of 2024. Regarding the National Recovery and Resilience Plan, the third payment request, submitted in December 2023, remains unvalidated by the European Commission and the timing of reforms, milestones, and targets is significantly delayed. With the NRRP's implementation deadline set for 2026, the risk of decommitted funds is substantial.

In previous years, Romania benefited from favourable investor sentiment and strong demand for sovereign bonds. However, political noise and heightened uncertainty in late 2024 have dampened investor confidence, which could constrain economic growth in 2025. Furthermore, the country's high twin deficits negatively affect both public and private debt, increasing external vulnerabilities. In line with the EU's new governance framework and Romania's National Medium-Term Fiscal-Structural Plan, 2025 will bring significant fiscal consolidation. This will likely be achieved through a combination of higher taxation, the elimination of certain tax exemptions, and stricter controls on public spending. While necessary, these restrictive fiscal measures could negatively impact consumption and investment, potentially exacerbating public dissatisfaction and eroding confidence in government institutions. Over the past three years, Romania's political landscape has been relatively stable. However, the most recent parliamentary elections revealed a high fragmentation of results. Moreover, in an unprecedented decision, presidential elections were cancelled and postponed to 2025. These developments are likely to negatively affect households and investor sentiment. Restoring public confidence in governance and implementing balanced economic and social policies will be crucial to mitigating these risks.

Table RO2 Summary of projections

	2024	2025	2026
Real GDP (% change)	**1.4**	**2.5**	**2.9**
Real private consumption (% change)	5.1	2.3	2.8
Real government consumption (% change)	3.8	-0.6	0.9
Real investment (% change)	5.4	6.7	7.4
Exports of goods and services (constant prices, % change)	-2.0	2.2	2.4
Imports of goods and services (constant prices, % change)	4.9	3.2	3.1
Current account balance (% of GDP)	-8.3	-7.6	-6.9
Consumer prices (% change, pa)	5.5	4.2	3.3
Exchange rate, national currency/EUR (pa)	4.98	5.03	5.09
Unemployment rate (LFS, %, pa)	5.5	5.5	5.4
General government balance (ESA 2010 definition, % of GDP)	-8.0	-7.9	-7.9
Total domestic credit (% change, eop)	N/A	N/A	N/A

Source: European Commission – Autumn Forecast, November 2024

S E R B I A

The Republic of Serbia demonstrated resilient economic growth in H1 2024

The Republic of Serbia's economic health in 2024 is a mixed picture – throughout the year's initial six months the country has managed to maintain stable growth, bolstered by the rising private sector employment and wages, the fortified consumer and investor trust, the robust foreign direct investment inflows, and an unprecedented accumulation of foreign exchange reserves; while, conversely, it has struggled to address a range of challenging issues, including the inflation-induced erosion of lower-income households' purchasing power, the widening of fiscal deficits, the deceleration in economic activity among key trading partners, the energy production system fragility, the elevated borrowing costs for both citizens and businesses, the labour shortages in vital sectors, the regional political tensions, as well as the standstill in the EU integration process.

According to the National Bank of Serbia's latest available data, the Republic of Serbia's economic performance, as reflected in the real GDP growth rate, recorded a commendable 4.3% year-on-year increase in 2024's initial six-month interval (with the first and the

second quarter marking growth of 4.6% and 4.0%, respectively). This solid performance bolsters the International Monetary Fund's forecast for the year, which anticipates real GDP growth to settle around 3.8%.

Domestic demand and investment activity propelled GDP growth in H1 2024

Observed from the production side, the primary catalyst of growth was the services sector (excluding trade), contributing 1.7 percentage points to the second quarter's GDP performance. From the perspective of aggregates of GDP use, domestic demand and investment activity stood out as the main growth-driving forces. Domestic demand – particularly private consumption, fueled by a rebound in real household incomes, recorded 4.6% year-on-year growth in the first semester of 2024, contributing 3.2 percentage points to the overall GDP growth. Meanwhile, government consumption, fueled by growth in expenditures for public sector employees and the procurement of goods and services, recorded 4.1% year-on-year growth in the first semester of 2024, contributing 3.8 percentage points to the overall GDP growth. On the investment front, the country made strides with ambitious infrastructure projects in transportation, energy, and utilities, alongside high-profile initiatives like the "Leap Into the Future – Serbia EXPO 2027" programme. As a result, investment activity surged with an impressive 8.0% year-on-year growth in 2024's initial six-month interval, contributing 1.8 percentage points to the overall GDP growth.

Furthermore, the National Bank of Serbia's data also indicates that the Republic of Serbia's nominal GDP at the end of 2024's first semester attained EUR 18,929 million, marking a significant increase of 9.7% relative to the end of the prior year's first semester. Finally, the GDP per capita remained robust at the end of 2024's first six-month interval (EUR 2,870), experiencing a notable year-on-year increase of 9.9%.

The mining and processing industry drove industrial production growth in H1 2024

The growth of industrial production, according to the National Bank of Serbia's representative estimation, amounted to 2.4% year-on-year in the first half of 2024. This growth was driven by heightened activity in both the mining and processing industry – mining production rose by 10.6% year-on-year in 2024's first semester (primarily due to the accelerated growth in metal ore extraction and production in the "Other mining" sector), the production volume in the processing industry increased by 2.8% year-on-year in 2024's first semester (with production growth recorded in 13 out of 24 processing industry branches, and with the largest positive contributions coming from the rise in the production of computers, metal products, and the food industry); while, conversely, agricultural production in 2024's first semester decreased by 3.9% year-on-year (due to adverse weather conditions and lower than expected wheat/certain fruit varieties yields).

Unemployment dropped and wages gained momentum in H1 2024

According to the Labour Force Survey's data on the Republic of Serbia's labour market dynamics, a total of 2,899,700 people were employed, 257,800 were unemployed, while 2,484,400 people aged 15 and older were outside the labour force in the second quarter of 2024. The unemployment rate stood at 8.2%, reflecting a decrease of a 1.2 percentage point compared to the first quarter of 2024, and a 1.4 percentage point drop year-on-year. The number of unemployed individuals decreased by 41,300, while the number of people outside the labour force increased by 8,700. Observing the regional context, the unemployment rate fell across all regions in the second quarter of 2024 compared to the previous quarter – in the Belgrade region it declined from 6.5% to 6.3%, in the Vojvodina region from 9.6% to 7.6%, in the Šumadija and Western Serbia region from 9.1% to 7.8%, and in the Southern and Eastern Serbia region it declined from 13.5% to 12.0%.

As the Statistical Office of the Republic of Serbia's representatives claim, in the first half of 2024, favourable trends were also evident with respect of average wages. The nominal net wage averaged RSD 96,579 (EUR 824), reflecting a 15% year-on-year increase, with both the public and private sectors experiencing nearly identical wage growth. The median wage rose by 15.6% year-on-year, while the minimum wage increased by 17.8%, averaging RSD 74,225 and RSD 46,973, respectively. As for wage growth by sector, the highest year-on-year increase was seen in the processing industry, where the average nominal wage grew by 16.3%, followed by the hospitality industry (15.9%), and transport and storage (15.6%). Remarkably, nearly all economic sectors experienced a double-digit year-on-year increase in average wages, with the exception of professional, scientific, and technical services, which saw a more modest rise

(9.3%). Additionally, average nominal wage growth was recorded in public sector-dominated areas such as education (18.1%), public administration (13.8%), as well as healthcare (13.6%).

