SEE-6

Economic Outlook

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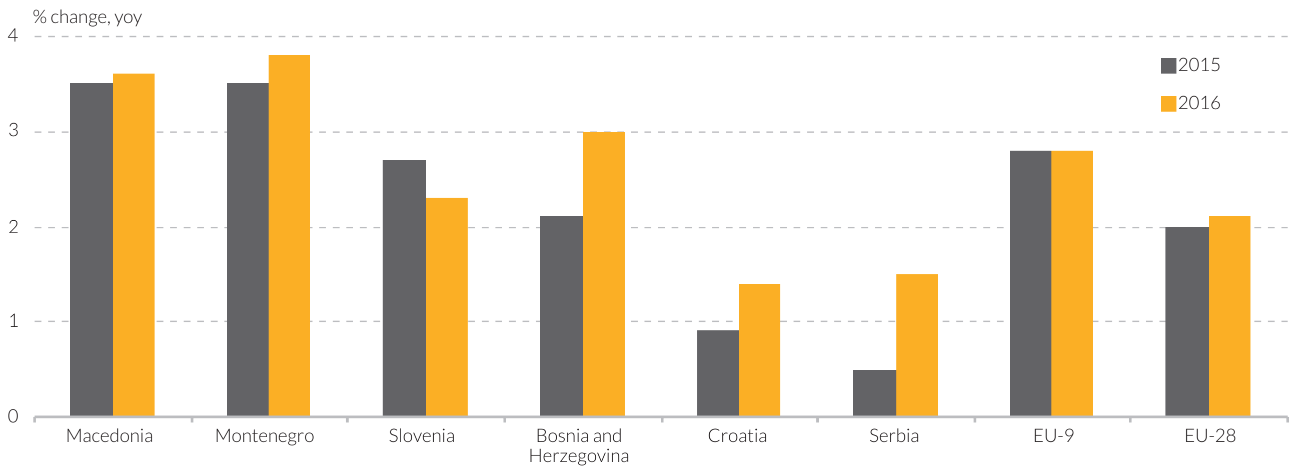
REAL GDP GROWTH PROJECTIONS FOR SEE-6, EU-9* AND EU-28



Source: European Economic Forecast, European Commission, Autumn 2015 and authors for SEE-6.
Note: * EU-9 include Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania and Slovakia.

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BOSNIA AND HERZEGOVINA

Rising economy in a changing environment

Recent economic developments

Getting closer to EU

The Government of Bosnia and Herzegovina currently faces an exceptional challenge of adopting new legislation aimed at creating functional market economy, aligned with EU standards. Complex constitutional setup and inability to establish stable government majority aggravate the legislation harmonization process whereas a requirement of the Stabilization and Association Agreement *(SAA)* to complete the process until the end of 2015 puts additional pressure on the Government. Future economic developments and growth potentials of the economy of Bosnia and Herzegovina are supposed to be determined by the success in fulfilling the conditions set in SAA which entered into force on June 1st, 2015. The most important request refers to new trade quotas for Croatia, calculated at CEFTA terms. If the SAA trade requirements are not met, it could lead to export suspension to European Union.

Positive trends continue while the drivers of growth change

In the second quarter of 2015 real GDP grew by 4.4 percent compared to same period last year. This is just a continuation of positive growth rates in the last four quarters, averaging 1 percent quarter-on-quarter. Consumption increase, especially private, is the main driver of this year's growth. Mild recovery of economic activity is expected to be sustained in 2016, with a more significant role of state investment. World Bank and IMF forecasts for

2016 indicate that Bosnia and Herzegovina could achieve real GDP growth of above 3 percent, i.e., higher than average growth in the EU.

Industrial production is recovering after last year's floods. In the second quarter 2015 it was 2 percent higher than in the same period last year, with the highest growth rate of 3.3 percent recorded in manufacturing.

Flexibility and competitiveness – focus of labor market reform

Labor market in Bosnia and Herzegovina is characterized by high and persistent unemployment rate which hovered around 27 percent in both 2014 and in the first half of 2015. In the first half of 2015 the employment rate increased by 1.8 percent compared to the first half of 2014, whereas real wages remained unchanged. The new Labor law will hopefully bring some positive twist into the gloomy reality both with respect to real wages and the unemployment rate, despite the public perception that the new law would lead to a demotion of labor rights. This new Labor law should serve as a basis for comprehensive labor market reforms, providing for better connection between labor market and education system and lower taxes and contributions paid on wages. This might have a positive impact on labor market flexibility as well as on the competitiveness of national economy.

New state borrowing for new investments

Government revenues are increasing in 2015 due to improved tax collection and without any significant change in tax system, while the increase in expenditures is driven by rising wage-bill and social benefits. Lower government debt, compared to the EU average, opens up space for government debt to be used as an instrument for financing infrastructural projects. Due to higher capital expenditures, the composition of government expenditures in Bosnia and Herzegovina will change in 2015 and 2016 in comparison with previous years.

Government debt has been growing continuously but due to relatively low debt level, this does not have any negative influence on Government's credit ratings. Available data on government debt do not yet include all the elements of outstanding debt. According to some estimates, total government debt by the end of 2015 might stand at EUR 500-700 million.

Growth of credits intended for final consumption

Strong and constant growth of bank deposits supported banks' lending activity in 2014 and first part of 2015. There was a high expansion of credits to households, spurred by rising private consumption in an environment of negative price inflation. Credits to business sector declined in 2014 and in the first quarter of 2015 due to business sector deleveraging, but started to rise in the second quarter of 2015.

World prices volatility causes current account balance improvement

Thanks to increased demand from its main trading partners BiH is exports rose in first two quarters of 2015 by 4.1 percent compared to the first half of 2014. Industries with the most pronounced exports growth were the production of base metals, food industry, chemical industry, and production of electronic products and gas coke. Increase in prices of metal on international market had a positive impact on production of metals, the export of which has been rising for four consecutive quarters. Exports of processed animal products went up by 90 percent compared to first half of last year, within which category exports of meat to Turkey quadrupled in comparison with the first six months of 2014.

Table BH1 Main economic indicators

	2013	2014	2014	2015	
			Q4	Q1	Q2
ECONOMIC ACTIVITY					
Real GDP (% change, yoy)	2.4	1.1	2.4	2.1	4.4
Real private consumption (% change, yoy)	0.8	2.2	-	-	-
Real government consumption (% change, yoy)	-0.6	0.9	-	-	-
Industrial output (% change, yoy)	6.7	6.1	1.0	1.1	4.5
Unemployment rate (registered, %, pa)	27.5	27.5	27.5	27.6	27.1
Nominal GDP (EUR million)	13,674	13,937	-	-	-
GDP per capita (EUR)	3,569	3,641	-	-	-
PRICES, WAGES AND EXCHANGE RATES					
Implicit GDP deflator (% change, yoy)	0.6	-0.4	-	-	-
Consumer prices (% change, yoy, pa)	-0.1	2.2	-0.1	-0.6	-0.4
Producer prices (% change, yoy, pa)	-2.3	0.4	1.0	1.4	1.6
Average gross wage (% change, yoy, pa)	0.0	0.1	1.0	0.5	-0.3
Exchange rate, BAM/EUR (pa)	1.96	1.96	1.963	1.96	1.96
Exchange rate, BAM/US$ (pa)	1.47	1.47	1.57	1.73	1.77
FOREIGN TRADE AND CAPITAL FLOWS					
Exports of goods (EUR million)	4,285	4,439	1,157	1,083	1,157
Exports of goods (EUR, % change, yoy)	6.6	3.6	8.5	2.5	6.2
Imports of goods (EUR million)	7,756	8,283	2,196	1,820	2,085
Imports of goods (EUR, % change, yoy)	-0.5	6.8	6.7	-0.2	1.8
Current account balance (EUR million)	-751	-1,091	-269	-185	-283
Current account balance (% of GDP)	-5.7	-7.7	-	-	-
Gross foreign direct investment (EUR million)	119	378	67	62	-
Foreign exchange reserves (EUR million, eop)	3,627	4,013	4,013	3,906	4,046
Foreign debt (EUR million, eop)	7,015	7,106	-	-	-
GOVERNMENT FINANCE*					
Revenue (national currency)**	11,407	11,961	5,344	1,252	2,618
Expense (national currency)**	10,389	11,350	5,181	1,189	2,440
Net = Gross operating balance (BAM million)**	1,080	611	163	63	178
Net acquisition of non-financial assets (BAM million)**	374	554	363	24	51
Net lending/borrowing (national currency)**	194	486	-44	100	270
Domestic government debt (EUR million, eop)	1,130	1,386	1,386	1,430	1,434
Foreign government debt (EUR million, eop)	3,788	4,152	4,152	4,392	4,287
Total government debt (% of GDP)	35.1	39.7	-	-	-
MONETARY INDICATORS					
Narrow money, M1 (% change, yoy, eop)	9.0	9.1	8.9	9.3	10.2
Broad money, M2)5 (% change, yoy, eop)	7.9	7.5	7.5	7.1	8.3
Total domestic credit (% change, yoy, eop)	2.9	2.9	2.9	1.5	1.8
DMBs credit to households (% change, yoy, eop)	3.9	5.7	5.7	5.6	5.1
DMBs credit to enterprises (% change, yoy, eop)	1.5	-1.4	-1.4	-2.5	1.2
DMBs credit rate for enterprises, short-term, (%, pa)	7.2	6.6	6.1	6.4	6.1
DMBs credit rate for households, short-term (%, pa)	7.0	7.3	7.2	7.4	7.2

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

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

Sources: Agency for Statistics of BiH, BiH Directorate for Economic Planning, BiH Indirect taxation authority, Central Bank of BiH.

The development of imports in 2014 and 2015 has been influenced by two important factors: the decrease of oil prices and natural disasters. As for the latter, both floods in 2014 and drought in 2015 had severe negative impacts on agricultural production and caused rise in imports of food products. In total, the rise in imports was higher than the rise in exports in 2014, but this may be reversed in 2015.

FDI still on hold

In 2014 FDI to Bosnia and Herzegovina stood at BAM 740 million, which is 66 percent higher than in 2013. Most of the foreign investments in 2014 came from Russia, Austria and Croatia. Industries that attracted most of foreign direct investment are manufacturing, real estate trade and financial industry.

Policy assumptions and projections summary

Moderate growth in 2015 and 2016 mainly thanks to public sector investments

Growth projections for 2015 and 2016 are based on the assumption of economic recovery in the European Union and successful implementation of reforms in public finance, labor market, social insurance and pension system in BiH. It is also assumed that the prices on global market would stabilize, which coupled with rising domestic and international demand, might curb the price deflation in Bosnia and Herzegovina. Price increase will be encouraged by the increase of royalties on tobacco and cigarettes, with the positive impact on budget thereof. In spite of optimistic developments regarding overall economic activity, we do not foresee significant improvement of the unemployment rate. Insufficient investment activity of private sector should be compensated for by public sector investments in highways and energy sector.

