

Developments in selected CESEE countries:

Temporarily sluggish investment dampens CESEE growth whereas domestic demand continues to thrive^{1,2}

International environment remains challenging

1 Regional overview

The international environment for CESEE countries continued to pose challenges in the review period: Global growth lagged behind the buoyant pace of previous years, reflecting rebalancing in China, investment downscaling in commodity-exporting countries, exceptionally low world trade growth, and more moderate economic dynamics in several advanced economies. The expansion in the euro area – the CESEE region’s most important trading partner – decelerated notably from the first to the second quarter of 2016 and is projected to remain somewhat subdued throughout 2016.

Moreover, uncertainties continued to be high in the period. The U.K.’s vote to leave the EU in June had the most striking impact, with the implications and possible consequences of Brexit only just beginning to unfold. The potential risks for CESEE are manifold: Brexit is likely to have a negative impact on exports from the CESEE region, as several countries maintain close trade relations with the U.K. (e.g. the Czech Republic, Hungary, Poland and Slovakia). Furthermore, Brexit has already led to a moderate downward revision of growth forecasts for the euro area for the year 2017. Negative effects might also stem from stricter labor market regulations for foreigners working in the U.K. Especially Bulgaria, Poland and Romania have large shares of migrant workers in the U.K. Brexit will end inflows from one of the biggest net contributors to the EU budget and could potentially also impair EU fund flows to CESEE.

Increased global economic uncertainty put further downward pressure on global interest rates, as monetary policy is now expected to remain accommodative for longer than originally anticipated. The shift in expectations was particularly notable in the U.K., but U.S. rate hikes are now expected to be postponed as well. The ECB remained committed to monthly asset purchases and kept its policy rate at 0%. But monetary accommodation has so far failed to drive up inflation rates substantially. A range of additional factors contributed further to uncertainty: an increasingly fraying consensus about the benefits of cross-border economic integration, the war in Syria and the related refugee situation, and multiple acts of terrorism.

Growth moderates especially in the first quarter of 2016

Growth in the EU Member States in the country sample experienced a temporary setback especially in the first quarter of 2016. Gross fixed capital formation (GFCF) suffered from the end of the EU’s 2007–2013 programming period under the multiannual financial framework for the disbursement of EU funds (funds could be drawn until the end of 2015). Economic output accelerated again in the second quarter of 2016, however, bringing average growth back to a robust 1%

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² Cutoff date: October 7, 2016. This report focuses primarily on data releases and developments from April 2016 up to the cutoff date and covers Slovakia, Slovenia, Bulgaria, Croatia, the Czech Republic, Hungary, Poland and Romania, as well as Turkey and Russia. The countries are ranked according to their level of EU integration (euro area member states, EU Member States, EU candidate countries and non-EU countries). For statistical information on selected economic indicators for CESEE countries not covered in this section (Albania, Bosnia and Herzegovina, Kosovo, FYR Macedonia, Montenegro, Serbia and Ukraine), see the statistical annex in this issue.

quarter-on-quarter rate, up from only 0.3% in the first quarter of 2016. This pattern was especially pronounced in Hungary, Poland and the Czech Republic, whereas GDP dynamics remained more stable in the other countries of the region. Growth was especially vigorous in Romania and fell substantially short of the regional average only in Slovenia and Croatia. Even in these countries, however, the economy expanded by a solid 0.5% (quarter on quarter). In Croatia, this rate represents a stable recovery from the recession that ended in 2015.

Russia reported some improvement in economic conditions, as the contraction of GDP slowed down markedly in the review period both in quarter-on-quarter and year-on-year terms. Hence, the recession is bottoming out.

By contrast, growth decelerated markedly in Turkey in the second quarter of 2016 (quarter on quarter and seasonally adjusted), as political uncertainties impacted negatively on capital formation and the tourism sector. Additionally, bilateral economic sanctions between Turkey and Russia reduced trade between the two countries in the first half of 2016.

Table 1

Real GDP growth

	2014	2015	Q1 15	Q2 15	Q3 15	Q4 15	Q1 16	Q2 16
<i>Period-on-period change in %</i>								
Slovakia	2.5	3.6	1.0	0.9	1.0	1.0	0.8	0.9
Slovenia	3.1	2.3	0.5	0.6	0.3	0.6	0.5	0.5
Bulgaria	1.3	3.6	1.1	0.8	0.9	0.9	0.8	0.9
Croatia	-0.4	1.6	0.2	0.9	1.4	-0.5	0.5	0.5
Czech Republic	2.7	4.5	1.4	1.3	1.0	0.3	0.4	0.9
Hungary	3.7	2.9	1.4	0.1	0.4	0.9	-0.5	1.0
Poland	3.3	3.6	1.4	0.4	0.8	1.3	-0.1	0.9
Romania	3.0	3.8	1.2	-0.1	1.6	1.2	1.5	1.5
Turkey	3.0	4.0	1.3	1.3	1.3	0.7	0.8	0.2
Russia	0.7	-3.7	-1.2	-1.3	-0.6	-0.6	-0.2	-0.2
CESEE average ¹	1.9	0.2	0.1	-0.2	0.3	0.2	0.2	0.3
Euro area	0.9	1.7	0.6	0.4	0.3	0.4	0.5	0.3

Source: Eurostat, national statistical offices.

¹ Average weighted with GDP at PPP.

The strong development of domestic demand, the most important component of GDP growth in all countries under observation besides Russia, continued to support the economies of the region. Private consumption displayed an especially remarkable momentum.

Domestic demand benefited from two factors in particular: improving labor market conditions and rising real wages. Unemployment rates have been falling consistently since early 2013 in most CESEE countries, substantially so in some. For example, Hungary's unemployment rate in seasonally adjusted terms declined from a peak value of 11.4% in February 2012 to 5.1% in August 2016, the lowest rate since recording started in 1996. The decrease was also considerable in Bulgaria, Poland and Slovakia. The Czech Republic chalked up an unemployment rate of 3.9% in August 2016, the lowest rate in the EU. At the same time, unemployment also declined among the most vulnerable age cohorts, namely young persons (below 25 years) and older persons (above 50 years). Long-term unem-

Domestic demand reasserts its position as the most important driver of growth

ployment generally remained elevated, but some favorable trends could also be observed (e.g. in the Czech Republic, Slovakia, Bulgaria, Croatia and Poland). Employment expanded noticeably in all countries but Romania, making the first half of 2016 a generally very successful period for the labor market.

In some countries, however, those positive developments have led to signs of overheating. One important signal is wage growth: Nominal wages rose powerfully in the review period, averaging around 4.5% growth in the first half of 2016. Romania even reported double-digit wage increases (also caused by a hike in the minimum wage). This development has already caused competitiveness in several countries to deteriorate somewhat, as will be explained below.

Real wage growth was further boosted by low or negative inflation rates, especially in Central and Southeastern Europe (see also the description of inflation rates below). All of the above developments supported consumer spending but also had a positive impact on consumer sentiment, which in September 2016 reached the highest level since late 2007.

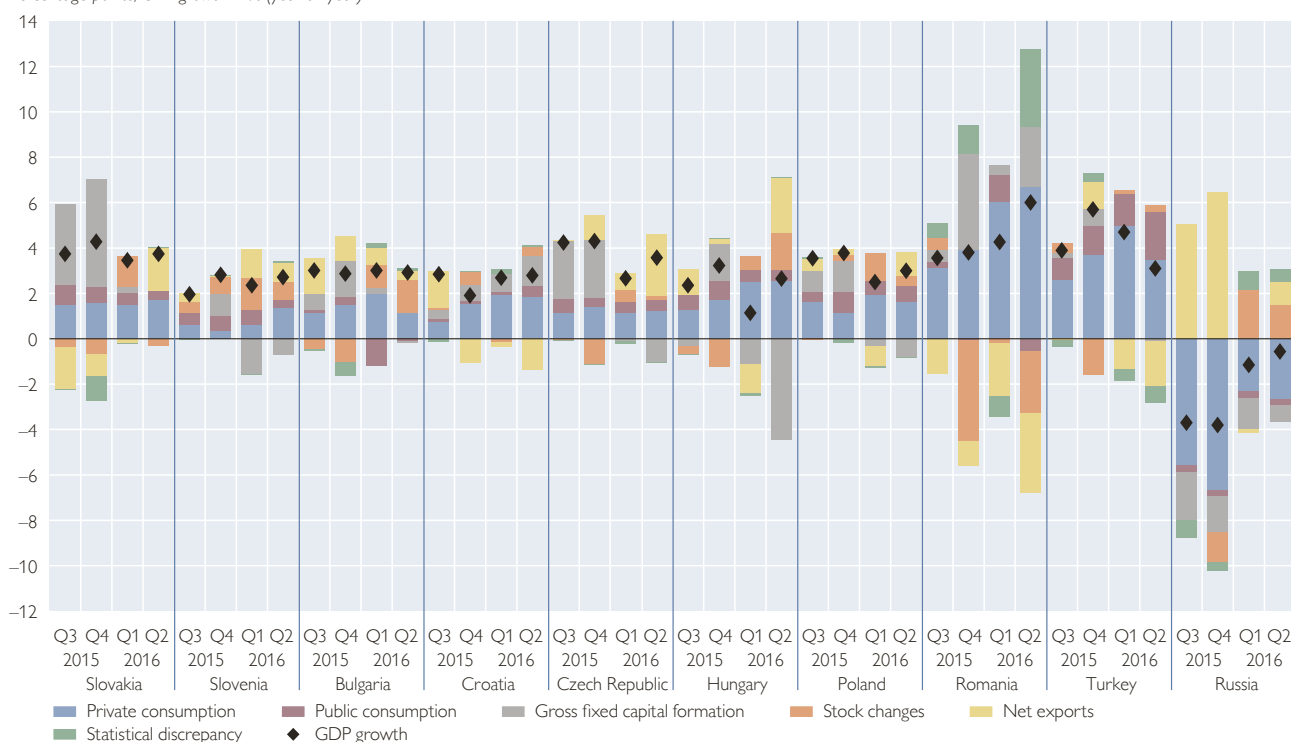
While consumption growth continued its dynamic trend of previous quarters, capital formation experienced a noticeable setback, especially in the EU Member States of the sample. Investment growth decelerated from an average 8.7% in the final quarter of 2015 to -1.2% in the first quarter of 2016 and to -2.6% in the second quarter of 2016. This drop was related to the end of the last year of overlapping programming periods for the disbursement of EU funds from the

Investment experiences a noticeable setback

Chart 1

GDP growth and its main components

Percentage points, GDP growth in % (year on year)



Source: Eurostat, national statistical offices.

2007–2013 and the 2014–2020 financial frameworks. Public investment and investment in construction were particularly affected, but investment in machinery was also weaker in most countries.

In Turkey, investment growth weakened, too, and turned negative (year on year) in the second quarter of 2016. Capital formation has been softening for several quarters already. The recent decline, however, might well be linked to mounting political uncertainty and security risks in the country. By contrast, the contraction of investment in Russia moderated in the review period.

The external sector's contribution to growth developed somewhat unevenly in CESEE. Net exports exerted a notable drag on growth especially in Romania and Turkey. In both countries, imports increased more strongly than exports against the background of brisk consumption. In Turkey, exports also suffered from the ongoing economic downturn in major trading partner countries (e.g. Iraq), economic sanctions imposed by Russia as from January 2016, and a weak tourist season. A moderately negative growth contribution of net exports was also reported for Croatia, where both import and export growth decelerated somewhat from exceptionally high rates seen in 2015. In Russia, the contribution of net exports to growth declined to close to zero as exports dipped into the red, triggered by the renewed fall in the oil price at the beginning of the year. Conversely, the contraction of imports moderated, given the incipient recovery of the economy.

Yet in the other countries of the region, improving net exports absorbed some of the negative impact of weakening investment on GDP growth. Export growth picked up somewhat in Slovenia and Poland but lost some steam in Slovakia, the Czech Republic, Bulgaria and Hungary. However, the strong deterioration of investment activity caused import growth to decelerate even more than export growth.

Net exports absorb some of the negative impact weakening investment has on GDP

The weakening export dynamics observed in many countries of the region reflected somewhat softer demand from the euro area but may also be related to a rather broad-based deterioration of competitiveness. Unit labor costs (ULCs) in manufacturing (measured in euro) increased more strongly than in the euro area in all countries but Slovenia, Poland and Russia. While Slovenia benefited from a favorable development of productivity, competitiveness in Poland and Russia was bolstered most by exchange rate depreciation. The same is true for Turkey, where a weakening lira counteracted a pronounced rise in nominal labor costs (+19.2% in the first half of 2016), bringing ULC growth in line with that in the euro area. In the other countries, competitiveness deteriorated amid rising labor cost pressure and weak or in some cases even declining productivity. This development was strongest in Bulgaria and Romania.

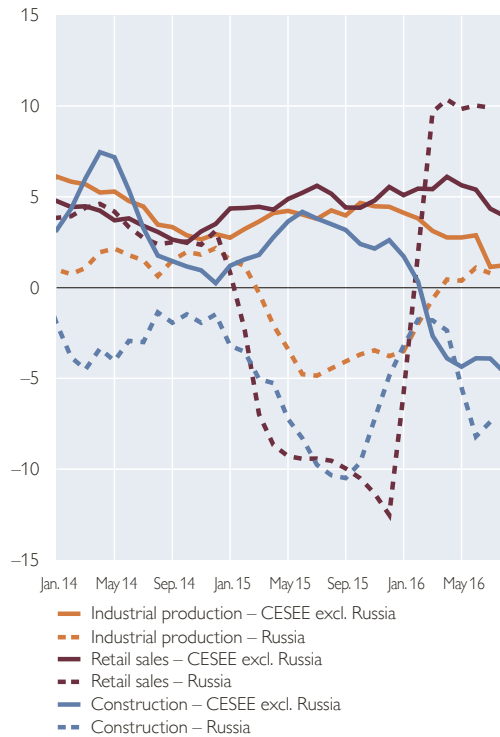
High-frequency activity indicators subsided in the review period in all countries but Russia. Above all, construction output started to contract at the beginning of the year, mirroring the development of capital formation against the background of lower EU fund disbursements. In August 2016, construction output declined by 4.7% in the region on average. Furthermore, the growth of industrial production decelerated notably, coming down from 4.1% at the beginning of the year to 1.2% in August 2016. Retail sales held up comparatively well and expanded by an average of 3.9% in August 2016. This figure, however, is also notably below the peak retail sales value of +6.1% in April.

High-frequency and sentiment indicators soften somewhat

Leading indicators

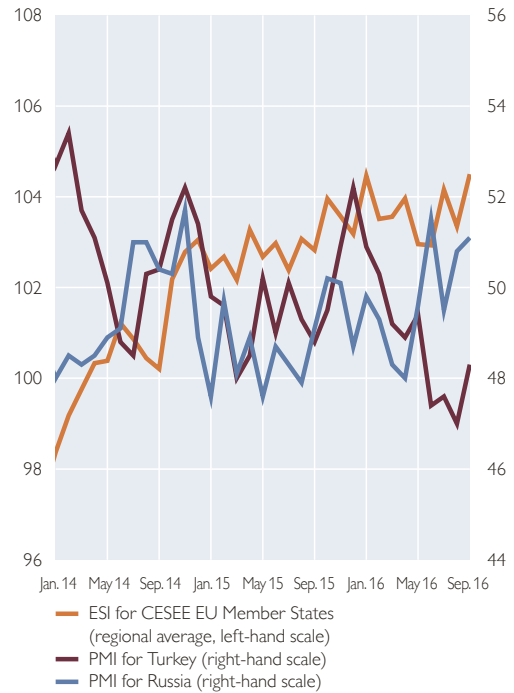
Activity indicators (CESEE regional average)

Year-on-year change in %, three-month moving averages



Sentiment indicators

Points



Source: Eurostat, wiw, European Commission, Markit.

As already mentioned, Russia marks the only exception to this general picture. Activity indicators clearly confirm that the recession in Russia has bottomed out. The growth of industrial production turned marginally positive, and retail sales even skyrocketed (+9.9% year on year in July 2016). Only construction did not manage a turnaround; it continued to contract substantially in the review period (−7.4% year on year in July).

Economic sentiment generally developed more favorably than activity indicators. The European Commission’s Economic Sentiment Indicator (ESI) stood at levels substantially above its long-term average throughout the review period (average for the CESEE EU Member States). In September 2016, it even reached a peak of above 104 points, the highest level since mid-2008. The Purchasing Managers’ Index (PMI) for Russia corroborates the improving state of the Russian economy, as it increased to above 50 points (the threshold indicating an expansion) in the review period. The PMI for Turkey, though, deteriorated markedly against the background of mounting political risks.