Prices, wages, and exchange rates

Inflation followed a downward trend in the first two quarters of 2024. In May, inflation was back within the target tolerance band of 3 ± 1.5% for the first time in the last 3 years. At the end of the Q2 quarter, inflation stood at 3.8%. This decline was the result of falls in all key inflation components, with the largest contribution coming from lower food prices. Core inflation also recorded a notable decline, falling from over 11% in March of the previous year to 5% at the end of Q2. Producer prices increased by 2.1% in the first quarter and by 2.8% in the second quarter. The Serbian dinar remained stable against the EUR in the first two quarters and remained at the level of the beginning of the year with a slight nominal appreciation of 0.1%. At the same time, due to the strengthening of the EUR against the dollar on the international markets, the dinar appreciated nominally by 2.2% against the dollar in the second quarter compared to the start of the year. The average gross wage at the end of Q2 amounted to RSD 132,290.00, while the average net wage was RSD 95,804. The growth in gross wages from January to June 2024 compared to the same period of the previous year was 14.8% in nominal terms and 9.3% in real terms. The average net wage also increased by 14.7% in nominal terms and 9.2% in real terms.

Inflation is projected to remain within the target range over the next three years. Year-on-year inflation is expected to gradually slow down, aligning with the central target value by the end of next year. This trend will be supported by restrictive monetary policies, anchored short- and medium-term inflation expectations, lower import inflation, and declining oil prices in line with future market trends. Additionally, wage growth in line with productivity increases is expected to contribute to reducing core inflation and bring it in line with overall inflation.

The current account gap widened due to rising imports and acceleration of the investment cycle

According to the National Bank of the Republic of Serbia, the country's current account deficit more than doubled in the first half of 2024 compared to the same period in 2023, surpassing EUR 1.1 billion (or 3.2% of GDP). This negative trend was primarily attributed to higher imports followed by substantial dividend outflows and reduced government transfers from abroad. The rise in imports, in turn, reflected stronger domestic consumption and investment activity. With the expected acceleration of the investment cycle, characterized by increased imports of equipment and intermediate goods, the current account deficit is forecast to reach around 4% of GDP in 2024 and approximately 5% of GDP in the following years.

Despite the significant increase in the current account deficit, it was fully offset by foreign direct investment (FDI) inflows. In the first six months of 2024, FDI inflows reached nearly EUR 2.4 billion (EUR

2.0 billion net), marking an 8.8% year-on-year increase. A substantial portion of these inflows originated from EU countries (EUR 1,007.4 million) and Asia (EUR 745.8 million). Among individual countries, China led with EUR 697.9 million, followed by the Netherlands (EUR 527.8 million), Luxembourg (EUR 312.3 million), and the United Kingdom (EUR 284.9 million).

Total trade slowed down, reflecting weakening exports and a modest increase in imports

Data from the Statistical Office of the Republic of Serbia indicates that the slowdown in goods trade observed in earlier periods persisted into the first half of 2024. Year-on-year, total trade grew by just 0.7%, reaching EUR 33.4 billion. Exports of goods showed minimal growth, increasing by only 0.1% year-on-year, while imports recorded a slightly higher rise of 1.3%. The modest export performance was largely driven by a significant 65% year-on-year decline in electricity exports. Meanwhile, the manufacturing sector, traditionally a key contributor to export growth, recorded a modest increase of only 2.4%. These declines were partially offset by substantial growth in the exports of agricultural products (up 52%) and the mining sector (up 5%). On the import side, the slight increase was primarily attributed to higher imports of capital and consumer goods, while energy imports saw a decline. The combination of rising imports and weakening exports resulted in a widening trade deficit, which reached nearly EUR 4.3 billion—5.6% higher than in the same period of 2023. The year-on-year ratio of export coverage of imports remained largely unchanged at 77%.

Analysis of the trade structure by Standard International Trade Classification (SITC), in accordance with the data of the Statistical Office of the Republic of Serbia, revealed that in the first half of 2024, in terms of exports, Machinery and transport equipment and Manufactured goods classified chiefly by material were the main sections, with a share of 30.0% and 21.8%, respectively. On the imports side, the main sections were Machinery and transport equipment (25.1% of total imports of goods), Manufactured goods classified chiefly by material (17.0%), Chemicals and related products, n.e.s (13.8%), and Commodities and transactions not classified elsewhere in the SITC (13.4%).

The EU countries remain leading trade partners of Serbia, while bilateral trade relations with China are deepening

The EU countries remained Serbian main trade partners, accounting for 62.8% of its exports and 57.7% of its imports during the observed period. Broken down by country, Germany (15.0%), Bosnia and Herzegovina (6.3%), Italy (6.1%), China (6.0%), and Romania (4.5%) were the top destinations for Serbian exports of goods. On the import side, the leading trade partners were Germany (13.4%), followed by China (13.0%), Italy (7.1%), Turkey (5.2%) and Hungary (4.9%).

Notably, China's position as an export destination for Serbia improved significantly over the previous period. Serbian exports to China nearly doubled year-on-year, rising from EUR 513.2 million in 2023 to EUR

877.3 million in 2024. This surge highlights the growing importance of China in Serbia's trade dynamics.

The entry into force of the Free Trade Agreement between Serbia and China on July 1, 2024, is expected to further boost Serbia's exports to China in the coming months. The agreement provides Serbian exporters with preferential access to the Chinese market, creating new opportunities for trade expansion. Furthermore, it is likely to encourage diversification of exports, which have primarily been dominated by copper and copper ores, accounting for about 90% of Serbia's total exports to China. The inclusion of other products, such as agricultural goods, processed foods, and manufactured goods, could significantly enhance the trade relationship and reduce dependency on raw materials.