Table BH2 Summary of projections

	2015	2016
Real GDP (% change)	**2.1**	**3.0**
Real private consumption (% change)	1.7	1.8
Real investment (% change)	8.3	10.4
Exports of goods and services (constant prices, % change)	6.4	7.9
Imports of goods and services (constant prices, % change)	3.9	7
Current account balance (% of GDP)	-7.9	-7.8
Consumer prices (% change, pa)	-0.3	1
Exchange rate, national currency/EUR (pa)	1.96	1.96
Unemployment rate (registered, %, pa)	27.5	26.5
General government balance (ESA95 definition, % of GDP)	-2.4	-2.8
Broad money, M4 (% change, eop)	5.6	5.9
Total domestic credit (% change, eop)	15.5	14.6

Notes: Cut-off date for information used in the compilation of projections was October 20, 2015.
Conventional abbreviations: pa - period average, eop - end of period, EUR - euro.
Sources: BiH Directorate for Economic Planning, World Bank, IMF and author's projections.

C R O A T I A

Growth expected to speed up

Recent economic developments

Inconclusive results of parliamentary elections

In Croatia, the second part of 2015 was dominated by the immigration crisis and coming parliamentary elections. Immigration crisis emerged in September when migrants and refugees fleeing war and poverty in Syria, Iraq, Afghanistan and Pakistan were urged to seek for alternative ways to enter the European Union after Hungary started to block further inflow of immigrants. Initially, Croatian Government seemed somewhat unprepared for the wave of immigrants that has flooded Croatia's eastern borders, but soon it took control over this exceptional situation and started to provide organized support to immigrants' safe transfer further to the west. However, there is constant threat that Croatia could become the hotspot in case Slovenia and Austria close their borders. One can only speculate about the scope of the adverse economic effects of such a scenario.

Apart from the refugee crisis, public scene was overwhelmed by the campaign preceding parliamentary elections taking place on November 8, 2015. The distinct feature of the campaign was the rivalry between two big coalition blocks and their leaders – the right wing block around Croatian Democratic Union and the left wing coalition around incumbent social democrats. The public polls indicated that the difference in number of mandates between the two blocks would be slim. Election results did not only prove the accuracy of these forecasts, but have also revealed that the voters gave an unexpectedly high support to the list of independent candidates named MOST (The Bridge). Unlike both big coalitions, MOST is strongly advocating structural reforms in many areas, from judiciary to public administration, local government and

taxation. Since MOST won a large number of parliamentary seats, none of the big coalitions can form the majority government without them. The coalition talks between political blocks are underway and the uncertainty about who will form the next government is higher than ever in democratic history of independent Croatia.

2015 - first year with positive growth rate after six years of recession

Real GDP has been constantly falling from 2008 to 2014 and cumulative decline in that period exceeds 12 percent. Investments are the element of domestic demand which was hit the most by the recession, whereas government consumption seemed to be the least elastic to overall development of economic activity. Its level in 2014 was only 2.5 percent lower than in 2008. First signs of economic recovery that appeared in the last quarter of 2014 were followed by still modest, but higher growth rates in the first half of 2015. In the second quarter of 2015 real GDP increased by 1.2 percent compared to the same period last year. High frequency data such as those on retail trade and industrial output suggest that the same trend will continue in the third quarter.

Net exports that recovered already in 2013 have contributed mostly to Croatia's eventual exit from the long-lasting recession, while personal consumption started to grow in the first quarter of 2015. Investments recovery kick-started only in the second quarter of 2015 when they were 0.8 percent higher than in the same quarter last year and when the seasonally adjusted data did not show any further quarter-on-quarter decline in investment activity. Positive developments are expected to continue in the second half of 2015 implying that 2015 will be the first year with positive real growth after six consecutive years of economic downturn.

Positive developments on the labor market, but still high unemployment rate

Revived economic activity brought some life to the labor market as well. Employment that was steadily declining since the end of 2008 reached its low in the middle of 2014. Its recovery since then has been rather modest but constant, and has happened mostly in service activities. Seasonally adjusted number of jobless persons was at its peak at the beginning of 2014 and has been falling ever since. Therefore, the unemployment rate that exceeded 20 percent in 2013 started to decline. In August 2015 it stood at 16.2 percent, which is 1.5 percentage points less than in the same month last year. In spite of the latest positive developments, the seasonally adjusted rate of unemployment in Croatia, which stood at 15.4 percent in September 2015, was the third highest unemployment rate in the EU, after Greece and Spain. Average nominal gross and net wages were rising at low rates in both 2013 and 2014 and have continued to rise somewhat stronger in the first half of 2015. Due to almost no change in price level in that period, there was no difference between the dynamics of gross and net wages. Unlike in the pre-crisis period, increase in wages in recent time has been more intense in private than in the public sector.

Populist measures obtained priority over necessary fiscal consolidation in pre-election year

Stability of public finances was seriously impaired during recession. Over the last four-year period from 2011 to 2014 general government deficit averaged at 6 percent of GDP, and the share of public debt to GDP rose from 63.7 to 85 percent. Government interest expenditures currently stand at already high 3.5 percent of GDP and any increase in interest rates might provoke the unpleasant snowball effect. High deficits reflect the reluctance of the Government to implement drastic fiscal austerity measures since, according to its view, by cutting expenditures the Government would risk entering even more severe economic contraction. Only half a year after joining the EU, Croatia entered the Excessive Deficit Procedure, received the European Commission's binding recommendations and had to submit a credible plan on how to correct the excessive deficit by 2016. At the beginning of 2015 the Government prepared the National Reform Programme and a Convergence Programme by which it committed itself to implementing measures that should result in deficit reduction and reach a 3-percent deficit target by 2017. However, the incumbent Government did not put much effort in fulfilling its own target and implemented a number of costly populist measures towards the end of its mandate. The responsibility for meeting a deficit target by 2017 will thus fully fall on the new Government. It is worth noting that in July 2015, two rating agencies, Standard&Poor's and Fitch Ratings, have changed the outlook for Croatia from stable to negative while maintaining the same credit grade assessment for Croatia. 2016 government budget, that is to be drafted immediately after the new Government enters into power, will have to clearly demonstrate a determination of the new Government to lessen the fiscal imbalance. Otherwise, the credit rating will be further downgraded.

Conversion of Swiss franc loans to euro – a solution or a new problem?

Deleveraging of both household and enterprise sector is the most pronounced feature in the monetary developments in last years. In spite of relatively low interest rates and changing growth prospects in 2014, credit activity is not yet gaining momentum. As for the households, their aspirations to take credits seem to be influenced by the bitter aftertaste of loans denominated in Swiss francs which have significant proportion in total credits to households. Since the Government has proposed and the Parliament has adopted a law allowing all Swiss franc loans to be converted to euro denominated loans,

Table HR1 Main economic indicators

	2013	2014	2014		2015	
			Q3	Q4	Q1	Q2
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	-1.1	-0.4	-0.2	0.2	0.5	1.2
Real private consumption (% change, yoy)	-1.9	-0.7	-1.0	-0.5	0.3	0.6
Real government consumption (% change, yoy)	0.3	-1.9	-1.3	-0.5	0.6	0.4
Real investment (% change, yoy)	1.4	-3.6	-3.5	-4.1	-0.4	0.8
Industrial output (% change, yoy)	-1.8	1.2	0.4	4.1	-0.1	2.4
Unemployment rate (registered, %, pa)	20.2	19.6	17.6	19.0	20.1	17.2
Nominal GDP (EUR million)	43,591	43,110	-	-	-	-
GDP per capita (EUR)	10,242	10,130	-	-	-	-
PRICES, WAGES AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	0.9	0.0	0.4	0.4	0.3	0.4
Consumer prices (% change, yoy, pa)	2.2	-0.2	-0.2	0.0	-0.4	0.0
Producer prices (% change, yoy, pa)	0.5	-2.7	-2.9	-2.6	-4.1	-2.8
Average gross wage (% change, yoy, pa)	0.8	0.2	0.3	0.6	0.7	1.5
Exchange rate, HRK/EUR (pa)	7.57	7.63	7.61	7.66	7.68	7.57
Exchange rate, HRK/US$ (pa)	5.71	5.75	5.74	6.13	6.81	6.86
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	9,589	10,369	2,716	2,755	2,573	2,923
Exports of goods (EUR, % change, yoy)	-0.4	8.1	4.2	5.0	9.2	15.0
Imports of goods (EUR million)	16,528	17,129	4,512	4,123	4,268	4,754
Imports of goods (EUR, % change, yoy)	1.9	3.6	4.2	0.9	7.1	5.4
Current account balance (EUR million)	438	340	2,800	-597	-1,283	3.0
Current account balance (% of GDP)	0.8	0.7	-	-	-	-
Gross foreign direct investment (EUR million)	703	2,893	412	96	394	104
Foreign exchange reserves (EUR million, eop)	12,908	12,688	12,116	12,688	14,158	13,734
Foreign debt (EUR million, eop)	45,958	46,664	46,512	46,664	49,131	48,826
GOVERNMENT FINANCE*						
Revenue (HRK million)**	125,879	131,917	34,692	33,179	32,342	-
Expense (HRK million)**	138,217	139,532	33,120	36,860	36,312	-
Net = Gross operating balance (HRK million)**	-12,339	-7,615	1,572	-3,681	-3,970	-
Net acquisition of non-financial assets (HRK million)**	5,264	4,855	1,033	1,951	829	-
Net lending/borrowing (HRK million)**	-17,603	-12,470	539	-5,632	-4,799	-
Domestic government debt (EUR million, eop)	20,458	21,630	20,452	21,630	23,686	21,639
Foreign government debt (EUR million, eop)	14,387	14,861	14,957	14,861	17,149	15,693
Total government debt (eop, % of GDP)	84,1	88,6	-	-	-	-
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	11.5	9.6	9.9	9.6	8.3	11.6
Broad money, M4 (% change, yoy, eop)	4.0	3.2	3.2	3.2	2.8	4.8
Total domestic credit (% change, yoy, eop)	0.9	-2.3	-5.2	-2.3	-0.6	-0.7
DMBs credit to households (% change, yoy, eop)	-1.8	-0.8	-1.5	-0.8	0.9	0.9
DMBs credit to enterprises (% change, yoy, eop)	-1.0	-3.7	-6.3	-3.7	-2.3	-2.6
Money market interest rate (%, pa)	0.6	0.5	0.4	0.5	0.5	0.4
DMBs credit rate for enterprises, short-term, (%, pa)***	6.4	5.9	5.9	5.7	5.6	5.6
DMBs credit rate for households, short-term (%, pa)***	7.6	7.4	7.3	7.3	7.3	7.2

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

the household's sentiments towards loan might improve. However, the same law will not be that welcome from the banks' perspective. Namely, the conversion of loans will, at least temporarily, imply high costs for the banks and thus damage their profitability. High share of Swiss franc denominated loans in total loans, contributed to a rising share of non-performing loans which was as high as 17.3 percent in June 2015. It is to be hoped that a conversion of Swiss franc denominated loans to euro, would positively influence the households' demand for credits and lead to a reduction in the share of non-performing loans.

