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Economic Prospects for Central, East and Southeast Europe

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Crisis Is Over, but Problems Loom Ahead

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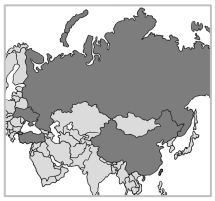

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Executive summary

After a long period of convergence, the New EU Member States (NMS) experienced a deep recession in 2009, the extent of which corresponded on average fairly closely to that of the more developed old EU member states (Table I). However, the relatively moderate decline (-3.6%) for the NMS reflects Poland's weight in the group, the only country in the EU to have recorded positive GDP growth last year. Of the other nine NMS economies, only the Czech Republic experienced a recession that corresponded roughly to the EU average decline. Bulgaria, Hungary, Romania, Slovakia and Slovenia suffered a noticeably stronger recession, while the Baltic States recorded a dramatic contraction of their economies which was much larger than the EU average. In these countries the catching-up process was interrupted, in particular the Baltic States were thrown back several years.

The most conspicuous response to the crisis was a radical depletion of inventories. Whereas in the euro area the decline in inventories also contributed negatively to GDP change, in most of the NMS the inventories' negative growth contribution was extremely large. Even Poland reports a depletion of inventories much greater than that recorded in the euro area. Another noticeable deviation in the GDP growth pattern as compared to the EU as a whole was the dramatic improvement in NMS net exports. Shrinking export opportunities, weak domestic demand and a dearth of funds created an atmosphere of profound pessimism which motivated a reduction in output and a cutback in import purchases for production, consumption or investment. This brought about import cuts which were much larger than reductions of exports and thus resulted in the radical shrinkage of the previous huge current account deficits.

The analysis suggests unambiguously that the NMS as a group have emerged from the trough of the crisis already in the final quarter of 2009. Capacity utilization levels, industrial output and export growth rates, order books in the manufacturing sector and diminishing negative expectations concerning employment and exports – all point to a modest growth upswing. The wiiw reckons with a marginal recovery of GDP growth for the NMS in 2010. Poland's growth will once again boost the NMS average, while the rate of expansion in the Czech Republic, Slovakia and Slovenia will be a meagre 1% (Table I). Hungary, Romania and Bulgaria are still expected to stagnate this year, the Baltic States will record further negative growth rates. Despite the anticipated recovery of economic activities in the region, none of the NMS will be able to regain the high pre-crisis growth rates over the next two to three years. Given the weak rebound of economic activities, unemployment will continue to rise, probably peaking in 2010 before falling slowly and gradually to pre-crisis levels. The most vulnerable group of workers affected by the crisis are again those with low skills.

There are several downward risks to our forecast. The revival of financial intermediation may turn out to be sluggish. With the incipient upturn of economic activities, more and more firms may find it difficult to secure funding. Shifting away from demand-supporting schemes, and the need to consolidate unsustainable fiscal balances in most of the old member states may delay recovery there and indirectly put a brake on export-driven growth of the NMS. A possible rebound of foreign direct and portfolio investment and cross-border capital flows would exert again strong pressure on exchange rate appreciation – with all the familiar negative effects. The main risk associated with the current problems in Greece is that the extension of the euro area may be delayed. That would well cross the plans of those NMS that have based their medium-term economic strategy on the earliest possible adoption of the euro.

The global crisis hit the FMS region hard (the term future member states – FMS – covers three EU candidate countries: Croatia, Macedonia and Turkey, and four potential candidate countries: Albania, Bosnia and Herzegovina, Montenegro and Serbia). The global crisis set off a series of 'semi-stops', of which we can identify the following: disruption in foreign demand for goods, decline in remittances from abroad, decline in foreign direct investment and of other capital flows as well as a slowdown in internal lending. In none of the FMS did the crisis reach catastrophic proportions. At the same time, differences between the individual countries are again considerable (Table I). Furthermore, the crisis did not hit all segments of the economy with equal force. Producers of tradable goods were immediately hit (Turkey) whereas the crisis had almost no immediate impact on large segments in the production of non-tradable goods and services, including such services as public administration, education and healthcare. The impact was also mild in industries such as public transport, telecommunications and even commercial banks.

One of the policy dilemmas was to keep the exchange rate pegged to the euro, officially or unofficially, or allow for variations. Serbia and Turkey continued their flexible exchange rate regimes and Albania joined them; in all three countries, the currency depreciated. Montenegro uses the euro as legal tender, and the other countries have continued pegging to the euro. Serbia, followed by Bosnia and Herzegovina at a later stage, concluded a stand-by arrangement with the IMF. Moreover, the IMF, EU, EBRD and other western institutions came out in support of the Vienna

Initiative, with foreign-owned banks agreeing to leave their capital in the countries in order to curb the crisis. This has had a strong stabilizing effect. The governments' fiscal responses also varied widely within the FMS group. Except for Albania, fiscal discipline had been high prior to the crisis and this policy paid off when the crisis came.

We expect all FMS economies to be growing again by 2011. That growth will accelerate slightly in 2012 but will in general be slower than in the pre-crisis period (Table I). The main prerequisite is some degree of recovery in global trade, including a rise in EU demand for imports. In the FMS, increases in private consumption are not likely to be very pronounced as long as employment fails to grow and profits remain low. Investment will not act as a strong engine of growth. Employment is a severe problem throughout the FMS. Unemployment may become worse before it gets better. The modest rate of the expected GDP growth will not change unemployment problems too much.

As for the EU future of the FMS, the Lisbon Treaty has improved the institutional preconditions for future enlargement. It is, however, quite feasible that unsolved stability problems in the current EU member states will have a retarding impact on the integration process of West Balkan countries.

Country summaries

The economic slump continued in **Bulgaria** through the final months of 2009 with GDP for the year as a whole contracting by 5%. Weak domestic demand was responsible for most of the contraction as exports gradually started to gain pace in the second half of the year. The abrupt withdrawal of policy stimulus initiated by the new centre-right government added to the anaemic economic performance in the second semester. Unless there is a change in policies towards a more supportive policy stance, the economy can be expected to stagnate in 2010 and start to grow only thereafter.

Consumption (both private and public) helped to moderate the 2009 recession in the **Czech Republic**. The recession was caused largely by deep decline in gross capital formation and the weak performance of foreign trade. The year 2010 is going to be a better one – primarily on account of the economic revival in the euro area. But risks remain high: the Czech currency seems likely to strengthen too much, while the current government's fiscal policy takes a rather restrictive turn.

Hungarian GDP declined by some 6.5% in 2009. As opposed to most other countries of the region, household consumption bore the main burden of the recession; gross fixed investment contracted slightly less. 2010 will be a year of stagnation on average, with a mild decline in the first and a moderate upturn in the second half of the year. Net exports will, just as in 2009, make a positive contribution to GDP change, but much less so than in the previous year. The reason for closing the export/import gap will be the recovery of imports driven by a restocking of inventories. Consumption and investment will still decrease this year, even if to a moderate extent.

Poland's growth performance in 2009 was quite satisfactory, given the external circumstances. Private consumption proved resilient and gross fixed capital formation practically did not fall. The government's fiscal inaction paid off. But foreign trade was a major contributor to growth, possibly thanks to a large currency depreciation. The year 2010 is going to be even better – provided the zloty does not strengthen too much.

Romania faces a year of stagnation in 2010. Although the recovery in Western Europe invigorates Romanian exports and brings new orders for manufacturing, restrictive fiscal measures will curtail consumption and investment. It is expected that the conditions of the IMF loan arrangement will be met. Following a strong depreciation last year, the currency will be rather stable. If exports and manufacturing recover more robustly and fiscal revenues rebound, the second half of the year may already bring a modest economic upswing which will show up more strongly in 2011.

Sharp contraction of investments and a depletion of inventories are crucial explanatory factors for the **Slovak** GDP drop in 2009. The weak foreign demand has been exacerbated by the strong currency appreciation and the related deterioration of export competitiveness. The government's anti-crisis measures have primarily targeted infrastructure investment and the support of consumption and employment. This will possibly encourage an expansion of the GDP and certainly undermine the fiscal consolidation. A lasting recovery of the Slovak economy will depend above all on the revival of foreign demand.

Slovenia's GDP will grow slightly in 2010, supported by moderately rising foreign demand. Investment will need some time to recover and will regain strength only in 2011. Unemployment, still rising, will also negatively affect household decisions on consumption. The general government deficit may be even higher than in 2009 and decrease only slightly thereafter. Key to a potential recovery will be the developments in Slovenia's main trading partners. More robust growth can be expected in 2011 and 2012 under the assumption of stronger export demand as well as a recovery in domestic demand (investments in particular).

The **Baltic States** suffered the most severe depression since the transitional recession at the beginning of the 1990s, with their GDPs shrinking in the range of 14% to 19% in 2009. The magnitude of the slump was caused by the combination of the burst of the local housing bubble leading to a credit crunch and the worldwide economic crisis that brought about a dramatic fall in external demand. Although the scenario of a forced devaluation of the **Latvian** lats was an imminent risk more than once in the past year, the pressure on the currency eased in the second half of 2009, when the enormous contraction of internal demand turned the current account into positive. The fading of the devaluation scenario, which would have put immediate pressure also on the **Estonian** and **Lithuanian** currencies, and the enhanced growth prospects of the main trading partners in Western and Northern Europe have improved the poor prospects of the Baltic States in 2010. Nevertheless, also for 2010 a further, though much smaller decline of GDP is to be expected, postponing a return to GDP growth in the Baltic region to 2011.

Overall prospects for economic development in **Albania** in 2010 are rather modest and certain downward risks seem to arise from the Greek economic crisis, although these effects are difficult to forecast. We expect Albania's economy to grow by merely 1% in 2010. Further currency depreciation could support the export sector in subsequent years. This, together with regaining strength of household consumption and improving access to credit for the private sector, could accelerate economic growth to some 4% in 2011 and 5% in 2012.

Bosnia and Herzegovina belongs to the countries with limited crisis impact in terms of GDP decline (approximately 3% in 2009), but impulses for renewed growth would need to come from outside. Otherwise, the GDP may more or less stagnate in 2010 and grow only slightly in 2011. The economy is also stable in nominal terms: Throughout most of 2009, the CPI remained stable or slightly declined, and the peg to the euro enjoys IMF backing in the form of a stand-by agreement.

GDP in **Croatia** will decline by another 1% in 2010. Fiscal constraints represent a major obstacle to financing public investment projects. Employment contraction will continue and may trigger a further decline in household consumption. The servicing and/or restructuring of the high foreign debt will remain one of the major challenges in the near future. Prospects of joining the EU in the foreseeable future might help to strengthen Croatia's standing vis-à-vis foreign creditors.

GDP growth in **Macedonia** should be supported by public spending. Recovery will depend on the demand from regional partners. The risk is that the Greek crisis may have negative effects.

Montenegro will suffer recession probable this year too. Investments in infrastructure and tourism may help in the medium run. An IMF stand-by agreement to deal with the financial problems may be in the working.

Serbia will witness slow recovery in the short to medium run. Net exports are expected to be the main driver. Private consumption and investments are expected to be subdued due to procyclical demand policies.

The crisis has hit **Turkey's** economy in a critical moment: growth dynamics had eroded as strong currency appreciation had reduced the companies' competitiveness and provoked high current account deficits. Under the impact of the crisis the currency depreciated and the GDP declined drastically. Thereafter, trends turned positive with support by fiscal and monetary policies (growth-stimulation packages and lowering of the policy rate). In 2010, the GDP is likely to grow substantially (by over 4%), so that in 2011 the government may put an end to expansionary policies. We do not expect the growth rate to surpass the 5% mark in 2012.

Kazakhstan was one of the few transition countries which recorded positive economic growth last year – owing to the increase in oil prices and active anti-crisis policies of the government. However, the efficient anti-crisis policy also means growing concentration of state property, which

not only may cause efficiency problems later on, but also strengthens the position of the authoritarian power in the country. In 2010-2012, Kazakhstan's economy is expected to continue recovery, but growth will be not as fast as in the pre-crisis period due to the structural issues caused by the crisis (particularly in the banking and construction sectors).

The global crisis hit **Russia** particularly hard and the vulnerability of the economic development model based on excessive dependence on energy became obvious. The government's long-term strategic target of economic diversification and modernization is getting out of reach. The huge fiscal stimulus adopted for mitigating the crisis was not very effective. However, GDP growth resumed in the fourth quarter of 2009, not least thanks to statistical base effects and higher oil prices, with modest (up to 4% per year) growth acceleration possible in 2010-2012.

Ukraine's economy has been hit hard by the falling steel prices and the global credit crunch. However, in the last quarter of 2009, industry started recovering in response to the favourable world market trends and the pronounced currency devaluation. For 2010, we expect an export-driven GDP growth of around 3%, with a gradual acceleration in the years to come. The key challenge for the newly elected president will be the formation of a loyal government, which could put an end to the long-standing political stalemate. After a budget deficit of some 8.5% last year, the government will need to come up with a realistic budget for 2010, which is also a prerequisite for the resumption of the IMF 'stand-by' programme suspended in November 2009.

China's economy expanded at a rate of 8.7% in 2009, exceeding most forecasts made earlier in the year. The fast growth of the economy despite a big slump in exports was due to massive stimulus measures of the Chinese government driving investment in fixed assets and supporting private consumption. With the expansive fiscal policy still in place and foreign demand picking up, the Chinese economy may grow even faster this year, probably reaching a rate of 9.5%. In 2011, given the continued recovery of the world economy, we expect a further acceleration of GDP growth; in 2012, China's economy might experience double-digit growth again.

Special Section: 'Redirecting the growth model'?

The period from the late 1990s until the recent economic crisis was a period in which Central, East and Southeast European countries benefited from a classic process of 'catching-up' or 'convergence' based on two pillars: (i) a high degree of liberalization of trade, capital movements and financial market integration with Western Europe, and (ii) the prospects of either EU accession or a strong association with the European Union. This Special Section argues that in principle, both these two sets of factors will still be in operation also after the crisis, but there will be some significant changes in the way the 'growth model' in this region will function.

First of all, credits will be extended more cautiously both to households and to enterprises. Secondly, the fiscal situation in the CEECs has been deteriorating as a result of the economic crisis and hence a relatively cautious attitude will be taken with respect to fiscal spending in the

coming years. Thirdly, we expect an increase in the savings rate of the household sector which in a number of countries had become very low (in some countries negative) in the years prior to the crisis. All the above three factors will have a dampening effect on trend growth rates in the medium run (next four to six years). Apart from these developments internal to the NMS and FMS economies, there will be three principal factors which are mostly external and which might have a significant impact on these countries' characteristics of growth:

- a tightening of financial market regulation;
- growth rates in Western Europe might remain lower than before the crisis;
- effective entry conditions into EMU might be tightened.

The paper analyses how the combination of both external conditions as well as internal behavioural responses is going to shape the recovery and growth paths of the NMS and FMS economies. Due attention is paid to the heterogeneity within the region. The paper then goes on to discuss the policy issues which arise from the necessary 'redirecting of the growth model'. We particularly emphasize the role of countercyclical fiscal policy, the importance of facilitating an adjustment in the real exchange rate under varying circumstances in a range of economies, the importance to getting the credit system going in the short and medium run and the issue of changes in regulatory frameworks and shared responsibilities in an integrated financial market context.

Finally, we emphasize a range of supply-side policies directed at strengthening the tradable sector in countries which remain very vulnerable on external accounts. It is our view that the EU and neighbouring countries in Western Europe can play important roles in assisting these economies in their adjustments to the new situation and allowing them to return as quickly as possible to a sustainable catching-up growth path. We make a number of recommendations to this effect.

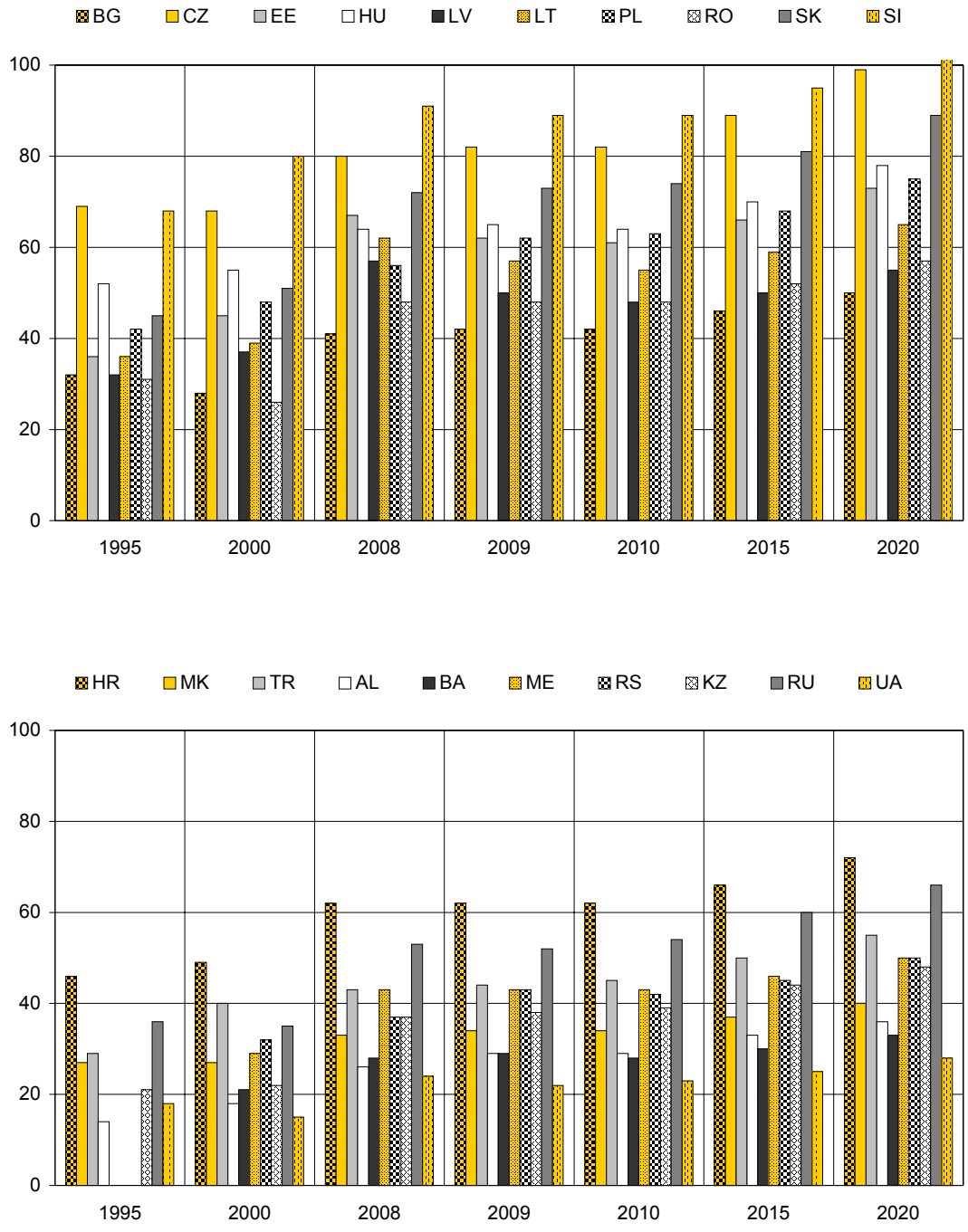
Keywords: Central and East European new EU member states, Southeast Europe, future EU member states, Balkans, former Soviet Union, China, Turkey, economic forecasts, growth model, employment, competitiveness, exchange rates, inflation, EU integration, foreign trade, fiscal policy

JEL classification: G01, G18, O52, O57, P24, P27, P33, P52

Figure I

GDP per capita at PPPs in Central, East and Southeast Europe

EU-27 average = 100



Remark: Projection assuming a 2 percentage point growth differential with respect to the EU from 2012.

Source: National statistics, Eurostat, wiiw estimates.

Table I

Overview developments 2008-2009 and outlook 2010-2012

	GDP real change in % against previous year					Consumer prices change in % against previous year					Unemployment, based on LFS [1] rate in %, annual average					Current account in % of GDP				
	2008	2009	2010	2011 Forecast	2012	2008	2009	2010	2011 Forecast	2012	2008	2009	2010	2011 Forecast	2011	2008	2009	2010	2011 Forecast	2012
Czech Republic	2.5	-4.1	1.0	2.6	3.5	6.3	0.6	1.5	2.0	2.5	4.4	6.7	8.5	8.5	7.5	-3.1	-0.7	-1.1	-1.3	-1.2
Hungary	0.6	-6.5	0	3	3.5	6.0	4.0	3.8	3.5	3.3	7.8	10.3	10.5	10	9.3	-7.1	0.5	-1.3	-2.2	-2.4
Poland	5.0	1.7	2.5	3	3.4	4.2	4.0	2.6	2.5	2.5	7.1	8.5	10	9	8.5	-5.1	-1.6	-1.7	-2.5	-3.1
Slovakia	6.2	-5	1	3	4	3.9	0.9	1.5	2	2	9.5	12.3	13	13	12	-6.6	-2.9	-3.8	-4.3	-4.6
Slovenia	3.5	-8	1	2	2.5	5.5	0.9	1.5	2	2	4.4	6	7	7	6.5	-6.2	-0.6	-1.1	-2.0	-2.3
NMS-5 [2)3)]	*3.9*	*-1.6*	*1.7*	*2.9*	*3.5*	*4.9*	*2.9*	*2.4*	*2.5*	*2.5*	*6.9*	*8.7*	*10.1*	*9.4*	*8.7*	*-5.2*	*-1.2*	*-1.7*	*-2.4*	*-2.7*
Bulgaria	6.0	-5.1	0	3	3.5	12.0	2.5	2	3	3	5.6	6.7	9.0	8.5	8	-25.4	-8.6	-7.8	-8.5	-9.3
Romania	7.3	-7.2	0	3	4	7.9	5.6	4	3	4	5.8	7	8.5	8	6	-11.6	-4.3	-5.6	-6.5	-7.1
Estonia	-3.6	-14	-1.5	2	4	10.6	0.2	-3	-1	2	5.5	15	16	14	13	-9.4	4.7	4.2	2.2	-3.5
Latvia	-4.5	-19	-4.5	1	2	15.2	3.3	-5	-3	0	7.5	18	22	20	17	-13.0	8.7	3.4	1.7	-0.6
Lithuania	2.8	-15.0	-3	2	3	11.1	4.2	-3	1	2	5.8	13.5	15	13	12	-11.9	1.9	3.2	-0.8	-2.2
NMS-10 [2)3)]	*4.2*	*-3.6*	*1.0*	*2.8*	*3.6*	*6.3*	*3.4*	*2.3*	*2.4*	*2.7*	*6.5*	*8.7*	*10.2*	*9.5*	*8.4*	*-7.3*	*-1.5*	*-2.2*	*-3.0*	*-3.6*
EU-15 [3)]	*0.5*	*-4.1*	*0.7*	*1.5*	.	*3.3*	*0.3*	*1.1*	*1.5*	.	*7.1*	*9.1*	*10.3*	*10.3*	.	*-0.3*	*-0.1*	*-0.4*	*-0.2*	.
EU-27 [3)]	*1.0*	*-4.0*	*0.7*	*1.7*	.	*3.7*	*0.7*	*1.3*	*1.6*	.	*7.0*	*9.0*	*10.3*	*10.1*	.	*-0.8*	*-0.2*	*-1.5*	*-1.3*	.
Croatia	2.4	-6	-1	2	2.5	6.1	2.4	2.5	2.5	2	8.4	9.3	10	10	9	-9.2	-5.5	-6.5	-7	-7.5
Macedonia	4.8	-2	0	2	3	8.3	-0.8	3	3	3	33.8	34	33	33	33	-13.1	-7.0	-8	-8	-8
Turkey	0.9	-6	4	3	5	10.4	6.3	7	6	5	11.0	14	14	14	12	-5.7	-2.3	-2.6	-2.7	-2.9
Candidate countries [2)3)]	*1.1*	*-5.9*	*3.5*	*2.9*	*4.8*	*10.0*	*5.9*	*6.6*	*5.7*	*4.7*	*11.6*	*14.4*	*14.4*	*14.4*	*12.5*	*-6.1*	*-2.6*	*-3.0*	*-3.1*	*-3.3*
Albania	8.0	4.2	1	4	5	3.4	2.2	2	3	3	13.1	13.1	15	14	13	-14.7	-18.6	-20.1	-18.0	-17.5
Bosnia & Herzegovina	5.4	-3	-1	1	3	7.5	-0.4	0	1	1	23.4	24	27	27	27	-14.9	-7.8	-8	-8	-8
Montenegro	6.9	-5	-1	2	3	7.4	4.0	3	3	3	17.2	19	20	20	20	-32.6	-15	-10	-10	-10
Serbia	5.5	-2.9	0	2	3	11.7	8.4	6	4	4	13.6	16.1	20	20	20	-17.7	-7	-9	-10	-10
Potential candidate countries [2)3)]	*6.0*	*-1.8*	*-0.1*	*2.1*	*3.3*	*9.1*	*5.3*	*3.9*	*3.2*	*3.2*	*15.6*	*17.1*	*20.3*	*20.0*	*19.6*	*-17.4*	*-9.5*	*-10.5*	*-11.2*	*-11.1*
Kazakhstan	3.3	0.5	3	5	4.5	17.1	7.3	7.5	6.5	6	6.6	6.6	6.5	6.4	6.2	5.2	-3.9	-3.4	-3.6	-3.9
Russia	5.6	-7.9	3.4	4	4.3	14.1	11.8	6	7.5	8	6.3	8.5	8.5	8	8	6.2	3.9	4.2	3.4	2.9
Ukraine	2.1	-13.5	3	4.5	6	25.2	15.9	12	10	8	6.4	9.5	9	8.5	8	-7.1	-1.6	0	-0.2	-0.3
China [4)]	9.6	8.7	9.5	9.8	11	5.9	-0.7	3.5	3	2	4.2	4.3	4.3	4.2	4.2	9.4	6.1	3.7	5.2	5.2

Note: NMS: The New EU Member States.

1) LFS - Labour Force Survey. - 2) wiiw estimate. - 3) Current account data include flows within the region (this is not the case for EU-15 and EU-27 in 2010-2011). - 4) Registered urban unemployment rate, end of period.

Source: wiiw (February 2010), Eurostat. Forecasts by wiiw and European Commission (Economic Forecast, Autumn 2009) for EU-15.

Table II **Central and East European new EU member states (NMS-10): an overview of economic fundamentals, 2009**

	Bulgaria	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	*NMS-10* [1]	*EU-15*	*EU-27* [2]
GDP in EUR at exchange rates, EUR bn	33.85	134.67	13.85	91.68	19.27	26.78	309.64	118.28	64.50	34.46	*847.0*	*10986.5*	*11856.7*
GDP in EUR at PPP, EUR bn	75.91	204.67	19.77	153.81	26.77	44.97	556.39	244.02	94.37	43.05	*1463.7*	*10414.6*	*11856.7*
GDP in EUR at PPP, EU-27=100	0.6	1.7	0.2	1.3	0.2	0.4	4.7	2.1	0.8	0.4	*12.3*	*87.8*	*100.0*
GDP in EUR at PPP, per capita	10000	19500	14800	15300	11900	13500	14600	11400	17400	21100	*14300*	*26200*	*23700*
GDP in EUR at PPP per capita, EU-27=100	42	82	62	65	50	57	62	48	73	89	*60*	*111*	*100*
GDP at constant prices, 1990=100	119.0	137.3	137.5	130.6	99.2	108.5	181.0 [3]	127.3	157.0	155.0	*158.0*	*137.8*	*140.3*
GDP at constant prices, 2000=100	146.9	133.8	143.2	121.6	141.5	150.6	141.0	150.9	153.8	128.9	*140.4*	*110.7*	*113.7*
Industrial production real, 2000=100	140.8	130.3	129.4	128.6	126.9	158.8	157.5	119.5	155.2	111.7	*141.0*	*90.6*	*96.4*
Population - thousands, average	7592	10490	1340	10022	2255	3340	38150	21482	5418	2043	*102133*	*397295*	*500537*
Employed persons - LFS, thousands, average	3250	4930	595	3775	980	1420	15800	9250	2360	981	*43341*	*173600*	*217500*
Unemployment rate - LFS, in %	6.7	6.7	15	10.3	18	13.5	8.5	7	12.3	6	*8.7*	*9.1*	*9.0*
General gov. revenues, EU-def., in % of GDP	38.1	40.3	41.9	45.0	34.9	37.0	39.5	31.0	31.3	43.2	*38.4*	*43.9*	*43.4*
General gov. expenditures, EU-def., in % of GDP	38.9	46.9	44.8	48.7	43.8	46.0	45.0	38.2	37.5	49.1	*44.1*	*50.9*	*50.4*
General gov. balance, EU-def., in % of GDP	-0.8	-6.6	-3.0	-3.7	-9.0	-9.0	-5.5	-7.2	-6.3	-5.9	*-5.8*	*-7.0*	*-6.9*
Public debt, EU def., in % of GDP	15.2	35	7.5	79	33.2	29.9	51	22	37.0	34.4	*42.5*	*75.4*	*73.0*
Price level, EU-27=100 (PPP/exch. rate)	45	66	70	60	72	60	56	48	68	80	*58*	*105*	*100*
Compensation per employee, monthly, in EUR [4]	391	1206	1141	1096	842	820	782	631	1113	1977	*861*	*3283*	*2808*
Compensation per employee, monthly, EU-27=100	13.9	43.0	40.6	39.0	30.0	29.2	27.9	22.5	39.6	70.4	*30.7*	*116.9*	*100.0*
Exports of goods in % of GDP	34.8	59.7	46.9	64.2	26.8	43.3	32.2	24.5	58.9	47.0	*37.1* [5]	*24.8* [5]	*25.7* [5]
Imports of goods in % of GDP	46.9	54.6	50.7	59.4	33.2	45.9	33.3	30.3	57.4	48.5	*37.6* [5]	*24.7* [5]	*25.8* [5]
Exports of services in % of GDP	14.9	10.8	22.8	14.3	14.2	9.7	6.8	5.9	7.1	12.4	*8.1* [5]	*8.8* [5]	*8.8* [5]
Imports of services in % of GDP	10.9	9.2	13.2	12.7	8.1	8.2	5.5	6.1	9.3	9.4	*5.5* [5]	*7.9* [5]	*7.7* [5]
Current account in % of GDP	-8.6	-0.7	4.7	0.5	8.7	1.9	-1.6	-4.3	-2.9	-0.6	*-1.5* [5]	*-0.1* [5]	*-0.2* [5]
FDI stock per capita in EUR	4800	8600	8200	6000	3600	3000	3200	2300	6100	5400	4200	.	.

NMS-10: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia. PPP: Purchasing power parity.

1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) 1989=100, which in the Polish case is the appropriate reference year. - 4) Gross wages plus indirect labour costs, according to national account concept. - 5) Data for NMS-10, EU-15 and EU-27 include flows within the region.

Source: wiiw, Eurostat, AMECO.

Table III

Southeast Europe: an overview of economic fundamentals, 2009

	Croatia	Macedonia	Turkey	Albania	Bosnia and Herzegovina	Montenegro	Serbia	*NMS-10* [1]	*EU-15*	*EU-27* [2]
GDP in EUR at exchange rates, EUR bn	44.86	6.31	439.2	8.94	12.22	3.00	30.81	*847.0*	*10986.5*	*11856.7*
GDP in EUR at PPP, EUR bn	65.50	16.63	779.7	21.97	26.36	6.51	73.79	*1463.7*	*10414.6*	*11856.7*
GDP in EUR at PPP, EU-27=100	0.6	0.1	6.6	0.2	0.2	0.05	0.6	*12.3*	*87.8*	*100.0*
GDP in EUR at PPP, per capita	14800	8100	10400	6900	6900	10300	10100	*14300*	*26200*	*23700*
GDP in EUR at PPP per capita, EU-27=100	62	34	44	29	29	43	43	*60*	*111*	*100*
GDP at constant prices, 1990=100	112.5	110.6	190.1	192.9	.	.	.	*158.0*	*137.8*	*140.3*
GDP at constant prices, 2000=100	132.6	121.4	132.8	167.2	142.0	140.1	148.1	*140.4*	*110.7*	*113.7*
Industrial production real, 2000=100	124.4	103.2	130.3	177.2	179.2	79.2	102.4	*141.0*	*90.6*	*96.4*
Population - thousands, average	4435	2050	75200	3190	3843	630	7320	*102133*	*397295*	*500537*
Employed persons - LFS, thousands, average	1600	640	21200	1110	859	215	2616	*43341*	*173600*	*217500*
Unemployment rate - LFS, in %	9.3	34	14	13.1	24	19	16.1	*8.7*	*9.1*	*9.0*
General gov. revenues, nat. def., in % of GDP	40.1	33.2	18.5 [3]	25.5	42	48	38	*38.4* [3]	*43.9* [3]	*43.4* [3]
General gov. expenditures, nat. def., in % of GDP	43.0	36.0	25.1 [3]	32.5	45	50	43	*44.1* [3]	*50.9* [3]	*50.4* [3]
General gov. balance, nat. def., in % of GDP	-2.9	-2.8	-6.6 [3]	-7	-3	-2	-5	*-5.8* [3]	*-7.0* [3]	*-6.9* [3]
Public debt, nat. def., in % of GDP	37.7	30	47.3 [3]	55	30	37	31.5	*42.5* [3]	*75.4* [3]	*73.0* [3]
Price level, EU-27=100 (PPP/exch. rate)	68	38	56	41	46	46	42	*58*	*105*	*100*
Average gross monthly wages, EUR at exchange rate	1049	488	662 [4]	242	614	640	469	*861* [4]	*3283* [4]	*2808* [4]
Average gross monthly wages, EU-27=100	37.4	17.4	23.6 [4]	8.6	21.9	22.8	16.7	*30.7* [4]	*116.9* [4]	*100* [4]
Exports of goods in % of GDP	17.1	30.1	17.9	8.5	23.7	12.1	19.1	*37.1* [5]	*24.8* [5]	*25.7* [5]
Imports of goods in % of GDP	34.0	52.3	22.0	36.3	50.7	43.7	35.4	*37.6* [5]	*24.7* [5]	*25.8* [5]
Exports of services in % of GDP	19.1	10.3	5.4	20.1	8.2	22.7	8.3	*8.1* [5]	*8.8* [5]	*8.8* [5]
Imports of services in % of GDP	6.4	10.3	2.7	19.7	3.3	10.0	8.0	*5.5* [5]	*7.9* [5]	*7.7* [5]
Current account in % of GDP	-5.5	-7.0	-2.3	-18.6	-7.8	-15	-7	*-1.5* [5]	*-0.1* [5]	*-0.2* [5]
FDI stock per capita in EUR	5900	1500	1100	900	1400	4800	1800	4200	.	.

NMS-10: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia. PPP: Purchasing power parity according to Eurostat, wiiw estimates for Albania, Bosnia and Herzegovina, Montenegro, Serbia.

1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) EU definition: expenditures and revenues according to ESA'95, excessive deficit procedure. - 4) Gross wages plus indirect labour costs, according to national account concept. - 5) Data for NMS-10, EU-15 and EU-27 include flows within the region.

Source: wiiw, Eurostat, AMECO.

Michael Landesmann and Vladimir Gligorov

Redirecting the growth model in Central and Eastern Europe: Policy issues

1 Introduction

From the beginning of the transition in 1989/1990, policy makers and the public alike envisaged a near complete integration of the countries of Central and Eastern Europe – with the exception of most member countries of the CIS (the Commonwealth of Independent States) – into the integrated economic (and partly political) space constructed by the European Union (EU) and its preceding organization (the EC).

The vision of 'integration' provided an anchor to reform and transition processes in the countries of Central and Eastern Europe (CEE) and, after the end of the military conflicts in Southeastern Europe (SEE), also the follower countries of Yugoslavia (as well as Albania).[1] One can hence think of an 'implicit pact' between the CEE, SEE and the incumbent European Union member countries: on the one hand, the prospect of full membership provided an institutional, legal and behavioural anchor for the dramatic adjustment processes which 'transition' implied. On the other hand, policy makers and important interest groups in the incumbent EU countries could look forward to integrate with a region which had differential growth prospects due to an expected income convergence process, could offer interesting possibilities to extend the Internal Market, exploit location and specialization advantages in the newly integrated region and, above all, serve the purpose of political stabilization of developments both in CEE and SEE countries and in cross-European relations.

By 2007 ten formerly CEE/SEE transition countries had become full members of the European Union and there was a process in place which would lead to the whole of ex-Yugoslavia and Albania also to become members (most likely in the course of the second decade of the new millennium). None of the new or prospective members were given the option of not joining the EMU in due course and hence they also had the perspective of becoming full members of the eurozone.

The first eight years of the new millennium were rather special years of sustained 'catching-up' or 'convergence' in income levels between a wide range of transition economies (both, candidates and prospective members, but also some of the countries in Eastern Europe outside this group) and the EU-15. The transition economies achieved in this period sustained growth rates above those of the EU-15. There was also a general tendency of 'real appreciation' of their currencies which reflected both underlying processes of price convergence (as predicted by the Balassa-Samuelson effect) and also the sustained influx of capital in its various forms (foreign direct investment, portfolio investment, credits, remittances). The capital inflow was attracted by the view of a longer-run positive growth differential of this region relative to the EU-15, a reliance on a certain degree of institutional, legal and

[1] See, for example, Havrylyshyn (2008).

political consolidation and stability, and an expectation of a continued strive towards monetary and exchange rate stability. The latter was the result of a commitment to improved practices of monetary policy authorities, the underlying expectation of exchange rate stability (with an upward trend in the real exchange rate) and also a reliance on sound banking practices which seemed to be guaranteed by the strong presence of Western banks.

The international financial and economic crisis which erupted in full after the collapse of Lehman Brothers in September 2008, interrupted the vision of stability of the catching-up processes in CEE and SEE economies. It is to be stressed though that in some economies there was concern already in the preceding period about strong expansion of private sector debt (particularly in the Baltics, Romania, Croatia, Hungary) and – mostly in Hungary – a concern about fiscal sustainability. This had already led to a severe downturn in growth in the Baltic countries and in Hungary. In other countries (e.g. Poland, Romania and Slovakia) there was, immediately prior to the crisis, concern about fast wage growth outstripping productivity growth, combined with an appreciating currency, which led to a loss in competitiveness. However, in most cases, informed analysts of the region were surprised by the vehemence with which the global financial and ensuing crisis affected the CEE, SEE and CIS regions.

The various channels through which the international financial crisis affected the CEE, SEE and CIS regions have been well analysed and we shall not repeat this here (see e.g. EBRD, 2009). Instead, we shall concentrate in this paper on the prospects of resumption of growth and on the type of 'growth model' one can envisage for the region over the coming medium- and longer-run period. Let us define medium-run as a time horizon of four to six years and longer-run as a time horizon beyond that. In relation to both these two time horizons we shall discuss policy recommendations in section 5 of this paper.

2 A 'new growth model' in the making

If we speak of a 'new growth model' we must delineate first what characterized the 'old model' in order to understand which features would likely change as a result of either changed characteristics and reactions of market participants resulting from the crisis or because policy makers face different constraints and embark on a change in their interventions.

The older growth model was accompanied and in parts determined by an attempt to reach candidate and then membership status of the EU as quickly as possible: an upshot of this attempt was a very high degree of liberalization in external (and also internal) economic relations. Trade relations were liberalized, there was a commitment to free international capital movements (in all its various forms) and financial markets were opened up to foreign financial institutions. In relation to the last issue, foreign banks attained in most countries of the region dominant market positions.

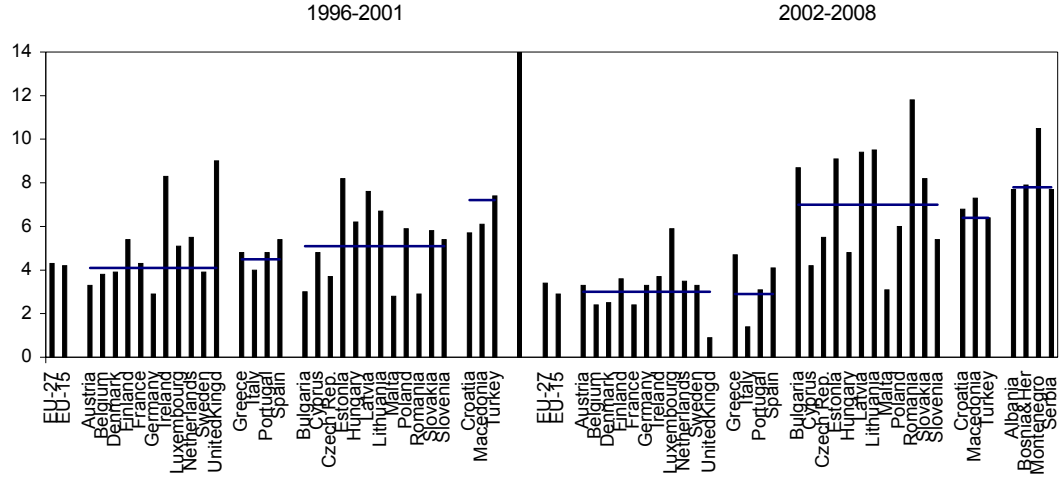
Liberalization and openness in external economic relations coincided with a classic process of 'convergence', i.e. the CEE economies embarked from the mid-1990s on a growth path with rates substantially above those of the Western European neighbours even though such catching-up

processes were at times (e.g. Czech Republic and Slovakia in the late 1990s, Poland in the early years of 2000s, Hungary thereafter) interrupted by policy mistakes (e.g. too early peg in the exchange rate, at times mistakes in monetary policy or profligate fiscal spending, etc.) or by misalignments in wage and productivity dynamics.

Figure 1

Growth – GDP per capita, PPP

Average annual growth rates, 1996-2001 and 2002-2008, in %



Source: wiiw Annual Database incorporating national statistics, Eurostat.

Over the period 2002-2008 (see Figure 1) all CEE economies experienced significantly higher growth than countries in Western Europe and this also extended to SEE economies. The catching-up was based on low relative unit labour costs combined with relatively high human capital endowment which made the region attractive to foreign investors; this induced fast technology transfer, access to high-income markets and the possibility to integrate into cross-border production networks. Many of the CEE countries experienced a period of re-industrialization (i.e. fast growth in industrial production and in industrial exports) after the earlier period of de-industrialization at the beginning of the transition. Furthermore, the CEE economies showed evidence of significant qualitative upgrading of their industrial and export structures. Countries in Southeastern Europe (SEE), on the other hand, had gone through a longer period of economic and political turbulence and hence they embarked on a process of renewed growth with a considerable time lag relative to the Central European (CEE) economies and had to struggle with the long-term impact of a much more protracted period of industrial production decline which opened up a sustained gap in trade balances. This had grave implications for their vulnerability to external shocks to which we shall return below. The Baltic States experienced phenomenal growth from the second half of the 1990s onwards, and in line with many countries in Southeast Europe adopted various versions of fixed exchange rate regimes. The purpose was often to cover for the lack of trust in domestic monetary authorities or a very ambitious plan for complete financial and monetary integration with the eurozone. This choice of exchange rate regime played an important role in the type of imbalances which developed and in fact contributed strongly to sustain and accentuate the problem with deteriorating trade balances.

Moving on to the impact of the recent crisis let us start with financial market developments:

The crisis has revealed significant miscalculations in risk perceptions both in relation to asset values, in the evaluation of balance-sheet positions of some of the important actors in financial markets and of default risks of households and of businesses under changed circumstances; an important element of such risks related to exchange rates. Finally, given these changed risk perceptions, also the evaluation of sovereign public sector debt changed.

A shared evaluation of the outcome of the current crisis is that risk perceptions are not going to revert to pre-crisis levels. If risk perceptions are going to remain at a higher level over a medium-run horizon, this means that credit conditions will remain tighter than they were before the crisis; this relates to both lending behaviour within the countries but also in relation to the outside world. In addition, the crisis brought about worse balance-sheet positions of banks and of households and this also leads to more cautious lending and borrowing behaviour.

Hence one of the most important outcomes of the current crisis will be that transition and catching-up economies have to adjust to *more difficult financing conditions*, both concerning finance from domestic financial institutions as well as by foreign banks. Economists will, however, find it hard to predict how long higher risk perceptions are going to last.[2] It should also be noticed that the volume of credit currently stagnates primarily because of low demand for it.

The second likely effect of the crisis is the behaviour of the household sector itself which for a number of reasons has and will experience a deterioration of its own debt and/or financing position. In this respect there is considerable variation across the different CEE/SEE economies. In some economies the levels (and/or rates of increase) of household debt have been high or very high in the build-up to the crisis (Baltics, Romania, Croatia, Hungary) and this indeed has been one important reason for the vehemence of the transmission of the global financial crisis to this region. In other economies the levels of household debt might not have been that high, but depreciation of the national currencies led to a jump of household indebtedness in the cases where loans were taken out in foreign currency; this affected more strongly economies which started off with high levels of foreign-currency denominated loans (which is not an issue for some countries such as the Czech Republic or Poland). The impact of the crisis shows up in stricter rules of providing credit all the way to full credit rationing. The implication of these financial constraints is that households have to rely more on own income sources for even 'lumpy' purchases and might be forced to repay loans which could otherwise have been rescheduled; both imply higher savings rates. In addition, households will likely also undergo a process of voluntary deleveraging, i.e. attempts to reduce the levels of their debt as lower expected income flows imply a lower longer-run wealth position of households and there are worse rescheduling conditions. On the other hand, if households believe that the recession is only short-run, the tendency would be towards lower savings to achieve 'consumption smoothing'. Given that such expectations are unlikely at the moment, the other factors all point to a *rise in*

[2] The fact that the domestic financial conditions have already eased in Poland and the Czech Republic (to the point that the National Banks have resumed mopping up the excess liquidity from the commercial banking system) may indicate that strain in the financing conditions could ease also in some other countries.

household savings rates in CEE/SEE economies over the medium term although this is likely to affect some countries much more than others.

Thirdly, *fiscal positions have and will significantly worsen* in the course of the crisis: lower incomes reduce tax revenues and the economic recession increases public expenditure commitments; together this has led to rising fiscal deficits in CEE/SEE economies. Furthermore, some of the public debt is in foreign currency and hence devaluation again affects public debt/GDP ratios. In a number of countries there was also an increase in debt to IFIs (IMF agreements). Hence although most CEE/SEE economies (with the major exception of Hungary) went into the crisis with rather low public debt levels and governments could feel confident, in a climate of high growth and relatively low interest rates, that this debt could easily be serviced, the outcome of the crisis has significantly changed this perspective. While sustainability of fiscal positions did not seem a problem in a period of high growth, trend nominal appreciation of the currency and low interest rates, this scenario has now changed to the worse in all these respects: the predictions are that the trend growth (potential output) path will be negatively affected as an after-effect of the crisis, there has been a depreciation in most local currencies which had a flexible exchange rate regime and there is an expectation that, in due course, interest rates will rise globally from their current very low levels.

The outlook on the fiscal side will be further discussed in section 5 especially with respect to the scope in CEE/SEE countries for countercyclical fiscal policy; at this stage we want to mention two possible policy scenarios in so far as they affect medium- and long-run growth:

In principle it is possible to both have a positive or a negative outlook on fiscal policy as it affects economic growth: The positive outlook would be that the stronger fiscal constraints felt as a result of the crisis (see above) would lead to a streamlining of public expenditure programmes; this could put pressure on reforming a host of social expenditure programmes (pensions, health, labour market support) in such a way that they get more targeted and the efficiency of administrative procedures gets improved. Furthermore, governments could use the opportunity to specifically set up growth-enhancing spending programmes, i.e. those which enhance the skill levels of the work forces, improve infrastructure, support investment by enterprises and the dynamic development of regional clusters.

A negative outlook on the impact of the crisis on public spending from the point of view of economic growth would be that pressures on public spending in a downturn would lead to a relative neglect of public investment in favour of defending existing government programmes rather than their reform. That is, a crisis situation might favour a defence of spending programmes by those who are politically most vocal and public spending in favour of schemes with a positive longer-term growth impact would be rather cut.

To summarize: The medium-run impact of the economic crisis upon Central and Eastern Europe will show up in

- more difficult internal and external financing conditions,
- deleveraging processes and higher savings rates by the household sector, at least in some countries, and

- a worsened public debt situation and increased pressures to reform public expenditure programmes, in many places.

3 Sustainability of growth differentiation across economies

Let us now come to an assessment of growth prospects in Central and Eastern Europe after the crisis (medium- and longer-term) before we discuss a range of policy suggestions:

To start off, we should not forget that, before the outbreak of the crisis, the growth and catching-up experiences of many of the economies in Central Eastern Europe (CEE) were very impressive – since about the mid-1990s – and, furthermore, also the countries of Southeast Europe (SEE) started to follow that pattern from about 2000 onwards (see again Figure 1).

Behind that growth performance lay the scope for any lower-income, lower-productivity economy to benefit from technology transfer (to be interpreted in a wider sense including the adoption of better organizational practices, improvements in institutions and behavioural practices) which is the main driver behind 'convergence' processes. Comparative growth accounting exercises (see e.g. World Bank, 2008) show that growth in TFP (total factor productivity, which is a proxy for general productivity catching-up) is by far the dominant factor explaining overall growth. In the case of CEE/SEE economies the speed of such 'technology' transfer was strongly supported by the anchorage in pre-accession and accession arrangements with the EU as was pointed out earlier. This anchorage also supported the fast and substantial influx of foreign investors which acted as an important conduit of that transfer. On the negative side, it also led to an under-estimation of 'risks', of vulnerability to external shocks, to an household credit boom and overexposure in foreign-exchange denominated debt in some of the economies, all of which was discussed earlier.

We should not ignore the fact that amongst CEE economies we also saw examples of real improvements in conditions for long-run sustainability both with respect to

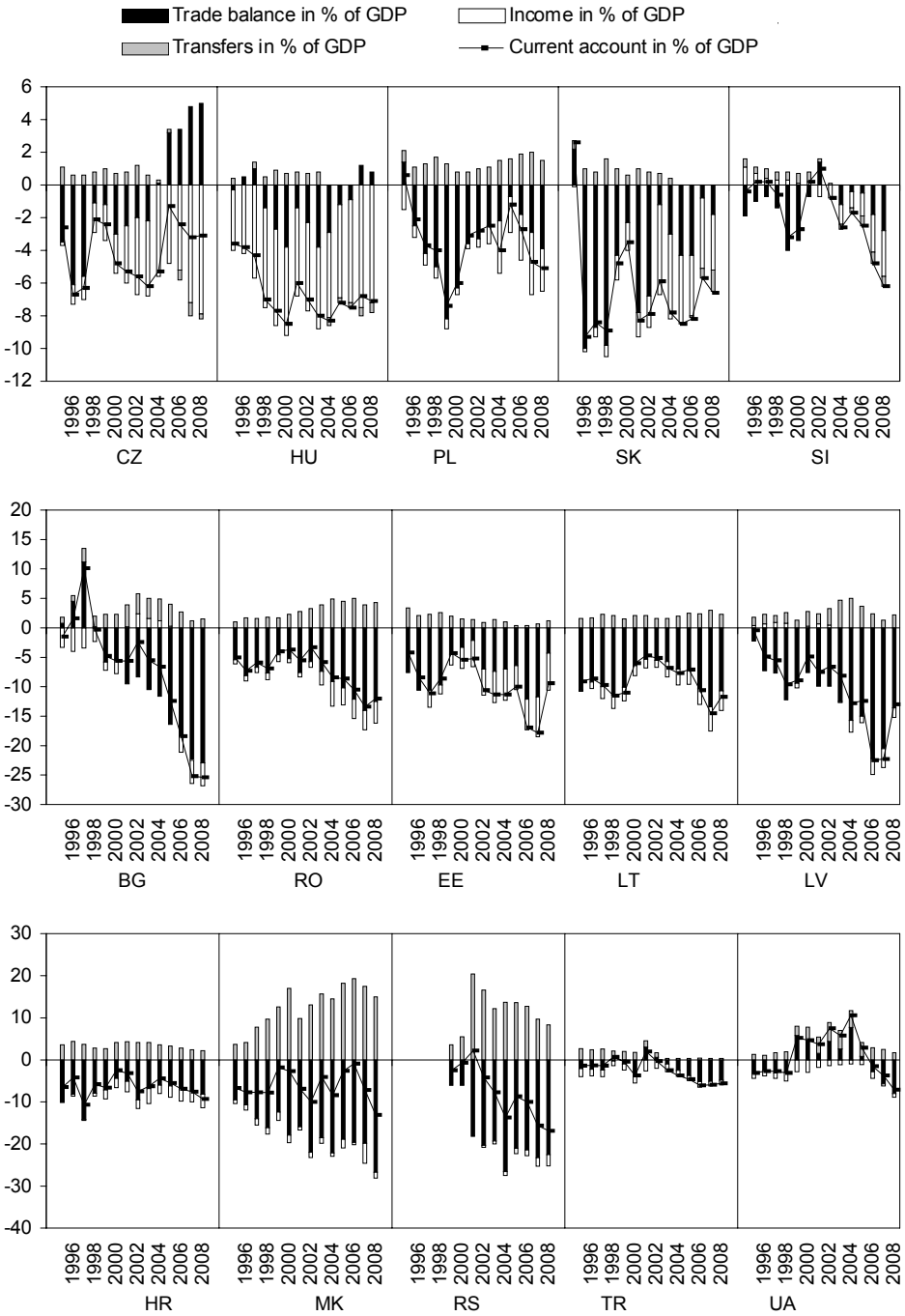
- sustainability of external accounts and
- sustainability of fiscal positions (further discussed in section 5).