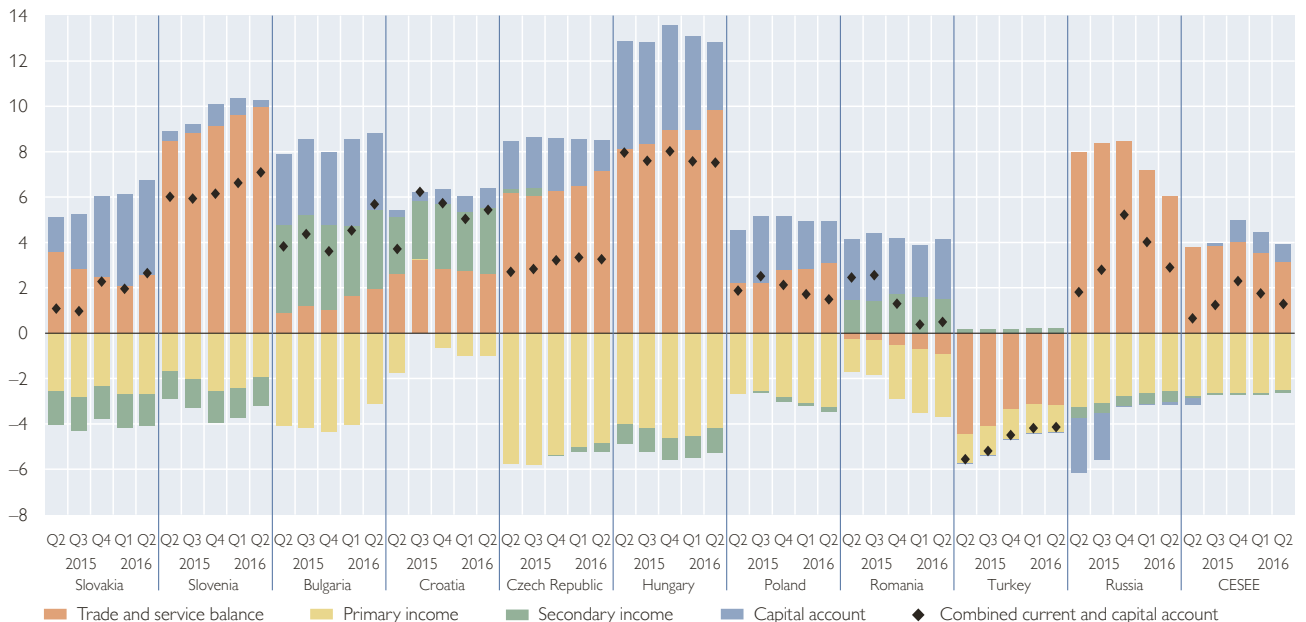
The combined current and capital account balance for the region as a whole deteriorated somewhat in the review period, decreasing from a surplus of 2.3% of GDP in the fourth quarter of 2015 to 1.3% of GDP in second quarter of 2016 (four-quarter moving sums). This development was mainly driven by a lower surplus in the trade and service balance, while the other components of the current account remained broadly unchanged.

CESEE’s current account surplus declines moderately

Chart 3

Combined current and capital account balance

% of GDP, four-quarter moving sum



Source: Eurostat, IMF, national central banks.

At the country level, it was especially Russia that influenced the development of the regional aggregate. In particular, the Russian surplus in the trade and service balance weakened in line with the low oil price and the slower contraction of domestic demand. A more notable improvement in the external position was reported for Bulgaria, whose trade balance and balance on primary income improved. In the other CESEE countries, external positions remained broadly unchanged, with absolute changes in the combined current and capital account balance not exceeding 1% of GDP in all countries between the end of 2015 and mid-2016. However, some more striking changes in the individual components of the current account were observed in several countries: Better outcomes in trade balances cushioned the deterioration in capital accounts that was related to lower EU funds flowing into the region.

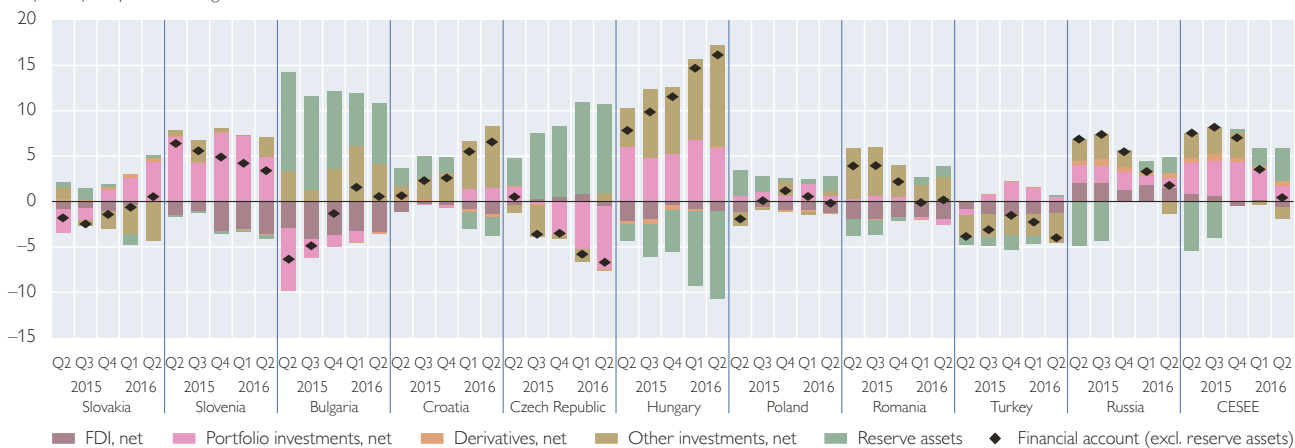
The financial account balance (the difference between the net acquisition of assets and the net incurrence of liabilities, excluding reserves) of the ten CESEE countries as a whole diminished from 7% of GDP in the fourth quarter of 2015 to 0.4% of GDP in the second quarter of 2016. Accordingly, CESEE countries' net acquisition of assets was roughly equal to their net incurrence of liabilities. This development was driven by other investments, where the CESEE region became a net debtor in the review period. Furthermore, holdings of portfolio investment assets declined substantially.

Developments in individual countries were heterogeneous. The financial account deteriorated in Slovenia, the Czech Republic, Poland, Romania, Turkey and Russia. Slovenia and Russia remained net creditors vis-à-vis the world, and the financial account was broadly balanced in Romania and Poland. The Czech Republic and Turkey incurred net liabilities in the review period.

Financial account reports a broadly balanced position

Financial account balance

% of GDP, four-quarter moving sum



Source: National central banks.

No price pressure
in the CESEE region
except in Turkey
and Russia

Slovakia, Bulgaria, Croatia and Hungary reported improvements of the financial account balance. All countries are net creditors vis-à-vis the world. While Slovenia and Hungary have already held this position for several quarters, Slovakia and Bulgaria became creditors in the review period.

Low energy prices continued to exert downward pressure on inflation rates in the CESEE EU Member States. Average annual inflation hovered around -0.5% throughout the review period without clearly tending up or down. The only notable exception from this pattern was Romania. Price rises gained speed against the background of a base effect stemming from a broadening of the application of a reduced VAT rate in June 2015. Apart from Romania, only the Czech Republic reported positive inflation in August 2016.

Declining prices were clearly a function of deflationary pressure from the energy component of the HICP, as other components did not add much dynamism to price developments. Neither food nor industrial goods made a substantially positive contribution to inflation in most countries. Only services pushed prices up somewhat in the CESEE EU Member States. Against this background, core inflation rates remained low but still positive in the region. Only Bulgaria and – as of late – also Croatia reported moderate deflation also for the core components of the HICP.

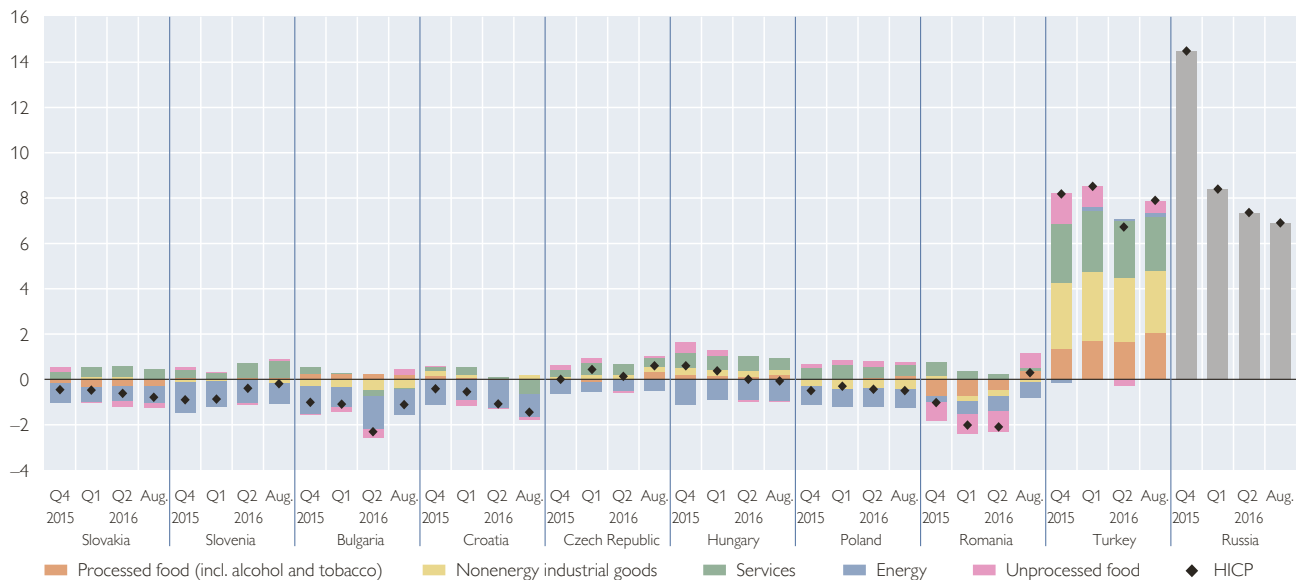
In Turkey, inflation came in at 7.9% in August 2016, notably below the 9.6% observed in January but also markedly above the inflation rate of 6.6% in April and May. Especially in July, inflation augmented sharply (to 8.3%), as food prices edged up owing to higher prices for fresh produce and higher sales taxes on cigarettes. Some of the increased price pressure might have also been due to the slide of the Turkish lira following the attempted coup in mid-July. The currency stabilized in the weeks thereafter, but continues to trade weaker than before the failed coup.

In Russia, the inflation rate came down from 15.8% in August 2015 to 6.9% in August 2016. The drop in annual inflation was aided by a base effect (the impact of the sharp price rise in 2015 dissipated), persisting weak demand and the shrinking ratio of imports to GDP.

Chart 5

HICP inflation and its main drivers

Percentage points, contribution to year-on-year change in HICP; HICP in %



Source: Eurostat.

Note: Russia: CPI. No breakdown according to COICOP available.

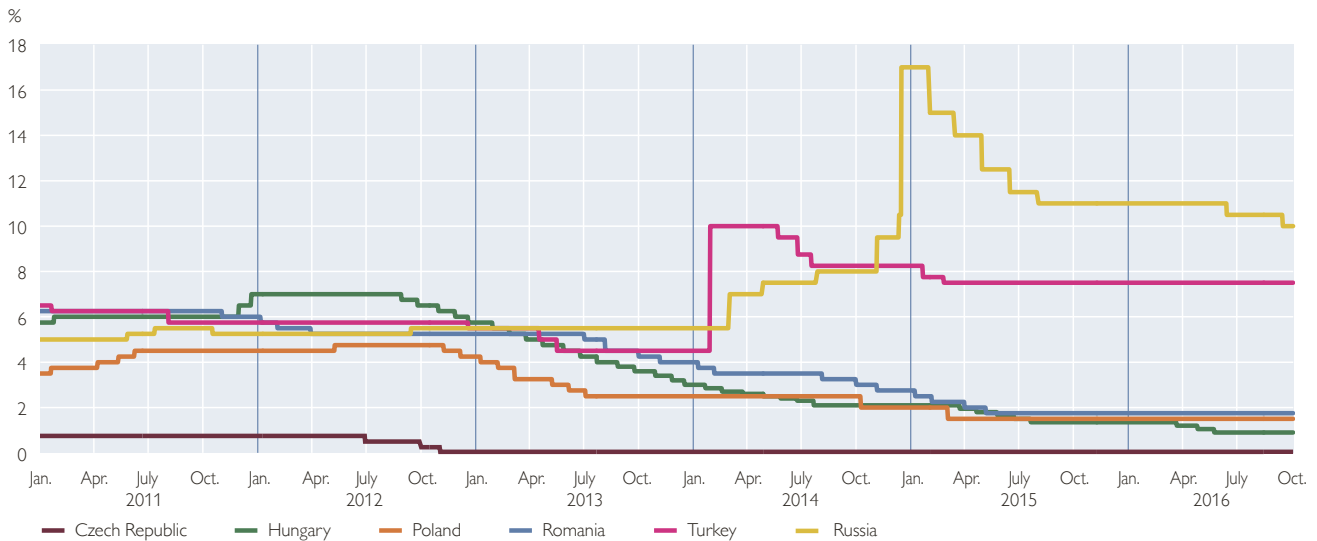
Against the backdrop of disinflation or deflationary trends, the central banks of CESEE countries continued to pursue a policy of monetary accommodation (see chart 6) and retained policy rates at historically low levels. The Hungarian central bank (MNB) even cut its policy rate in two steps from 1.2% in March to 0.9% in May. The overnight deposit rate has also remained below zero (−0.05%) since March 2016. Moreover, to support lending to the nonfinancial sector, the MNB has put a limit on access to the three-month deposit facility (its main policy tool), thereby increasing banking sector liquidity. The Czech Republic's policy rate has been standing at “technically zero” since October 2012. In November 2013, the Czech National Bank (CNB) had decided to use the exchange rate as an additional instrument to ease monetary conditions and to prevent the exchange rate of the koruna from appreciating to levels below CZK 27 per EUR 1. The CNB ruled out a discontinuation of the exchange rate commitment before the start of 2017. In the review period, the CNB intervened several times in the foreign exchange market, buying a total of EUR 2.65 billion. Russia cut its policy rate in two steps by a total of 100 basis points to 10% in September as risks to inflation moderated.

Turkey kept its main policy rate (one-week repo lending rate) on hold in the review period. In an attempt to simplify its monetary policy framework, however, it adjusted its overnight lending rate several times from 10.75% in March to 8.25% in September, substantially narrowing the rate corridor of its overnight rates. The Turkish central bank's rate cuts have deferred to government pressure for lower rates. At the same time, expectations of U.S. policy rate increases have been repeatedly postponed, resulting in relatively loose global liquidity conditions that have enabled Turkey to reduce rates without major negative consequences for the already weak lira.

Monetary policy stays accommodative

Chart 6

Policy rate developments in CESEE



Source: National central banks.

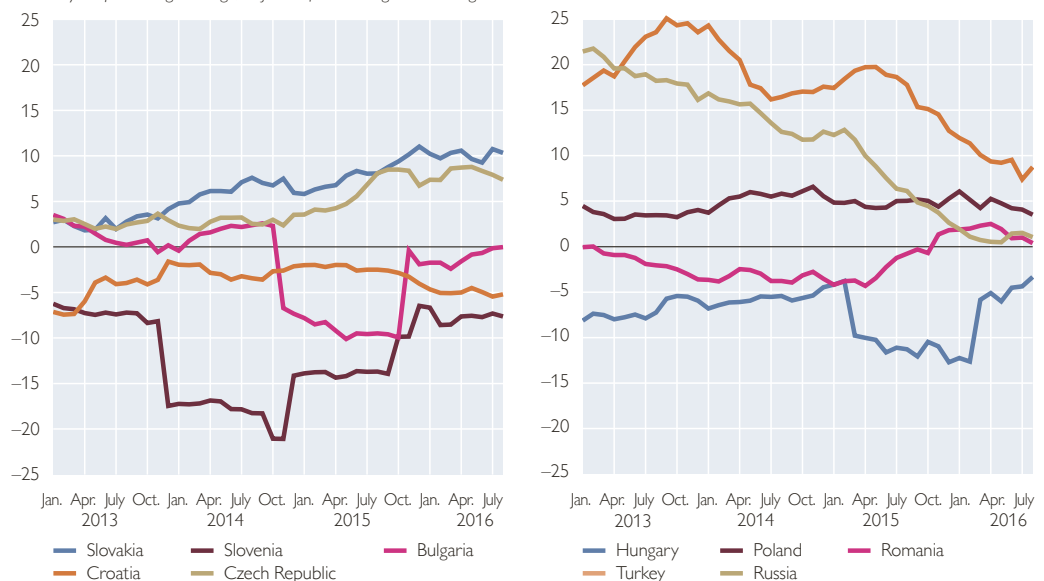
Deleveraging still ongoing in several countries despite heterogeneous credit developments

The development of domestic credit to the private sector (nominal lending to the nonbank private sector adjusted for exchange rate changes) was somewhat heterogeneous in the review period. Among the EU Member States, credit growth was highest in the Czech Republic and Slovakia at 7.4% and 10.3%, respectively, in August 2016. While dynamics were broadly unchanged in Slovakia, credit growth decelerated somewhat in the Czech Republic as corporate credit growth lost speed.

Chart 7

Growth of credit to the private sector

Year-on-year percentage change, adjusted for exchange rate changes



Source: National central banks.

Solid credit developments in both countries were promoted by favorable expectations regarding general economic developments and a sound liquidity position. Furthermore, banking sectors are in healthy shape, with low nonperforming loan (NPL) ratios, sound profitability, deposit overhangs over credit, persistent competitive pressure as well as low stocks of loans denominated in foreign currency.

Credit growth was also rather swift in Poland. Key indicators for the country's banking sector, however, are somewhat weaker than in Slovakia and the Czech Republic. In Poland, the loan-to-deposit ratio remained above 100, and the country still reports a substantial share of foreign currency loans (especially Swiss franc loans) in total loans. The discussion about a conversion of those loans is ongoing, thereby adding to banking sector uncertainty. Furthermore, a bank asset tax in effect since February 2016 might dent banks' profitability and capital ratios. Bank lending has already softened moderately in recent months.