Table SRB 1 Main economic indicators

	2023				Total 2023 year	2024	
	Q1	Q2	Q3	Q4		Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	0.9	1.6	3.6	3.8	**2.5**	4.6	4.0
Real private consumption (% change, yoy)	0.0	-0.7	1.4	2.6	**0.8**	4.4	4.7
Real government consumption (% change, yoy)	-5.1	-1.6	1.8	5.9	**0.3**	3.6	4.5
Real investment (% change, yoy)	2.1	3.7	4.1	5.2	**3.8**	7.5	8.5
Industrial output (% change, yoy)	2.8	0.5	3.7	2.8	**2.5**	3.2	1.6
Unemployment rate (LFS, % pa)	10.0	9.6	9.0	9.1	**9.4**	9.4	8.2
Nominal GDP (EUR million)	15,239	17,260	17,879	19,136	**69,514**	16,799	18,929
GDP per capita (EUR)	2,300	2,610	2,700	2,890	**10,500**	2,550	2,870
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	11.4	14.0	12.3	17.3	**18.2**	2.5	5.5
Consumer prices (% change, yoy, pa)	16.2	13.7	10.2	7.6	**7.6**	5.0	3.8
Producer prices (% change, yoy, pa)	5.5	1.2	2.2	1.6	**1.6**	2.1	2.8
Average gross wage (% change, yoy, pa)	9.2	16.1	14.9	-4.9	**14.8**	18.9	11.2
Exchange rate (BAM/EUR, pa)	117.29	117.23	117.20	117.17	**117.17**	117.14	117.05
Exchange rate (BAM/USD, pa)	107.56	107.82	110,75	105.87	**105.87**	108.69	109.52
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	7,088	7,102	6,759	6,980	**27,930**	6,971	7,301
Exports of goods (EUR, % change, yoy)	15.3	4.1	-0.9	-2.3	**3.7**	-1.7	2.8
Imports of goods (EUR million)	8,847	8,622	8,003	9,062	**34,534**	8,508	9,149
Imports of goods (EUR, % change, yoy)	1.3	-9.8	-8.1	-2.4	**-4.8**	-3.9	6.0
Current account balance (EUR million)	-162	-404	-208	-1,037	**-1,810**	-367	-798
Current account balance (% of GDP)	-1.1	-2.3	-1.2	-5.4	**-2.6**	-2.2	-4.2
Foreign Direct Investment net inflows (EUR million)	781	1,245	965	1,550	**1,228**	1,080	929
Foreign exchange reserves (EUR million, eop)	23,782	24,840	26,275	27,863	**27,863**	24,942	27,507
Foreign debt (EUR million, eop)	43,528	44,318	44,763	41,895	**45,391**	45,653	48,088
GOVERNMENT FINANCE							
Revenues (EUR_million)	773	904	839	957	**3,473**	880	1,034
Expense (EUR million)	705	731	751	898	**3,086**	802	848
Net = Gross operating balance	68	173	88	58	**388**	78	186
Net acquisition of non-financial assets (EUR million)	93	103	117	255	**569**	96	134
Net lending/borrowing (EUR_million)	-25	70	-29	-197	**-181**		
Domestic government debt (EUR million, eop)	11,125	11,204	10,283	10,791	**10,791**	10,868	10,880
Foreign government debt (EUR million, eop)	24,127	24,541	25,178	25,362	**25,362**	25,474	27,307
Total government debt (eop. % of GDP)	53.37	51.97	49.54	48.48	**48.48**	47.67	48.93
MONETARY INDICATORS							
Narrow money, M1 (% change, yoy, eop)	10.8	15.9	19.4	22.0	**22.0**	20.1	22.2
Broad money, M4 (% change, yoy, eop)							
Total domestic credit (% change, yoy, eop)	3.26	2.00	-1.96	-0.14	**-0.14**	0.27	4.04
DMBs credit to households (% change, yoy, eop)	4.19	2.60	1.60	1.12	**1.12**	2.57	4.81
DMBs credit to enterprises (% change, yoy, eop)	1.79	0.25	-0.31	2.41	**2.41**	2.79	7.29
Money market interest rate (%, pa)	4.67	5.22	5.46	5.54	**5.23**	5.56	5.51
DMBs credit rate for enterprises short-term (%, pa)	6.26	6.81	7.16	7.45	**6.92**	7.22	7.17
DMBs credit rate for households short-term (%, pa)	9.15	9.77	10.00	9.09	**9.50**	9.73	9.22

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

Mid-term shift to the expansive fiscal policy

Following the announcement of the program "Leap into the Future – Serbia EXPO 2027", which envisages an investment plan worth 17.8 EUR billion in the next 4 years to fund infrastructural projects, a gradual shift to expansive fiscal policy in the mid-run has occurred. The belated draft of Fiscal Strategy for 2025 including projections for 2026 and 2027 revealed that the Government decided to postpone implementation of the recently adopted new fiscal rules on deficit and debt constraints from 2025 to 2029. The Fiscal Strategy draft abandoned the plan to reduce the government deficit to 1.5% of GDP in 2025 and stabilize it at that level in subsequent years, effectively postponing the implementation of the fiscal rules. Instead, it was projected that the fiscal deficit for the 2025–2027 period would amount to slightly over 2% of GDP. Subsequently, the budget revision for 2024 increased the budget deficit for that year to 2.7% of GDP. Eventually, the revised Fiscal Strategy foresees a significant increase in public expenditures in the coming years, which resulted in a consequent increase in the planned government deficit for the 2025–2027 period to 3% of GDP annually.

Despite the shift to the expansive fiscal policy, fiscal solvency doesn't seem to be jeopardized at least in the mid-run. The credit rating agency S&P Global Ratings has improved Serbia's credit rating to BBB-, moving Serbia to investment grade for the first time in history. Also, the majority of the fiscal indicators improved after the recent revision of the national accounts by the Serbian Statistical Office has considerably revalued nominal GDP upward. For instance, after GDP revaluation, public debt to GDP has dropped from 52.3% to 48.4% in 2023. Nevertheless, the Government's practices of non-transparent public investment prioritization, spending of current budget reserves and exemptions from the Public Procurement Law, which were discussed in the previous issue of outlook, continue to seriously undermine the soundness and credibility of fiscal and budget planning.

Recovery of credit activities following the decline in interest rates

After the prolonged period from July 2023 to June 2024 in which the key policy rate was kept stable at 6.5%, in June 2024 the NBS Executive Board decided to slightly decrease the key rate to 6.25%. Our expectations from the previous outlook issue about gradual relaxation of monetary policy turned true since the NBS has continued to decrease key policy rate down to 5.75%, 75 basis points lower than in June. Following the decline in key policy rates, other interest rates have also decreased during the third quarter of 2024. By the end of 2024 Q3, the money market interest rate was around 4.8%, only 70 basis points lower than its value in 2024 Q2. The average short-term interest rate on new loans to households, that was continuously above 9% in 2023 and the first half of 2024, dropped to 8.8% in 2024 Q3. A similar trend is also observed with the average short-term interest rate on new loans to enterprises, which in 2024 Q3 dropped to 6.8%, which is almost 40 basis points lower than in 2024 Q2. A decline in interest rates leads to accelerated recovery of credit activities in the second and third quarters of 2024, both by households and enterprises. In 2024 Q3, y-o-y changes in credit to households and enterprises were 7.6% and 6.3%, respectively. The trend of gradual relaxation of monetary policy is expected to extend in 2025.

Policy assumptions and projections summary

The overall shift towards expansive fiscal policy combined with the big revision of the national accounts leads to the substantial revision of the macroeconomic projections. The expansive fiscal policy and high level of public investment (around 7.5% in 2025, among the highest in Europe) is reflected in the upward revision of the GDP growth rate in 2025, from the forecasted 3.8% in the previous outlook issue to 4.2%. As usual, the main contributor to GDP growth will be private consumption, followed by investments in fixed assets.

The fiscal expansion will also boost private consumption and import, widening the current account deficit above 5% in the next two years. Despite the worsening of the current balance, the EUR/RSD exchange rate is expected expected inflow from foreign investments is sufficient to preserve the exchange rate without jeopardizing foreign exchange reserves.

On the monetary side, in the upcoming period, we expect further relaxation of inflationary pressures due to the effects of the monetary policy tightening, a slowdown in imported inflation, weakening global cost pressures, weak external demand, and the expected further decline in inflation expectations. On the fiscal side, despite shifting to an expansive policy, we are expecting that the government will continue with the usual practice of overestimating fiscal deficits. Therefore, fiscal deficits in the period 2024-2026 will most likely be lower than those forecasted by the revised Fiscal Strategy for 2025-2027.