As regards external accounts, we witnessed in a number of economies substantial improvements in trade accounts over the past decade even in a period when the CEE economies experienced positive growth differentials relative to the main trading partners (see Figure 2); deficits in current accounts were mostly due to negative entries in the income accounts which resulted from the repatriation of profits by international investors. Quite a few of the CEE economies had witnessed substantial upgrading in their export structures (for details see Landesmann and Stehrer, 2009) although there were differences with regard to the degree of diversification of trade and production structures (see also Landesmann, 2008). Hence, the CEE economies were on a robust path towards sustainability of external accounts and the main worry concerned periodic strong upward pressures on the exchange rate through capital inflows. In some countries, the relative movements of productivity and labour costs also impacted upon competitiveness and external accounts in specific periods.

Figure 2

Trade balances of goods and services and income balances, 1995-2008

in % of GDP



Note: Notice that scales vary across figures.

Source: wiiw Annual Database incorporating national statistics, Eurostat.

Hence from the point of view of sustainability of external accounts, quite a few of the CEE economies were on a positive path and this served and will continue to serve as a model to be emulated by other economies.[3] In these economies the ground was thus laid for a sustainable pattern of economic growth and this provides scope to learn for other catching-up economies both regarding positive and negative experiences (for the latter, the conduct of Hungarian fiscal policy is a case in point).

On the other hand, as also clearly emerges from Figure 2, there is a range of economies, especially in Southeastern Europe and in the Baltics, where the evidence did not point towards 'sustainability' in external economic relationships. Trade accounts continued to deteriorate and transfers were insufficient to compensate for this; as a result we witnessed – before the crisis – at times dramatically worsening current accounts. Hence we have a set of economies in Central and Eastern Europe which suffer from persistent weaknesses of their tradable sectors. The underlying issue here is the dramatic fall in industrial production in the early phase of transition from which a sizable group of economies (in Southeast Europe and the Baltics) has not properly recovered so far. The problem are also over-valued exchange rates (see Egert, 2005; Holzner, 2006), partly due to the importance of transfers, partly due to exchange rate regime choices and associated monetary policies, in some countries entrenched by a type of Dutch disease based on the importance of the tourism sector, all of which hinder the development of a sufficiently sized and competitive export sector.

Hence the crucial issue for sustainable catching-up (convergence) processes in Central, Eastern and Southeastern European economies is the successful development of the tradable sector so as to achieve differential growth (relative to the advanced EU member countries) without incurring strong current account vulnerabilities.

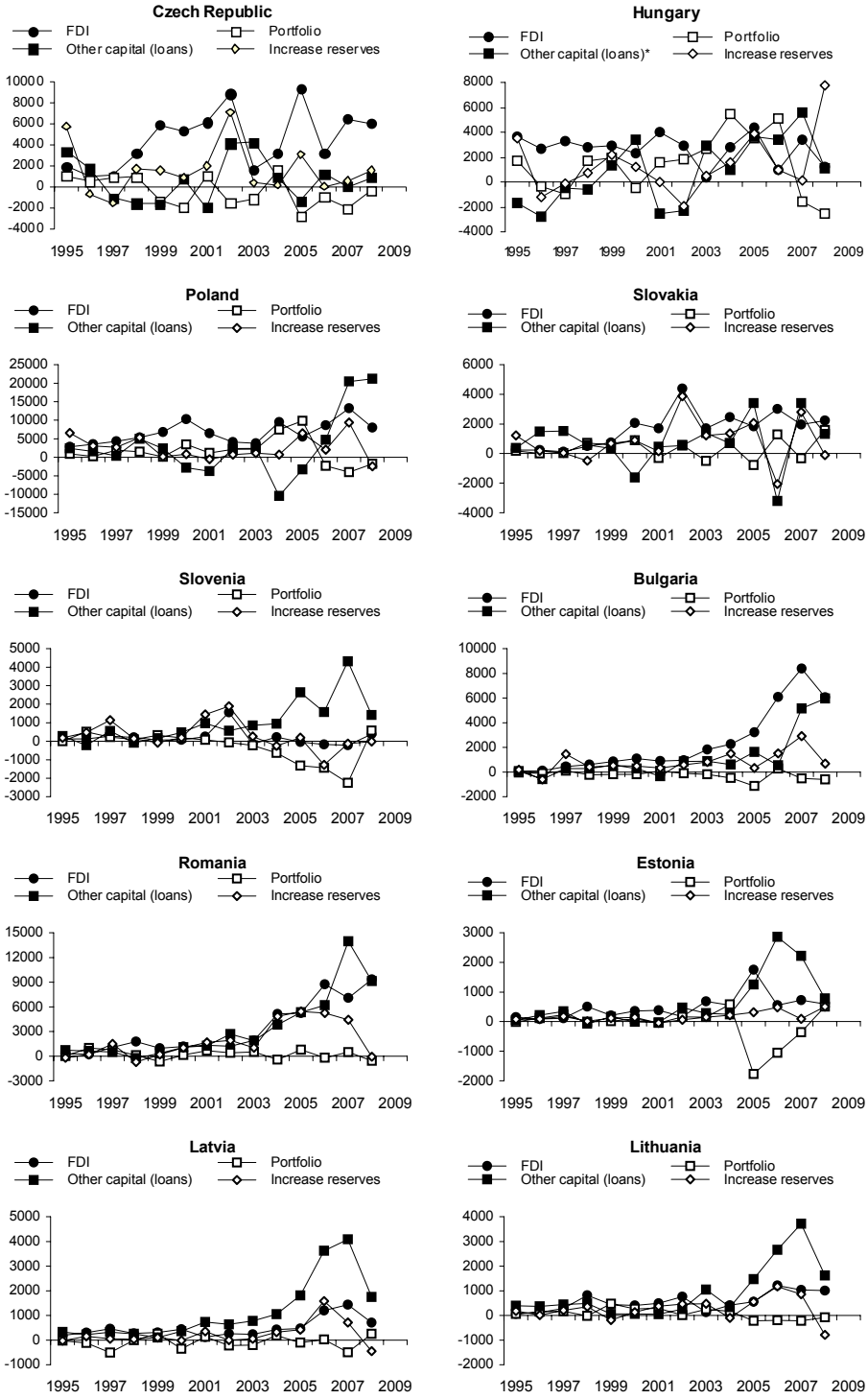
The conditions for a 'redirected growth model' in the light of the after-effects of the current crisis should therefore take account of the rather different situations found in the two groups of economies: (i) the relatively successful CEE economies and (ii) the economies in the Baltics and in Southeastern Europe which moved along an unsustainable path of external disequilibrium even before the crisis. Both these two types of economies will have to adjust to changes brought about by the crisis but before we discuss these adjustments let us point to further differences between the two groups of economies which are explored in Figures 3 and 4:

Figure 3 shows the composition of the different main items in the capital accounts (note different scales in the figures): net flows in foreign direct investment (FDI), flows in portfolio investment, cross-border loans, and changes in reserves. The strong differentiation across economies re-emerges:

[3] There were also other factors at work in the successful 'growth models' of the CEE countries:
- changes in educational structures and hence the skill structure of the 'future' labour force (for this see Applica and wiiw, 2009);
- a change in sectoral and regional economic structures which meant difficult adaptation processes, but this resulted in more forward-looking patterns of sectoral and regional growth (see e.g. Römisch, 2007);
- a qualitative upgrading of trade and production structures and increasing integration into cross-border production networks (see Landesmann and Stehrer, 2009).

Figure 3

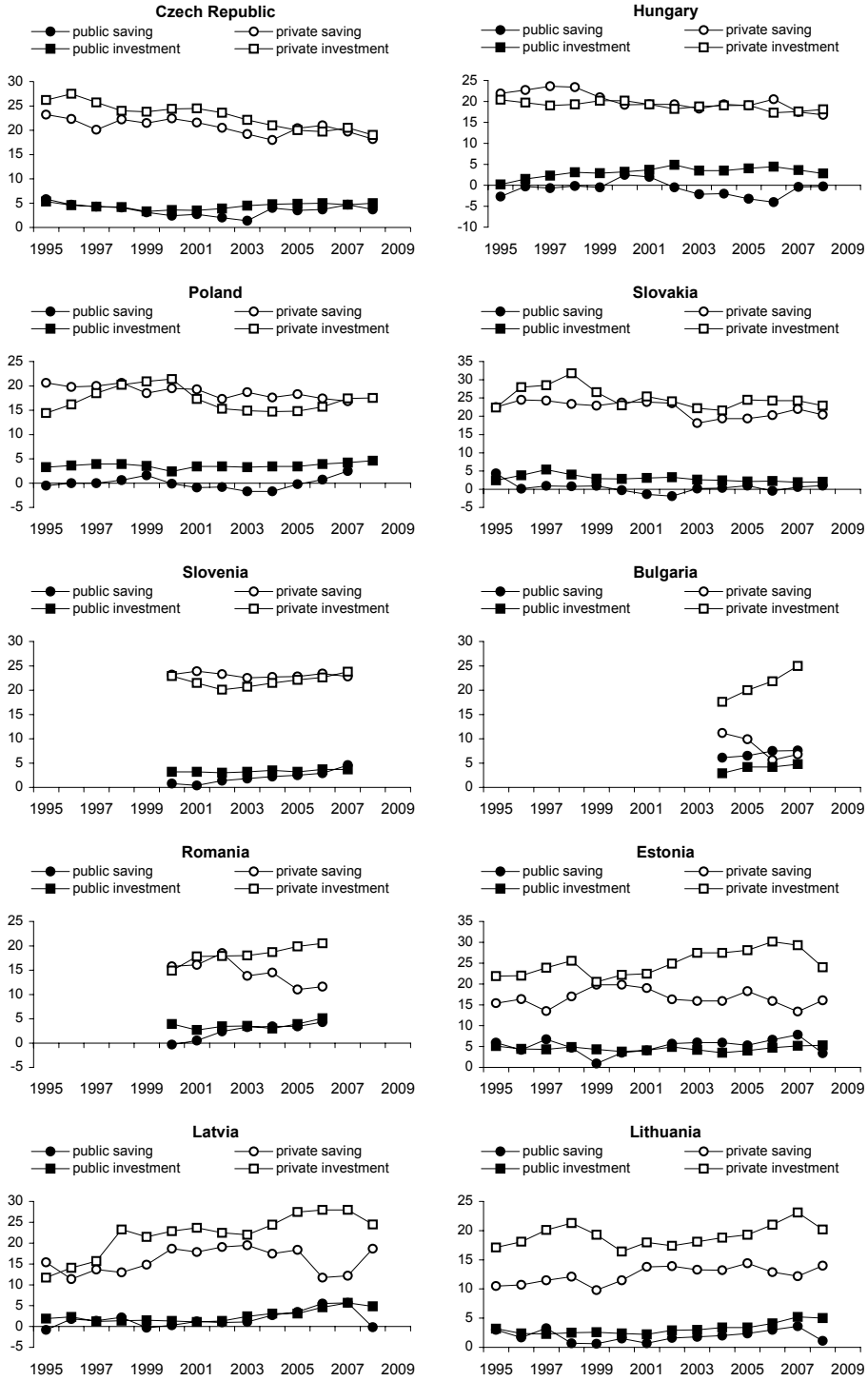
Net capital flows, EUR million, 1995-2008



Note: * Hungary 2008 excl. IMF loans. Notice that scales vary across figures.
Source: wiiw Annual Database incorporating national statistics, Eurostat.

Figure 4

Savings and investment, gross, in % of GDP



Note: Notice that scales vary across figures.

Source: wiiw Annual Database incorporating national statistics, Eurostat.

four of the economies (Czech Republic, Hungary, Slovakia and Poland) have rather persistent net capital inflows in FDI and no big spikes in net credit inflows (except for Poland in the last two years before the crisis). All the other countries had very fast net credit growth in the years before the crisis which was particularly pronounced in the case of the Baltics where these credit flows far outstripped FDI inflows (which was not the case with Bulgaria and Romania where strong credit inflows were accompanied by strong FDI activity). Figure 3 therefore shows that a sub-group of CEEC economies not only had ballooning current account deficits, but that these deficits were heavily financed through external loans (rather than other forms of capital inflows such as FDI). These economies became thus very vulnerable to shocks in financial markets which affect risk assessment.

Finally, we refer to another indicator of imbalances which can generate an important need for adjustment in case of external financing shocks. Figure 4 depicts savings and investments (both in % of GDP, note again different scales) for the private and the public sectors of the economy: We see again a striking difference between the CEE countries, in which no persistent gap between private savings and investment can be detected, and the Baltic and Southeast European economies (for the latter we are only able to show data for Bulgaria and Romania) where persistent gaps have opened up leading to strong growth in private sector debt. Notice that the figures also show that these economies did not suffer from persistent gaps between public investment and public saving.

Let us summarize the main differences between CEE economies and the other two groups of economies (Southeastern Europe and the Baltics):

- There are substantial differences in trade account developments (exports minus imports): the CEE economies have achieved manageable proportions in their trade balances while the trends in all the other economies indicate very high and in many cases deteriorating trade deficits. The underlying difference lies in the ability of CEE economies to build up a sufficiently sized and competitive export sector, while both SEE and Baltic economies have suffered from deeper transition and other crises which had severely weakened their tradable sectors combined with long phases of persistent and growing real exchange rate overvaluation.
- The weaknesses and negative trends in the trade accounts were reflected in strongly worsening current accounts. This pointed towards unsustainability even before the outbreak of the crisis and indicated a lack of an equilibrating mechanism which would allow the SEE & Baltic economies to follow on a path of structural economic development (specifically with regard to a strengthening of the tradable sector) similar to that experienced by the CEE economies.
- Differences between the different groups of economies also emerge from an examination of the composition of capital flows in the capital accounts. While CEE economies (with the exception of Slovenia in the most recent period) showed no signs of a strong bout of net credit inflows outstripping FDI inflows, this was a strong feature of the Baltic economies. SEE economies (Bulgaria and Romania) experienced sharp increases in both net credit inflows and FDI inflows. Baltic and SEE economies were hence strongly vulnerable to a change in risk assessment as happened in the recent crisis.
- Finally, we have shown that in terms of domestic savings-investment gaps, these are most striking in relation to private sector savings-investment shortfalls which had to be covered through

borrowing. Roughly the same grouping of economies emerged in this respect. Hence strong growth of net credit inflows and large savings-investment gaps of the private sector in Baltic and SEE economies before the crisis indicate a problem of effectiveness of monetary policy and capital market regulation.

In summary, the analysis shows that it would be wrong to speak of uniform problems with the 'growth model' of the entire range of Central and Eastern European economies and hence suggestions regarding the 'redesign' of such a growth model must take such differences into account. We shall return to this issue in the concluding policy section (section 5) of this chapter.

4 Redesigning the 'growth model' in the light of changed external conditions

In section 2 we already alluded to changes which the recent economic crisis either has already brought about or will bring about with regard to internal behavioural responses and constraints. In the following we want to also point to changes in external conditions in the wake of the crisis under which a renewal of the growth process has to take place in the CEECs. The following three factors are relevant in this respect:

(i) Drop in the trend growth path of the main European export markets

The expected longer-term impact of the crisis on potential growth paths is not only relevant for the CEE/SEE region for the reasons discussed above, but also for the main export markets of the countries in this region[4]. The reasons for the expected slow-down in export markets are partly over-lapping with those relevant for the CEE/SEE region (see section 2) and are at times also country-specific: thus, e.g. there is stronger dependence of some economies (such as the United Kingdom) on the recovery of the financial services industry, in other economies (Ireland, Spain, UK) the crisis had a very strong impact on the real estate sector and hence on construction activity; furthermore, there are differences in the extent of disarray in public finance positions (Greece, Ireland, Spain, UK etc.) which will also impact upon the extent of economic recovery. Hence most countries of Western Europe face a lower potential growth trajectory over the medium to longer run than that of the CEE/SEE region and this in turn means that low growth in the main export markets will be a growth-dampening factor for the CEE/SEE countries.

(ii) Reforms in the financial architecture at national, European and global levels

The experience of the crisis has shown that CEE/SEE countries were very vulnerable to instabilities and shocks to global financial markets and, in the final analysis, these were the causes of the rather dramatic and unexpected, interruption of growth processes in CEE/SEE economies.

Changes in the financial architecture will likely go in the direction of strengthening the capital-base of any future credit expansion, as well as empowering regulatory authorities to monitor macro-stability issues of financial (particularly banking) institutions. In all these areas, the growth processes in the

[4] See various publications analysing the impact of the crisis on potential output: Boewer and Turini (2009), European Commission (2009), Fouceri and Mourougane (2009).

CEE/SEE region could benefit from such changes in regulation as in the past there were signs of overheated and misdirected expansion of credit (particularly of household borrowing) and lack of effective instruments which could be used by domestic regulatory authorities particularly with respect to cross-border financial market transactions. Any agreements on regulatory reforms which tackle these issues of cross-border financial market integration might be beneficial for the characteristics of financial intermediation in the CEE/SEE region[5].

(iii) Possible tightening of (effective) entry criteria to EMU membership

The experience of the crisis, particularly the fact that serious external accounts imbalances and processes of credit expansion made CEE/SEE economies prone to contagion effects, has produced the feeling that non-Euro CEE/SEE countries are very vulnerable to financial market shocks. This had a number of contrary effects: Within the Euro-system, it strengthened the sentiment that any quick enlargement of the Euro-group would add to financial instability of the group as a whole.[6]On the other side, the events have increased the desire of some would-be-members (Baltics, some Balkan economies) to join as fast as possible to obtain the support in terms of financial and monetary stability which full Euro-membership supplies. Thirdly, the differential experiences of 'fix-ex' vs. 'flex-ex' countries during the crisis have also strengthened the position of some (mostly 'flex-ex') countries that giving up their own currency too soon deprives the economy of an important instrument to absorb shocks. Hence the likelihood of earlier or later entry has become much more diverse across CEE/SEE economies as a result of the crisis and the balance is likely to tilt towards a stricter application of rules for EMU entry.

5 Policy suggestions to support a 'reoriented' growth model

The experience so far, does not warrant a wholesale reconsideration of the 'integration model of growth' which most of the CEEC countries (with the exception of Russia and some of the other CIS countries) have pursued before the crisis. However, the changed circumstances and the revealed vulnerabilities suggest that some adjustments might be necessary. The most immediate task is to identify the short-run and medium-run structural and policy adjustments that may be needed in different countries or groups of countries. Following that, but also to be addressed very soon, are the longer-term issues which have led to severe imbalances in the development of both EU and EMU member countries and also of countries closely linked to these.

In the short run, and probably in the medium run too, the risks of the resumption of large financial and capital inflows are rather low. Indeed, throughout the EU and the region closely integrated or connected with it, slow growth of credit and investments is likely to prove to be the main problem. As discussed earlier, in most economies there is likely to be an increase in household savings rates; this will especially be the case in countries with weak private savings, high private debt and current account deficits. As most of these economies are small and open, the rebalancing of aggregate

[5] For more on this see Daianu (2010, forthcoming)

[6] This position was further significantly strengthened by the strains which the post-crisis developments in the PIGS countries – Portugal, Ireland, Spain and particularly in Greece - generated inside the Euro-bloc.

economy savings and investments, if it is to lead to convergent growth rates, will have to be based on the faster growth of tradable goods. In some cases, it will also have to be supported with increased diversification of the tradable sector.

For this adjustment to take place, the real exchange rate needs to be corrected. Savings will increase as part of the deleveraging process, but investment will increase only to the extent that increased competitiveness leads to higher external demand. That implies the need for real interest rates not to be driven up too high and indeed they need to be at a level that is consistent with the real exchange rate adjustment. This adjustment could be accomplished in the medium term. The length of the adjustment period may vary depending on the existing level of integration, the weight of imbalances, and the availability of policy instruments. Difficulties inherent in the real exchange rate adjustments in the currency board (or euro area) countries must not be underestimated though.

The main advantage of the integration model of growth should however be preserved. Less developed or converging economies should be able to draw, within limits, on savings from more developed countries. But it makes sense for savings and investment gaps to narrow over the process of convergence. However, it is not to be suggested that external imbalances should be eliminated altogether. The key is for those to be dynamically stable, that is to be sustainable. That, on most criteria of sustainability, implies rebalancing of savings and investments and the implied adjustment in the real exchange and real interest rates.

Policy issues I: exchange rates

Though there is no clear-cut differentiation of effects of the crisis on countries with different exchange rate regimes, there is no doubt that countries with fixed exchange rates are facing bigger problems than those with flexible exchange rates. The motivation for fixing the exchange rates had been to achieve price stability and financial integration that would lead to the *ex post* convergence to the conditions of an optimum currency area with the eurozone. The latter argument was strengthened by the claim that flexible exchange rates with high inflows of foreign capital would lead to exchange rate appreciation, which would lead to even stronger deterioration of the current account and thus to a divergence from an optimum currency area with the euro.

In that context, it may look puzzling that flexible exchange rate countries (in Central Europe) have tended to have sustainable current account deficits while there was a clear move towards unsustainability in the case of fixed exchange rate countries (e.g. in the Baltics and the Balkans). From that, it could be concluded that flexible exchange rates are equilibrating even in the face of large financial and capital inflows. Equilibration tends, quite automatically, to go along with adjustments in trade balances and competitiveness. Phases of excessive appreciation generate trade imbalances (falling competitiveness) which in due time slow the level of domestic activity and otherwise undermine the confidence in the value of the domestic currency. This triggers nominal depreciation (usually self-reinforcing) which then generates gains in competitiveness and improves the trade balances. The fact that the region's 'flex' countries are inflation targeters (overall successful in controlling inflation) is of some importance as well. By controlling inflation (and having influence on

interest rates), the monetary authorities in the 'flex' countries are in a position to reduce real (if not nominal) exchange rate appreciation tendencies.

Fixed exchange rates in the presence of high capital inflows may either push prices up (in the case of currency boards) or require restrictive monetary policy (to slow down the growth of money via sterilization or high reserve requirements), which means high interest rates. The latter will induce further foreign financial inflows and that will widen the current account deficit. In addition, fixed exchange rates, to the extent that they either lead to high inflation rates or to high interest rates or both, will lead to investments that aim to exploit the interest rate differential rather than the difference in the profit margin. Therefore, it can be expected that flexible exchange rates will be supportive of investments, especially in tradable goods and services, while fixed exchange rates will have the opposite effect. This is perhaps the reason why countries in the eurozone have experienced real exchange rate appreciations with widening and unsustainable current account deficits.

From that, it can be concluded that flexible exchange rates are to be preferred over fixed exchange rates as long as the criteria for an optimum currency area are not satisfied *ex ante* or at least sufficiently for the *ex post* convergence to be sustainable. That does not mean that other policy mistakes may not be made in that regime too and thus it is to be understood that by themselves flexible exchange rates are not going to ensure the sustainability of the external balances. However, combined with other policy instruments (especially those directed towards productivity enhancement and proper wage-productivity bargaining structures), they should be supportive of the integration model of growth in the original or the modified form that we are suggesting for the short and medium run in the post-crisis period.

In the case of countries with fixed exchange rates, where the switch to flexible exchange rates may prove to be too risky, e.g. in the case of countries with currency boards (Bulgaria and the Baltic States) or those with the euro as their official currency (e.g. Montenegro, Kosovo), the EU needs to take over part of the costs of adjustment. One can conceive here of coordinated and supported real exchange rate adjustments even within a fixed exchange rate system with a system of burden-sharing both with respect to real income losses and asset price adjustments.[7]

Policy issues II: fiscal policy

Membership in the EU or EMU has not necessarily supported sustainable fiscal balances. However, most CEE/SEE countries have not been in violation of the Maastricht criteria before the crisis and many will remain within these criteria (corrected for fiscal deficit overruns during recessions) in the medium run. Indeed, most of these countries had declining public debt to GDP ratios before the crisis, though only a minority of those also ran countercyclical fiscal policies, i.e. they ran fiscal deficits even in years of above-potential growth.

[7] On this see Becker (2010, forthcoming).

Figure 5

Public and private debt in % of GDP

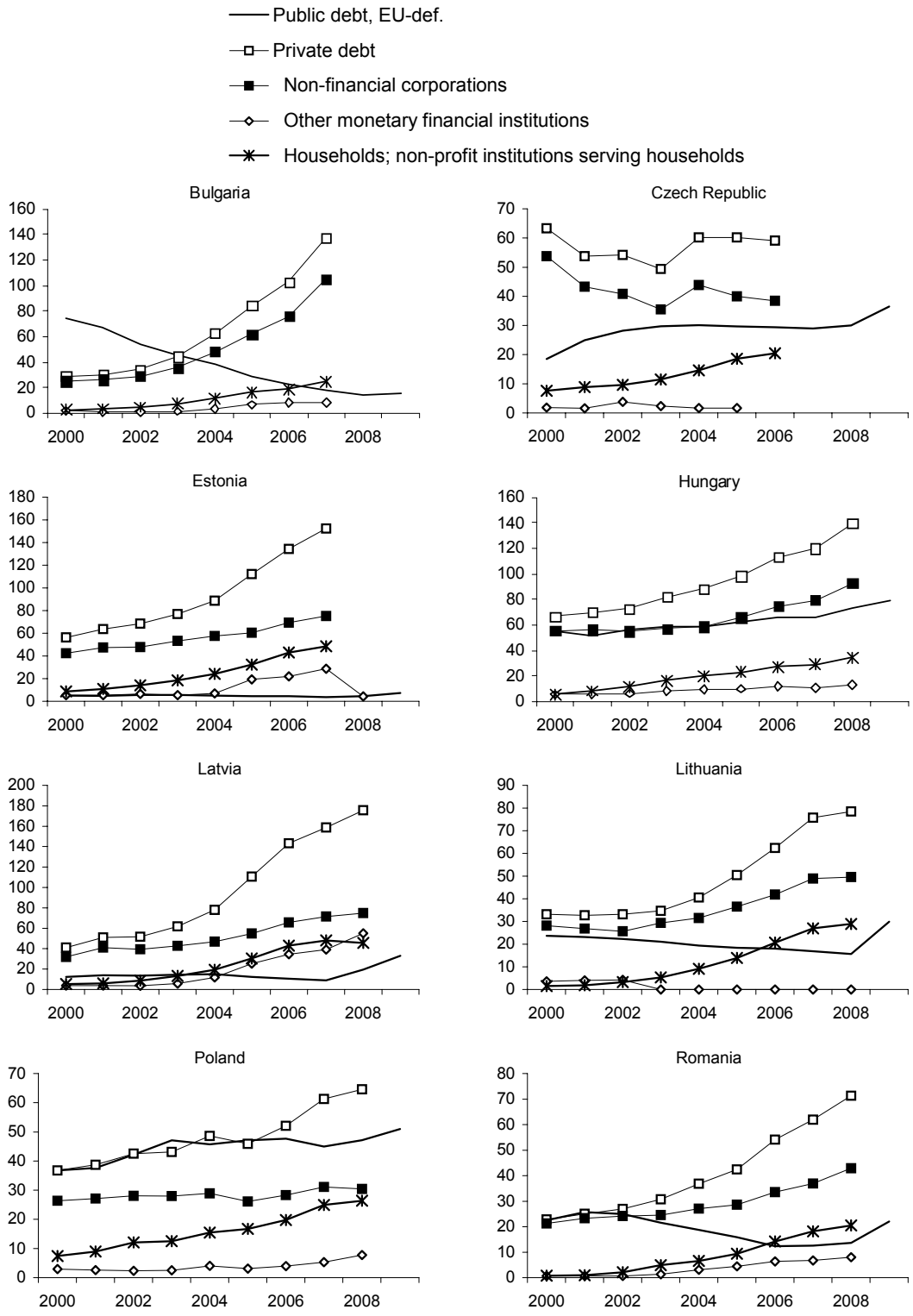
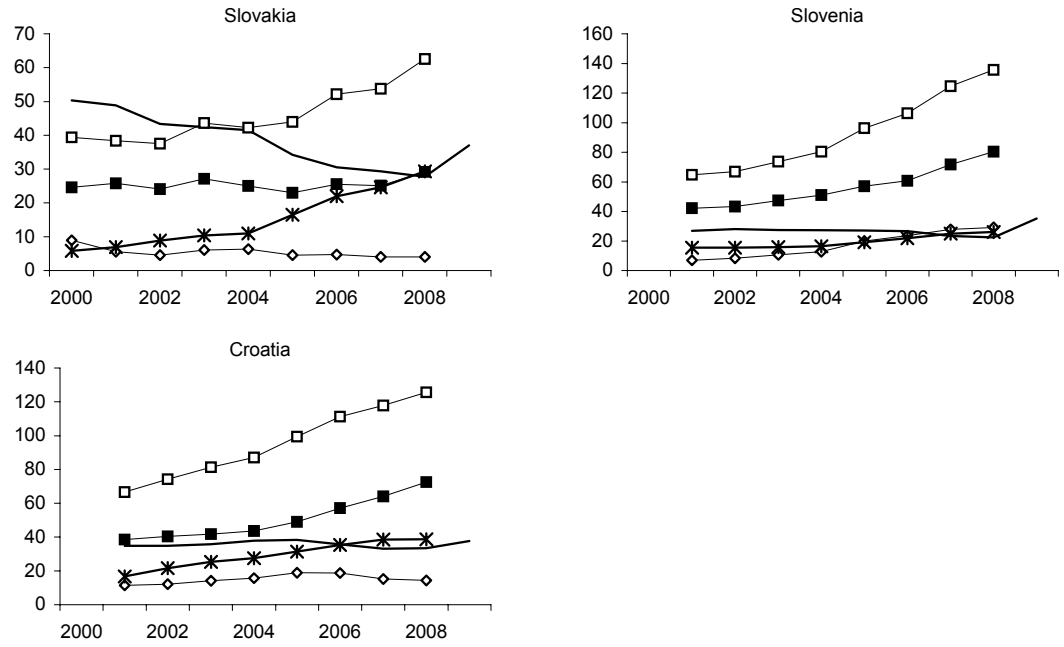


Figure 5 (contd.)



Note: Notice that scales vary across figures.

Source: Eurostat.

Thus, given the record and the states of public finances, in the majority of cases, sustainability of fiscal balances is not an issue even if these have deteriorated during the crisis and may take some time to improve. In the medium term, countercyclical fiscal policy can therefore play an important role in Central and Eastern European economies to counteract the deleveraging impact of the crisis on private sector spending. In some cases, however, procyclical fiscal policies cannot be avoided now or in the immediate future due to pre-crisis fiscal mismanagement and the need to adopt a programme of fiscal adjustment. In some cases, support from the IMF and the EU was needed. It is possible that such support may still be needed in a number of countries (most probably in the Balkans) that have so far been able to manage the crisis without an external anchor.

As is clearly visible from Figure 5, the key problem in a range of CEE/SEE economies is not public, but private debts. Again, countries differ in that respect. A number of Central European countries have not had either strong growth of public or of private debts. The Baltic and some Balkan countries, however, have experienced stagnant or declining public debts, but rising private debts before the crisis. As the private sector is deleveraging, public debts are increasing. This process may continue over the medium run, though it should not continue for much longer.

The problem seems to be the following. As corporations and households are deleveraging, and as current account deficits are shrinking, the growth of private savings is being reflected in the fiscal deficit. The demand for public expenditures is also increasing because of cyclical factors, i.e. due to automatic stabilizers and to increases of discretionary spending (i.e. public investments). Thus, key

to fiscal sustainability is an increase of private investments and eventual winding down of cyclical spending both due to the speed-up of growth. Premature fiscal consolidation would in all probability lead to increased investments abroad either via growing reserves or via current account surpluses.

If public debt sustainability is not an issue in the medium run, *support for some countercyclical fiscal deficits from the EU should be recommended*. This could be done in a number of ways and may not imply outright fiscal transfers or support.

Policy issues III: financial regulation

The problems of financial sector regulation within an integrated economic area are different from those globally or nationally. In the wake of the financial crisis, there was a need to come to the rescue of the banking and the financial systems. The risks to the EU and the EU-dominated financial sector emanated mostly from within the EU financial centres rather than from the peripheral countries. In fact, countries with current account deficits did not, as a rule, face significant risks to their banking sectors, which cannot be said about the countries with oversized financial sectors. In some cases, IMF support was needed, which came together with EU support and an agreement with banks not to lower their credit exposure in these countries, which is known as the Vienna Initiative. These programmes resembled typical IMF stand-by agreements which aim to stabilize a country's finances and to reassure the banks to continue with their financial commitments. The programmes' principal aim is to stabilize the economy and not to lead to long-term growth and sustainability. For the latter, a reform in financial regulation would be needed.

The deficiencies of EU financial regulation are well known. Financial integration goes with systemic risks that are not clearly attributed to the system that is at risk. Even in the euro area, where monetary policy is centralized but banking supervision is decentralized, it is the responsibility of national central banks. Thus, all the externalities and the networking effects are not addressed in an appropriate way or not at all. If that is true, these externalities and network effects will lead to various inefficiencies not only within the banking sector but also among the various regulatory bodies.

These deficiencies will have to be addressed. In the case of the risks to CEE/SEE countries, in the short and medium run, the issue will be the availability of credit. In the long run, there may again be an issue of too much credit. The regulatory system that is now being put in place will have to have in mind these two distinct problems.

In the short and medium run, in some countries the balance sheets of the banks will have to be improved. This has been addressed sporadically, but the predominant expectation is that financial balance sheets will continue to deteriorate as long as the real economy does not start to recover strongly. The latter may depend on the former to a significant extent, which will then suggest the need for some private debt restructuring. In a way, the regulation now discussed and which may be put in place should take into account the need for an orderly restructuring of bank debts.

In the long run, however, a financially integrated area will need to have a way to deal with systemic risks. That means that changes in banking supervision will be necessary as well as some kind of insurance against the behaviour of banks that may present significant systemic risks. All these need to be done at the EU level, but the participating countries may not be restricted to EU member states.

Policy issues IV: EU integration and the room to manoeuvre for fiscal policy

The key deficiency of the process of EU integration has been the limited fiscal integration. The remedy has come with various monetary and fiscal rules, but those have been hard to design and even harder to enforce and modify. As increased fiscal integration is not on the cards, alternative ways of dealing with the policy challenges will have to be devised.

For the integration model of growth to work, the path of development of relative prices is highly relevant. If it is believed that *ex ante* compliance with the criteria for an optimal currency area (OCA) is beneficial, the Maastricht criteria should be interpreted in such a way as to be supportive of OCA criteria. Once exchange rates are fixed or countries are within the EMU, it will be necessary to address the issue of risk sharing due to the need to adjust the real exchange rate or to keep the real interest rate at a level not far away from the one that the monetary authorities, i.e. the ECB is targeting.

As fiscal sharing is quite limited, fiscal rules need to be adhered too. Those should be such as to favour sustainable and countercyclical fiscal policies. The main deficiency of the current system is that it has hardly any mechanism to deal with short run fiscal problems. Because of that, countries find themselves pressured to follow procyclical fiscal policies even though fiscal sustainability is not a short term problem. One remedy is to have an insurance facility (or 'Stabilization Fund') that is instated at the EU level and which would be available with conditionality. Participation in such a scheme would require being subject to strict monitoring with regard to longer-term sustainability. It is likely that the currently experienced Greek crisis will move the EU in this direction.

These policies and instruments should not only apply to euro or EU member states, but also, in a modified way, to candidate countries and also to countries that are participating in neighbourhood policies and programmes. The level and mechanisms of involvement should depend on the level of integration, but the principles should be more or less the same.

Policy issues V: Further on longer-term policies strengthening the supply side

We argued above that a likely outcome of this crisis will be a medium-term increase in the household savings rate in CEE/SEE economies. Such an increase does not have to be considered detrimental in the longer run as, in many cases, savings rates were rather low in CEE/SEE economies by international comparison and low savings rates were the cause of severe imbalances in a number of economies. However, an upward adjustment of household savings rates will *ceteris paribus* lead to a medium-run problem of dampened domestic demand. This can be compensated through increased fiscal stimulus and a drive to support the tradable sector and hence net exports. Hence we have

linked the issue of adjusting to higher medium-run domestic household savings rates to the discussion of the important role of fiscal policy in the recovery phase from the economic crisis.

From a longer-run point of view we also want to emphasize that improvements in the structure of expenditure programmes are called for and especially countering – in the current conditions of economic crisis – a change away from growth-enhancing public spending items (education, infrastructure, etc.). In this respect it will be of some assistance that, over the coming years, the countries from the CEEC region will receive increased flows from the EU budget as they become full recipients of Structural Funds and other EU policy programmes. In the case of other economies, changes in pre-accession or candidate status will lead to an increase of such flows. This will be a counter-weight to the more difficult situation with respect to private sector capital inflows and a tightened national fiscal situation. Given the importance of strengthening the tradable sector in many of the CEEC economies, a host of policies can be directed at strengthening the supply side (i.e. technology policy, human capital policy, regional and industrial policies). The various EU regional and other policy programmes should be used in a complementary fashion to support such initiatives. The design of such policies and the timing of spending should proceed in such a way that they support a timely re-launch of growth and support a sustainable growth trajectory. Governance mechanisms to ensure that programmes are used efficiently need to be put into place or strengthened.

Further to the expected increase in private savings rates, policies can also address the issue of efficient use of savings. Policy instruments (credit support for SMEs, support for exporting activities, credit facilities to support skill acquisition, retraining and new technology adoption, controls on mortgage lending) could be used to make sure that savings flow in the direction that supports a sustained growth process and tackles the main weaknesses in external accounts. With regard to policy support for the re-launch of the stalled credit system discussed above, we want to emphasize that a shift in banks' lending policies in the direction of more credit to the enterprise sector and less to the household sector would be beneficial to avoid the imbalances which appeared in the CEE/SEE region in the past.

Finally, CEECs will have – in most cases – to cope with an even worse demographic prospect in terms of 'ageing' than do most Western European countries. Policies directed at increasing the utilization of the available labour force (increasing activity and employment rates) as well as improving its quality through human capital enhancing policies will be an important item on the policy agenda. On top of that, CEECs which had for long been net-emigrant countries, will have to learn the art of successful (and human capital enhancing) migration policy. Such migration policies will have to include efforts to attract and exploit the labour force potential of return migrants.

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*Sándor Richter**

New EU member states:
Deep recession over, mild recovery ahead

International environment: export markets slowly recovering

In early 2010, global growth prospects seem to improve. After dropping 0.8% the previous year, world output is now expected to increase by 3.9% in the course of the current year and 4.3% the year thereafter.[8] More importantly, the prediction is that after last year's inordinate slump (-12.3%), world trade both this year and next will come close to the average rate of expansion registered in the period 1997-2006.[9]

The European Union, in which the new EU member states (NMS) are embedded, experienced a 4.1% recession in 2009 that was more intense than the contraction of the world economy. Also the recovery in the EU is expected to be protracted: the European Commission has forecast 0.7% GDP growth for the current year and 1.6% expansion for 2011. Recovery in the EU will be driven by an increase in private and public consumption and a restocking of inventories. Given the low capacity utilization, weak demand and limited profit prospects, investment will still contract by close to 2% in the current year after the steep decline of almost 11% in 2009.[10]

Net exports and inventory changes in the limelight

After a long period of real convergence, the NMS as a group experienced recession in 2009, the extent of which (-3.6%) corresponded fairly closely to that of the more developed old EU member states (see Figure 1 and Table I). The aggregate data, however, are misleading as they reflect Poland's weight in the NMS group and that country's extraordinary resilience despite last year's global recession. Indeed, Poland was the only country in the EU to have recorded a positive GDP change in 2009. Of the other nine NMS economies, only the Czech Republic experienced a recession that corresponded roughly to the EU average. Hungary, Romania, Slovakia and Slovenia suffered from a noticeably stronger recession, while the Baltic States recorded a dramatic contraction of their economy 4 to 5 times larger than the EU average.

* The research on this overview was completed on 23 February 2010. Peter Havlik, Kazimierz Laski, Michael Landesmann and the authors of the individual country reports provided useful comments on the earlier draft.

8 IMF, *World Economic Outlook*, Update, 26 January 2010.

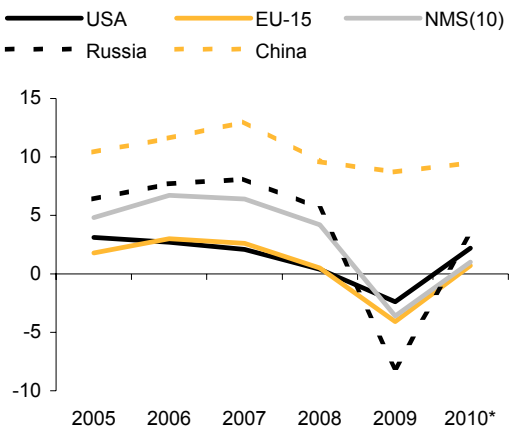
9 Op. cit.; OECD, *Economic Outlook*, 86, November 2009, p. 12.

10 European Commission, *Interim forecast February 2010*, p. 1.; European Commission, *European Economic Forecast*, Autumn (October) 2009, pp. 20-21.

Figure 1

GDP in selected regions and countries, 2005-2010

real change in % against preceding year

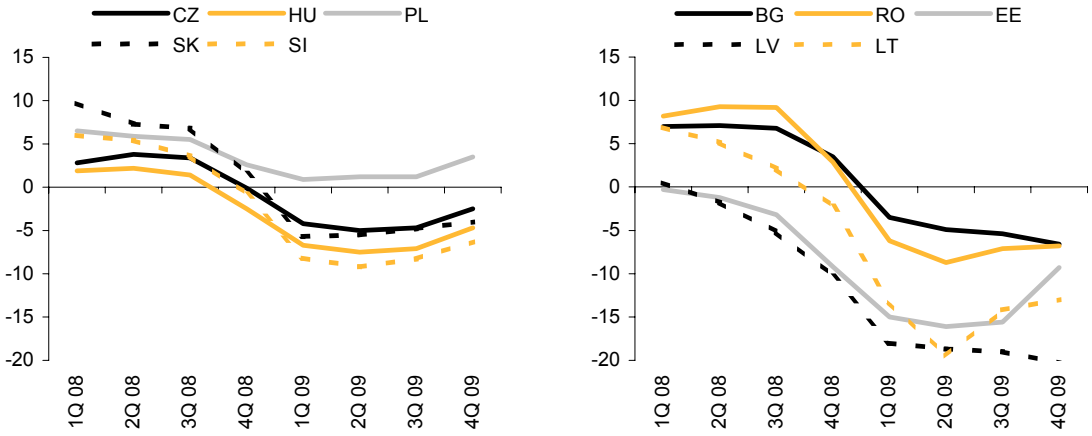


Source: wiiw Database incorporating Eurostat and national statistics; IMF, World Economic Outlook, Update January 2010.
*Forecasts by wiiw and IMF.

Figure 2

Quarterly GDP

real change in % against preceding year



Source: Eurostat and national statistics.

Quarterly GDP data (Figure 2) show that the recession took on a similar shape in the individual NMS economies.[11] Except for the Baltic States where the decline started earlier and was much steeper, contraction gained momentum in the fourth quarter of 2008 and remained pronounced over the first three quarters of 2009. In the EU-27, the third quarter of 2009 brought about a tangible easing of the recession (with 1.7 percentage points less contraction than in the second quarter). In the NMS

[11] Eurostat data are not necessarily identical with respective data published by national statistical offices.

group, however, only in Lithuania and Romania was the decline (5.3 and 1.6 percentage points, respectively) considerably less than in the previous quarter (see Table 1). Preliminary fourth quarter data indicate an easing of the GDP decline in the NMS region except for Bulgaria and Latvia. Growth in Poland seems to have accelerated. We must bear in mind, however, that an improvement in fourth quarter data may not necessarily reflect an improvement in real development terms; it may, however, reflect, at least in part, the low basis for comparison in the fourth quarter of 2008, when the recession initially unfolded.

In the EU-27, the pattern of GDP change in the past year was characterized by a relatively mild (1.7%) decline in consumption and a marked contraction (11.4%) of investment (see Table 2). All NMS, with the exception of Slovakia and, to a certain extent, the Czech Republic, deviated substantially from that pattern. Bulgaria, Hungary, Romania and the three Baltic States did not experience any smoothing of consumption expenditures; in fact, they suffered a much steeper decline in household consumption than that observed in the EU-27. Successful smoothing, however, was to be observed in Poland, the Czech Republic and Slovakia, and the decline was also relatively mild in Slovenia. As for gross fixed capital formation, the Baltic States, Bulgaria and Slovenia experienced an implosion of investments (ranging from -24% to -38%). At the other end of the scale, contraction in investment in Hungary was lower than the EU average, while Poland recorded hardly any contraction at all. The most unfavourable combination, a dramatic double digit decline in both consumption and investment, occurred in the Baltic States and Romania. The best performer in all respects, not only among the NMS but in the EU-27 as well, was Poland; it recorded a positive GDP change in 2009.

The difference between the growth patterns in the NMS and the euro area is illustrated from another angle in Table 1, which contains data on the contribution of individual GDP components to economic growth/decline.[12] The most conspicuous response of the NMS to the crisis was a radical depletion of inventories. Whereas in the euro area the decline in inventories contributed negatively to GDP change, yet remained below 1 percentage point in any quarter observed, in most of the NMS the same component's negative contribution was extremely large. Rising to a quarterly maximum of nearly 14 percentage points in the Baltic States, it ranged from 2.5 to 4 percentage points in the Czech Republic, Slovakia and Slovenia, with 8 to 11 percentage point quarterly peaks in Bulgaria and Hungary. Even the positive outlier Poland recorded a depletion of inventories some 3 to 4 times greater than that recorded in the euro area.

This major, in some cases drastic, drop in stocks is one of the explanatory factors behind the other noticeable deviation in the NMS GDP pattern of change compared to the EU-27: the dramatic improvement in net exports. Shrinking export opportunities, weak domestic demand and a dearth of funds created an atmosphere of profound pessimism (except for Poland) which motivated a reduction in output and a cutback in import purchases for production, consumption or investment. Outstanding orders were met from stocks, but inventories were no longer restocked as a matter of

[12] The source, the Eurostat database, contained no data for Romania. All 2009 data are preliminary; data on inventories are typically subject to substantial revisions.