Price inflation close to zero or negative, exchange rate stable

Consumer prices in 2014 and 2015 were largely determined by the movements of energy prices, chiefly the prices of crude oil on the world market. Therefore, in the first half of the year, as well as in the third quarter 2015 their level was around 0.6 percent lower than in the same period last year. In the summer months additional contribution to the price decrease came from the prices of fruit and prices of clothing and footwear, but their fall can be mainly attributed to the usual seasonal factors. Core inflation, on the other hand, is still in the positive zone, and its level in the period from January to September 2015 some 0.3 percent higher than in the first nine months last year. Factors on the demand side that would cause a more intense consumer price increase are very weak due to high unemployment, bleak consumer sentiments and private sector deleveraging. The kuna/euro exchange rate is stable, but this year the depreciation pressures have dominated over the appreciation pressures that were usually most pronounced during the tourist season. Namely, conversion of Swiss franc loan to euro created additional demand for foreign currency and caused the kuna/euro exchange rate to go up in September. The Croatian National Bank intervened by selling foreign currency to banks and thus maintaining the exchange rate stability.

Goods exports rise constantly at higher rates than imports

After going up by 8.1 percent in 2014, exports continue to grow at an even higher rate in 2015. In the first eight months of 2015, the value of exports in euro was almost 11 percent higher than in the same period last year. Imports went up as well, but due to still depressed domestic demand, the rise in imports was much weaker – only 6.5 percent in the first eight months. However, growth in exports can only to a certain extent be explained by the positive effect of Croatia's accession to the EU and reaping the benefits of an easier excess to the large single European market. The other part of the explanation lies within the fact that the value of goods imported from third countries, entering the EU through Croatia, but intended to be delivered to other EU countries, are counted as Croatian exports. Therefore, the value of pure Croatian exports is not as high as suggested by the statistics.

Negative balance of international trade is in any case getting smaller, which coupled with positive trends in tourism and higher inflows of secondary income due to the absorption of EU funds, results in the surplus on the current account of the balance of payments. Surplus on the current account was recorded in 2013 and 2014, and according to the available data for 2015 is expected this year as well.

Policy assumptions and projections summary

Table HR2 Summary of projections

	2015	2016
Real GDP (% change)	**0.9**	**1.4**
Real private consumption (% change)	0.7	0.7
Real government consumption (% change)	0.2	-1.0
Real investment (% change)	1.9	2.0
Exports of goods and services (constant prices, % change)	5.7	5.2
Imports of goods and services (constant prices, % change)	5.4	3.6
Current account balance (% of GDP)	0.8	1.0
Consumer prices (% change, pa)	0.1	1.1
Exchange rate, national currency/EUR (pa)	7.65	7.65
Unemployment rate (registered, %, pa)	18.0	17.6
General government balance (ESA2010 definition, % of GDP)	-5.5	-4.5
Broad money, M4 (% change, eop)	2.9	3.8
Total domestic credit (% change, eop)	-0.2	1.6

Notes: Cut-off date for information used in the compilation of projections was October 20, 2015.
Conventional abbreviations: pa - period average, eop - end of period, EUR - euro.
Source: The Institute of Economics, Zagreb.

Positive trends prevail; growth might even speed up in 2016

Projections for 2015 and 2016 for Croatia are prepared by the Institute of Economics, Zagreb and are based on the projections presented in Croatian Economic Outlook Quarterly issued in September 2015. The projections for GDP and its component depart from the ones from September issue and were subject to an upward revision after new high frequency indicators became available.

The projections are based on the assumption that positive trends, stemming also from favorable economic developments in Croatian trading partners, will prevail, and that any new Government will intensify structural reforms and implement fiscal consolidation measures as recommended by the European Commission. As a result, we expect growth to be close to 1 percent in 2015 and around 1.4 percent in 2016. Positive growth rate would be influenced primarily by positive net exports in both years, but we also expect investments to go up both in the private and in the public sector, and private consumption to continue rising. Government consumption on the other hand, we hope, might go down by 1 percent in 2016. Although the prospects of the economy are generally optimistic, the recovery will still be too weak to lead to a more significant rise in employment and decrease in unemployment. Therefore, we project the unemployment rate to be 18 percent in 2015 and then to fall to 17.6 percent in 2016.

As for the government budget, we do not foresee reduction of deficit in 2015 – according to our view it is going to stay at 5.5 percent of GDP. However, for the next year we foresee that the government revenues will rise as a result of economic upturn, whereas the new Government will at least not allow expenditures to increase. Consequently, deficit might go down by 1 percentage point.

Consumer prices inflation will stay in the vicinity of zero in 2015, and rise to 1.1 percent in 2015 due to the gradual recovery of personal consumption. The exchange rate will remain stable. ■

MACEDONIA

Solid growth prospects in spite of a challenging political situation

Recent economic developments

Political instability and lack of political will impede the reforms

Since becoming a candidate country in 2005, the Republic of Macedonia has completed most reforms regarding the judiciary and public administration. However, the Government's failure to respond adequately to a number of key issues damaged the sustainability of the reforms. Although progress has been made in many areas, serious challenges persist. They are most pronounced in increasingly divisive political culture, rising politicization, bulky administration, lack of capacities and inefficiency in public administration, impaired independence of courts and a still fragile inter-ethnic relationship. Recent political crises showed that political parties' interests are increasingly prevailing over national interests. One of the main political problems of the country is also the 'name issue' with Greece, which has an adverse impact on the country's European aspirations. Surprisingly, thus far the 'name issue' had no negative effect on economic cooperation between these two countries, since Greece is one of the five biggest investors and one of the Macedonia's main trading partners. However, resolving the name issue would further improve business cooperation, not only in relation to Greece, but also with other countries since it would allow Macedonia's membership in NATO alliance.

Due to global financial and economic crisis, Macedonian economic activity went down in 2009, but only by 0.4 percent in real terms. After two years of relatively stable economic growth of approximately 3 percent, it registered a slight decline in 2012 due to continued uncertainty in the external environment and economic slowdown of its most important trading partners. In the following two years, Macedonian economy returned into the zone of positive growth rates. According to the estimated data, in 2013 and 2014 GDP has increased by 2.7 and 3.8 percent, respectively. During these two years GDP growth was brought up by the improvement of the external environment and the activation of new facilities in the technological-industrial export-oriented development zones, the activity of which resulted in significant increase in production and exports. In addition, public investments in infrastructure provided further stimulus to the economic activity.

Government investments strongly influence economic performance

Moderate increase in household consumption that occurred in the same period resulted from favorable labor market developments and growth in real wages. Government consumption, on the other hand, contributed negatively to GDP growth. Increased domestic demand and stronger export activity gave rise to imports, thus leading to a negative impact of net exports to GDP growth. Similar trends continued in the first two quarters of 2015.

Some improvements on the labor market, but employment prospects still weak for the young

In spite of continuous employment increase and unemployment decrease, in the last few years, the situation on the labor market in the Republic of Macedonia has not significantly improved. With employment rate of only around 41 percent, the Republic of Macedonia still belongs to the group of countries with very low employment rate. Data on officially insured persons suggest that in the period 2010–2014 the number of employed increased by approximately 50 thousand, out of which a substantial part found work in the public sector. At the same time the number of employed in the agriculture increased from 115.6 thousand in 2010 to 127.4 thousand in 2014, but majority of them are not officially insured or are recorded as unpaid family workers. The unemployment rate declined from 32 percent in 2010 to 26.8 percent in the first half of 2015. However, the Republic of Macedonia is still one of the countries with highest unemployment in Europe. Unemployment rate of persons aged 25-29 stubbornly remains around 40 percent, but the unemployment among persons with university education is also exceptionally high i.e., around 23 percent. High unemployment and low activity rate of only 57 percent coupled with relatively modest growth perspectives indicate that there are slim chances for emigration issue to vanish in years to come.

Public debt share doubled within one decade

In the whole period 2006–2015 fiscal policy has been very expansionary. In nominal terms, public revenues increased in that period by 60 percent mainly due to higher VAT revenues, and public expenditures increased by 72 percent. There is a lot of inertia in government expenditures that are mainly composed of wages and social transfers, and the inability to adjust the expenditure side to the revenue dynamics ends up in high fiscal deficits. As a result, public sector debt has nearly doubled over the past decade, reaching 43.3 percent of GDP in 2014.

Being aware of the shrinking fiscal manoeuvre space, the Government is striving to preserve the fiscal sustainability by putting in place fiscal rules, strengthening public finance management, improving tax collection and rationalizing expenditures. However, all these efforts are obviously not sufficient to retain deficit and public debt within affordable limits.

Revival of corporate credits and deceleration of non-performing loans

In 2015 growth of credits and monetary aggregates was higher than the average for the period 2009–2014. The structure of credit growth has also improved due to a revival of corporate credits signalling possible acceleration of investments and overall economic activity. Monetary policy continued to stimulate credit growth by keeping the interest rates low. Positive credit market developments reflected the increased quality of credit portfolio, followed by the deceleration of non-performing loans. Share of NLPs in total loans has been constantly declining since the 2000s and the historical low has been reached in the third quarter of 2008 when its level was only as low as 6.5 percent. The crisis has somewhat disturbed the falling trend of the NLPs share, but not dramatically. The NLPs share is currently standing at 11 percent.

In recent years household deposits picked up mostly due to increased long-term deposits. It is worth noting that the share of Denar deposits in total deposits is going up, unlike in previous periods when deposits in Euro represented the major part of total deposits. Such a reversal of trends could indicate rising credibility in the banking sector and increased confidence in the monetary authority.

Inflation, as measured by the cost of living index, went down by 0.9 percent in the first quarter of 2015 compared to the same quarter last year. A 0.4-percent drop in the inflation has also been recorded on the quarter-on-quarter basis. Since the price decrease was mainly triggered by the fall in oil prices, the highest fall in prices is recorded for the prices of transportation.

Political crisis will most probably have a negative impact on FDI inflows

Negative trade balance constantly causes deficits on the current account of the balance of payments in the Republic of Macedonia. Major part of the deficit is covered by the remittance inflows. In 2013 and 2014 the current account deficit was reduced and in 2014 it reached the lowest level in the last eight years. Exports of goods went up, but imports followed the same dynamics, confirming high import dependence of the Macedonian exports.

In 2013 and 2014 foreign direct investments contributed largely to the inflows on the financial account of the balance of payments. The Republic of Macedonia is obviously becoming attractive to foreign investors thanks to a number of factors, from low labor costs and low tax burden, to price and exchange rate stability. Yet, the comparatively weak economy as well as the political crisis in the country, will most probably have a negative impact on the investors' perception of the country.