The credit stock continued to decrease in Hungary and Slovenia in the review period. Especially in Hungary, however, the contraction moderated. This was in part a statistical effect: The conversion of foreign currency loans to households at an exchange rate below the prevailing market exchange rate in the first quarter of 2015 dropped out of the base. Nevertheless, both household and corporate loans displayed some more favorable momentum in recent months, partly owing to central bank measures (Funding for Growth Scheme, Growth Supporting Programme). Furthermore, the reduction of the bank tax as of January 2016 already strengthened banking sector profitability.

In Slovenia, credit to households expanded moderately. This development, however, was not sufficient to offset the effect of strongly contracting corporate credit on private sector credit growth. Nevertheless, the country made some progress in cleaning up balance sheets, raising banking sector profitability and improving capitalization.

In Romania, credit growth declined and came to a standstill in August. As in the case of Slovenia, especially corporate credit was a drag on credit growth; household credit actually accelerated. Progress has been achieved in shoring up the banking sector in recent years; NPLs have been reduced and the loan-to-deposit ratio has been lowered. The recently adopted mortgage law allowing retail mortgage borrowers to return real estate collateral to banks in exchange for writing off their loans, however, might have negative implications for profitability and capitalization.

The contraction of the credit stock in Bulgaria ground to a halt in August 2016. The development was driven by both corporate credit and household credit. The Bulgarian banking sector reports an overhang of deposits over credit, a comparatively high but declining share of credit denominated in foreign currency, and rising profitability amid improving balance sheets. The release of a stress test and an asset quality review in August certified that the Bulgarian banking system remains well capitalized.

In Croatia, the process of conversion and the partial write-off of loans in Swiss francs initiated in the last quarter of 2015 compounded the impact of the debt overhang and the lack of collateral, thus causing credit growth to decline further in the review period.

Credit growth moderated in Turkey and Russia. In Turkey, loan growth has been declining since mid-2015 and came down to 7.4% in July before picking up

Lending surveys
draw a broadly
positive picture

again to 8.7% in August 2016. Macroprudential measures adopted in previous years impacted especially on household credit. In Russia, slower credit growth was clearly related to the ongoing economic recession. The most recent data indicate that the credit cycle might have reached its bottom in summer 2016: The contraction of household credit abated and corporate credit gained some speed.

Lending surveys clearly indicate a pickup in demand for credit in the CESEE region. The most recent CESEE Bank Lending Survey of the European Investment Bank (EIB) found that demand for loans rallied across the board in the first half of 2016. This marked the sixth consecutive semester of favorable developments. All factors influencing demand made a positive contribution. Access to funding also continued to improve in the CESEE region, supported by easy access to domestic sources, mainly retail and corporate deposits. The development of supply conditions, however, was less straightforward, as already observed in the second half of 2015. Credit standards continued to ease for consumers as well as for corporates. However, the regulatory environment and banks' capital constraints adversely affected supply conditions. NPLs are also consistently indicated as a drag on supply by the EIB survey.

Banks expect demand to continue to increase robustly in the second half of 2016. However, supply conditions are expected to make significantly less progress, generating a widening demand-supply gap.

Country-level bank lending surveys reported mixed findings that only partly support this general picture. A positive development of supply and demand conditions was found only in Hungary and the Czech Republic. In the other countries, lending standards remained unchanged or were tightened depending on the particular loan segment. Demand has been increasing for consumer loans in most countries, while demand for corporate loans and housing loans was stable or in some cases weaker.

Analyzing the operation of international banking groups in the region, the EIB survey found that 27% of banking groups continued to reduce their total exposure to the region, thereby contributing to a further moderate decline of aggregate exposure in the review period. However, this negative trend seems to be bottoming out, as more and more groups expect a stabilization of exposure over the second half of 2016. While cross-border banking groups continue to discriminate between countries of operation as they reassess their country-by-country strategies, they are also increasingly signaling their intentions to expand operations selectively in the region. The survey also found that roughly 70% of groups describe the profitability of CESEE operations as outperforming the profitability of the banking group as a whole.

Western Balkans:¹ domestic demand is key to economic growth

In the first half of 2016, economic growth moderated in most Western Balkan countries compared to the same period of the previous year. In Bosnia and Herzegovina, FYR Macedonia and Montenegro, GDP growth slowed by around 1.5 percentage points and amounted to about 2%. With a growth rate of 3%, Kosovo exhibited a less pronounced slowdown (first half of 2015: 3.5%). By contrast, the Albanian and Serbian economies performed more favorably in the first half of 2016, recording growth of 3.1% and 2.9%, respectively. Particularly Serbia made up leeway, with growth 2 percentage points higher than in the same period of 2015, supported especially by a strong first quarter.

Despite more moderate economic growth, private consumption gained speed in almost all countries. Household consumption was marginally lower only in FYR Macedonia, as the ongoing political tensions weighted negatively on consumer confidence. In Kosovo, notably, private consumption rose by almost 6% in the first half of 2016. Furthermore, private consumption growth turned positive in the first half of 2016 in Albania and Serbia compared to a decline in 2015. This turnaround was largely supported by positive developments in the labor markets and higher purchasing power supported by muted price pressure. Impulses for growth from remittances were rather weak. In Albania, for instance, remittances slumped by 10% in the first quarter of 2016 (no data are available yet for the second quarter of 2016). The poor economic situation in Italy and Greece, the main destination of Albanian migrants, weighed on the flow of funds. In Kosovo – another country that relies heavily on remittances – inflows also dipped slightly in the first half of 2016. Public consumption growth was rather subdued or negative in most Western Balkan countries, reflecting fiscal consolidation.

Investment activity in the region generally developed positively in the first half of 2016, mostly because public sector investment was dynamic. In Montenegro, GFCF grew by an astonishing 25% in the first half of 2016; in Kosovo, GFCF also accelerated by more than 20% in the first quarter of 2016 (no data are available yet for the second quarter of 2016). In both countries, highway construction was behind booming (public sector) investment. In Montenegro, additionally, expenditures for power-generating projects and for tourism infrastructure boosted public investment. In Albania and Serbia, fixed investment expanded at a robust pace in the first half of 2016, albeit somewhat more moderately than in 2015. FYR Macedonia registered a drop of almost 10% in GFCF in the first quarter of 2016, but public infrastructure projects supported stepped-up investment activity in the subsequent months. To some extent, slowing private investment dynamics in FYR Macedonia are due to base effects, but they are also grounded in greater uncertainty of investors on the fence because of ongoing political disputes.

Turning to foreign trade, export growth gained momentum in most countries. In particular, Albania, FYR Macedonia and Serbia posted higher export growth in the first half of 2016. In Kosovo, export growth remained more or less unchanged. Import growth also speeded up in the region, reflecting higher domestic demand. Public demand for investment goods mounted owing to import-intensive infrastructure projects, such as activities related to the Trans-Adriatic Pipeline and hydropower plants in Albania and to the already mentioned highway construction and further infrastructure projects in Montenegro. Additionally, imports were lifted by accelerating private consumption growth. Stronger export growth fell far short of booming import growth; hence, the contribution of net exports dragged down economic growth in the Western Balkans. This was especially the case for Montenegro, where the negative contribution reached almost 10 percentage points in the first half of 2016.

¹ The Western Balkans comprise the EU candidate countries Albania, FYR Macedonia, Montenegro and Serbia as well as the potential candidate countries Bosnia and Herzegovina, and Kosovo. The designation “Kosovo” is used without prejudice to positions on status and is in line with UNSC 1244 and the opinion on the Kosovo Declaration of Independence.

The Western Balkan countries are marked by deep shortfalls in the trade balance. In the first half of 2016, Montenegro posted the highest trade deficit; at more than 43% of GDP, the trade deficit has climbed further compared to 2015. Albania and Kosovo also posted widening trade deficits. Only in Serbia, the country with the lowest shortfall among the Western Balkans, did the trade deficit narrow by almost 2 percentage points to around 11% of GDP. The worsening of trade balances is largely the result of increasing imports connected to large public investments. The trade deficits have also left their mark on current account balances. Most countries posted higher current account deficits in the first half of 2016 than in 2015, with Montenegro showing the largest shortfall of around 18% of GDP (2015: 13.3%). In Serbia, by contrast, the deficit narrowed to 4.3%. Serbia was also the only country of the region where the current account deficit was fully covered by net FDI. In the other countries, the coverage ratio lay between 14% (Montenegro) and 66% (Albania) in the first half of 2016. Despite stubbornly high unemployment rates, improvements in the labor market were perceivable especially in FYR Macedonia and Serbia. Both countries brought their unemployment rates down by 2 to 3 percentage points in the second quarter of 2016 from the same period of last year. Progress in the labor markets was also reflected in higher employment rates, with Albania and Serbia topping the list. At the same time, wage growth gained speed in the region. In Montenegro and Serbia, gross real wages in the whole economy picked up by more than 3% in the first half of 2016 after declining for several consecutive quarters. Bosnia and Herzegovina as well as FYR Macedonia also showed positive wage dynamics ranging from 2% to 3%. Even though wages increased, average monthly incomes only reached comparatively low levels that currently range from below EUR 400 in Albania to about EUR 750 in Montenegro (no data for Kosovo available).

The growth of domestic credit to resident households and nonfinancial corporations (adjusted for exchange rate movements) was positive in all Western Balkan countries in the first half of 2016. The ongoing process of cleaning up banks' balance sheets, more favorable lending conditions and elevated domestic demand fed through to credit dynamics. Growth moved into positive territory in the second half of 2016 (+1.4% year on year), even in Albania, the country with the most sluggish credit dynamics in 2015 and with one of the highest NPL levels. Similarly, both Montenegro and Serbia returned to positive credit growth in the first half of 2016 after deleveraging in 2015. More recent data for both countries show that credit continued to expand in July and August 2016. In Bosnia and Herzegovina, credit growth also quickened slightly in the first half of 2016, accelerating to almost 3% year on year after posting just 1% in 2015. With annual growth of more than 8%, credit growth in FYR Macedonia and Kosovo remained very robust. However, especially in FYR Macedonia, credit growth lost momentum in July and August 2016, subsiding to less than 4%.

In the first eight months of 2016, deflation persisted across most of the region, largely as a result of low commodity prices. Only in Albania and Serbia were price rises positive, with inflation at around 1% in the first eight months of 2016. Driven by higher food prices, inflation in Albania registered 2% in August 2016, close to the lower bound of the inflation target of the Bank of Albania (3% with a tolerance band of ± 1 percentage point). Yet inflation moderated slightly again in September. In Serbia, the second inflation targeting country, inflation amounted to 0.6% in September, which is well below the inflation target of 4% ± 1.5 percentage points. The National Bank of Serbia loosened its monetary policy stance and cut its key interest rate by 25 basis points to 4% in July 2016 in view of ongoing low inflationary pressure.

Fiscal consolidation needs in the Western Balkans are high on the agenda, with developments in Serbia taking center stage, as the Stand-By Arrangement (SBA) between the IMF and Serbia is largely contingent on the country's budgetary performance. According to the fourth and fifth program reviews of September 2016, Serbia's consolidation path is well on track. The IMF expects Serbia's deficit to come down from 3.8% of GDP in 2015 to 2.5% of GDP in 2016, considerably below the IMF program target, as a result of higher-than-expected revenues. In Montenegro, the fiscal situation remains challenging. The fiscal outcome reflects

budgetary strains in particular from the highway project mentioned above. According to Montenegro's Economic Reform Program 2016–2018 published early this year, the budget deficit is scheduled to drop to 6.1% of GDP in 2016 from 8.6% in 2015. However, the IMF (World Economic Outlook, October 2016) projects the 2016 shortfall to rise to above 12% of GDP. FYR Macedonia adopted two supplementary budgets in 2016. Lower-than-expected GDP growth for 2016² necessitated the first supplementary budget to adjust for lower revenues. Accordingly, the expected budgetary shortfall was set to increase from 3.2% to 3.6%. The second supplementary budget of August 2016 included expenditure related to the flood damage of the summer of 2016 and brought the expected budget deficit to 4% of GDP. The IMF expects the budget deficit to reach 0.8% (2015: 0.2%) in Bosnia and Herzegovina and 2.0% (2015: 1.9%) in Kosovo.

With regard to the EU accession process of the Western Balkans, some further steps were taken. Negotiations with Montenegro and Serbia are progressing: Montenegro has now opened 24 chapters, with four chapters having been added since early 2016. Serbia opened two more chapters, bringing the total to four open chapters. Negotiations have not yet begun with Albania or FYR Macedonia. Albania, however, has passed comprehensive judicial reforms, which will support its EU integration process. In September 2016, the Council of the EU accepted the membership application of Bosnia and Herzegovina, a potential candidate country to the EU. The country applied for membership in February 2016 but was requested to implement reforms to have the membership application accepted. In a next step, the European Commission will prepare an assessment of the country's readiness to join the EU.

Looking at relations with the IMF, Albania just completed its eighth review under a three-year Extended Fund Facility (EFF, in place since 2014), freeing up the next tranche for disbursement, as the program is considered to be largely on track. In Serbia, the combined fourth and fifth reviews of the precautionary SBA were completed in August 2016. In Kosovo, the first review under a 22-month SBA was concluded in early 2016. The second review, which started in spring 2016, has not been finalized yet. In Bosnia and Herzegovina, the IMF agreed to a three-year EFF in September 2016.

² The IMF revised down its forecast for FYR Macedonia from 3.6% (World Economic Outlook, April 2016) to 2.2% (World Economic Outlook, October 2016).

2 Slovakia: competitive exporting sector bolsters consumption-based growth

Export growth offsets temporary decline in investment activity

Notwithstanding a sharp decline in GFCF growth, Slovakia's economy expanded rapidly (by 3.6% on average) during the first half of 2016. Brisk private consumption growth as well as noticeable export growth in the second quarter were the main forces behind this favorable development. While the recent slump in capital formation contrasts dramatically with expansion rates of 18% prevailing late in 2015, the slowdown was largely due to the start of a new EU funding cycle and is thus a temporary phenomenon. Public investment will regain momentum as the new programming period progresses. The stock of private capital, on the other hand, will benefit from a new automotive plant slated for construction from 2016.

Sustained dynamics in the labor market buoy private consumption

Following a dip to 2.5% year on year in the first quarter, private consumption growth picked up in the second quarter of 2016 (3%). The rebound was partly the result of beneficial trends in the labor market. Employment levels have already been improving for two years and increased by another 2.3% in the second quarter of 2016. Tax and social security system reforms, deflationary tendencies, and nominal wage growth fostered real disposable income and were thus additional key drivers of private consumption growth. According to a survey by the National Bank of Slovakia, the private sector is starting to perceive shortages in skilled labor, however. This labor market tightness has likely added to the recent wage dynamics (+5% in the trade and construction sector, for instance) and potentially explains why vacant positions are increasingly being filled by foreigners. The government's plan to increase teachers' salaries may prompt a further short-run acceleration of wage growth, thus underscoring the importance of private consumption for real activity.

Consumer prices continue to decline

Headline inflation was negative in the first half of 2016 and decreased more rapidly than anticipated (-0.5% in the first quarter, -0.6% in the second quarter), owing to domestic and global developments alike. While the base effect of a notable oil price decline in 2015 is starting to fade, energy prices continued to decline in the first part of 2016. The government contributed to negative food price developments by extending the basket of items which qualify for a reduced VAT rate. The sluggish price dynamics prevailing in the entire euro area have triggered monetary policy measures by the ECB that are likely to be conducive to Slovakia's robust credit growth. Loans to households advanced by double-digit rates throughout the review period. Broad money increased by roughly 9% in the first half of 2016, with two-thirds of the rise stemming from the expansion of household credit.

Policies to stimulate investment lift public debt

Surging public investment in the last year of the drawdown window for EU funds led to higher-than-expected government expenditures. As a consequence, the fiscal balance hit the excessive deficit threshold of 3% of GDP in 2015. Going forward, gross debt as a share of GDP is projected to stay constant at 52.9% of GDP this year, according to the latest forecast of the National Bank of Slovakia. As envisaged public spending includes the construction of a highway around Bratislava, the reduction in the corporate tax rate and the elimination of required minimum corporate tax payments (corporate tax licenses), reaching the medium-term budgetary objective (a structural deficit of 0.5% of GDP) by 2018 as foreseen in the latest EU Stability Programme for Slovakia will require considerable consolidation efforts.