Table 1

Contributions to GDP growth in 2008 and 2009 (in percentage points)

	2008 1 Q	2 Q	3 Q	4 Q	2009 1 Q	2 Q	3 Q
EU-27							
GDP growth rate (%)	**1.9**	**2.0**	**1.0**	**-1.6**	**-5.3**	**-5.8**	**-4.1**
Euro area [1]							
GDP growth rate (%)	**1.8**	**1.9**	**0.7**	**-1.8**	**-5.3**	**-5.7**	**-3.9**
Final consumption expenditure	1.1	0.9	0.6	-0.1	-0.4	-0.2	-0.1
Household final consumption	0.7	0.5	0.2	-0.5	-0.9	-0.7	-0.5
Government final consumption	0.3	0.4	0.4	0.5	0.6	0.5	0.4
Gross capital formation	0.2	0.3	0.0	-0.6	-3.0	-3.8	-2.8
Gross fixed capital formation	0.4	0.5	0.0	-1.3	-2.4	-2.9	-2.3
Change in inventories	-0.2	-0.2	0.0	0.7	-0.6	-0.9	-0.5
Balance of goods and NFS	0.5	0.6	0.1	-1.2	-1.9	-1.7	-1.1
Exports of goods and NFS	1.8	1.9	0.8	-2.7	-7.1	-7.8	-5.5
Imports of goods and NFS	1.2	1.3	0.7	-1.5	-5.2	-6.1	-4.4
GDP (calculated from expenditures)	1.8	1.9	0.7	-1.8	-5.4	-5.7	-4.0
Statistical discrepancy [2]	0.0	0.0	0.0	0.0	0.1	0.0	0.1
Czech Republic							
GDP growth rate (%)	**2.8**	**3.8**	**3.4**	**-0.1**	**-4.2**	**-5.0**	**-4.7**
Final consumption expenditure	1.9	2.3	2.4	1.1	2.0	1.6	1.6
Household final consumption	2.0	1.9	1.8	1.1	1.1	0.8	0.5
Government final consumption	-0.2	0.4	0.6	-0.1	0.9	0.8	1.0
Gross capital formation	-0.9	-2.2	-1.9	1.9	-3.9	-5.7	-6.3
Gross fixed capital formation	0.2	-0.4	-0.3	-1.1	-1.4	-1.7	-2.3
Change in inventories	-1.1	-1.8	-1.6	2.9	-2.5	-4.0	-3.9
Balance of goods and NFS	1.9	3.7	2.9	-3.1	-2.4	-1.2	-0.2
Exports of goods and NFS	11.4	11.5	6.2	-8.6	-16.4	-13.7	-6.5
Imports of goods and NFS	9.5	7.9	3.3	-5.4	-13.9	-12.6	-6.4
GDP (calculated from expenditures)	2.8	3.8	3.4	-0.2	-4.3	-5.2	-4.9
Statistical discrepancy [2]	0.0	0.0	0.0	0.1	0.1	0.2	0.2
Hungary							
GDP growth rate (%)	**1.9**	**2.2**	**1.4**	**-2.5**	**-6.7**	**-7.5**	**-7.1**
Final consumption expenditure	0.5	0.8	0.9	-3.7	-4.5	-3.6	-5.8
Household final consumption	0.3	0.8	0.1	-2.1	-3.9	-3.4	-5.1
Government final consumption	0.2	0.0	0.7	-1.5	-0.4	-0.1	-0.6
Gross capital formation	-0.7	3.0	0.7	1.5	-5.7	-11.5	-7.5
Gross fixed capital formation	-0.4	0.2	0.3	0.1	-1.1	-0.6	-1.4
Change in inventories	-0.3	2.8	0.3	1.3	-4.5	-10.9	-6.1
Balance of goods and NFS	1.9	-1.7	-0.1	-0.2	2.9	7.3	6.1
Exports of goods and NFS	14.0	9.1	3.7	-5.5	-16.6	-12.0	-5.7
Imports of goods and NFS	12.1	10.8	3.8	-5.3	-19.5	-19.3	-11.7
GDP (calculated from expenditures)	1.7	2.2	1.4	-2.5	-7.2	-7.8	-7.3
Statistical discrepancy [2]	0.2	0.0	0.0	0.0	0.5	0.3	0.2
Poland							
GDP growth rate (%)	**6.5**	**5.9**	**5.5**	**2.6**	**0.9**	**1.2**	**1.2**
Final consumption expenditure	5.3	4.5	4.6	5.4	3.7	0.8	1.5
Household final consumption	4.1	3.6	3.2	3.4	2.6	1.0	1.5
Government final consumption	1.2	0.8	1.3	2.0	1.1	-0.3	0.1
Gross capital formation	2.6	2.2	1.1	-2.5	-4.9	-3.0	-3.1
Gross fixed capital formation	2.1	2.8	1.0	1.3	-0.1	-0.3	-0.1
Change in inventories	0.5	-0.6	0.1	-3.8	-4.8	-2.7	-3.0
Balance of goods and NFS	-1.5	-0.9	-0.3	-0.4	1.2	2.6	2.0
Exports of goods and NFS	4.7	4.8	3.9	-1.1	-6.6	-6.7	-4.9
Imports of goods and NFS	6.2	5.7	4.1	-0.7	-7.8	-9.3	-6.9
GDP (calculated from expenditures)	6.4	5.8	5.4	2.5	0.0	0.4	0.4
Statistical discrepancy [2]	0.1	0.1	0.1	0.1	0.9	0.8	0.8
Slovakia							
GDP growth rate (%)	**9.7**	**7.3**	**6.8**	**1.6**	**-5.7**	**-5.5**	**-4.8**
Final consumption expenditure	4.7	5.1	4.2	3.2	-0.3	1.4	-0.3
Household final consumption	4.5	3.4	3.2	2.4	-0.5	0.3	-0.2
Government final consumption	0.2	1.6	0.9	0.8	0.2	1.1	-0.1
Gross capital formation	4.7	2.1	3.1	-2.1	-3.6	-8.1	-5.9
Gross fixed capital formation	1.6	2.5	0.2	-2.0	-0.9	-4.8	-2.8
Change in inventories	3.2	-0.4	2.9	-0.2	-2.7	-3.3	-3.1
Balance of goods and NFS	0.2	0.2	-0.5	0.4	-2.6	1.7	1.5
Exports of goods and NFS	9.9	7.2	2.4	-6.7	-23.3	-17.8	-11.7
Imports of goods and NFS	9.7	6.9	2.9	-7.2	-20.7	-19.5	-13.2
GDP (calculated from expenditures)	9.6	7.4	6.8	1.5	-6.5	-5.0	-4.8
Statistical discrepancy [2]	0.1	-0.1	0.0	0.1	0.8	-0.5	0.0

	2008 1 Q	2 Q	3 Q	4 Q	2009 1 Q	2 Q	3 Q
Slovenia							
GDP growth rate (%)	**6.0**	**5.4**	**3.6**	**-0.8**	**-8.2**	**-9.2**	**-8.3**
Final consumption expenditure	3.2	2.8	0.8	1.9	0.3	-0.8	-0.3
Household final consumption	2.1	1.8	-0.2	0.7	-0.5	-1.6	-1.0
Government final consumption	1.1	0.9	1.0	1.3	0.9	0.8	0.7
Gross capital formation	4.2	3.2	2.2	-3.7	-9.8	-10.3	-10.6
Gross fixed capital formation	4.7	3.4	1.6	-0.9	-6.3	-7.6	-7.0
Change in inventories	-0.5	-0.2	0.6	-2.8	-3.5	-2.8	-3.6
Balance of goods and NFS	-1.4	-0.5	0.7	0.9	1.2	1.7	2.5
Exports of goods and NFS	4.5	5.9	2.3	-4.3	-13.8	-15.1	-11.2
Imports of goods and NFS	5.9	6.4	1.7	-5.2	-15.0	-16.8	-13.7
GDP (calculated from expenditures)	6.0	5.4	3.6	-0.8	-8.3	-9.4	-8.5
Statistical discrepancy [2)]	0.0	0.0	0.0	0.0	0.1	0.2	0.2
Bulgaria							
GDP growth rate (%)	**7.0**	**7.1**	**6.8**	**3.5**	**-3.5**	**-4.9**	**-5.4**
Final consumption expenditure	4.4	4.1	4.3	1.2	-4.9	-3.0	-3.2
Household final consumption	5.0	3.7	4.2	1.0	-4.9	-3.8	-3.4
Government final consumption	-0.7	0.3	0.1	0.2	-0.1	0.6	0.1
Gross capital formation	1.7	11.5	-0.1	3.1	-8.4	-13.9	-17.8
Gross fixed capital formation	4.3	8.3	6.1	5.4	-4.3	-5.7	-11.4
Change in inventories	-2.7	3.2	-6.2	-2.3	-4.2	-8.2	-6.4
Balance of goods and NFS	0.5	-8.6	-0.8	-0.6	8.1	12.1	13.9
Exports of goods and NFS	6.0	3.5	2.6	-3.3	-11.6	-10.4	-4.4
Imports of goods and NFS	5.5	12.1	3.4	-2.7	-19.6	-22.6	-18.3
GDP (calculated from expenditures)	6.6	6.9	3.4	3.7	-5.3	-4.8	-7.1
Statistical discrepancy [2)]	0.4	0.2	3.4	-0.2	1.8	-0.1	1.7
Romania[3)]							
GDP growth rate (%)	**8.2**	**9.3**	**9.2**	**2.9**	**-6.2**	**-8.7**	**-7.1**
Estonia							
GDP growth rate (%)	**-0.3**	**-1.2**	**-3.2**	**-9.2**	**-15.0**	**-16.1**	**-15.6**
Final consumption expenditure	1.1	-0.2	-2.3	-5.8	-9.9	-10.9	-9.0
Household final consumption	0.1	-1.2	-2.7	-6.5	-9.9	-11.0	-10.4
Government final consumption	0.9	0.8	0.4	0.5	-0.1	0.1	-0.2
Gross capital formation	-6.7	-6.8	-11.4	-15.5	-13.0	-21.3	-13.6
Gross fixed capital formation	0.1	-4.2	-5.0	-7.7	-8.9	-11.9	-12.0
Change in inventories	-6.8	-2.5	-6.5	-7.8	-4.2	-9.5	-1.7
Balance of goods and NFS	4.6	5.6	9.9	9.2	10.5	15.9	13.6
Exports of goods and NFS	-1.3	-3.5	3.7	-0.9	-12.2	-8.1	-7.3
Imports of goods and NFS	-5.9	-9.1	-6.2	-10.1	-22.6	-24.0	-20.9
GDP (calculated from expenditures)	-1.0	-1.4	-3.9	-12.2	-12.5	-16.3	-9.1
Statistical discrepancy [2)]	0.7	0.2	0.7	3.0	-2.5	0.2	-6.5
Latvia							
GDP growth rate (%)	**0.5**	**-1.8**	**-5.2**	**-10.3**	**-18.0**	**-18.7**	**-19.0**
Final consumption expenditure	1.6	-1.4	-4.5	-9.1	-12.4	-17.7	-20.4
Household final consumption	1.1	-1.5	-4.4	-8.8	-11.3	-15.6	-17.5
Government final consumption	0.6	0.3	0.0	0.2	-0.2	-1.2	-2.1
Gross capital formation	-7.7	-9.5	-10.4	-11.7	-22.0	-17.3	-12.8
Gross fixed capital formation	-2.8	-4.6	-6.3	-5.7	-9.1	-11.4	-11.8
Change in inventories	-4.8	-4.9	-4.1	-6.0	-12.8	-5.9	-1.0
Balance of goods and NFS	6.2	8.5	9.6	10.6	13.6	14.4	13.9
Exports of goods and NFS	1.4	0.2	-0.9	-2.5	-7.5	-8.1	-6.3
Imports of goods and NFS	-4.8	-8.3	-10.5	-13.2	-21.2	-22.5	-20.2
GDP (calculated from expenditures)	0.1	-2.4	-5.3	-10.1	-20.7	-20.6	-19.2
Statistical discrepancy [2)]	0.4	0.6	0.1	-0.2	2.7	1.9	0.2
Lithuania							
GDP growth rate (%)	**6.9**	**5.1**	**2.1**	**-2.2**	**-13.3**	**-19.5**	**-14.2**
Final consumption expenditure	9.0	6.4	4.3	-3.4	-10.2	-11.7	-10.8
Household final consumption	7.7	4.9	2.7	-5.0	-10.7	-11.7	-10.4
Government final consumption	1.2	1.5	1.4	1.5	0.5	0.0	-0.4
Gross capital formation	5.4	-1.8	-0.3	-4.3	-23.1	-19.8	-15.9
Gross fixed capital formation	0.3	-0.8	-1.6	-4.7	-9.2	-11.2	-10.9
Change in inventories	5.2	-1.0	1.3	0.5	-13.9	-8.6	-5.1
Balance of goods and NFS	-7.7	0.4	-2.0	5.8	18.7	10.9	11.9
Exports of goods and NFS	6.1	8.5	7.0	5.3	-7.7	-14.3	-9.9
Imports of goods and NFS	13.8	8.2	9.0	-0.5	-26.4	-25.2	-21.7
GDP (calculated from expenditures)	6.7	5.0	2.0	-1.9	-14.6	-20.6	-14.8
Statistical discrepancy [2)]	0.2	0.1	0.1	-0.3	1.3	1.1	0.6

1) Euro area with 15, from 2009 with 16 countries. - 2) The difference between GDP reported and calculated from expenditures, respectively. - 3) Comparable data for Romania were not available at the time of writing.

Source: wiiw estimates incorporating Eurostat.

routine. This helped to reduce imports to a much larger extent than exports. More resilient export performance was possible because the EU-15, the main NMS export markets, did not deplete their inventories to the same dramatic degree and their demand for imports in general and for NMS export products in particular did not drop to the same extent as import demand in the NMS. The different patterns are reflected spectacularly in the figures for net exports. In the period between the fourth quarter 2008 and the third quarter 2009, euro area net exports contributed negatively to the GDP each quarter in the order of 1.1 to 1.9 percentage points. This was not the case in most of the NMS. The positive contribution of net exports reached double digits in the Baltic States and Bulgaria. In Hungary net exports also played an outstanding role in softening the GDP decline – with 3 to 7 percentage points in the period concerned. In Poland and Slovenia, its positive contribution to GDP change was 1 to 2.5 percentage points. Slovakia and the Czech Republic are the two outliers. In both countries inventories underwent the same slimming diet as in other NMS, but in the Czech Republic the decline in imports did not outpace the contraction of exports, while in Slovakia exports increased only marginally faster than imports. In Slovakia, the reason may well have been the (all too) ambitious SKK/EUR conversion rate in the wake of adopting the euro and the resultant reduced competitiveness of Slovak firms on both foreign and domestic markets. In the Czech Republic, unlike Slovakia, the exchange rate depreciated at an early stage during the crisis. Nevertheless owing to the gradual strengthening of the koruna since spring 2009, many of the exchange rate related competitiveness gains have been lost. Moreover, in the Czech Republic consumption underwent 'smoothing'; its positive contribution to GDP change was hardly less than before the crisis (Q1-Q3 in 2008). This, however, had a price tag attached to it in terms of a lower decline in imports than exports; net exports thus contributed negatively to GDP change.

Table 2

Consumption and Investment

real change in % against preceding year

	Household final consumption					Gross fixed capital formation				
	2008	2009 [1]	2010	2011	2012	2008	2009 [1]	2010	2011	2012
				Forecast					Forecast	
Czech Republic [2]	3.6	1.5	1	2	3	-1.5	-8.0	0	4	6
Hungary	-0.5	-7.0	-1.5	1	2	0.4	-5.0	-1	9	10
Poland	5.9	2.3	3	5	5	8.1	-0.3	4	8	12
Slovakia	6.1	0	2	3	4	1.8	-12	1	4	6
Slovenia	2.1	-2.5	1	2	2.5	7.7	-23.5	1	4	5
Bulgaria	4.9	-6	0	3	3.5	20.4	-24.9	-6	6	10
Romania	9.5	-12	-1	1	2	16.2	-16	3	7	9
Estonia	-4.8	-18	-10	-3	3	-12.1	-33	-8	8	12
Latvia	-5.5	-24	-8	-3	1	-15.6	-35	-12	-1	2
Lithuania	3.6	-17.5	-6	-1	2	-6.5	-38	-8	5	6
EU-27	0.8	-1.7	0.2	1.2	.	-0.4	-11.4	-2	2.5	.

1) Preliminary and wiiw estimates.

Source: wiiw Database incorporating Eurostat statistics. Forecasts by wiiw and European Commission (Economic Forecast, Autumn 2009) for EU-27.

It must be pointed out that the recent statistics relating to GDP components are far from flawless. As figures for 2009 in the line 'Statistical discrepancy' in Table 1 show, the officially reported quarterly GDP growth rates and those calculated through adding each component's contribution to the GDP change are not always identical, even though they should be. The discrepancy is strikingly high in the case of the Baltic States and in certain quarters in Bulgaria, Poland and Slovakia as well.

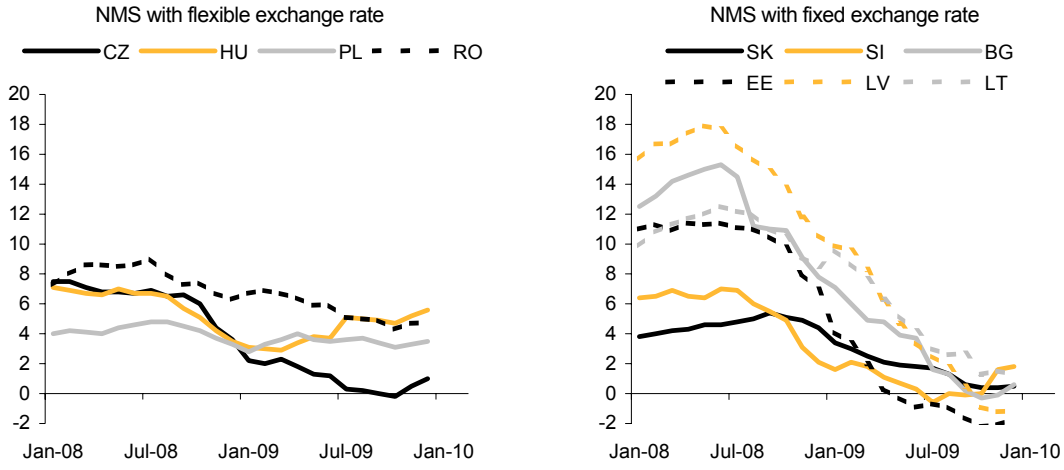
With inventory changes playing such a prominent role in NMS recent economic performance, the question is justified whether re-stocking will take place at a similar rate in 2010-2011, thus lending a similarly strong push to recovery as it did to recession in 2009. As import demand in the EU is likely to experience a less speedy upturn than was the case with the pace of decline, the positive contribution of re-stocking for growth will be somewhat protracted. Ultimately, however, things will bounce back. That, however, will have an immediate deleterious effect on net export balances.

The considerable drop in NMS economic performance occurred in a deflationary external and internal environment. Consumer price inflation declined in each country, but with noticeable differences (see Figure 3). In three of the four NMS with flexible exchange rates, disinflation was mild (Hungary, Poland and Romania). The only exception was the Czech Republic, a traditionally 'inflation-resistant' economy, where similar to the NMS with fixed exchange rates, deflation or near-deflation came about in the second half of last year, with a minuscule correction at the end of the year.

Figure 3

Consumer prices

change in % against preceding year



Source: wiiw Database incorporating national statistics.

Highly skilled employees have again the better cards

The crisis brought about a decline in employment in all the NMS except Poland (see Table 3). Labour market contraction reached dramatic proportions in the Baltic States. That notwithstanding, in the Czech Republic, Slovenia and Romania employment shrinkage was less than in the EU-15.

Unemployment rates recorded remarkable increases everywhere, but they soared to extreme heights by any standards in the Baltic States from what had been moderate starting levels in 2008. Nevertheless, in half of the NMS countries unemployment rates last year were lower than in the EU-15.

Table 3

Employment and unemployment

	employed persons change in % against preceding year					unemployment rate in %				
	2008	2009 [1]	2010	2011	2012	2008	2009 [1]	2010	2011	2012
				Forecast					Forecast	
Czech Republic	1.6	-1.4	-1.4	0	1	4.4	6.7	8.5	8.5	7.5
Hungary	-1.2	-2.7	-0.1	1	1	7.8	10.3	10.5	10	9.3
Poland	3.7	0	-0.5	0.5	2	7.1	8.5	10	9	8.5
Slovakia	3.2	-3	-2	0	1	9.5	12.3	13	13	12
Slovenia	1.1	-1.5	-1.5	0	1	4.4	6	7	7	6.5
NMS-5 [2]	*2.5*	*-0.9*	*-0.8*	*0.4*	*1.6*	*6.9*	*8.7*	*10.1*	*9.4*	*8.7*
Bulgaria	3.3	-3	-4.6	1.6	1.0	5.6	6.7	9.0	8.5	8
Romania	0.2	-1.3	-1	0	1	5.8	7	8.5	8	6
Estonia	0.2	-9	-1	2	2	5.5	15	16	14	13
Latvia	0.6	-13	-8	0	3	7.5	18	22	20	17
Lithuania	-0.9	-6.6	-3	3	2	5.8	13.5	15	13	12
NMS-10 [2]	*1.8*	*-1.8*	*-1.4*	*0.5*	*1.4*	*6.5*	*8.7*	*10.2*	*9.5*	*8.4*
EU-15	*1.0*	*-1.9*	*-1.4*	*0.2*	*.*	*7.1*	*9.1*	*10.3*	*10.3*	*.*
EU-27	*1.2*	*-1.9*	*-1.4*	*0.3*	*.*	*7.0*	*9.0*	*10.3*	*10.1*	*.*

1) Preliminary and wiiw estimates. - 2) wiiw estimate.

Source: wiiw Database incorporating Eurostat statistics. Forecasts by wiiw and European Commission (Economic Forecast, Autumn 2009) for EU-15 and EU-27.

As data in Table 4 confirm, a shift in employment growth to the benefit of highly skilled labour and to the detriment of medium- but especially low-skilled labour has been a long-term process in the EU-27[13]. The speed of this realignment is an important indicator of the pace of modernization in an economy. The crisis accelerated this process – also in the NMS. In the first three quarters of the previous year, the Czech Republic, Poland and, to a lesser extent, Slovakia performed well in this respect, with growth in the rate of employment in the highly skilled segment far surpassing the EU average. Slovenia had enjoyed a very good record in this respect in 2000-2007; however, in the current crisis, the relevant indicator corresponded to that of the EU-27, as was the case in Hungary and Romania. Bulgaria's indicators in this field, however, are disappointing. The Baltic States constitute a separate category; their growth rates in terms of highly skilled labour are not impressive

[13] See, for instance, R. Stehrer, T. Ward and E. F. Macías, 'Changes in the Structure of Employment in the EU and their Implications for Job Quality', *wiiw Research Reports*, No. 354, Vienna, May 2009.

Table 4

Employment growth rate by level of education

		2000-2007 annual average growth rate in %	2008 change in % against preceding year	1-3Q 2009 change in % against preceding year
EU-27	Total	1.2	1.2	-1.6
	Low skilled	-1.3	-2.4	-5.6
	Medium skilled	1.8	1.3	-2.2
	High skilled	3.9	4.2	2.9
Czech Republic	Total	0.7	1.6	-1.1
	Low skilled	-4.7	-1.5	-8.6
	Medium skilled	0.8	0.8	-2.4
	High skilled	3.3	7.0	8.0
Hungary	Total	0.4	-1.2	-2.5
	Low skilled	-4.1	-2.3	-9.6
	Medium skilled	0.5	-3.2	-2.8
	High skilled	3.9	5.6	2.3
Poland	Total	0.7	3.7	0.8
	Low skilled	-5.5	-1.9	-6.3
	Medium skilled	-0.0	3.4	-1.3
	High skilled	8.0	6.8	9.8
Slovakia	Total	1.8	3.2	-1.8
	Low skilled	-4.3	3.9	-14.4
	Medium skilled	1.5	2.7	-2.6
	High skilled	5.9	5.4	5.4
Slovenia	Total	1.4	1.3	-1.7
	Low skilled	-2.3	-2.6	-8.9
	Medium skilled	0.9	1.7	-2.1
	High skilled	6.0	2.9	3.8
Bulgaria	Total	1.8	3.2	-2.2
	Low skilled	-4.1	6.0	-3.5
	Medium skilled	3.0	2.6	-3.1
	High skilled	3.5	3.3	0.5
Romania	Total	-1.8	0.2	-1.0
	Low skilled	-6.6	-1.2	0.4
	Medium skilled	-0.5	-0.9	-2.6
	High skilled	4.5	7.4	3.1
Estonia	Total	2.1	0.2	-8.7
	Low skilled	0.8	5.0	-23.5
	Medium skilled	1.7	-1.0	-13.4
	High skilled	3.0	0.7	3.3
Latvia	Total	2.5	0.6	-12.1
	Low skilled	3.4	-8.9	-25.1
	Medium skilled	1.6	-1.8	-13.2
	High skilled	4.6	13.1	-3.5
Lithuania	Total	1.2	-0.9	-6.5
	Low skilled	-3.4	-23.2	-15.5
	Medium skilled	5.9	-1.0	-7.7
	High skilled	-3.6	4.8	-2.7

Note: Employment data refer to persons between 17 and 74 years based on LFS (Labour Force Survey) and ISCED 1997 (International Standard Classification of Education).

Source: Eurostat.

when taken on their own (except Estonia), but the same rates of change are more promising in the context of the pronounced contraction in total employment in those economies in general and in the medium- and low-skilled segment in particular.

Productivity and unit labour costs fall – temporarily[14]

Declining employment and rising unemployment notwithstanding (see Table 3), last year's recession (decline of GDP) was much deeper than the fall in the number of workers. The adverse social and labour market effects of the crisis could thus be temporarily mitigated. However, aggregate labour productivity (defined as GDP per employed person) fell in all NMS except Poland during 2009 as labour markets adjust with a lag in times of crisis – at least as far as the number of employed persons is concerned.[15] In countries with flexible exchange rates, international unit labour costs (ULCs, euro-adjusted) still fell in 2009 as the increase in domestic labour costs was more than compensated by currency depreciation (particularly so in Poland – see left part in Figure 4 and Tables A2-A3 in the Appendix for detailed data). In countries with fixed exchange rates (including the two eurozone members Slovakia and Slovenia) unit labour costs have grown considerably (except in Estonia where nominal wages fell) and their international cost competitiveness deteriorated during 2009 – see right part in Figure 4.

wiiw forecasts for 2010-2012 reckon with another drop in employment in 2010 and with only modest employment growth in the following years as labour markets will gradually adjust to the new post-crisis situation (Table 3). Together with the expectation of only moderate GDP growth in the years to come (and a return to the longer-term trend of real currency appreciation), international ULCs are generally expected to resume their growth in most NMS – the exceptions being Bulgaria and the Baltic States where employment is projected to fall more strongly than GDP. Moreover, the Baltic States will be forced to continue their 'internal devaluations', that is, to cut nominal wages even more and to restore their international costs competitiveness.

Figure 5 provides an international comparison of ULC levels using Austria as a benchmark (detailed data, also for other countries, are provided in the Appendix). The 'floaters' (the Czech Republic, Hungary, Poland and Romania) temporarily improved their competitive cost position in 2009, in some cases (such as Poland – for the reasons see the above discussion) quite considerably. On the other hand, all 'fixers' suffer from deteriorating costs competitiveness, again with the exception of the Baltic States due to their internal devaluations. Apart from Slovenia (and the candidate country Croatia – see Table A2 in the Appendix), all NMS have unit labour cost levels of less than half of those observed in Austria (with Bulgaria being the extreme case with a ULC level less than 30% of Austria in 2009). With the transitory labour mobility restrictions for NMS workers expiring in 2011 (in 2013 for Bulgaria and Romania) the labour cost differentials remain still substantial.

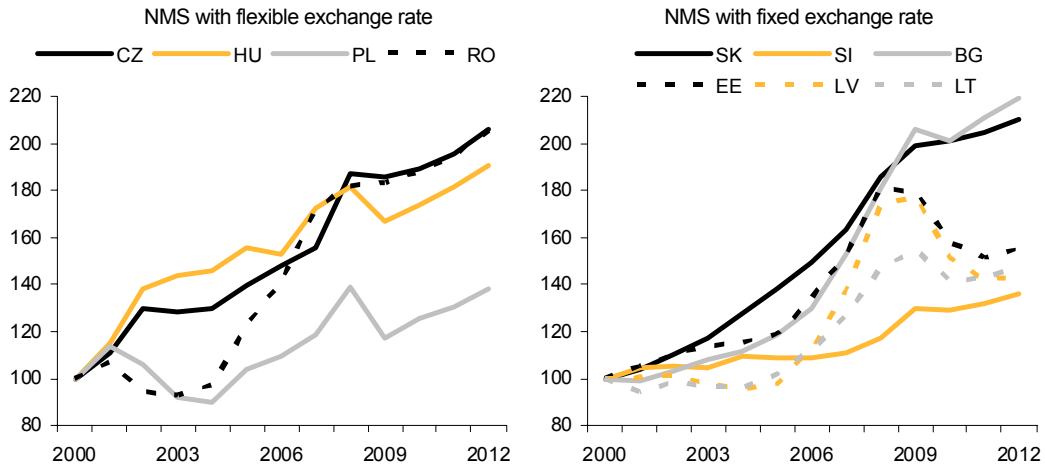
[14] This section was written by Peter Havlik (wiiw).

[15] The number of hours worked may have declined more than the number of employed persons due to various shorter work week schemes applied during 2009, for example, in the Czech and Slovak car industry. Data on hours worked in 2009 are not yet available,

Figure 4

Aggregate ULCs (at GDP level), EUR-adjusted

2000 = 100

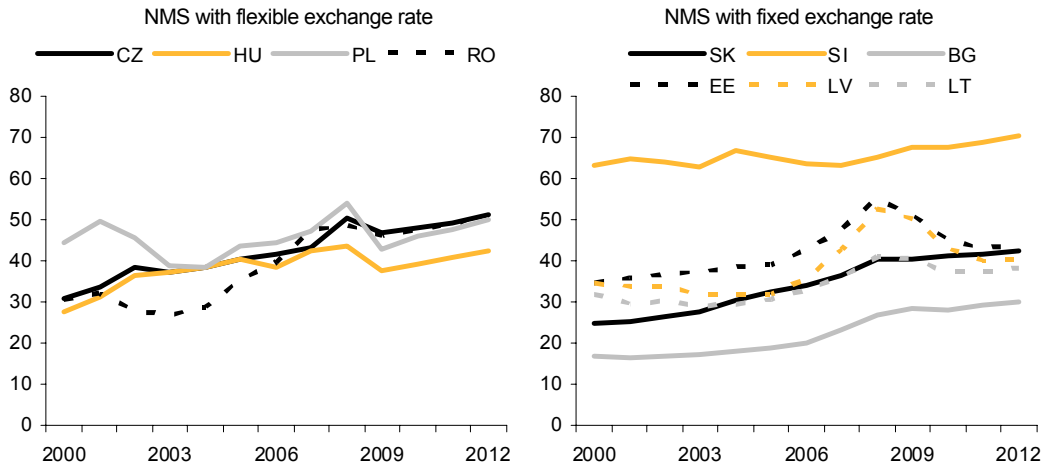


Source: wiiw Database incorporating Eurostat and national statistics, wiiw estimates.

Figure 5

International comparison of aggregate ULCs (at GDP level)

Austria = 100



Source: wiiw Database incorporating Eurostat and national statistics, wiiw estimates.

Signs of recovery are discernible but fragile

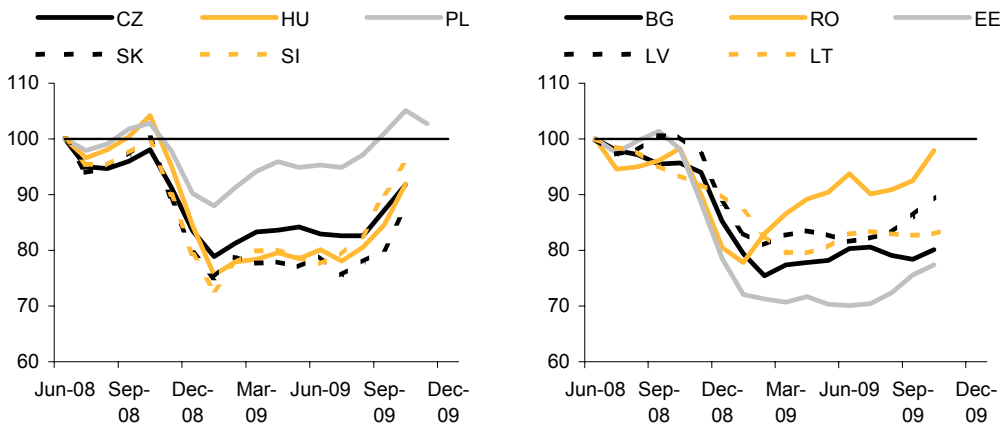
As already mentioned, quarterly GDP growth rates hint at the recession bottoming out and climbing back up. As for the other economic indicators, the question arises whether the NMS region is showing signs of a turnaround. The monthly development of industrial production shows an abrupt decline in the period October 2008 to March 2009 followed by several months' stagnation at a much lower level than before the crisis (see Figure 6). An unambiguous recovery of industrial output began

first in Romania in early 2009; Poland followed suit a few months later and then at the beginning of autumn it was the turn of Slovakia, Hungary, Slovenia, the Czech Republic, Estonia and Latvia. In Bulgaria and Lithuania the trend towards recovery was not clearly discernible until the end of the year. That notwithstanding, by the end of last year, only Poland had surpassed the pre-crisis level of industrial output, with Romania close to attaining it.

Figure 6

Gross industrial production

June 2008 = 100, 3-month moving average



Source: wiiw Database incorporating Eurostat and national statistics.

Table 5

Level of capacity utilization

	2008			2009				2010
	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q
Czech Republic	90.4	88.9	85.3	76.8	74.3	74.8	77.3	78.3
Hungary	85.9	84.4	85.6	74.8	69.3	71.7	73.3	76.4
Poland	81.1	80.0	78.9	74.0	71.9	71.2	71.5	72.4
Slovakia	72.7	71.5	68.9	53.3	50.9	51.9	58.8	58.1
Slovenia	85.3	83.8	82.6	75.2	69.1	69.3	70.7	73.0
Bulgaria	74.7	72.5	71.4	68.9	67.2	62.7	60.6	62.3
Romania	80.9	79.5	78.5	73.9	72.0	70.7	68.9	70.8
Estonia	72.3	69.4	66.6	61.0	56.9	56.5	58.0	61.6
Latvia	68.0	67.1	64.8	59.3	53.8	54.5	54.8	58.0
Lithuania	71.4	70.6	69.3	65.0	60.4	60.1	59.9	61.7
EU-27	83.7	82.7	81.0	74.6	70.8	70.2	71.6	73.1

Source: EU Commission (DG ECFIN), Business and Consumer Survey Results January 2010.

The European Commission's Business and Consumer Surveys[16] regularly address capacity utilization in the European manufacturing industry. The results show that before the crisis, manufacturing firms in five NMS reported 80% and higher capacity utilization, whereas in the Baltic States, Bulgaria and Slovakia substantially lower levels were reported (see Table 5). The pre-crisis level of capacity utilization in the EU-27 was also higher than 80%. The impact of the crisis can be easily tracked in terms of the drop in capacity utilization since the second quarter of 2008. Responses by firms in the latest survey already show an improvement, albeit a rather fragile improvement in the case of the Czech Republic, Estonia, Latvia, Hungary, Slovenia and Slovakia, as well as for the EU-27. No significant change for the better is to be seen in Bulgaria, Lithuania, Poland and Romania.

Table 6

New orders index for total manufacturing

June 2008 = 100

	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Jul-09	Aug-09	Sep-09	Oct-09	Nov-09	Dec-09
Czech Republic	100	97.1	67.3	81.4	86.5	71.0	72.7	83.5	83.5	84.9	.
Hungary	100	98.3	68.1	83.4	75.5	66.6	62.6	81.1	90.1	84.3	.
Poland	100	102.6	85.1	78.7	71.8	80.8	66.2	83.0	78.2	80.4	74.2
Slovakia	100	105.1	61.7	75.5	73.0	69.9	75.9	89.8	88.5	87.0	.
Slovenia	100	104.7	62.0	63.0	66.1	64.5	71.9	81.3	80.8	67.9	.
Bulgaria	100	97.5	76.6	69.3	72.4	75.4	68.8	72.5	76.9	71.1	70.5
Romania	100	111.0	86.8	77.5	84.2	78.8	68.2	89.8	95.9	83.3	76.3
Estonia	100	115.7	72.0	68.4	65.3	61.9	66.8	72.2	67.8	69.7	62.4
Latvia	100	128.3	78.8	87.2	73.5	66.3	70.5	88.5	95.5	86.5	88.8
Lithuania	100	100.8	66.4	61.8	58.4	58.3	55.7	58.3	58.4	55.6	59.0
Austria	100	100.9	65.4	71.5	72.3	72.7	64.5	85.2	74.9	79.8	.
Germany	100	93.5	68.5	72.7	71.9	74.2	65.9	77.9	75.8	77.9	72.7
Italy	100	96.1	70.9	76.5	76.8	86.6	37.8	76.3	72.1	72.1	.
Sweden	100	89.6	68.6	75.7	75.9	60.0	62.1	77.2	71.8	72.4	72.7
EU-15	100	95.0	71.8	75.3	75.4	74.6	58.2	79.5	75.3	75.1	.
EU-27	100	95.6	72.1	75.6	75.5	74.6	59.0	79.8	76.0	75.7	.

Source: Eurostat and own calculations.

In November 2009 the value of new orders in the manufacturing sector amounted to 75% of the pre-crisis (June 2008) level in the EU-15 (see Table 6). Some of the NMS recorded better levels. In the period September–November 2009, new orders in the manufacturing sector were only about 20 percentage points lower than before the crisis in the Czech Republic, Hungary, Slovakia and

[16] European Commission, *Business and Consumer Survey Results*, DG ECFIN, January 2010; http://ec.europa.eu/economy_finance/bcs. In each member state, a representative sample of enterprises complete questionnaires about their current operational capacity. Answers present actual capacity utilization as a percentage of full capacity.

Romania. Less promising are the respective indicators for Slovenia, while in Bulgaria, Estonia and Lithuania they border on the disappointing. Latvia's good record is to some extent misleading as the crisis there began well before the reference date for comparison. Of the important NMS export markets only in Austria do new orders show a more or less encouraging development, while in Germany, Italy and Sweden they are far below the pre-crisis level.

Figure 7a

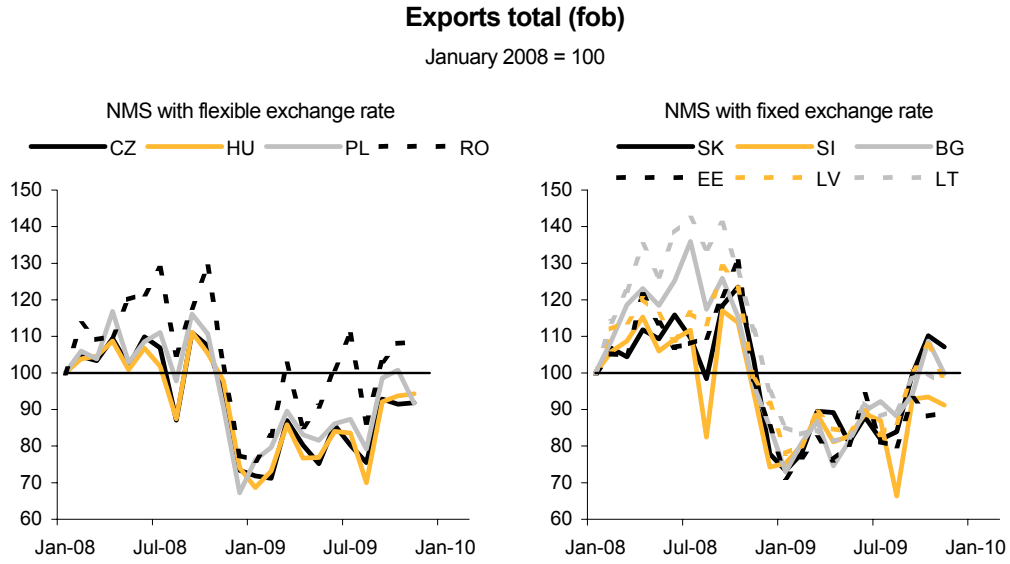
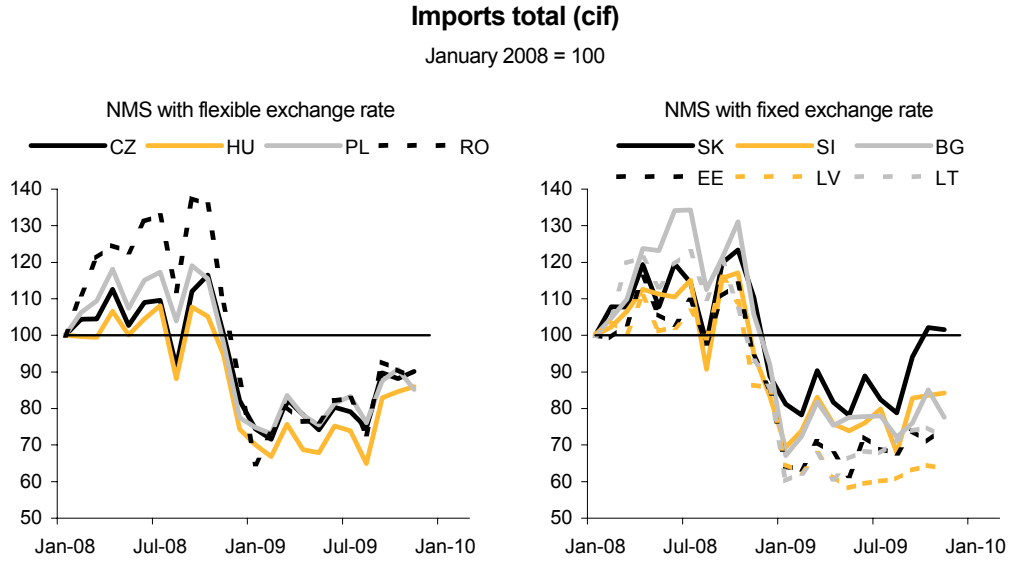


Figure 7b



Source: wiiw Database incorporating national statistics.

NMS export performance deteriorated abruptly in the fourth quarter of 2008 (see Figures 7a and 7b). The almost free fall in deliveries to foreign markets was replaced by a gradual, but appreciable recovery from the early months of 2009 onwards. That notwithstanding, up to the end of 2009 none of the NMS countries has managed to attain the peak level of exports they enjoyed before the crisis. There seems to be no difference in the export performance between countries with flexible or fixed exchange rates.

According to the earlier quoted European Commission's Business and Consumer Survey Results the export expectations for the months ahead of the respondent firms were substantially better in each NMS in January 2010 than in the preceding quarters. This points to a gradual improvement since the most pessimistic results were registered in the first quarter of 2009. In Lithuania, Hungary and Slovenia firms were already more or less as optimistic about their export prospects as they had been before the crisis in the second quarter of 2008. Expectations were much less optimistic in Bulgaria and Estonia.

Although the employment expectations of firms in the NMS for the coming months have improved to a considerable extent since the spring of the last year, they still are primarily negative. The balance of negative and positive answers to the question 'How do you expect your firm's total employment to change over the next three months?' shows an unambiguous improvement in employment expectations in the second half of the past year and in January 2010. Outliers from the general trend are Bulgaria and Romania, where recent improvements proved weaker. In Lithuania and Slovakia respondent firms seem more persistently pessimistic than in other NMS.

In conclusion, the various indicators reviewed above suggest unambiguously that even allowing for different countries to a different extent, the NMS emerged from the trough of the crisis in the final quarter of 2009. Capacity utilization levels, industrial output and export growth rates, order books in the manufacturing sector and, last but not least, diminishing negative expectations concerning employment and exports – all point to a turnaround, an upswing in economic activities on the approach path.

Radically improving current accounts, drastically declining capital inflow

One of the most important features of the evolving post-crisis world economy is the radical shrinkage of the previous huge current account deficits. Figures in Table 7 show that four of the ten NMS (Romania, Lithuania, Latvia and Bulgaria) had cultivated exorbitant imbalances immediately before the crisis, ranging from 12 to over 25% of the GDP. All other economies in the region (except for the Czech Republic) maintained smaller, but still fairly high current account deficits (5 to 7% of their GDP). Data for 2009 display how radical the turnaround in this field has been. The explanation for this phenomenon is two-fold. First, goods and services trade balances improved to a large extent across the board. Second, due to the crisis, foreign-owned enterprises accrued much lower profits than before the crisis. This, in turn, improved the income balance component of the current account and, in turn, the whole current account balance.

Table 7

Foreign financial position

in % of GDP

	Current account					Gross external debt [1]			Reserves of National Bank (excluding gold) [1][2]		
	2008	2009 [3]	2010	2011	2012	2007	2008	2009 [3]	2007	2008	2009 [3]
	Forecast										
Czech Republic	-3.1	-0.7	-1.1	-1.3	-1.2	38.9	42.1	43	17.7	19.2	21.2
Hungary	-7.1	0.5	-1.3	-2.2	-2.4	99.3	122.3	131.5	16.3	23.9	32.2
Poland	-5.1	-1.6	-1.7	-2.5	-3.1	48.6	56.4	60	13.0	13.8	16.1
Slovakia	-6.6	-2.9	-3.8	-4.3	-4.6	54.6	55.5	78	22.2	18.9	0.7
Slovenia	-6.2	-0.6	-1.1	-1.9	-2.3	100.5	105.3	116.1	1.9	1.7	1.9
Bulgaria	-25.4	-8.6	-7.8	-8.5	-9.3	100.3	108.4	108.4	38.8	35.0	35.3
Romania	-11.6	-4.3	-5.6	-6.5	-7.1	50.8	56.6	66.4	22.0	20.3	23.9
Estonia	-9.4	4.7	4.2	2.2	-3.5	111.0	118.5	123	14.3	17.5	19.9
Latvia	-13.0	8.7	3.4	1.7	-0.6	126.4	129.5	151	18.2	15.3	24.1
Lithuania	-11.9	1.9	3.2	-0.8	-2	71.9	71.6	82	18.1	13.8	15.5

1) End of period. - 2) Forex reserves, SDR and reserve position with the IMF. Due to euro introduction (Slovenia: from 2007, Slovakia from 2009) only foreign currency reserves denominated in non-euro currencies are given. - 3) Preliminary and wiiw estimates.

Source: wiiw Database incorporating Eurostat statistics. Forecasts by wiiw.

As Figures 7a and 7b illustrate, both NMS exports and imports fell dramatically in the wake of the global financial and economic crisis even in nominal euro terms. However, in each NMS imports dropped more markedly than exports. In 2009 the gap between nominal export and import growth/decline rates in all but two NMS economies opened wide, to the benefit of export rates, and showed no continuity with the track record of the individual countries in this field (see Table 8 and the previous discussion of contributions to GDP growth). The patterns that emerged showed no variances regardless whether the economies had flexible or fixed exchange rate regimes. The Czech Republic and Slovakia are outliers with no characteristic departures from pre-crisis relative growth rates. The explanation is easier for Slovakia where the high conversion rate of the Slovak koruna to the euro in the process of adopting the euro has resulted in Slovak exports being less competitive than those of other countries. Furthermore, in Slovakia household consumption did not contract last year and imports did not drop to the same extent as in those NMS where consumption decreased. The Czech Republic had fewer problems with an overvalued exchange rate, but the explanation by consumption-induced high imports still holds true. Poland presents a special, exceptionally positive case. Last year, consumption in Poland increased more than marginally while investment hardly declined, despite which the export-import growth rate gap improved by more than 9 percentage points over the period 2008-2009. At least part of this improvement can be attributed to a strong depreciation at the Polish zloty (see below).

Table 8

Difference between export and import annual growth rates

export and imports of goods and non-factor services, BOP data in current euro prices (percentage points)

	2005	2006	2007	2008	2009 [1)]	2010	2011 Forecast	2012
Czech Republic	5.0	0.0	1.9	0.6	0.7	-0.5	1.4	1.7
Hungary	2.9	0.7	3.1	-0.7	6.1	0.8	0.0	-0.8
Poland	4.5	-3.2	-2.8	-3.0	6.1	-0.8	-0.7	-0.9
Slovakia	-1.8	0.7	5.0	-1.4	1.0	-2.8	-1.3	-1.1
Slovenia	1.6	-0.2	-2.1	-1.6	5.7	-0.4	-0.6	-0.5
Bulgaria	-6.9	-1.1	-6.1	-2.1	14.2	3.3	-0.7	-2.3
Romania	-5.4	-5.9	-8.7	3.5	13.8	1.0	-1.7	-1.7
Estonia	1.9	-7.9	-1.0	9.7	11.0	3.7	-0.7	-1.0
Latvia	3.8	-16.2	0.9	12.3	19.9	3.2	3.6	1.1
Lithuania	0.9	-5.1	-6.7	6.7	9.9	3.6	-0.1	-1.3

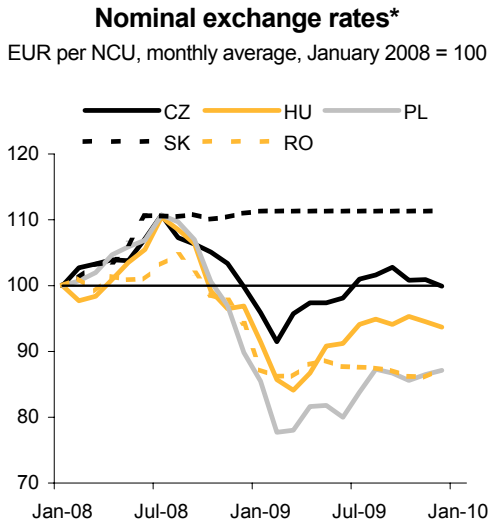
1) Preliminary and wiiw estimates.

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.

The four NMS (the Czech Republic, Hungary, Poland and Romania) that entered the crisis with flexible exchange rate regimes witnessed a marked nominal appreciation of their national currencies up until mid-2008 (see Figure 8). After July 2008, when the nominal appreciation of their exchange rates had peaked, the four countries embarked on a fairly similar course of depreciation. That similarity notwithstanding, the extent of depreciation varied widely in the individual countries, most of all in Poland and least of all in the Czech Republic. The turnaround came in spring 2009. Although nominal appreciation has started anew at a similar pace in all four countries, the Czech Republic has got closer to the pre-crisis level of its exchange rate than either Hungary, Romania or even Poland.

Figure 9 displays the real appreciation of the national currencies against the euro in the NMS. Since in this case differences between the producer price index in the euro area (average) and individual euro area member countries, respectively, play a role, the right-hand box in Figure 9 provides information on real appreciation in Slovenia and Slovakia with euro as legal tender, as well as on Bulgaria and the Baltic States, the four NMS economies with pegged exchange rate regimes. The most remarkable feature of Figure 9 (left-hand box) is that Poland was able to preserve most of its depreciation-related competitiveness gains, less so Hungary, Romania and even less the Czech Republic. That may be the explanation for Poland's surprisingly good foreign trade balance despite growing consumption and stagnating investment the previous year and, indeed, for the last year's GDP growth as well. Of the NMS with fixed exchange rates, Lithuania and Bulgaria, thanks to their marked producer price deflation last year (13.5% and 6.5%, respectively), managed to improve their exchange rate-related competitiveness despite unchanged nominal exchange rates. Estonia and Latvia are caught in the competitiveness trap of fixed (and overvalued) exchange rates.

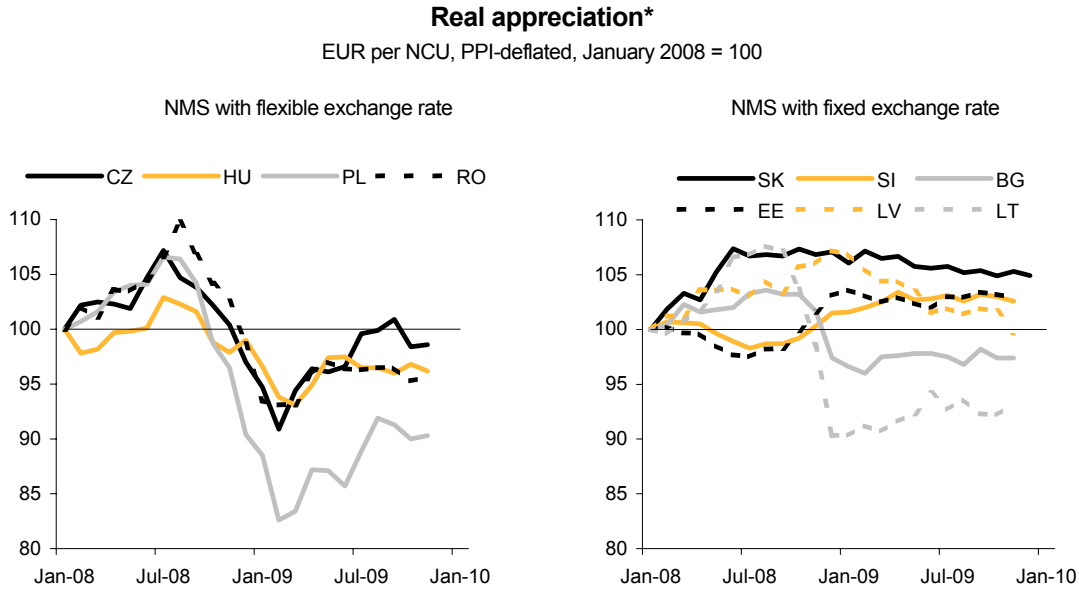
Figure 8



* Values over 100 indicate appreciation relative to January 2008. Euro-fixed series for SK.

Source: wiiw Database incorporating national statistics.

Figure 9



* Values over 100 indicate appreciation relative to January 2008. Euro-fixed series for euro area countries (SK, SI).

Source: wiiw Database incorporating national statistics.

Table 7 shows that gross external debt increased significantly last year, relative to the GDP in each NMS, except the Czech Republic. A substantial part of this increase derives from the diminishing basis for projection (GDP) in real terms. In countries with flexible exchange rates, it is also due to the national currencies on average being weaker in 2009 than in the previous year. In the crisis year

2009, each NMS increased its foreign exchange reserves (relative to the GDP) except for the euro area members, Slovenia and Slovakia.[17] The increase in central bank reserves, however, lagged far behind the increase in gross external debt in Estonia, Latvia and Romania.

Balance of payments data indicate that net capital inflows contracted in each NMS in the first three quarters of 2009 compared to the respective pre-crisis period in 2008 (see Table 9). Only Poland survived the last year with relatively moderate losses (21%). The decline in net capital inflows in the Czech Republic and Hungary was about 40%, in Slovakia 46%, in Romania 68% and in Bulgaria 81%. The figures also point to net outflows from Slovenia and the Baltic States. Although the main discernible trend in Table 13, a steep decline in net inflows, is undoubtedly true, caution should be exercised when interpreting these figures with regard to the extremely high values shown in the line 'Errors and omissions'.

It is worth scrutinizing, however, one important segment of capital inflows in greater detail: foreign direct investment (FDI). FDI has been the engine of modernization and restructuring in the NMS since the early years of transition. At the same time, it has contributed significantly to sustainable external equilibrium as a major item in counterbalancing excessive current account deficits.[18] In the course of the international financial crisis, FDI flows, like other segments of international financial flows, also underwent radical contraction. Although no final data are available on developments for 2009 as a whole, a wiiw estimation for the whole year allows us to draw an initial provisional balance for the previous year (see Table 10). In 2009 Hungary, Slovakia and Slovenia received practically no FDI inflows according to wiiw estimates. From detailed balance of payments data (not displayed in this report) we can see that in both Hungary and Slovakia equity continued to flow into both countries last year, but the subsidiaries of foreign-owned firms credited their parent companies abroad. Furthermore, foreign-owned companies in Hungary dissolved and repatriated their profit reserves.[19] For the other seven NMS there were positive but much smaller inflows than in 2008: the decline in FDI inflows ranged between 44% (Lithuania) and 66% (Latvia), except Poland and Estonia, where contraction remained moderate (around 16% each). Poland's case comes as no surprise since with its good performance the country has excelled during the current crisis. Estonia's relative success is explained by one major privatization deal in the telecom sector. Although the wiiw expects an unambiguous improvement in FDI inflows in 2010, the value of investments received will lag far behind the level of the pre-crisis years 2007 and 2008.