Table MK1 Main economic indicators

	2013	2014	2014 Q4	2015 Q1	2015 Q2
ECONOMIC ACTIVITY					
Real GDP (% change, yoy)	2.7	3.8	2.7	3.2	2.6
Real private consumption (% change, yoy)	2.1	2.3	2.9	2.2	-
Real government consumption (% change, yoy)	2.5	-1.2	1.9	0.9	-
Real investment (% change, yoy)	-16.6	13.5	1.8	2.4	-7.6
Industrial output (% change, yoy)	3.2	4.8	4.7	1.5	-
Unemployment rate (registered, %, pa)	29	28	27.6	27.3	-
Nominal GDP (EUR million)	8,112	8,533	-	-	-
GDP per capita (EUR)	3,931	4,127	63.6	-	-
PRICES, WAGES AND EXCHANGE RATES					
Implicit GDP deflator (% change, yoy)	4.3	1.4	-	2.3	-
Consumer prices (% change, yoy, pa)	2.8	-0.3	-0.4	-0.9	-
Producer prices (% change, yoy, pa)	0.4	-1.2	-1.0	-3.8	-
Average gross wage (% change, yoy, pa)	-1.6	1.3	3.2	3.1	-
Exchange rate, MKD/EUR (pa)	61.58	61.62	61.65	61.55	-
Exchange rate, MKD/US$ (pa)	46.40	46.44	49.35	54.59	-
FOREIGN TRADE AND CAPITAL FLOWS					
Exports of goods (EUR million)	2,370.3	2,779.2	761.2	669.3	-
Exports of goods (EUR, % change, yoy)	6.6	15.6	5.2	-6.7	-11.9
Imports of goods (EUR million)	4,228.4	4,634.9	1,244.8	1,087.8	-
Imports of goods (EUR, % change, yoy)	1.4	10.3	1.8	-13.8	-12.7
Current account balance (EUR million)	-146.8	-113.7	-9.7	-37.1	-
Current account balance (% of GDP)	-1.7	-0.8	-	-1.5	-2.9
Gross foreign direct investment (EUR million)	302,1	37,0	-84,0	32,2	76,2
Foreign exchange reserves (EUR million, eop)	1,993	2,436.5	2,436.5	2,354.8	2,254.8
Foreign debt (EUR million, eop)	5,219.7	5,992.3	5,992.3	6,242.6	6,342.2
GOVERNMENT FINANCE*					
Revenue (million Denars)**	140,267	145,929	41,365	37,779	40,352
Expense (million Denars)**	159,520	168,063	46,045	44,080	43,572
Net = Gross operating balance (MKD million)**	-19,253	-22,134	-4,680	-6,301	-3,220
Net acquisition of non-financial assets (MKD million)**	-13,229	-15,742	-5,718	-3,827	-2,180
Net lending/borrowing (EUR million)**	-6,024	-6392	1,038	-2474	-1,040
Domestic government debt (EUR million, eop)	1,174.1	1,170.3	1,170.3	1,256.1	1,281.1
Foreign government debt (EUR million, eop)	1,597.5	2,092.2	2,092.2	1,974.7	1,957.4
Total government debt (% of GDP)	34.2	38.2	38.2	36.0	36.1
MONETARY INDICATORS					
Narrow money, M1 (% change, yoy, eop)	6.2	22.2	22.2	16.4	23.0
Broad money, M4 (% change, yoy, eop)	5.3	10.5	10.5	8.8	9.2
Total domestic credit (% change, yoy, eop)	6.4	10.0	10.0	9.2	9.0
DMBs credit to households (% change, yoy, eop)	1.7	6.1	8.2	7.3	7.6
DMBs credit to enterprises (% change, yoy, eop)	7.9	11.7	12.1	11.8	12.4
Money market interest rate (%, pa)	1.9	1.8	1.6	1.5	1.0
DMBs credit rate for enterprises, short-term, (%, pa)	7.6	7.3	7.0	7.1	6.9
DMBs credit rate for households, short-term (%, pa)	7.3	7.8	6.6	6.5	6.2

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

Conventional abbreviations: pa - period average, eop - end of period, yoy - year on year, EUR - Euro, MKD - Macedonian Denar, US$ - US dollar, DMB – deposit money bank.

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

Policy assumptions and projections summary

Solid GDP growth in 2015 and 2016

We project that GDP is going to rise in the coming years at more or less the same pace as in 2014. There are no signs of significant policy changes as well. Through low interest rates monetary policy will support further increase in credit activity, mainly in the area of corporate credits, leading to a boost in the economic activity. Fiscal policy will most probably remain expansionary so that capital investments will be used as means of raising domestic demand. Exports are expected to grow at double-digit rates as a result of trade zones' activities, whereas imports are supposed to rise at somewhat lower rates. Thus, current account deficit will be kept relatively low. In the environment of economic growth and with the help of labor market policy measures unemployment is expected to go down although positive trends will not be sufficiently pronounced to push the unemployment rate below 25 percent. It is foreseen that the consumer prices will rise only moderately in the following period. ■

Table MK2 Summary of projections

	2015	2016
Real GDP (% change)	**3.5**	**3.6**
Real private consumption (% change)	2.3	2.4
Real government consumption (% change)	2.5	2.7
Real investment (% change)	5.3	5.2
Exports of goods and services (constant prices, % change)	14.1	12.1
Imports of goods and services (constant prices, % change)	11.8	9.4
Current account balance (% of GDP)	-2.4	-2.2
Consumer prices (% change, pa)	1.1	1.7
Exchange rate, national currency/EUR (pa)	61.5	-
Unemployment rate (registered, %, pa)	27.5	26.4
General government balance (ESA95 definition, % of GDP)	-3.4	-3.2
Broad money, M4 (% change, eop)	8.1	9.3
Total domestic credit (% change, eop)	-	-

Notes: Cut-off date for information used in the compilation of projections was October 20, 2015.
Conventional abbreviations: pa - period average, eop - end of period, EUR - euro.
Sources: Ministry of Finance of the Republic of Macedonia; National Bank of the Republic of Macedonia and State Statistical Office of the Republic of Macedonia.

MONTENEGRO

Booming at a cost of high twin deficits

Recent economic developments

EU accession – necessary, but not sufficient condition for economic growth

Montenegro officially declared its independence from Serbia in 2006. The dissolution of the loose political union between Serbia and Montenegro in 2006 led to separate memberships in several international financial institutions, such as the European Bank for Reconstruction and Development, the World Bank and the IMF. Montenegro was invited to submit a NATO Membership Action Plan in 2009, became an EU accession candidate in 2010, and member of World Trade Organization in 2011. Montenegro started the negotiations with the European Commission in June, 2012, having met the conditions set down by the European Council, which called on Montenegro to take steps to fight corruption and organized crime.

Participation in the Euro-Atlantic integration process as the basic political orientation of the country is perceived as the key economic framework within which Montenegro is to achieve its objectives on the road to renewed economic growth and development. However, recent economic developments clearly confirm that joining the EU does not guarantee good economic performance and that sound economic policies designed and implemented by local economic policy-makers are crucial in that respect.

After a deceleration, growth expected to resume in 2015

After a boom in the 2006–2008 period, when average growth rate reached 8.7 percent, Montenegrin economy entered a recession. Global financial and

economic crisis caused a 5.7-percent GDP decline in 2009, and high negative growth rate was recorded again in 2012 as a consequence of euro area crisis.

After recovering in 2013, GDP continued to rise in 2014, but at a slower pace due to a substantial decline in industrial production and only modest growth rates in tourism and trade. External factors such as slow recovery of eurozone economies and sanctions against Russia affected overall economic trends in Montenegro as well. The data for the first half of this year imply that the growth could resume in 2015 thanks to optimistic developments in tourism, trade, transport and construction.

Employment rising, mainly in the services sector

The unemployment rate in Montenegro in the second quarter of 2015 stood at close to 18 percent. The most important cause of unemployment is structural mismatch between demand and supply on labor market, the damaging effects of which seem to be reflected mostly in high youth unemployment.

During the first six months of 2015, the number of employees amounted to 174 thousand on average, and it recorded a year-on-year increase of 1.1 percent. Number of employees was increased in fifteen out of nineteen sectors while the highest rates of growth were recorded in real estate business (12.2 percent), sector of arts, entertainment and recreation (6.1 percent) and sector of professional, scientific and technical activities (6 percent). The largest decline in employment was recorded in manufacturing and agriculture (5.7 percent).

Expansionary fiscal stance

As a consequence of economic recession government revenues dropped considerably, creating high public deficits from 2009 onwards. Consolidation of public finances through cutting expenditures and better collection of taxes, primarily VAT, contributed to the reduction of budget deficit in 2014 to 3 percent of GDP. Unlike in 2014, public finances will revert to expansionary path in 2015. The deficit is projected to exceed 6.6 percent as a result of large capital expenditures.

In 2014 public debt stood at 55 percent of GDP. Due to the refinancing of the existing debt and the high negative budget balance in 2015, debt ratio will rise in 2015. Therefore, sustaining the debt level below 60 percent seems to be one of the biggest economic challenges in years to come.

Worrying share of non-performing loans

Pre-crisis period in Montenegro was characterized by high credit growth - loans increased 8 times during a three-year period. The negative impact of global financial crisis led to contraction of lending activity, followed by deterioration of the quality of banking assets. In spite of economic growth in 2013, real sector insolvency remained one of the biggest weaknesses of Montenegrin economy. In banking sector there was an apparent decline in non-performing loans, while liquid assets and deposits started to grow.

In 2014 Montenegrin banking system was characterized by high levels of liquidity and solvency. Profitability indicators improved as well, compared to previous periods. Same trends were recorded in the first six months of 2015.

Lending activity was somewhat more intense in the first half of 2015 than in the same period last year. In the same period there was constant and robust growth of banks' deposits. As a consequence, loan to deposit ratio became negative for the first time since 2006.

Table MN1 Main economic indicators

	2013	2014	2014	2015	
			Q4	Q1	Q2
ECONOMIC ACTIVITY					
Real GDP (% change, yoy)	3.5	1.8	2.6	3.2	3.4
Real private consumption (% change, yoy)	4.5	2.8	-	4.5	0.9
Real government consumption (% change, yoy)	-4.1	-1.5	-	3.6	-4.8
Real investment (% change, yoy)	3.7	0.9	-	6.8	32.3
Industrial output (% change, yoy)	10.6	-11.4	-7.3	7.1	12.8
Unemployment rate (%, ILO definition)	19.5	18	18.1	18.2	17.7
Nominal GDP (EUR million)	3,335.9	3,425	855	667	834
GDP per capita (EUR)	5,290	5,450	1,354	1,069	1,306
PRICES AND WAGES					
Implicit GDP deflator (% change, yoy)	1.9	-1.0	-	-1.6	1.4
Consumer prices (% change, yoy, pa)	2.2	-0.7	-0.3	0.8	2.1
Producer prices (% change, yoy, pa)	1.7	0.2	1	0.6	0.4
Average gross wage (% change, yoy, pa)	-0.1	-0.4	-0.3	0.4	0.1
FOREIGN TRADE AND CAPITAL FLOWS					
Exports of goods (EUR million)	402	357	101	76	72
Exports of goods (EUR, % change, yoy)	2.8	-9.7	5.2	3	-5.3
Imports of goods (EUR million)	1,732	1,733	438	346	489
Imports of goods (EUR, % change, yoy)	-2.7	0.6	1.9	4.4	41.0
Current account balance (EUR million)	-487	-525	-242	-197	-293
Current account balance (% of GDP)	-14.6	15.3	-	-	-
Gross foreign direct investment (EUR million)	479	498	92	100	-
Foreign exchange reserves (EUR million, eop)	423	544	544	938	818
Foreign debt (EUR million, eop)	29,035	30,997	30,997	33,292	32,643
GOVERNMENT FINANCE*					
Revenue (EUR million)**	1,243	1,351	-	-	-
Expense (EUR million)**	605	691	-	-	-
Net = Gross operating balance (EUR million)**	638	960	-	-	-
Net acquisition of non-financial assets (EUR million)**	853	1,062	-	-	-
Net lending/borrowing (EUR million)**	-216	-103			
Domestic government debt (EUR million, eop)	500.7	381		395.9	372.2
Foreign government debt (EUR million, eop)	1,433	1,561		2,047	2,160
Total government debt (% of GDP)	58.0	55.3		54.1	60.1
MONETARY INDICATORS					
Total domestic credit (% change, yoy, eop)	6.2	-2.5	-2.5	-24.0	-8.7
DMBs credit to households (% change, yoy, eop)	23.7	-3.5	11.0	16.4	31.0
DMBs credit to enterprises (% change, yoy, eop)	-5.8	28	40.0	11.0	47.0
Money market interest rate (%, pa)	3.25	1.4	0.4	0.5	/
DMBs credit rate for enterprises, short-term, (%, pa)	10.0	9.4	9.1	8.9	8.6
DMBs credit rate for households, short-term (%, pa)	11.3	11.0	12.1	12.2	12.0

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

High level of non-performing loans has been present in Montenegrin banking system since the escalation of economic crisis. In the recent period there have been some improvements, so that the share of non-performing loans currently stands at some 15.6 percent. According to the IMF's financial stability indicators, Montenegro belongs to the group of countries with the share of NPLs in total loans of over 15 percent. Together with Montenegro, in the same group of countries there are Bulgaria, Croatia, Cyprus, Greece, Ireland and Italy.