Table SRB2 Summary of projections

	2024	2025	2026
Real GDP (% change)	**3.8**	**4.2**	**4.0**
Real private consumption (% change)	4.5	4.1	3.2
Real government consumption (% change)	3.1	2.2	2.2
Real investment (% change)	2.9	7.0	7.0
Exports of goods and services (constant prices, % change)	4.4	5.9	6.9
Imports of goods and services (constant prices, % change)	8.0	6.5	6.8
Current account balance (% of GDP)	-4.4	-5.2	-5.4
Consumer prices (% change, pa)	4.8	3.4	3.0
Exchange rate, national currency/EUR (pa)	117.1	117.1	117.1
Unemployment rate (LFS, %, pa)	8.5	8.5	8.5
General government balance (ESA 2010 definition, % of GDP)	-2.5	-2.5	-2.5
Total domestic credit (% change, eop)	N/A	N/A	N/A

Source: Fiscal Strategy for 2025-2027, author's estimate

SLOVENIA

Economic growth slowed by weak external demand and falling investment

GDP growth moderates

Slovenia's GDP growth continued to decelerate in the first half of 2024. While it expanded by 2.2% year-on-year in the first quarter, year-on-year growth slowed to 0.7% in the second quarter. The slowdown in GDP growth in the first part of 2024 was driven by a collapse in investment growth and a negative contribution from the external balance, as import growth significantly outpaced export growth. On the other hand, growth in general government final consumption expenditure increased significantly in the first half of the year, and household consumption was also higher than a year earlier. The latest data point to a moderate rebound in economic growth in the third quarter, with GDP rising by 1.4% year-on-year. An important factor in this recovery was a rebound in exports of goods and services.

Strong growth in government consumption

In the first half of 2024, government consumption was the main driver of GDP growth. Having already picked up significantly in the last quarter of 2023, it strengthened further in the first quarter of 2024 (6.5% year-on-year) and accelerated in the second quarter, growing by 12.6% year-on-year. The strong growth in government consumption was partly driven

by increased spending on health care related to the reclassification of supplementary health insurance as a compulsory contribution to health care, as well as post-flood reconstruction.

Household consumption picks up

After slowing significantly in 2023 as inflation eroded households' purchasing power, household consumption picked up this year amid falling inflation and a buoyant labour market. Although the year-on-year increase was moderate (2.0%), household consumption growth was robust in the first three quarters of the year and, together with government consumption, supported GDP growth.

Investment growth turned negative

The strong investment activity observed in 2023, mainly driven by buoyant construction investment, slowed significantly in 2024. Year-on-year growth in gross fixed capital formation fell to 1.0% in the first quarter of 2024 and turned negative in the second quarter (-1.5%), for the first time since the end of 2020. The latest data point to a sharp decline in gross fixed capital formation in the third quarter of this year (-8.2%).

Year-on-year growth in construction investment, which already started to slow in the second half of 2023, fell to 4.4% in the first quarter of 2024 and turned negative in the second quarter (-3.9%). The decline in year-on-year growth was observed in both residential and other buildings and structures. For the latter, year-on-year growth turned negative in the second quarter and depend in the third quarter amid weaker government investment. Year-on-year growth in residential construction remained positive in the first half of this year but slowed considerably and the latest data show a year-on-year decline in the third quarter.

Investment in machinery and equipment fell in the first quarter of this year (-2.6%) compared to a year earlier, as capacity utilisation in the manufacturing sector continued to fall. In the second quarter, it remained at the same level as a year earlier, as investment in transport equipment accelerated. However, the latest data for the third quarter again point to a year-on-year decline in investment in machinery and equipment driven by a year-on-year decline in investment in transport equipment.

Despite the decline in investment, the large positive contribution from re-stocking of inventories, which firms had run down intensively in previous quarters, contributed to a year-on-year increase in gross capital formation in the first half of 2024.

Decline in industrial production eases

The decline in industrial production observed throughout 2023 continued in the first half of 2024 amid concerns about the uncertain economic situation, coupled with low external demand and labour shortages. Electricity, gas, steam and air conditioning supply continued to show the largest year-on-year decline, but the rate of decline has slowed in the first six months of this year: while production almost halved year-on-year in January, the year-on-year decline slowed to around -5.0% in June.

During the first six months of this year, manufacturing output was highly volatile across the different groups of manufacturing activities. Significant year-on-year increases in output were recorded in the manufacture of wearing apparel and the manufacture of other transport equipment, while output fell in the energy-intensive manufacture of other non-metallic mineral products and the repair and installation of machinery and equipment, as well as in some low-technology industries such as textiles, leather, wood and furniture. On average, manufacturing output remained at a similar level to the first half of last year (-0.2%).

Slowdown in external trade decline

In the first half of 2024, external trade continued to decline on a year-on-year basis amid weak activity in Slovenia's main trading partners and unfavourable price and cost competitiveness of Slovenian exporters. However, the decline was much smaller than in the second half of 2023, as only exports of services continued to decline, while exports of goods remained at a similar level as in the previous year. The latest data for the third quarter of this year show a rebound in exports of goods, but this was mainly due to the very low base of the previous year and a higher number of working days. Imports of goods rebounded sharply in 2024, growing by 0.9% and 5% year-on-year in the first and second quarters respectively, and continued to grow solidly in the third quarter, reflecting robust growth in domestic consumption, including the build-up of business inventories.

Exports of services fell in the first half of 2024 compared with the same period a year earlier. In the first quarter, they were down by 3.8% year on year, and by 1.5% in the second quarter of 2024. On the other hand, imports of services increased in the first half of 2024 compared with the same period a year earlier, mainly due to increases in transport and travel services.

The decline in relative prices in the second half of 2023 and at the beginning of this year has somewhat improved the sharply deteriorated price competitiveness of Slovenian exporters. However, the appreciation of the nominal exchange rate in the second quarter of 2024 halted this improvement and the cost and price competitiveness of Slovenian exporters remained weak.

Current account still in surplus

The current account remained in surplus in the first half of 2024. It amounted to more than EUR 1.4 billion or 4.4% of GDP and was slightly lower than in the same period of 2023. The current account surplus was mainly due to the surplus in trade in services, in particular the high surplus in trade in transportation services. The first available data for the third quarter point to a strong increase in the current account surplus (by EUR 1.2 billion), driven by the surplus in the trade in goods and services, the latter reinforced by the surplus in the trade in transportation and travel services.

Unemployment rate remains low, demand for new jobs declines

The labour market remained tight in the first half of 2024, with the working-age population continuing to decline and the unemployment rate at historically low levels. Foreign workers continued to be the main source of new labour for enterprises. According to the Labour Force Survey, the unemployment rate stood at 3.4% in the first and second quarters of this year. Compared with the first and second quarters of the previous year, the unemployment rate was 0.4 and 0.2 percentage points lower, respectively. However, the decrease was only observed for the male unemployment rate, while the female unemployment rate remained the same as in the corresponding quarters of the previous year.

According to the survey sources, the number of persons in employment exceeded 1 million in the first quarter of this year, which is historically high. Compared to the same quarter of 2023, the number of persons in employment was 3.2% higher. However, the year-on-year increase is partly due to a methodological change in the definition of persons in employment, which since January 2024 also includes detached workers. In the second quarter, the number of employed persons fell to 998 thousand, which was 0.2% higher than in the same quarter of 2023.

In the first half of 2024, rise in employment was mainly driven by services. Employment in manufacturing was also slightly higher than in the first half of 2023, but employment growth slowed compared to the same period of the previous year. In contrast, employment growth in the construction sector, on the other hand, came to a halt in the first quarter of 2024 and turned negative in the second quarter, due to the slowdown in construction activity and a very high base in the previous year.

The year-on-year decline in demand for new jobs continued in the first part of 2024. The average job vacancy rate was 2.5%, around 0.5 percentage points lower than in the first half of 2023. Job vacancy rates remain highest in accommodation and food service activities, construction and transportation.

Wage growth remains above long-term average

Wage growth slowed slightly in the first half of 2024 compared with the same period of a year earlier, but remained above its long-term average amid tight labour markets, increases in the minimum wage and compensation for past inflation. With further slowdown in inflation, real wage growth strengthened. In the first six months of 2024, the average monthly gross wage was 6.5% higher (3.5% in real terms) than in the same period of 2023. Wage growth was higher in the private sector (7.7%) than in the public sector (4.4%). Net wages increased by 4.0% (1.1% in real terms).