Transfers from the EU budget have been another engine of modernization in the NMS since 2004 and one that has gradually increased in significance. Under crisis conditions those transfers gained in importance, but their real weight is far from being acknowledged. The ever increasing EU transfers over 2007-2013 constitute an important contribution to domestic demand. This is especially

[17] With the accession to the eurozone, Slovenia and Slovakia transferred their foreign exchange reserves to the ECB.

[18] It must be pointed out here that FDI inflow has had also a negative impact on the current account as profits of foreign-owned enterprises appear as a diminishing item in the income balance, a component of the current account.

[19] Calculations by Gábor Hunya (wiiw) based on balance of payments data (wiiw Database).

Table 9

Net capital flows

EUR million

	2008 1-3Q	2009 1-3Q	2008 1-3Q	2009 1-3Q
	Czech Republic		Hungary	
Capital inflow transfer (A)	**4886**	**2951**	**8794**	**5275**
Capital transfer	864	968	454	1035
FDI	4703	93	-62	-1293
Portfolio	1424	3647	1957	-1286
Other capital (loans)	-1758	-1430	5300	6233
Financial derivatives	-347	-327	1145	586
Destination of capital inflow (B)	**3839**	**2493**	**6211**	**4448**
Current account	2315	934	5135	-1051
Increase reserves	1524	1559	1076	5499
Errors & omissions (B-A)	-1048	-457	-2582	-827
	Poland		Slovakia	
Capital inflow transfer (A)	**28165**	**22295**	**3912**	**2116**
Capital transfer	3537	3272	595	402
FDI	6018	5357	1020	-665
Portfolio	1240	8032	1486	-1653
Other capital (loans)	17413	6858	791	3745
Financial derivatives	-43	-1224	20	287
Destination of capital inflow (B)	**19239**	**11582**	**2902**	**690**
Current account	13481	2431	2982	1266
Increase reserves	5758	9151	-80	-576
Errors & omissions (B-A)	-8926	-10713	-1010	-1425
	Slovenia		Bulgaria	
Capital inflow transfer (A)	**1807**	**-240**	**10268**	**1997**
Capital transfer	-13	32	236	381
FDI	100	-540	4618	2230
Portfolio	-682	4348	-448	-170
Other capital (loans)	2362	-4080	5948	-442
Financial derivatives	40	0	-86	-2
Destination of capital inflow (B)	**1553**	**27**	**8379**	**1144**
Current account	1553	174	5658	2212
Increase reserves	0	-147	2721	-1068
Errors & omissions (B-A)	-254	267	-1890	-855
	Romania		Estonia	
Capital inflow transfer (A)	**14215**	**5507**	**1569**	**-684**
Capital transfer	368	252	98	194
FDI	6914	4308	478	-364
Portfolio	263	175	138	-544
Other capital (loans)	6783	815	842	-18
Financial derivatives	-113	-43	13	47
Destination of capital inflow (B)	**13267**	**4750**	**1543**	**-725**
Current account	13043	3453	1304	-433
Increase reserves	224	1297	239	-292
Errors & omissions (B-A)	-951	-757	-26	-41
	Latvia		Lithuania	
Capital inflow transfer (A)	**3121**	**-635**	**2610**	**-404**
Capital transfer	268	348	513	699
FDI	856	64	763	87
Portfolio	226	134	-504	114
Other capital (loans)	1685	-1493	1829	-1342
Financial derivatives	86	313	9	38
Destination of capital inflow (B)	**2866**	**-469**	**2686**	**-381**
Current account	2545	-1208	3480	-299
Increase reserves	321	739	-794	-82
Errors & omissions (B-A)	-255	166	78	24

Source: Eurostat statistics.

important in those NMS where governments did not intervene to curb the drop in domestic demand. Contrary to countercyclical government spending, EU transfers do not create new debt, although their demand-stimulating effect is practically the same. In 2009, these net inflows from the EU are estimated to have reached roughly some 1.5% of the GDP in Hungary and Poland, 1% in the Czech Republic and 0.8% in Slovakia.[20]

Table 10

Foreign direct investment to new EU member states

	Inflow, EUR mn					FDI stock EUR mn
	2007	2008	2009 [1)]	2009 growth in %	2010 forecast	2009 [1)]
Czech Republic	7667	7356	3369	-54.2	5000	90000
Hungary [2)]	4182	3067	0	.	2500	60000
Poland	17241	10036	8384	-16.5	9000	124000
Slovakia	2108	2395	0	.	1000	33000
Slovenia	1106	1313	-80	.	500	11000
NMS-5	*32304*	*24167*	*11674*	.	*18000*	*318000*
Bulgaria	8589	6549	2845	-56.6	2500	36000
Romania	7280	9501	4899	-48.4	4000	50000
Estonia	1998	1317	1106	-16.1	1000	11000
Latvia	1705	869	292	-66.4	200	8000
Lithuania	1473	1245	700	-43.8	900	10000
NMS-10	*53349*	*43648*	*21515*	.	*26600*	*433000*

1) Preliminary wiiw estimate. - 2) Excluding Special Purpose Enterprises (SPEs).

Source: wiiw Database incorporating national bank statistics. Forecasts by wiiw.

The new fiscal situation and policy options

From October 2008 onwards, countercyclical economic policy measures and vigorous efforts to prevent the collapse of financial intermediation called for major increases in government spending in the majority of advanced economies (as well in many other countries, such as China, Russia and Kazakhstan). Combined general government deficits in the EU-27 amounted to 0.8% of the aggregate EU GDP in 2007, 2.3% in 2008 and around 7% in 2009. The Commission's forecast is 7.5% for the current year and 6.9% for 2011.[21]

Since the very beginning of the global financial and economic crisis, government interventions throughout the developed world have featured three central components: (i) bailing out the banks; (ii) rescuing selected major-employer firms; and (iii) increasing budget expenditures to bolster demand in the context of countercyclical economic policy, including a wide range of schemes from car

[20] Estimation based on balance of payments data for the first three quarters of 2009 (wiiw Database based on Eurostat).

[21] European Commission, *European Economic Forecast*, Autumn 2009, p. 30.

scrappage discounts to investment in infrastructure and supporting the short working hours schemes. The NMS were far less involved in such interventions than the EU-15 and developed economies overseas.

According to the autumn forecast of the European Commission, public intervention in the banking sector of individual EU member states (capital injections, guarantees on bank liabilities, relief of impaired assets and liquidity and bank support) amounted to 31.4% of the aggregate EU GDP at the level of approved measures. In terms of effective measures, the ratio was far smaller, yet still extremely high: 12.7%.[22] It is important to point out here that these government interventions represent mostly confidence building measures and do not feature in the national economy as additional demand.

The NMS record in terms of banking sector interventions has been strikingly different: no public intervention at all was approved or undertaken in Bulgaria, the Czech Republic, Estonia, Lithuania, Poland, Romania and Slovakia. In Hungary effective measures amounted to 2.6% of the GDP, in Slovenia to 6.9% and in Latvia 8.9%, respectively.[23] This deviation from the western (and other) countries can be explained as follows. First, banks in the NMS were hardly (if at all) involved in dealing with toxic securities. Secondly, as the NMS banks are to a major degree owned by foreign parent companies, bailout procedures, if required, were initiated by the foreign owners: typically western banks. In several instances, however, those banks were bailed out by their own governments, with the budgetary impact being absorbed in the parent companies' host country.

Hardly any major government intervention to bail out major companies in the industry or services sector in the NMS region occurred after the crisis hit the region.

As for countercyclical economic policy measures, four NMS (Bulgaria, the Czech Republic, Slovakia and Slovenia) took deliberate steps to support domestic demand with the aim of diminishing the negative effects of the drastic drop in foreign and private domestic demand. In two cases, the programmes were interrupted owing to a political developments following (i) general elections in Bulgaria (July 2009) and (ii) a no-confidence vote in the Czech Republic (May 2009). In both cases, the incoming governments adopted a new economic policy. They abandoned the countercyclical measures and adopted a new approach that focused on rolling back the general government deficit. In Slovakia and Slovenia, the anti-crisis fiscal packages approved and implemented last year may have amounted to some 2% of the GDP. As for the intentions of both governments to prevent a major increase in public deficit, the subsidy schemes still in place will be gradually phased out in the course of the current year.

It should be mentioned that similar to the bailout in the western companies of foreign-owned banks in the NMS, some of the countercyclical measures in the West also indirectly benefited the NMS,

[22] European Commission, *European Economic Forecast*, Autumn 2009, p. 61. Cut-off date for the data was 31 August 2009.

[23] Op. cit.

even if only to a limited extent. Through various transmissions, part of the additional demand created by western governments surfaced as demand for imports from the NMS. Perhaps the most obvious examples of this phenomenon were the premia or discounts granted under the car scrappage scheme. Not only does the German or French automotive industry rely heavily on imports of components and parts from the NMS region, but the motor car manufacturers in the NMS (Czech Republic, Slovakia and Poland) benefited from the exports as well. As government intervention in support of demand only occurred in some of the NMS (and even then only to a limited degree), the countries involved were able to avoid the inverse free-rider problem, whereby part of their government expenditures finances imports instead of furthering domestic consumption or production. Needless to say, a withdrawal of these schemes will have a demand dampening effect as well.

All in all, the deteriorating fiscal balances in the NMS are mainly the outcome of diminishing budget revenues and increasing expenditures due to automatic stabilisers, both as a result of the secession, (see Table 11). In this respect, the exit strategy for withdrawing from subsidy schemes (and tightening the monetary policy) is much less an issue in the NMS than in Western Europe. The strikingly different problems that the different EU members face are best illustrated in Figure 10. As the position of the individual member states shows, before the crisis in 2008 all the NMS (except Hungary) were located in the *Maastricht-compliant* or *briefly sustainable* quadrants. (In the latter quadrant, a relatively low level of public debt permits a temporary deterioration of the general government deficit.) The West European EU members were scattered across all four quadrants in the figure.[24] This situation will dramatically change in 2010. Whereas the NMS (Hungary proving the exception yet again) will continued to be located in the *Maastricht-compliant* or *briefly sustainable* quadrants, the EU-15, with one exception, are to be found in a far worse location: the *unsustainable* quadrant, with the grey rhombus showing the position of the EU-27 as a whole. The quadrant is labelled *unsustainable* because the high level of public debt calls for urgent measures in order to reduce general government deficits to a substantially lower level in the member states involved.

It is clear from Figure 10 that a return to lower levels of general government deficit will pose the NMS a challenging task over the coming years. However, the efforts they will have to undertake to move back to sustainable positions are not comparable to those that the OMS will have to undertake as they deal with a combination of excessive public debt and inordinate deficits. The real message of Figure 10 is that very soon the NMS will have to face up to a change in the economic and political environment that will be determined by painful fiscal stabilization in the whole EU.

This bears a number of extremely important implications. First and foremost, abandoning demand-supporting schemes in the West will most probably delay recovery and/or permit only a less vigorous upturn over the next two years. This will, indirectly, put a brake on the hopes for export-driven recovery in the NMS. The situation may be aggravated by possible measures of masked or (in some cases) open protectionism. NMS exporters may be better advised to invest in the establishment or

[24] For the sake of transparency and easier orientation on the graph, data relating to Cyprus, Finland, Belgium, Luxemburg and Malta have been omitted. Greece's highly unsustainable position was already apparent in 2008.

expansion of positions in rapidly expanding non-EU markets, at least in the short term. Secondly, with nearly all euro area economies failing to meet the required fiscal parameters and the growing concerns over Greece, Italy, Portugal and Spain, the prospects of imminent accession for would-be new euro area members appear bleak. Reconsideration of the Growth and Stability Pact may prove unavoidable in order to overcome the current problems leading to a temporary interruption of the accession process for new members. This is of crucial importance to those NMS which had based their economic strategy on the premise that they would be adopting the euro in the near future. It would be expedient for those countries to elaborate alternative strategies with the national currency remaining legal tender for a longer period than originally expected. Last but not least, the negotiations on the EU financial perspectives (medium-term budget) for the period 2013-2020 are rapidly approaching; they should be concluded by the end of 2011. Given the current fiscal calamities and the forthcoming budget consolidation programmes that the main 'net payer' EU member states will have to face in the years to come, the NMS should start to coordinate their strategy for a reform of the current outdated system of intra-EU redistribution as soon as possible. The NMS are currently the main beneficiaries of the system; it is thus in their immediate interest to take the lead in the endeavours to avoid the collapse of cross-member state redistribution after 2013.

Table 11

	Fiscal balance [1)2)] in % of GDP						Public debt [1)] in % of GDP					
	2007	2008	2009 [3)]	2010	2011	2012	2007	2008	2009 [3)]	2010	2011	2012
					Forecast						Forecast	
Czech Republic	-0.7	-2.0	-6.6	-5.5	-5.7	-4.5	29.0	30.0	35	39	42	45
Hungary	-5.0	-3.7	-3.7	-5.0	-4.0	-3.5	65.9	72.9	79	81	82	80
Poland	-1.9	-3.7	-5.5	-5.5	-4.0	-4	45.0	47.2	51	55	57	58
Slovakia	-1.9	-2.3	-6.3	-6	-5.5	-5	29.3	27.7	37.0	40	43	43
Slovenia	0.0	-1.8	-5.9	-6	-4.5	-4.5	23.3	22.5	34.4	40	42	43
Bulgaria	0.1	1.8	-0.8	-0.5	0	0.5	18.2	14.1	15.2	15.5	14.5	13.5
Romania	-2.5	-5.4	-7.2	-6	-5	-4	12.6	13.6	22	27	31	33
Estonia	2.6	-2.8	-3.0	-3	-3	-3	3.8	4.6	7.5	11	14	15
Latvia	-0.3	-4.1	-9.0	-8	-7	-5	9.0	19.5	33.2	50	60	65
Lithuania	-1.0	-3.2	-9	-8	-6	-4	16.9	15.6	29.9	40	48	55

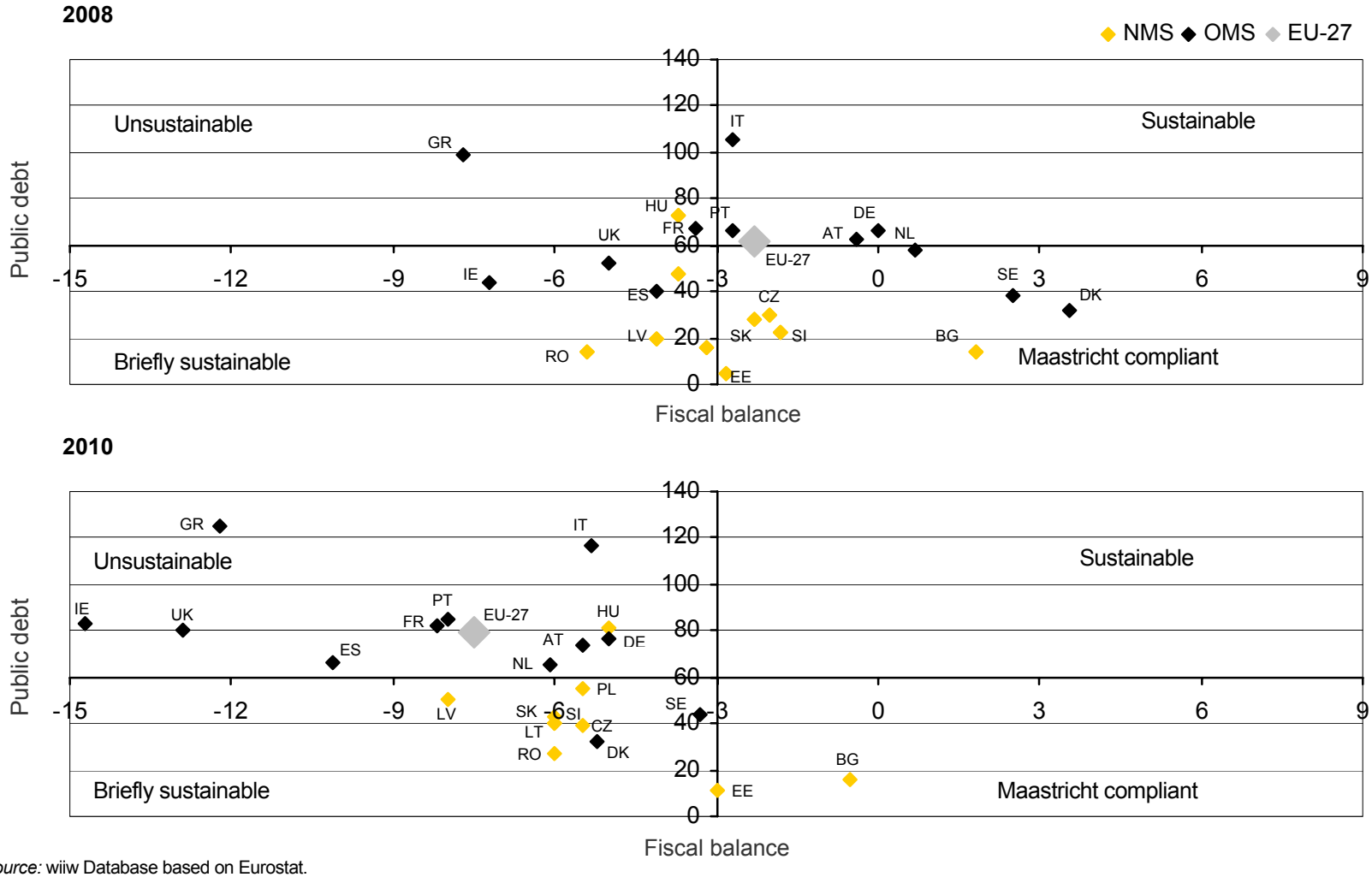
1) According to ESA'95 excessive deficit procedure. - 2) Net lending (+) or net borrowing (-). - 3) Preliminary and wiiw estimate

Source: wiiw Database incorporating national statistics. Forecasts by wiiw.

Figure 10

Fiscal balance and public debt in selected EU member states, 2008 and 2010

in % of GDP



Source: wiiw Database based on Eurostat.

Low demand for loans, but funding may soon become a bottleneck

Although the foreign parent companies of NMS banks have maintained their exposure in the region[25] and inter-bank lending rates point to sufficient liquidity in the banking system in the countries concerned, the growth rate of loans to the non-financial private sector (businesses and households) has been rapidly dropping in the region. In 2009 the growth rate in the Baltic States turned negative in the middle of the year and Hungary followed suit in the final quarter (see Table 12). Lending in the NMS region has contracted in line with developments in the euro area.[26]

Table 12

Bank loans to non-financial private sector

change in % against preceding year

	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
Czech Republic	23.9	21.4	16.2	13.4	7.3	2.8	0.8
Hungary	15.8	17.0	19.5	22.2	14.3	5.0	-3.7
Poland	29.7	29.1	37.5	35.7	27.4	18.5	7.2
Slovakia	23.3	22.1	16.3	11.0	6.8	3.2	0.9
Slovenia	27.2	23.2	18.1	13.6	8.0	4.7	2.8
Bulgaria	53.0	47.8	32.5	24.5	11.2	5.0	3.6
Romania	52.5	38.2	26.7	25.2	20.5	13.9	19.2
Estonia	36.5	29.5	21.5	1.0	-2.2	-6.5	-8.6
Latvia	21.4	16.5	11.1	6.3	1.1	-3.7	-6.1
Lithuania	35.1	27.6	18.3	8.7	-0.2	-6.0	-8.8

Source: National bank statistics, wiiw own calculations.

The contraction of lending can be caused either by supply side problems (credit crunch) or by a drop in demand for credits as a consequence of the deep recession. The World Bank's Enterprise Financial Crisis Survey conducted in the summer months of 2009 revealed that in five selected NMS (Bulgaria, Hungary, Latvia, Lithuania, Romania), about 75% of the firms interviewed found that the most important impact of the crisis had been 'the drop in demand'. Other difficulties such as 'increase in input costs' or 'increased level of debt' and further unspecified reasons were mentioned more frequently than 'reduced access to credits'. This implies that businesses in the region are hesitant about relying on external financing, even to finance working capital, not to mention investments, given the reduced export opportunities, shrinking domestic demand and bleak outlook for profits. Survival strategies during the crisis included mobilizing internal funds, delaying payments to tax authorities or suppliers and attempting to restructure company debts.[27] NMS businesses will

[25] The European Bank Coordination Initiative (earlier Vienna Initiative) played an important role in this respect. In the framework of this initiative launched by the EBRD, the European Commission and the IMF, 15 parent banks with affiliates in the NMS and FMS have made specific rollover and recapitalization commitments in Hungary, Latvia, Romania, Bosnia & Herzegovina and Serbia – see EBRD Transition Report 2009. p.18.

[26] *ECB Monthly Bulletin*, February 2010, p. 16.

[27] The World Bank, *Enterprise Financial Crisis Survey*, p. 1.

face the post-crisis reality of stricter screening and higher borrowing costs when recovery gains momentum later this year. As for the obverse, the pace of recovery will be detrimentally affected by greater constraints on lending. That, however, will only become an issue of particular relevance when expanding sales opportunities and improving profit expectations render firm-internal funds insufficient for financing purposes.

There is a distinct time pattern in the interplay of supply- and demand-side factors that offers an explanation for the decline in credit growth dynamism in the NMS.[28] In the early phase of the crisis (Autumn 2008), supply-side constraints through financial shocks (Lehman Brothers effect) were the dominant feature; that no doubt contributed to augmenting the output shock. From the first quarter of 2009 onwards, the insufficient demand for loans became the main factor responsible for the slower expansion of credits. It is quite possible that, with the onset of recovery, supply-side constraints will once again gain in importance.

The very fact that the foreign banks have maintained their exposure in the NMS region indicates that no significant external deleveraging has occurred in the NMS to date. This is borne out by the external liability-to-total assets ratios having hardly changed.[29] The prevalent heavy dependence on foreign funding is evident in the loan-to-deposit ratios which are well above 100 in the NMS, except in the Czech Republic and Poland.[30]

Table 13

Share of non-performing loans in % of total loans

end of period

	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
Czech Republic	.	2.6	2.8	3.3	3.8	4.3	.
Hungary	3.9	4.6	4.7	4.9	7.9	.	.
Poland	4.8	4.4	4.5	5.3	6.4	7.0	7.6
Slovakia	.	.	.	.	.	.	.
Slovenia	.	.	.	.	.	.	.
Bulgaria	2.0	2.1	2.6	2.1	1.7	2.2	.
Romania	4.7	5.3	6.5	9.4	11.8	14.2	15.3
Estonia	1.6	2.0	2.7	4.2	5.5	6.1	6.1
Latvia	0.6	0.7	2.4	.	.	.	.
Lithuania	2.4	2.6	4.6	8.2	.	.	.

Source: National bank statistics, wiiw own calculations.

[28] The World Bank, *EU 10 Regular Economic Report*, October 2009, pp. 37-43.

[29] '2010: Deleveraging is the name of the game', *Credit Monitor Eastern Europe*, Deutsche Bank Research, 17 December 2009. pp. 1-2.

[30] The euro area average is about 120. (Op. cit.)

With recovery in the OECD area in sight, we must reckon with the monetary stimuli introduced in the highly developed economies in 2008 and 2009 being phased out. The impact will be rising borrowing costs across the board and accelerated adjustment to the new post-crisis international environment. The latter may involve increasing constraints on both market-based and intra-group funding for foreign-owned banks operating in the NMS. Those banks may be compelled to lower the credit-to-deposit ratios from their currently high levels. The increasing share of non-performing loans in the NMS points in the same direction (see table 13).

All in all, over the next two to three years access to credit for both companies and households will become more difficult and more expensive than before the crisis. That may slow down considerably the pace of the upturn expected in the region.

A broad spectrum of NMS growth trajectories

After a 3.6% average rate of GDP decline in the NMS in 2009, the wiiw reckons with a marginal 1% recovery for the NMS group in 2010 (see Table 14). This average figure will undoubtedly mask substantially different individual performances. Poland will clearly enjoy encouraging growth (2.5%), once again substantially boosting the NMS average, while the rate of expansion in the Czech Republic, Slovakia and Slovenia will be a meagre 1% in line with the NMS average. Hungary, Romania and Bulgaria are expected to stagnate this year; however, the slight decline in the first half of the year may be offset by a moderate upswing in the second half. The extremely deep recession in the Baltic States will phase out at a much slower pace than in the other NMS, thus implying further negative growth rates there in 2010.

As the forecasts for 2011 and 2012 show, despite the expected unambiguous recovery of economic activities in the region over the next two to three years, none of the NMS will be able to regain the high pre-crisis (2007-2008) growth rates soon.[31] The aggregate NMS GDP growth rate in 2012 will be 2.8 percentage points less compared to the peak figure in 2007 (6.4%). Only Hungary will surpass its 2007-2008 economic performance; that, however, will be due to Hungary's home-made crisis that set in years prior to the global crisis and the stability packages it introduced which had the damaging collateral effect of reducing the economy to a state of near-stagnation. The Baltic States will not return to the pre-crisis bonanza either. In terms of GDP levels and catching up process the crisis will cost NMS several years – most again in the Baltic States (Table A1).

The patterns of recovery will differ across three discrete groups of NMS. The first group (Poland the Czech Republic, Slovakia and Slovenia) will achieve a 1-3% increase in household consumption this year, while investment will hardly increase (see Table 2). Household consumption in this group will accelerate in 2011 and a remarkable contribution to growth will also come from investment. This pattern will bear inevitable consequences in terms of foreign trade where, contrary to the crisis year 2009, export growth rates will once again lag behind import growth rates (see Table 8).

[31] For Hungary the last year with relatively high growth was 2004.

In the second group (Hungary, Bulgaria and Romania) household consumption will continue to decline or stagnate in 2010, as will investment (except for Romania). Those countries, however, will be able to carry over their positive export-import gap from 2009. This development might first be spoiled in 2011 (for Bulgaria and Romania) and 2012 (in Hungary) when investment, but not consumption, gains momentum and triggers a noticeable increase in imports.

Table 14

Gross domestic product

real change in % against preceding year

	2007	2008	2009 [1)]	2010	2011 Forecast	2012	Index 2000=100 2009
Czech Republic	6.1	2.5	-4.1	1.0	2.6	3.5	133.8
Hungary	1.0	0.6	-6.5	0	3	3.5	121.6
Poland	6.8	5.0	1.7	2.5	3	3.4	141.0
Slovakia	10.6	6.2	-5	1	3	4	153.8
Slovenia	6.8	3.5	-8	1	2	2.5	128.9
NMS-5 [2)]	*6.1*	*3.9*	*-1.6*	*1.7*	*2.9*	*3.5*	*137.3*
Bulgaria	6.2	6.0	-5.1	0	3	3.5	147.9
Romania	6.3	7.3	-7.2	0	3	4	151.5
Estonia	7.2	-3.6	-14	-1.5	2	4	141.5
Latvia	10.0	-4.5	-19	-4.5	1	2	141.5
Lithuania	9.8	2.8	-15.0	-3	2	3	150.6
NMS-10 [2)]	*6.4*	*4.2*	*-3.6*	*1.0*	*2.8*	*3.6*	*140.4*

1) Preliminary and wiiw estimates. - 2) wiiw estimate.

Source: wiiw Database incorporating Eurostat statistics. Forecasts by wiiw.

This year the Baltic States will still have to endure a major contraction of both consumption and investment. Consumption will still be in decline in 2011. Estonia and Lithuania, however, may already experience a strong recovery in terms of investment in that year, whereas Latvia will still face a slight contraction. In 2010 a considerable export-import gap will persist in all three countries. As economic growth returns in 2011, an increase in imports will see the gap turn negative in Estonia and Lithuania, but not in Latvia where recovery will suffer a delay compared to the other two Baltic States.

Although current account balances radically improved in the NMS region over the past year, in most NMS the pendulum will swing in the opposite direction in 2010, albeit to a varying degree (see Table 7). In Bulgaria and Lithuania the current account balance will continue to improve this year. Even in these two countries, however, deterioration of the current account will set in by next year at the latest as a consequence of accelerating economic growth. The wiiw forecast for current accounts in 2012 mirrors our conviction that there will be no return to the high pre-crisis deficits.

2008 was the final year in a longer period of growing employment and decreasing unemployment in most of the NMS economies. With the onset of the recession in late 2008, unemployment rates started to rise with a time lag; it will only reach peak values towards the end of the current year (see Table 3). The aggregate NMS unemployment rate was lower than the respective indicator for the EU-27 both before the crisis and in 2009 as well. To all intents and purposes, this difference will evaporate this year, only to re-emerge in 2011 when NMS GDP growth is expected once more to surpass that of the EU-27. Intra-NMS differences in unemployment rates will continue to remain significant: by 2012 unemployment rates threaten again to remain double digits in Slovakia and the three Baltic States.

Upward and downward risks of the forecast

The crisis has radically changed both the external environment and the internal conditions for growth in the NMS region. Contrary to the decade preceding the crisis, forecasts for the NMS have become nearly as uncertain as they were in the early years of transition. It seems fairly probable, however, that future growth rates will be lower than in the booming golden era of 2004-2008 and the 'growth model' will have to be reconsidered accordingly (see Special section).

Upward risks

The upward risks in our forecast are less significant than the downward risks, yet they warrant being listed. First of all, the pattern of recession with its disproportionately large inventory depletions opens up an opportunity for a more rapid recovery than that currently forecast via restocking over a relatively short period of time. This scenario would not only yield more vigorous growth but, simultaneously, it would also lead to less favourable net export positions compared to the baseline scenario. It is an open question, however, whether the necessary funding conditions can be secured for this scenario.

Another, albeit less likely source of better than expected growth performance may be the improved competitive position of NMS with flexible exchange rates and productivity/quality improvements, the proviso being that there will be no further real appreciation, with the currencies involved remaining well below their pre-crisis position vis-à-vis the euro. That may contribute to an export-driven recovery being more robust than currently anticipated. Parallel to gains in foreign trade, undervalued exchange rates (relative to pre-crisis levels) again may attract more export-oriented FDI projects, whose managers hope to benefit from low costs. NMS with fixed exchange rates cannot avail themselves of these 'easy' gains in competitiveness, unless they implement 'internal devaluation' – principally via wage cuts as has already been seen in the Baltic States. In political terms, however, this option means a very bumpy ride, and through decreasing domestic demand it is detrimental to economic growth.

Downward risks

The most important downward risk is the sluggish revival of financial intermediation. As mentioned earlier in this report, it is quite difficult to judge the extent to which supply- and demand-side

problems will provide the explanation for the ebb in loans to non-financial enterprises in the NMS. While currently demand-side issues are prevalent, with the incipient upturn of economic activities more and more firms may find it difficult, if not impossible, to secure external funding for working capital, trade and investment purposes. This may be the outcome of various developments. As deleveraging in the banking sector will be a central issue in nearly all NMS, possible quantitative constraints on the growth of loans may cut off several firms, even if orders abound, from borrowing. Depending on the seriousness of the constraints, the negative impact on output growth may vary. Even without credit rationing, financial transmissions can be effectively hampered by far stricter screening of loan applicants and higher borrowing costs. While the former is largely an administrative issue and can be eased or lifted at will, borrowing costs are mostly determined by market factors. Greater global risk awareness coupled with the phasing out of one-off monetary policy instruments to offset the crisis, a return to higher policy rates may render the combined costs of borrowing too high for a large number of enterprises. Greater reliance on own resources than before the crisis would offer firms only limited space for expansion.

Possible changes in household behaviour (increasing saving propensity) may also negatively influence growth prospects (see Special section). Less job security and stagnating or decreasing real wages may also lead to an increased propensity to save among households. That, in turn, would foster deleverage through increasing deposits and controlled credit growth. In any event, restrained household expenditures have a negative impact on domestic demand – and thus on output recovery.

As mentioned earlier, shifting away from demand-supporting schemes and the need to consolidate unsustainable fiscal balances in most of the West European countries may delay recovery there. Indirectly, via export channels, it may put a brake on export-driven growth in the NMS. The increased level of public debt in the NMS and the need to roll over expiring financing will heighten the attractiveness of government bonds as investment targets for the banking system. This will possibly crowd out loans for businesses since they will be rated a riskier venture than purchasing government securities.

The rapid growth of loans to the private sector in the NMS (non-financial companies and households) before the crisis was possible only via massive intra-group lending among foreign-owned affiliates from the parent banks and those affiliates' easy access to other external funds. Both channels may now become permanently less permeable. The parent banks themselves will also deleverage, thus checking the expansion of their exposure in the NMS. Despite the NMS banks' good capital adequacy ratios, deteriorating payment practices in general and the growing share of non-performing loans in particular may narrow those banks' opportunities to raise funds abroad.

A possible successful rebound of foreign direct and portfolio investment and the unimpeded revival of cross-border credit flows would doubtless facilitate NMS recovery. Though a highly welcome development per se, it would, however, re-exert strong pressure in favour of exchange rate appreciation with all the familiar negative effects from the pre-crisis era.

We cannot at present assess the full impact on the prospects for the NMS of the near-collapse of Greece and the increasingly fragile financial position of Portugal, Spain and Italy. It is, however, indisputable that whatever the impact, it can only be negative. The main risk associated with recent developments along the southern periphery of the EU is that the extension of the euro area will be either delayed or suspended. That may well cross the plans of those NMS that have based their economic strategy on the earliest possible adoption of the euro (Latvia, Lithuania, Bulgaria). Most probably, however, the recent developments cannot stop Estonia's accession to the euro area at the beginning of 2011.

Anton Mihailov

Bulgaria:
withdrawal of policy stimulus delays recovery

The economic slump in Bulgaria continued through the final months of 2009 with GDP for the year as a whole contracting by some 5%. Weak domestic demand was responsible for most of the contraction as exports gradually started to gain pace in the second half of the year. The abrupt withdrawal of policy stimulus initiated by the newly elected centre-right government (GERB party) which took office in July has undoubtedly added to the weakness of domestic demand, thus contributing to the anaemic economic performance in the second semester.

This pattern of macroeconomic performance reflects the ongoing major adjustment towards more reliance on export-led growth, reversing the pattern that prevailed during the period 2001-2008. While domestic demand remained subdued in the second half of 2009, exporters benefited from the recovery in the manufacturing sector of some of the large EU economies. Merchandise exports gradually started to recover, at first on a month-on-month basis, and by November in year-on-year terms. In statistical terms, net exports contributed a positive 13.9 percentage points to GDP growth in the third quarter, up from 8.1 points in the first quarter and 12.1 points in the second quarter. Although the current account balance remained negative (and large in absolute terms), the deficit has shrunk by almost two thirds compared to the previous year.

Against the backdrop of weak domestic demand, deflationary trends prevailed during most of the year. PPI dropped by several percentage points both year-on-year and in average annual terms. The average annual rate of consumer prices remained in the positive territory mostly due to carryover effects from the previous year. With the nascent recovery in exports, the slowdown in manufacturing started to decelerate in the final months of 2009. Unemployment kept rising steadily in the second semester. Many of those that joined the pool of unemployed were made redundant by small and medium-sized enterprises, which are less prepared to shelter their workforce during a recession. The gap between officially registered unemployment and LFS measures continued to widen, suggesting an increasing shift towards the informal labour market. Notwithstanding that, the labour market adjustment is far from over, with no end to the rise in unemployment in sight.

After coming to a standstill at mid-2009, credit to the corporate sector experienced a modest recovery in the second half of the year. However, access to bank finance remains difficult mostly due to much more stringent credit screening. Generally there are no signs of a liquidity crunch in the banking system as evidenced by the fall in interest rates on the interbank market in the second half of the year. By contrast, while there was no further rise in borrowing rates in the same period, their level remained elevated reflecting still high risk premia. The share of non-performing loans more

than doubled in 2009 but at some 6.4% at the end of the year they are not considered as a threat to the stability of the financial system.

A major change in the policy stance since the new government took over in July has also affected the macroeconomic outcome. This change amounted to the early withdrawal of a large chunk of the policy stimulus installed by the previous government, especially as regards public investment. Under the dictum of re-balancing the budget, the new government undertook major cuts in public spending, with disproportionately drastic cuts in public capital expenditure. Thus, while during the first seven months of the year (under the Socialist-led Stanishev government) capital expenditure accounted for 15.3% of all public expenditure in the consolidated government budget, in the period August to November (under the centre-right GERB government led by Boyko Borisov) this share dropped to 12.4%. Moreover, if public expenditure financed from EU transfers are excluded from this count, the share of public capital expenditure dropped by more than 5 percentage points (from 13.1% in January-July to 7.8% in August-November).

Given the current macroeconomic situation in Bulgaria, the new policy of drastic fiscal austerity appears puzzling. The resulting major downsizing of public investment projects as well as the downgrading of automatic stabilizers (the social safety net as well as some income support measures introduced by the previous government were also scaled back) amount to a switch from a countercyclical towards a procyclical policy stance, suppressing further economic activity, which is hard to justify in the current economic environment.

Although an amendment of the 2009 budget was probably unavoidable in view of the shortfall in revenue caused by the recession, the magnitude of the fiscal adjustment, and especially the early and drastic withdrawal of policy stimulus, seem unwarranted and unjustified. The deterioration in the fiscal outcome in 2009 was mostly a cyclical outcome, whereas there was no evidence that the structural fiscal balance was endangered (between 2004 and 2008, Bulgaria recorded five consecutive years of large fiscal surpluses). Furthermore, one of the functions of the large fiscal reserve accumulated during the surplus years (amounting to some 12% of GDP) is exactly to act as a buffer dampening the negative effects of a cyclical downturn such as the current one. The main argument put forward for the switch in the policy stance – a fast-track entry into ERM-2 – is also difficult to justify in view of the sound structural fiscal balance. The fact is that Bulgaria could have easily stayed within the range of the Maastricht deficit criterion with less economic pain.

The same policy stance of drastic fiscal restrictions has been incorporated in the 2010 budget. Firstly, the budgetary framework is based on very conservative estimates of public revenue (under the assumption of a drop in GDP by 2% in 2010) and, consequently, of planned expenditure. Secondly, within this conservative framework, the consolidated budget balance targets a deficit of 0.7% of GDP. Therefore, if there is no subsequent upward amendments to planned spending, this would amount to a further tightening of the fiscal stance. The public investment targets are more than modest: planned public expenditure financed from local sources amount to 7.9% of all public expenditure in the consolidated government budget. This is a reduction by one half in relative terms as compared to 2008 when this share amounted to 15.8%. By contrast, the 2010 budget envisages

that approximately the same amount of public capital expenditure would be financed from EU sources, which may be wishful thinking in terms of the country's absorptive capacity regarding EU funds (in relative terms, this is more than double the amount of EU investment funding absorbed in 2009). Employment protection and support have also been downsized in the 2010 budget.

Raising the capacity of the economy to absorb EU funds is perhaps the greatest economic policy challenge that Bulgaria faces at present: during the first three years of EU membership, the level of fund absorption in Bulgaria has been close to nil and the lowest in the EU as a whole. This challenge is related to the inefficiency, lack of transparency and perceived high level of corruption in the workings of the public administration. The GERB government that took over in July 2009 won its electoral victory on a ticket pledging the eradication of corruption and raising considerably the level of absorption of EU funds. While there have been a number of positive steps in this direction, the results so far have fallen below expectations. Thus the government still faces the daunting task of removing or at least reducing the existing institutional and other barriers and re-organizing and streamlining the related administrative procedures so as to ensure a fair and efficient channelling of EU funds.

Against this background, there is not much room for optimism in the economic outlook for Bulgaria in 2010. Importantly, sluggish domestic demand will remain a major drag on the economy. The expected cuts in public investment and subdued private investor confidence are likely to depress further overall fixed investment. Private consumption will probably stagnate due to cautious consumer spending and more difficult access to consumer credit. Recovering exports (under the assumption of a stronger Western European import demand) can be expected to be the main growth driver in the short run but this would hardly be sufficient to pull overall economic growth into the positive territory. Therefore, unless there is a radical change in policies towards a more supportive policy stance, the economy as a whole can be expected to stagnate in 2010. Given the economic weakness and the withdrawal of some support measures, unemployment will keep rising as labour continues to adjust further downwards. On the positive side, sluggish domestic demand would contribute to a further downward adjustment in the current account deficit in 2010. In the absence of either cost-push or demand-pull factors, inflation will also remain low.

Developments in 2011-2012 will depend on both the strength of the global (and, especially, Western European) recovery and on possible changes in the domestic policy stance. In any case, it is clear that there will be no return to the pre-crisis pattern of economic performance when economic growth was mostly driven by an unsustainable expansion in domestic demand which, in turn, was fuelled by external private borrowing. So, under a moderately optimistic assumption of continuing recovery in the major European economies, predominantly export-led growth in Bulgaria, and a more supportive domestic economic policy stance, annual GDP growth in the next two years could be in the range of 3.0-3.5%. Under the same assumptions, one could expect relatively low inflationary pressures and a modest recovery in employment towards the end of the period. While the current account deficit will probably start rising along with the recovery, it will stay much below the highs seen in the past several years.

Table BG

Bulgaria: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average	7781.2	7739.9	7699.0	7659.8	7623.4	7591.7	7560	7540	7520
Gross domestic product, BGN mn, nom.	38822.6	42797.4	49361.0	56519.8	66728.1	66197	67500	71500	76000
annual change in % (real)	6.6	6.2	6.3	6.2	6.0	-5.1	0	3	3.5
GDP/capita (EUR at exchange rate)	2600	2800	3300	3800	4500	4500	.	.	.
GDP/capita (EUR at PPP)	7300	7800	8600	9400	10400	10000	.	.	.
Consumption of households, BGN mn, nom.	26732.0	29841.5	34554.3	38826.5	45200.7	41500	.	.	.
annual change in % (real)	5.9	6.1	9.5	5.3	4.9	-6	0	3	3.5
Gross fixed capital form., BGN mn, nom.	7969.4	10346.5	12805.2	16832.5	22253.9	16936	.	.	.
annual change in % (real)	13.5	23.3	14.7	21.7	20.4	-24.9	-6	6	10
Gross industrial production [2]									
annual change in % (real)	12.8	7.0	6.0	9.6	0.6	-17.4	3	6	10
Gross agricultural production									
annual change in % (real)	6.6	-6.0	-0.1	-21.0	33.0	-0.4	.	.	.
Construction industry [3]									
annual change in % (real)	35.1	31.9	23.9	27.9	-3.3	-15	.	.	.
Employed persons - LFS, th, average	2922.5	2981.9	3110.0	3252.6	3360.7	3250	3100	3150	3180
annual change in %	3.1	2.0	4.3	4.6	3.3	-3	-4.6	1.6	1.0
Unemployed persons - LFS, th, average	399.7	334.4	305.7	240.2	199.7	235.0	.	.	.
Unemployment rate - LFS, in %, average	12.0	10.1	9.0	6.9	5.6	6.7	9.0	8.5	8
Reg. unemployment rate, in %, end of period	12.2	10.7	9.1	6.9	6.3	9.1			
Average gross monthly wages, BGN	292.4	323.7	360.3	431.2	524.5	585.1	.	.	.
annual change in % (real, gross)	0.8	5.4	3.7	10.4	8.3	8.6	.	.	.
Consumer prices (HICP), % p.a.	6.1	6.0	7.4	7.6	12.0	2.5	2	3	3
Producer prices in industry, % p.a.	5.5	7.9	12.0	7.7	10.9	-6.5	.	.	.
General governm.budget, EU-def., % GDP									
Revenues	41.3	41.2	39.5	41.5	39.1	38.1	.	.	.
Expenditures	39.7	39.3	36.5	41.5	37.3	38.9	.	.	.
Net lending (+) / net borrowing (-)	1.6	1.9	3.0	0.1	1.8	-0.8	-0.5	0	0.5
Public debt, EU-def., in % of GDP	37.9	29.2	22.7	18.2	14.1	15.2	15.5	14.5	13.5
Base rate of NB % p.a., end of period [4]	2.4	2.1	3.3	4.6	5.8	0.6	.	.	.
Current account, EUR mn	-1306.9	-2705.7	-4647.0	-7275.0	-8653.0	-2912.2	-2700	-3100	-3600
Current account in % of GDP	-6.6	-12.4	-18.4	-25.2	-25.4	-8.6	-7.8	-8.5	-9.3
Exports of goods, BOP, EUR mn	7984.9	9466.3	12012.0	13512.0	15203.0	11783.5	12800	13800	15000
annual growth rate in %	19.7	18.6	26.9	12.5	12.5	-22.5	8.6	7.8	8.7
Imports of goods, BOP, EUR mn	10938.4	13876.1	17575.0	20758.0	23800.0	15867.3	16700	18200	20000
annual growth rate in %	20.3	26.9	26.7	18.1	14.7	-33.3	5.2	9.0	9.9
Exports of services, BOP, EUR mn	3262.1	3564.1	4187.0	4745.0	5369.0	5047.7	5400	5800	6300
annual growth rate in %	19.5	9.3	17.5	13.3	13.2	-6.0	7.0	7.4	8.6
Imports of services, BOP, EUR mn	2605.8	2745.2	3264.0	3990.0	4597.0	3680.5	3900	4200	4600
annual growth rate in %	19.8	5.3	18.9	22.2	15.2	-19.9	6.0	7.7	9.5
FDI inflow, EUR mn	2735.9	3152.1	6221.0	8589.0	6549.0	2844.9	2500	2800	3500
FDI outflow, EUR mn	-165.6	249.1	141.0	207.0	486.0	115.4	.	.	.
Gross reserves of NB excl. gold, EUR mn	6443.1	6813.9	8309.1	11215.9	11927.6	11942.8	.	.	.
Gross external debt, EUR mn	12658.5	15506.9	20690.9	28988.8	36973.8	36700	.	.	.
Gross external debt in % of GDP	63.8	70.9	82.0	100.3	108.4	108.4	.	.	.
Average exchange rate BGN/EUR	1.953	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956
Purchasing power parity BGN/EUR	0.685	0.715	0.745	0.787	0.847	0.872	.	.	.

Note: Gross industrial production, construction output and producer price index refer to NACE Rev. 2.

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) Pirvate enterprises with 5 and more employees, all enterprises of public sector. - 4) The BNB basic interest rate is not a policy rate but a monthly reference rate computed by the BNB as the average interbank LEONIA rate of previous month (valid from 2005).

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.

Leon Pokaminer

The Czech Republic:
Bottoming out?

The continuing output decline seems to have become somewhat less steep in the final quarter of 2009 as GDP declined by an estimated 2.4% vs. the same period of 2008. Nonetheless, the entire year 2009 was a bad one, with GDP plummeting by over 4%. Provisional calculations indicate that a rise in consumption prevented an even deeper recession. Household consumption rose by 1.5% and public consumption even more, by about 4%. Public and private consumption contributed positively to the overall GDP growth, by 0.8 and 0.7 percentage points (pp) respectively. Gross fixed capital formation fell by some 8%. Inventories were reduced very strongly (particularly in the second and third quarters) resulting in the entire gross capital formation falling by close to 20% in 2009. Gross capital formation thus contributed about minus 5 pp to GDP growth.

Household consumption proved relatively dynamic despite the total value of compensation of employees most probably falling in real terms. A measured decline in the households' gross savings rate was one reason for that outcome. The second reason had much to do with the extraordinary fiscal policy measures in force in 2009. According to data available from the Finance Ministry, taxes and social contributions burdening the household sector fell by 6% in 2009, while social benefits and transfers received by the sector rose by 8% (nominally). All in all, the household sector's gross disposable income rose by about 1% (in real terms) in 2009.

In 2010 the conditions will be much more restrictive as far as household incomes are concerned. Awed by the general government deficit reaching 6.6% of GDP in 2009, the new, liberal-leaning caretaker government abandoned the policy of stimulating demand followed under the previous government of Mr. Topolanek. The caretaker government has enacted the budget for 2010 stipulating a number of 'austerity' measures aimed at cutting the deficit to 5.3% of GDP. Transfers to the household sector are to be 'streamlined' (as with the sickness and pension payments) with the effect they would rise by less than 3% nominally. At the same time the tax burden on households is to rise. As of 1 January 2010, the VAT and excise rates have been raised accordingly (while the rate of the corporate income tax has been *lowered* from 20% to 19%). The wage bill of the public sector employees is to be cut. All in all, the household sector's disposable income is set to shrink by about 2% in real terms in 2010. Under such conditions it is a fall in the households' saving rate that would be needed to generate growth in private consumption. Such a fall is not unlikely. Currently the household savings rate (gross) of about 10% is much higher than it used to be only a couple of years ago. The gross savings rate of the household sector was 7.5% (years 2002-2005). The low levels of household debt and the quite low interest rates expected to prevail for quite some time now will also be supportive of growth of private consumption. But public consumption is unlikely to grow

all that much. (In actual fact, the Finance Ministry seeks to engineer a rather massive decline in public consumption as well.)

Foreign trade, which for many years was positively contributing to GDP growth, proved a disappointment in 2009. Unlike elsewhere in most of the new EU member states, exports of goods and non-factor services have not fallen more strongly in real terms than their imports. This is not unusual because the Czech Republic has been unique in showing a consistently positive balance of trade (i.e. exports by far greater than imports). Under recession in the main trading partners, the trade-surplus countries are likely to suffer more than the endemic trade-deficit countries. On the same principle, the export-led economies benefited more from fast growth in their trading partners than the import-fed countries. The Czech Republic is no exception in this respect. Its exports to the main ailing partners (primarily in the euro area) have been hit hard. In real terms both exports and imports of goods and non-factor services contracted by an estimated 13% in 2009. Overall, the external trade contributed negatively to GDP growth (minus 0.6 pp) in 2009. But the scale of these negative contributions has been declining rapidly in the course of the year. Further improvements in trade (resulting in its making meaningful positive contributions to GDP growth) seem now quite likely. The year-on-year indicators for manufacturing production, sales and exports seem to have stopped falling in the closing months of 2009. Although this reflects the fact that all these items started to decline strongly only in the second half of 2008, one must notice a quantum jump in new export (and total) orders placed with industry. The January 2010 business climate survey shows a rather strong improvement in entrepreneurs' confidence, quoting rising external demand, higher production capacity utilization, and expectations of rising production and employment. Not surprisingly (given the fiscal austerity measures), consumer sentiments deteriorated significantly in January 2010.

On the import side one cannot count on radical improvements. The recovery of exports will certainly be associated with a recovery of imports. Moreover, the current nominal appreciation of the Czech koruna will encourage imports. The current appreciation trend, which started in May 2009, does not show any sign of bending towards depreciation. Rather, it is likely to continue. Given the already very low levels of interest rates administered by the Czech National Bank (and very low levels of interest rates at which the Czech commercial banks finance themselves domestically) the policy is unable to weaken the appreciation trend to any perceptible degree – even if the policy makers desired that eventuality. But, even if imports and exports start to grow at equal speeds, the overall contribution of trade to GDP growth is likely to be positive in 2010 (and rising further later on).

The main recessionary impact which determined the final scale of the GDP decline in 2009 came from the item that is exceptionally difficult to predict, namely, the change in inventories. The decline in inventories had been in the cards well before the outbreak of the crisis. No doubt the crisis has made the downsizing of inventories even more urgently necessary. The recovery of exports and industrial production is likely to necessitate some restocking of inventories. Even if gross fixed capital formation remains flat (which is not unlikely), the overall impact of gross capital formation (equal the change in inventories plus gross fixed capital formation) will contribute to GDP growth in 2010.