After a decline in 2014, consumer prices went up again in 2015

As a result of imported inflation in combination with modest growth of disposable income, prices in 2014 had a deflationary trend. Consumer prices in the last year registered a continuous decline, caused by decline in prices of food and sharp decline in the price of fuel by the end of the year. The annual rate of inflation (CPI) in December 2014 was -0.3 percent, while for the period from January to December this rate decreased by 0.7 percent year on year.

In 2015 prices started to rise again. In June this year, price level was 2.2 percent higher than at the end of December last year, and 1.9 percent higher on the annual level.

Goods imports more than five times higher than goods exports

In 2014, total Montenegro's international trade in goods amounted to EUR 2 billion. Total exports of goods amounted to only EUR 357 million, while the value of imported goods amounted to EUR 1.733 billion. Deficit in trade of goods was thus extremely high, and the surplus in trade in services brought about by good tourist season could not compensate for that. As a result, the current account deficit reached 15.3 percent of GDP. Similar trends continued in 2015, with goods exports covering less than 20 percent of goods imports in the first half of the year.

Policy assumptions and projections summary

Projections in Table MN2 reflect fully the official projections of the Ministry of Finance of Montenegro presented in its document Montenegro Economic Reform Programme 2015–2017. The macroeconomic projections for the period 2015–2017 foresee real GDP growth of 3.5 to 4 percent. High growth rates will result mainly from lively investment activity. It is also expected that tourism and complementary sectors such as trade, transport, and mining and quarrying, will strongly contribute to growth over the projected period. ■

Public investment as a fuel to economic growth in 2015 and 2016

Table MN2 Summary of projections

	2015	2016
Real GDP (% change)	**3.5**	**3.8**
Real private consumption (% change)	1.6	2.6
Real government consumption (% change)	1.3	1.5
Real investment (% change)	8.0	12.1
Exports of goods and services (constant prices, % change)	4.0	3.5
Imports of goods and services (constant prices, % change)	2.0	4.0
Current account balance (% of GDP)	-13.3	-13.8
Consumer prices (% change, pa)	1.0	1.5
Unemployment rate (ILO definition, %, pa)	18.2	17.6
General government balance (ESA95 definition, % of GDP)	-6.7	-5.4
Total domestic credit (% change, eop)	3.9	4.6

Notes: Cut-off date for information used in the compilation of projections was October 20, 2015.
Conventional abbreviations: pa - period average, eop - end of period, EUR - euro.
Source: The Ministry of Finance of Montenegro.

S E R B I A

Economic recovery in spite of severe fiscal consolidation

Recent economic developments

Political considerations might affect negotiations on EU accession

Serbia is faced with a protracted refugee crisis that might have damaging effects on its vulnerable transition economy. According to UNHCR, there were over 40,000 refugees and over 200,000 internally displaced persons in Serbia in 2014. There is an additional influx of several thousand people (up to 2014) on the basis of readmission agreements. According to the Danish Refugee Council, Serbia "...is still hosting the largest displaced population in Europe and it was proclaimed one of top 5 countries worldwide affected by a protracted refugee crisis...". In addition to the already present long-term refugee crisis, Serbia has been affected by the "new" refugee crisis, the one triggered by the war in Syria. Refugees passing through Serbia in transit to western European countries are mainly originating from Syria, Afghanistan and Iraq. Besides the refugee crisis, Serbia, as a candidate for the EU membership, faces a possible opening of Chapter 35 in negotiations with the EU, which deals with the issue of Kosovo. It is possible that some requirements would be unacceptable for Serbia, leading to deterioration of its political stability.

Modest recovery likely in 2015

After a steady growth recorded in the period 2005–2008 with an average annual real GDP growth rate of 5.4 percent, Serbia experienced a sharp

decline of economic activity in 2009 when GDP recorded a decrease of 3.1 percent. The following years were characterized by economic stagnation and relatively slow recovery. In 2014 GDP fell by 1.8 percent and was 1.5 percent lower when compared to the pre-crisis level (end of 2008), measured in constant prices.

Negative trend continued in the first quarter of 2015 when GDP decreased 2 percent on year-on-year basis, resulting mainly from lower government consumption and lower net exports. Second quarter brought a slight year-on-year improvement of 1 percent, which is a consequence of real investments increasing 8.6 percent (year-on-year) and of net exports improving influenced by lower rise of imports in comparison to exports (3 percent and 8.7 percent respectively).

High unemployment rate and large regional differences in employment

Recent labor market developments do not indicate positive changes in the number of unemployed persons. The unemployment rate stood at 29.2 percent in 2013 and remained unchanged in 2014. In the first half of 2015, the situation on the labor market somewhat changed. In the first two quarters of 2015 one can observe a mild decrease of the unemployment rate. The Republic of Serbia is trying to tackle the problem of the large unemployed population with the Strategy for Development Policy 2011–2020, which aims to establish a link between employers and scientific institutions. According to the official data, the share of people with a university degree within the younger cohorts is rising. Still, after graduating from university they remain unemployed or inactive. Another problem are the pronounced regional differences regarding employment. The number of those working within informal economy is higher in Šumadija and Western Serbia than in Belgrade by more than 15 percentage points.

New Labor law brings lower costs of hiring and firing of workers

The dynamics of real wages in Serbia has been strongly influenced by the public sector wage bill reduction that occurred in November 2014. After a sharp decline in the last quarter of 2014, gross real wages continued to fall. The decline of real net wages was slightly lower. Serbia has adopted the new Labor Law in July 2014. This Law should stimulate labor demand, especially by the private sector, since it will imply a reduction of costs related to workers' hiring and firing. The law also foresees shorter maximum length of fixed-term contract; more flexibility regarding working hours, with full- and part-time possibilities at the same employer; same conditions and salary for working at home or doing distance work, as for the regular work at the employer's premises; lower severance payments when workers opt for retirement, etc. In effect, the Law is intended to support the Government's effort to downsize the public sector. Industrial relations are still underdeveloped as the Government has a dominant role in the collective bargaining process, particularly at the national level.

Surprisingly good results of fiscal consolidation measures

In spite of the attempts to implement fiscal consolidation and structural reforms after the emergence of global crisis, growing government deficit and debt are jeopardizing the solvency of public finance, even in the medium run. The package of fiscal consolidation measures applied during 2014 was quite unsuccessful, as the Government failed to sustain the projected level of expenditure. A new set of measures was adopted at the end of 2014, and some of them have been already applied in 2015 e.g., cuts in public wages and pensions. The results of the most recent fiscal consolidation are so far surprisingly good, and the drop in fiscal deficit is even better than planned, mostly due to an improvement in tax collection. The overall deficit in the first half of 2015 can be estimated at 2 percent of the annual GDP and is 70 percent lower relative to the same period last year, with positive primary balance of some 2 percent of GDP. Consequently, if nothing changes in the rest of the year, 2015 could be the first year without a budget revision in quite a long period of time.

However, high level of public debt still remains the most serious threat to fiscal and macroeconomic stability, even in the case of successful implementation of all fiscal consolidation measures, since there are many threats to debt sustainability, such as currency depreciation shocks or weak economic growth.

Banks reluctant to lend money to the corporate sector

Successful fiscal consolidation in 2015 opened the possibility for more expansionary monetary policy. The National Bank of Serbia reduced the key policy rate by 2 percentage points i.e., from 8 percent to 6 percent, leading to a decrease in other interest rates on money market and loans. Reduction in the key policy rate was accompanied by the decrease in reserve requirement rate by 1 percentage point.

Despite the efforts of monetary authorities to stimulate credit activities of banks toward non-financial sector, credits declined during the first half of the 2015, after the program of subsidized loans has been terminated. The National Bank expects a further decline in credit activities, as most of the subsidized loans are falling due in the following period. In June 2015 the value of loans

Table RS1 Main economic indicators

	2013	2014	2014	2015	
			Q4	Q1	Q2
ECONOMIC ACTIVITY					
Real GDP (% change, yoy)	2.6	-1.8	-1.8	-2.0	1.0
Real private consumption (% change, yoy)	-13.2	-0.9	-1.2	-0.5	-1.4
Real government consumption (% change, yoy)	-1.1	0.1	1.9	-3.7	-2.9
Real investment (% change, yoy)	-12.0	-2.7	0.9	4.3	8.6
Industrial output (% change, yoy)	6.0	-7.1	-	-	-
Unemployment rate (registered, %, pa)	29.2	29.3	28.4	29.0	28.8
Nominal GDP (EUR million)	34,263	33,059	-	-	-
GDP per capita (EUR)	4,783	4,635	-	-	-
PRICES, WAGES AND EXCHANGE RATES					
Consumer prices (% change, yoy, pa)	2.2	1.7	-0.6	1.4	0.7
Producer prices (% change, yoy, pa)	0.8	0.2	0.2	0.7	1.2
Average gross wage (% change, yoy, pa)	-1.9	-1.7	-1.7	-1.4	-2.7
Exchange rate, RSD/EUR (pa)	113.1	117.3	121.0	121.5	120.4
Exchange rate, RSD/US$ (pa)	85.2	88.5	99.5	108.1	108.9
FOREIGN TRADE AND CAPITAL FLOWS					
Exports of goods (EUR million)	10,997	11,159	2,860	2,771	3,183
Exports of goods (EUR, % change, yoy)	25.8	1.5	-3.2	5.1	10.7
Imports of goods (EUR million)	15,469	15,497	4,052	3,862	4,155
Imports of goods (EUR, % change, yoy)	5.1	0.2	-4.2	8.3	5.1
Current account balance (EUR million)	-2,098	-1,985	-563	-521	-257
Current account balance (% of GDP)	-6.1	-6.0	-6.5	-7.2	-3.2
Gross foreign direct investment (EUR million)	1,548	1,500	347	374	463
Foreign exchange reserves (EUR million, eop)	12,102	11,643	11,643	12,169	11,977
Foreign debt (EUR million, eop)	25,747	25,829	25,829	26,735	26,512
GOVERNMENT FINANCE*					
Revenue (RSD billion)**	1,538.1	1,620.8		380.5	805.2
Expense (RSD billion)**	1,750.2	1,878.9		401.7	840.5
Net lending/borrowing (RSD billion)**	-212.1	-258.1		-21.1	-35.3
Domestic government debt (EUR million, eop)***	7,911.7	8,912.5		9,419.9	9,112.6
Foreign government debt (EUR million, eop)***	12,229	13,849		14,772	14,662
Total government debt (% of GDP)	61.0	72.2		74.6	73.0
MONETARY INDICATORS					
Narrow money, M1 (% change, yoy, eop)	25.8	11.0	-	10.5	6.3
Broad money, M4**** (% change, yoy, eop)	4.6	8.7	-	8.5	7.8
Total domestic credit (% change, yoy, eop)	-5.0	4.5	-	7.3	5.4
DMBs credit to households (% change, yoy, eop)	3.2	7.5	-	8.5	7.8
DMBs credit to enterprises (% change, yoy, eop)	-9.3	2.6	-	6.5	3.9
Money market interest rate (%, pa)	9.0	6.8	6.24	6.0	4.6
DMBs credit rate for enterprises, short-term*****, (%, pa)	10.6	8.5	8.2	8.2	7.4
DMBs credit rate for households, short-term***** (%, pa)	25.9	24.5	23.8	24.0	23.7

Notes: * Data refer to consolidated general government. . ** On the cash principle, cumulative from the beginning of the year. Expense includes net acquisitions of non-financial assets; statistics on gross operating balance is not available ***Statistics on domestic and foreign debt is available only for central government level **** Data on M3, being the broadest category of money for which statistic is compiled by the NBS ***** Interest rate on outstanding loans.