Table 2

Main economic indicators: Slovakia

	2013	2014	2015	Q1 15	Q2 15	Q3 15	Q4 15	Q1 16	Q2 16
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	1.4	2.5	3.6	2.9	3.4	3.7	4.3	3.5	3.7
Private consumption	-0.8	2.3	2.4	1.5	2.3	2.8	2.8	2.5	3.0
Public consumption	2.2	5.9	3.4	1.8	3.6	5.2	3.2	3.1	2.2
Gross fixed capital formation	-1.1	3.5	14.0	6.7	9.6	17.3	19.4	1.5	0.0
Exports of goods and services	6.2	3.6	7.0	5.4	6.1	7.3	9.2	0.2	7.7
Imports of goods and services	5.1	4.3	8.2	5.2	7.3	9.9	10.5	0.4	5.9
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	0.3	2.9	4.7	2.5	4.2	5.6	6.3	3.7	1.8
Net exports of goods and services	1.2	-0.4	-0.8	0.5	-0.8	-1.8	-1.0	-0.2	1.9
Exports of goods and services	5.7	3.4	6.4	5.3	5.7	6.2	8.4	0.2	7.3
Imports of goods and services	-4.5	-3.8	-7.3	-4.9	-6.5	-8.0	-9.4	-0.4	-5.4
<i>Year-on-year change of the period average in %</i>									
Unit labor costs in the whole economy (nominal, per person)	0.4	0.7	0.8	0.7	0.2	0.5	1.6	1.6	0.5
Unit labor costs in manufacturing (nominal, per hour)	-1.1	-3.8	-1.4	-6.8	-0.1	-1.2	2.4	5.0	-11.4
Labor productivity in manufacturing (real, per hour)	6.6	8.2	5.9	13.0	3.8	5.1	2.7	-1.5	16.5
Labor costs in manufacturing (nominal, per hour)	5.3	4.1	4.5	5.3	3.6	3.9	5.1	3.4	3.1
Producer price index (PPI) in industry	-1.0	-3.5	-3.0	-3.7	-2.6	-2.4	-3.2	-4.2	-5.1
Consumer price index (here: HICP)	1.5	-0.1	-0.3	-0.5	-0.1	-0.3	-0.5	-0.5	-0.6
EUR per 1 SKK, + = SKK appreciation	..	..	..	..	..	..	..	..	..
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	14.3	13.2	11.5	12.5	11.3	11.3	11.0	10.4	9.7
Employment rate (%, 15–64 years)	59.9	61.0	62.7	61.9	62.5	63.0	63.5	64.1	64.9
Key interest rate per annum (%)	0.5	0.2	0.1	0.1	0.1	0.1	0.1	0.0	0.0
SKK per 1 EUR	..	..	..	..	..	..	..	..	..
<i>Nominal year-on-year change in the period-end stock in %</i>									
Broad money (including foreign currency deposits)	5.9	4.9	11.1	5.6	7.5	10.7	11.1	9.3	8.8
<i>Contributions to the year-on-year change of broad money in percentage points</i>									
Net foreign assets of the banking system	-2.7	4.9	6.1	10.4	8.1	10.6	1.7	-2.2	2.9
Domestic credit of the banking system	-6.3	7.9	24.8	14.1	11.3	14.2	17.2	13.5	12.4
<i>of which: claims on the private sector</i>	5.3	10.5	13.2	5.7	6.4	6.4	7.7	6.5	5.7
<i>claims on households</i>	8.2	9.8	11.6	5.7	5.7	6.1	5.9	5.8	6.1
<i>claims on enterprises</i>	-2.9	0.7	1.6	0.0	0.7	0.3	1.9	0.7	-0.4
<i>claims on the public sector (net)</i>	-11.6	-2.6	11.6	8.4	4.9	7.8	9.5	7.0	6.7
Other assets (net) of the banking system	21.9	-1.7	-14.4	-18.9	-12.0	-14.1	-7.9	-2.0	-6.6
<i>% of GDP</i>									
General government revenues	38.6	39.2	42.7	..	..	..	..	..	..
General government expenditures	41.3	41.9	45.6	..	..	..	..	..	..
General government balance	-2.7	-2.7	-3.0	..	..	..	..	..	..
Primary balance	-0.8	-0.8	-1.1	..	..	..	..	..	..
Gross public debt	55.0	53.9	52.9	..	..	..	..	..	..
<i>% of GDP</i>									
Debt of nonfinancial corporations (nonconsolidated)	49.8	50.0	49.5	..	..	..	..	..	..
Debt of households and NPISHs (nonconsolidated)	30.1	32.8	35.3	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>									
Trade balance	4.1	3.8	2.4	5.1	3.2	0.8	0.8	3.4	4.7
Services balance	0.6	0.1	0.1	0.4	0.2	0.3	-0.4	0.4	0.5
Primary income	-0.9	-2.2	-2.3	-2.1	-3.5	-3.5	-0.3	-3.7	-3.4
Secondary income	-1.8	-1.6	-1.4	-1.6	-1.6	-1.4	-1.2	-1.7	-1.3
Current account balance	2.0	0.1	-1.3	1.8	-1.7	-3.8	-1.1	-1.5	0.4
Capital account balance	1.4	1.0	3.6	1.2	1.7	4.0	7.0	3.3	2.4
Foreign direct investment (net)	0.3	0.2	-1.1	-4.5	3.0	0.1	-3.5	-1.4	4.4
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	83.0	89.3	86.3	90.8	87.4	87.3	86.3	85.6	87.9
Gross official reserves (excluding gold)	0.9	1.5	2.1	3.2	1.7	2.6	2.1	2.0	2.0
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	0.1	0.2	0.3	0.4	0.2	0.3	0.3	0.3	0.3
<i>EUR million, period total</i>									
GDP at current prices	73,835	75,560	78,071	17,859	19,425	20,619	20,169	18,403	20,053

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiw, OeNB.

3 Slovenia: stabilization entrenched

GDP growth holds up unexpectedly well during the first half of 2016

GDP growth accelerated to 2.5% year on year during the first half of 2016, also helped by working-day effects. Despite some deterioration in consumer confidence, private consumption growth quickened particularly strongly, supported by employment gains, steadily falling unemployment, faster real wage growth and weak but continued credit expansion. Public consumption also advanced more robustly due to public sector wage increases. Investment growth turned negative as the overlapping disbursement period of EU funds stopped at the end of 2015, causing a slump in construction investment. By contrast, investment in machinery and equipment continued to expand at a double-digit pace, reflecting historically high capacity utilization rates and optimistic business expectations. However, stock changes offset the negative contribution of investment to overall growth. Export growth speeded up somewhat during the first half of 2016, mirroring gains in price competitiveness during 2015. However, as imports also mounted, the contribution of net real exports remained broadly unchanged from 2015. In its spring forecast, the European Commission expected GDP growth to decline to 1.7% in 2016, mainly as a result of lower public investment and a smaller contribution of net real exports. Available high-frequency indicators suggest ongoing strong economic activity at the beginning of the third quarter of 2016. Inflation remained in negative territory throughout the review period, but deflationary pressure moderated somewhat over the summer months.

Excessive deficit procedure closes in mid-2016; further deficit reduction planned

Following Slovenia's budget deficit reduction to 2.9% of GDP in 2015 and given a projected deficit of 2.2% of GDP in 2016, the EU Council closed the excessive deficit procedure for Slovenia in June 2016. The government plans to cut the deficit further from 1.6% of GDP in 2017 to 0.4% of GDP by 2019. The structural deficit is also set to decline from 1.5% of GDP in 2016 to 0.6% of GDP by 2019, thus undershooting the medium-term objective (MTO). According to the government's plans, this reduction should take the form of structural measures of a permanent nature. Major objectives include shifting tax revenues away from labor taxation toward real property taxation, reducing administrative barriers and improving the effectiveness of tax collection; on the expenditure side, they include containing wage costs and following a restrictive policy of social transfers and subsidies. The EU Council is less optimistic about Slovenia's fiscal prospects, forecasting higher deficits in 2016 and 2017 and requesting additional action to ensure adjustment to the MTO. The EU Council has also called for sufficiently specified measures to achieve budgetary goals from 2017 onward.

Banking sector profitability improves as credit risks diminish

Deleveraging remains a characteristic of the Slovenian financial sector. Banking sector assets as well as domestic credit to the nonbank private sector kept on contracting during the first half of 2016. Nonetheless, banking sector profitability improved substantially in the reporting period, helped by the decline in provisioning and value adjustments and improvements in noninterest income. Lower provisions are linked to the improvement in banks' asset quality, as indicated by the continuous decline in nonperforming assets, with foreign borrowers and non-financial corporations remaining the riskiest client segments. Even so, alongside income risk amid the persistent environment of low interest rates and contracting assets, credit risk has remained the biggest risk for banks.

Table 3

Main economic indicators: Slovenia

	2013	2014	2015	Q1 15	Q2 15	Q3 15	Q4 15	Q1 16	Q2 16
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	-1.1	3.1	2.3	2.5	2.0	2.0	2.8	2.3	2.7
Private consumption	-4.0	2.0	0.5	0.3	-0.3	1.1	0.6	1.2	2.6
Public consumption	-2.1	-1.2	2.4	1.4	1.8	3.2	3.4	3.4	2.1
Gross fixed capital formation	3.2	1.4	1.0	-1.7	0.7	-0.2	5.4	-7.8	-3.6
Exports of goods and services	3.1	5.7	5.6	6.5	6.5	5.0	4.3	5.1	6.7
Imports of goods and services	2.1	4.2	4.6	3.9	4.8	5.1	4.7	3.9	6.5
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	-1.9	1.7	1.3	0.2	0.5	1.6	2.7	1.1	1.8
Net exports of goods and services	0.8	1.4	1.1	2.3	1.6	0.4	0.1	1.3	0.8
Exports of goods and services	2.2	4.3	4.2	5.0	4.8	3.8	3.4	4.0	5.1
Imports of goods and services	-1.4	-2.9	-3.2	-2.8	-3.2	-3.4	-3.3	-2.8	-4.3
<i>Year-on-year change of the period average in %</i>									
Unit labor costs in the whole economy (nominal, per person)	0.5	-1.3	0.3	-0.2	0.7	0.2	0.4	1.8	0.3
Unit labor costs in manufacturing (nominal, per hour)	3.0	0.0	-5.3	-5.1	-4.0	-7.9	-3.8	-6.1	-6.2
Labor productivity in manufacturing (real, per hour)	-2.3	3.7	6.0	7.3	6.3	6.4	4.2	7.0	7.6
Labor costs in manufacturing (nominal, per hour)	0.6	3.8	0.5	1.9	2.0	-2.0	0.2	0.5	1.0
Producer price index (PPI) in industry	0.0	-0.7	-0.2	0.1	0.6	-0.4	-1.2	-1.9	-2.3
Consumer price index (here: HICP)	1.9	0.4	-0.8	-0.5	-0.8	-0.8	-0.9	-0.9	-0.4
EUR per 1 SIT, + = SIT appreciation	..	..	..	..	..	..	..	..	..
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	10.3	9.9	9.1	9.9	9.3	8.7	8.5	9.0	7.9
Employment rate (%, 15–64 years)	63.3	63.9	65.2	63.5	65.5	66.7	65.2	64.2	66.2
Key interest rate per annum (%)	0.5	0.2	0.1	0.1	0.1	0.1	0.1	0.0	0.0
SIT per 1 EUR	..	..	..	..	..	..	..	..	..
<i>Nominal year-on-year change in the period-end stock in %</i>									
Broad money (including foreign currency deposits)	0.2	7.8	5.3	5.5	5.0	3.8	5.3	6.3	5.4
<i>Contributions to year-on-year change of broad money in percentage points</i>									
Net foreign assets of the banking system	29.1	48.9	23.5	16.8	3.3	-0.7	-1.6	-6.4	1.5
Domestic credit of the banking system	-16.4	-32.9	-10.7	-11.0	1.0	3.0	7.8	11.6	3.8
<i>of which: claims on the private sector</i>	-30.0	-38.4	-20.7	-13.4	-12.6	-12.4	-4.8	-8.0	-6.7
<i>claims on households</i>	-2.3	-2.2	-0.3	-0.1	0.1	0.0	0.4	0.0	0.3
<i>claims on enterprises</i>	-27.7	-36.2	-20.4	-13.4	-12.7	-12.4	-5.2	-8.0	-7.0
<i>claims on the public sector (net)</i>	13.6	5.5	10.0	2.4	13.6	15.4	12.6	19.6	10.4
Other assets (net) of the banking system	-13.2	-7.9	0.8	-0.3	0.7	1.5	-0.9	1.1	0.1
<i>% of GDP</i>									
General government revenues	45.2	44.9	45.1	..	..	..	..	..	..
General government expenditures	60.3	49.9	48.0	..	..	..	..	..	..
General government balance	-15.0	-5.0	-2.9	..	..	..	..	..	..
Primary balance	-12.5	-1.8	0.1	..	..	..	..	..	..
Gross public debt	71.0	81.0	83.2	..	..	..	..	..	..
<i>% of GDP</i>									
Debt of nonfinancial corporations (nonconsolidated)	89.4	81.1	71.4	..	..	..	..	..	..
Debt of households and NPISHs (nonconsolidated)	30.0	28.5	27.8	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>									
Trade balance	2.0	3.2	3.9	3.9	3.9	4.3	3.5	5.3	4.8
Services balance	4.8	4.5	5.2	4.4	5.3	6.1	5.0	5.0	5.8
Primary income	-0.5	-0.3	-2.5	-1.3	-3.4	-2.9	-2.6	-0.9	-1.5
Secondary income	-1.4	-1.1	-1.4	-2.2	-1.1	-1.1	-1.3	-1.7	-1.0
Current account balance	4.8	6.2	5.2	4.9	4.7	6.5	4.7	7.8	8.1
Capital account balance	0.5	0.4	1.0	0.5	0.6	1.3	1.4	-0.4	-1.0
Foreign direct investment (net)	-0.1	-1.6	-3.2	-3.9	-0.5	-2.2	-6.4	-3.5	-2.5
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	117.3	124.0	116.7	126.1	119.4	119.2	116.7	116.6	113.9
Gross official reserves (excluding gold)	1.6	2.0	1.8	2.1	2.1	1.9	1.8	1.7	1.7
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	0.3	0.3	0.3	0.4	0.4	0.3	0.3	0.3	0.3
<i>EUR million, period total</i>									
GDP at current prices	35,917	37,332	38,570	8,938	9,870	9,931	9,831	9,298	10,213

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiw, OeNB.

4 Bulgaria: growth driven by private consumption

Lower unemployment rates and positive consumer sentiment propel GDP

Robust GDP growth was sustained throughout the first half of 2016 and amounted to 3%. Gaining 1.6 percentage points, private consumption contributed the lion's share to growth in the review period. However, public consumption reduced GDP growth by 0.6 percentage points due to the continued budget consolidation policy of the government. Moreover, export dynamics slowed down somewhat in the first half of 2016 from 2015. Still, net exports added 0.5 percentage points to GDP growth. Investment was subdued in the first half of 2016, contributing just 0.1 percentage points to GDP growth. Benefiting from a further moderate decline of the unemployment rate (to 8.2% as of end-June 2016), dynamic wage growth, low oil prices and positive consumer sentiment, powerful private consumption was also reflected in retail sales growth rates of above 3%. Strong wage growth was already reflected in a notable increase in unit labor costs. Investment activity was weak in the first half of 2016. The new programming period for EU investment (2014–2020) has not been effectively exploited to date, and public sector investment was subdued.

Deflationary phase is ongoing in Bulgaria

Bulgaria is still experiencing a deflationary phase, with negative headline inflation coming to -1.1% in August 2016. Moreover, core inflation was negative at -0.3% in August 2016. With the exception of food prices, all inflation components contributed negatively to price rises in the review period. Food prices and especially processed food prices added to inflation in the wake of the boost in fees and duties on tobacco products.

Bulgarian National Bank publishes stress test results

The growth of loans to households (-0.3%) and corporates (-0.9%) remained negative in the first half of 2016, although deposits were increasing (9.5%). A lending survey conducted by the Bulgarian National Bank (BNB) shows that banks also tightened their lending standards on corporate loans but eased them on consumer loans. After the failure of Corporate Commercial Bank in 2014, the BNB performed an asset quality review and stress test for the whole banking sector. The results were published in August 2016. The asset quality review will lead to additional adjustments of BGN 665 million, which will be reflected in banks' 2016 financial statements. The stress test results also show that under the adverse scenario, the aggregated common equity tier 1 ratio would fall from 18.9% (year-end 2015) to 14.4% by the end of the projection period (year-end 2018), thus remaining well above the regulatory minimum requirement.

Strong government commitment to budget consolidation path

Bulgaria's budgetary position developed positively in the first half of 2016. Tax revenues increased by 7.5% over the first five months of 2016, mainly based on increased revenues from value added tax and customs duties. On the expenditure side, outlays decreased by 5.1% , mainly because the government sector cut capital expenditures. Based on the EU Convergence Programme for 2016–2019, Bulgaria's main policy goal with regard to fiscal policy is to overcome fiscal imbalances through gradual fiscal consolidation. The government expects a reduction of the general government deficit from 2.1% of GDP in 2015 to 1.9% of GDP for the whole year 2016. The primary deficit is also expected to decrease in 2016, and a surplus is envisaged from 2017 onward.