The levels of risks facing the Czech banking system continue to remain very low – generally much lower than elsewhere, and not yet any worse than reported a year earlier. It has a uniquely low loans/deposit ratio (77%), negligible gross external debt (and a positive external investment position, quite uniquely among the NMS). The exchange rate risks it faces are small (only 18% of loans to the corporate sector are denominated in foreign currency, and virtually 0% of loans to households). Although the shares of non-performing loans to the household and corporate sector stood, as of end-September 2009, at some 4% and 10% respectively, the strong rise in profits (retained) raised the Capital Adequacy Ratio to 14% – well above the levels considered satisfactory. Despite the Czech National Bank's not engaging in any 'quantitative easing', the banking sector is liquid (actually excessively liquid). This is not to say that there are no problems. Lending to the corporate sector has been contracting, despite quite low interest rates. But this is not the banks' fault. The business sector's demand for loans has been contracting, reflecting the slack in demand for 'real' goods and services. If the demand for goods and services rebounds, the banking sector would be in a position to accommodate the rising demand for loans without any difficulty.

The overall, if still muted, recovery generally expected for the euro area in 2010 should spill over into the Czech Republic. It is now quite reasonable to estimate the Czech GDP growth rate at about 1% in 2010. But the risks persist. If the recovery abroad does not materialize, or turns out to be rather weak, the recession in the Czech Republic may well continue, or even deepen. The fiscal policy restricting domestic demand in 2010 may well prove premature. A modest acceleration of GDP growth is forecast for 2011-2012, but the expected growth will be much slower than before the crisis.

Table CZ

Czech Republic: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average	10216.0	10235.8	10269.1	10334.2	10424.3	10490	10550	10600	10650
Gross domestic product, CZK bn, nom.	2814.8	2983.9	3222.4	3535.5	3689.0	3560	3650	3820	4050
annual change in % (real)	4.5	6.3	6.8	6.1	2.5	-4.1	1.0	2.6	3.5
GDP/capita (EUR at exchange rate)	8600	9800	11100	12300	14200	12800	.	.	.
GDP/capita (EUR at PPP)	16300	17100	18200	19900	20200	19500	.	.	.
Consumption of households, CZK bn, nom.	1399.2	1442.7	1537.2	1658.8	1803.7	1830	.	.	.
annual change in % (real)	2.9	2.5	5.1	4.8	3.6	1.5	1	2	3
Gross fixed capital form., CZK bn, nom.	727.2	741.9	796.3	890.3	883.2	830	.	.	.
annual change in % (real)	3.9	1.8	6.0	10.8	-1.5	-8.0	0	4	6
Gross industrial production									
annual change in % (real)	10.4	3.9	8.3	10.6	-1.9	-15	0	4	6
Gross agricultural production									
annual change in % (real)	16.3	-2.0	-4.2	3.1	6.6	-0.5	.	.	.
Construction industry									
annual change in % (real)	8.7	5.3	6.1	7.0	-0.2	-1	.	.	.
Employed persons - LFS, th, average	4706.6	4764.0	4828.1	4922.0	5002.5	4930	4860	4860	4910
annual change in %	-0.6	1.2	1.3	1.9	1.6	-1.4	-1.5	0	1
Unemployed persons - LFS, th, average	425.9	410.2	371.7	276.6	229.8	350	.	.	.
Unemployment rate - LFS, in %, average	8.3	7.9	7.1	5.3	4.4	6.7	8.5	8.5	7.5
Reg. unemployment rate, in %, end of period	9.5	8.9	7.7	6.0	6.0	9.2	.	.	.
Average gross monthly wages, CZK [2]	18041	18992	20219	21694	23542	24150	.	.	.
annual change in % (real, gross)	3.7	3.3	3.9	4.4	2.1	2	1	3	3
Consumer prices (HICP), % p.a.	2.5	1.6	2.1	2.9	6.3	0.6	1.5	2.0	2.5
Producer prices in industry, % p.a.	4.2	0.5	0.1	2.6	0.4	-1.4	.	.	.
General governm. budget, EU-def., % GDP									
Revenues	42.2	41.4	41.1	41.9	40.9	40.3	41.0	40.9	.
Expenditures	45.1	45.0	43.7	42.5	42.9	46.9	46.5	46.6	.
Net lending (+) / net borrowing (-)	-2.9	-3.6	-2.6	-0.7	-2.0	-6.6	-5.5	-5.7	-4.5
Public debt, EU-def., in % of GDP	30.1	29.7	29.4	29.0	30.0	35	39	42	45
Discount rate of NB, % p.a., end of period	1.5	1.0	1.5	2.5	1.3	0.3	0.5	2.5	2.5
Current account, EUR mn	-4650	-1346	-2745	-4090	-4610	-960	-1500	-2000	-2000
Current account in % of GDP	-5.3	-1.3	-2.4	-3.2	-3.1	-0.7	-1.1	-1.3	-1.2
Exports of goods, BOP, EUR mn	54091	62781	75706	89379	98824	80393	86000	93000	104000
annual growth rate in %	25.6	16.1	20.6	18.1	10.6	-18.7	7	8	12
Imports of goods, BOP, EUR mn	54517	60797	73415	85038	94677	73514	79000	84000	92000
annual growth rate in %	20.5	11.5	20.8	15.8	11.3	-22.4	7	6	10
Exports of services, BOP, EUR mn	7761	9491	11086	12311	15133	14580	15000	17000	19000
annual growth rate in %	12.8	22.3	16.8	11.0	22.9	-3.7	4	10	10
Imports of services, BOP, EUR mn	7245	8254	9494	10526	11847	12448	13000	15000	17000
annual growth rate in %	12.1	13.9	15.0	10.9	12.5	5.1	8	12	10
FDI inflow, EUR mn	4009	9354	4363	7667	7356	3369	5000	.	.
FDI outflow, EUR mn	824	-12	1172	1187	1299	2014	1500	.	.
Gross reserves of NB excl. gold, EUR mn	20745	24868	23684	23456	26377	28478	.	.	.
Gross external debt, EUR mn	33212	39379	43415	51642	57778	58000	.	.	.
Gross external debt in % of GDP	35.9	38.3	37.0	38.9	42.1	43	.	.	.
Average exchange rate CZK/EUR	31.89	29.78	28.34	27.77	24.95	26.44	26.0	25.5	25.0
Purchasing power parity CZK/EUR	16.96	17.09	17.23	17.17	17.55	17.39	.	.	.

Note: Gross industrial production, construction output and producer price index refer to NACE Rev. 2.

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees, including part of the Ministry of Defence and the Ministry of the Interior.

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.

Sándor Richter

Hungary:
Fiscal balance under control, economic growth yet to surface

Contrary to previous years when Hungary lagged behind its neighbours in terms of economic growth, last year the country's poor performance was similar to that of the other Central European economies. The annual rate of Hungary's GDP decline is estimated to have amounted to 6.5%.

As opposed to most other countries of the region, household consumption bore the main burden of the recession: it declined by about 7% in the full year 2009. Gross fixed investment contracted by about 5%, which is relatively mild as compared to the collapse of investments in Bulgaria, Slovakia, Slovenia or Romania. The change in inventories reached an exorbitant extent in 2009, contributing 4.5 to 10.9 percentage points (pp) to the GDP decline in individual quarters. Only developments in foreign trade were able to prevent an even stronger shrinkage of the economy. While in the last quarter of 2008 net exports still contributed negatively to GDP (-0.2 pp), from the first quarter of 2009 net exports played an important positive role in the country's economic performance. From the first to the third quarter net exports contributed positively to GDP with 2.9, 7.3 and 6 percentage points, respectively.

The primary and secondary sectors of the economy suffered more strongly from the recession than the services sector. In the first three quarters of 2009 the former two sectors (combined) declined by 16.5%, the services sector by 2.5% only. The services sector showed an uneven performance last year: catering and transport suffered strong negative growth rates, obviously due to contracting household expenditures and the drop in industrial and agricultural output as well as foreign trade transactions, while value added by financial services, real estates and all kinds of public services remained at the previous year's level. The strong decline in consumption originates in sinking real incomes plus falling employment and contracting loans for households. The relatively moderate decrease of gross fixed investment is a result of a stronger decline in corporate investment caused by the bleak profit outlook that was counterbalanced, to some extent, by a better performance of mainly EU co-financed public investment projects, primarily in infrastructure. EU transfers thus played an important role in supporting domestic demand, mainly via fostering investment. These unilateral transfers have all the positive effects of countercyclical fiscal measures but, contrary to these, they do not create new debt. Net inflows from the EU budget registered in the current account amounted to about 1.7% of Hungary's GDP last year, up from 0.7% in 2007 and 1% in 2008.

The fiscal consolidation that began in-mid 2006 continued in 2009. The deficit target envisaged in the latest update of the IMF/EU/World Bank stand-by agreement was achieved. The general government deficit relative to GDP amounted to about 3.7%. This is nominally the same proportion

as in 2008 but due to diminishing tax revenues (caused by the recession) a considerable fiscal adjustment with painful procyclical effects had to be accomplished in order to fulfil this target.

Hungary's external financial position improved significantly in the second half of the year. The government managed to return to market-based financing of public debt. Yields on forint-denominated government bonds fell to pre-crisis levels. That enabled the government to stop drawing IMF/EU/World Bank resources while the stand-by agreement was prolonged up to October 2010 providing a potential life belt for the incoming government after the elections.

There has been an important turnaround in the current account. For the first time since the transition began Hungary's current account may have closed with a surplus in 2009. One of the explanations for this turn is the huge surplus emerging in trade in goods and services. While both export and import transactions declined compared to the previous year, imports decreased much more strongly than exports because of the sharp decline in demand for imports due to shrinking consumption and investment and the strong depletion of inventories. The smaller decline in exports than in imports may be explained by the lesser extent of the recession in main export markets as compared to Hungary and by the improving competitiveness of Hungarian exports due to depreciation of the forint. Although the Hungarian currency appreciated substantially in the second half of the year as compared to the weakest position in March 2009 (over 310 HUF/EUR), the annual average exchange rate 280 HUF/EUR was significantly below the 2008 annual average 252 HUF/EUR. Another reason for the current account improvement has been the diminishing deficit in the income balance caused by much smaller profits realized by foreign-owned companies. While the current account balance indicates an improvement in the country's external financial position, another important component of external financing, FDI, was disappointing with virtually no inflow of new resources.

Although bottlenecks in the banking system's liquidity have been eliminated over the last year, non-financial enterprises' stock of credits decreased in each month of 2009. The contraction was stronger in foreign exchange credits than in forint-denominated ones. Increased costs of borrowing and the bleak profit expectations in the business sector explain this ebb in lending activities.

Developments in 2010 will be decisively influenced by the outcome of the elections to be held in April this year. A victory of the right-wing populist FIDESZ party is very likely. The only question seems to be whether it will have a two-thirds majority with a mandate to amend the constitution or only a simple majority. Although the election campaign has already started, it is far from clear what FIDESZ intends to do about the economy, once in power. As an opposition party it had supported some of the most irresponsible decisions of the socialist-liberal government in the parliament (such as a 50% increase in public servants' salaries in one step and the introduction of the 13th month pension) which led to the fiscal disaster by 2006. Simultaneously FIDESZ was a fervent opponent of all government-initiated reforms aimed at attaining a sustainable fiscal stance in the medium and long run. It also viciously attacked the government's short-run fiscal stabilization measures starting from mid-2006 and the crisis management in the wake of the global financial and economic crisis. Though this may be seen as pure rhetoric, FIDESZ' current popularity is based on the very high

expectations of the party's supporters concerning a painless way out of the crisis – without restrictive measures and unpleasant reforms.

The general government deficit will be the critical issue in 2010. The current government's budget reckons with a 3.8% deficit relative to GDP, a target approved by the IMF. This target is probably impossible to reach without improvized expenditure cuts as extraordinary support may prove necessary for the ailing state railways and the Budapest public transport company. Further, the Constitutional Court abolished the newly introduced tax on real estate which also leaves a hole in the projected revenues. Also, some hospitals and local governments may need a bailout. That means that the incoming government must begin with some restrictions in order to observe the official deficit target. A 7% new deficit target has already been mentioned by FIDESZ politicians, a proposal that was rejected by the IMF. Nevertheless, a somewhat higher deficit target (around 5%) than originally projected may possibly be agree upon. This would fit the prevailing general picture concerning budget deficits in the region and give some scope for the new government to fulfil at least a fragment of the inflamed expectations of those voting for FIDESZ.

The currently propagated vague ideas of FIDESZ on the economy – facilitating economic growth through radical tax cuts on the one hand, and leaving alone fiscal expenditures (only in the field of bureaucracy are there plans to diminish outlays) on the other – seems to be an equation without any known formula for solution if the budget deficit ought to remain under control. In the given international environment and in the current Hungarian circumstances, the most likely scenario for post-election economic policy in Hungary is one that foresees a willy-nilly continuation of fiscal stability oriented policies in accordance with the IMF stand-by agreement (which may possibly be renegotiated in some details). In another, less likely scenario, this pragmatic policy making will be preceded by a brief adventurous episode along the lines of FIDESZ pre-election rhetoric – which will most probably be sanctioned very soon by the international environment. A strong devaluation of the forint and rocketing spreads on or even denied access to the bond markets might follow.

In the baseline scenario, 2010 will be a year of stagnation on average, with a mild decline in the first and a moderate upturn in the second half of the year. Net exports will still make a positive contribution to GDP change, but much less so than in the previous year. The reason for closing the export/import gap will be the recovery of imports driven by a restocking of inventories. Consumption and investment will still decrease this year, even if to a moderate extent. The surplus on the current account in 2009 was a result of extraordinary circumstances and cannot be repeated in 2010. Nevertheless, the forecast deficit (1.3% of GDP) is far from the huge pre-crisis deficits. A strongly positive balance of goods and services trade is expected while still meagre profits realized by foreign-owned companies will lend, provisionally, a fancy look to the income balance. The sustainability of the trade surplus is explained by the lasting devaluation of the Hungarian currency compared to the pre-crisis levels (about 10%) and an improvement in Hungarian exporters' competitiveness through a diminished tax burden on labour. A recovery in FDI inflows is likely to follow, with at least one major project, the Daimler-Benz investment in Kecskemét. Foreign financing for revolving public debt seems secured. All in all, there seem to be no external constraints on the beginning recovery in Hungary.

Table HU

Hungary: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average	10107.1	10087.1	10071.4	10055.8	10038.2	10022.3	10011	10005	10000
Gross domestic product, HUF bn, nom.	20803.8	21988.6	23755.5	25408.1	26543.3	25700	26400	27700	29200
annual change in % (real)	4.9	3.5	4.0	1.0	0.6	-6.5	0	3	3.5
GDP/capita (EUR at exchange rate)	8200	8800	8900	10100	10500	9100	.	.	.
GDP/capita (EUR at PPP)	13700	14200	15000	15600	16100	15300	.	.	.
Consumption of households, HUF bn, nom.	11029.5	11813.9	12436.5	13254.9	13919.4	13500	.	.	.
annual change in % (real)	3.0	3.2	1.9	0.3	-0.5	-7	-1.5	1	2
Gross fixed capital form., HUF bn, nom.	4677.8	5065.9	5161.3	5380.5	5559.1	5600	.	.	.
annual change in % (real)	7.9	5.7	-3.6	1.6	0.4	-5	-1	9	10
Gross industrial production									
annual change in % (real)	7.7	6.8	9.9	7.9	-0.2	-17.5	0	10	10
Gross agricultural production									
annual change in % (real)	24.1	-7.1	-2.9	-11.6	27.6	-10.6	.	.	.
Construction industry									
annual change in % (real)	4.3	15.7	-0.7	-14.0	-5.2	-2	4	10	10
Employed persons - LFS, th, average	3900.4	3901.5	3930.0	3926.2	3879.4	3775	3770	3810	3850
annual change in %	-0.5	0.0	0.7	-0.1	-1.2	-2.7	-0.2	1	1
Unemployed persons - LFS, th, average	252.9	302.2	316.7	312.0	329.1	420	.	.	.
Unemployment rate - LFS, in %, average	6.1	7.2	7.5	7.4	7.8	10.3	10.5	10	9.3
Reg. unemployment rate, in %, end of period	9.1	9.3	9.1	10.1	10.9	13.3	.	.	.
Average gross monthly wages, HUF [2]	145520	158343	171351	185017	198964	196000	.	.	.
annual change in % (real, net)	-1.0	6.3	3.5	-4.8	0.8	-2.3	.	.	.
Consumer prices (HICP), % p.a.	6.8	3.5	4.0	7.9	6.0	4.0	3.8	3.5	3.3
Producer prices in industry, % p.a.	3.9	3.1	6.6	0.3	4.6	4.5	.	.	.
General governm.budget, EU-def., % GDP									
Revenues	42.3	42.2	42.6	44.8	45.5	45.0	.	.	.
Expenditures	48.7	50.1	52.0	49.8	49.2	48.7	.	.	.
Net lending (+) / net borrowing (-)	-6.4	-7.9	-9.4	-5.0	-3.7	-3.7	-5.0	-4.0	-3.5
Public debt, EU-def., in % of GDP	59.1	61.8	65.6	65.9	72.9	79	81	82	80
Base rate of NB, % p.a., end of period	9.5	6.0	8.0	7.5	10.0	6.3	.	.	.
Current account, EUR mn [3]	-6838	-6380	-6762	-6845	-7519	500	-1200	-2300	-2600
Current account in % of GDP	-8.3	-7.2	-7.5	-6.8	-7.1	0.5	-1.3	-2.2	-2.4
Exports of goods, BOP, EUR mn [3]	44507	49672	58380	68178	72671	58900	62400	69300	76900
annual growth rate in %	17.4	11.6	17.5	16.8	6.6	-19	6	11	11
Imports of goods, BOP, EUR mn [3]	47369	51882	60433	67987	72730	54500	57200	63500	71100
annual growth rate in %	16.1	9.5	16.5	12.5	7.0	-25	5	11	12
Exports of services, BOP, EUR mn [3]	8672	10351	10876	12574	13648	13100	13800	14900	16400
annual growth rate in %	6.8	19.4	5.1	15.6	8.5	-4	5	8	10
Imports of services, BOP, EUR mn [3]	8188	9219	9643	11524	12795	11600	12200	13200	14500
annual growth rate in %	1.4	12.6	4.6	19.5	11.0	-9	5	8	10
FDI inflow, EUR mn [3]	3633	6172	15809	52327	42735	.	.	.	.
FDI outflow, EUR mn [3]	892	1756	14846	48915	41491	.	.	.	.
FDI inflow, excl. SPE, EUR mn	3633	6172	5887	4182	3067	0	2500	4500	4500
FDI outflow, excl. SPE, EUR mn	892	1756	3127	2598	568	800	500	1000	1000
Gross reserves of NB, excl. gold, EUR mn	11669	15670	16384	16305	23807	30601	.	.	.
Gross external debt, EUR mn	55615	67071	81898	99468	121769	125000	.	.	.
Gross external debt in % of GDP	65.8	77.1	86.8	99.3	122.3	131.5	.	.	.
Average exchange rate HUF/EUR	251.66	248.05	264.26	251.35	251.51	280.33	275	270	265
Purchasing power parity HUF/EUR	149.88	153.53	157.74	161.97	163.81	167.09	.	.	.

Note: Gross industrial production, construction output and producer price index refer to NACE Rev. 2.

1) Preliminary and wiiw estimates. - 2) Enterprises with 5 and more employees. - 3) From 2006 including Special Purpose Entities (SPE), 2009-2012 data are estimated excluding SPE.

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.

Leon Podkaminer

Poland:
Moderate acceleration, not a headlong rush

After a slow start (in the first quarter of 2009 GDP rose by 0.8%), growth has accelerated throughout the year. Eventually, GDP increased by 1.7% in 2009, according to official estimations. Expectations of recession, voiced not quite long ago by most institutions (including the European Commission and OECD), turned out incorrect. Poland is thus one of the few countries in Europe which avoided recession in 2009.

The contracting inventories continue to be the major drag on growth. They contributed minus 2.5 percentage points (pp) to overall GDP growth in 2009. However, the inventory contraction seems to have been slowing down. Gross *fixed* capital formation, which quite minimally declined in the second and third quarters of the year, rebounded already in the fourth. Its contribution to the yearly GDP growth rate is close to zero. Growth of consumption (both private and public) weakened considerably in the second quarter. But growth of private consumption accelerated anew in the second half of 2009. Overall private consumption rose by 2.3%, contributing 1.4 pp to overall growth. Public consumption rose less vigorously so that total consumption increased by a mere 2%. Despite some decline in employment, the total wage bill (gross) rose by 5.2% nominally in 2009, or by over 1.6% in real terms. Households' disposable purchasing power was strongly augmented by high increases in pensions, retirement pays and other mandatory social transfers. The average retirement pay and pension rose by 4.3% in real terms. Together with private consumption, foreign trade remains the major force behind the economy's resilience. In 2009 foreign trade contributed about 2.7 pp to overall GDP growth.

Industrial sales, which had fallen by some 10% in the first quarter of 2009, recovered later on. In the closing months of 2009 industrial production accelerated very strongly. Overall, industrial output fell by just 3.2% in 2009. The sales by industrial branches producing primarily intermediate and investment goods were about 6.3% and 9% lower than a year earlier, respectively. But the same indices for sales of nondurable and durable consumer goods were positive: 5.1% and 13.8% respectively. Clearly, consumer sentiments have been quite buoyant. Importantly, in the fourth quarter of 2009 sales of intermediate goods also accelerated, and quite strongly too, while the decline in sales of investment goods seems to have stopped. This bodes quite well for the recovery in 2010.

Average employment in industry fell by some 5.5% in 2009, while the average nominal wage rose by some estimated 4.9%. The initial losses in terms of labour productivity and unit labour costs suffered in 2008 and the first quarter of 2009 have thus been fully offset.

Net post-tax profits earned in industry in the third quarter of 2009 rose by 30% over the same period of 2008. However, the extraordinary losses recorded in the first quarter (due mainly to earlier reckless engagement in the purely speculative currency options business[32]) were not yet retrieved. Net profit earned in industry in the first three quarters of 2009 was still over 6% lower than in the same period of 2008. Other segments of the non-financial corporate sector performed similarly. The net profit earned by the whole non-financial corporate sector in the first three quarters of 2009 was 5% lower than a year earlier. But the sector's profits are recovering fast: in the third quarter profits were already 18.6% higher than a year before. Importantly, the recovery of profits is strengthening the liquidity position of non-financial firms. According to the January 2010 business climate survey of the National Bank of Poland, close to 72% of firms do not report liquidity problems, and over 89% of firms service their bank debts regularly. The latter indicator is still lower than a year ago when it stood at 93% (but far from its lowest value of 76% reported in 2002). Progress has been uneven though, with the liquidity position and the ability to service the debts continuing to deteriorate in the segment of small firms and also for the producers of capital goods.

Banks' profits, strongly depressed in the first quarter of 2009, have continued to recover as well. But they are still lower than in the exceptionally good first three quarters of 2008. Banks' net profits made in the third quarter of 2009 were still some 34% lower than a year before. This is due primarily to large provisions (i.e. reserves mitigating eventual losses) made by the banks. Larger provisions are to counter higher risks following the deterioration of banks' balance sheets. The share of problematic loans has been on the rise. At the end of September 2009 the ratio of such loans in the total stocks of loans stood at 7% (up from 4.4% a year earlier). The ratio for the problematic loans to the corporate sector roughly doubled (to 10.8%), but the ratio for such loans to households continues to be small (1.4%). Interestingly, the irregular loan ratios for loans denominated in foreign currencies are much lower than for loans in domestic currency (in all loan categories). At about 1.07, the banks' loans/deposits ratio has improved – and is very low by international standards. Banks' solvency rate (i.e. the Capital Adequacy Ratio) stands at a level considered quite satisfactory (13% up from 11.6% a year ago). The leverage ratio (assets/own funds) fell to 12.5% (from 15% reported for the first quarter of 2009). These improvements followed the retention of the large profits earned in 2008. Other available indicators suggest that the banking sector is in fairly good shape. In particular its liquidity position remains strong. The risk of larger-scale withdrawals of foreign financing of the banks seems to have diminished further.

In 2009, the stock of bank loans to households and non-financial corporations rose by about 6% nominally. Credit expansion is still clearly subdued, especially as far as the non-financial corporate sector is concerned. The stock of loans to that sector fell nominally by close to 1.5%. This development is quite understandable given the corporate sector's generally good financial standing coupled with its currently low propensity to invest in new production capacities. Relatively low interest rates on new loans to the corporate sector and the banks' somewhat less restrictive lending standards (as compared to early 2009) appear unable to induce higher demand for corporate loans.

[32] Throughout the first half of 2008 the continuing steep appreciation of the zloty attracted very many managers and entrepreneurs to the currency (call) option business. As the zloty depreciated steeply in the closing months of 2008 and in January/February 2009, the option business left them with huge losses.

It may be added that the nominal stock of loans to households has been rising more meaningfully, by 11% (since the year's beginning). The bulk of new credit (currently denominated predominantly in domestic currency) to households serves the satisfaction of their housing needs.

The dramatic changes in the foreign trade balances reported in 2009 have helped to radically reduce the current account deficits. This was supportive in restoring the confidence of foreign investors. The massive capital outflows observed in the closing months of 2008 have been replaced with fairly high inflows, including FDI. Consequently, the official reserves of the National Bank have risen sharply and the zloty/euro exchange rate has strengthened again. So far that strengthening has not been excessive.

A general government deficit of up to 6% of GDP is likely in 2010. The deficit expands primarily due to the operation of 'automatic stabilizers', and not because of any deliberate actions aimed at demand stimulation. Infrastructure investment, co-financed out of EU transfers, remains strong. Politics (with the upcoming presidential elections later this year, and general elections due in 2011) make truly dramatic changes in the public financial system rather unlikely anytime soon. But some potential for cutting the public sector deficits certainly exist – and seems to be seriously considered by the government. Specifically, it has been proposed that the so-called second pillar of the pension system (part and parcel of the radical reform introduced ten years ago) be now radically downsized. By reducing the contributions currently amassed by the private pension societies, the public sector deficits could be lowered by up to 1.5% of GDP per year. It goes without saying that the proposal is vehemently protested by the pension societies and their experts.

The tendencies prevailing so far with respect to exchange rates, foreign trade, consumption and gross capital formation are likely to continue. Growth in 2010 could accelerate further if external demand strengthens – as generally expected. There are, however, some unknowns as concerns the performance in 2010 and beyond. First of all, the course of the future exchange rate is hard to predict. Should the zloty strengthen radically, the trade engine generating much of Poland's recent growth may slow down. But the other important reason for Poland's extraordinary growth performance in 2009 (healthy financial position of households, firms and banks) would anyway help to sustain recovery, especially if recession in Poland's major trading partners comes to an end.

Table PL

Poland: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average	38182.2	38165.4	38141.3	38120.6	38125.8	38149.9	38175	38150	38150
Gross domestic product, PLN bn, nom.	924.5	983.3	1060.0	1176.7	1272.8	1340	1410	1490	1580
annual change in % (real)	5.3	3.6	6.2	6.8	5.0	1.7	2.5	3	3.4
GDP/capita (EUR at exchange rate)	5300	6400	7100	8200	9500	8100	.	.	.
GDP/capita (EUR at PPP)	11000	11500	12300	13600	14100	14600	.	.	.
Consumption of households, PLN bn, nom.	589.4	614.3	652.8	701.6	773.9	820	.	.	.
annual change in % (real)	4.7	2.1	5.0	4.9	5.9	2.3	3	5	5
Gross fixed capital form., PLN bn, nom.	167.2	179.2	208.3	253.7	280.9	290	.	.	.
annual change in % (real)	6.4	6.5	14.9	17.5	8.1	-0.3	4	8	12
Gross industrial production (sales) [2]									
annual change in % (real)	12.7	3.7	12.1	9.3	2.6	-3.7	4	6	7
Gross agricultural production									
annual change in % (real)	13.9	-0.7	-1.1	5.2	0.9	-5.3	.	.	.
Construction industry [2]									
annual change in % (real)	-0.9	9.3	15.9	16.4	9.8	3.7	.	.	.
Employed persons - LFS, th, average	13794.8	14115.6	14593.6	15240.5	15799.6	15800	15720	15800	16120
annual change in %	1.3	2.3	3.4	4.4	3.7	0	-0.5	0.5	2
Unemployed persons - LFS, th, average	3230.3	3045.4	2344.3	1618.8	1210.7	1350	.	.	.
Unemployment rate - LFS, in %, average	19.0	17.7	13.8	9.6	7.1	8.5	10	9	8.5
Reg. unemployment rate, in %, end of period	19.1	17.6	14.8	11.4	9.5	11.9	12.5	10.5	9.5
Average gross monthly wages, PLN	2273.4	2360.6	2475.9	2672.6	2942.2	3103.0	3250	3460	3710
annual change in % (real, gross)	0.7	1.8	4.0	5.5	5.9	2.1	2.5	4	4.5
Consumer prices (HICP), % p.a.	3.6	2.1	1.3	2.6	4.2	4.0	2.6	2.5	2.5
Producer prices in industry, % p.a.	6.6	0.5	1.8	2.0	2.4	3.9	2	2	2
General governm.budget, EU-def., % GDP									
Revenues	36.9	39.4	40.2	40.3	39.6	39.5	.	.	.
Expenditures	42.6	43.4	43.9	42.2	43.3	45	.	.	.
Net lending (+) / net borrowing (-)	-5.7	-4.1	-3.6	-1.9	-3.7	-5.5	-5.5	-4.0	-4
Public debt, EU-def., in % of GDP	45.7	47.1	47.7	45.0	47.2	51	55	57	58
Discount rate of NB % p.a., end of period	7.0	4.8	4.3	5.3	5.3	3.8	3.8	3.8	3.8
Current account, EUR mn [3]	-8166	-3016	-7443	-14701	-18320	-4968	-6000	-9000	-12000
Current account in % of GDP [3]	-4.0	-1.2	-2.7	-4.7	-5.1	-1.6	-1.7	-2.5	-3.1
Exports of goods, BOP, EUR mn [3]	65847	77562	93382	105883	120953	99827	102800	111000	121000
annual growth rate in %	22.3	17.8	20.4	13.4	14.2	-17.5	3	8	9
Imports of goods, BOP, EUR mn [3]	70399	79804	98918	118249	138691	103254	107000	116000	128000
annual growth rate in %	19.5	13.4	24.0	19.5	17.3	-25.6	4	8	10
Exports of services, BOP, EUR mn [3]	10815	13105	16349	21018	24228	21010	22250	24500	27400
annual growth rate in %	9.8	21.2	24.8	28.6	15.3	-13.3	6	10	12
Imports of services, BOP, EUR mn [3]	10787	12520	15768	17583	20745	17184	17800	20100	22700
annual growth rate in %	11.7	16.1	25.9	11.5	18.0	-17.2	7	13	13
FDI inflow, EUR mn [3]	10237	8330	15737	17241	10036	8384	9000	.	.
FDI outflow, EUR mn [3]	757	2767	7122	4018	2047	2315	2000	.	.
Gross reserves of NB excl. gold, EUR mn	25870	34535	35237	42675	42299	52687	.	.	.
Gross external debt, EUR mn	95298	112316	128870	159106	172832	196000	.	.	.
Gross external debt in % of GDP	42.1	44.1	46.6	48.6	56.4	60	.	.	.
Average exchange rate PLN/EUR	4.53	4.02	3.90	3.78	3.51	4.33	4.1	4.1	4.1
Purchasing power parity PLN/EUR	2.21	2.23	2.26	2.28	2.36	2.41	.	.	.

Note: Gross industrial production, construction output and producer price index refer to NACE Rev. 2.

1) Preliminary and wiiw estimates. - 2) Enterprises with 10 and more employees. - 3) From 2006 including Special Purpose Entities (SPEs).

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.

Gábor Hunya

Romania: Stagnation

The year 2010 began with good news: the re-elected president and the re-installed prime minister have ended the political stalemate that halted the reforms required for receiving the December instalment of the IMF and EU loan. The budget law for the current year was passed in mid-January, stipulating austerity measures in line with the stand-by agreement, and enabled the release of multilateral funding. The announced austerity measures will suppress domestic demand. At the same time the outlook for exports is positive driven by the inception of European recovery. The question is, what will have a stronger impact, the recovery of exports or the drop in public demand? The most likely scenario is that the contradicting forces will extinguish each other and the Romanian economy will stagnate in 2010.

In 2009 GDP contracted by 7.2%, first of all due the strong fall in private consumption and investment. Public consumption expanded and the trade balance improved remarkably forestalling an even stronger GDP decline. Romania was among those few EU members where the GDP decline continued in the fourth quarter of 2009. But industrial output recovered already in the final months of the year riding on the waves of increasing external demand. Manufacturing production was 3% higher in November 2009 than a year before; the production of capital goods in particular recovered strongly. This trend is due to continue in 2010 and beyond as Romania has established itself as a relatively cheap manufacturing location. Agricultural production contracted only marginally as against the previous peak year. But it is facing major difficulties in 2010 as several domestic subsidies expire in accordance with the EU accession agreement while farmers cannot easily access support provided under the Common Agricultural Policy.

Inflation came down somewhat but was still rather high in a European comparison. Due to the depreciation of the local currency by 15% on annual average, import prices rose and compensated for the deflationary effect of the recession. The exchange rate is expected to be more or less stable in 2010 which will easy inflationary pressure. But the increase in excises and forthcoming gas price hikes will not allow much inflation decline in 2010 either.

The consolidated fiscal deficit in 2010 was more than 7% of GDP, much higher than initially envisaged but in line with the modified IMF target. Further slippage could be avoided by seriously curtailing spending in the last quarter of the year. Authorities simply did not pay their obligations and increased arrears towards the rest of the economy. The 2010 budget law foresees expenditure cuts in the public sector, a wage freeze and releasing about a hundred-thousand employees. The government faced the dilemma either to cut public sector wages or decrease employment there;

they opted for a mix of the two solutions. Labour unrest, expected for the coming months, may modify these intentions. Earlier plans of increasing one or the other taxes were abandoned except for excises.

The unemployment rate based on registration rose to 7.6% in December, from 4.4% a year earlier, and the annual average for 2009 stood at 6.3%. LFS data come usually with some delay and may still show a milder increase. Most of the unemployed had to leave the private sector, in particular construction. Net real wages rose by some 2% as the public sector continued paying bonuses up to the middle of the year. The labour market situation will worsen in 2010 due to the expected layoffs in the public sector and registered unemployment may rise to 10%. A recovery in some industries may come from productivity increases and not from re-employment. Another factor influencing employment and income is the behaviour of Romanian migrants. Return migration was weak in 2009 but may accelerate if the economic rebound in Italy and Spain turns out weak. Unemployment and the threat of it forces the population to save more and curtail consumption, depressing the main domestic source of economic growth. Bank deposits rose by 7.9% in real terms in December year-on-year and the central bank expects this trend to continue. Labour market, income and savings trends point to falling private consumption in 2010.

In 2009 the current account deficit narrowed to less than one third compared to the previous year as both the trade and services balance improved and also the income deficit shrank. Imports contracted more than twice as fast as exports. Machinery and equipment (including cars) was the major export commodity group with 43% in exports while they accounted for only one third of imports. This reflects the strong position of cheap Romanian cars on foreign markets and the sharp drop in demand for vehicles and investment goods in the country. In November 2009 exports already outpaced the level of November 2008 and more recovery can be expected for 2010. Another important current account item, transfers, declined by one third indicating that emigrant workers could send home less than before. The inflow of direct investments was EUR 4.9 billion, half the amount registered in the previous year but still covering almost the whole current account deficit. In 2010 neither remittances nor FDI are expected to recover; the trade and thus also the current account deficit will most probably start to grow in euro terms.

The IMF Executive Board allowed two disbursements worth EUR 2.3 billion from the loan package which had been frozen in October after the government's dismissal by Parliament. Also the European Commission indicated it would unlock EUR 1 billion in funding. Half of the IMF funds will go directly to the government budget, which is an exceptional measure allowed by the Fund. Thus external financing is sufficient to ensure stability, provided the agreed policy measures are implemented.

In 2010 Romania faces a year with stagnating GDP. This wiiw forecast is more pessimistic than those of the multilateral institutions and of the Romanian government, which have agreed on 1.3% recovery. The positive component is the recovery in Western Europe, which invigorates Romanian exports and will bring new orders for manufacturing, but will not necessarily have a positive impact on employment and only a modest one on investment and consumption. Meanwhile also imports will

be increasing thus net exports may stagnate. Importantly, the above-mentioned restrictive fiscal measures will curtail consumption and investment. As to the latter, one may expect some increase only due to EU-financed programmes. Agriculture is another uncertain factor with an eventually strong impact on GDP. As 2009 was better than average in this field despite a slight production drop compared to the peak-year 2008, decline is more likely than recovery. For the overall economy, the balance of the positive and negative trends may be zero for the year as a whole. If exports and manufacturing recover more robustly and fiscal revenues rebound, the second half of the year may already bring some recovery which will show up more strongly in 2011. Beyond that year our forecast refers to a kind of balanced growth over the medium term. It is expected that the inflow of external financing will remain modest and growth that is primarily based on domestic savings cannot be very robust. The boom of 2006-2008 will thus not return any time soon. Still economic growth of about 4% will ensure the resumption of a modest catching-up process.

Table RO

Romania: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average	21685	21634	21588	21547	21514	21482	21460	21440	21410
Gross domestic product, RON mn, nom.	247368	288955	344651	416007	514654	501500	526600	564100	616000
annual change in % (real)	8.5	4.2	7.9	6.3	7.3	-7.2	0	3	4
GDP/capita (EUR at exchange rate)	2800	3700	4500	5800	6500	5500	.	.	.
GDP/capita (EUR at PPP)	7400	7900	9100	10400	12000	11400	.	.	.
Consumption of households, RON mn, nom.	167644	197069	233135	273418	327882	303000	.	.	.
annual change in % (real)	15.8	10.1	12.9	12.0	9.5	-12	-1	1	2
Gross fixed capital formation, RON mn, nom.	53850	68527	88272	125645	164264	144900	.		
annual change in % (real)	11.0	15.3	19.9	30.3	16.2	-16	3	7	9
Gross industrial production [2]									
annual change in % (real)	2.7	-3.1	9.3	10.3	2.6	-5.5	3	5	7
Gross agricultural production									
annual change in % (real)	18.1	-13.1	2.4	-17.7	21.2	-2.7	.	.	.
Construction industry [2]									
annual change in % (real)	2.0	6.1	15.4	33.2	26.7	-15.1	.	.	.
Employed persons - LFS, th, avgerage	9157.6	9114.6	9291.2	9353.3	9369.1	9250	9150	9150	9200
annual change in %	-0.7	-0.5	1.9	0.7	0.2	-1.3	-1	0	1
Unemployed persons - LFS, th, average	799.5	704.5	728.4	640.9	575.5	700	.	.	
Unemployment rate - LFS, in %, average	8.0	7.2	7.3	6.4	5.8	7	8.5	8	6
Reg. unemployment rate, in %, end of period	6.3	5.9	5.2	4.0	4.4	7.6	.	.	.
Average gross monthly wages, RON	818.3	968.0	1146.0	1396.0	1742.2	1900	.	.	.
annual change in % (real, net)	10.5	14.3	9.0	14.7	14.1	2	.	.	.
Consumer prices (HICP), % p.a.	11.9	9.1	6.6	4.9	7.9	5.6	4	3	4
Producer prices in industry, % p.a.	19.2	8.1	9.5	7.5	15.3	1.8	.	.	.
General governm.budget, EU-def., % GDP									
Revenues	32.3	32.3	33.1	33.5	32.1	31.0	.	.	.
Expenditures	33.5	33.5	35.3	36.0	37.6	38.2	.	.	.
Net lending (+) / net borrowing (-)	-1.2	-1.2	-2.2	-2.5	-5.4	-7.2	-6	-5	-4
Public debt, EU-def., in % of GDP	18.7	15.8	12.4	12.6	13.6	22	27	31	33
Discount rate of NB, % p.a., end of period [3]	17.96	7.50	8.75	7.50	10.25	8.00	.	.	.
Current account, EUR mn	-5099	-6888	-10220	-16758	-16178	-5054	-7000	-9000	-11000
Current account in % of GDP	-8.4	-8.6	-10.5	-13.4	-11.6	-4.3	-5.6	-6.5	-7.1
Exports of goods, BOP, EUR mn	18935	22255	25953	29542	33656	29036	30500	33600	37600
annual growth rate in %	21.3	17.5	16.6	13.8	13.9	-13.7	5	10	12
Imports of goods, BOP, EUR mn	24258	30061	37765	47365	52729	35790	37200	41700	47500
annual growth rate in %	24.0	23.9	25.6	25.4	11.3	-32.1	4	12	14
Exports of services, BOP, EUR mn	2903	4102	5585	6885	8751	7000	7700	8500	9400
annual growth rate in %	8.7	41.3	36.2	23.3	27.1	-20.0	10	10	10
Imports of services, BOP, EUR mn	3116	4451	5581	6475	8091	7267	8000	8800	9700
annual growth rate in %	19.4	42.8	25.4	16.0	25.0	-10.2	10	10	10
FDI inflow, EUR mn	5183	5213	9060	7280	9501	4899	4000	.	.
FDI outflow, EUR mn	56	-24	338	206	186	131	.	.	.
Gross reserves of NB excl. gold, EUR mn	10923	16785	21299	25325	25978	28303	.	.	.
Gross external debt, EUR mn	21504	30914	41196	58628	72354	78656	.	.	.
Gross external debt in % of GDP	34.2	39.4	40.4	50.8	56.6	66.4	.	.	.
Average exchange rate RON/EUR	4.0510	3.6209	3.5258	3.3353	3.6826	4.2399	4.2	4.1	4.0
Purchasing power parity RON/EUR	1.5442	1.6989	1.7600	1.8621	1.9869	2.0552	.	.	.

Note: Gross industrial production, construction output and producer price index refer to NACE Rev. 2.

1) Preliminary and wiiw estimates. - 2) Enterprises with 4 and more employees. - 3) Reference rate of NB.

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.

Zdenek Lukas

Slovakia:
After gloom, still no boom

At the beginning of the turbulent year 2009 Slovakia adopted the euro, which definitely eased the impact of the financial crisis on Slovak banking. The financial sector in Slovakia was hardly affected by the turmoil. Some 95% of bank assets are in foreign ownership, with a dominance of the traditionally conservative Austrian banks not engaged in toxic transactions. However, the strongly export-oriented Slovak economy was hit hard by the sharp contraction in foreign demand in the wake of the global economic crisis. Over the year the Slovak government adopted several anti-crisis measures chiefly targeted at the support of consumption and employment. According to the implementation report of the National Reform Programme for 2008-2010, it is expected that the total amount spent on anti-crisis measures in 2009 reached EUR 1.5 billion or 2.3% of GDP.

GDP contracted by 5% in 2009. The volume of exports and imports (goods and services) dropped by 20% and 21%, respectively. Still, contribution of foreign trade to GDP was positive. Gross capital formation declined by 21%, gross fixed capital formation was down by 12%. The difference is accountable to falling inventories, which were the main explanatory component of the GDP decline. Stagnating real wages and consumers' caution resulted in a stagnation of private consumption, whereas government consumption (and the budget deficit) increased. Following FDI inflows of EUR 2.4 billion in 2008, foreign direct investment came to a standstill in 2009. Some investors left the country; for instance, the large investor Molex Slovakia, producing car components in the Kechnec Industrial Park (located on the southeast border with Hungary) closed down its production after nine years of operation.

On the supply side, the GDP contraction followed mostly from a decline in gross value-added in manufacturing. Slovak car makers hardly profited from the car scrapping subsidies introduced in several EU countries including Slovakia. Foreign demand both for low-cost cars (such as small models of KIA, Citroen or Peugeot) and luxury cars (VW Touareg, Audi Q7 and Porsche Cayenne) produced by foreign-owned companies in Slovakia was disappointing. The excessive dependence on the automotive industry may also backfire – especially in times of crisis. Mainly due to the fall in car production (-27%), gross industrial production was down by 15% in 2009, accompanied by some 8% decline in industrial employment and stagnating real wages. As a result, labour productivity in industry fell by about 7% and unit labour costs (ULCs) rose in 2009. Because of the strong appreciation of the Slovak koruna before adopting the euro, Slovak export goods became less competitive. Nevertheless, in March 2009, the French automaker PSA Peugeot Citroen introduced its new C3 Picasso on the market. Four months later Korean carmaker Kia Motors Slovakia launched a new version of its Kia cee'd model. Following the record production of above 580,000

cars in 2008, output was down to some 470,000 cars in 2009. Only the electronics industries and coke and refinery products registered modest growth in 2009.

Gross output of construction dropped by 11% in 2009. Prospects are, however, encouraging: in 2009 the government launched the first public-private partnership (PPP) projects for the construction of one highway and one less ambitious double-track road connecting Bratislava with underdeveloped eastern Slovakia. The first PPP, signed with an international consortium led by a French company, will construct a total length of 75 kilometres with an investment value of over EUR 3 billion. The second PPP, signed with an international consortium (Granvia), will build 52 kilometres of the dual-carriage way worth EUR 930 million. In addition, the Slovak electric utility company Slovenské elektrárne (66% of shares owned by the Italian energy company Enel) will complete the third and fourth units of the Mochovce nuclear power station. This biggest private investment (EUR 2.7 billion) is to be spent up to 2013.

The labour market situation has been worsening, particularly in industrial regions where the demand crisis in industry resulted in layoffs, first of part-time workers and later on of regular workers. In 2009 the unemployment rate (LFS) rose by 2.8 percentage points to 12.3% year-on-year; the number of employed persons dropped by close to 3%. In 2010 the unemployment rate will continue to rise because the labour market follows the development of the real economy with a time lag. The consumer price index (HICP) has been falling continuously. At 0.9%, the annual inflation recorded in 2009 is the lowest in history. The main reasons behind are low energy prices, falling prices of manufacturing products and building materials as well as food.

As a result of the sharp GDP decline, the budgetary revenues in 2009 were down by 7% as the collection of the most important VAT dropped by 17% year-on-year. Revenues from excise taxes contracted by some 4% and those from income taxes stagnated. Driven by expenditures for the anti-crisis package, total budgetary expenditures in 2009 rose by 11% year-on-year. As a result, instead of the originally assumed deficit of EUR 1 billion, the general government deficit amounted to EUR 2.8 billion, or 6.3% of GDP. The trade balance slightly improved in 2009, as imports dropped more strongly than exports. In addition, shrinking profits of foreign investors improved the income balance and in this way contributed to reducing the current account deficit to some 3% of GDP. However, gross external debt and public debt have been rising rapidly.

The three foreign-owned enterprises in the automotive industry have remained the flagships of the Slovak economy and are important driving forces for other industrial sectors. Slovakia's biggest car maker VW Bratislava (with annual sales of about EUR 5 billion) is optimistic and preparing new investment. Starting in 2011, VW will produce its New Small Family models in Slovakia and invest here EUR 300 million. The VW annual production capacity is to gradually rise to 400 thousand cars. PSA and Kia are also fighting the crisis by expanding the production of new car models. Partly based on purposive optimism, the Slovak Ministry of Economy expects the output to increase to 540 thousand cars in 2010 with a further expansion to 900 thousand units in 2012. Taking into account the investment intentions in car production as well as in construction (highways, nuclear

power station), we expect a modest recovery in FDI inflows in 2010 (about EUR 1 billion) with further FDI growth in the years to come.

Starting in 2010 the Slovak authorities are to implement deficit reducing measures, aimed at a reduction of the annual average deficit by 0.75% to 1% of GDP over the period 2010-2013. With reference to the EU's Stability and Growth Pact, the National Fiscal Consolidation Strategy (NFCS), approved by the government on 14 December 2009, has envisaged the reduction of the general government deficit from 6.3% to 5.5% in 2010 and step-by-step to 3% of GDP in 2012. These targets are probably out of reach, however, mainly because of (i) the consolidation being solely backed by strong growth of budgetary revenues, a plan relying on unrealistically high GDP growth; (ii) the absence of measures on the budgetary expenditure side; and (iii) the absence of binding limits on budgetary expenditures. In addition, despite the very limited ability to absorb EU funds, the government believes to be able to finance some expenditures by an ambitious drawing of EU funds. Another concern is the long-term sustainability of the pension system, which is not warranted by the NFCS. The system faces deficits induced by the ageing of the population. Last but not least, the deficit consolidation will be undermined by rising unemployment-related transfers as the unemployment rate will increase in 2010 and remain unchanged beyond. Should the global economic rebound projected for 2010 really materialize, the Slovak economy may slightly expand in 2010 and somewhat more forcefully in 2011. Perhaps in 2012 a strong growth in foreign demand may drive a higher economic expansion. Past experience shows that only several years of strong GDP growth has employment supporting effects.

In this context, the wage development will be a crucial competitiveness factor because in the past, in the course of massive currency appreciation, Slovakia was losing part of its low-cost advantages. During the period November 2005 to May 2008 the central exchange rate parity (SKK/EUR) appreciated by 28% and that was finally accepted as the conversion rate for accession to the eurozone in 2009. No wonder that unit labour costs (ULCs) rose rapidly in euro terms, though Slovakia still has lower average wages and ULCs than other Central European competitors (the Czech Republic, Hungary, Poland). However, this important comparative advantage has been rapidly diminishing.

In the short run, Slovakia's competitiveness against those neighbouring countries may theoretically be restored by wage reduction or price deflation; in the longer term, wages should rise less than in the competing countries. However, a drop in real wages would reduce the population's purchasing power prior to the parliamentary elections in mid-2010 and thus will be difficult to implement. In the long run, given the excessively strong domestic currency, the highly export-oriented manufacturing sector may remain vulnerable. Sustainable economic growth has to be backed by investments in new, advanced technology for the knowledge economy coupled with a restructuring of the labour market in order to regain competitiveness in international markets and to revitalize export expansion.

To sum up, the most challenging issues in the future relate to (i) deteriorating competitiveness of exports and (ii) rising public debt and gross external debt leaving little scope for countercyclical measures. Public and gross external debt will rise and the overall external position will deteriorate.

Table SK

Slovakia: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average	5382.4	5387.0	5391.4	5397.3	5406.6	5418.2	5420	5430	5440
Gross domestic product, EUR mn, nom.	45128.2	49280.0	55045.5	61547.1	67221.0	64500	66400	70400	76100
annual change in % (real)	5.0	6.7	8.5	10.6	6.2	-5	1	3	4
GDP/capita (EUR at exchange rate)	6300	7100	8300	10200	12000	11900	12300	13000	14000
GDP/capita (EUR at PPP)	12300	13500	15000	16900	18100	17400	.	.	.
Consumption of househ., EUR mn, nom.	25384.3	27750.8	30815.7	33860.3	37554.9	37500	.	.	.
annual change in % (real)	4.2	6.5	5.9	7.1	6.1	0	2	3	4
Gross fixed capital form., EUR mn, nom.	10836.0	13089.5	14588.8	16096.5	16715.6	14700	.	.	.
annual change in % (real)	4.8	17.5	9.3	9.1	1.8	-12	1	4	6
Gross industrial production									
annual change in % (real)	3.8	-1.4	15.0	17.2	3.2	-15	2	5	7
Gross agricultural production									
annual change in % (real)	12.5	-8.7	-2.9	-4.5	10.6	-6.1	.	.	.
Construction industry									
annual change in % (real)	5.6	14.7	14.9	5.7	11.9	-11	.	.	.
Employed persons - LFS, th, average	2170.4	2215.2	2302.3	2357.7	2433.7	2360	2310	2310	2330
annual change in %	0.3	2.1	3.9	2.4	3.2	-3	-2	0	1
Unemployed persons - LFS, th, average	480.7	430.0	355.4	295.7	255.7	330	.	.	.
Unemployment rate - LFS, in %, average	18.1	16.3	13.4	11.1	9.5	12.3	13	13	12
Reg. unemployment rate, in %, end of period	13.1	11.4	9.4	8.0	8.4	12.7	13	13	12
Average gross monthly wages, EUR [2]	525	573	623	669	723	730	.	.	.
annual change in % (real, gross)	2.5	6.3	3.3	4.3	3.3	0.1	.	.	.
Consumer prices (HICP), % p.a.	7.5	2.8	4.3	1.9	3.9	0.9	1.5	2	2
Producer prices in industry, % p.a.	1.7	3.4	3.0	-1.4	2.5	-6.6	1	2	2
General governm.budget, EU-def., % GDP									
Revenues	35.3	35.2	33.5	32.5	32.5	31.3	.	.	.
Expenditures	37.6	38.0	36.9	34.4	34.8	37.5	.	.	.
Net lending (+) / net borrowing (-)	-2.4	-2.8	-3.5	-1.9	-2.3	-6.3	-6	-5.5	-5
Public debt, EU-def., in % of GDP	41.5	34.2	30.5	29.3	27.7	37.0	40	43	43
Discount rate of NB, % p.a., end of period [3]	4.0	3.0	4.8	4.3	2.5	1.0	.	.	.
Current account, EUR mn	-2656	-3268	-3636	-3141	-4279	-1900	-2500	-3000	-3500
Current account in % of GDP	-7.8	-8.5	-8.2	-5.7	-6.6	-2.9	-3.8	-4.3	-4.6
Exports of goods, BOP, EUR mn	22248	25654	33349	42171	47722	38000	39000	40000	42000
annual growth rate in %	14.9	15.3	30.0	26.5	13.2	-20	2	2	5
Imports of goods, BOP, EUR mn	23485	27571	35817	43009	48435	37000	39000	40000	42000
annual growth rate in %	17.9	17.4	29.9	20.1	12.6	-24	5	3	6
Exports of services, BOP, EUR mn	3000	3542	4322	5140	5796	4600	4800	4900	5100
annual growth rate in %	3.0	18.1	22.0	18.9	12.8	-21	4	3	4
Imports of services, BOP, EUR mn	2785	3285	3790	4752	6269	6000	6300	6600	7000
annual growth rate in %	3.0	18.0	15.4	25.4	31.9	-4	5	5	6
FDI inflow, EUR mn	2441	1952	3311	2108	2395	0	1000	1500	2000
FDI outflow, EUR mn	-17	120	292	149	177	400	300	400	500
Gross reserves of NB excl. gold, EUR mn [4]	10605	12567	9639	12280	12674	481	.	.	.
Gross external debt, EUR mn	17421	22705	24449	30156	37286	50000	.	.	.
Gross external debt in % of GDP	49.6	57.9	50.8	54.6	55.5	78	.	.	.
Average exchange rate EUR/EUR	1.328	1.281	1.236	1.121	1.038	1.000	1.00	1.00	1.00
Purchasing power parity EUR/EUR	0.679	0.676	0.681	0.677	0.687	0.683	.	.	.