Conventional abbreviations: pa - period average, eop - end of period, yoy - year on year, EUR - Euro, US$ - US dollar, DMB – deposit money bank., RSD – Serbian Dinar.

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

to the non-financial companies was by 2.5 percent lower than at the end of 2014. The banks are reluctant to expand credit activities mostly due to risks stemming from non-performing loans. Share of the NPL in the first half of 2015 has increased both in households and corporate sectors, reaching 11.3 percent and 25.8 percent respectively. Although the share of NPL remains high, the banking sector is stable and the rate of capital adequacy is high at 21 percent. On the other side, deposits of non-financial sectors are on the rise in 2015, especially in foreign currency.

Stable prices and exchange rate

Until 2013, inflation in Serbia was perceived as a one of the biggest economic challenges. Its value was fluctuating within a range of 2.5 to 5.5 percent. Since then, annual inflation has had a decreasing trend, amounting to 1 percent in the first seven months of 2015. Low inflationary pressures resulted from low aggregate demand, lower food prices, stable inflation in the neighboring countries, and the decrease in prices of oil products on the world market. The prices of industrial products in July 2015 were increased by 0.6 percent when compared to July 2014.

During the first eight months of 2015, there were no significant fluctuations of the dinar exchange rate. For the first time, national currency is considered to be relatively stable over a longer period. Serbian dinar weakened against EUR by 0.8 percent when compared to the value from the beginning of 2015. Its value is 2.9 percent lower compared to the average level recorded in the previous year. Since the beginning of 2015, the National Bank of Serbia sold EUR 130 million and purchased EUR 880 million on the inter-bank foreign currency market, in order to prevent high daily fluctuations. The stability on the Serbian foreign exchange market has been achieved mostly due to the improved macroeconomic situation and favorable fiscal tendencies.

Rise in exports exceed the rise in imports

Over the first seven months of 2015 Serbia's current account deficit was nominally 30 percent lower in relation to the previous year. This improvement of the current account balance was caused mainly by the increased inflow of workers' remittances, and also by a rise in the services' surplus due to a surge in the exports of computer services. Trade deficits declined as well. In the observed period, FDI inflow reached over EUR 1 billion, recording a small year-on-year increase in nominal terms.

As far as the merchandise trade is concerned, exports exhibited a modest and slightly stronger growth than imports, resulting in a minor decrease in trade deficit. A year-on-year increase in the euro-denominated value of exports in current prices during the first eight months of 2015 stood at 9 percent. This growth was driven by agricultural products (cereals and fruits) and manufacturing industry (in particular steel, cigarettes and furniture). It is noteworthy that a growth in exports was attained even though exports of cars, Serbia's main export product, recorded a year-on-year decrease. Comparable tendency can be observed on the import side as well: main import goods (petroleum and cars) recorded year-on-year declines, so that the 5.9 percent rise in merchandise imports has been driven mainly by various machinery products, and, to a smaller extent, by metal ores.

Policy assumptions and projections summary

Table RS2 Summary of projections

	2015	2016
Real GDP (% change)	**0.5**	**1.5**
Exports of goods and services (constant prices, % change)	3.1	5.0
Imports of goods and services (constant prices, % change)	-1.5	2.9
Current account balance (% of GDP)	-4.7	-4.5
Consumer prices (% change, pa)	3.0	4.2
Exchange rate, national currency/EUR (pa)	122.4	124.8
Unemployment rate (registered, %, pa)	28.4	28.5
General government balance (ESA95 definition, % of GDP)	-4.0	-4.0
Broad money, M4* (% change, eop)	5.0	5.0
Total domestic credit (% change, eop)	3.0	3.0

Notes: Cut-off date for information used in the compilation of projections was October 20, 2015. * Data on M3, the broadest category of money for which statistic is compiled by the NBS.

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

Sources: Authors' projections, Fiscal strategy of the Republic of Serbia for 2015 with projections for 2016 and 2017, the IMF WEO.

Mild acceleration of economic activity in 2015–2017 period

Recent IMF projections indicate that positive growth trends in Serbia will continue in the final quarter of 2015. Annual growth rate is estimated to be around 0.5 percent. IMF data are in line with projections of the National Bank of Serbia. Both institutions are optimistic and foresee further growth acceleration in 2016 and 2017. Projected growth rates of 1.5 percent and 2 percent respectively will depend mainly on success in the implementation of structural reforms and on the level of investments.

The expected unemployment rate for 2015 and 2016 suggests no significant change; unemployment rate will be about 28.5 percent.

The declining trend of real wages will continue until the end of 2015. In spite of the announced wage growth in the public sector, due to the requirements of the International Monetary Fund, it cannot be expected that the decreasing path of real wages will be reversed in 2016. The Government currently considers increasing public wages and pensions in 2016, which is subject to negotiations with the IMF. ■

SLOVENIA

More stability provides for good growth prospects

Recent economic developments

Focus on fiscal consolidation and smart specialization

On his Government's first anniversary in September 2015, Prime Minister Miro Cerar highlighted political stability as a major achievement of the Government. Within the stabilization process, important steps have been made towards fiscal stabilization and consolidation aimed at balancing public finances and reducing public debt in the long term. Fiscal consolidation measures include recent adoption of draft budgets for the next two years, adoption of the state asset management strategy that should serve as a basis for more transparent privatization, and the adoption of the fiscal rule. In September 2015, the Government finally accepted a Smart Specialization Strategy (SSS) that defines the development priorities of Slovenia by 2023 and is an implementation document for three key strategies: Research and Innovation Strategy, Slovenia's Industrial Policy, and the Digital Agenda. SSS is strategically focused on sustainable technologies and services for a healthy life. According to SSS, Slovenia's target is to improve its competitiveness on the global market by increasing the extent of knowledge and technologies in its exports and increasing entrepreneurial activity.

Strong exports support further GDP growth

The outbreak of the global economic crisis in 2008 caused a sharp fall in Slovenia's GDP in 2009 by 7.9 percent. This contraction was mostly a result of

the relatively severe decline in exports and investments following an investment boom in the previous years. Slovenia experienced a double-dip recession. After a weak short-term recovery in 2010 and 2011, economic activity declined again in 2012 and 2013. Only in 2014 was a stronger recovery recorded with real GDP increasing by 2.6 percent. The growth was mostly driven by higher exports. Investments recovered as well, particularly the investments in public infrastructure, which were brought about by accelerated use of EU funds just before the 2006–2013 Financial Perspective elapsed. Domestic consumption increased in 2014 for the first time since 2008, due to a modest recovery in private consumption resulting from favorable labor market trends. At the same time, continued fiscal consolidation reduced government spending for the fourth consecutive year. In the first and second quarter of 2015, economic activity continued to recover primarily thanks to exports although their year-on-year growth slowed down. Inventories contributed to GDP growth in the first quarter and revived private consumption in the second quarter. Household consumption is, together with exports, expected to drive growth in the second half of the year as well as in 2016.

Lower labor protection and enhanced economic activity stimulates employment in the private sector

The situation on the labor market worsened significantly during the crisis. According to the Labor Force Survey, unemployment rate increased from 4.4 percent to 10.1 percent in the period 2008–2013 while it doubled among the young (15-24 years old) and stood at 21.6 percent in 2013. The new legislation entering into force in April 2013 improved the labor market flexibility. In the second quarter of 2013 the number of employed persons began to increase more intensely as a result of both the new labor market legislation and an enhanced economic activity. The survey-based unemployment rate declined to 9.7 percent in 2014 while the registered unemployment rate remained at the same level as in 2013. In the first half of 2015 we can observe the continuation of the rise in employment in the private sector. In public services, the increase in employment was most pronounced in health and social work and education, while employment in public administration continued to decline year-on-year. In the first eight months of 2015, the registered unemployment rate declined year-on-year, mainly as a result of fewer job losses.

Wages following the overall economic trends at a restrained pace

In the 2008–2014 period, economic crisis had a strong influence on wages, but the administrative measures such as minimum wage increase, salary system review in the government sector and fiscal consolidation measures determined the wage dynamics as well. Overall, wages adjusted less than employment during the crisis. After a nominal stagnation in 2012 and 2013, the average gross wage increased in 2014 both in the private and public sector. In the first eight months of 2015, the average gross earnings increased only by a moderate 0.5 percent due to the modest growth of earnings in the private sector. On the other hand, in public sector, wages went up by 1.1 percent, reflecting the growth of earnings in state-owned enterprises and last year's payments of suspended promotions in the general government.

Public finances again more sustainable

The stability of public finances deteriorated during the crisis. General government deficit widened considerably and became excessive already in 2009. Due to one-off factors, most significant of them being the bailout of state-owned banks, the general government deficit hit the record high in 2013 and reached 15 percent of GDP, but then declined to 5 percent of GDP in 2014. Excluding one-off measures, the general government deficit in 2014 was only as high as 3.3 percent of GDP which is its lowest level since 2008. The deficit narrowing was a result of the economic growth rebound and fiscal adjustment measures implemented on both revenue and expenditure side of the budget. In the first half of 2015, the general government deficit was slightly lower than in the same period of 2014 due to higher tax revenues and social contributions. The general government deficit is projected to account for 2.9 percent of GDP in 2015. Slovenia recorded a sharp increase in the general government gross debt-to-GDP ratio over the period 2008–2014. In 2014 it amounted to 80.9 percent of GDP which was 59 percentage points higher than in 2008. After skyrocketing in 2013 due to bank recapitalization, general government debt rose again in 2014 since the Government issued new debt in an attempt to make use of improved borrowing conditions. The general government gross debt-to-GDP ratio is expected to slightly decline this year.