Against the background of continued wage growth, the adverse developments in the cost competitiveness of Slovenian exporters continued in the early part of 2024. According to the Bank of Slovenia, the deterioration in the cost competitiveness of the Slovenian economy since 2019 is one of the largest in the euro area and is mainly due to higher growth in unit labour costs (ULCs) compared to our trading partners.

Decline in fuels and energy prices drives down inflation

Inflation, as measured by the Consumer Price Index, continues to fall in 2024, from 3.4% in the first quarter to 0.9% in the third quarter. In October 2024, the annual inflation rate was zero. The decline in inflation was mainly due to a significant slowdown in the growth of fuel and energy prices, which have been declining on an annual basis since June 2024. The decline was most marked for solid fuels, which fell by 23% on an annual basis in the first ten months of the year, followed by gas and electricity prices (-6.2% and -3.4%, respectively). Electricity prices fell most sharply in September and October, due to the negative base effect associated with the resumption of full payment of the environmental levy in September 2023, and the new system of electricity network charges, which came into force in October this year for both businesses and households.

Amid weak external demand and easing price pressures, goods prices rose by only 0.8% in the first ten months of 2024 compared with the same period in 2023. On the other hand, services inflation remains elevated, driven by relatively high wage growth. From January to October, services prices were on average 4.4% higher than in the same period of 2023. As a result of high services inflation, core inflation (inflation excluding energy and food prices) continues to exceed headline inflation.

As regards producer prices, they fell on an annual basis in the first ten months of 2024, with the rate of decline slowing from -2.6% in the first quarter to -1.3% in the third quarter. The decline was mainly driven by the fall in energy prices, which were on average around 10% lower year-on-year in the first ten months of 2024. The decline was also supported by the fall in prices for intermediate goods and, from May 2024, for consumer durables. In contrast, prices for capital goods and non-durable consumer goods were slightly higher than a year earlier.

Decline in loans to enterprises continues

Amid high borrowing costs and subdued economic activity, the volume of bank loans to enterprises began to decline year-on-year in August 2023 and continued to do so in the first three quarters of this year. However, following the ECB's interest rate cuts and a slight pick-up in economic activity in the third quarter, the decline slowed from -5.3% in December 2023 to - 3.5% in September 2024.

On the other hand, the year-on-year increase in the volume of household loans continued, accelerating from 3.6% in December 2023 to 5.8% in September this year. Growth was mainly driven by strong growth in consumer loans, which commenced in October 2022, accelerated throughout 2023 and continued to rise in the first half of 2024. In June 2024, consumer loans were 16.7% higher than a year earlier. Growth then eased slightly over the summer. On the other hand, year-on-year growth in housing loans contracted sharply in 2023 amid a significant rise in the interest rates. This year, the year-on-year growth in new loans for house purchases gradually increased from 0.7% in December 2023 to 3.1% in September 2024.

Declining general government deficit

The general government deficit amounted to EUR 613 million in the first half of 2024, which is more than a third lower than the deficit in the first half of 2023 (EUR 945 million). This strong decline compared to the previous year was largely due to high revenue growth and lower expenditure on intervention measures. In the first six months of this year, general government revenues were 8.9% higher than a year earlier. The increase in revenues was mainly due to a large increase in social security contributions as a result of the transformation of the supplementary health insurance contribution into a compulsory health insurance contribution.

Revenue growth was also boosted by an increase in corporate income tax due to large corporate income tax settlements for 2023 and higher tax rates related to flood recovery. Revenue from personal income tax was also higher amid favourable labour market developments. General government expenditure, on the other hand, increased by 6.0% year-on-year in the first half of 2024. The largest absolute increase was in social transfers, mainly due to pensions, which rose by 8.8% in 2024. Expenditure on goods and services was also higher than in the previous year, reflecting changes in health care and flood reconstruction costs.

Conversely, expenditure on subsidies was lower than in the previous year, mainly due to a reduction in measures to mitigate rising energy prices. At the end of the second quarter of 2024, the consolidated general government gross debt stood at 69.6% of GDP, a decrease of 0.4 percentage point compared to the same quarter of the previous year.

Table SLO1 Main economic indicators

	2023				Total 2023 year	2024	
	Q1	Q2	Q3	Q4		Q1	Q2
ECONOMIC ACTIVITY							
Real GDP (% change, yoy)	1.6	2.2	1.9	2.7	**2.1**	2.2	0.7
Real private consumption (% change, yoy)	2.0	-0.9	-1.1	0.8	**0.2**	2.0	2.0
Real government consumption (% change, yoy)	0.4	2.3	1.5	5.1	**2.4**	6.5	12.6
Real investment (% change, yoy)	4.5	5.3	2.6	3.2	**3.9**	1.0	-1.5
Industrial output (% change, yoy)	-3.4	-4.1	-10.1	-5.1	**-5.6**	-5.0	-3.5
Unemployment rate (LFS, % pa)	3.8	3.6	3.9	3.4	**3.7**	3.4	3.4
Nominal GDP (EUR million)	14,740	16,325	16,311	16,575	**63,951**	15,715	16,806
GDP per capita (EUR)	6,963	7,709	7,690	7,807	**30,158**	7,399	7,910
PRICES, WAGES AND EXCHANGE RATES							
Implicit GDP deflator (% change, yoy)	13.7	11.3	7.3	8.4	**10.1**	2.3	3.0
Consumer prices (% change, yoy, pa)	9.9	8.2	6.6	5.3	**7.4**	3.4	2.3
Producer prices (% change, yoy, pa)	15.5	7.1	2.4	0.4	**6.4**	-2.6	-2.5
Average gross wage (% change, yoy, pa)	10.4	9.9	10.0	8.7	**9.7**	7.2	5.9
Exchange rate (EUR/USD, pa)	0.93	0.92	0.92	0.93	**0.92**	0.92	0.93
FOREIGN TRADE AND CAPITAL FLOWS							
Exports of goods (EUR million)	10,895	10,804	9,502	10,220	**41,420**	10,401	10,705
Exports of goods (EUR, % change, yoy)	2.1	0.0	-9.6	-3.1	**-2.7**	0.3	0.0
Imports of goods (EUR million)	10,815	10,339	9,503	10,333	**40,990**	10,292	10,707
Imports of goods (EUR, % change, yoy)	-1.6	-4.9	-12.1	-2.6	**-5.3**	0.9	5.0
Current account balance (EUR million)	720	1,039	532	568	**2,858**	681	738
Current account balance (% of GDP)	4.9	6.4	3.3	3.4	**4.5**	4.3	4.4
Foreign Direct Investment net inflows (EUR million)	472	512	279	75	**1,338**	632	351
Foreign exchange reserves (EUR million, eop)	804	814	826	797	**797**	1,054	1,144
Foreign debt (EUR million, eop)	54,816	55,621	57,166	57,837	**57,837**	59,171	59,541
GOVERNMENT FINANCE							
Revenues (EUR million)	6,365	6,983	7,099	7,638	**28,084**	6,992	7,545
Expense (EUR million)	6,884	7,409	7,312	8,119	**29,724**	7,215	7,935
Net lending/borrowing (EUR million)	-519	-427	-213	-482	**-1,640**	-224	-390
Domestic government debt (EUR million, eop)	36,267	36,537	36,621	36,404	**36,404**	38,715	38,701
Foreign government debt (EUR million, eop)	2,299	2,193	3,125	3,424	**3,424**	2,867	2,860
Total government debt (eop. % of GDP)	71.9	70.0	71.0	68.4	**68.4**	70.1	69.6
MONETARY INDICATORS							
Total domestic credit (% change, yoy, eop)	3.0	8.0	5.2	4.0	**4.0**	-2.0	-3.3
DMBs credit to households (% change, yoy, eop)	6.1	4.0	3.2	3.6	**3.6**	4.4	5.7
DMBs credit to enterprises (% change, yoy, eop)	5.0	3.8	-1.9	-5.3	**-5.3**	-3.6	-4.5
Money market interest rate (%, pa)	2.2	3.1	3.6	3.9	**3.2**	3.9	3.9
DMBs credit rate for enterprises short-term (%, pa)	4.2	5.0	5.1	5.5	**5.5**	5.4	5.4
DMBs credit rate for households short-term (%, pa)	6.0	6.2	6.6	6.4	**6.4**	6.3	6.1