Notes: Slovakia introduced the euro on 1 January 2009. Up to and including 2008 all time series in SKK as well as the exchange rates and PPP rates have been divided for statistical purposes by the conversion factor 30.126 (SKK per EUR) to a 'statistical' EUR (euro-fixed). - Gross industrial production, construction output and producer price index refer to NACE Rev. 2.

1) Preliminary and wiiw estimates. - 2) From 2006 including wages of armed forces. - 3) 2-week limit rate of NB for REPO tenders, from 2009 official refinancing operation rates for euro area (ECB). - 4) From January 2009 (euro introduction) only foreign currency reserves denominated in non-euro currencies.

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.

Hermine Vidovic

Slovenia:
Unprecedented drop followed by mild recovery

Slovenia's sharp economic downturn eased somewhat in the final quarter of 2009, but on an annual average GDP still dropped by unprecedented 8%. The slippage into the deepest crisis since gaining independence was mainly the result of a dramatic decline in investment; gross fixed capital formation fell by nearly one quarter, affecting all types of investment. The investment slump was a consequence of the sharp decline in export orders along with a running down of stocks built up in the past couple of years. Household consumption fell for the first time in nine years; by contrast government consumption reported an increase. Though falling significantly, the contribution of foreign demand to GDP growth was positive as exports dropped less than imports.

Owing to the strong contraction of both merchandise exports and imports (dropping by 19% and 26% respectively in nominal terms) the foreign trade deficit shrank significantly. In services trade exports fell faster than imports due to a significant drop in transport but also construction services, while the decline in tourism was less pronounced. Thus, the traditional services trade surplus narrowed by about one third compared to 2008. The current account closed with a small deficit equal to 0.6% of GDP in 2009. Similar to previous years, Slovenia has remained an FDI net exporter. Gross foreign indebtedness reached EUR 40 billion by the end of 2009, representing 116% of GDP.

Industrial production, after months of declining, started to grow slightly in July as compared to previous months, but dropped by 17% in 2009 as a whole, in manufacturing even by 19%. Manufacturing output fell in all branches, most notably in the production of textiles (by 50%) and manufacture of furniture and basic metals (by nearly one third each). In the car industry, Slovenia's main exporting sector, production was down by 5%. In mid-January 2010 the management of Renault, owner of the car manufacturer Revoz, announced the stop of production of the 'Clio' model in Slovenia, while the production of 'Twingo' cars will not be affected by this decision. In construction, one of the drivers of GDP growth in the past couple of years, output fell by 22%.

The impact of the economic downturn on the labour market is becoming increasingly visible, although the implementation of short-time work, reducing overtime work, increasing participation of unemployed in active labour market policies and other measures have apparently helped to keep people in employment. Employment cuts were largest in manufacturing, agriculture and mining, sectors that have been under restructuring pressure for several years. Information obtained from registration data shows a steady increase in unemployment since September 2008, putting the unemployment rate at over 10% at the end of December 2009. Labour Force Survey

data indicate a 1.5% employment decline and an unemployment rate of about 6%. Informal sector employment increased most probably. In order to mitigate the impact of the economic downturn on the labour market the government approved amendments to the Plan of the Active Employment Policy Programme for 2010 and 2011 by providing additional funds to implement active labour market policy measures. The programme envisages, among other things, subsidy schemes for employment, self-employment and public works.

The general government deficit deteriorated significantly in 2009, to 5.9% of GDP. This was mainly due to a strong decline in tax revenues coupled with rising expenditures, such as for social transfers, measures counteracting the crisis as well as increased expenditures for public sector wages (due to an agreement on a gradual elimination of wage disparities in the public sector reached with the social partners in 2008). As of 2 December 2009 the EU Economic and Fiscal Affairs Council opened an excessive deficit procedure against Slovenia (along with eight other countries). Accordingly the Council called on Slovenia to reduce its deficit below the 3% of GDP threshold by 2013. In doing so the Slovenian government has decided in its policy objectives for 2010-2013: (i) a gradual withdrawal of fiscal stimuli by the end of 2010 and a gradual phasing out of financial support measures; (ii) to rely on an expenditure-based fiscal consolidation strategy instead of increasing taxes; and (iii) ensuring long-term fiscal consolidation by implementing structural reforms. The latter should concentrate on the reforms of the pension system (change of the indexation formula) and the health system (widening the tax base for social security contributions for health). The budgets for 2010 and 2011 foresee deficits at 5.7% and 4.2% of GDP respectively. This should be made possible by reducing current expenditure growth, e.g. in the area of social transfers and public sector wages. Having reported relatively low levels in the past (22.5% of GDP in 2008, 34% in 2009), public debt will rise in the years to come, up to 43% in 2012. After issuing three Eurobonds worth EUR 4 billion in 2009, Slovenia issued a new ten-year maturity EUR 1.5 billion syndicated bond on 18 January 2010.

wiiw expects GDP to grow slightly in 2010 owing to moderately rising foreign demand. In addition, first results owing to the government's loan guarantee programme launched in 2009 should become visible. Investment will need some time to recover and will regain strength only in 2011. Considering the usual lag between changes in production and employment, we expect a further job decline this year and probably stagnation in 2011. These developments will also negatively affect household decisions on consumption. The general government deficit may be even higher than in 2009 and decrease only slightly thereafter. Key to a potential recovery will be the developments in Slovenia's main trading partners, Germany and Italy in particular. More robust growth can be expected in 2011 and 2012 under the assumption of stronger export demand than in 2010 as well as a mild recovery in domestic demand (investments in particular).

Table SI

Slovenia: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average	1997.0	2000.5	2006.9	2018.1	2021.3	2043.2	2045	2045	2045
Gross domestic product, EUR mn, nom.	27073.4	28749.6	31050.4	34568.2	37135.4	34460	35330	36760	38430
annual change in % (real)	4.3	4.5	5.8	6.8	3.5	-8	1	2	2.5
GDP/capita (EUR at exchange rate)	13600	14400	15500	17100	18400	16900	17300	18000	18800
GDP/capita (EUR at PPP)	18700	19700	20700	22100	22800	21100	.	.	.
Consumption of households, EUR mn, nom.	14582.1	15331.2	16156.1	17944.2	19296.9	18980	.	.	.
annual change in % (real)	2.8	2.8	2.9	6.7	2.1	-2.5	1	2	2.5
Gross fixed capital form., EUR mn, nom.	6752.1	7321.3	8242.1	9571.3	10742.4	8290	.	.	.
annual change in % (real)	5.6	3.7	9.9	11.7	7.7	-23.5	1	4	5
Gross industrial production									
annual change in % (real)	4.9	3.5	5.7	7.1	2.4	-17.1	2	3	3
Gross agricultural production									
annual change in % (real)	19.0	-1.2	-7.4	3.9	-0.8	-1.7	.	.	.
Construction industry [2]									
annual change in % (real)	0.7	2.0	15.7	18.5	15.5	-22	.	.	.
Employed persons - LFS, th, average	943	949	961	985	996	981	966	966	976
annual change in %	5.1	0.7	1.3	2.5	1.1	-1.5	-1.5	0	1
Unemployed persons - LFS, th, average	64	66	61	50	46	63	.	.	.
Unemployment rate - LFS, in %, average	6.3	6.5	6.0	4.8	4.4	6	7	7	6.5
Reg. unemployment rate, in %, end of period	10.1	10.2	8.6	7.3	7.0	10.5	11.5	11	10.5
Average gross monthly wages, EUR [3]	1117	1157	1213	1285	1391	1435	.	.	.
annual change in % (real, net) [3]	2.1	3.5	2.5	4.2	2.0	2.7	.	.	.
Consumer prices (HICP), % p.a.	3.7	2.5	2.5	3.8	5.5	0.9	1.5	2	2
Producer prices in industry, % p.a.	2.6	1.9	2.3	4.4	3.9	-1.4	-1	2	2
General governm.budget, EU-def., % GDP									
Revenues	43.6	43.8	43.2	42.4	42.4	43.2	.	.	.
Expenditures	45.8	45.2	44.5	42.4	44.2	49.1	.	.	.
Net lending (+) / net borrowing (-)	-2.2	-1.4	-1.3	0.0	-1.8	-5.9	-6	-4.5	-4.5
Public debt, EU-def., in % of GDP	27.2	27.0	26.7	23.3	22.5	34.4	40	42	43
Discount rate of NB, % p.a., end of period [4]	3.3	3.8	3.8	4.0	2.5	1.0	.	.	.
Current account, EUR mn	-719.7	-497.6	-772.0	-1646.0	-2286.0	-207.3	-400	-700	-900
Current account in % of GDP	-2.6	-1.7	-2.5	-4.8	-6.2	-0.6	-1.1	-2	-2.3
Exports of goods, BOP, EUR mn	12932.8	14599.2	17028.0	19799.0	20048.0	16190.0	16700	17500	18500
annual growth rate in %	13.3	12.9	16.6	16.3	1.3	-19.2	3	5	6
Imports of goods, BOP, EUR mn	13941.6	15625.0	18179.0	21465.0	22699.0	16719.0	17400	18400	19600
annual growth rate in %	16.6	12.1	16.3	18.1	5.7	-26.3	4	6	7
Exports of services, BOP, EUR mn	2782.6	3213.5	3573.0	4146.0	5041.0	4287.0	4550	4840	5250
annual growth rate in %	12.9	15.5	11.2	16.0	21.6	-15.0	6	6	8
Imports of services, BOP, EUR mn	2095.0	2293.5	2580.0	3098.0	3431.0	3234.0	3260	3500	3800
annual growth rate in %	8.8	9.5	12.5	20.1	10.7	-5.7	1	7	9
FDI inflow, EUR mn	665.2	472.6	514.0	1106.0	1313.0	-79.5	500	.	.
FDI outflow, EUR mn	441.0	515.6	687.0	1316.0	933.0	609.7	.	.	.
Gross reserves of NB excl. gold, EUR mn [5]	6466.8	6822.2	5341.7	666.0	623.0	670.8	.	.	.
Gross external debt, EUR mn	15343	20496	24067	34752	39096	40008	.	.	.
Gross external debt in % of GDP	56.7	71.3	77.5	100.5	105.3	116.1	.	.	.
Average exchange rate EUR/EUR	0.997	1.000	1.000	1.000	1.000	1.000	1	1	1
Purchasing power parity EUR/EUR	0.725	0.730	0.746	0.776	0.806	0.800	.	.	.

Note: Gross industrial production, construction output and producer price index refer to NACE Rev. 2.

1) Preliminary and wiiw estimates. - 2) Enterprises with at least 20 employees. - 3) From January 2005 including legal persons with 1 or 2 employees in the private sector. - 4) Main refinancing rate, from 2007 for euro area. - 5) From January 2007 (euro introduction) only foreign currency reserves denominated in non-euro currencies.

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.

Sebastian Leitner

Baltic States:
Depression almost over, yet still no growth

In 2009 the Baltic States suffered the most severe depression since the transitional recession at the beginning of the 1990s, with their GDPs shrinking in the range of 14% to 19%. The magnitude of the slump was caused by the combination of the burst of the local housing bubble leading to a credit crunch and the worldwide economic crisis that brought about a dramatic fall in external demand. Although the scenario of a forced devaluation of the Latvian lats was an imminent risk more than once in the past year, the pressure on the currency eased in the second half of 2009, when the enormous contraction of internal demand turned the current account into positive. The fading of the devaluation scenario and the enhanced growth prospects of the main trading partners in Western and Northern Europe have improved the poor prospects of the Baltic States in 2010. Nevertheless, also for 2010 a further, though much smaller decline of GDP is to be expected, postponing a return to GDP growth to 2011. The return to potential growth, which will obviously be lower than what these countries experienced in the boom phase before the crisis due to massive capital inflows, may be accomplished not earlier than 2013.

Estonia

Still in the midst of severe economic depression, Estonia is heading towards euro introduction in 2011. In order to present the European Commission a budget deficit of no more than 3% of GDP for 2009, the Estonian government and parliament approved supplementary budgets throughout 2009, envisaging revenue increases and expenditure cuts of about 7.5% of GDP in net terms. Furthermore, the release of reserves accumulated by the government in the years of extraordinary growth enabled the country to meet the Maastricht criteria. In order to reach the goal of a 3% budget deficit also this year, the 2010 budget includes a further cut of public expenses, another rise in excise taxes on energy and one-off revenue measures such as public property sales. Although these austerity measures amount to 3% of GDP, a further supplementary budget is likely to be necessary in the course the year. In addition, some of the expenditure cuts being implemented in 2009, e.g. the reduction of contributions to the third pillar of the pension system, will be phased out in 2011. Therefore the political debate on the 2011 budget next autumn, after the most likely approval of the euro introduction by ECOFIN in July, may lead to a demise of the minority government of Andrus Ansip and to early elections in Estonia.

Obviously, the procyclical fiscal policies already implemented have led to a drastic curbing of domestic demand: household consumption and investments slumped by 18% and 33% respectively in 2009. As wages will decline further this year and real incomes even more so due to the rise in

taxes and unemployment, household consumption will continue to fall throughout 2010 but also in 2011 although to a lower extent. In addition, households, having raised their debt levels swiftly in the past several years, will be eager to deleverage in the medium run, lowering their consumption propensity. However, the situation of Estonian households' over-indebtedness does not seem to be too dramatic, since the rate of loans overdue more than 60 days rose to only 6% in August 2009 and remained stable until the end of the year.

The strategy of the Estonian government to stick to the currency board regime instead of devaluing the Estonian kroon in order to rebalance the current account deficit has led to the start of a deflationary period. Year-on-year monthly inflation rates started to turn negative in May 2009. Depending on the revival of prices of imported energy and on export development, consumer prices are expected to fall by about 3% this year and by 1% in 2011. This will have a negative effect especially on gross fixed capital investment. The reduction in private investment will only partly be counterbalanced by growing EU-funded public investments in 2010.

Since all components of domestic demand will remain sluggish in the medium term, the only hope for revival is to be found in the development of external demand, which has stabilized since mid-2009. However, a swift growth of exports, as can be observed in some Central European NMS, cannot be detected in Estonia so far. Since wage reductions have been only minor in the tradable goods sector up to now, real effective exchange rate movements do not show significant gains in external competitiveness either. Throughout 2010 we therefore expect the rise in goods exports to be still sluggish. Moreover, the slump in exports and industrial production last year was particularly pronounced in the metal and wood industry, sectors that depend heavily upon the revival of the export dynamics of Swedish and Finnish electronics and paper producers.

Due to the severe economic crisis in 2008 and 2009, employment fell by 9% in 2009 year-on-year, which results in a tripling of the average annual unemployment rate to almost 15%. Although economic output is going to grow in the second half of the year, unemployment will still be on the rise throughout 2010. Before the recruitment of new personnel, employers will be more likely to reduce short-time work schemes and to raise productivity by new investment.

Latvia

In 2009 Latvia experienced the most severe economic depression of all European countries with a GDP slump of 19%. After the demise of the government in March 2009, the main job of the newly appointed prime minister Valdis Dombrovskis was to fulfil the fiscal specifications implicit in the rescue loan by the IMF, the EU and the Nordic countries (Sweden, Denmark, Norway and Finland), the latter having contributed no less than 25% to the total credit line. The dispute over the necessary magnitude of expenditure cuts in order to stay within the limits of 10% of budget deficit agreed upon and the timing of implementation caused the IMF to suspend the transfer of the credit tranche envisaged for May 2009. As forex reserves of the Bank of Latvia had fallen by 40% from October 2008 to June 2009, the effect was that the lats was on the verge of collapse. In order to ease the

turmoil, the supplementary budget approved in June met the stipulations of IMF and EU. In total, throughout 2009 Latvia implemented austerity packages in the scope of as much 11% of GDP.

However, already in autumn 2009 the discussion of the 2010 budget brought about a new dispute with the international lenders. The IMF, EU Commissioner Almunia and Scandinavian politicians put pressure on the government to further cut down the 2010 budget by 500 million lats (4.2% of GDP) to achieve the goal of a budget deficit of not more than 8.5% of GDP in 2010. On 1 December the parliament at last approved the measures, including a broadening of the income tax base to capital income and an increase in the flat tax rate from 23% to 26%. Furthermore, the tax on income from self-employment will be raised to that on employees' income. On the expenditure side, a further reduction of the staff of ministries is planned as well as cuts in welfare expenditures. The reduction of pensions by 10% and those of working pensioners by 70%, a measure already implemented in June 2009, had to be withdrawn after being classified as illegal by the Constitutional Court in December last year.

Looking at the development of public wage expenses, the austerity measures put down in the supplementary budget of June 2009 were fully implemented by the end of the year. Wages of public employees fell by nearly 30% nominally. In addition, central government budget institutions have reduced their staff by 17% year-on-year.

From the time of the approval of the supplementary budget in June 2009, the situation on the financial markets eased in Latvia; for instance, the three-month interbank rate Rigibor (which peaked at an extraordinary 30% at the end of June) gradually declined to not more than 3.6% at the end of January 2010.

The flight of capital, documented in the capital balance (excluding foreign exchange reserve changes) amounted to 6% of annual GDP over the first 11 months of 2009. However, as already described above, the pressure on foreign exchange reserves of the Bank of Latvia was eased by the enormous decline in imports. Whereas goods and services exports fell by about 20% nominally in euro terms, imports were slashed by almost 40% year-on-year in 2009.

While the government struggled with procyclical fiscal measures to meet the requirements of international lenders and stick to the currency peg, which is interpreted as an anchor of stability, domestic demand fell dramatically: household consumption was down by 24% and gross fixed capital formation by 35% year-on-year. The former can be attributed to significant wage cuts and the rise in unemployment, whereas the latter reflects the impact of the bursting housing bubble and the credit crunch in its aftermath. Also this year a substantial fall in both GDP components can be expected. Household consumption is curbed by further wage cuts and additional employment reductions, *inter alia* in the public sector. At the same time deflationary developments will make companies defer investments, while credit flows to enterprises will slow down even more following the need to deleverage in the banking sector. Although affiliates of foreign financial institutions are backed adequately by their home bases, the losses have not been fully eliminated yet. By the end of 2009 the rate of non-performing loans increased to 17% in Latvia and it continues to rise.

Consumer price inflation was still rising during the year 2009, influenced by the increase in VAT rates and excise taxes. As the 2010 budget foresees to raise revenues predominantly in the field of income taxation, consumer prices are to fall, this year even more strongly than in the other two Baltic States. The resulting improvement in price competitiveness of Latvian producers should help exports to recover. However, Latvia's manufacturing sector, with a share of 10% of gross valued-added, is much smaller than in other NMS. Moreover, the Baltic States have not managed to restructure their industrial production towards more technology-driven sectors in a fast manner as was the case in Central European countries. Amongst other things this was caused by the overvaluation of their pegged currencies. An export-led strategy therefore requires an industrial policy that goes beyond focusing on pure price competitiveness and the specialization on subcontracting or assembly niches. However, such measures obviously unfold their effects only in the medium to long run.

The exceptionally strong depression in Latvia had a disastrous impact on the labour market. In December 2009, the LFS-based unemployment rate jumped to 22.6%, and it will continue to rise in the first half of this year. In the eastern industrial and rural regions of the country the rate even amounts to 30%. Since replacement rates of unemployment insurance are quite low in all Baltic countries and eligibility rules quite restrictive, the effect of rising long-term unemployment is expected to cause a substantial increase in poverty. Already in 2008, Latvia's poverty rate (households below the threshold of 60% of mean equivalized income) was with 26% the highest in the European Union. A rise in emigration can therefore be expected, not only in Latvia, but also in the other Baltic countries, which experienced above-average migration outflows as compared to other new member states after accession (except for Poland). Although unemployment rose substantially also in the target countries Ireland and Great Britain, immigration statistics there already reveal a doubling of migration figures from Latvia in 2009 as against 2008.

Lithuania

In the first half of 2009, it appeared as though the depression of the Lithuanian economy (17% GDP decline) would force the government to follow Latvia in seeking rescue from the IMF and the EU in order to remain solvent. However, the Lithuanian government tried to avoid a rescue package, which they argued would have a negative signalling function. Nevertheless, for international financial investors the slump in GDP and the expected double-digit budget deficit were enough to question the sustainability of the Lithuanian fiscal policies: this pushed the yields on interest rates for Lithuanian ten-year government bonds to over 14% throughout 2009 (the highest of all EU member states, even above the ones for Latvian bonds). They fell to 9% only in December 2009.

In order to manage the refinancing of public debt – which was quite low, at 15% of GDP, at the end of 2008 – and raise additional funds, the government tried to appease the sentiments of international financial investors by adhering to the same austerity measures which their Baltic neighbours had implemented: a rise in VAT and excise rates and income tax revenues respectively, a substantial wage cut for public employees and a reduction of social benefits in general. In total, the net effect of all discretionary measures amounted to 8% of GDP in 2009. However, due to the sharp fall of

government revenues, the budget deficit for 2009 will still be slightly above 9% of GDP. The budget of 2010 again includes the announcement of measures similar to those recommended by the IMF to the government of Latvia, labelled 'efficiency-enhancing structural reforms in the healthcare sector and the social security system'. Obviously, this will lead to cuts in public employment and in health sector services, and most likely some social benefits will become means tested.

In the second half of 2009 the GDP decline slowed down, effected predominantly by a halt in destocking. Moreover, year-on-year industrial production fell less sharply in Lithuania than in its Baltic neighbours. The recovery in industry, starting in May 2009, was driven by the petrochemical and chemical sectors. However, comparing production and export developments in the Baltic countries in general with those in other NMS shows that exports performed better in those countries with flexible exchange rates.

Consumer prices rose by 4.2% on average in 2009, also as an effect of the increase in the VAT rate by 2 percentage points in September. However, the fall of crude oil prices caused a reduction of producer prices of 13.5% annually. Real wages fell by 7% throughout 2009. Surprisingly, earnings fell more strongly in the private than in the public sector in the second half of the year. This may well result in a more swift revival of export figures in Lithuania as compared to Estonia and Latvia. This development will obviously be driven by an upswing in external demand for oil derivatives, the most important products in the Lithuanian trade balance.

In total, GDP declined by 15% in 2009, with the same structural features as in the other two Baltic countries, i.e. a slump in household consumption by 17.5% and an even more dramatic drop in gross fixed capital formation (40%). The burst of the housing bubble actually halved Lithuania's construction industry activity last year. The positive contribution to growth of external trade was again due to the collapse of imports by more than 35%.

In 2010 the Lithuanian economy is going to shrink by another 3%, owing to a further contraction of household consumption and capital formation, while the government will also cut expenses in order to keep the budget deficit from growing even further. As described above, wiiw expects exports to recover faster in Lithuania than in Estonia and Latvia this year and 2011. Economic growth is expected to revive from 2011 onwards, however, the sluggish development of domestic demand will keep GDP growth rates at about 2% to 3% both in 2011 and 2012.

The nuclear power plant of Ignalina, which delivered more than 70% of the country's electricity needs, was finally shut down on 31 December 2009 on request of the EU. The replacement is delivered by a gas power station and a rise in electricity imports from Russia. This will result in an increase in the price of electricity for households and industry. Thus, at the beginning of February 2010, the Lithuanian minister of energy announced that an agreement of potential investors to build a substitute for the Ignalina nuclear power plant should be finalized at the beginning of next year at the latest. The new plant could then go online not earlier than 2018 to 2020.

Conclusions

The current economic situation in the three Baltic States is similar in many respects. The short- to medium-term prospects very much depend upon the revival of external demand. The strategy chosen by all Baltic States is to defend their fixed currency pegs at any costs. This will, however, lead to gains in competitiveness by wage reduction only in the medium term. Meanwhile, domestic demand is curbed by shrinking household consumption and the need to deleverage. Moreover, the phase of deflation will reduce enterprises' propensity to invest. Only the better utilization of EU funds may bring about some stabilizing effect to stop the fall in investments. The effect of further austerity packages to be implemented in 2010 and 2011 will bring about another cut in public expenditures and a squeeze of incomes. Up to the end of 2009 unemployment rates already tripled as compared to mid-2008 and amounted to 15% to 23%. Since a further rise is to be expected in the coming two years, social tensions and an increase in outward migration are most likely to be observed.

By contrast, budget deficits and thus public debt levels took a diverging course of development in the three countries. While Estonia is expected to keep public debt below 20% of GDP, in Lithuania the forecast for 2013 is at 60% of GDP, for Latvia even somewhat above that figure. In Estonia, the likely adoption of the euro already in 2011 will, in addition, lead to a much better refinancing situation for the country as compared to Latvia and Lithuania.

Table EE

Estonia: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average	1349.3	1346.1	1343.5	1341.7	1340.7	1340.3	1336	1336	1335
Gross domestic product, EEK mn, nom.	151542	174956	206996	244504	251493	216700	207000	209000	221700
annual change, % (real)	7.2	9.4	10.0	7.2	-3.6	-14	-1.5	2	4
GDP/capita (EUR at exchange rate)	7200	8300	9800	11600	12000	10300	.	.	.
GDP/capita (EUR at PPP)	12400	13800	15400	17100	16900	14800	.	.	.
Consumption of households, EEK mn, nom.	83374	94976	112950	132335	137499	113000	98600	94700	99500
annual change in % (real)	9.6	9.9	13.0	9.1	-4.8	-18	-10	-3	3
Gross fixed capital form., EEK mn, nom	46781	56115	72325	84385	73729	49500	44200	47300	54000
annual change in % (real)	5.2	15.3	18.6	9.0	-12.1	-33	-8	8	12
Gross industrial production									
annual change in % (real)	10.4	11.0	9.9	6.4	-6.5	-26.2	4	5	5
Gross agricultural production									
annual change in % (real)	0.4	7.2	-2.1	12.5	-1.0	-2.6	.	.	.
Construction industry									
annual change in % (real)	12.5	24.5	27.1	16.5	-15.4	-30	.	.	.
Employed persons - LFS, th, average	595.5	607.4	646.3	655.3	656.5	595	590	600	610
annual change in %	0.2	2.0	6.4	1.4	0.2	-9	-1	2	2
Unemployed persons - LFS, th, average	63.6	52.2	40.5	32.0	38.4	100	.	.	.
Unemployment rate - LFS, in %, average	9.6	7.9	5.9	4.7	5.5	15	16	14	13
Reg. unemployment rate, in %, end of period	4.8	3.6	1.9	2.2	4.6	13.3	.	.	.
Average gross monthly wages, EEK	7287	8073	9407	11336	12912	12150	.	.	.
annual change in % (real, gross)	5.2	6.4	11.6	13.0	3.2	-5.8	.	.	.
Consumer prices (HICP), % p.a.	3.0	4.1	4.5	6.7	10.6	0.2	-3	-1	2
Producer prices in industry, % p.a.	2.8	1.8	4.2	8.1	8.0	0.7	.	.	.
General governm. budget, EU-def., % GDP									
Revenues	35.6	35.2	36.3	37.4	37.1	41.9	.	.	.
Expenditures	34.0	33.6	34.0	34.8	39.9	44.8	.	.	.
Net lending (+) / net borrowing (-)	1.6	1.6	2.3	2.6	-2.8	-3.0	-3	-3	-3
Public debt, EU-def., in % of GDP	5.0	4.6	4.5	3.8	4.6	7.5	11	14	15
Money market rate, % p.a., end of period [2]	2.4	2.5	3.8	7.0	7.0	2.8	.	.	.
Current account, EUR mn	-1095.0	-1116.0	-2237.0	-2783.0	-1504.0	648.0	550	300	-500
Current account in % of GDP	-11.3	-10.0	-16.9	-17.8	-9.4	4.7	4.2	2.2	-3.5
Exports of goods, BOP, EUR mn	4764.2	6347.9	7761.0	8087.0	8536.0	6500.0	6700	7000	7300
annual growth rate in %	17.5	33.2	22.3	4.2	5.6	-23.9	3	4	4
Imports of goods, BOP, EUR mn	6333.3	7898.0	10149.0	10873.0	10413.0	7015.9	6900	7300	7700
annual growth rate in %	16.6	24.7	28.5	7.1	-4.2	-32.6	-2	6	5
Exports of services, BOP, EUR mn	2293.7	2612.0	2787.0	3200.0	3531.0	3160.6	3300	3500	3700
annual growth rate in %	17.0	13.9	6.7	14.8	10.3	-10.5	4	6	6
Imports of services, BOP, EUR mn	1403.0	1772.7	1996.0	2242.0	2338.0	1833.2	1850	1950	2100
annual growth rate in %	14.3	26.4	12.6	12.3	4.3	-21.6	1	5	8
FDI inflow, EUR mn	770.8	2307.3	1432.0	1998.0	1317.0	1105.5	1000	.	.
FDI outflow, EUR mn	216.6	556.0	880.0	1273.0	723.0	1197.6	.	.	.
Gross reserves of NB excl. gold, EUR mn	1314.2	1643.6	2115.3	2235.6	2814.0	2758.7	.	.	.
Gross external debt, EUR mn	7458.7	9671.9	12903.8	17339.5	19052.1	17000	.	.	.
Gross external debt in % of GDP	77.0	86.5	97.5	111.0	118.5	123	.	.	.
Average exchange rate EEK/EUR	15.6466	15.6466	15.6466	15.6466	15.6466	15.6466	15.65	15.65	15.65
Purchasing power parity EEK/EUR	9.0217	9.3772	9.9923	10.6247	11.1035	10.9603	.	.	.

Note: Gross industrial production, construction output and producer price index refer to NACE Rev. 2.

1) Preliminary and wiiw estimates. - 2) TALIBOR 1 month interbank offered rate, average of December.

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.

Table LT

Lithuania: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average	3435.6	3414.3	3394.1	3375.6	3358.1	3339.6	3323	3306	3289
Gross domestic product, LTL mn, nom.	62697.8	72060.4	82792.8	98669.1	111189.8	92450.2	87000	89600	94100
annual change in % (real)	7.3	7.8	7.8	9.8	2.8	-15.0	-3	2	3
GDP/capita (EUR at exchange rate)	5300	6100	7100	8500	9600	8000	.	.	.
GDP/capita (EUR at PPP)	10900	11900	13100	14800	15500	13500	.	.	.
Consumption of households, LTL mn, nom.	40562.4	46312.0	53268.6	63508.4	72140.6	62000	56500	56500	58800
annual change in % (real)	11.9	12.3	10.6	12.0	3.6	-17.5	-6	-1	2
Gross fixed capital form., LTL mn, nom.	13971.6	16405.0	20840.8	27918.8	27984.0	18100	16700	17700	19100
annual change in % (real)	15.7	11.2	19.4	23.0	-6.5	-38	-8	5	6
Gross industrial production (sales)									
annual change in % (real)	11.3	7.1	6.5	2.4	5.5	-14.6	5	4	6
Gross agricultural production									
annual change in % (real)	11.1	10.5	-4.1	8.2	8.8	0.9	.	.	.
Construction industry									
annual change in % (real)	6.8	9.9	21.7	22.2	4.0	-48	.	.	.
Employed persons - LFS, th, average	1436.3	1473.9	1499.0	1534.2	1520.0	1420	1380	1420	1450
annual change in %	-0.1	2.6	1.7	2.3	-0.9	-6.6	-3	3	2
Unemployed persons - LFS, th, average	184.4	133.0	89.4	69.0	94.3	220	220	.	.
Unemployment rate - LFS, in %, average	11.4	8.3	5.6	4.3	5.8	13.5	15	13	12
Reg. unemployment rate, in %, end of period [2]	6.0	4.1	3.7	3.3	4.4	12.5	.	.	.
Average gross monthly wages, LTL	1149.3	1276.2	1495.7	1802.4	2174.0	2080	.	.	.
annual change in % (real, net)	5.0	6.8	15.0	17.0	11.2	-7	.	.	.
Consumer prices (HICP), % p.a.	1.2	2.7	3.8	5.8	11.1	4.2	-3	1	2
Producer prices in industry, % p.a.	6.0	11.7	7.3	7.0	18.2	-13.5	.	.	.
General goverm.budget, EU-def., % GDP									
Revenues	31.8	32.8	33.1	33.8	34.2	37	.	.	.
Expenditures	33.3	33.3	33.6	34.8	37.4	46	.	.	.
Net lending (+) / net borrowing (-)	-1.5	-0.5	-0.4	-1.0	-3.2	-9	-8	-6	-4
Public debt, EU-def., in % of GDP	19.4	18.4	18.0	16.9	15.6	29.9	40	48	55
Money market rate, % p.a., end of period [3]	2.3	2.5	3.7	6.8	7.8	1.6	.	.	.
Current account, EUR mn	-1393.6	-1481.3	-2551.0	-4149.0	-3840.0	520	800	-200	-600
Current account in % of GDP	-7.7	-7.1	-10.6	-14.5	-11.9	1.9	3.2	-0.8	-2.2
Exports of goods, BOP, EUR mn	7477.7	9490.0	11262.0	12509.0	16077.0	11600	12500	13500	15000
annual growth rate in %	10.4	26.9	18.7	11.1	28.5	-28	8	8	11
Imports of goods, BOP, EUR mn	9398.2	11849.0	14600.0	16788.0	19939.0	12300	12800	13800	15500
annual growth rate in %	13.8	26.1	23.2	15.0	18.8	-38	4	8	12
Exports of services, BOP, EUR mn	1968.7	2502.8	2879.0	2931.0	3306.0	2600	2750	2900	3100
annual growth rate in %	18.5	27.1	15.0	1.8	12.8	-21	6	5	7
Imports of services, BOP, EUR mn	1313.4	1655.3	2018.0	2471.0	2953.0	2200	2300	2500	2700
annual growth rate in %	17.9	26.0	21.9	22.4	19.5	-25	5	9	8
FDI inflow, EUR mn	623.1	826.0	1448.0	1473.0	1245.0	700	900	.	.
FDI outflow, EUR mn	211.6	277.7	232.0	437.0	229.0	250	.	.	.
Gross reserves of NB excl. gold, EUR mn	2578.5	3135.7	4307.5	5165.1	4458.4	4142.7	.	.	.
Gross external debt, EUR mn	7686.6	10586.5	14441.8	20547.2	23048.2	22000	.	.	.
Gross external debt in % of GDP	42.3	50.7	60.2	71.9	71.6	82	.	.	.
Average exchange rate LTL/EUR	3.45	3.45	3.45	3.45	3.45	3.45	3.45	3.45	3.45
Purchasing power parity LTL/EUR	1.67	1.77	1.87	1.98	2.13	2.06	.	.	.

Note: Gross industrial production, construction output and producer price index refer to NACE Rev. 2.

1) Preliminary and wiiw estimates. - 2) In % of working-age population. - 3) VILIBOR 1 month interbank offered rate, average of December.

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.

Table LV

Latvia: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average	2312.8	2300.5	2287.9	2276.1	2266.1	2255.1	2240	2230	2220
Gross domestic product, LVL mn, nom.	7434.5	9059.1	11171.7	14779.8	16274.5	13600	12300	12100	12300
annual change in % (real)	8.7	10.6	12.2	10.0	-4.5	-19	-4.5	1	2
GDP/capita (EUR at exchange rate)	4800	5700	7000	9300	10200	8500	.	.	.
GDP/capita (EUR at PPP)	9900	10900	12200	13900	14400	11900	.	.	.
Consumption of households, LVL mn, nom.	4605.9	5578.2	7184.2	9104.3	9935.6	7800	6800	6400	6500
annual change in % (real)	9.1	11.3	21.4	14.8	-5.5	-24	-8	-3	1
Gross fixed capital form., LVL mn, nom.	2041.8	2773.8	3644.1	4975.1	4777.3	3200	2700	2600	2700
annual change in % (real)	23.8	23.6	16.3	7.5	-15.6	-35	-12	-1	2
Gross industrial production [2]									
annual change in % (real)	7.1	7.1	6.5	1.1	-3.9	-16.2	3	3	5
Gross agricultural production									
annual change in % (real)	4.5	11.8	-1.9	10.8	0.1	-0.3	.	.	.
Construction industry									
annual change in % (real)	13.1	15.5	13.3	13.6	-3.1	-35	.	.	.
Employed persons - LFS, th, average	1017.7	1033.7	1087.1	1118.0	1124.5	980	900	900	930
annual change in %	1.1	1.6	5.2	2.8	0.6	-13	-8	0	3
Unemployed persons - LFS, th, average	118.6	101.0	79.5	71.3	90.5	215	.	.	.
Unemployment rate - LFS, in %, average	10.4	8.9	6.8	6.0	7.5	18	22	20	17
Reg. unemployment rate, in %, end of period	8.5	7.4	6.5	4.9	7.0	16.0	.	.	.
Average gross monthly wages, LVL	211	246	302	398	479	455	.	.	.
annual change in % (real, net)	2.4	9.7	15.6	19.9	6.1	-6.5	.	.	.
Consumer prices (HICP), % p.a.	6.2	6.9	6.6	10.1	15.2	3.3	-5	-3	0
Producer prices in industry, % p.a.	8.1	8.0	10.3	16.1	11.4	-4.6	.	.	.
General government budget, EU-def., % GDP									
Revenues	34.7	35.1	37.7	35.5	34.6	34.9	.	.	.
Expenditures	35.8	35.6	38.2	35.9	38.8	43.8	.	.	.
Net lending (+) / net borrowing (-)	-1.0	-0.4	-0.5	-0.3	-4.1	-9.0	-8	-7	-5
Public debt, EU-def., in % of GDP	14.9	12.4	10.7	9.0	19.5	33.2	50	60	65
Refinancing rate of NB, % p.a., end of period	4.0	4.0	5.0	6.0	6.0	4.0	.	.	.
Current account, EUR mn	-1429.1	-1610.1	-3603.0	-4710.0	-3014.0	1670.4	600	300	-100
Current account in % of GDP	-12.8	-12.4	-22.5	-22.3	-13.0	8.7	3.4	1.7	-0.6
Exports of goods, BOP, EUR mn	3394.5	4313.1	4929.0	6020.0	6531.0	5161.6	5300	5700	6200
annual growth rate in %	21.2	27.1	14.3	22.1	8.5	-21.0	3	8	9
Imports of goods, BOP, EUR mn	5637.4	6753.4	9032.0	11074.0	10603.0	6392.8	6300	6500	7000
annual growth rate in %	23.5	19.8	33.7	22.6	-4.3	-39.7	-1	3	8
Exports of services, BOP, EUR mn	1432.4	1743.0	2121.0	2707.0	3088.0	2731.2	2850	3100	3400
annual growth rate in %	7.4	21.7	21.7	27.6	14.1	-11.6	4	9	10
Imports of services, BOP, EUR mn	947.3	1255.6	1586.0	1974.0	2169.0	1560.2	1550	1650	1800
annual growth rate in %	15.5	32.5	26.3	24.5	9.9	-28.1	-1	6	9
FDI inflow, EUR mn	512.6	567.9	1339.0	1705.0	869.0	292.2	200	.	.
FDI outflow, EUR mn	88.7	103.0	136.0	270.0	169.0	5.3	.	.	.
Gross reserves of NB excl. gold, EUR mn	1412.8	1901.8	3346.2	3859.9	3514.0	4614.2	.	.	.
Gross external debt, EUR mn	9871.2	12807.7	18127.7	26834.6	29762.8	29000	.	.	.
Gross external debt in % of GDP	92.7	98.4	113.1	126.4	129.5	151	.	.	.
Average exchange rate LVL/EUR	0.6652	0.6962	0.6962	0.7001	0.7027	0.7057	0.7027	0.7027	0.7027
Purchasing power parity LVL/EUR	0.3252	0.3605	0.3999	0.4681	0.4999	0.5081	.	.	.

Note: Gross industrial production, construction output and producer price index refer to NACE Rev. 2.

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees.

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.

*Josef Pöschl**

Future EU member states:
A crisis of the sustainable kind

Introduction

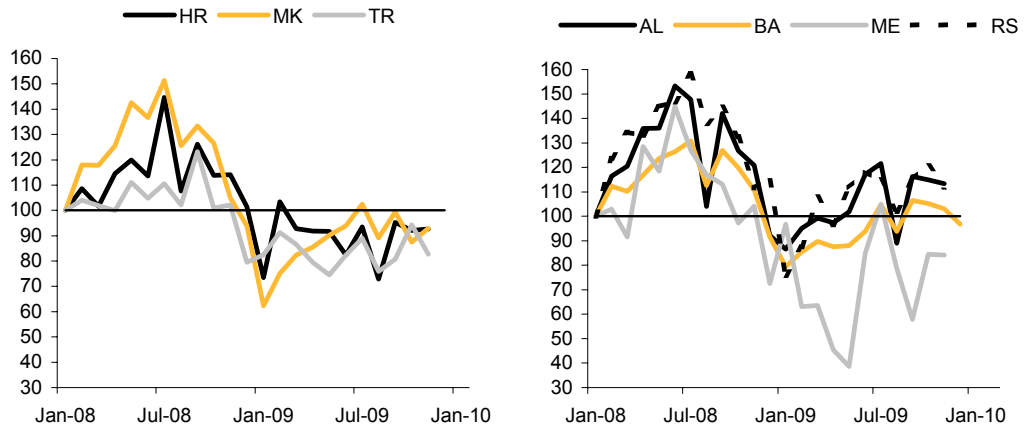
In this section, the term future member states (FMS) covers three EU candidate countries, Croatia, Macedonia and Turkey, and four potential candidate countries: Albania, Bosnia and Herzegovina (BiH), Montenegro and Serbia. Geographically speaking, the paper takes the six West Balkan countries together as one group. It treats Turkey as a separate entity, since in terms of land area, population and GDP it far outstrips the West Balkan countries (see Table III).

The analysis below focuses on the ways in which the global financial and economic crisis hit the region and its impact on GDP, industrial production, employment and price developments. Policy responses and the outlook for 2010-2012 are also addressed with due account being taken of the potential risks and stabilizing factors.

Figure 1

Exports total (fob)

January 2008=100



Source: wiiw Database incorporating national statistics and Eurostat.

* The research on this overview was completed on 23 February 2010. Peter Havlik, Kazimierz Laski and the authors of the individual country reports provided useful comments on a draft version of this overview.

Some kind of sudden stop or a host of sudden semi-stops?

This chapter addresses the channels through which the global financial and economic crisis hit the region. When the collapse of Lehman Brothers translated into a global economic crisis in the final quarter of 2008, it set off a series of 'semi-stops' throughout most regions in the world, including the FMS. We can identify six types of these 'semi-stops':

Disruption in foreign demand for goods

In all FMS and in keeping with the individual countries' economic structure and export specialization, exports declined sharply after mid-2008 (see Figure 1). For example, Montenegrin exports were hit hard owing to a drop in demand on international aluminium markets. In BiH, exports also suffered from the recession on international metal markets. Having established itself as a major producer and exporter of transport equipment and durable consumer goods, two industrial sectors with massive crisis exposure, Turkish exports went into correspondingly steep decline. Croatia suffered from a slump in the demand for ships. As can be seen in Table 1, external demand for tradable services, however, shrank far less.

Decline in remittances from abroad

The inflow of remittances from migrant workers in the EU, the United States and other countries declined. Given the far-reaching impact of the international crisis and the associated job losses and diminished incomes (profits and wages), some of those sending remittances from abroad cut back on the transfers of funds to their relatives (except for Serbia see Table 1). For the West Balkan countries, especially Albania and BiH, remittances represent an important source of income. They support private consumption and private investment, and via those two channels, i.e. indirectly, imports as well. Over the past few years, remittances together with FDI also boosted the demand for real estate. In 2009, real estate prices tumbled. Compared to 2007 and 2008, transfers to BiH in the first three quarters of 2009 were down by 14% and 11%, respectively. Compared to 2008, the net inflow of workers' remittances to Turkey in 2009 declined by a third. The aggregate transfer balance, however, improved thanks mainly to an increased inflow of government transfers.

Decline in foreign direct investment

In 2009, the inflow of foreign direct investment (FDI) also declined dramatically in all FMS, but did not dry up completely. For foreign investors, project funding proved increasingly difficult, although new opportunities for favourable deals opened up on account of less competition and lower prices. On the supply side, however, governments decided in numerous instances to postpone privatization projects on account of the poor revenue prospects.

Little change in the inflow of portfolio investment

Croatia is the only country in the West Balkans to have undergone a significant change in the net inflow of portfolio investment; it shifted from being slightly positive to highly negative. In Macedonia and Turkey, the inflow increased; however, in relation to the GDP the balance was marginal. The latter outcome was characteristic of all other FMS.

Table 1

Components of the Balance of Payments (BOP)

EUR million

	Croatia		Macedonia		Turkey		Albania		Bosnia and Herzegovina		Montenegro		Serbia	
	1-3Q 2008	1-3Q 2009	1-3Q 2008	1-3Q 2009	1-3Q 2008	1-3Q 2009	1-3Q 2008	1-3Q 2009	1-3Q 2008	1-3Q 2009	1-3Q 2008	1-3Q 2009	1-3Q 2008	1-3Q 2009
Current account	**-2472**	**-941**	**-452**	**-335**	**-23643**	**-6711**	**-862**	**-1034**	**-1398**	**-652**	**-718**	**-332**	**-4565**	**-1271**
Trade balance of goods	-8346	-5579	-1258	-1087	-29612	-12773	-1691	-1675	-3617	-2532	-1177	-737	-5687	-3470
Goods exports	7451	5719	2093	1424	73490	57610	709	573	2701	2139	410	242	5698	4377
Goods imports	-15797	-11298	-3351	-2510	-103102	-70383	-2400	-2248	-6319	-4671	-1587	-979	-11385	-7847
Services, net	6481	5261	22	21	9034	9483	66	49	518	427	399	389	-147	-17
Services exports	8798	8798	.	.	18080	18153	1268	1367	871	752	665	610	2052	1836
Services imports	-2317	-2317	.	.	-9047	-8670	-1202	-1319	-353	-325	-266	-221	-2199	-1853
Income, net	-1371	-1366	10	-57	-4170	-4471	58	-70	321	221	7	-44	-571	-348
Current transfers, net	764	742	774	788	1105	1051	705	661	1380	1232	52	60	1840	2564
Capital and financial account	**3774**	**2629**	**462**	**322**	**24612**	**2680**	**646**	**848**	**1424**	**672**	**585**	**15**	**4611**	**1322**
Capital transfers, net	23	19	-4	18	0	0	58	68	147	114	0	2	13	-1
Foreign direct investment, net	2277	869	329	102	7857	3949	351	565	481	237	452	765	1614	1007
Portfolio investment, net	9	-499	-27	117	305	569	-10	2	-3	-23	-10	-33	-59	-56
Other investment, net	1873	2135	308	103	19207	-2326	349	267	869	415	225	-614	3046	1729
Reserve assets	-409	106	-143	-18	-2757	488	-101	-55	-69	-72	-82	-105	-3	-1357
Errors and omissions	**-1302**	**-1688**	**-10**	**13**	**-969**	**4031**	**215**	**187**	**-26**	**-20**	**134**	**317**	**-47**	**-51**

Source: National banks of respective countries.

Decline in the inflow of other investment

In Croatia, the net inflow of other investment (primarily loans) was high and even increased (the first three quarters 2009 compared to the first three quarters 2008). Although high in Serbia as well, the inflow declined somewhat. Albania, BiH and Macedonia maintained a net inflow, while in Montenegro it turned negative. A similar reversal of flows on a larger scale occurred in Turkey (a shift from EUR 19 billion net inflow to EUR 2.3 billion net outflow). The shift reflected the efforts of the private sector to diminish foreign indebtedness, as well as the endeavours of foreign investors to reduce their exposure. The Turkish government ignored the many recommendations to sign a stand-by agreement with the IMF, unlike BiH and Serbia, both of which entered into such an arrangement.

A sudden stop to internal lending

In the wake of the global crisis, commercial banks grew increasingly concerned about the quality of debts outstanding and adopted an extremely cautious attitude towards new loans. This wariness extended to both inter-bank deals and deals with non-financial enterprises. After September 2008, lending operations did one of three things: the stock of loans stopped growing at the previously high rates, stagnated or declined. In the non-financial sector, problems related to timely debt servicing became increasingly frequent. Lenders found themselves compelled to decide whether they should enter into debt restructuring deals or treat arrears as non-performing loans. Banks were loath to adopt the latter approach mainly for two reasons: (i) a high proportion of non-performing loans could raise doubts about their own performance; and (ii) the market value of collaterals had dropped perceptibly.

Private households and enterprises thus faced the dilemma of not being granted any access at all to new credits or having to accept far more rigorous borrowing conditions in terms of higher interest rates and supplementary guarantee requirements. At the same time, the revenue prospects of many enterprises deteriorated and profits as a complementary source of funding shrank. The demand curve for loans thus shifted to the left. Under such conditions, private investment in construction and productive equipment dropped dramatically.