Table 4

Main economic indicators: Bulgaria

	2013	2014	2015	Q1 15	Q2 15	Q3 15	Q4 15	Q1 16	Q2 16
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	0.9	1.3	3.6	3.9	3.1	3.8	3.6	3.6	3.5
Private consumption	-2.5	2.7	4.5	1.5	2.0	6.4	7.5	2.5	1.2
Public consumption	0.6	0.1	1.4	-2.4	1.9	2.0	3.6	-6.4	-0.6
Gross fixed capital formation	0.3	3.4	2.7	-3.4	0.8	3.4	7.4	1.4	-0.3
Exports of goods and services	9.6	3.1	5.7	14.9	6.5	1.9	2.1	3.0	4.6
Imports of goods and services	4.3	5.2	5.4	8.0	7.0	2.5	4.6	0.9	2.8
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	-2.2	2.7	3.5	0.0	3.5	4.1	5.3	1.9	2.2
Net exports of goods and services	3.1	-1.3	0.1	3.7	-0.4	1.6	1.1	0.7	0.4
Exports of goods and services	5.9	2.0	3.7	9.7	4.3	3.0	3.7	2.5	3.4
Imports of goods and services	-2.8	-3.4	-3.6	-6.0	-4.7	-1.5	-2.7	-1.8	-3.0
<i>Year-on-year change of the period average in %</i>									
Unit labor costs in the whole economy (nominal, per person)	7.8	4.5	-1.4	-1.3	-1.4	-3.3	0.4	6.1	4.8
Unit labor costs in manufacturing (nominal, per hour)	4.4	0.4	5.7	4.9	5.1	6.4	6.5	8.2	11.5
Labor productivity in manufacturing (real, per hour)	-0.3	6.4	2.4	1.2	3.5	2.4	2.3	2.9	-0.8
Labor costs in manufacturing (nominal, per hour)	4.3	6.8	8.3	6.1	8.8	9.0	9.0	11.4	10.6
Producer price index (PPI) in industry	-1.5	-1.2	-2.0	-1.3	0.0	-2.4	-4.2	-4.7	-5.2
Consumer price index (here: HICP)	0.4	-1.6	-1.1	-1.7	-0.6	-0.9	-1.0	-1.1	-2.3
EUR per 1 BGN, + = BGN appreciation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	13.0	11.5	9.3	10.7	10.0	8.3	8.0	8.7	8.2
Employment rate (%, 15–64 years)	59.5	61.1	62.9	61.0	62.4	64.5	63.7	62.3	63.7
Key interest rate per annum (%) ¹	..	..	..	..	..	..	..	..	..
BGN per 1 EUR	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
<i>Nominal year-on-year change in the period-end stock in %</i>									
Broad money (including foreign currency deposits)	8.9	1.1	8.8	1.9	2.5	2.1	8.8	6.1	8.9
<i>Contributions to year-on-year change of broad money in percentage points</i>									
Net foreign assets of the banking system	12.8	15.7	18.3	14.0	15.7	11.3	8.3	11.0	14.1
Domestic credit of the banking system	5.9	-4.9	-5.7	-10.1	-12.5	-8.4	1.7	-3.0	-2.5
<i>of which: claims on the private sector</i>	2.9	-6.7	-7.6	-6.8	-8.0	-7.7	-1.2	-1.8	-0.6
<i>claims on households</i>	-0.4	-0.5	-0.8	-0.5	-0.5	-0.4	-0.4	-0.4	-0.2
<i>claims on enterprises</i>	3.3	-6.2	-6.8	-6.3	-7.5	-7.3	-0.9	-1.4	-0.4
<i>claims on the public sector (net)</i>	3.0	1.8	1.9	-3.3	-4.6	-0.7	2.9	-1.2	-2.0
Other assets (net) of the banking system	-0.6	-0.6	-2.6	-2.0	-0.7	-0.8	-1.3	-2.0	-2.7
<i>% of GDP</i>									
General government revenues	37.2	36.6	38.2	..	..	..	..	..	..
General government expenditures	37.6	42.1	40.2	..	..	..	..	..	..
General government balance	-0.4	-5.4	-2.1	..	..	..	..	..	..
Primary balance	0.3	-4.6	-1.0	..	..	..	..	..	..
Gross public debt	17.1	27.0	26.7	..	..	..	..	..	..
<i>% of GDP</i>									
Debt of nonfinancial corporations (nonconsolidated)	112.3	108.9	96.6	..	..	..	..	..	..
Debt of households and NPISHs (nonconsolidated)	25.5	24.9	23.3	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>									
Trade balance	-7.0	-6.5	-5.8	-6.7	-4.6	-3.9	-8.0	-3.6	-4.1
Services balance	6.3	5.9	6.8	4.0	5.6	13.8	3.1	3.8	6.2
Primary income	-3.8	-3.1	-4.3	-4.2	-6.8	-4.0	-2.3	-2.6	-3.2
Secondary income	5.7	3.8	3.6	8.1	4.0	2.6	1.0	5.0	5.6
Current account balance	1.3	0.1	0.4	1.2	-1.8	8.6	-6.2	2.7	4.5
Capital account balance	1.1	2.2	3.1	3.1	3.9	2.5	3.1	5.7	2.2
Foreign direct investment (net)	-3.0	-2.1	-3.5	-6.0	-3.5	-5.0	-0.2	-4.0	-3.9
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	91.8	97.1	81.4	96.5	83.9	82.5	81.4	82.1	82.4
Gross official reserves (excluding gold)	31.9	35.6	42.3	40.4	39.3	41.7	42.3	43.5	45.4
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	5.9	6.5	8.1	7.4	7.3	7.9	8.1	8.5	9.0
<i>EUR million, period total</i>									
GDP at current prices	42,011	42,762	45,287	9,260	11,214	12,207	12,605	9,816	11,403

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiiw, OeNB.

¹ Not available in a currency board regime.

5 Croatia: recovery gains traction amid slow but steady fiscal consolidation

<p>Return to growth backed by recovery of private consumption and investment</p>	<p>In the first half of 2016, GDP growth accelerated further to 2.75%. It remained fueled by domestic demand – both by private consumption and investment. Conversely, the contribution of net exports to growth was mildly negative.</p>
<p>Tourism boosts current account surplus</p>	<p>The current account surplus had increased to 5.1% of GDP in 2015. The surplus was bolstered by the rise in tourism and a further increase in the surplus of secondary income attributable to the growing use of EU funds. Balance of payments data for the first half of 2016 do not signal major changes in trend. Croatia has seen a record tourist season this year: Tourism revenues rose noticeably in the first three quarters of 2016. Croatia seems to profit from a high level of internal security and, unlike some other parts of the Mediterranean region, the absence of terrorist attacks. Comparing the first half of 2015 to the first half of 2016, the goods trade deficit showed no significant changes. Growth in goods exports was to a large extent due to higher exports of ships as well as oil and refined petroleum products; exports of medicinal and pharmaceutical products also strengthened. At end-2015, gross external debt, around one-third of which was government debt, stood at 103.7% of GDP. External debt declined to 97.3% of GDP in the second quarter, as a result of a deleveraging of all major sectors in the economy.</p>
<p>Price level contracts mildly; NPL ratio high but declining</p>	<p>Inflation turned negative in 2015 and remained in negative territory in the first half of 2016, mainly as a result of more moderate energy prices and somewhat lower food prices. The ratio of NPLs to total loans remained high at about 15% in the second quarter of 2016 but fell for the fifth quarter in a row. Credit growth was again negative in 2015 and remained so in the first half of 2016. The development of household debt was largely influenced by the conversion of Swiss franc loans into euro loans at historical exchange rates under the legal framework which entered into force on September 30, 2015. According to the Croatian National Bank (HNB), household loans in Swiss francs and indexed to Swiss franc stood at HRK 21.7 billion at the end of November 2015 and declined to HRK 2.3 billion at the end of May 2016. As much as HRK 11.2 billion of this HRK 19.4 billion decline can be ascribed to conversion, and HRK 5.8 billion of the decline consisted in the write-off of part of the principal of Swiss franc-denominated loans. Overall, the percentage of foreign currency loans to resident non-MFIs remains high at 66.1% of total loans (July 2016).</p>
<p>Broadly stable exchange rate, moderately favorable financial market developments</p>	<p>During the course of this year, the kuna has marginally appreciated against the euro within its exchange rate framework of a tightly managed float. In February 2016, the HNB introduced structural repo operations aimed at providing banks with longer-term sources of kuna liquidity and has so far placed a total of HRK 0.9 billion with banks.</p>
<p>Budgetary situation improves but further consolidation efforts are needed</p>	<p>Despite the improvements in the fiscal situation in 2015 further progress is needed to underpin the sustainability of the fiscal position, especially in light of high gross public sector debt (86.7% of GDP at end-2015). After the center-right coalition, which had taken office following the last parliamentary elections in late 2015, fell apart after being in office for only five months, it is up to the new government, again a center-right coalition, to address these fiscal challenges. The new prime minister announced that the 2017 budget will clearly reflect efforts to reduce the budget deficit and public debt. The plan is to cut the deficit to 2% of GDP next year (from an expected shortfall of 2.5% in 2016).</p>

Table 5

Main economic indicators: Croatia

	2013	2014	2015	Q1 15	Q2 15	Q3 15	Q4 15	Q1 16	Q2 16
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	-1.1	-0.4	1.6	0.5	1.2	2.8	1.9	2.7	2.8
Private consumption	-1.8	-0.7	1.2	0.4	0.6	1.4	2.4	3.1	3.0
Public consumption	0.3	-1.9	0.6	0.6	0.4	0.6	0.8	0.6	2.6
Gross fixed capital formation	1.4	-3.6	1.6	-0.4	0.8	2.2	3.7	4.3	6.3
Exports of goods and services	3.1	7.3	9.2	7.2	10.2	8.0	11.6	7.1	4.1
Imports of goods and services	3.1	4.3	8.6	5.7	6.9	8.1	13.6	6.1	6.7
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	-1.1	-1.7	1.2	0.4	0.0	1.3	3.0	2.7	4.1
Net exports of goods and services	0.0	1.3	0.5	0.0	1.1	1.6	-1.1	-0.2	-1.4
Exports of goods and services	1.3	3.1	4.2	2.5	4.3	5.1	4.8	2.6	1.9
Imports of goods and services	-1.3	-1.8	-3.8	-2.5	-3.2	-3.5	-5.9	-2.8	-3.3
<i>Year-on-year change of the period average in %</i>									
Unit labor costs in the whole economy (nominal, per person)	-2.2	-2.4	-0.4	-0.3	0.7	-0.9	-1.2	-2.3	-3.6
Unit labor costs in manufacturing (nominal, per hour)	2.5	-5.4	-3.6	-1.8	-2.8	-5.0	-5.1	..	..
Labor productivity in manufacturing (real, per hour)	-1.0	5.3	6.0	3.0	7.0	6.8	6.7	..	..
Labor costs in manufacturing (nominal, per hour)	2.0	-0.3	2.0	1.2	4.0	1.4	1.3	3.2	2.7
Producer price index (PPI) in industry	-0.4	-2.7	-3.9	-4.6	-2.6	-4.1	-4.2	-4.7	-6.1
Consumer price index (here: CPI)	2.3	0.2	-0.3	-0.3	0.0	-0.3	-0.4	-0.5	-1.1
EUR per 1 HRK, + = HRK appreciation	-0.8	-0.7	0.3	-0.4	0.3	0.6	0.6	0.8	0.9
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	17.5	17.5	16.5	18.3	15.8	15.6	16.3	15.6	13.0
Employment rate (%, 15–64 years)	52.6	54.6	55.8	53.8	56.2	57.5	55.8	54.9	57.4
Key interest rate per annum (%)	..	..	..	..	..	..	..	..	..
HRK per 1 EUR	7.6	7.6	7.6	7.7	7.6	7.6	7.6	7.6	7.5
<i>Nominal year-on-year change in the period-end stock in %</i>									
Broad money (including foreign currency deposits)	4.0	3.2	5.1	2.8	4.8	4.6	5.1	3.4	4.6
<i>Contributions to year-on-year change of broad money in percentage points</i>									
Net foreign assets of the banking system	12.7	10.9	11.5	7.3	5.3	4.7	6.5	3.7	5.9
Domestic credit of the banking system	-3.1	-1.8	-0.2	-1.2	2.1	1.8	-0.3	-2.4	-2.6
<i>of which: claims on the private sector</i>	-7.0	-2.5	-4.1	-0.8	-0.7	-1.5	-2.4	-5.2	-4.8
<i>claims on households</i>	-1.7	-1.3	-1.1	0.4	0.4	-0.3	-0.7	-3.8	-3.4
<i>claims on enterprises</i>	-5.3	-1.2	-3.0	-1.2	-1.2	-1.2	-1.7	-1.4	-1.4
<i>claims on the public sector (net)</i>	3.9	0.7	3.9	-0.4	2.8	3.3	2.2	2.8	2.2
Other assets (net) of the banking system	-1.8	-1.8	-2.8	-3.4	-2.6	-1.9	-1.1	2.1	1.3
<i>% of GDP</i>									
General government revenues	42.5	42.6	43.7	..	..	..	..	..	..
General government expenditures	47.8	48.1	46.9	..	..	..	..	..	..
General government balance	-5.3	-5.5	-3.2	..	..	..	..	..	..
Primary balance	-1.8	-2.0	0.4	..	..	..	..	..	..
Gross public debt	82.2	86.5	86.7	..	..	..	..	..	..
<i>% of GDP</i>									
Debt of nonfinancial corporations (nonconsolidated)	102.7	101.4	97.8	..	..	..	..	..	..
Debt of households and NPISHs (nonconsolidated)	40.2	40.2	38.9	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>									
Trade balance	-15.1	-14.8	-15.2	-17.1	-16.1	-14.2	-13.5	-16.6	-16.9
Services balance	15.6	16.8	18.0	3.4	17.4	41.3	5.9	3.2	17.7
Primary income	-2.0	-2.0	-0.6	-2.1	-3.8	2.8	0.0	-3.7	-3.6
Secondary income	2.6	2.1	2.9	3.0	2.8	2.3	3.5	1.6	4.2
Current account balance	1.0	2.1	5.1	-12.8	0.3	32.3	-4.2	-15.5	1.3
Capital account balance	0.1	0.2	0.6	0.3	0.5	0.4	1.4	0.6	1.2
Foreign direct investment (net)	-1.9	-1.9	-0.4	-2.7	-0.1	0.5	0.2	-4.6	-2.2
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	105.7	108.5	103.7	114.1	112.8	107.5	103.7	100.1	97.3
Gross official reserves (excluding gold)	29.7	29.5	31.2	32.9	31.7	30.8	31.2	29.8	29.0
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	8.3	8.0	7.9	8.8	8.3	8.0	7.9	7.6	7.3
<i>EUR million, period total</i>									
GDP at current prices	43,492	43,024	43,911	9,834	10,965	12,140	10,973	10,163	11,342

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiw, OeNB.

6 Czech Republic: exports and private consumption fuel solid growth

Exports compensate temporary shortfall in capital formation

The Czech Republic returned to more modest but solid growth dynamics. Real GDP expanded by more than 3% on average in the first two quarters of 2016. When contrasted with the exceptional performance of 2015 (4.5% on average), the slowdown is notable. However, it was mainly caused by temporary and external factors. Most importantly, the start of a new EU programming period implied a substantial drop in GFCF. Investment activity is expected to regain some momentum as the new EU funding cycle proceeds. With a growth contribution of 2.7 percentage points in the second quarter, net exports were the main driver behind the recent growth dynamics. The Czech National Bank's (CNB's) exchange rate floor, implemented chiefly with the intention to support price stability, arguably also helped shield the competitiveness of the exporting industry to some degree by preventing an appreciation of the Czech koruna against the euro to below 27 CZK per 1 EUR. Going forward, however, high-frequency indicators suggest that economic activity will be more firmly based on private consumption again.

Private consumption remains a key source for growth

Private consumption expanded by 2.5% in the first two quarters of 2016. This increase was the result of positive consumer sentiment, beneficial wage and employment dynamics and accommodative monetary policies. Real purchasing power was bolstered by continuing subdued inflation. Disposable income increased in the first half of 2016 notwithstanding a sizeable decline in property income and reforms of the tax and social security systems.

Price dynamics disappoint again

Headline inflation remained below the CNB's projection and well below its target in the first two quarters of 2016. While consumer prices started to pick up in the first quarter (0.4%), a decline in administered and food prices caused headline inflation to slow down to 0.1% in the second quarter. External factors are perceived to be the main drivers in the sluggish price dynamics. Deflationary tendencies emanated from declining foreign producer prices, low oil prices and low or negative interest rates abroad. The CNB's policy rate has been standing at "technically zero" since October 2012. In November 2013, the CNB decided to use the exchange rate as an additional instrument to ease monetary conditions. According to a recent CNB survey, credit standards in the Czech banking sector were eased further for both corporate and consumer loans. This partly explains the vivid private sector credit growth observed throughout the first half of 2016.

Lower debt servicing costs support fiscal consolidation

Gross public debt as a share of GDP has decreased noticeably over the last few years. With a structural balance of -0.3% of GDP, the Czech Republic exceeded its medium-term budgetary objective of -1% of GDP in 2015. These beneficial developments are further supported by a reduction in debt servicing costs. Advantageous financial market developments and the perception of the Czech Republic as a credible borrower reflected in a heightened demand for the Czech koruna – the CNB needed to intervene repeatedly in the foreign exchange market to uphold its commitment – have pushed government bond yields to a record low. The average time to maturity of government debt decreased from 6.5 years in 2011 to 3.4 years in the second quarter of 2016.