Loan volume continues to fall

The stability of the banking system in Slovenia was disrupted during the crisis. At the end of 2013, the process of stabilization of the banking system began, involving recapitalization of state-owned banks and the transfer of non-performing loans to the Bank Assets Management Company. Despite the more stable situation in the banking system and the continuous decline in corporate indebtedness, bank loans to the economy are not yet rising this year. The volume of loans to domestic non-banking sectors declined

Table SI1 Main economic indicators

	2013	2014	2014 Q4	2015 Q1	2015 Q2
ECONOMIC ACTIVITY					
Real GDP (% change, yoy)	-1.1	3.0	2.8	2.8	2.6
Real private consumption (% change, yoy)	-4.1	0.7	-0.2	0.5	1.7
Real government consumption (% change, yoy)	-1.5	-0.1	0.8	-1.0	0.4
Real investment (% change, yoy)	2.7	5.7	-3.6	11.5	-0.6
Gross-fixed capital formation (% change, yoy)	1.7	3.2	-4.1	1.6	-1.5
Industrial output (% change, yoy)	-0.9	2.2	2.6	5.4	3.9
Unemployment rate (registered, %, pa)	13.1	13.1	12.7	13.2	12.3
Nominal GDP (EUR million)	35,908	37,303	9,410	8,952	9,849
GDP per capita (EUR)	17,435	18,093	na	na	na
PRICES AND WAGES					
Implicit GDP deflator (% change, yoy)	0.8	0.8	0.6	0.6	0.1
Consumer prices (% change, yoy, pa)	1.8	0.2	-0.1	-0.4	-0.6
Producer prices (% change, yoy, pa)	0.0	-0.6	-0.1	0.1	0.6
Average gross wage (% change, yoy, pa)	-0.2	1.1	1.3	1.2	0.5
FOREIGN TRADE AND CAPITAL FLOWS					
Exports of goods (EUR million)	21,692	22,989	5,928	5,895	5,960
Exports of goods (EUR, % change, yoy)	3.3	6.4	8.5	6.5	6.1
Imports of goods (EUR million)	21,306	21,755	5,534	5,594	5,598
Imports of goods (EUR, % change, yoy)	2.5	3.7	3.9	7.6	4.0
Current account balance (EUR million)	2,023	2,607	733	451	806
Current account balance (percent of GDP)	5.6	7.0	7.8	5.0	8.2
Gross foreign direct investment (EUR million)	71	746	-173	390	35
Foreign exchange reserves (EUR million, eop)	669	837	837	900	893
Foreign debt (EUR million, eop)	41,658	47,184	47,184	47,147	44,978
GOVERNMENT FINANCE*					
Revenue (EUR million)**	16,250	16,732	4,505	3,896	4,331
Expense (EUR million)**	21,650	18,580	5,314	4,301	4,649
Net = Gross operating balance (EUR million)**					
Net acquisition of non-financial assets (EUR million)**					
Net lending/borrowing (EUR million)**	-5,400	-1,849	-809	-405	-318
Domestic government debt (EUR million, eop)	14,763	15,988	15,988	15,660	15,606
Foreign government debt (EUR million, eop)	7,233	10,027	10,027	10,025	10,026
Total government debt (% of GDP)	70.3	80.9			
MONETARY INDICATORS					
Narrow money, M1 (% change, yoy, eop)***	0.1	18.5	18.5	20.6	21.3
Broad money, M3 (% change, yoy, eop)***	-1.3	6.1	6.1	4.8	4.5
Total domestic credit (% change, yoy, eop)	-16.8	-12.6	-12.6	-11.9	-11.6
DMBs credit to households (% change, yoy, eop)	-3.8	-1.7	-1.7	-0.2	0.3
DMBs credit to enterprises (% change, yoy, eop)	-23.8	-21.1	-21.1	-20.6	-21.0
3 months EURIBOR (%, pa)	0.2	0.2	0.1	0.1	-0.0
6 months EURIBOR (%, pa)	0.3	0.3	0.2	0.1	0.1
DMBs credit rate for enterprises, short-term, (%, pa)	4.8	4.3	3.8	3.3	3.1
DMBs credit rate for households, short-term (%, pa)	4.5	4.3	4.0	3.7	3.5

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

Conventional abbreviations: pa - period average, eop - end of period, yoy - year on year, EUR - Euro, US$ - US dollar, DMB – deposit money bank.

Sources: Statistical Office of the Republic of Slovenia, Institute for Macroeconomic Analysis and Development; Ministry of Finance; Bank of Slovenia and calculations by IER.

somewhat less in 2014 than in 2013, but the decline was still quite impressive, reaching 12.6 percent year-on-year. In the first seven months of 2015, both government and households' loans rose slightly, while corporate and non-financial institutions loan volume continued to fall although less than in the same period of last year. The loan-to-deposit ratio that stood at 1.6 in 2008 decreased continuously and reached only 0.98 by the end of the year. A 24-basis points-drop in the loan-to-deposit ratio in 2014 resulted mainly from a decline in loans to non-banking sectors, but also to some extent from a rise in corporate and household deposits. The share of non-performing loans increased considerably during the crisis and reached 17.3 percent in November 2013. Since the start of the banking system stabilization, the share of NPLs has been in decline and is hovering around 11 percent in 2015.

Weak demand and falling energy prices keep inflation in negative zone

Annual inflation in 2014 was at a historically low 0.2 percent, reflecting falling energy prices, in particular oil prices on global markets as well as a further decline in prices of durables. Dropping below zero in August 2014, inflation remained below zero in the first eight months of 2015. Lower energy prices had a major contribution to the 0.5 percent year-on-year deflation from January to August 2015. Core inflation has remained low due to a persistently weak domestic demand. After it has been declining at the monthly level for ten months, the real effective exchange rate deflated by the relative HICP increased in June 2015 for the second consecutive month due to the appreciation of the euro against most main trading partners; however, it remained lower than in June 2014.

Current account surplus expected to remain high in 2015 and 2016

The current account, which recorded a significant 5.4 percent of GDP deficit at the beginning of the crisis, turned into a surplus in 2011 and widened further over the last years reaching 7 percent of GDP in 2014. Aside from the quantity of traded goods and services, which contributed mostly to changes in the current account balance during the crisis, the increase in surplus has also recently been attributed to the terms of trade i.e., a decline in import prices. In the first and second quarter of 2015, the surplus in foreign trade increased further and is expected to remain high in 2015 and 2016 as long as deleveraging in the corporate sector continues.

The share of inward FDI in GDP has not increased much in the last years, standing at 24.7 percent at the end of 2013. Boosted by the renewal of the privatization process and increased sales of equity stakes in Slovenian companies, FDI inflow increased more significantly in 2014 amounting to EUR 746 million (more than three times the figure in 2013) with equity capital inflows totaling EUR 1,447 million. In the first quarter of 2015 foreign direct investment recorded an inflow of EUR 390 million, mainly consisting of equity capital. In the second quarter, however, the equity inflows were modest, and net claims abroad in the amount of EUR 96 million were recorded. Outward FDI, which recorded an unfavorable trend throughout the crisis, remained modest in the first half of 2015.

Policy assumptions and projections summary

Table SI2 Summary of projections

	2015	2016
Real GDP (% change)	**2.7**	**2.3**
Real private consumption (% change)	2.0	2.6
Real government consumption (% change)	-0.1	-0.4
Gross fixed capital formation (% change)	2.0	-1.8
Exports of goods and services (constant prices, percent change)	5.0	5.2
Imports of goods and services (constant prices, percent change)	4.9	3.8
Current account balance (% of GDP)	6.2	7.2
Consumer prices (% change, pa)	-0.4	0.8
Exchange rate, national currency/USD (pa)	1,109	1,102
Unemployment rate (registered, percent, pa)	12.3	11.8
General government balance (ESA95 definition, percent of GDP)	-5.0	-2.9

Notes: Cut-off date for information used in the IMAD's projections was September 4, 2015.

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

Sources: Institute for Macroeconomic Analysis and Development (Autumn Forecast of Economic Trends 2015) and European Commission (Spring 2015 Economic Forecast).

Reduced imbalances expected to provide stable environment for sustained growth

The projected values of the main macroeconomic aggregates are those presented in the Autumn Forecast 2015 of the Institute for Macroeconomic Analysis and Development (IMAD). The forecast reflects favorable developments in 2015 and foresees no changes in economic policies. In addition, it is based on the expectations of further economic recovery in the euro area, stable conditions on the financial markets and no major changes in monetary policy in the euro area. Regarding fiscal consolidation in Slovenia, the forecast assumes that some of the temporary measures for holding down government expenditure growth will remain in effect over the forecast horizon and that further deleveraging of the corporate sector and the stabilization of the banking system will gradually stimulate a revival of bank lending to the corporate sector.

The IMAD forecast for GDP growth in 2015 and 2016 is 2.7 percent and 2.3 percent respectively. The main drivers of economic recovery in 2015 and 2016 will be exports and private consumption; the somewhat weaker growth in 2016 will be attributable mainly to reduced government investment during the transition to the 2014–2020 Financial Perspective. A deceleration of net exports will act in the same direction, and is supposed to result from somewhat weaker growth in exports and a rebound in imports owing to rising domestic consumption. Growth in private investments is expected to accelerate gradually building on higher profits in the private sector and improved access to finance.

Yearly growth in employment is expected to be 1.5 percent in 2015. In the next two years employment is projected to rise further albeit at a slower pace. Employment recovery will happen predominantly in the private sector while the number of employed by the general government is expected to moderately increase only in 2017. ■

ANALYSIS

The business environment in SEE-6 countries

The World Bank's Doing Business Report offers a useful tool for comparing business environment in 189 economies. The latest report, Doing Business 2016, was published at the end of October 2015. The report assesses the ease of doing business through ten sets of indicators, measuring quality and efficiency of regulations and regulatory processes involved in setting up and operating a business. Since the Doing Business Report strives to improve the way regulation is assessed, eight out of ten sets of indicators have been subject to methodology changes in this year's report. Therefore, direct comparison of this year's ranking with the one from last year would not be advisable. However, Doing Business Report 2016 allows us to compare the business environment in six South East European countries included in SEE-6 Economic Outlook.

Rich dataset comprised in the Doing Business Report provides a comprehensive insight into elements of national legislation that have an impact on doing business in a particular country in the following areas: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency. It also assesses the features of the labor market regulation, but in 2016 report those assessments

were not included in the ranking. The information obtained from the report can undoubtedly be useful for investors and help them reach an informed investment decision. Also, this information can serve policy-makers as an objective indication on the areas that should be addressed and improved in order to increase growth prospects of a country. However, Doing Business Report does not measure the macroeconomic stability, market size, quality of the labor force, political stability, availability and quality of infrastructure and many other features of an economy that also determine the attractiveness of a location and overall business environment. It should therefore be considered as important, but not sufficient source of information for both, businesses and policy-makers.