In the meantime, the situation has relaxed somewhat. More recently credit volumes have once again started expanding or growing more rapidly – at least in some of the FMS. In any case, the rate of expansion is much lower than it was prior to 2008. Furthermore, credit is likely to remain far less accessible and much more costly for quite some time to come. As Table 2 shows, the expansion of credit volumes temporarily declined in all FMS. The onset and intensity of decline varied considerably among countries. In the final quarter of 2009, the credit volume increased in all countries, apart from BiH and Montenegro. As for the interest rates that non-financial bank clients had to face, some detailed information is available for Turkey. Interest rates for consumer and commercial loans in Turkey peaked in November 2008, and the margin over the policy rate increased excessively, especially for consumer loans. By that time, the central bank had already started gradually reducing its policy rate. At the end of 2009 the overnight borrowing rate was down to 6.5% (from 16.5% in mid-2008). In the case of consumer loans, the spread remained broad at some eight percentage points, but narrowed to less than five percentage points for commercial

Table 2

Bank loans to non-financial private sector

change in % against preceding year

	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09	Oct-09	Nov-09	Dec-09
Croatia	11.6	11.5	11.2	12.4	11.5	11.8	12.2	11.3	9.5	8.7	7.0	5.0	4.5	3.5	2.1	-0.4	1.4	.
Macedonia	42.0	40.1	38.5	39.6	37.6	34.4	32.0	28.8	25.2	21.2	18.4	14.3	11.2	9.3	6.4	4.6	4.1	3.5
Turkey	33.5	32.2	35.9	33.2	27.6	23.2	19.7	15.4	9.8	6.3	6.3	3.2	2.4	2.3	1.2	1.1	5.3	.
Albania	45.5	44.2	44.7	43.6	42.6	34.8	36.0	33.3	31.6	28.1	22.2	16.3	13.8	12.4	13.2	11.1	8.8	.
Bosnia and Herzegovina	28.1	27.4	27.0	26.0	24.0	20.8	19.5	16.3	12.7	9.2	6.8	4.0	1.5	-0.3	-1.9	-3.3	-4.0	-3.7
Montenegro	78.6	72.5	58.5	45.6	38.3	23.6	21.6	11.8	8.5	2.6	-0.3	-3.3	-6.7	-9.2	-10.1	-9.8	-8.7	.
Serbia	29.0	26.8	29.4	39.2	31.7	33.6	32.6	32.0	32.6	32.8	28.2	27.0	27.9	26.3	23.1	14.1	13.3	16.4

Source: National bank statistics, wiiw own calculations.

loans. An increasing number of households in Turkey are facing problems with credit card loans; the share of non-performing loans is relatively high among SMEs. In Croatia, the average interest rate for household loans over the period January to November 2009 was up more than 2 percentage points compared to the 2007 average. For enterprises, however, the increase was significantly less.

For a long time households and private companies in the West Balkan countries, especially small and medium-sized enterprises, enjoyed very limited access to long-term loans. Although things changed for the better in the years leading up to 2008, the degree of private indebtedness has remained rather low compared to most developed countries. Under the current circumstances, this has reduced the countries' exposure to the crisis.

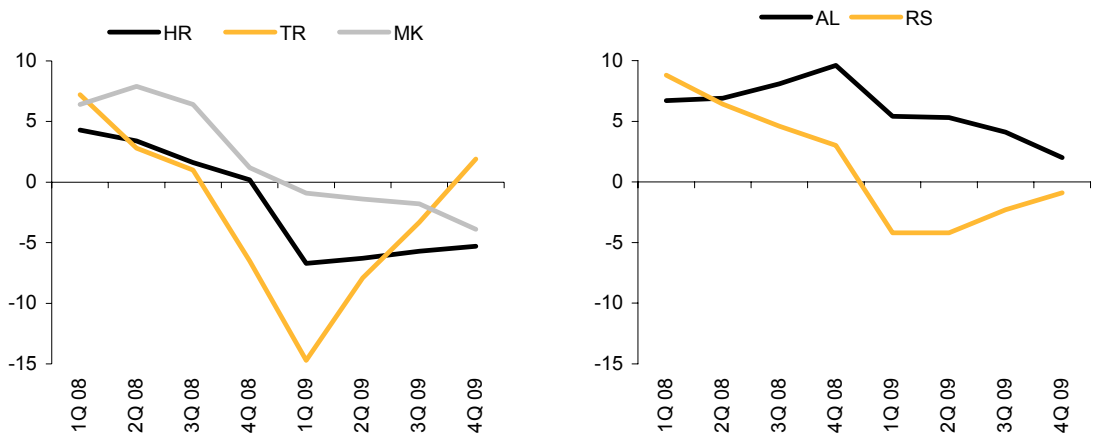
The cumulative macroeconomic impact of the sudden semi-stops

In the previous section, the channels through which the global financial and economic crisis suddenly hit the region were identified. This section addresses the impact that the crisis had on GDP, industrial production, employment and price developments.

Figure 2

Quarterly GDP

real change in % against preceding year



Source: National statistics and Eurostat.

The GDP development under the impact of the sudden semi-stops (of foreign demand, inflow of capital and access to domestic loans) can be seen in Figure 2.[33] In the fourth quarter of 2008, the GDP in Croatia, Macedonia and Serbia reached approximately the same level as the previous year. The GDP in the first quarter of 2009, however, was significantly below the level in the first quarter of 2008. The remarkable exception is Albania, where GDP growth decelerated, but never vanished completely. In Turkey, developments in this respect also differed from the other FMS. By the third quarter in 2008, the GDP growth rate had already dropped close to zero and went on to drop further

[33] BiH and Montenegro are not represented, as they do not publish quarterly GDP data.

to -13.5% in the first quarter of 2009: a far greater slump than in the other FMS. Thereafter, the trend in Turkey has undergone a highly visible change; we can now count on a positive growth rate in the final quarter of 2009. This stands in sharp contrast to Croatia, Macedonia and Serbia, where signs of recovery remain weak, as well as to Albania, where the growth has continued to slow down after the first quarter in 2009 (but remained positive for the year as a whole).

We can thus conclude that in none of the countries under review did the crisis reach the catastrophic proportions that marked the Baltic States and Ukraine (even though a 6% drop in the annual GDP growth rate for 2009 in Croatia and Turkey is no laughing matter). At the same time, differences between the FMS are considerable. This is attributable to many factors, such as the precarious pre-crisis position in Turkey which experienced competitiveness problems in the wake of major real appreciation.

Furthermore, the crisis did not hit all segments of the economy with equal force. Producers of tradable goods were immediately hit – and hit hard – by shrinking external demand. However, within that segment of the economy differences were again marked. Producers of goods, purchases of which are usually backed by credits, were hit hardest. The goods concerned were durable consumer goods, including motor cars, and industrial equipment, all of which are bulwarks of the Turkish manufacturing sector. Industries producing raw materials and semi-finished goods, especially in the metal sector (aluminium and steel) suffered from the decline in world market prices. In those industries, labour lay-offs were massive. Producers of tradable services (tourism) were hit much less severely (see Table 1). This is indicative of a relatively minor decline in services exports. On the other hand, the crisis had almost no immediate impact on large segments in the production of non-tradable goods and services, including such services as public securities, education and health-care. For example, government employees neither lost their jobs nor did they have to face income losses (except for some wage increase adjustments in BiH, Croatia and Serbia). Moreover, the impact was also soft in industries such as public transport, water and electricity supply, media, telecommunications and even commercial banks.

To simplify things, a distinction can be drawn between two blocks in terms of income and employment: a fixed block and a variable block. In the context of GDP growth, the important aspect is the proportional variance between the fixed and variable segments of the economy. The variable component displayed the same response pattern to the crisis as in many other countries. This can be observed in the industrial output and foreign trade development patterns. In those countries where the fixed segment of the economy produces a high share of the GDP, GDP decline has tended to be limited. Of course, other factors have played a role as well.

In the West Balkan countries, the fixed block produces a high proportion of the GDP, as the variable block is not highly developed, notwithstanding the differences between countries in this respect as well. As for the proportion between fixed and variable blocks, the GDP share of government expenditures offers some indication. A high share points to strong economic influence on the part of the government, including redistribution of income and funding of government institutions. The volatility of government expenditures is relatively limited, as shortfalls in revenues tend to be offset

by borrowing. In this regard, Turkey differs from the West Balkan countries. The variable block carries more weight. Turkey's ratio between government expenditures and GDP was 25% in 2009 compared to nearly 50% in Montenegro, over 40% in BiH and close to 40% in both Croatia and Serbia (see Table 3). Albania is the only country in the West Balkans with a fairly lean public sector accounting for a GDP share of around 30%, whereas Croatia and Macedonia are more in the middle. In Turkey, a large proportion of those in employment have no social insurance coverage; they enjoy no protection against market volatility. For them, social security is a family affair. Moreover, the inflow of remittances, a low-volatility source of income in the West Balkan countries, does not play an important role in Turkey, where a number of things are more volatile.

Table 3

	Fiscal balance [1] in % of GDP						Public debt [2] in % of GDP					
	2007	2008	2009 [3]	2010	2011	2012	2007	2008	2009 [3]	2010	2011	2012
				Forecast						Forecast		
Croatia [4]	-1.2	-1.0	-2.9	-3	-2.5	-2.5	33.1	33.5	37.7	39	39	42
Macedonia [5]	0.6	-1.0	-2.8	-2	0	0	33.3	28.7	30	33	31	29
Turkey	-1.0	-2.2	-6.6	-6	-4	-3	39.4	39.5	47.3	49	49	48
Albania	-3.5	-5.5	-7	-6	-3	-3	52.8	52.6	55	58	57	56
Bosnia and Herzegovina	1.3	-2.0	-3	-4	-2	-2	29.6	27.6	30	30	30	30
Montenegro	8.2	1.7	-2	0	0	0	26.3	26.8	37	38	36	32
Serbia	-1.9	-2.4	-5	-4	-2	-2	30.0	25.8	31.5	34	35	35

1) National definition, for Turkey EU definition: according to ESA'95, excessive deficit procedure.- 2) National definition, for Croatia and Turkey EU definition: according to ESA'95, for Albania and Bosnia and Herzegovina IMF data. - 3) Preliminary and wiiw estimates. - 4) Budget on accrual basis including change in arrears and non-recorded expenditures. - 5) Budget refers to central government budget + extra budgetary funds.

Source: wiiw Database incorporating national statistic. Forecasts by wiiw.

A high export-GDP ratio (see Table III in Executive Summary) is another indicator of a high share held by the flexible – or volatile – block. As a rule, it is much higher in very small economies than in large economies where the domestic market plays a more dominant role. In Montenegro, the smallest FMS, however, exports of goods comprise a mere 12% of GDP, an extremely low figure, whereas the exports of services account for approximately one quarter of the GDP: a high figure attributable to the country's specialization in tourism. In Albania, the situation is the same, but the ratios are lower. Exports of goods constitute less than 10% of the GDP and exports of services amount to 20%. Croatia shows a similar pattern of specialization. In 2009, its exports of goods amounted to 17% of the GDP, less than the GDP ratio of services (19%). By West Balkan standards, Macedonia and BiH are *the* specialists in the export of goods, with GDP ratios of about 30% and 25%, respectively. Compared to the Czech Republic, Slovakia or Slovenia, for example, these ratios are very low (see Table II). In terms of economic magnitude, Turkey is similar to Poland, and both countries' foreign trade openness (as measured in terms of the ratio between exports of goods and services and GDP) is roughly similar in dimension. In the West Balkan countries, both the

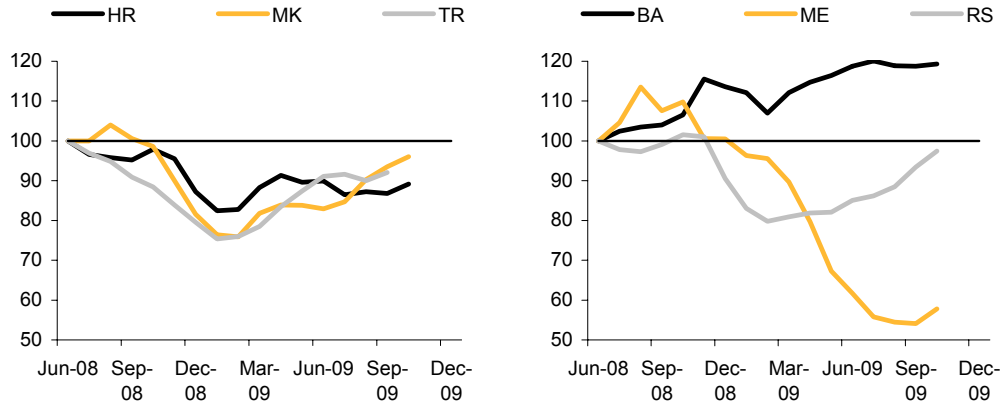
low ratios of exports to GDP and the high ratios between government expenditures and GDP reflect the predominance of the stable sector. This predominance is one of the reasons for (a) the relatively small GDP decline in most of the West Balkan countries and (b) no decline at all – as in Albania.

Starting from a low initial position (in 2000), industrial output in 2009 in BiH and Albania was up by almost 80%. In Macedonia and Serbia, which started from a higher initial position, industrial production did not go up substantially, while in Montenegro it dropped by 20% (see Table III). As mentioned above, after September 2008 industrial output development followed the general pattern of decline; it bottomed out in January and February 2009 and more or less stagnated thereafter. Two countries were exceptions: BiH and Macedonia (see Figure 3). The only reason for BiH not following the above pattern is the inclusion of the refinery sector. Its production had been insignificant prior to December 2008, the month in which the refinery in Bosanski Brod went back on stream. Statistically, restarting operations resulted in refinery output recording exceptional year-on-year growth rates up to November 2009 and within the aggregate index the refinery sector's weight was relatively high. In fact, after December 2008, output increased only slightly – up by approximately 10% in December 2009. By way of contrast, the aluminium plant in Montenegro had to cut back production drastically in December 2008 and failed to recover fully in subsequent months (industrial output dropped by 30% in 2009).

Figure 3

Gross industrial production

June 2008 = 100, 3-month moving average, NACE Rev. 2



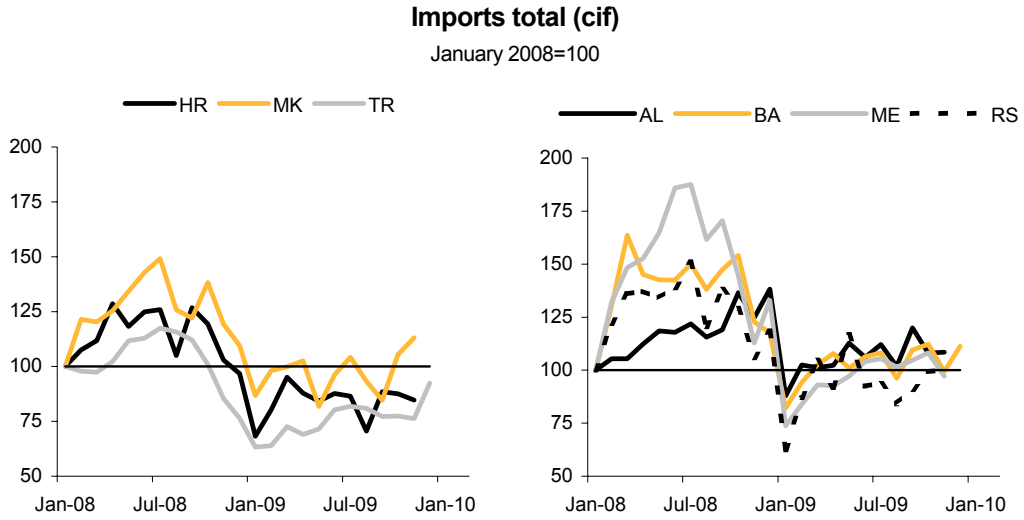
Note: MK, BA, ME, RS data refer to NACE Rev. 1.

Source: wiiw Database incorporating national statistics and Eurostat.

For a number of reasons, the graphs portraying the development of imports show basically the same pattern as industrial production. One reason is that manufacturing absorbs a considerable share of the imports. Another is that international energy prices dropped drastically. A third reason is that it became costly or well nigh impossible to finance high trade deficits. In mid-2008, imports were far above the level of January 2008, only to drop below that level in the last quarter of 2008. The decline came to a stop in the first months of 2009; imports stagnated or recovered somewhat thereafter (see

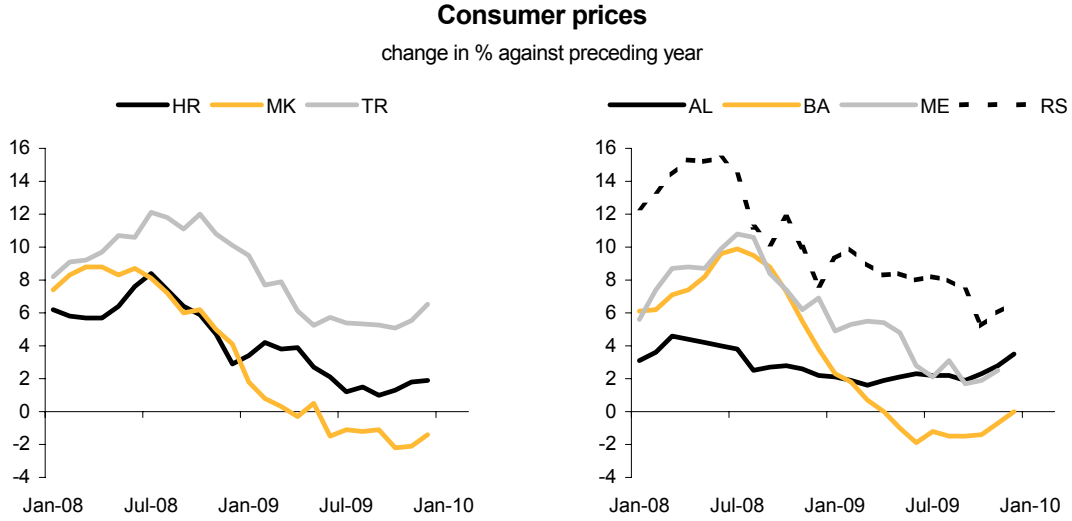
Figure 4). Towards the end of 2009, they had regained January 2008 levels in Albania, BiH and Serbia, yet remained below that level in Croatia and Turkey.

Figure 4



Source: wiiw Database incorporating national statistics and Eurostat.

Figure 5



Source: wiiw Database incorporating national statistics and Eurostat.

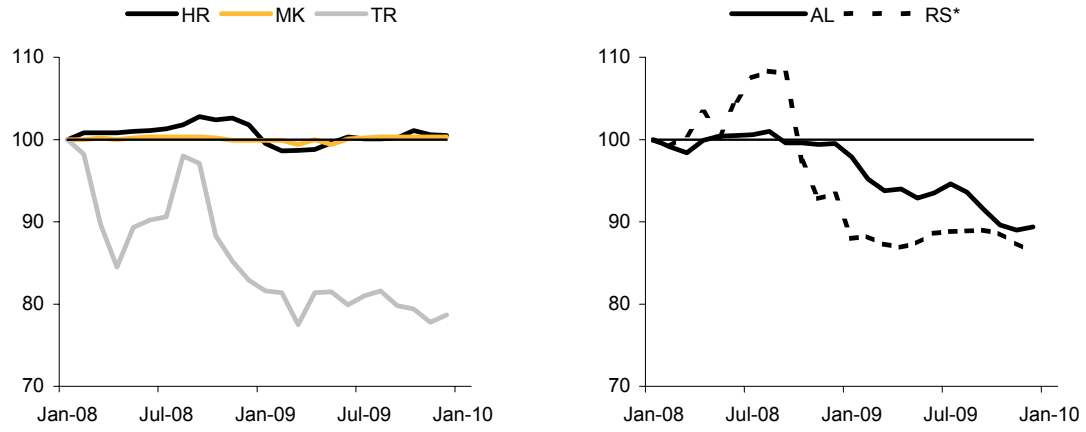
The mix of declining world market prices for energy and agricultural products and leftward shifts in demand for certain types of consumer goods checked inflation pressures; in some FMS (BiH and Macedonia), it even provoked a slight drop in the consumer price index (see Figure 5). In Serbia and Turkey, inflationary pressures diminished as well, but remained above an annual rate of 5%. The reason was strong nominal currency depreciation in the final months of 2008 and first months of

2009, which provoked an increase in the domestic prices of imported goods. In Albania, the national currency also depreciated, while given continued GDP growth, inflation did not drop significantly (see Figure 6).

Figure 6

Nominal exchange rates*

EUR per NCU, monthly average, January 2008 = 100



* Ascending line indicates appreciation. RS: based on end of period.

Source: wiiw Database incorporating national statistics and Eurostat.

Policy responses

After the above discussion of the channels through which the global financial and economic crisis hit the region and the impact it had on GDP, industrial production, employment and price developments, this section looks at policy responses in the FMS.

One of the policy decisions was to keep the exchange rate pegged to the euro, officially or unofficially, or allow for variations. Serbia and Turkey continued their flexible exchange rate regimes and Albania joined them; in all three countries, the currency depreciated. Montenegro uses the euro as legal tender, and the other countries have continued pegging to the euro. This has not granted monetary policy much manoeuvring space. This holds especially true for BiH with its currency board regime that has become an anchor ensuring reliable nominal stability. Given the weakening of inflationary pressures, Turkey's monetary authorities took the daring step of gradually lowering the policy rate (see Figure 7).[34] The outcome was renewed evidence that lowering policy rates and decelerating inflation can go hand in hand, as the Czech monetary authorities have demonstrated for a number of years. At the same time, the reduction of the policy rate offered sound protection against appreciation tendencies. Turkey was the only country, where the policy rate also declined in real terms – from close to 10% in January 2008 down to less than 4% in December 2009 (see Figure 8). The Turkish central bank has firmly supported the government's policy of stimulating

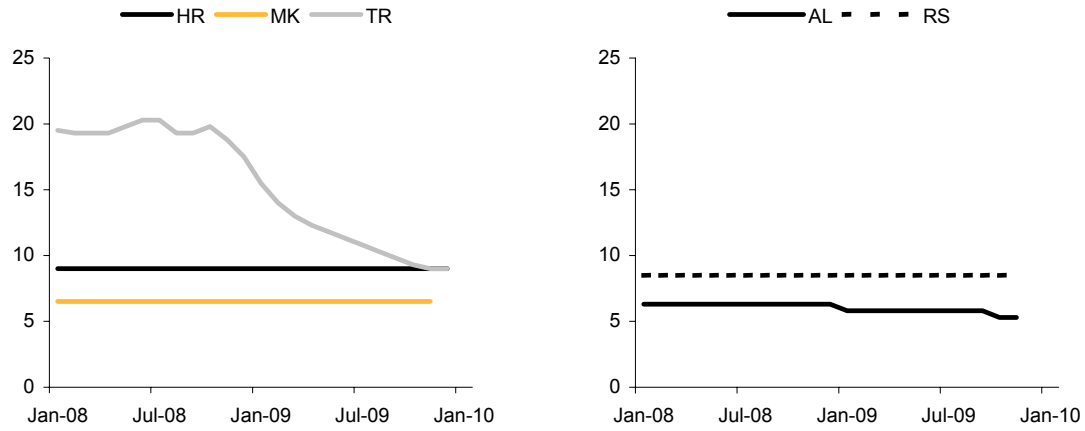
[34] Figure 7 shows the development of the Turkish Central Bank's overnight lending rate.

economic activities. The commercial bank lending rates peaked around October 2008, but then shadowed the drop in the policy rate. The spread between commercial rates and the policy rate has, however, remained wider than it used to be up to mid-2008. This holds especially true for household loans.

Figure 7

Leading NB interest rates

in % p.a.



Source: wiiw Database incorporating national statistics and Eurostat.

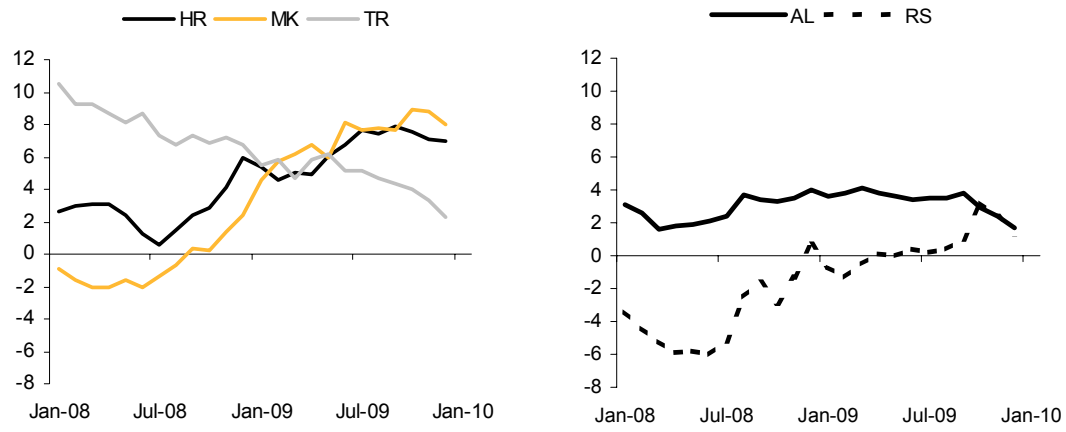
Serbia, followed by BiH at a later stage, concluded a stand-by arrangement with the IMF. Moreover, the IMF, EU, EBRD and other western institutions came out in support of the Vienna Initiative, whereby foreign-owned banks agreed to leave their capital in the countries in order to curb the crisis. This has had a strong stabilizing effect. Quite possibly, Montenegro will also seek an agreement with the IMF. For some time, Croatia had been discussing an IMF loan on terms similar to those that Poland had negotiated earlier. In the ultimate analysis, the understanding was that the country did not fully meet the requirements. Turkey's government ignored urgent recommendations to go for a stand-by agreement. Perhaps that was a good policy decision in terms of the exchange rate. Concluding such a deal would have made it more difficult to avoid appreciation.

The governments' fiscal responses also varied widely within the FMS group. Serbia reduced its budget deficit-GDP ratio (see Table 3), the background to the decision being a stand-by agreement with the IMF. Under a similar arrangement, BiH increased its deficit somewhat. All other governments granted the automatic stabilizers a certain degree of leeway so as to do their job. Furthermore, Turkey decided to support business activities with a stimulus package, while Montenegro prevented a domestic bank and its aluminium producer from collapsing by injecting liquidity and/or credit. In Turkey, these interventions implied a much higher budget deficit in 2009 compared to 2008; in Montenegro, they marked a switch from a budgetary surplus to a deficit. The government deficits in Albania, Croatia and Macedonia also increased substantially. In 2009, in most of the countries the budget deficits remained below 3% of GDP. Albania and Turkey were the exceptions with budget deficits of 5-7% of GDP.

Figure 8

Real leading NB-interest rates

(CPI deflated), in % p.a.



Source: wiiw Database incorporating national statistics and Eurostat.

Except for Albania, fiscal discipline had been high prior to the crisis and this policy paid off when the crisis came. BiH maintained a surplus over the period 2004-2007; Croatia reduced its deficits substantially; Macedonia's budget remained more or less balanced throughout; Montenegro recorded surpluses over the period 2006-2008; and Turkey recorded a surplus in 2006 and low deficits in other years. Thanks to this discipline, in 2009 in all but one country (Albania), FMS public debt was far below 50% of GDP. In summary, the fiscal stance has provided for some deficit-spending.

A cautiously optimistic outlook despite serious risks

Our forecast is based on the assumption that no new external shocks will disturb economic developments in the region. However, a few endogenous risk factors could hamper positive development. We shall briefly discuss four main risk factors.

A high current account deficit

In the FMS group, the Achilles heel has traditionally been the high current account deficit. In 2008 it reached peak values of 15% of GDP in BiH, 9% in Croatia, 13% in Macedonia, 33% in Montenegro and 17% in Serbia. Turkey's current account deficit had already peaked in 2006 (6%).

Marked dependence on capital inflows heightens potential exposure to crisis, as evidenced by developments in the Baltic States. In the case of the FMS, however, the situation remained manageable. In 2009, the current account deficits dropped drastically in most countries in the region. Once again, the exception was Albania where in the context of continued GDP growth, the deficit in the current account is likely to climb back up to 20% of GDP in 2010.

In mid-2008, all the FMS recorded trade deficits. By January or February 2009, however, they had dropped dramatically: in Turkey to about one tenth of the level in July 2008; in Montenegro and Serbia to one third; and in BiH to about 50%. The drop was less striking in Croatia, Macedonia and Albania. Thereafter, the deficits started increasing once again: a development fuelling expectations of increases in current account deficits (see Table 4).

Excessive reliance on foreign financing (and the accompanying current account deficits) was a key aspect of the economic development 'model' adopted by the FMS group as a whole (see Special topic for details). A contrasting development scheme would be one characterized by export surpluses. The latter scheme implies higher domestic profits and therefore more domestic sources of funds to invest in physical capital. It makes the economy less dependent on external decisions. China, Germany, Japan and Korea, as well as Ireland in its heyday, opted for such development paths. If they were to switch to such a development scheme, the West Balkan countries would need to undertake a swathe of comprehensive reforms, something that is unlikely to happen in the foreseeable future. In the case of Turkey, it is more a question of eschewing real appreciation.

Table 4

Foreign financial position

in % of GDP

	Gross external debt [1)2)]			Reserves of National Bank (excluding gold) [1)]			Current account				
	2007	2008	2009	2007	2008	2009	2008	2009	2010 Forecast	2011 Forecast	2012
Croatia	76.8	83.8	95	21.7	19.5	23.0	-9.2	-5.5	-6.5	-7.0	-7.5
Macedonia	49.1	50.9	55	24.2	21.0	19.0	-13.1	-7.0	-8	-8	-8
Turkey	34.5	45.2	42	10.6	10.2	10.9	-5.7	-2.3	-2.6	-2.7	-2.9
Albania	18.1	29.5	.	17.8	18.3	17.5	-14.7	-18.6	-20.1	-18.0	-17.5
Bosnia and Herzegovina	18.2	17.2	20	30.8	25.5	25.2	-14.9	-8	-8	-8	-8
Montenegro	17.2	15.6	18	9.7	7.0	5.8	-32.6	-15	-10	-10	-10
Serbia	59.7	69.2	74	31.7	25.2	34.7	-17.7	-7	-9	-10	-10

1) End of period.- 2) Gross external public debt for Bosnia and Herzegovina and Montenegro.

Source: wiiw Database incorporating national statistics. Forecasts by wiiw.

Strong real appreciation

For the FMS, a particularly severe risk factor is pronounced real appreciation, which might contribute to an erosion of competitiveness (which would hinder export development and boost imports), thus provoking a full-scale return to unsustainable trade and current account deficits. Of the FMS, only Albania and Turkey managed to avoid real appreciation throughout 2009 (see Figure 9). At the end of 2009, the ratio between their prices and those of the EU-27 was significantly lower than it had been in January 2008. In the case of Croatia it was higher: something that can hardly be conducive to the competitiveness of the business sector, given that Croatia's price level is rather elevated

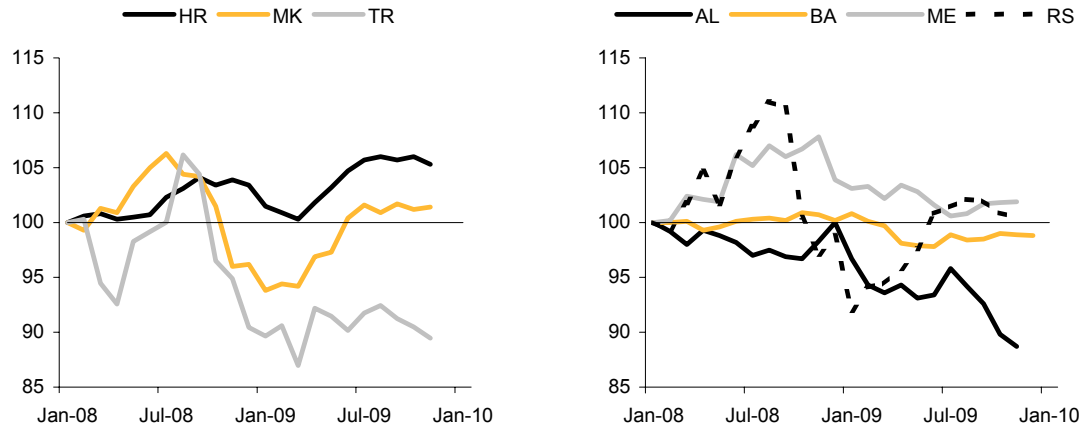
anyway (more than two thirds of the EU-27 price level – see Appendix). Of the FMS, Turkey is the country with the second highest price levels; this means that real appreciation is also a risk factor in Turkey. Macedonia is the FMS with the lowest price level; this should grant the country scope for producing more tradables than at present.

In the case of Croatia and Montenegro, foreign (speculative) investment has pushed up prices on the real estate and other markets to levels that are not healthy for the producers of tradable goods. Tourists, who are used to high EU prices, may also have lent some impetus to price increases. In services, tourism at least, the countries enjoy some comparative advantage. Albania has the potential to move in the same direction, albeit at a later juncture.

Figure 9

Real appreciation*

EUR per NCU, PPI-deflated, January 2008 = 100



* Values over 100 indicate appreciation relative to January 2008.

Source: wiiw Database incorporating national statistics and Eurostat.

High indebtedness

In any country, high indebtedness of all kind of economic agents, private and public alike, is a risk factor (see Special topic). The risk is enhanced in the case of foreign currency debt (either from domestic or external sources) or euro-indexed debt, which is the customary approach in Croatia and certain other West Balkan countries, as debtors tend to underestimate the risk of currency depreciation. The gross external debt is close to 100% of GDP in Croatia and about three quarters of the GDP in Serbia. It is mainly private debt, as the overall government debt is relatively low: 38% of the total in Croatia and 32% in Serbia (see Table 3). A high share of debt in foreign currency and the euro-indexation of loans in domestic currency mean that the monetary authorities cannot resort to exchange rate depreciation as a tool for strengthening companies' competitiveness without threatening the debt servicing. That would prove too costly for a large proportion of the population – and hence for the politicians as well. Thanks to the IMF backing the currency board, considerations of this kind do not play a role in BiH.

The need for continuous fiscal austerity

As for the fixed income and employment blocks of the economy in the individual countries, they will most likely feel the impact of the global crisis after some delay. In some of the countries, public sector employees have already had to accept wage cuts or reductions of planned increases. The need to return to low budget deficits will generate pressure in favour of cuts in expenditures or the restriction of increases for several years to come. Semi- or non-governmental producers of non-tradable goods and services will need to achieve higher productivity. In the event of a strong global and EU recovery of business activities (which is rather unlikely). It may transpire that countries with a large fixed block are better off in terms of social and economic costs of the crisis. This will become clear in retrospect – some five to ten years hence. Should global recovery remain weak, even in the medium term, it may well happen that in the fixed income and employment sector neither incomes nor employment levels will remain all that stable. Where that sector's GDP share is high, as is the case to some degree in the West Balkan countries, recovery could be slower and less pronounced.

In any event, for the West Balkan countries and especially for the poorer ones (all except Croatia and Turkey), EU assistance and projects funded by international financial institutions will become even more essential. They have already played an important role as a stability and development factor over the past few years.

Optimism linked to real sector developments and EU integration

In the absence of major setbacks in global economic development, we expect all FMS economies to be growing again by 2011. That growth will accelerate slightly in 2012 but will in general be slower than in the pre-crisis period (see Table I). For this to happen, the main prerequisite is some degree of recovery in global trade, including a rise in EU demand for imports. In the FMS, increases in private consumption are not likely to be very pronounced as long as employment fails to grow and profits remain low. It is also unlikely that investment will act as a strong engine of growth. It will only become more likely after a return to a higher utilization of existing capacities.

Employment is a severe problem throughout the FMS. Only a low proportion of the working-age population (15-64) was employed in 2009: 57% in Croatia, 54% in Albania, somewhat over 50% in Serbia, 50% in Montenegro, 46% in Turkey, 42% in Macedonia, and 40% in BiH. This may become worse before it gets better. A modest rate of GDP growth (as we expect) tends to be accompanied by increases in labour productivity; employment may thus continue to stagnate.

We do not expect current account deficits to return rapidly to the high levels they displayed in 2008, as financial investors have become more cautious in this regard. Nor do we expect an alarming escalation of inflation within the FMS group over the next few years.

As for the EU future of the FMS, the Lisbon Treaty has improved the institutional preconditions for future enlargement. It is, however, quite feasible that unsolved stability problems in the current EU member states (Greece) will have a retarding impact on the integration process of West Balkan countries. That notwithstanding, Croatia enjoys the advantage of its EU accession negotiations

having reached an advanced stage. Furthermore, the country is small and not considered problematic (except for corruption), so that accession within the next few years looks quite likely. Turkey's accession is another issue. Hesitance seems to have gained ground on both sides. On the other hand, whatever the politicians may be saying today, nobody can possibly know what the decisions to be taken in five or ten years hence will look like.

Mario Holzner

Albania:
Part of a Greek tragedy?

Economic growth in 2009 turned out much stronger than expected. Data for the first three quarters exhibit real GDP growth of almost 5%. In fact, for the whole year 2009 we expect a growth rate of above 4% (the earlier forecast from July 2009 was a 1% decline). The main drivers of growth were strong government investment in the wake of the parliamentary elections and a boom in the telecommunications industry due to more competition in the mobile telephony sector. For 2010 we expect growth as low as 1% given that government expenditures will tend to decrease and household consumption will stagnate in a fragile global economic environment. In particular the unfolding economic crisis in Greece may pose a threat to economic growth in Albania in 2010 and thereafter.

In the closing months of 2009 economic activity in Albania was decelerating. Growth of credit to residents decreased from a peak of about 30% in early 2009 to 15% in mid-2009 and to some 5% at the end of the year as compared to the same months a year earlier. This is despite the National Bank having decreased its base rate and the president of the National Bank asking the heads of the commercial banks to maintain lending. Quarterly GDP growth rates were decelerating: from above 5% in the first two quarters to some 4% in the third quarter of 2009. The Economic Sentiment Indicator from the National Bank's Business and Consumer Survey, though improving slightly in the course of the year, was well below its long-term average throughout all three quarters of 2009.

By December 2009 the Albanian lek depreciated by some 11% as compared to the same month of the previous year. This, along with an increase in excise taxes, has *inter alia* caused price increases in the food and beverages sector. This will further dampen the consumption of households. In addition, heavy flooding has devastated the country's north-western plane lands. This will also have negative effects on agricultural production in 2010. On the positive side, due to the heavy rainfalls the Albanian hydro power production could operate at full capacity and export electricity.

Another gleam of hope arises from the fact that the lek depreciation may improve the conditions of the tiny Albanian export sector during 2010. While in 2009 exports fell by nearly 20%, 2010 may bring a reversal. Also the tourism sector might finally generate a stronger surplus. Figures for 2009 show a growth of some 17% in net tourism revenues. This is mainly attributable to the opening of the newly built highway from neighbouring Kosovo to the Albanian coast in June 2009.

In 2009 it was possible to finance a huge and increasing current account deficit with growing FDI revenues from privatization. It will be difficult to reach a similarly high level of FDI in 2010. Also

remittances sent home from Albanian migrants abroad tend to further decline. Thus continued consumption of imported goods and services will have to be financed increasingly by borrowings. In this respect the Albanian Ministry of Finance has opened a tender for a bond management company in a bid to emit EUR 300 million in euro-denominated bonds, after a first attempt failed in early 2009.

It is yet unclear whether and to what extent Albania will be affected by the economic crisis in neighbouring Greece. Heavily increasing budget deficits and public debt triggered a collapse in the Greek bond market. At present it is not known in what way the Greek government will raise money to refinance existing debt and keep paying public sector salaries and pensions. A pay freeze for civil servants, tax increases and a substantial cut in government expenditures seem to be inevitable. This will most probably lead to several years of poor economic activity for one of Albania's most important economic partners. Four possible transmission channels can be identified: trade, remittances, FDI and banking.

Greece is Albania's second most important export partner (after Italy) with a share of about 8% in total Albanian exports. Most likely a fall in Greek demand would cause a drop in Albanian exports, but not necessarily. It might well be that lower-priced goods from Albania substitute for higher-priced goods from other countries. There are about half a million holders of Albanian citizenship living in Greece, which makes the country one of the most preferred targets of Albanian work migration. Though the actual amounts of remittances sent to Albania are not precisely known, it can be expected that the share is large. Again, an economic downturn in Greece will most likely cause remittances to decrease, but this may not necessarily happen. Albanians in Greece are barely working in the public sector and might thus be affected only indirectly by the crisis. Latest data from 2004 suggest that Greece is by far the most important source country of FDI in Albania. A slowdown of Greek FDI inflows is very likely and will cause additional pressure on the economy. Finally, Greek banks have a strong position in the Albanian banking sector. Here the Greek mother banks may find it more profitable to lend money to the Greek state and hence less capital could flow to their branches in Albania – but again, not necessarily.

Thus, overall prospects for economic developments in Albania in 2010 are rather modest and certain downward risks seem to arise from the Greek economic crisis, although these effects are difficult to forecast. We expect Albania's economy to grow by merely 1% in 2010. Further currency depreciation in 2010 could support Albania's export sector in subsequent years in spite of potential slight re-appreciation. This, together with household consumption regaining strength and improving access to credit for the private sector, could raise economic growth to some 4% in 2011 and 5% in 2012.

Table AL

Albania: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average	3127	3149	3135	3161	3177	3190	3210	3220	3240
Gross domestic product, ALL bn, nom.	750.8	814.8	882.2	971.2	1100.0	1180.0	1240	1350	1500
annual change in % (real)	5.7	5.7	5.4	6.0	8.0	4.2	1	4	5
GDP/capita (EUR at exchange rate)	1900	2100	2300	2500	2800	2800	.	.	.
GDP/capita (EUR at PPP - wiiw)	4600	5000	5500	5800	6500	6900	.	.	.
Consumption of households, ALL bn, nom.	584.7	634.5	680.3	775.1	860	910	.	.	.
annual change in % (real)	9.4	6.0	4.7	10.7	7.0	3	0	3	6
Gross fixed capital form., ALL bn, nom.	279.4	301.4	343.9	374.9	450	470	.	.	.
annual change in % (real)	2.7	4.9	13.0	5.8	12.0	6	1	8	10
Gross industrial production [2]									
annual change in % (real)	14.1	11.7	12.1	-10.3	2.0	4.3	1	3	7
Gross agricultural production [3]									
annual change in % (real)	6.3	0.9	3.1	2.6	1.0	3	1	3	3
Construction output total [2]									
annual change in % (real)	7.9	6.3	10.5	10.1	7.0	7	0	3	5
Employed persons - LFS, th, June	.	.	.	1188.3	1103.0	1110	1050	1070	1120
annual change in %	.	.	.	.	-7.2	0.6	-5	2	5
Employment reg. total, th pers., end of period	931.2	932.1	935.1	965.5	974.1	970	910	930	980
annual change in %	0.5	0.1	0.3	3.3	0.9	-0.4	.	.	.
Unemployed persons - LFS, th, June	.	.	.	185.0	166.0	167.0	190	180	165
Unemployment rate - LFS, in %, June	.	.	.	13.5	13.1	13.1	15	14	13
Reg. unemployment rate, in %, end of period	14.4	14.1	13.8	13.2	12.7	12.8	14	13	12
Average gross monthly wages, ALL	19039	19993	21842	27350	29000	31900	.	.	.
annual change in % (real, gross)	-0.1	2.6	6.7	21.6	2.6	7.6	.	.	.
Consumer prices, % p.a.	2.9	2.4	2.4	2.9	3.4	2.2	2	3	3
Producer prices in industry, % p.a. [4]	12.2	4.9	0.8	3.5	6.5	-2	-1	2	4
General governm.budget, nat.def., % GDP									
Revenues	24.6	25.1	26.0	25.9	26.5	25.5	23	25	26
Expenditures	29.6	28.5	29.3	29.4	32.0	32.5	29	28	29
Deficit (-) / surplus (+)	-5.1	-3.5	-3.3	-3.5	-5.5	-7	-6	-3	-3
Public debt, EU-def., in % of GDP [5]	57.7	58.1	56.0	52.8	52.6	55	58	57	56
Base rate of NB, % p.a., end of period [6]	5.3	5.0	5.5	6.3	6.3	5.3	5	6	6
Current account, EUR mn	-340.2	-589.1	-471.0	-831.0	-1318.8	-1660	-1780	-1800	-2100
Current account in % of GDP	-5.8	-9.0	-6.6	-10.6	-14.7	-18.6	-20.1	-18.0	-17.5
Exports of goods, BOP, EUR mn	485.6	530.2	630.6	786.3	917.5	760	810	890	970
annual growth rate in %	23.0	9.2	18.9	24.7	16.7	-17	7	10	9
Imports of goods, BOP, EUR mn	1762.3	2006.9	2289.6	2890.4	3348.9	3240	3400	3600	3900
annual growth rate in %	12.1	13.9	14.1	26.2	15.9	-3	5	6	8
Exports of services, BOP, EUR mn	807.6	967.3	1156.6	1415.1	1687.8	1800	1900	2100	2300
annual growth rate in %	27.6	19.8	19.6	22.3	19.3	7	6	11	10
Imports of services, BOP, EUR mn	848.1	1107.7	1188.0	1402.3	1618.4	1760	1800	1900	2100
annual growth rate in %	20.3	30.6	7.2	18.0	15.4	9	2	6	11
FDI inflow, EUR mn	278.4	212.6	258.6	481.1	653.1	750	600	500	700
FDI outflow, EUR mn	11.0	3.3	8.3	11.1	62.6	20	10	20	30
Gross reserves of NB excl. gold, EUR mn	982.7	1171.6	1329.2	1415.9	1626.1	1500	.	.	.
Gross external debt, EUR mn [7]	1224.0	1373.5	1445.4	1445.7	2624.2	3000	.	.	.
Gross external debt in % of GDP	20.6	20.7	20.3	18.1	29.5	35	.	.	.
Average exchange rate ALL/EUR	127.7	124.2	123.1	123.6	122.8	132.1	140	135	125
Purchasing power parity ALL/EUR [8]	51.9	52.1	51.2	52.7	52.9	53.7	.	.	.

1) Preliminary and wiiw estimates. - 2) Gross value-added. - 3) Gross value-added of agriculture, forestry and fishing. - 4) Until 2005 producer prices in manufacturing industry. - 5) Based on IMF data. - 6) One week repo rate. - 7) Until 2007 based on IMF data. - 8) Benchmark results 2005 from Eurostat and wiiw estimates.

Source: wiiw Database incorporating national statistics and IMF. Forecasts by wiiw.

Josef Pöschl

Bosnia and Herzegovina:
Is the worst still to come?

Bosnia and Herzegovina (BiH) is not what one would call a stronghold of optimism, particularly not in these days and certainly not among those responsible for the funding of public sector activities. Last December, the finance minister of the Federation of Bosnia and Herzegovina (FBiH), Vjekoslav Bevenda, uttered concerns that the economic crisis might reach its peak only in 2010. In January 2010, Dragan Vrankic, the central government's finance minister, said the crisis had reached BiH with a delay, and the same could hold true for recovery. Revenues from tax collection, customs and social security contributions have shrunk; arrears are on the rise. This gave a bad fit with past boom years' high increases in public sector wages and social benefits for war veterans, and they had to be revised at least partially in the context of a stand-by agreement with the IMF. In the first half of 2009, the discrepancy between revenues and law-based expenditure obligations brought the FBiH fiscal system close to collapse. For BiH, the agreement with the IMF and the need to comply with it had a crucial stabilizing impact. Continued investment into infrastructure is very much needed, so the IMF, and should not be subject to cuts. At the same time, BiH has to fight the fiscal deficit. Recovery alone will not do the job; there is need for public sector reform in the context of a new, more suitable constitution. The economy suffers from a disproportionate public sector and above-average public sector wages. The government (using the plural would in fact be more appropriate in the case of BiH) still controls an important segment of the corporate sector with a large burden of unsettled liabilities. This is certainly not a guarantee for good management. To give an example, Energopetrol makes losses from operating a countrywide network of petrol filling stations.

From a macroeconomic point of view, the government and the public utilities sector are a kind of 'fixed-income block', and its high share in GDP reduces the impact of the crisis on GDP development. By Central East and Southeast European standards, a GDP decline of about 3% in 2009 is quite modest. The counterpart to the fixed-income block is relatively small. It is located within the private sector and consists especially of producers of tradable goods and services who are as much impacted by the international crisis as in comparable countries.

Voices from the private sector are, again, quite pessimistic, in spite of some encouraging examples of success even under current conditions. The metal industry is upset as the parliament has paved the way for government subsidies last year, but money has never started flowing, and employees fear additional layoffs. At an Economic and Social Council meeting at the end of January 2010, a representative of an FBiH employer association warned that in the near future a number of companies may have to lay off part of their work force or shut down completely. More loans are turning bad and have become a source of concern for micro credit organizations in particular. The

board of the FBiH Banking Agency has adopted interim measures for loan rescheduling. A bank is free to agree on the rescheduling of a natural or legal person's loan excluding current account overdrafts, as long as that person is not in default for over three months. Managers of non-financial companies are disappointed by worsened borrowing conditions and banks' reluctance to finance exports, whereas banks complain about lack of clients with good quality projects, which prevents them from using their full lending potential. They defend high commercial lending rates (in the range of 8-10%) with complaints about expensive foreign capital. Real estate prices fell significantly in 2009 and may fall again in 2010. The volume of transactions is low.

BiH is running a large trade deficit with its partner countries in the framework of the Central European Free Trade Agreement (CEFTA), and discomfort with all kinds of trade liberalization (CEFTA, SAA/IA, WTO) is widespread. This is particularly true for farmers, as the BiH government cannot afford supporting them as much as is the case, e.g., in Croatia or the EU.

Most of the external assessments of the country's economy are also rather pessimistic. BiH holds rank 109 in the World Economic Forum's Global Competitiveness Report 2009-2010 and rank 87 in a World Bank study focused on trade logistics. In mid-January, Valentin Inzko, High Representative (formally at least, still) and EU Special Representative, characterized the economy as being in a sad state. According to him, the loss of 70,000 jobs after October 2008 was not exclusively attributable to the international crisis; BiH has missed opportunities of adopting investment-friendly legislation and has not reformed the banking supervision in a way that would facilitate SME credit access. The latest EU progress report encourages a speeding-up of accession efforts after many months of very slow progress. In December 2009, Standard & Poor upgraded the economy's credit rating (to B+ for long-tem and B with stable outlook for short-term credits), whereas in January 2010 Moody's decided to keep its rating constant (B2 with stable outlook).

In our view, pure pessimism is not justified. If we take industrial output data on the years 2009 and 2008, in a number of industries the December-on-December results are much better than the results of full-year comparisons. This is the case, for example, for textiles and clothing, where the full-year change was -3% whereas the December-on-December change was +24.7%. Wood and wood products, again a rather important BiH industry, also recorded a switch from negative to positive (-16% vs. +5.6%) as well as leather and leather products (-1.8% vs. 14.3%). In the case of transport equipment, the switch was from +2.9% to +33.4%. In recent years, this has been a small but dynamic sector. A switch from massive decline (full-year change) to small decline in the December/December ratio occurred in machinery as well as electrical and optical equipment. The output decline in basic metals and metal products, a key industry, was worse December-over-December (-25%) than in a whole-year comparison (-17.2%). However, Aluminij Mostar, one of the big players in this branch, now plans to return to higher capacity utilization in response to improved world market prices. The decline in the output of non-metallic mineral products, too, was larger in December than in the full year, pointing to decreased construction activities. These figures were not subject to any adjustment, which makes their interpretation more difficult. In a few months' time, the degree of recovery of at least some of the industries will become clearer.

The small overall decline in industrial production, -3.3% (2009 over 2008), follows mainly from the increase in the output of coke and refined petroleum products (+498.6% sic!) in the context of the relaunch of production of the Bosanski Brod refinery in December 2008. The December-on-December increase was merely 9.6%. The company envisages a modernization and expansion of its production.

The GDP development during the next few months and years will of course be massively influenced by international business climate developments. Should the latter be favourable, any export expansion will be easier; citizens working abroad will earn more money and send more remittances, and more foreign capital will be inclined to enter the country. We count with a return of export expansion, which will increase over time. It is quite feasible that BiH will manage to become a WTO member in 2010, finally. A new WTO-conforming institutional framework together with institutional reforms associated with the SAA-related Interim Agreement with the EU could boost exports. However, imports will start growing again as well. A return to current account deficits as large as they were in the past is unlikely. Import development will have to be better adjusted to export growth.

Gross fixed capital formation will depend on projects the public sector will perform in cooperation with the EU and IFIs, as well as on the private sector's investment decisions. The former are on track, whereas the latter will not gain momentum rapidly: capacity utilization is low; the stock of accumulated profits is low; and borrowing will remain more costly than it was in the past.