Table 6

Main economic indicators: Czech Republic

	2013	2014	2015	Q1 15	Q2 15	Q3 15	Q4 15	Q1 16	Q2 16
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	-0.5	2.7	4.5	4.6	5.0	4.2	4.3	2.7	3.6
Private consumption	0.5	1.8	3.0	3.6	3.3	2.4	2.9	2.4	2.6
Public consumption	2.5	1.1	2.0	1.3	1.3	3.3	1.9	2.3	2.5
Gross fixed capital formation	-2.5	3.9	9.0	5.4	10.5	10.1	9.5	-0.5	-4.1
Exports of goods and services	0.2	8.7	7.7	7.6	7.5	6.3	9.3	5.0	8.4
Imports of goods and services	0.1	10.1	8.2	8.9	8.9	6.8	8.4	4.6	5.6
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	-0.6	3.2	4.4	4.8	5.5	4.3	3.3	2.0	0.9
Net exports of goods and services	0.1	-0.5	0.1	-0.3	-0.5	0.0	1.1	0.7	2.7
Exports of goods and services	0.1	6.6	6.4	6.6	6.2	5.0	7.6	4.4	6.9
Imports of goods and services	0.0	-7.1	-6.3	-6.9	-6.7	-5.0	-6.5	-3.6	-4.2
<i>Year-on-year change of the period average in %</i>									
Unit labor costs in the whole economy (nominal, per person)	0.6	0.4	-0.5	-1.1	-0.5	-0.3	0.0	2.5	1.5
Unit labor costs in manufacturing (nominal, per hour)	-0.6	-1.3	-1.2	-2.9	-2.4	-6.4	7.3	-3.3	3.1
Labor productivity in manufacturing (real, per hour)	3.2	4.9	4.2	5.0	4.6	5.1	2.3	3.0	0.9
Labor costs in manufacturing (nominal, per hour)	2.4	3.6	3.1	1.9	2.2	-1.6	9.7	-0.4	4.0
Producer price index (PPI) in industry	0.7	1.0	-2.5	-2.0	-1.5	-3.1	-3.4	-4.0	-4.5
Consumer price index (here: HICP)	1.4	0.4	0.3	0.0	0.7	0.3	0.0	0.4	0.1
EUR per 1 CZK, + = CZK appreciation	-3.2	-5.6	0.9	-0.7	0.2	2.0	2.1	2.2	1.3
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	7.0	6.2	5.1	6.0	5.0	4.9	4.5	4.4	4.0
Employment rate (%, 15–64 years)	67.7	69.0	70.2	69.4	70.2	70.5	70.8	71.0	71.7
Key interest rate per annum (%)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
CZK per 1 EUR	26.0	27.5	27.3	27.6	27.4	27.1	27.1	27.0	27.0
<i>Nominal year-on-year change in the period-end stock in %</i>									
Broad money (including foreign currency deposits)	5.8	5.9	8.0	5.6	7.0	8.8	8.0	9.4	9.5
<i>Contributions to year-on-year change of broad money in percentage points</i>									
Net foreign assets of the banking system	11.3	5.8	7.2	0.5	2.2	3.5	6.7	6.4	8.0
Domestic credit of the banking system	5.2	12.1	10.2	8.9	6.8	5.5	2.0	1.7	1.1
<i>of which: claims on the private sector</i>	4.8	5.8	7.7	3.2	4.5	6.3	4.6	5.8	5.6
<i>claims on households</i>	3.1	2.5	4.0	1.1	2.1	2.2	2.8	2.8	2.4
<i>claims on enterprises</i>	1.6	3.3	3.7	2.1	2.4	4.1	1.8	3.0	3.2
<i>claims on the public sector (net)</i>	0.4	6.3	2.5	5.7	2.3	-0.8	-2.6	-4.2	-4.5
Other assets (net) of the banking system	-5.6	-5.7	-3.1	-3.9	-2.1	-0.2	-0.8	1.4	0.4
<i>% of GDP</i>									
General government revenues	41.6	40.8	42.2	..	..	..	..	..	..
General government expenditures	42.8	42.8	42.6	..	..	..	..	..	..
General government balance	-1.3	-1.9	-0.4	..	..	..	..	..	..
Primary balance	0.1	-0.7	0.7	..	..	..	..	..	..
Gross public debt	45.1	42.7	41.1	..	..	..	..	..	..
<i>% of GDP</i>									
Debt of nonfinancial corporations (nonconsolidated)	57.9	60.5	59.4	..	..	..	..	..	..
Debt of households and NPISHs (nonconsolidated)	29.8	30.1	30.7	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>									
Trade balance	4.1	5.1	4.6	7.3	4.9	3.3	3.2	7.9	7.1
Services balance	1.7	1.3	1.6	1.7	1.8	1.7	1.5	2.0	2.0
Primary income	-6.1	-6.0	-5.4	-1.6	-9.0	-7.9	-2.6	-0.4	-8.1
Secondary income	-0.3	-0.2	0.0	1.4	-0.3	-0.2	-0.9	0.6	-1.0
Current account balance	-0.5	0.2	0.9	8.7	-2.6	-3.1	1.2	10.0	0.0
Capital account balance	2.0	0.7	2.3	2.9	4.6	0.7	1.2	1.7	1.8
Foreign direct investment (net)	0.2	-1.9	0.6	-0.2	-0.6	1.2	1.8	0.9	-5.7
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	63.2	67.8	69.4	67.7	67.7	71.7	69.4	70.3	71.9
Gross official reserves (excluding gold)	25.7	28.4	35.3	30.5	31.4	34.1	35.3	37.8	39.0
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	4.3	4.5	5.5	4.8	4.9	5.3	5.5	6.0	6.3
<i>EUR million, period total</i>									
GDP at current prices	157,625	156,641	167,003	38,109	41,744	42,938	44,212	40,500	44,156

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiw, OeNB.

7 Hungary: loose monetary policy and fiscal stimulus to help economy out of temporary low

GDP growth slows during first half of 2016

Hungarian GDP registered 1.9% year-on-year growth (unadjusted) during the first half of 2016, down from 2.9% in 2015. The key factor behind the deceleration was the sharp contraction of investment activity as the inflow of EU funds slowed following the end of the dual disbursement period at end-2015. By contrast, after several years of destocking, stock changes added around 1.3 percentage points to the overall GDP growth rate. Private consumption growth accelerated gradually during the first half of 2016, supported by faster real wage growth and continued employment gains, a lower and less risky debt burden, historically strong consumer confidence and improving credit developments. Public consumption advanced by a steady 2.5% during the first two quarters of 2016. Export growth decelerated somewhat from the levels seen in 2015, reflecting the temporary closure of a car factory during the first quarter and weaker demand for Hungarian goods by EU countries. As import growth fell less than export growth, the contribution of net real exports was cut by roughly half from 2015 levels. So far, high-frequency indicators have not signaled an improvement in economic activity in the third quarter.

Fiscal expansion planned for 2017

Calculations by the central bank indicate that favorable budgetary developments during the first half of 2016 allow the government considerable fiscal room to stimulate the economy without endangering the budget deficit target of 2% of GDP in 2016. For 2017, the government plans an increase in the headline deficit to 2.4% of GDP. The widening of the deficit will be caused mainly by the reduction of VAT rates for selected products, additional tax benefits for families, the cut in the special tax on financial institutions, increased outlays for home subsidies for households and public sector pay rises. This widening will not be fully counterbalanced by stronger GDP growth and better tax collection efficiency. The fiscal expansion should, however, be reversed in the coming years, with the deficit sinking gradually to 1.2% of GDP by 2020. In the same period, the structural deficit is also expected to fall from 2.1% of GDP in 2016 and 2017 to 1.2% of GDP, i.e. below the new medium-term objective of 1.5% of GDP. The EU Council was less upbeat on the outlook in its assessment of the Convergence Programme, missing sufficiently specified measures for the planned deficit reduction and thus seeing a high risk of a significant deviation from the adjustment path.

Central bank maintains loose policy stance

In its latest rate cutting cycle from March to May 2016, the Hungarian National Bank (MNB) lowered its policy rate by a total of 45 basis points to 0.9%. The overnight deposit rate has been negative (-0.05%) since late March 2016. Since the last rate cut, the MNB has repeatedly signaled that maintaining the current loose monetary conditions for an extended period is consistent with the medium-term inflation target. Moreover, in order to support lending, the MNB has put a limit on access to the three-month deposit facility (main policy tool), thereby increasing banking sector liquidity that would otherwise end up on the government securities and the interbank market and that would cause a drop in interest rates. This move should also benefit lending to the private sector. Additionally, in June 2016, the MNB increased the volume of funds available until end-2016 in its Growth Supporting Scheme by one-third in response to banking sector requests.

Table 7

Main economic indicators: Hungary

	2013	2014	2015	Q1 15	Q2 15	Q3 15	Q4 15	Q1 16	Q2 16
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	1.9	3.7	2.9	3.5	2.7	2.4	3.2	1.1	2.6
Private consumption	0.3	1.8	3.0	3.3	2.7	2.7	3.4	4.8	5.1
Public consumption	2.4	2.9	0.6	-3.3	-2.4	3.5	4.3	2.5	2.5
Gross fixed capital formation	7.3	11.2	1.9	-5.5	5.0	-1.4	6.5	-7.8	-20.0
Exports of goods and services	6.4	7.6	8.4	8.7	8.8	8.6	7.7	5.7	8.2
Imports of goods and services	6.3	8.5	7.8	7.4	7.5	8.1	8.0	7.8	6.1
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	1.4	3.9	1.8	1.7	1.0	1.3	3.0	2.4	0.2
Net exports of goods and services	0.5	-0.2	1.2	1.8	1.7	1.1	0.2	-1.2	2.4
Exports of goods and services	5.5	6.7	7.5	8.1	7.9	7.6	6.6	5.5	7.6
Imports of goods and services	-5.1	-6.9	-6.4	-6.3	-6.2	-6.5	-6.4	-6.7	-5.2
<i>Year-on-year change of the period average in %</i>									
Unit labor costs in the whole economy (nominal, per person)	0.9	1.9	3.3	4.7	3.2	3.2	2.0	5.8	4.9
Unit labor costs in manufacturing (nominal, per hour)	3.1	-2.4	-0.1	-0.6	0.6	-0.2	-0.2	8.4	6.3
Labor productivity in manufacturing (real, per hour)	0.6	5.9	4.1	4.0	3.7	4.2	4.6	-3.0	-1.6
Labor costs in manufacturing (nominal, per hour)	3.6	3.4	4.0	3.3	4.3	4.0	4.3	5.1	4.6
Producer price index (PPI) in industry	0.6	-0.4	-0.9	-2.2	0.2	-0.6	-1.1	-1.5	-2.0
Consumer price index (here: HICP)	1.7	0.0	0.1	-0.9	0.4	0.2	0.6	0.4	0.0
EUR per 1 HUF, + = HUF appreciation	-2.6	-3.8	-0.4	-0.3	0.0	0.1	-1.3	-1.0	-2.4
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	10.3	7.8	6.9	7.8	6.9	6.5	6.2	6.1	5.1
Employment rate (%, 15–64 years)	58.1	61.8	64.0	62.4	63.8	64.8	64.8	65.1	66.4
Key interest rate per annum (%)	4.4	2.4	1.6	2.1	1.8	1.4	1.4	1.3	1.0
HUF per 1 EUR	296.9	308.7	309.9	308.9	305.9	312.1	312.6	312.1	313.3
<i>Nominal year-on-year change in the period-end stock in %</i>									
Broad money (including foreign currency deposits)	5.5	5.1	6.3	4.7	3.9	4.1	6.3	5.0	5.4
<i>Contributions to year-on-year change of broad money in percentage points</i>									
Net foreign assets of the banking system	11.7	14.5	8.9	5.1	2.5	-0.3	1.4	-1.2	-0.6
Domestic credit of the banking system	-11.6	0.6	2.3	-3.4	1.3	2.4	1.8	6.4	4.5
<i>of which: claims on the private sector</i>	-18.1	-4.9	-8.1	-5.2	-5.6	-6.1	-7.4	-3.3	-2.8
<i>claims on households</i>	-9.6	-3.0	-5.3	-3.7	-3.9	-4.1	-4.4	-2.2	-2.0
<i>claims on enterprises</i>	-8.5	-1.9	-2.8	-1.6	-1.8	-2.0	-3.0	-0.9	-0.6
<i>claims on the public sector (net)</i>	6.4	5.5	10.4	1.8	6.9	8.5	9.2	9.8	7.4
Other assets (net) of the banking system	2.0	-4.2	0.5	3.0	0.1	2.0	3.1	-0.2	1.4
<i>% of GDP</i>									
General government revenues	47.0	47.5	48.7	..	..	..	..	..	..
General government expenditures	49.6	49.8	50.7	..	..	..	..	..	..
General government balance	-2.6	-2.3	-2.0	..	..	..	..	..	..
Primary balance	1.9	1.7	1.6	..	..	..	..	..	..
Gross public debt	76.8	76.2	75.3	..	..	..	..	..	..
<i>% of GDP</i>									
Debt of nonfinancial corporations (nonconsolidated)	92.0	88.8	87.6	..	..	..	..	..	..
Debt of households and NPISHs (nonconsolidated)	28.1	25.3	21.2	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>									
Trade balance	3.3	2.3	4.0	6.2	2.6	2.8	4.7	6.2	5.1
Services balance	3.7	4.7	5.0	4.7	5.6	6.5	3.1	4.7	6.4
Primary income	-2.7	-4.2	-4.6	-3.0	-5.2	-4.9	-5.2	-2.7	-3.8
Secondary income	-0.5	-0.7	-0.9	-1.9	-0.8	-0.8	-0.5	-2.0	-1.3
Current account balance	3.8	2.1	3.4	6.0	2.2	3.6	2.2	6.2	6.4
Capital account balance	3.6	3.8	4.6	3.2	4.7	2.5	7.5	1.1	0.3
Foreign direct investment (net)	-1.1	-2.7	-0.4	0.5	3.3	-3.4	-1.5	-1.7	2.3
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	118.5	115.2	107.5	121.5	116.5	109.3	107.5	104.6	104.3
Gross official reserves (excluding gold)	33.3	33.1	27.8	35.0	32.6	29.8	27.8	25.2	22.5
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	5.0	4.8	4.0	5.1	4.7	4.3	4.0	3.6	3.2
<i>EUR million, period total</i>									
GDP at current prices	101,268	104,245	108,731	24,304	26,924	27,865	29,639	24,629	27,520

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiw, OeNB.

8 Poland: growth rebounds after slowdown due to lower fixed investment

Exports as the main pillar of growth; stronger import growth despite investment slump

GDP growth reached 2.7% in the first half of 2016 (2015: 3.6%) and speeded up in the second quarter. Total final demand growth increased to 5.2%, as real exports rose by 9.7%, domestic demand went up by 2.7% and real imports expanded by 10.1%. Foreign demand contributed nearly twice as much as domestic demand to GDP growth, while the net export contribution was close to zero. Compared to 2015, both export and import growth accelerated substantially, while domestic demand growth declined. The main reason for the growth slowdown was the slump in fixed investment caused mainly by initially lower EU fund absorption under the new EU budget and affecting above all public investment. A strong inventory buildup could only partially offset this. Conditions for business investment remained supportive, given contained ULC increases, stable profitability, a healthy liquidity position, stable industrial confidence and rising export orders. Housing investment growth slackened in parallel to housing loan growth. Real wage sum growth remained close to 5% also because of higher employment and deflation, yet real pension growth weakened. Consumer confidence continued to improve, but private consumption expanded considerably less than real income, possibly due to deflation expectations. In seasonal and working-day adjusted terms, private consumption growth remained at the comparatively low level of the fourth quarter of 2015. On October 19, the Sejm is scheduled to start discussing the issue of Swiss franc loans, with President Duda's proposal envisaging compensation payments for foreign exchange spreads; earlier plans for compulsory conversion (at historical exchange rates) were dropped for financial stability reasons.

Weaker złoty offsets moderate ULC rise, preserving price competitiveness

In manufacturing, labor costs increased faster, while labor productivity growth declined thanks to higher employment growth. Thus, ULCs rose by about 2 percentage points more year on year than those in the euro area. However, the złoty's euro value was about 5 percentage points lower in the first half of 2016 than a year earlier. In the third quarter, the złoty reappreciated moderately. In August, annual headline inflation was negative (−0.5% HICP, −0.8% national CPI), while core inflation stood at 0.2% (HICP) and −0.4% (CPI), with deflation in industrial goods and inflation in services. The Polish Monetary Policy Council (MPC), pursuing an inflation target of 2.5% (CPI), has kept rates on hold since March 2015. On October 5, 2016, it again decided to keep the key interest rate at 1.5%, expecting stable economic growth and abating headline deflation in the coming months.

Fiscal headline deficit may undershoot 2.6% target; substantial structural deficit

In the first eight months of 2016, the central budget deficit amounted to roughly one-quarter of the annual plan (2.3% of GDP), given tax revenue growth of 7% and expenditures below plan. Thus, the gross general government deficit 2016 could be lower than the target of 2.6% of GDP envisaged in the government's Convergence Programme submitted in April 2016 (2015: 2.6%). For 2017, a headline deficit of 2.9% of GDP is foreseen, while the structural deficit path aims at 3.1% of GDP in 2016 (after 2.3% of GDP in 2015) and 2.9% in 2017. This implies a marked deviation from the MTO of a structural deficit of 1% of GDP. General government gross debt is expected to rise moderately to 52.5% of GDP at the end of 2017.