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

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

Policy assumptions and projections summary

After weakening this year, economic growth is forecast to accelerate in the next two years

Slovenia's GDP growth forecast for this year has been revised sharply downwards by major international and national institutions. Both the European Commission and the national Institute of Macroeconomic Analysis and Development (IMAD) have lowered their spring forecasts for this year by 0.9 percentage points to 1.4% and 1.5% respectively. The IMF also expects Slovenia's GDP to grow by 1.5% this year. The downgrades are due to lower export growth than forecast in the spring amid weaker external demand and higher unit labour costs. Over the next two years, all three institutions expect GDP growth to accelerate to around 2.5%. It will be underpinned by stronger private consumption and an increase in exports and investment. Growth in private consumption is expected to rise from 1.6% this year to 2.5% over the next two years, driven by rising real wages. With rising external demand, exports, manufacturing output and investment in machinery and equipment are also expected to increase. Growth in exports of goods and services is forecast to accelerate from 0.9% this year to 2.7% in 2025 and 3.7% in 2026. Amid higher consumption and investment, imports will increase even more than exports, so that the contribution of net exports to GDP growth is expected to remain negative over the projection horizon. Construction activity is projected to increase, supported by strong government investment related to flood recovery and the implementation of measures financed by the Recovery and Resilience Plan. Gross fixed capital formation, which is expected to stagnate this year, is projected to grow by 3.5% in 2025 and 2026.

Despite the projected higher economic growth, employment is not expected to increase significantly over the next two years due to already high employment levels and labour supply shortages. The unemployment rate is expected to remain broadly stable at around 3.6% (EC estimate) or 3.7% (IMAD estimate). Against this background, wage growth is expected to remain strong over the forecast horizon, reinforced also by the reform of the public sector wage system, which will enter into force in January 2025.

The inflation forecast for 2024 has also been revised downwards (by 0.6 p.p. and 0.7 p.p. in the IMAD and EC projections, respectively) to 2.1% for the year as a whole. The faster-than-expected deceleration in inflation is attributed to the stronger-than-expected decline in commodity prices, the slowdown in economic activity and last year's high base effect. Services inflation, on the other hand, is projected to remain rather elevated, especially in 2025, driven by continued strong wage growth. Average inflation is projected to exceed 3% in 2025 (3.2% in the EC forecast and 3.3% in the IMAD forecast), mainly due to the expiry of temporary measures to curb high energy prices, before decelerating in 2026 and approaching the 2% target rate.

According to the EC forecast, the general government deficit is expected to decline to 2.4% this year and further to 2.1% next year. This decline is largely due to strong revenue growth, boosted by the new long-term care contribution and higher revenues from the environmental tax on carbon emissions, as well as lower expenditure on intervention measures to mitigate the impact of high energy prices.

Table SLO2 Summary of projections

	2024	2025	2026
Real GDP (% change)	**1.5**	**2.4**	**2.5**
Real private consumption (% change)	1.6	2.5	2.4
Real government consumption (% change)	8.5	1.7	4.1
Real investment (% change)	0.0	3.5	3.5
Exports of goods and services (constant prices, % change)	0.9	2.7	3.7
Imports of goods and services (constant prices, % change)	3.5	3.0	4.1
Current account balance (% of GDP)	2.8	2.3	2.1
Consumer prices (% change, pa)	2.1	3.3	2.3
Exchange rate, EUR/USD (pa)	0.92	0.92	0.92
Unemployment rate (LFS, %, pa)	3.7	3.7	3.6
General government balance (ESA 2010 definition, % of GDP)	-2.4	-2.1	-2.1

Source: IMAD – Autumn Forecast of Economic Trends 2024, European Commission – Autumn 2024 Economic Forecast.

ANALYSIS

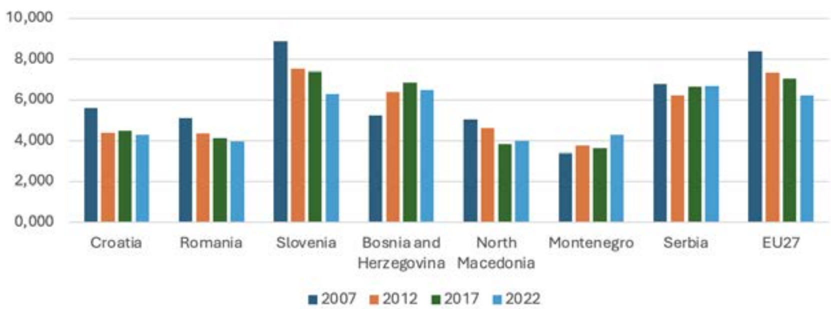
Greening convergence: Is it good or bad?

On 8 November 2023, the European Commission adopted a new Growth Plan for the Western Balkans, with the aim of bringing the Western Balkan partners closer to the EU through offering some of the benefits of EU membership to the region in advance of accession, boosting economic growth and accelerating socio-economic convergence. The lack of convergence emerged as a major issue for the Western Balkan region; for instance, GDP per capita has been around 35% of the EU average level for the last decade. This translates into a limited revenue base to fund the accession process and related reforms, and it also contributes to large-scale outward migration. Nevertheless, even countries that already became member states like Bulgaria, Romania and Croatia are still trailing EU average in many economic variables and indicators.

This study particularly focuses on the issue of convergence in the area of green economics. The first objective is to show dynamics of the selected "greening" indicators in the recent period (mostly 2007-2022), for selected South-Eastern European economies: Croatia, Romania, Slovenia, Bosnia and Herzegovina, North Macedonia, Montenegro and Serbia (henceforth SEE7) vis-à-vis the EU average (henceforth EU27). The second objective is to illustrate the pace of convergence of SEE7 countries toward the average of EU27, as well as the average of EU "core", which in this study comprise only those EU member states before 2004 enlargement (excluding the UK). The analysis considers the next set of indicators: CO2 emissions, municipal waste generation, fertilizer consumption, energy productivity and share of renewable energy.

The measurement unit of CO2 emission here is tone of CO2 equivalent per capita. CO2 emissions considerably varied between SEE7 countries, considering level of emissions and dynamic of emissions (Figure 1). Apart from Slovenia, emission of CO2 in SEE7 countries are lower than the EU27 average. This is not a surprise, as many empirical studies indicated a positive relationship between GDP per capita and CO2 emissions. Nevertheless, the EU countries have benefited from the strong decarbonization initiatives the recent years. While CO2 emission in EU27 and Slovenia has steadily declined during the period 2007-2022, in other SEE7 countries CO2 emission after 2012 is stagnating.