Macedonia – the best ranked out of SEE-6 countries

Within six countries which we want to shed some light on, Macedonia ranks the best, i.e., 12th out of 189 compared countries. It is worth mentioning that only four EU members – Denmark, United Kingdom, Sweden and Finland are ranked better than Macedonia. It seems that Macedonian economic policy-makers have realized that a small economy like Macedonia should put a lot of effort into creating an exceptionally stimulating business environment if it wants to compete for investments with much bigger markets. Bosnia and Herzegovina, on the other hand is ranked 79th. Only one EU country, Malta, performs worse and is ranked immediately after Bosnia and Herzegovina. Two out of six SEE-6 countries, Slovenia and Croatia, are members of the European Union. It is clear that, being the members of the single EU market, these two countries perform well in the area of trading across borders. This automatically improves their rankings and makes them similar to those of other EU countries.

Table A1 **Ease of doing business ranking SEE-6**

	Ease of doing business rank	Overall distance to frontier	GNI per capita (US$)
Macedonia, FYR	12 / 189	80.18	5,070
Slovenia	29 / 189	75.62	23,436
Croatia	40 / 189	72.71	13,020
Montenegro	46 / 189	71.85	7,240
Serbia	59 / 189	68.41	5,820
Bosnia and Herzegovina	79 / 189	63.71	4,770

Source: Doing Business database.

SEE-6 more distant from the frontier than their peers

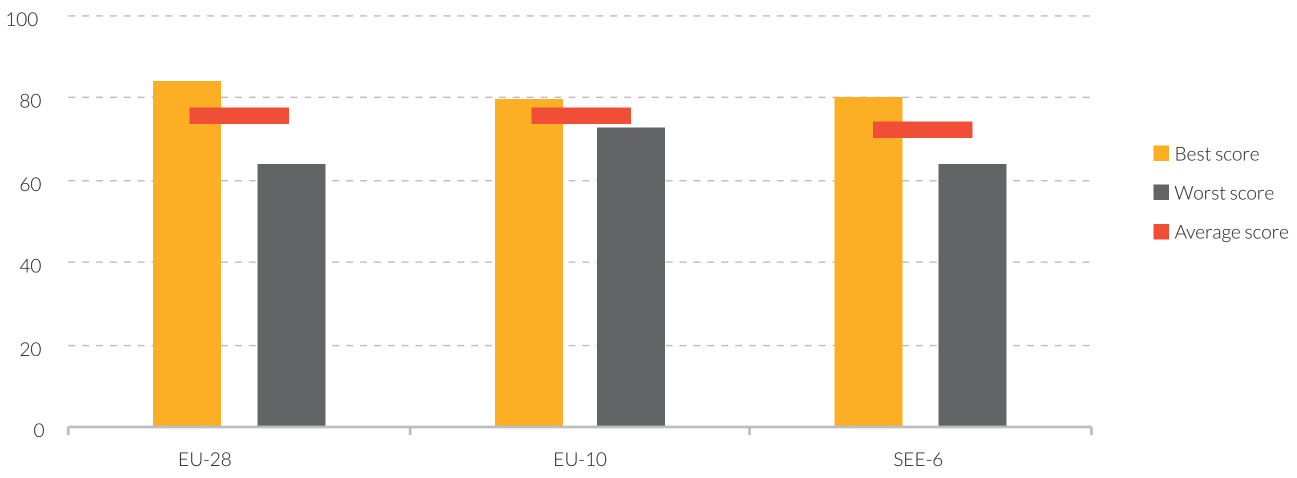
If one compares the countries that are the subject of interest of this publication with the EU-28 countries according to the distance to frontier scores, it is visible that the distance from frontier in SEE-6 countries is, on average, bigger for SEE-6 countries than for the EU-28 countries. Best score in EU-28 is better than in SEE-6, but on the other hand, worst scores for EU-28 and SEE-6 are almost equal. In other words, there is no country within the SEE-6 group whose business environment is worse than the one in any out of the 28 EU countries. The distance frontier score represents the difference between an economy's performance and a measure of best practice across the entire sample of 36 indicators. The value of this indicator equal to 100 is frontier and 0 is the furthest from frontier.

Comparison of the SEE-6 group with its peers, i.e., the post-transition EU countries (Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia) reveals that the average distance to frontier in SEE-6 is worse than in this group's peers, and also that the worst score for the EU-10 group is substantially better than the worst score for SEE-6. Hungary has the worst ranking in the EU-10 group, but only by two positions worse than that of Croatia, the third best ranked country in the SEE-6 group.

Narrow gap between SEE-6 and EU-28, but improvements are possible in many areas

A closer look into the aspects of business environment that are evaluated, allows us to discern the areas in which some countries perform better from the areas in which they lag behind their peers or other EU members. Since all of the SEE-6 countries belong to the first half of countries on the Doing Business ranking list, our first general conclusion is that the gap between them and the EU-28 is relatively narrow. However, there is room for improvement,

Figure A1 **Distance from frontier score in EU-28, EU-10 and SEE-6**



Source: Doing Business database.

and governments of all the SEE-6 countries should focus on implementing measures that would make the regulation in those countries more business-friendly. Aspects of regulation in which the SEE-6 countries are already quite advanced are the ones related to starting a business, getting credit and protecting minority rights. Some of the SEE-6 countries have an edge over the EU-28 in the area of paying taxes, which reflects low tax burden on companies brought about by low rates of corporate income tax and low or no tax on business property. However, the amount of time needed to pay taxes is still substantial and harms the ease of doing business in SEE-6. In the area of trading across borders the non-EU members of SEE-6 group still lag behind Slovenia and Croatia, but their distance to frontier in that respect is on average quite low. Areas into which most of the SEE-6 countries should put additional effort are: dealing with construction permits, lowering cost and time for getting electricity, increasing the efficiency regarding registration of property, and for the non-EU countries easing the trading across borders.

The comparison of distance to frontier score for the six South East European countries shows that in many aspects of business environment these economies perform quite differently. Their difference is the least in the area of trading across borders and registering property, while in respect of the ease of getting credit these economies largely differ. It is easy to get credit in Montenegro, whereas in Slovenia getting a credit could be problematic. Taken as a group, the SEE countries can be perceived as a welcoming business environment in terms of trading across borders and starting a business. On the other hand, regulations affecting access to credit, protecting minority investors and enforcing contracts make these countries less competitive than the best performers.

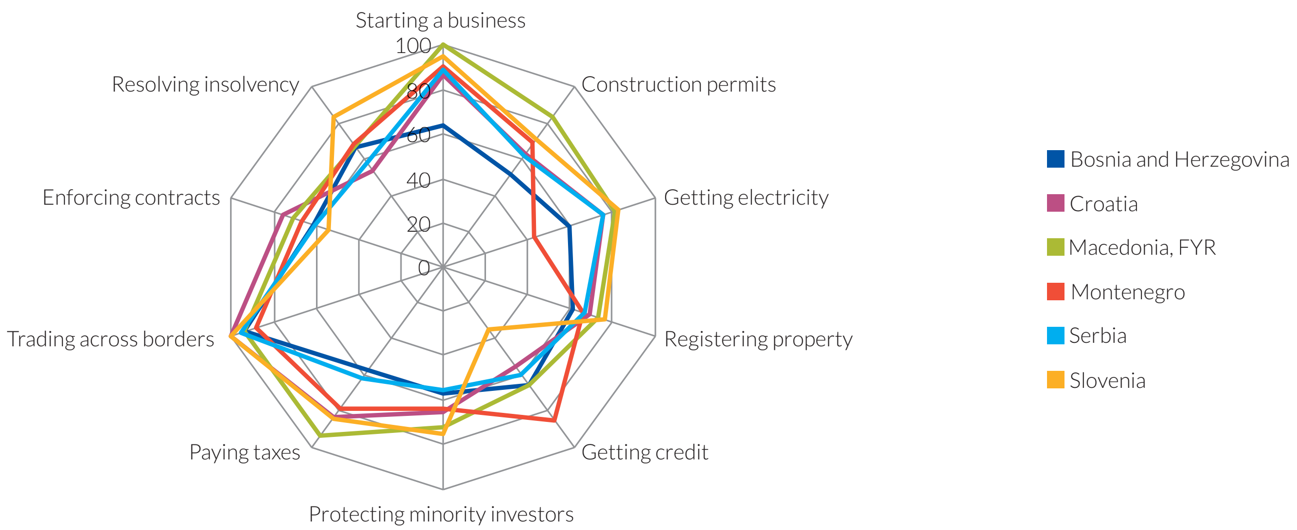
Table A2 Values of indicators in 10 areas, SEE-6 vis-a-vis EU-28 average

	Economy	Bosnia and Herzegovina	Croatia	Macedonia, FYR	Montenegro	Serbia	Slovenia
Starting a business	Procedures	12	7	1	6	6	2
	Time	67	12	1	10	12	6
	Cost	15	3	0	1	7	0
	Paid-in Min. Capital	28	27	0	0	0	42
Construction permits	Procedures	15	19	10	9	18	12
	Time	179	128	74	154	272	225
	Cost	19	9	5	12	4	3
Getting electricity	Procedures	8	5	3	7	4	5
	Time	125	70	97	142	131	38
	Cost	418	317	230	465	429	113
	Reliability of supply and transparency of tariff index	6	5	5	0	6	6
Registering property	Procedures	7	5	7	6	6	5
	Time	24	62	30	69	54	50
	Cost	5	5	3	3	3	2
	Quality of land administration index	13	23	24	18	16	23
Getting credit	Credit Information Index	6	6	7	5	7	4
	Legal Rights Index	7	5	6	12	5	3
Protecting minority investors	Extent of conflict of interest regulation index	5	5	7	6	5	7
	Extent of shareholder governance index	7	8	7	6	6	8
	Strength of minority investors protection index	6	7	7	6	6	8
Paying taxes	Payments	45	19	7	17	42	10
	Time	420	206	119	314	244	245
	Total tax rate	23	20	13	22	40	31
Trading across borders	Time to export: Border compliance	5	0	9	8	4	0
	Time to export: Documentary compliance	4	1	2	5	2	1
	Cost to export: Border compliance	106	0	103	158	47	0
	Cost to export: Documentary compliance	67	0	45	67	66	0
	Time to import: Border compliance	6	0	8	23	3	0
	Time to import: Documentary compliance	8	1	3	10	3	1
	Cost to import: Border compliance	87	0	150	306	52	0
	Cost to import: Documentary compliance	57	0	50	100	71	0
Enforcing contracts	Quality of judicial processes index	11	15	16	12	11	11
	Time	595	572	604	545	635	1160
	Cost	34	17	29	26	34	13
Resolving insolvency	Recovery rate	36	31	45	48	30	88
	Strength of insolvency framework index	15	12	14	14	14	12

Note: Red indicates large underperformance, light red slight underperformance, orange average performance, yellow slight better-than-average performance and green large better-than-average performance in comparison with EU-28.

Source: Doing Business database.

Figure A2 **Distance to frontiers for 10 indicator sets, SEE-6**



Source: Doing Business database.

At the end, it is worth noting that SEE-6 countries belong to the top ten performers in some areas, which proves that they have the ability to achieve remarkable results and set the pace in the global race. For instance, Macedonia ranks 2nd regarding the ease of starting business, 7th regarding paying taxes and 10th regarding the ease of dealing with construction permits. Montenegro is ranked 7th when it comes to the ease of getting credit, and Slovenia ranks 7th according to the minority investors' protection. Both Slovenia and Croatia rank 1st regarding the ease of trading across borders.

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