Table 8

Main economic indicators: Poland

	2013	2014	2015	Q1 15	Q2 15	Q3 15	Q4 15	Q1 16	Q2 16
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	1.3	3.3	3.6	3.8	3.1	3.3	4.3	2.5	3.0
Private consumption	0.2	2.4	3.0	3.7	3.4	2.7	2.2	3.0	2.7
Public consumption	2.2	4.7	3.4	1.6	1.0	0.6	9.0	3.6	4.0
Gross fixed capital formation	-1.1	10.0	5.8	10.9	5.5	5.2	4.4	-2.2	-4.6
Exports of goods and services	6.1	6.4	6.8	8.3	5.4	5.4	8.2	6.8	12.5
Imports of goods and services	1.7	10.0	6.3	7.3	5.5	4.6	8.0	9.2	11.1
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	-0.7	4.8	3.3	3.1	3.1	2.9	4.2	3.4	1.9
Net exports of goods and services	1.9	-1.5	0.3	0.6	0.0	0.6	0.2	-0.9	1.0
Exports of goods and services	2.7	3.0	3.2	4.1	2.6	1.9	4.0	3.5	6.2
Imports of goods and services	-0.8	-4.4	-2.9	-3.4	-2.6	-1.3	-3.8	-4.4	-5.2
<i>Year-on-year change of the period average in %</i>									
Unit labor costs in the whole economy (nominal, per person)	0.5	0.6	-2.3	-2.3	-2.6	-1.9	-2.3	1.2	1.4
Unit labor costs in manufacturing (nominal, per hour)	-0.1	2.1	1.0	0.8	1.0	1.7	0.5	3.4	2.5
Labor productivity in manufacturing (real, per hour)	3.5	2.4	2.8	5.1	1.9	2.9	1.6	0.3	0.6
Labor costs in manufacturing (nominal, per hour)	3.4	4.7	3.9	5.9	3.0	4.7	2.1	3.7	3.1
Producer price index (PPI) in industry	-1.2	-1.3	-2.1	-2.5	-1.9	-2.3	-1.6	-1.5	-1.0
Consumer price index (here: HICP)	0.8	0.1	-0.7	-1.2	-0.6	-0.5	-0.5	-0.3	-0.4
EUR per 1 PLN, + = PLN appreciation	-0.3	0.3	0.0	-0.2	2.0	-0.3	-1.2	-4.0	-6.5
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	10.5	9.1	7.6	8.7	7.5	7.1	7.0	7.1	6.3
Employment rate (%, 15–64 years)	60.0	61.7	62.9	61.9	62.6	63.5	63.7	63.7	64.3
Key interest rate per annum (%)	2.9	2.4	1.6	1.8	1.5	1.5	1.5	1.5	1.5
PLN per 1 EUR	4.2	4.2	4.2	4.2	4.1	4.2	4.3	4.4	4.4
<i>Nominal year-on-year change in the period-end stock in %</i>									
Broad money (including foreign currency deposits)	6.2	8.2	9.1	8.7	8.2	8.3	9.1	9.1	11.4
<i>Contributions to year-on-year change of broad money in percentage points</i>									
Net foreign assets of the banking system	0.3	0.4	4.5	5.2	2.5	1.8	1.3	-1.1	4.3
Domestic credit of the banking system	9.5	18.2	20.1	8.1	9.5	8.1	9.9	11.5	10.8
<i>of which: claims on the private sector</i>	6.7	11.5	14.3	7.6	7.7	7.4	6.8	4.6	4.9
<i>claims on households</i>	3.0	6.1	7.2	4.2	4.7	3.6	3.7	2.5	2.7
<i>claims on enterprises</i>	3.7	5.4	7.0	3.3	3.0	3.8	3.1	2.1	2.2
<i>claims on the public sector (net)</i>	2.8	6.7	5.9	0.5	1.8	0.7	3.0	6.9	6.0
Other assets (net) of the banking system	1.2	-3.6	-6.7	-4.5	-3.8	-1.6	-2.1	-1.3	-3.7
<i>% of GDP</i>									
General government revenues	38.4	38.9	38.9	..	..	..	..	..	..
General government expenditures	42.4	42.2	41.5	..	..	..	..	..	..
General government balance	-4.0	-3.3	-2.6	..	..	..	..	..	..
Primary balance	-1.5	-1.4	-0.8	..	..	..	..	..	..
Gross public debt	56.0	50.5	51.3	..	..	..	..	..	..
<i>% of GDP</i>									
Debt of nonfinancial corporations (nonconsolidated)	44.1	45.0	45.8	..	..	..	..	..	..
Debt of households and NPISHs (nonconsolidated)	35.4	34.9	35.6	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>									
Trade balance	-0.1	-0.8	0.5	1.6	0.3	-0.7	0.9	1.0	1.4
Services balance	1.9	2.2	2.6	2.5	2.9	2.5	2.2	3.0	3.5
Primary income	-3.0	-3.4	-3.5	-2.8	-3.2	-4.3	-3.6	-3.7	-4.0
Secondary income	-0.1	-0.1	-0.2	-0.9	0.4	0.1	-0.4	-0.5	0.0
Current account balance	-1.3	-2.1	-0.6	0.4	0.4	-2.4	-0.8	-0.2	1.0
Capital account balance	2.3	2.4	2.4	3.7	1.1	4.4	0.7	2.5	0.0
Foreign direct investment (net)	-0.8	-2.4	-2.1	-2.8	0.0	-2.5	-2.8	-3.3	-1.0
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	70.7	71.5	70.6	74.7	73.6	72.7	70.6	70.5	73.0
Gross official reserves (excluding gold)	18.8	19.3	19.6	21.0	21.5	20.7	19.6	19.9	22.5
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	5.1	5.0	5.0	5.4	5.5	5.3	5.0	5.1	5.7
<i>EUR million, period total</i>									
GDP at current prices	394,674	410,788	427,596	98,531	105,432	104,382	119,252	97,632	102,086

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiw, OeNB.

9 Romania: strong but unbalanced growth widens the current account deficit

Private consumption continues to boom

GDP growth speeded up in the first half of 2016, mainly propelled by the ongoing powerful acceleration of private consumption growth. In addition, GFCF continued to recover, whereas exports showed moderate growth. Procyclical economic policy continued to support private consumption, and a further minimum wage hike in May 2016 even pushed its annual growth rate above 10% in the second quarter. Real wages grew by 15% year on year in the first half of 2016. Residential building activity supported by government-guaranteed mortgage lending under the first home program (and the related growth of housing loans), late disbursements of EU funds under the 2007–2013 financial framework and an overall favorable economic sentiment backed the development of GFCF. Strong domestic demand resulted in quickly rising imports, dragging the contribution of net exports deeper into negative territory.

Current account deficit widens...

High, domestic demand-driven growth caused the trade deficit and in turn also the current account deficit to widen markedly. As the capital account remained robust thanks to EU fund inflows, Romania maintained a positive net lending position from the current and capital accounts in the first half of 2016, however. It is also noteworthy that net FDI inflows picked up somewhat. In sum, developments in the balance of payments still made a further reduction of the external debt stock possible without recourse to official foreign currency reserves. The banking sector contributed most to the decline of external debt, accompanied by a further fall in the domestic credit-to-deposit ratio.

...mainly due to the economic policy mix

The continued sharp rise in ULCs in the manufacturing sector precipitated by productivity declines and increases in labor costs poses risks to the export performance, whereas rapid wage growth and further fiscal stimulus are likely to keep import demand at elevated levels. Starting in August, wages in the health and education sector were raised by 10%. In parallel to a series of minimum wage hikes and public sector wage boosts, labor market conditions have tightened, as reflected by a falling unemployment rate and an increasing job vacancy rate. In the first eight months of 2016, the consolidated budget deficit came in lower than planned at 0.4% of GDP, implying fiscal space in the forefront of elections in December, as the full-year deficit target stands at 2.8% of GDP (considerably above the deficit of 0.7% of GDP recorded in 2015). Some initiatives in parliament ahead of parliamentary elections in December 2016 could also materialize in the fiscal burden for 2017 and could increase adjustment needs for the next government.

Lessening impact of indirect tax cuts in 2015 ends deflation

CPI and HICP inflation rates bottomed out in May 2016 at –3.0% and –2.9%, respectively. Since then, the year-on-year declines in price levels have moderated, as the direct impact of the extension of the 9% reduced VAT to all food items (implemented in June 2015) came to a halt from June. The annual change of the HCPI turned positive in August, while the CPI inflation rate came in at –0.3%. The direct disinflationary impact of the cut in the standard VAT rate (implemented in January 2016) will last until the end of this year. The Banca Națională României (BNR) currently projects the headline CPI rate to enter the target variation band of 2.5% ±1 percentage point in the second half of 2017. The BNR has kept its policy rate unchanged at 1.75% since May 2015.

Table 9

Main economic indicators: Romania

	2013	2014	2015	Q1 15	Q2 15	Q3 15	Q4 15	Q1 16	Q2 16
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	3.5	3.0	3.8	4.3	3.4	3.6	3.8	4.3	6.0
Private consumption	1.3	3.9	6.0	4.8	5.4	6.4	7.3	9.5	10.8
Public consumption	-6.8	0.5	1.7	2.9	1.6	2.9	0.2	3.9	3.4
Gross fixed capital formation	-6.8	3.1	7.7	8.4	7.6	2.1	17.6	2.3	10.7
Exports of goods and services	18.1	8.4	5.2	7.9	8.0	4.6	1.0	5.3	4.0
Imports of goods and services	9.4	8.3	9.2	11.3	9.9	9.7	6.5	9.7	12.1
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	-0.1	3.2	5.3	6.7	7.3	4.4	3.6	7.4	6.0
Net exports of goods and services	3.6	-0.2	-1.5	-2.0	-1.9	-1.5	-1.1	-2.3	-3.5
Exports of goods and services	7.4	3.4	2.3	4.2	3.3	1.8	-0.4	1.7	1.7
Imports of goods and services	-3.7	-3.6	-3.8	-6.2	-5.1	-3.3	-0.7	-4.0	-5.3
<i>Year-on-year change of the period average in %</i>									
Unit labor costs in the whole economy (nominal, per person)	0.5	2.6	-1.9	0.4	-4.2	-0.3	-3.5	5.0	7.7
Unit labor costs in manufacturing (nominal, per hour)	-0.5	-0.3	9.0	7.6	9.5	9.2	9.6	8.3	11.2
Labor productivity in manufacturing (real, per hour)	6.2	5.8	-0.3	0.6	-0.8	-1.1	0.2	-2.3	-1.7
Labor costs in manufacturing (nominal, per hour)	5.6	5.6	8.7	8.2	8.6	8.0	9.9	5.9	9.3
Producer price index (PPI) in industry	2.1	-0.1	-2.2	-1.6	-2.4	-2.6	-2.3	-2.9	-2.6
Consumer price index (here: HICP)	3.2	1.4	-0.4	0.5	0.4	-1.5	-1.0	-2.0	-2.1
EUR per 1 RON, + = RON appreciation	0.9	-0.6	0.0	1.1	-0.4	-0.3	-0.5	-0.9	-1.2
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	7.4	7.1	7.1	7.6	7.0	6.8	6.8	6.8	6.1
Employment rate (%, 15–64 years)	60.1	61.0	61.4	59.1	62.0	63.2	61.4	59.8	61.8
Key interest rate per annum (%)	4.8	3.3	1.9	2.4	1.8	1.8	1.8	1.8	1.8
RON per 1 EUR	4.4	4.4	4.4	4.5	4.4	4.4	4.5	4.5	4.5
<i>Nominal year-on-year change in the period-end stock in %</i>									
Broad money (including foreign currency deposits)	8.8	8.4	9.3	6.5	8.8	8.4	9.3	9.9	13.1
<i>Contributions to year-on-year change of broad money in percentage points</i>									
Net foreign assets of the banking system	20.7	26.6	17.8	8.8	6.0	4.4	5.5	7.0	11.3
Domestic credit of the banking system	-5.4	-10.9	0.7	-1.4	3.1	3.3	5.4	2.8	2.7
<i>of which: claims on the private sector</i>	-1.9	-6.3	0.0	-2.8	0.1	0.5	2.5	2.4	1.0
<i>claims on households</i>	-0.5	-1.1	1.9	0.0	1.5	1.5	2.2	2.2	2.1
<i>claims on enterprises</i>	-1.4	-5.2	-2.0	-2.8	-1.4	-1.0	0.3	0.2	-1.1
<i>claims on the public sector (net)</i>	-3.5	-4.7	0.7	1.4	3.0	2.7	2.9	0.4	1.8
Other assets (net) of the banking system	-3.6	2.3	0.0	-0.9	-0.2	0.6	-1.5	0.2	-1.0
<i>% of GDP</i>									
General government revenues	33.1	33.5	34.8	..	..	..	..	..	..
General government expenditures	35.2	34.3	35.5	..	..	..	..	..	..
General government balance	-2.1	-0.9	-0.7	..	..	..	..	..	..
Primary balance	-0.4	0.9	0.9	..	..	..	..	..	..
Gross public debt	38.0	39.8	38.4	..	..	..	..	..	..
<i>% of GDP</i>									
Debt of nonfinancial corporations (nonconsolidated)	48.0	44.7	41.2	..	..	..	..	..	..
Debt of households and NPISHs (nonconsolidated)	19.0	17.9	17.1	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>									
Trade balance	-4.0	-4.2	-4.9	-3.9	-4.6	-4.7	-5.8	-5.7	-5.7
Services balance	3.3	3.9	4.3	4.7	4.7	4.4	3.7	5.5	4.9
Primary income	-2.2	-1.3	-2.4	-1.3	-4.1	-2.2	-1.9	-3.4	-3.8
Secondary income	1.9	1.1	1.8	2.2	1.5	1.3	2.1	1.4	1.3
Current account balance	-1.1	-0.4	-1.1	1.7	-2.5	-1.2	-1.9	-2.2	-3.3
Capital account balance	2.1	2.6	2.4	4.8	1.8	2.0	1.8	4.0	3.2
Foreign direct investment (net)	-2.0	-1.8	-1.7	-2.6	-2.1	-2.2	-0.4	-2.6	-2.9
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	68.4	61.8	56.3	60.4	58.6	56.7	56.3	55.0	53.6
Gross official reserves (excluding gold)	22.7	21.4	20.2	19.9	19.4	18.5	20.2	19.4	19.3
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	6.7	6.2	5.8	5.8	5.5	5.3	5.8	5.5	5.5
<i>EUR million, period total</i>									
GDP at current prices	144,102	150,359	160,367	31,584	36,641	44,564	47,578	32,654	39,762

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiw, OeNB.

10 Turkey: economy starts to lose momentum amid elevated risks

Internal political risks increase considerably

GDP growth started to lose pace in the first half of 2016, coming down to 3.9% year on year. Available high-frequency indicators for the third quarter of 2016 already point toward a continued deceleration of economic momentum amid high and rising uncertainties. In particular, risks stemming from ongoing geopolitical tensions but also from higher domestic political instability following the military coup attempt in mid-July 2016 increased considerably.

On July 21, the Turkish government declared a state of emergency, which was extended in October for a total of six months. Following the coup attempt, several thousand civil servants and judges as well as teachers have been detained or suspended, which is likely to threaten the capacity of Turkey's policymaking institutions and suppress investor sentiment, in turn weighing on economic growth. Accordingly, Standard & Poor's and Moody's cut Turkey's rating to below investment grade in July and September, respectively.

GDP growth largely driven by an upswing in private consumption

The pronounced shift toward domestic-driven GDP growth, which had started in 2015, continued in the first half of 2016. In particular, easier financing conditions, elevated employment growth and the 30% hike of the minimum wage in January 2016 boosted private consumption. Both public consumption and public investment posted robust growth, thus partly balancing the slowdown of private investment. However, overall GFCF stagnated in the first half of 2016.

In the first half of 2016, net external demand exerted a drag on growth: Exports increased by a modest 1.3% while imports surged by 7.5%. Despite the slight uptick in exports to the EU, the ongoing economic downturn in major trading partner countries (e.g. Iraq), economic sanctions imposed by Russia as from January 2016 and a sharp deterioration in tourism weighed on export growth.

External imbalances continue to accumulate

The oil price-driven adjustment continued as the four-quarter current account deficit narrowed to 4.2% of GDP until June 2016, slightly down from 4.5% of GDP in 2015. On the financing side, net FDI inflows are on the decline and nearly halved to 0.7% of GDP in the first half of 2016, thus covering only 15% of the current account deficit. Accordingly, the economy continued to rely heavily on more volatile portfolio inflows and loans. Gross external debt is on a steady upward trend and stood at 61.3% of GDP as of mid-2016; the share of short-term debt has nearly doubled to 13% of GDP. Gross external financing needs remain elevated and are projected to amount to close to 25% of GDP in 2016.

Inflation pressures ease somewhat amid the central bank's continued monetary policy easing

Since April 2016, the Central Bank of the Republic of Turkey (CBRT) has followed a monetary policy easing cycle, progressively reducing the overnight lending rate in six steps from 10.5% to 8.25% in September 2016. These steps narrowed the interest rate corridor, leaving the lower band unchanged at 7.25%. The Turkish lira is under strong depreciation pressure, although at a decelerating pace. In fact, despite the depreciation spikes following the military coup attempt and Turkey's downgrade by Moody's, the lira weakened by 3.1% against the U.S. dollar and by 7% vis-à-vis the euro in the first nine months of 2016.

On a slightly positive note, price pressures eased somewhat in 2016, especially since the beginning of the second quarter, given lower unprocessed food prices. Conversely, the growth of property prices reached 7.9% year on year in real terms in the first quarter, substantially above readings for other emerging markets. Yet tax hikes on tobacco, alcohol and electricity and the minimum wage hike pushed inflation up to 7.3% in September 2016.