Figure 1: CO2 emissions 2007-2022, SEE7 vis-à-vis EU27

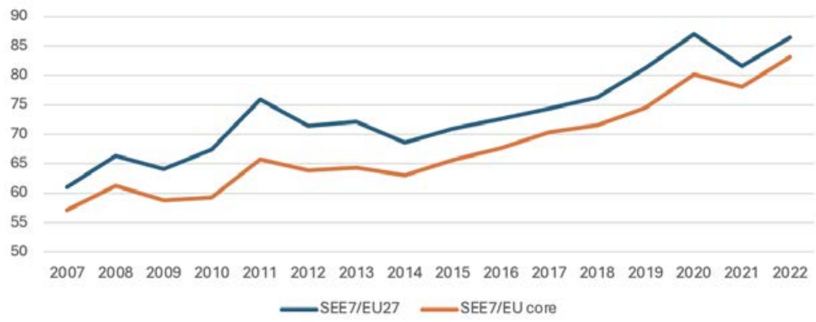


Source: EDGAR - Emissions Database for Global Atmospheric Research, authors' calculations;
Note: data for Serbia and Montenegro are retrieved from country reports of International Energy Agency.

Figure 2 indicates that the average CO2 emission per capita of SEE7 countries is getting closer to the EU average. In 2007, the SEE7 average was at 58.6% and 53.3% of EU27 and EU core averages, respectively. This gap considerably narrowed, following the different paces of decline: cumulative decrease in the SEE7 average for the period 2007-2022 was around 10%, while the corresponding decrease in the EU27 was around 26%. Therefore, it is tricky to conclude whether this convergence was favorable or not.

On one side, the convergence of CO2 emissions can be consequence of higher economic growth of SEE7 countries. On the other hand, it can indicate that decarbonization initiatives in SEE7 were not sufficient and successful.

Figure 2: CO2 emissions convergence 2007-2022

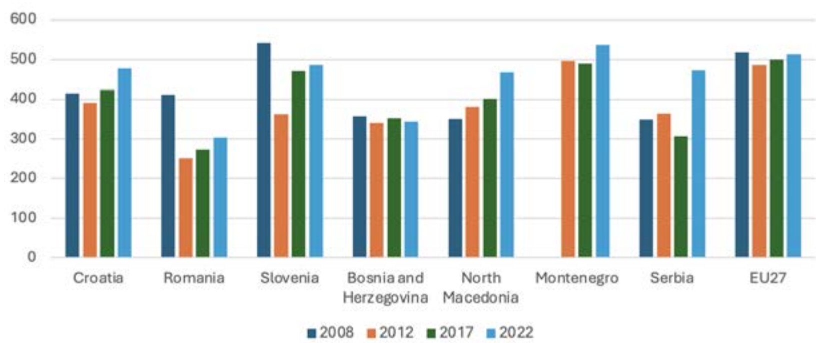


Source: EDGAR - Emissions Database for Global Atmospheric Research, authors' calculations; **Note:** data for Serbia and Montenegro are retrieved from country reports of International Energy Agency.

Municipal waste generation

Municipal waste generation encompasses waste produced by households and similar wastes from sources such as commerce and trade, small businesses, office buildings and institutions (schools, hospitals, government buildings). It mainly consists of bulky waste (e.g. disposed furniture), garden waste and the content of litter containers. The municipal waste generated is measured in kilograms per person. The observed period starts in 2008 due to lack of observations in 2007. Figure 3 illustrates differences in municipal waste generation among SEE7 countries and the EU27 average.

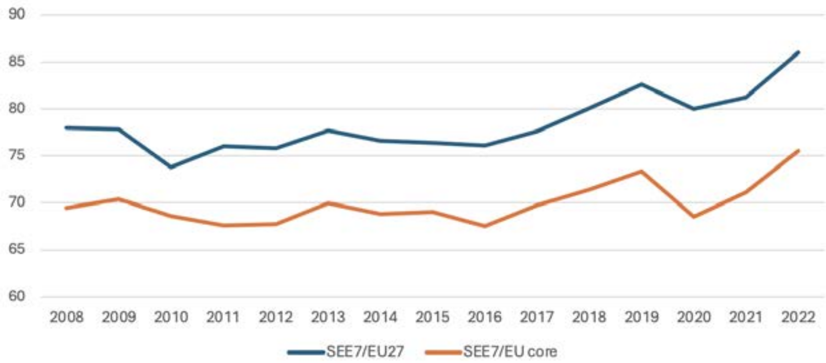
Figure 3: Municipal waste generation 2008-2022, SEE7 vis-à-vis EU27



Source: Eurostat, authors' calculations; Note: data for Montenegro are available since 2010.

As in case of CO_2 emission, dynamics of municipal waste generation indicate trend of convergence (Figure 4). The average municipal waste of SEE7 countries was at 77% of the EU27 average in 2008, and after some divergence at the beginning of the observed period, the gap narrowed to 86%. Yet, comparison of the growth rates implies that in this case convergence is not favorable outcome; while average municipality waste per capita in the EU27 countries remained almost the same level in 2022 as in 2008, cumulative growth of the SEE7 average municipality waste was around 9%.

Figure 4: Municipal waste generation convergence 2008-2022

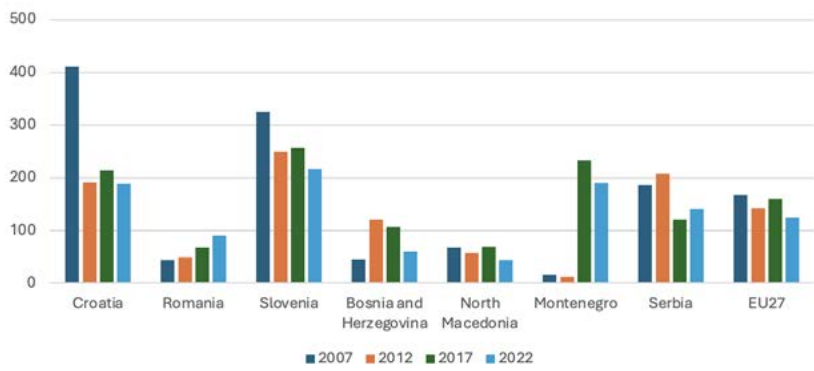


Source: Eurostat, authors' calculations; Note: data for Montenegro are available since 2010.

Fertilizer consumption

Fertilizer consumption measures the quantity of plant nutrients used per unit of arable land. Traditional nutrients--animal and plant manures--are not included. Arable land mostly includes land under temporary crops and temporary meadows for mowing or for pasture. The measurement unit is kilogram per hectare of arable land. Figure 5 illustrates differences in fertilizer consumption among SEE7 countries and the EU27 average. The 2007 data for Croatia and 2007-2013 data for Montenegro might be unreliable, as they appear to be outliers.