Table 10

Main economic indicators: Turkey

	2013	2014	2015	Q1 15	Q2 15	Q3 15	Q4 15	Q1 16	Q2 16
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	4.2	3.0	4.0	2.5	3.7	3.9	5.7	4.7	3.1
Private consumption	5.1	1.4	4.8	4.3	5.5	3.9	5.4	7.1	5.2
Public consumption	6.5	4.7	6.7	2.8	7.3	8.0	8.1	10.9	15.9
Gross fixed capital formation	4.4	-1.3	4.0	0.7	10.1	1.3	3.5	0.0	-0.6
Exports of goods and services	-0.2	7.4	-0.9	-1.4	-2.7	-1.4	2.0	2.4	0.2
Imports of goods and services	9.0	-0.3	0.2	3.6	1.4	-1.3	-2.6	7.3	7.7
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	7.4	1.1	4.1	4.2	4.0	4.2	4.1	6.5	5.8
Net exports of goods and services	-2.3	1.8	-0.3	-1.3	-1.0	-0.1	1.2	-1.3	-1.9
Exports of goods and services	-0.1	1.7	-0.2	-0.3	-0.7	-0.3	0.5	0.5	0.0
Imports of goods and services	-2.3	0.1	-0.1	-0.9	-0.4	0.3	0.7	-1.9	-2.0
<i>Year-on-year change of the period average in %</i>									
Unit labor costs in the whole economy (nominal, per hour)	..	..	..	..	..	..	..	..	..
Unit wage costs in manufacturing (nominal, per hour)	10.3	12.8	10.3	12.9	9.6	11.2	7.7	13.6	15.3
Labor productivity in manufacturing (real, per hour)	1.6	1.3	4.2	1.0	5.2	4.8	5.5	5.6	2.7
Gross wages in manufacturing (nominal, per hour)	12.1	14.3	14.9	14.1	15.3	16.5	13.6	20.0	18.3
Producer price index (PPI) in industry	4.5	10.2	5.3	3.3	6.0	6.3	5.6	4.7	3.2
Consumer price index (here: HICP)	7.5	8.9	7.7	7.5	7.9	7.4	8.2	8.5	6.7
EUR per 1 TRY, + = TRY appreciation	-8.6	-12.9	-3.8	9.5	-1.8	-9.8	-11.3	-14.6	-9.8
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	8.9	10.1	10.5	11.4	9.5	10.3	10.6	11.0	9.6
Employment rate (%, 15–64 years)	49.5	49.5	50.2	48.4	51.1	51.1	50.0	49.4	52.0
Key interest rate per annum (%)	4.8	8.7	7.6	7.8	7.5	7.5	7.5	7.5	7.5
TRY per 1 EUR	2.5	2.9	3.0	2.8	3.0	3.2	3.2	3.2	3.3
<i>Nominal year-on-year change in the period-end stock in %</i>									
Broad money (including foreign currency deposits)	21.1	11.8	16.2	15.8	18.3	20.4	16.2	13.2	12.0
<i>Contributions to year-on-year change of broad money in percentage points</i>									
Net foreign assets of the banking system	-5.2	-10.8	-6.5	-4.2	-4.7	-2.8	-2.3	-0.1	1.5
Domestic credit of the banking system	51.9	57.7	48.6	25.2	27.8	27.9	24.3	19.1	16.2
<i>of which: claims on the private sector</i>	55.6	58.6	47.2	25.1	28.6	28.9	23.6	17.8	15.1
<i>claims on households</i>	15.2	11.4	5.7	3.6	4.0	3.4	2.9	2.2	2.1
<i>claims on enterprises</i>	40.4	47.2	41.5	21.5	24.6	25.5	20.7	15.6	13.0
<i>claims on the public sector (net)</i>	-3.7	-0.9	1.4	0.0	-0.8	-1.0	0.7	1.3	1.1
Other assets (net) of the banking system	-12.9	-11.7	-12.2	-5.2	-4.8	-4.7	-5.7	-5.8	-5.6
<i>% of GDP</i>									
General government revenues	..	..	..	..	..	..	..	..	..
General government expenditures	..	..	..	..	..	..	..	..	..
General government balance	0.2	-1.5	-1.4	..	..	..	..	..	..
Primary balance	..	..	..	..	..	..	..	..	..
Gross public debt	36.1	33.5	32.9	..	..	..	..	..	..
<i>% of GDP</i>									
Debt of nonfinancial corporations (nonconsolidated)	..	..	..	..	..	..	..	..	..
Debt of households and NPISHs (nonconsolidated)	..	..	..	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>									
Trade balance	-9.8	-8.0	-6.7	-6.3	-7.8	-6.6	-6.0	-4.9	-6.7
Services balance	2.9	3.3	3.4	1.7	3.1	6.0	2.6	1.1	1.7
Primary income	-1.0	-1.0	-1.3	-1.4	-1.7	-1.0	-1.2	-1.1	-1.4
Secondary income	0.1	0.2	0.2	0.2	0.1	0.2	0.3	0.3	0.2
Current account balance	-7.8	-5.5	-4.5	-5.9	-6.3	-1.5	-4.4	-4.6	-6.2
Capital account balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign direct investment (net)	-1.1	-0.7	-1.6	-1.8	-1.1	-2.4	-1.2	-0.8	-0.6
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	50.2	59.5	58.3	62.4	59.1	57.9	58.4	58.3	61.3
Gross official reserves (excluding gold)	13.1	14.6	13.2	15.0	13.9	14.0	13.2	13.1	14.4
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	4.8	5.4	5.1	5.7	5.3	5.3	5.1	5.1	5.7
<i>EUR million, period total</i>									
GDP at current prices	619,300	602,390	646,126	160,064	163,459	163,405	159,198	153,306	160,832

Source: Bloomberg, European Commission, Eurostat, national statistical offices, national central banks, wiw, OeNB.

11 Russia: recession draws to a close, banking sector continues to face challenges

Domestic demand contraction slows substantially, helping to ease recession

The contraction of the Russian economy has slowed down considerably. Whereas in the past year, GDP shrank by 3.7%, in the first half of 2016 it declined by 0.9% (year on year), with negative growth rates moderating to 1.2% in the first quarter and to 0.6% in the second quarter (year on year). On the demand side, the decrease of private consumption and fixed investment slowed down, and the previously strong rundown of inventories came to a halt. On the supply side, a modest increase of agricultural, oil and other raw material output (which partly reached record levels) as well as a stagnation of industrial production (after a decrease in 2015) contributed to the weakening of the recession.

Weak demand, a shrinking ratio of imports to GDP and tight monetary policy drive inflation down further

Russia's recession eased despite the further drop in the Urals grade oil price by about 30% on average from January to August 2016 over the same period of the previous year, which may point to some adaptation of the economy to the low oil price environment. This easing was probably helped by the flexible exchange rate of the ruble, which depreciated by about 20% against the U.S. dollar in the same period. Persisting weak demand, the shrinking ratio of imports to GDP and the Central Bank of Russia's (CBR's) continued tight monetary policy (the CBR held the repo auction rate at 11% until June 2016) pushed CPI inflation (year on year) to below 8% in the spring of 2016. This relatively favorable development contributed to the decision of the CBR to lower the key rate to 10.5% in mid-June. Inflation subsided further to 6.6% in September 2016, which prompted the CBR to cut the rate to 10%.

Further drop of oil price raises budget deficit and erodes Reserve Fund

The further decline in the oil price drove up the federal budget deficit in the first eight months of the parliamentary election year 2016, bringing it to about 2.9% of pro-rata GDP. The shortfall was still largely financed by the Reserve Fund, whose level fell further to USD 32.2 billion at end-August 2016 (less than 3% of annual GDP). At this speed of withdrawal, the Reserve Fund could be exhausted at the end of 2016 or in the first half of 2017. By contrast, the assets of the National Wealth Fund, whose main purpose is to support the pension system, have remained stable since the beginning of 2016 (end-August: USD 72.7 billion or around 6% of annual GDP).

Marked decrease in current account surplus and in private capital outflows

The oil price-triggered further contraction of exports and the demand-triggered slower contraction of imports combined to reduce the current account surplus from January to August 2016 to USD 14.8 billion (about 1.9% of pro-rata GDP as against USD 47 billion in the corresponding period of 2015). By contrast, net private capital outflows fell to USD 10 billion from January to August 2016 (compared to USD 51 billion in the corresponding period of 2015). The shrinkage of net capital outflows is largely owed to reduced debt service payments and to the repatriation of assets from abroad. Russia's total external debt remained more or less stable in the first half year and came to USD 525.3 billion at mid-2016 (43% of GDP).

Banks are sufficiently liquid but struggle with rising NPLs and remain cautious lenders

Given the slide of the ruble and the rise of the ratio of NPLs (broadly defined) to 17.8% of total loans at end-July 2016 from 16.5% at the beginning of the year, lending continued to contract by 8.2% in the year to end-August 2016 (in real terms and exchange rate adjusted), while deposits increased marginally (+1.1%). The country's international reserves (including gold) rose by about EUR 2.8 billion from the beginning of the year to EUR 296.6 billion in the second quarter (27% of GDP).

Table 11

Main economic indicators: Russia

	2013	2014	2015	Q1 15	Q2 15	Q3 15	Q4 15	Q1 16	Q2 16
<i>Year-on-year change of the period total in %</i>									
GDP at constant prices	1.3	0.7	-3.7	-2.8	-4.5	-3.7	-3.8	-1.2	-0.6
Private consumption	4.3	1.5	-9.5	-6.9	-8.0	-10.4	-12.4	-4.3	-5.2
Public consumption	1.4	0.2	-1.8	-1.8	-1.8	-1.8	-1.7	-1.5	-1.2
Gross fixed capital formation	0.9	-2.6	-7.6	-6.4	-7.3	-11.3	-6.0	-9.9	-4.3
Exports of goods and services	4.6	0.6	3.6	5.8	0.5	-1.4	9.8	-5.6	0.0
Imports of goods and services	3.6	-7.6	-25.7	-26.0	-30.1	-25.4	-21.2	-10.9	-6.7
<i>Contribution to GDP growth in percentage points</i>									
Domestic demand	0.8	-0.9	-9.1	-8.8	-9.8	-8.0	-9.9	-1.8	-2.1
Net exports of goods and services	0.5	1.8	6.2	7.0	6.3	5.0	6.4	-0.2	1.0
Exports of goods and services	1.3	0.2	1.0	1.7	0.2	-0.4	2.6	-1.8	0.0
Imports of goods and services	-0.8	1.7	5.1	5.3	6.1	5.4	3.9	1.7	1.0
<i>Year-on-year change of the period average in %</i>									
Unit labor costs in the whole economy (nominal, per hour)	..	..	..	..	..	..	..	..	..
Unit labor costs in industry (nominal, per person)	7.9	5.6	9.9	6.9	13.7	9.7	9.4	7.1	4.1
Labor productivity in industry (real, per person)	2.3	3.4	-1.8	0.9	-3.3	-2.7	-1.8	2.1	3.3
Average gross earnings in industry (nominal, per person)	10.3	9.2	8.0	7.8	9.9	6.7	7.4	9.4	7.5
Producer price index (PPI) in industry	3.4	6.1	12.4	9.7	13.8	12.9	13.1	4.5	3.8
Consumer price index (here: CPI)	6.8	7.8	15.6	16.2	15.8	15.7	14.5	8.4	7.4
EUR per 1 RUB, + = RUB appreciation	-5.7	-17.0	-25.0	-32.4	-17.5	-31.8	-17.2	-13.8	-21.8
<i>Period average levels</i>									
Unemployment rate (ILO definition, %, 15–64 years)	5.5	5.2	5.6	5.7	5.6	5.3	5.7	5.9	5.7
Employment rate (%, 15–64 years)	..	..	..	..	..	..	..	..	..
Key interest rate per annum (%)	5.5	7.9	12.6	15.5	12.8	11.2	11.0	11.0	10.9
RUB per 1 EUR	42.3	51.0	68.0	71.1	58.1	70.5	72.4	82.5	74.4
<i>Nominal year-on-year change in the period-end stock in %</i>									
Broad money (including foreign currency deposits)	15.7	15.5	19.7	17.2	17.6	24.0	19.7	15.9	14.4
<i>Contributions to year-on-year change of broad money in percentage points</i>									
Net foreign assets of the banking system	2.7	24.6	40.1	15.3	17.8	28.3	18.3	15.6	12.3
Domestic credit of the banking system	35.1	33.6	31.6	16.1	15.0	16.3	15.4	14.7	15.0
<i>of which: claims on the private sector</i>	36.9	43.3	33.7	19.3	15.7	16.6	9.5	9.1	9.6
<i>claims on households</i>	16.5	11.9	2.0	1.9	0.1	-1.0	-1.6	-0.9	-0.3
<i>claims on enterprises</i>	20.4	31.4	31.7	17.3	15.6	17.7	11.1	10.0	9.8
<i>claims on the public sector (net)</i>	-1.9	-9.7	-2.1	-3.1	-0.7	-0.3	5.9	5.6	5.4
Other assets (net) of the banking system	-8.2	-24.7	-33.5	-14.2	-15.2	-20.7	-14.0	-14.4	-13.0
<i>% of GDP</i>									
General government revenues	34.4	34.3	32.8	..	..	..	..	..	..
General government expenditures	35.6	35.4	36.3	..	..	..	..	..	..
General government balance	-1.2	-1.1	-3.5	..	..	..	..	..	..
Primary balance	..	..	..	..	..	..	..	..	..
Gross public debt	9.8	10.8	10.6	..	..	..	..	..	..
<i>% of GDP</i>									
Debt of nonfinancial corporations (nonconsolidated)	..	..	..	..	..	..	..	..	..
Debt of households and NPISHs (nonconsolidated)	..	..	..	..	..	..	..	..	..
<i>% of GDP (based on EUR), period total</i>									
Trade balance	8.1	9.2	11.2	15.8	12.0	8.6	9.1	8.9	7.3
Services balance	-2.6	-2.7	-2.8	-2.9	-2.6	-3.6	-2.1	-2.0	-2.0
Primary income	-3.6	-3.3	-2.8	-2.1	-4.5	-2.1	-2.2	-1.5	-4.4
Secondary income	-0.4	-0.4	-0.4	-0.4	-0.3	-0.6	-0.5	-0.5	-0.4
Current account balance	1.5	2.8	5.2	10.4	4.5	2.3	4.4	4.9	0.5
Capital account balance	0.0	-2.2	0.0	0.0	0.0	0.0	0.0	0.0	-0.5
Foreign direct investment (net)	0.8	1.8	1.2	0.3	1.6	2.5	0.2	3.1	0.1
<i>% of GDP (rolling four-quarter GDP, based on EUR), end of period</i>									
Gross external debt	32.0	31.9	39.9	36.0	36.0	38.2	40.0	39.4	43.0
Gross official reserves (excluding gold)	20.5	18.1	24.6	20.0	20.4	23.0	24.6	24.8	27.0
<i>Months of imports of goods and services</i>									
Gross official reserves (excluding gold)	11.6	10.4	13.9	11.2	11.6	12.8	13.9	14.1	14.9
<i>EUR million, period total</i>									
GDP at current prices	1,675,267	1,533,694	1,194,438	256,162	331,809	302,232	304,235	225,059	268,716

Source: Bloomberg, national statistical offices, national central banks, wiiw, OeNB.

Ukraine: weak recovery after deep recession, further IMF tranche disbursed

Following a deep recession in 2014 and 2015, a hesitant recovery lifted economic activity by 0.8% in the first half of 2016. The slight rebound was driven by private consumption and gross fixed capital formation (GFCF), whereas net exports delivered a marginally negative growth contribution. After peaking at 60.9% in April 2015, inflation trended downward to 8.4% in August 2016, which helped real wages to recover. Moreover, disinflation allowed the central bank to cut its key policy rate in several steps to 15% in September 2016 from 22% at end-2015. Despite the difficult economic environment, the fiscal deficit has declined markedly in recent years. Including the deficit of the state-owned energy company Naftogaz, the deficit fell to 2.1% of GDP in 2015 from 10% in 2014. Now that gas and heating tariffs have been adjusted upward to cost recovery levels since the first half of 2016, Naftogaz will no longer be a drag on public finances.

Fiscal consolidation and energy sector reforms are part of the economic program agreed with the IMF in the framework of the Extended Fund Facility (EFF). Progress has also been made in other areas, such as banking sector reforms and, to some extent, the fight against corruption. Hence, the second review could be finalized – with a one-year delay – in September 2016. The IMF points out that notwithstanding the overall headway made in implementing the program, political resistance slowed down the progress in tackling corruption, privatizing state-owned enterprises and advancing the pension reform. The conclusion of the second review enabled the disbursement of the third tranche amounting to USD 1 billion, bringing total outlays under the EFF to about USD 7.6 billion (out of USD 17.5 billion). Moreover, Ukraine issued a USD 1 billion U.S. guaranteed Eurobond in September 2016.

As a result, foreign currency reserves rose to USD 15.6 billion (equivalent to 3.9 months of imports) in September 2016, after having remained remarkably stable in the absence of IMF disbursements in the preceding months. The impact of the worsening in the current account balance in the first eight months of 2016 (full-year figure projected at –1.5% of GDP by the IMF) was overcompensated by net inflows in the financial account. The trade balance showed a greater decline in exports than in imports from January to August 2016. The weak export performance was partly related to the tightening of trade restrictions by Russia. Whereas goods exports to Russia continued to shrink, exports to the EU augmented in the first half of 2016. The improvement in the financial account was to a large extent driven by the accelerated reduction of foreign currency cash holdings outside banks.

Since a de-escalation of the conflict in parts of Eastern Ukraine had been achieved in the course of 2015, the situation has remained broadly unchanged, with regular ceasefire violations along the contact line occurring in 2016. Most recently, the OSCE Special Monitoring Mission (SMM) observed a decline in violence after the two sides had renewed their commitment to the ceasefire in early September. Yet SMM monitors have continued to be confronted by freedom-of-movement restrictions, particularly in areas not controlled by the Ukrainian government. Furthermore, hardly any progress has been made in the implementation of the Minsk II agreement, which comprises the aim to achieve a complete ceasefire as well as further steps to settle the conflict.