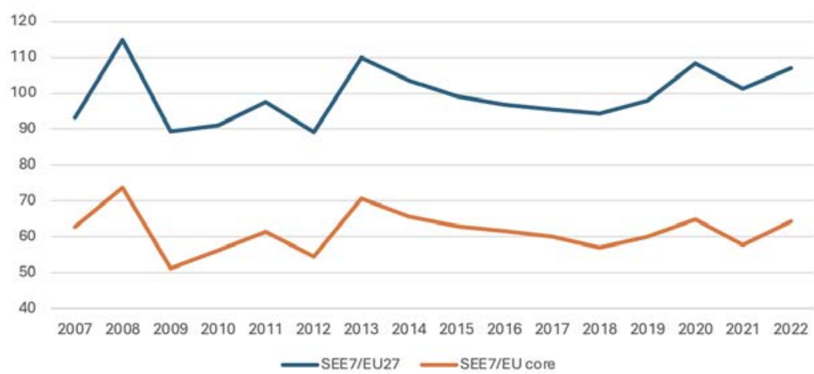
Figure 5: Fertilizer consumption 2007-2022, SEE7 vis-à-vis EU27



Source: World Bank, authors' calculations

Since data before 2014 seem dubious (exceptionally low values for Montenegro), convergence is considered only for the period 2014. Figure 6 shows that in 2014 average consumption of fertilizers in SEE7 countries was very close to EU27 average, and quite lower than EU core average. These proportions didn't change significantly during the period 2014-2022, so it appears that the use of fertilizers on average has already converged relative to EU27. Anyway, Figure 5 shows that there is a huge difference in fertilizer consumption across SEE7 countries, so convergence should be additionally considered at country-specific level as average in this case may be misleading.

Figure 6: Fertilizer consumption convergence 2007-2022

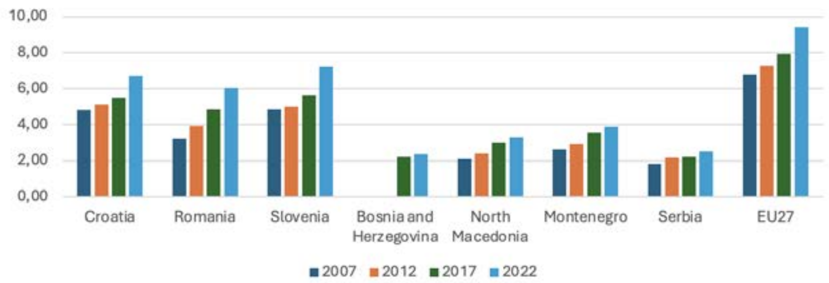


Source: World Bank, authors' calculations

Energy productivity

This indicator in general measures the amount of economic output that is produced per unit of gross available energy. The gross available energy represents the quantity of energy products necessary to satisfy all demand of entities in the geographical area under consideration. The economic output in this particular case is given in the unit of Euros in chain-linked volumes to the reference year 2010. Figure 7 illustrates differences in energy productivity among SEE7 countries and the EU27 average. Opposite to the previous indicators, dynamics and levels of energy productivity show clear patterns. First, it has steadily increased in all SEE7 countries, as well as in EU27 on average. Second, energy productivity is higher in EU than in SEE7 countries, and it is higher in SEE7 countries which are EU member states.

Figure 7: Energy productivity 2007-2022, SEE7 vis-à-vis EU27



Source: Eurostat, authors' calculations; Note: data for B&H are available since 2014.

Figure 8 shows that energy productivity in SEE7 countries did not converge to energy productivity in EU countries, as already indicated by Figure 7. It is especially notable in case when convergence is considered with respect to EU core countries; in 2007, the average energy productivity in the SEE7 countries was at 41.5% of the productivity in EU core, which is lower than in 2022 when it was at 39.3%. Overall, there is no indication that energy productivity converged over the considered period despite some temporary volatility.

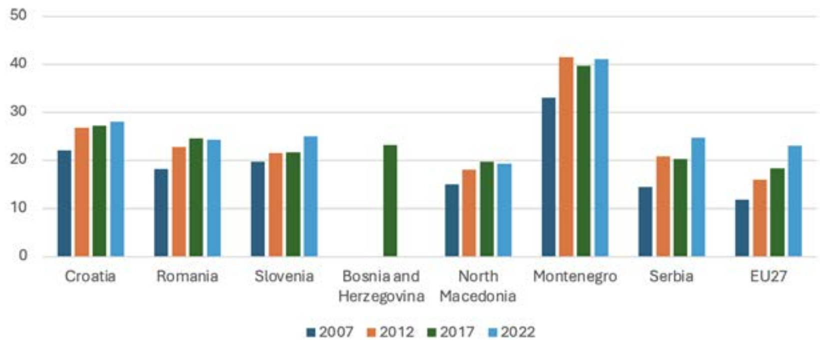
Figure 8: Energy productivity convergence 2007-2022

Source: Eurostat, authors' calculations; Note: data for B&H are available since 2014.

Share of renewable energy

The indicator measures the share of renewable energy consumption in gross final energy consumption. The gross final energy consumption is the energy used by end- plus grid losses and self-consumption of power plants. The measurement unit is percentage. Figure 9 illustrates differences in share of renewable energy among SEE7 countries and the EU27 average. The trend of increase in share of renewable energy is evident in all SEE7 countries, as well as in EU countries on average. Also, the share of renewable energy in SEE7 countries is higher than the EU27 average.

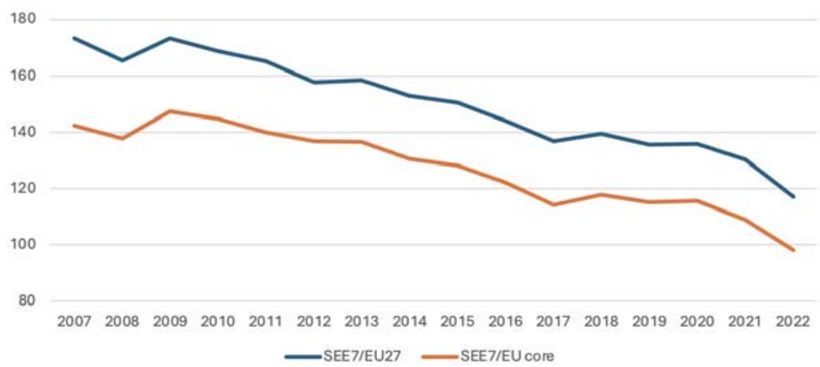
Figure 9: Share of renewable energy 2007-2022, SEE7 vis-à-vis EU27



Source: Eurostat, authors' calculations; Note: data for B&H are available from 2014 to 2021.

Figure 10 shows that in the case of renewable energy, significant convergence occurred during the period 2007-2022. Nevertheless, this convergence is arguably unfavorable outcome. In 2007, the average share of renewable energy in SEE7 countries was much higher than in EU countries, especially when all 27 EU member states are considered. Over the period 2007-2022, share of renewable energy in SEE7 countries cumulatively increased around 33% on average, while corresponding growth in EU27 countries was almost three times higher, around 96%. Consequently, the initial gap in use of renewable energy in total energy consumption, that was in favor of SEE7 countries, substantially decline imposing that the SEE7 countries need to put additional effort to encourage use of renewable energy.

Figure 10: Share of renewable energy convergence 2007-2022



Source: Figure 10: Share of renewable energy convergence 2007-2022

Going back to the question in the study title, it is not possible to give straightforward. It depends on the initial values and dynamics of change, as in case of municipality waste generation and share of renewable energy in total consumption, where SEE7 countries on average overperformed EU countries, but their relative performance over the years has either stagnated or worsened. In such cases, convergence turned out to be an unfavorable outcome. In case of CO2 emission even the insight into initial values and rate of change may be insufficient to make conclusions, as the qualitative assessment of the convergence depends on the knowledge of overall economic conditions. Nevertheless, when the empirical results of analysis are considered, there is a strong indication that SEE7 countries did not make significant advancements toward greening the economy (and in some cases their performance has even worsened), so more effective environmental policies in SEE7 should be established.

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Technical editor: Nikola Puzigaća

Print: Donat graf d.o.o, Belgrade

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

CIP - Каталогизација у публикацији
Народна библиотека Србије, Београд

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

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

COBISS.SR-ID 28100873