Private consumption will remain stagnant because of unemployment, which will remain high for quite some time, and wage growth, which will be slower than in the past. All this adds up to an only modest export-led resumption of GDP growth up until 2012. If so, one of the most severe problems of the BiH economy, and society, will continue to persist: less than one third of the population is economically active in the sense of having or seeking a job. Less than one quarter of the population has at least what is regarded as employment in terms of the labour force survey; and less than 20% are officially registered as employed. These dejecting circumstances have contributed to a political climate in which the majority of voters tend to opt for the status quo as a risk-minimizing strategy.

Currently, it is difficult to adopt a law on the census to be performed in 2011. There is a split regarding whether the questionnaire should address ethnic and religious affiliation. In the absence of consensus results, it will be hardly possible to integrate BiH into the EU. Per capita measures are of key importance in a number of aspects. In October 2010, BiH will vote for new members of the parliaments and of the BiH presidency. Thereafter, serious work on a new constitution may start. Here again, there is a sharp divide in BiH. The current reality is de facto federalism in a way that bears adverse consequences for the country's economic performance. In Banja Luka, the leadership of Republika Srpska seems determined to expand federalism to a degree close to independence, whereas in the FBiH the majority of political leaders tend to strictly reject the concept of BiH federalism. There may evolve something like Serbia and Montenegro's drifting apart scenario, but hardly with the same outcome. Or, things may develop in quite another direction: thanks to the recent adoption of the Lisbon Treaty it has become feasible that in the next few months or years Serbia will enter the fast track towards EU integration. In this case, Banja Luka's focus may turn towards BiH's EU integration, so that the elaboration of joint solutions can start.

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average	3842	3843	3843	3843	3842	3843	3843	3843	3843
Gross domestic product, BAM mn, nom. [2]	15786.0	16927.9	19121.1	21758.8	24716.6	23900	23700	24200	25200
annual change in % (real) [2]	6.3	3.9	6.9	6.0	5.4	-3	-1	1	3
GDP/capita (EUR at exchange rate)	2100	2300	2500	2900	3300	3200	3100	3200	3300
GDP/capita (EUR at PPP - wiiw)	4800	5100	5700	6300	7000	6900	.	.	.
GDP by expend. approach, BAM mn, nom. [2]	16680.2	18177.6	21366.1	24708.6	27933.7	.	.	.	.
Consumption of households, BAM mn, nom. [2]	15017.5	16513.9	18064.3	19930.8	22369.7	21370	.	.	.
annual change in % (real) [2]	.	6.2	4.5	6.0	5.5	-4	-1	0	1
Gross fixed capital form., BAM mn, nom. [2]	4044.4	4889.5	4756.8	6446.4	7429.7	5910	.	.	.
annual change in % (real)	.	18.5	-9.4	28.8	9.6	-20	0	5	8
Gross industrial production [3]									
annual change in % (real)	12.1	10.8	11.5	6.4	11.0	-6	0	3	7
Gross agricultural production, total									
annual change in % (real)	27.7	-0.5	2.3	.	.	.	.	.	.
Employed persons - LFS, th, April	.	.	811.0	849.6	890.2	859.2	820	820	820
annual change in %	.	.	.	4.8	4.8	-3.5	-5	0	0
Employees total - reg., th, average	637.2	642.8	653.3	686.1	705.6	650	650	650	650
annual change in %	0.3	0.9	1.6	5.0	2.9	-8	0	0	0
Unemployed persons - LFS, th, April	.	.	366.8	346.7	272.0	272.3	.	.	.
Unemployment rate - LFS, in %, April	.	.	31.1	29.0	23.4	24	27	27	27
Reg. unemployment rate, in %, end of period	43.2	44.1	44.1	42.5	40.6	43	44	44	44
Average gross monthly wages, BAM [4]	748	796	869	954	1112	1200	.	.	.
annual change in % (real, net) [4]	3.5	3.4	2.3	8.4	8.4	5.6	.	.	.
Consumer prices, % p.a. [5]	0.8	3.0	6.2	1.5	7.5	-0.4	0	1	1
Producer prices in industry, % p.a.	.	.	.	.	.	.	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	40.4	42.1	44.9	45.2	44.1	42	42	43	43
Expenditures	38.8	39.6	42.0	43.9	46.1	45	46	45	45
Deficit (-) / surplus (+)	1.6	2.4	2.9	1.3	-2.0	-3	-4	-2	-2
Public debt, nat. def., in % of GDP [6]	25.5	25.6	22.0	29.6	27.6	30	30	30	30
Base rate of NB, % p.a., end of period	.	.	.	.	.	.	.	.	.
Current account, EUR mn [7]	-1318.7	-1499.7	-769.6	-1151.5	-1879.1	-950	-1000	-1000	-1000
Current account in % of GDP	-16.3	-17.3	-7.9	-10.4	-14.9	-7.8	-8	-8	-8
Exports of goods, BOP, EUR mn [7]	1677.0	2059.7	2687.3	3091.5	3522.0	2900	3000	3200	3500
annual growth rate in %	28.7	22.8	30.5	15.0	13.9	-18	3	7	9
Imports of goods, BOP, EUR mn [7]	5354.5	6021.5	6093.0	7233.6	8341.3	6200	6400	6700	7100
annual growth rate in %	7.6	12.5	1.2	18.7	15.3	-26	3	5	6
Exports of services, BOP, EUR mn [7]	696.1	798.6	903.8	1062.1	1125.9	1000	1030	1080	1150
annual growth rate in %	9.4	14.7	13.2	17.5	6.0	-11	3	5	6
Imports of services, BOP, EUR mn [7]	349.3	352.4	375.0	442.4	438.7	400	400	410	420
annual growth rate in %	3.0	0.9	6.4	18.0	-0.8	-9	0	2	2
FDI inflow, EUR mn [7]	566.9	493.1	572.4	1546.2	726.0	250	300	400	700
FDI outflow, EUR mn [7]	1.2	0.4	3.2	17.2	9.2	3	5	5	5
Gross reserves of NB excl. gold, EUR mn [8]	1778.8	2160.0	2787.4	3424.9	3218.9	3080	3050	3050	4000
Gross external debt, EUR mn [9]	2061.4	2217.9	2081.5	2025.4	2168.0	2500	2700	2700	2500
Gross external debt in % of GDP	25.5	25.6	21.3	18.2	17.2	20	.	.	.
Average exchange rate BAM/EUR	1.956	1.956	1.956	1.956	1.956	1.956	1.96	1.96	1.96
Purchasing power parity BAM/EUR [10]	0.850	0.857	0.875	0.898	0.923	0.907	.	.	.

1) Preliminary and wiiw estimates. - 2) From 2000 according to ESA'95 (including shadow economy, real growth rates based on previous year prices). - 3) wiiw estimates based on weighted averages for the two entities (Federation BH and Republika Srpska). - 4) From 2005 District Brcko included. - 5) Until 2005 costs of living, from 2006 harmonized CPI. - 6) Based on IMF data. - 7) Converted from national currency with the average exchange rate. - 8) From 2006 including investment in foreign securities.- 9) Gross external public debt. - 10) Benchmark results 2005 from Eurostat and wiiw estimates.

Source: wiiw Database incorporating national statistics and IMF. Forecasts by wiiw.

Hermine Vidovic

Croatia:
Another critical year ahead

Croatia's economy contracted strongly in 2009, with GDP down by 6%. The drop in output was mainly due to a significant decline in domestic demand: household consumption fell by 9% and gross fixed capital formation by 12%; by contrast, government consumption reported a 3% increase. The sharp decline in private consumption is among other things a consequence of the continuing decline in household lending, particularly with respect to car purchases. Though shrinking significantly, the contribution of foreign trade to GDP growth was still positive. Industrial production fell by 9.2% (manufacturing output by 10.6%). Output dropped in all manufacturing branches except for the production of paper and paper products, coke and refined petroleum products, and repair and installation of machinery and equipment. The decline was most pronounced in the production of basic pharmaceutical products (43%). In the shipbuilding industry, Croatia's major exporter, production plunged by 13%.[35]

The worsening situation of the real sector has translated into employment losses. Based on registration data the unemployment rate rose to over 16% by the end of December 2009. By comparison, the unemployment rate obtained from the Labour Force Survey indicates a rate of around 10%. The large discrepancy between the two measures may indicate rising informal sector activities. Manufacturing is hit hardest by job losses, which were most pronounced in the textile and wood industries. Trade, construction and tourism were heavily affected by employment cuts as well.

Facing the worsening of fiscal developments, Croatia's government adopted three budget revisions in 2009. In July the government decided to raise the VAT by one percentage point to 23% and introduced a crisis tax effective from 1 August. The tax takes 2% of all pensions, salaries and other incomes higher than HRK 3000 (EUR 409) a month and 4% of all amounts higher than HRK 6000 (EUR 819; the average wage was HRK 7700). In the year as a whole the general government deficit reached 2.9% of the GDP. The 2010 budget was adopted by the Croatian parliament at the beginning of December, envisaging a 2.9% general government deficit. Considering that the budget is based on the assumption of 0.5% GDP growth, this seems to be too ambitious. A Eurobond issue is planned in the first half of the year.

[35] The first round of the privatization of Croatia's six state-owned shipyards closed with only two valid Croatian bids in an international tender. The second privatization tender was issued on 15 February 2010 and interested parties will have 60 days to submit their bids.

Because of companies' growing difficulties, the share of bad loans has been on the rise over the past couple of months; it reached 7.6% by the end of 2009. In order to provide the banking system with additional liquidity, the National Bank has announced to gradually reduce the mandatory reserve rate from 14% to 11% this year and lifted the credit growth limit (12% annually) which it had introduced in 2006 in counteracting the fast credit growth. In an attempt to stimulate economic growth, the Croatian government decided at the beginning of January 2010 to establish a special fund in order to provide companies with cheap loans, with the state and the private sector sharing the risk. In addition, the Prime Minister announced measures designed to support companies facing difficulties, particularly in the textile and construction sectors.

The downturn in foreign trade slowed somewhat during the final months of 2009. Nevertheless, data available from customs statistics indicate a drop in goods exports and imports by 22% and 27% respectively and the trade deficit fell significantly. Data on services trade available for the first nine months of the year indicate a declining surplus as against the same 2008 period. This is primarily due to shrinking earnings from tourism and transport. Owing to the sharp reduction of the trade deficit, the current account closed also with a significantly lower deficit than in previous years. As for FDI, inflows more than halved compared to the first nine months of 2008 and were almost exclusively directed towards the financial sector. The rise in external debt is largely a consequence of corporate borrowing and direct-investment related debt (borrowing of enterprises from their foreign owners), while banks' borrowing rose only modestly and government debt remained almost unchanged. According to the governor of the Croatian National Bank, Croatia has to repay (refinance) nearly EUR 10 billion in 2010; adding the amount required for financing the fiscal deficit, total borrowing requirements will amount to almost EUR 13 billion. Thus, the debt to GDP ratio is likely to reach or even exceed the 100% mark in 2010.

Ivo Josipovic from the Social Democratic Party, a law professor and composer, won overwhelmingly with 60.3% of the votes in the second round of the presidential elections held on 10 January 2010. His rival Milan Bandic, the mayor of Zagreb, took 39.7% of the vote as an independent candidate. In a first statement Mr. Josipovic emphasized to back the centre-right Prime Minister Jadranka Kosor in implementing reforms, fighting corruption and supporting the government efforts in joining the EU.

After the lifting of Slovenia's veto on Croatia's accession talks in September, Croatia may complete the negotiating process in the course of 2010. This would imply accession in 2012, or even only in 2013.

GDP will decline by another 1% in 2010. Fiscal constraints and high foreign debt obligations represent a major obstacle to financing public investment projects. Employment is expected to further contract, translating into rising unemployment or even inactivity. This may trigger a further decline in household consumption. Foreign demand will largely depend on the recovery of Croatia's most important trading partners, Germany, Italy, and Bosnia and Herzegovina. The current account deficit will remain at moderate levels, at about 6.5% of GDP, in 2010 and increase gradually thereafter. The servicing and/or restructuring of the high foreign debt will remain one of the major challenges in the near future. Prospects of joining the EU in the foreseeable future might help to strengthen Croatia's standing vis-à-vis foreign creditors.

Table HR

Croatia: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average	4439	4442	4440	4436	4435	4435	4435	4435	4435
Gross domestic product, HRK mn, nom.	245550	264368	286341	314223	342159	329300	334200	349400	365300
annual change in % (real)	4.2	4.2	4.7	5.5	2.4	-6	-1	2	2.5
GDP/capita (EUR at exchange rate)	7400	8000	8800	9700	10700	10100	10300	10800	11300
GDP/capita (EUR at PPP - wiiw)	12100	12700	13500	15000	15500	14800	.	.	.
Consumption of households, HRK mn, nom.	150341	162165	172744	188952	202194	188410	.	.	.
annual change in % (real)	4.3	4.4	3.5	6.2	0.8	-9	0	1.5	2
Gross fixed capital form., HRK mn, nom.	60512	65008	74792	82386	94281	84960	.	.	.
annual change in % (real)	5.0	4.8	10.9	6.5	8.2	-12	1	4	5
Gross industrial production [2]									
annual change in % (real)	3.2	4.6	4.2	4.9	1.2	-9.2	1	3	3.5
Gross agricultural production									
annual change in % (real)	11.9	-8.7	4.4	-3.9	8.0	.	.	.	.
Construction industry, hours worked [2]									
annual change in % (real)	1.9	-0.7	9.4	2.4	11.8	-6.0	.	.	.
Employed persons - LFS, th, average	1563	1573	1586	1615	1636	1600	1590	1590	1610
annual change in %	1.7	0.7	0.8	1.8	1.3	-2	-0.5	0	1
Unemployed persons - LFS, th, average	250	229	199	171	149	165	.	.	.
Unemployment rate - LFS, in %, average	13.8	12.7	11.1	9.6	8.4	9.3	10	10	9
Reg. unemployment rate in %, end of period	18.5	17.8	17.0	14.7	13.7	16.7	17.5	17	16.5
Average gross monthly wages, HRK	5985	6248	6634	7047	7544	7700	.	.	.
annual change in % (real, net)	3.7	1.5	1.9	2.2	0.8	0.7	.	.	.
Consumer prices, % p.a.	2.1	3.3	3.2	2.9	6.1	2.4	2.5	2.5	2
Producer prices in industry, % p.a. [3]	3.5	3.0	2.9	3.4	8.4	-0.4	.	.	.
General governm.budget, nat.def., % GDP [4]									
Revenues	39.3	38.9	39.2	40.3	39.4	40.1	.	.	.
Expenditures	43.4	42.3	41.6	41.5	40.3	43.0	.	.	.
Deficit (-) / surplus (+) [5]	-4.2	-3.5	-2.6	-1.2	-1.0	-2.9	-3	-2.5	-2.5
Public debt, EU-def., in % of GDP [6]	37.8	38.3	35.7	33.1	33.5	37.7	39	39	42
Discount rate of NB, % p.a., end of period	4.5	4.5	4.5	9.0	9.0	9.0	.	.	.
Current account, EUR mn	-1433.7	-1975.6	-2717.1	-3237.7	-4368.8	-2450	-3000	-3400	-3800
Current account in % of GDP	-4.4	-5.5	-6.9	-7.6	-9.2	-5.5	-6.5	-7	-7.5
Exports of goods, BOP, EUR mn	6606.8	7220.3	8463.6	9192.5	9814.0	7650	7800	8200	8800
annual growth rate in %	18.5	9.3	17.2	8.6	6.8	-22	2	5	7
Imports of goods, BOP, EUR mn	13330.9	14738.3	16807.8	18626.5	20607.8	15250	15700	16600	17800
annual growth rate in %	6.3	10.6	14.0	10.8	10.6	-26	3	6	7
Exports of services, BOP, EUR mn	7636.7	8052.6	8526.8	9114.7	10090.6	8580	8800	9100	9600
annual growth rate in %	0.9	5.4	5.9	6.9	10.7	-15	2	3	5
Imports of services, BOP, EUR mn	2867.8	2734.9	2824.2	2847.3	3132.7	2850	2900	3000	3100
annual growth rate in %	8.9	-4.6	3.3	0.8	10.0	-9	2	2	4
FDI inflow, EUR mn	949.6	1467.9	2764.8	3670.2	4190.2	1900	1900	.	.
FDI outflow, EUR mn	278.8	191.8	208.2	180.2	965.2	870	.	.	.
Gross reserves of NB excl. gold, EUR mn	6436.2	7438.4	8725.3	9307.4	9120.9	10372.7	.	.	.
Gross external debt, EUR mn [7]	22933.0	25747.7	29273.9	32929.2	39124.6	43000	.	.	.
Gross external debt in % of GDP [7]	71.6	71.8	75.1	76.8	83.8	95	.	.	.
Average exchange rate HRK/EUR	7.4957	7.4000	7.3228	7.3360	7.2232	7.3398	7.3	7.3	7.3
Purchasing power parity HRK/EUR	4.5804	4.6745	4.7861	4.7223	4.9838	5.0274	.	.	.

Note: Gross industrial production and construction output refer to NACE Rev. 2.

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) Domestic output prices, from 2009 according to NACE Rev. 2. - 4) On accrual basis. - 5) Including change in arrears and non-recorded expenditures. - 6) According to ESA'95, excessive deficit procedure. - 7) From 2008 new reporting system (estimated data for non-financial enterprises).

Source: wiiw Database incorporating Eurostat and national statistics. Forecasts by wiiw.

Vladimir Gligorov

Macedonia:
No growth stability

The key problem that the country faced was the threat to its foreign currency reserves. Macedonia has followed a strict peg to the euro for years now and the exchange rate policy is the main anchor to its stability. So, in times of crisis, the government tightens the monetary policy and keeps the necessary level of reserves in order to defend the peg. In the past, this has often had to be coupled with tight fiscal policy, and that policy mix has been responsible for the meagre growth performance for most of the past decade and a half.

This time around, however, the government has been able to capitalize on its prudent fiscal policy and permitted some increase in the fiscal deficit in order to allow the automatic stabilizers to work. This has supported consumption and as a consequence the current account deficit has not declined as much as in most other countries. On the other hand, this has led to a smaller decline of growth. GDP has shrunk by about 2%, though industrial production and exports have been hit hard as in most other countries.

The government has been able to borrow money to cover its deficit and is intending to do the same this year. As exports and investment are anticipated to improve, a positive growth rate is expected for this year. Both the decline and the recovery are in line with historical growth rates, so those forecasts look rather realistic. The government expects stronger recovery in the following years and that is more doubtful.

One reason why that might prove achievable is the fact that credit growth has not been excessive in the past. Thus, there is less need for deleveraging both by households and by corporations. Also, there is scope for increased public investments due to low public and foreign debt levels. Finally, increased support from EU funds may be forthcoming if there is a speed-up in the negotiations for EU accession.

The constraint, however, is weak external demand. Most regional partners will not be posting high growth rates and these are important markets for Macedonian exports. This has been a major constraint in the past and may prove to be an important constraint in the future. In addition, some regional partners have improved their competitiveness (e.g. Serbia) because they have been able to depreciate their currencies. So, export-led recovery may prove challenging.

Given the prospect for sluggish recovery, labour market imbalances cannot be expected to improve significantly. The low employment rate and high unemployment rate will continue to present main challenges for the foreseeable future.

Table MK

Macedonia: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average	2032.5	2036.9	2040.2	2043.6	2046.9	2050.0	2052	2054	2056
Gross domestic product, MKD mn, nom.	265257	286619	310915	354322	398491	387000	399000	419000	445000
annual change in % (real)	4.1	4.1	4.0	5.9	4.8	-2	0	2	3
GDP/capita (EUR at exchange rate)	2100	2300	2500	2800	3200	3100	.	.	.
GDP/capita (EUR at PPP - wiiw)	5800	6400	6900	7700	8200	8100	.	.	.
Consumption of households, MKD mn, nom. [2]	209075	222726	243131	273269	321020	318000	328000	345000	362000
annual change in % (real) [2]	8.0	5.7	6.0	9.8	8.1	0	0	2	2
Gross fixed capital form., MKD mn, nom.	47286	48868	56485	71557	86403	83000	85000	90000	96000
annual change in % (real)	10.9	-5.4	11.6	13.1	4.0	-3	0	3	4
Gross industrial production [3]									
annual change in % (real)	-2.2	7.1	3.6	3.7	5.5	-9.7	0	3	5
Gross agricultural production							.	.	.
annual change in % (real)	6.8	0.3	4.8	-3.0	5.4	4.6	.	.	.
Construction industry									
annual change in % (real)	-1.0	-20.5	-11.9	9.7	-9.6	-1	.	.	.
Employed persons - LFS, th, average	523.0	545.3	570.4	590.2	609.0	640	650	660	670
annual change in %	-4.1	4.3	4.6	3.5	3.2	5	1.6	1.5	1.5
Unnemployed persons - LFS, th, average	309.3	323.9	321.3	316.9	310.4	330	.	.	.
Unemployment rate - LFS, in %, average	37.2	37.3	36.0	34.9	33.8	34	33	33	33
Reg. unemployment rate, in %, end of period	.	.	.	.	.	.	.	.	.
Average gross monthly wages, MKD [4]	20771	21330	23036	24136	26229	29900	.	.	.
real growth rate, % (net wages) [4]	4.4	2.0	3.9	5.5	1.9	10.5	.	.	.
Consumer prices, % p.a.	-0.4	0.5	3.2	2.3	8.3	-0.8	3	3	3
Producer prices in industry, % p.a. [5]	0.9	3.2	7.3	2.5	10.3	-6.5	.	.	.
General governm. budget, nat.def., % GDP [6]									
Revenues	33.2	35.2	33.5	33.8	34.2	33.2	.	.	.
Expenditures	33.2	35.0	34.0	33.2	35.2	36.0	.	.	.
Deficit (-) / surplus (+)	0.0	0.3	-0.5	0.6	-1.0	-2.8	-2	0	0
Public debt, nat.def., in % of GDP	42.6	46.9	39.9	33.3	28.7	30	33	31	29
Discount rate of NB, % p.a., end of period	6.5	6.5	6.5	6.5	6.5	6.5	.	.	.
Current account, EUR mn	-361.8	-122.5	-23.3	-421.2	-853.3	-440	-520	-550	-580
Current account in % of GDP	-8.4	-2.6	-0.5	-7.3	-13.1	-7.0	-8	-8	-8
Exports of goods, BOP, EUR mn	1345.0	1642.9	1914.0	2472.2	2684.2	1900	2000	2100	2300
annual growth rate in %	11.8	22.2	16.5	29.2	8.6	-29	5	5	10
Imports of goods, BOP, EUR mn	2259.3	2501.4	2915.5	3653.3	4434.9	3300	3500	3700	4100
annual growth rate in %	15.5	10.7	16.6	25.3	21.4	-26	5	5	10
Exports of services, BOP, EUR mn	363.7	416.2	477.4	594.5	686.3	650	700	740	800
annual growth rate in %	8.5	14.4	14.7	24.5	15.4	-5	0	5	10
Imports of services, BOP, EUR mn	407.1	440.8	455.0	569.4	681.9	650	700	700	800
annual growth rate in %	19.3	8.3	3.2	25.2	19.8	-5	0	5	10
FDI inflow, EUR mn	260.7	77.2	344.8	506.0	399.9	120	150	.	.
FDI outflow, EUR mn	1.0	2.3	0.1	-0.9	-9.5	-2	0	.	.
Gross reserves of NB, excl. gold, EUR mn	653.3	1028.0	1311.3	1400.1	1361.0	1200	.	.	.
Gross external debt, EUR mn	2080.2	2528.2	2383.6	2841.1	3304.2	3500	.	.	.
Gross external debt in % of GDP	48.1	54.0	46.9	49.1	50.9	55	.	.	.
Average exchange rate MKD/EUR	61.34	61.30	61.19	61.18	61.27	61.32	61.2	61.2	61.2
Purchasing power parity MKD/EUR	22.65	21.95	21.93	22.51	23.86	23.27	.	.	.

1) Preliminary and wiiw estimates. - 2) Including NPISHs. - 3) Enterprises with 10 and more employees. - 4) Until 2005 excluding employees in Ministry of Interior and Defence. From 2009 including allowances for food and transport. - 5) Domestic output prices. - 6) Refers to central government budget and extra-budgetary funds.

Source: wiiw Database incorporating national statistics. Forecasts by wiiw.

Vladimir Gligorov

Montenegro:
IMF to the rescue, perhaps

The government estimates the GDP decline at about 5% in 2009. The IMF believes that the decline has been sharper, as much as 7%. Given that most of the economy is production of services, these differences are not unusual. In any case, recession has been deep. Negative growth is likely this year too due to difficulties in securing financing, both foreign and domestic.

Montenegro entered the crisis with an overheated economy and with an exceptionally high current account deficit. However, the fiscal balances were in good shape due to significant surpluses in the last few years before the recession. As a consequence, the government was in a position to come to the rescue to one failing domestic bank and to the main industrial enterprise, the aluminium plant. These fiscal injections were sizable for this small economy and have proved useful for stabilization and for the maintenance of employment. In addition, foreign investments continued to come in due to privatization of the electricity company and to some sales in the tourist sector. Of course, industrial production declined dramatically and so did exports of goods. However, the tourist season was not all that disappointing, which is crucially important for this economy.

The medium-run strategy is clear. The need for foreign investment is high, but the government intends to improve the attractiveness and to support employment by investing in infrastructure projects. Those may be financed from multilateral sources, which often prove to be more stable in a crisis. Thus, important investments in roads to the hinterland and in improved infrastructure on the coast should support consumption and employment. The government submitted its application for EU membership early last year and has been making progress towards achieving the status of a candidate country. It is conceivable that the EU will decide to accept the application by the end of this year. That will open up additional EU funds which are badly needed.

There is reluctance to requesting an IMF programme, though that may also prove necessary. Montenegro uses the euro, so it is not clear what conditions the IMF would insert in its stand-by programme. In any case, given that external finance is crucial for recovery, foreign investments may not be enough and thus additional funds from the international financial institutions may be necessary. The IMF programme may also be a condition to access some EU funding, so the government may not have much choice.

As in most countries in the region, recovery will probably prove to be slow and not very impressive. This is a small open economy that depends heavily on external investment and demand. Once those recover, growth will return.

Table ME

Montenegro: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average [2]	622.1	623.3	624.2	626.2	628.8	630	631	632	633
Gross domestic product, EUR mn, nom. [3]	1669.8	1815.0	2149.0	2680.5	3085.6	3000	3100	3300	3500
annual change in % (real) [3]	4.4	4.2	8.6	10.7	6.9	-5	-1	2	3
GDP/capita (EUR at exchange rate)	2700	2900	3400	4300	4900	4800	.	.	.
GDP/capita (EUR at PPP - wiiw)	6500	6900	8400	10000	10700	10300	.	.	.
Consumption of households, EUR mn, nom. [3]	1221.1	1268.0	1660.9	2369.0	2814.8	2800	.	.	.
annual change in % (real) [4]	16	3	10	8	7	-4	0	2	2
Gross fixed capital form., EUR mn, nom. [3]	286.1	326.3	469.8	867.1	1180.2	1100	.	.	.
annual change in % (real) [4]	37	12	8	10	8	-6	0	3	4
Gross industrial production									
annual change in % (real)	13.8	-1.9	1.0	0.1	-2.0	-30	0	2	4
Net agricultural production	.	.	.	.	.				
annual change in % (real)	3.8	-0.9	1.9	-11.0	10.0	2	.	.	.
Construction output total [5]	.	.	.	.	.	.	.	.	.
annual change in % (real)	3.7	18.4	28.0	23.6	20.7	5	.	.	.
Employed persons - LFS, th, average [6]	187.3	178.8	178.4	217.4	218.8	215	215	220	220
annual change in %	.	-4.5	-0.3	21.9	0.6	-1.7	0	1	1
Unemployed persons - LFS, th, average [6]	71.8	77.8	74.8	52.1	45.3	50	.	.	.
Unemployment rate - LFS, in %, average [6]	27.7	30.3	29.6	19.3	17.2	19	20	20	20
Reg. unemployment rate, in %, end of period [7]	29.3	25.2	20.5	16.5	14.4	14.5	.	.	.
Average gross monthly wages, EUR [8]	303	326	377	497	609	640	.	.	.
annual change in % (real, net)	9.1	6.7	12.0	15.0	14.6	8	.	.	.
Consumer prices, % p.a.	2.4	2.3	3.0	4.2	7.4	4.0	3	3	3
Producer prices in industry, % p.a. [9]	5.8	2.1	3.6	8.5	14.0	-4	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	39.2	39.4	45.4	61.1	49.1	48	.	.	.
Expenditures	41.8	42.0	42.7	52.9	47.5	50	.	.	.
Deficit(-)/Surplus(+)	-2.6	-2.6	2.7	8.2	1.7	-2	0	0	0
Public debt in % of GDP	44.5	38.6	32.6	26.3	26.8	37	38	36	32
Base rate of NB, % p.a., end of period	.	.	.	.	.	.	.	.	.
Current account, EUR mn [10]	-119.6	-154.0	-531.2	-642.8	-1005.7	-450	-310	-330	-350
Current account in % of GDP	-7.2	-8.5	-24.7	-24.0	-32.6	-15	-10	-10	-10
Exports of goods, BOP, EUR mn	452.1	460.6	648.3	543.4	519.1	363	440	460	480
annual growth rate in %	.	1.9	40.7	-16.2	-4.5	-30	20	5	5
Imports of goods, BOP, EUR mn	868.6	974.3	1497.7	1702.7	2008.7	1310	1180	1300	1430
annual growth rate in %	.	12.2	53.7	13.7	18.0	-35	-10	10	10
Exports of services, BOP, EUR mn	249.5	329.8	418.0	674.1	754.3	680	710	780	860
annual growth rate in %	30.4	32.2	26.8	61.2	11.9	-10	5	10	10
Imports of services, BOP, EUR mn	101.4	134.2	220.9	233.9	351.2	300	290	260	290
annual growth rate in %	27.2	32.4	64.6	5.9	50.1	-15	-5	-10	10
FDI inflow, EUR mn	52.7	384.5	492.8	639.8	641.3	800	1000	1000	1000
FDI outflow, EUR mn	2.1	3.6	26.1	115.0	73.7	25	.	.	.
Gross reserves of NB, excl. gold, EUR mn [11]	33.2	61.7	172.8	259.0	216.6	175	.	.	.
Gross external public debt, EUR mn	488.6	513.3	504.0	462.1	481.7	540	.	.	.
Gross external public debt in % of GDP	29.3	28.3	23.5	17.2	15.6	18	.	.	.
Purchasing power parity EUR/EUR [12]	0.41	0.42	0.41	0.43	0.46	0.46	.	.	.

1) Preliminary and wiiw estimates. - 2) wiiw estimate in 2009. - 3) According to ESA'95 (including shadow economy, real growth rates based on previous year prices). - 4) wiiw estimate. - 5) Gross value-added. - 6) Until 2007 as of October. - 7) In % of unemployed plus employment (excluding individual farmers). - 8) From 2007 wage data refer to employees who received wages (previously wages were divided by all registered employees in enterprises); comparable value for 2006: 433. - 9) Domestic output prices. - 10) Including all transactions with Serbia. - 11) Refer to reserve requirements of Central Bank. - 12) Benchmark results 2005 from Eurostat and wiiw estimates.

Source: wiiw Database incorporating national statistics. Forecasts by wiiw.

Vladimir Gligorov

Serbia:
IMF forever

Serbia went through the crisis more or less the same way as most other countries. There was a sharp deceleration in growth of industrial production; a sharp correction in the trade and current account deficits, due to the steeper decline in imports than in exports, which was supported by strong initial nominal exchange rate depreciation; an eventual decline in employment and some increase in unemployment; and an overall GDP decline of 3% (official estimate). By the second half of last year, there was some stabilization but not much of improvement in growth and employment.

The policy response was different from most other countries because Serbia decided to ask for IMF support. That led to a stand-by agreement and to the initiation of what was to be known as The Vienna Initiative. The latter is a commitment by participating banks, mostly foreign-owned, not to lower their credit exposure for a specified period of time (until the end of 2010). Other countries with IMF programmes joined in that initiative later on. As a consequence, financial markets were stabilized, though the flow of credit was not really kicked off.

At the end of last year and the beginning of this year, the dinar experienced some instability, depreciating by almost 5%. This has made the corporate sector nervous because the risks to macroeconomic stability have increased. This pressure on the dinar exchange rate was attributed to increased public spending and to financial outflows perhaps due to the anticipated relaxation in the terms of The Vienna Initiative. In any case, stability has remained fragile.

The government and the IMF expect GDP growth of 2% this year and a speed-up of growth to around 3% in 2011. It is not clear whether both of them consider this forecast as realistic. The government seems to suggest that they expect faster growth, while the IMF has been changing its forecasts quite frequently in the past and might do that again. In any case, demand is still quite weak, which is reflected in the fast deceleration of inflation. Though the CPI is expected to rise by 6% this year, headline inflation is very close to zero. Most of the rise in prices will be due to those that are under government control. That may even have deflationary effects on the rest of the economy because incomes cannot be expected to grow. With that in mind, if there is no additional fiscal stimulus or significant financial support, it is hard to see that GDP will post any growth this year.

In the next two years, it is expected that there will be some acceleration of growth mainly due to boosts to exports. The current IMF agreement does not envisage any significant recovery in public spending, and households and corporations have limited possibilities to expand either their

consumption or investments. Also, credit will most probably remain tight as long as the economy does not show significant signs of recovery. As a consequence, the return to potential growth rates may occur only slowly.

In that context, it is probably realistic to expect that Serbia will renew its programme with the IMF. The current one expires at the end of this year. However, with the need to ensure continuing macroeconomic stability and with shortage of financial resources, IMF financial support may prove needed for an extended period of time. Recovery may be speeded up if Serbia's recent application for EU membership is accepted and negotiations start. That will mean increased funds from the EU budget as well as improved risk assessment by the financial markets and by potential investors. So, medium-run prospects may prove to be better than they seem at the moment.

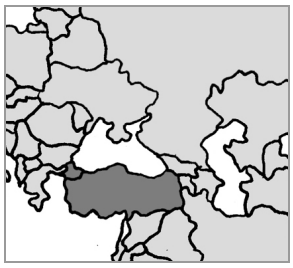
Table RS

Serbia: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average	7463.2	7440.8	7411.6	7381.6	7350.2	7320.0	7300	7280	7250
Gross domestic product, RSD bn, nom.	1384.3	1687.8	1980.2	2362.8	2790.9	2900	3100	3300	3500
annual change in % (real)	8.3	5.6	5.2	6.9	5.5	-2.9	0	2	3
GDP/capita (EUR at exchange rate)	2600	2700	3200	4000	4600	4200	.	.	.
GDP/capita (EUR at PPP - wiiw)	6800	7200	7800	8500	9300	10100	.	.	.
Consumption of households, RSD mn, nom.	1052.7	1281.0	1492.7	1714.0	2030	2160	.	.	.
annual change in % (real) [2]	.	5.0	5.4	6	6	-2	0	2	2
Gross fixed capital form., RSD mn, nom.	265.7	319.9	412.8	552.3	670	670	.	.	.
annual change in % (real) [2]	.	5.0	15.2	12	8	-5	0	3	4
Gross industrial production									
annual change in % (real)	7.1	0.8	4.7	3.7	1.1	-12.6	0	3	3
Gross agricultural production									
annual change in % (real)	26.0	-3.4	-2.6	-8.0	9.0	5.0	.	.	.
Construction output total [3]									
annual change in % (real)	3.5	2.0	7.7	10.8	4.6	4.8	.	.	.
Employed persons - LFS, th, Oct [4]	2930.8	2733.4	2630.7	2655.7	2821.7	2616.4	2560	2560	2560
annual change in %	.	-6.7	-3.8	1.0	.	-7.3	-2	0	0
Unemployed persons - LFS, th, Oct [4]	665.4	719.9	693.0	585.5	445.4	503.0	.	.	.
Unemployment rate - LFS, in %, Oct [4]	18.5	20.8	20.9	18.1	13.6	16.1	20	20	20
Reg. unemployment rate, in %, end of period	26.4	27.2	28.0	25.4	24.0	25	.	.	.
Average gross monthly wages, RSD [5]	20555	25514	31745	38744	45674	44147	.	.	.
annual change in % (real, net) [5]	10.1	6.4	11.4	19.5	3.9	0.2	.	.	.
Consumer prices, % p.a.	11.4	16.2	11.7	7.0	11.7	8.4	6	4	4
Producer prices in industry, % p.a. [6]	9.1	14.2	13.3	5.9	12.4	5.6	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	42.6	42.9	43.8	42.4	41.1	38	.	.	.
Expenditures	41.6	41.9	45.4	44.3	43.5	43	.	.	.
Deficit (-) / surplus (+), % GDP	0.9	0.9	-1.7	-1.9	-2.4	-5	-4	-2	-2
Public debt, nat.def., in % of GDP	50.7	50.5	39.8	30.0	25.8	31.5	34	35	35
Discount rate of NB, % p.a., end of period	8.5	8.5	8.5	8.5	8.5	8.1	.	.	.
Current account, EUR mn	-2620.0	-1778.0	-2356.0	-4615.0	-6054.0	-2150	-2700	-3100	-3100
Current account in % of GDP	-13.7	-8.7	-10.0	-15.6	-17.7	-7	-9	-10	-10
Exports of goods, BOP, EUR mn	3286.0	4009.0	5109.0	6382.0	7415.0	5900	6200	6800	7500
annual growth rate in %	12.1	22.0	27.4	24.9	16.2	-20	5	10	10
Imports of goods, BOP, EUR mn	8487.0	8287.0	10090.0	13020.0	14964.0	10900	11400	12500	13800
annual growth rate in %	31.2	-2.4	21.8	29.0	14.9	-27	5	10	10
Exports of services, BOP, EUR mn	1189.0	1320.0	1839.0	2304.0	2742.0	2550	2600	2900	3200
annual growth rate in %	29.9	11.0	39.3	25.3	19.0	-7	0	10	10
Imports of services, BOP, EUR mn	1056.0	1325.0	1880.0	2558.0	2913.0	2470	2500	2800	3100
annual growth rate in %	43.5	25.5	41.9	36.1	13.9	-15	0	10	10
FDI inflow, EUR mn	771.9	1268.1	3392.4	2512.6	2015.0	1200.0	1500	1500	1500
FDI outflow, EUR mn	-2	18	70	692	193	200	200	200	200
Gross reserves of NB, excl. gold, EUR mn	3022.8	4770.4	8857.9	9440.7	7938.5	10500	.	.	.
Gross external debt, EUR mn	10354.5	13064.0	14884.4	17789.4	21800.5	22500	.	.	.
Gross external debt in % of GDP	59.0	66.2	59.4	59.7	69.2	74	.	.	.
Average exchange rate RSD/EUR	72.57	82.91	84.19	79.98	81.47	94.12	100	110	115
Purchasing power parity RSD/EUR [7]	27.26	31.72	34.42	37.66	41.04	39.30	.	.	.

1) Preliminary and wiiw estimates. - 2) wiiw estimate. - 3) Gross value-added. - 4) From 2004 according to census 2002 and revisions based on ILO and Eurostat methodology; from 2008 extended survey as of April and October. - 5) From 2009 methodological changes of survey. - 6) Domestic output prices. - 7) Benchmark results 2005 from Eurostat and wiiw estimates.

Source: wiiw Database incorporating national statistics. Forecasts by wiiw.



Josef Pöschl

Turkey: The return of confidence

The outlook for the real sector, as monitored by the central bank, has been fast in recovering from the deep pessimism prevailing at the end of 2008/beginning of 2009. Already in May 2009, confidence was nearly back to normal. Thereafter, the confidence index has kept fluctuating around normal level in a narrow range. International financial institutions and rating agencies share this relatively optimistic stance. The EBRD has revised its forecast for 2010 from 3% (October 2009) to 4.7% (January 2010), and a firm-level survey done by the World Bank Group[36] concludes that Turkish companies could be fast in overcoming the crisis; Standard & Poor's, Moody's and Fitch all have upgraded their ratings in their latest revisions, i.e. between September 2009 and January 2010. At least in some of the underlying assessments, the impression of financial soundness plays a role. Developments in 2009 did not confirm concerns that external and internal debt-servicing obligations of both the public and the private sector might have a major destabilizing effect. The volume of consumer loans shrank only during the final quarter of 2008 and the first quarter of 2009. The decline of corporate loans ceased in mid-2009. Loan rates reached peak values of over 20% in November 2008, but fell to about 9% in the case of commercial loans and around 14% for consumers in the second half of 2009. The so-called credit squeeze seems to be over.

Should Turkey's economy indeed be sufficiently robust to overcome so rapidly the impact of the global crisis, it is worth asking why this impact was strong enough to cause a GDP contraction of close to 6% in 2009 as a whole and as much as 13.5% in the first quarter of 2009. This may have had mainly two reasons: Those commodities that were hit most by the global crisis have a high share in Turkey's exports: transport equipment and durable consumer goods. In addition, Turkey's textile and clothing sector is exposed to strong competition from East Asia. A second reason is that after the crisis in 2001 Turkey's GDP growth became very pronounced (with rates of 9.4% in 2004 and 8.4% in 2005). At the same time, strong real appreciation of the currency set in, triggering a gradual erosion of competitiveness and thus of growth sustainability. Compared to 2001, the year with a positive current account balance, in 2008 the Turkish lira's real appreciation against EU-27 was as much as 37% if calculated from producer price indices. On foreign as well as on domestic markets, the producers of tradable goods had difficulty to remain competitive, as was reflected in the strong expansion of the current account deficit (up to about 6% of GDP in 2008). Growth had already lost momentum when the economy was hit by the crisis.

[36] Paulo Correa and Mariana Lootty, 'The Impact of the Global Economic Crisis on the Corporate Sector in Europe and Central Asia: Evidence from Firm-Level Survey', Washington DC, 16 December 2009.

Under the impact of the crisis, real appreciation not only stopped but was to some degree reversed due to nominal depreciation in late 2008[37]. This reversal was, however, much weaker than in previous crises, so that this time the preconditions for industrial recovery are less propitious. External conditions are less favourable, too. In the meantime, real appreciation is on its way again, but so far to a minor extent. In order not to deteriorate competitiveness, increases in the euro (and US dollar) prices of Turkish goods need to be backed by quality gains. Slow gradual nominal depreciation could help to avoid disproportionate real appreciation, but may not be achievable easily.

Through a policy of low interest rates, the central bank can try to put a brake on the inflow of capital and in this way keep the nominal appreciation pressure low. This, in fact, seems to be the central bank's intention since the first quarter of 2009. In the case of accelerating inflation, however, it may become difficult to stick to this policy. From November 2009 up to February 2010, the increase in the consumer price index was quite substantial. This was mainly attributable to indirect tax increases for selected consumer goods (tobacco, alcoholic beverages, fuels) and an increase in food prices. The core inflation has remained modest, but there are concerns that inflation expectations could go up again. Electricity prices are likely to become an additional source of inflation. The government will have to allow for an increase, as otherwise privatization plans related to this sector would either not materialize or produce meagre revenues. For Turkey, inflation is a sensitive issue, no matter that as a rule in emerging markets fast growth is accompanied by somewhat elevated inflation.

Turkey's capability of returning to significant GDP growth depends on success in exports. For achieving this, the absence of strong real appreciation is a necessary precondition. In this respect, the central bank will face a challenge. The European Union continues to be the main trading partner, but hopes for fast trade expansion concentrate on other parts of the globe. The EU share in Turkey's exports is shrinking. Turkey has signed free trade agreements with a large number of non-EU countries. Their shares in Turkish exports are still low, but expanding overproportionately. This regional trade diversification has a positive impact on Turkey's overall export performance.

Gross fixed capital formation experienced a deep decline in late 2008/early 2009. Some recovery is likely, but it will gain momentum only later on, after the economy's return to higher degrees of capacity utilization. In the first months of 2010, the latter was still very low, around 60%. Currently, a considerable part of gross fixed capital formation is attributable to the government. As soon as GDP growth has returned, the government's focus will switch from growth stimulation towards budget consolidation. Public investment may expand less or even shrink.

Finally, household consumption is not likely to start growing fast in the near future. Unemployment is high, close to 17% in the non-agricultural sector, and GDP growth may be 'jobless' for quite some time, as was the case after 2001. Most likely, real wages will remain stagnant at best during the next few months and perhaps even years.

[37] At the end of 2008, the Turkish lira (TRY)-USD parity was 1.51 compared to 1.16 one year before (+30%), whereas the TRY-EUR parity was up to 2.14 from 1.71 (+25%). At the end of 2009, the parities were similar to end-2008: 1.49 vis-à-vis the US dollar and 2.14 vis-à-vis the euro.

Our new, substantially revised GDP forecast is 4% growth in 2010 thanks to export expansion, 3% in 2011, again because of export expansion but accompanied by restrictive government policies, and 5% in 2012 due to strong growth in gross capital formation. It is based on optimistic assumptions, namely the ability of the central bank to keep real appreciation low, and viable conditions prevailing for export expansion. In such a scenario, the widening of the current account deficit should remain moderate. We also assume that there will be no skyrocketing of energy prices, so that Turkey's consumer and producer price inflation may remain in the range between 5% and 8% (annual average). We are not very optimistic regarding a rise in employment starting anytime soon.

The government was very determined in fighting the impact of the global crisis with fiscal policy tools. Its deficit climbed from 2.2% of GDP in 2008 to 6.6% in 2009 due to nearly unchanged revenues, but much higher expenditures. The EU-defined public debt increased from 39.5% of GDP in 2008 to 47.3% in 2009. In per cent of GDP, government revenues and expenditures are still low (roughly between 20% and 25%). Privatization revenues will not continue to flow in forever, so the government will need to push through a tax reform. The tax authorities tend to feel free to choose between merciful and merciless treatment of individual taxpayers. The IMF proposal of establishing an independent fiscal supervisory body would make sense, but has so far failed to produce a positive echo.

Turkey has cultivated a number of political taboos for many decades, and the current government has touched upon them all. It was in a position to do so thanks to a sound majority in the parliament and the backing of the European Union. Internal tensions are strong and have been close to eruption at some points of time – such as in February 2010. The assumed homogeneity of the Turkish society has turned out to be a fiction, and it has become clear that the political system needs to create structures supportive of compromise and cooperation. The odds are good that this will happen. In this case, Turkey's position as a regional political and economic power, and as an EU candidate country as well, will strengthen.

Table TR

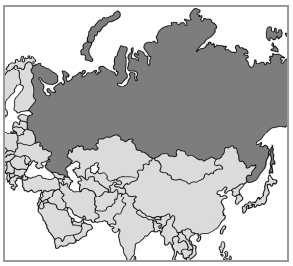
Turkey: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average [2]	71152	72065	72971	73436	74414	75200	76000	76700	77500
Gross domestic product, TRY bn, nom.	559.0	648.9	758.4	843.2	950.1	950	1060	1160	1280
annual change in % (real)	9.4	8.4	6.9	4.7	0.9	-6	4	3	5
GDP/capita (EUR at exchange rate)	4400	5400	5700	6400	6700	5800	6600	6900	7200
GDP/capita (EUR at PPP - wiiw)	8200	9100	10000	10600	10900	10400	.	.	.
Consumption of households,TRY bn, nom.	398.6	465.4	534.8	601.2	663.0	680	.	.	.
annual change in % (real)	11.0	7.9	4.6	5.5	-0.1	-4	1	2	3
Gross fixed capital form., TRY bn, nom.	113.7	136.5	169.0	180.6	188.8	170	.	.	.
annual change in % (real)	28.4	17.4	13.3	3.1	-5.0	-15	7	7	10
Gross industrial production									
annual change in % (real)	9.7	5.6	5.8	4.5	-0.8	-5.7	8	8	10
Gross agricultural production									
annual change in % (real)	2.7	6.6	1.3	-7.3	.	.	.	.	.
Construction industry									
annual change in % (real)	4.6	21.5	18.4	5.5	-7.5	-20	.	.	.
Employed persons - LFS, th, avg. [3]	21791	22046	22330	20738	21194	21200	21200	21500	22000
annual change in %	3.0	1.2	1.3	1.5	2.2	0.0	0	1	2
Unemployed persons - LFS, th, average [3]	2498	2520	2446	2376	2611	3500	.	.	.
Unemployment rate - LFS, in %, average	10.3	10.3	9.9	10.3	11.0	14	14	14	12
Reg. unemployment rate, in %, average	.	.	.	.	.		.	.	.
Average gross monthly wages, manuf.ind., TRY [4]	1030	1162	1301	1437	1590	.	.	.	.
annual change in % (real) [4]	.	4.3	2.1	1.6	0	.	.	.	.
Consumer prices, % p.a.	10.1	8.1	9.3	8.8	10.4	6.3	7	6	5
Producer prices in industry, % p.a.	12.2	7.1	9.7	6.0	13.0	1.0	.	.	.
General governm. budget, EU-def., % GDP [5]									
Revenues	.	.	.	19.6	19.3	18.5	19	20	21
Expenditures	.	.	.	20.6	21.5	25.1	25	24	24
Deficit (-) / surplus (+)	.	-0.6	1.2	-1.0	-2.2	-6.6	-6	-4	-3
Public debt, EU-def., in % of GDP [5]	59.2	52.3	46.1	39.4	39.5	47.3	49	49	48
Discount rate of NB % p.a., end of period [6]	22.0	17.5	22.5	20.0	17.5	9.0	.	.	.
Current account, EUR mn	-11601	-17843	-25640	-27954	-28520	-9944	-13000	-14000	-16000
Current account in % of GDP	-3.7	-4.6	-6.1	-5.9	-5.7	-2.3	-2.6	-2.7	-2.9
Exports of goods, BOP, EUR mn	55097	62989	74556	84174	95730	78716	91000	100000	114000
annual change in %	19.2	14.3	18.4	12.9	13.7	-17.8	15	10	14
Imports of goods, BOP, EUR mn	73375	89579	107255	118319	131779	96464	113000	123000	141000
annual change in %	26.3	22.1	19.7	10.3	11.4	-26.8	17	9	15
Exports of services, BOP, EUR mn	18443	21512	20348	21109	23677	23507	25000	26000	29000
annual growth rate in %	16.1	16.6	-5.4	3.7	12.2	-0.7	5	5	10
Imports of services, BOP, EUR mn	8155	9240	9507	11372	12036	11866	12000	13000	14000
annual growth rate in %	23.2	13.3	2.9	19.6	5.8	-1.4	5	6	10
FDI inflow, EUR mn	2239	8063	16076	16087	12421	5453	8000	10000	10000
FDI outflow, EUR mn	627	855	736	1537	1733	1128	1500	1500	1700
Gross reserves of CB, excl. gold, EUR mn	26436	42820	46251	49804	51022	48000	48000	49000	50000
Gross external debt, EUR mn	118184	143860	157626	169436	199973	186000	185000	190000	200000
Gross external debt in % of GDP	38.8	35.3	38.7	34.5	45.2	42			
Average exchange rate TRY/EUR	1.7771	1.6771	1.8090	1.7865	1.9064	2.1631	2.1	2.2	2.3
Purchasing power parity TRY/EUR	0.9637	0.9917	1.0403	1.0804	1.1711	1.2184	.	.	.

Note: Gross industrial production and construction output refer to NACE Rev. 2.

1) Preliminary and wiiw estimates. - 2) SIS projections. 2008 figure: Eurostat. SIS figure 2009 (end of year): 72561 th. persons based on new census methodology. - 3) From 2007 according to census 2006. - 4) Including overtime payment. - 5) According to ESA'95 excessive deficit procedure. - 6) Overnight lending rate.

Source: National statistics (Central Bank, State Institute for Statistics etc). Forecasts by wiiw.



Peter Havlik

Russian Federation:
'V-shaped' recovery underway

The global crisis hit Russia particularly hard and the vulnerability of the economic development model based on excessive dependence on energy became even more obvious. GDP growth virtually collapsed in the fourth quarter of 2008 and the economy plunged into a deep recession for almost one year. The stabilization and even (fragile) recovery in the fall of 2009 notwithstanding, GDP contracted by nearly 8% in 2009 – mainly due to the collapse of investment. Foreign trade, with falling exports and sharply reduced imports (in both nominal and real terms), mitigated the overall economic decline: the real contribution of foreign trade to GDP growth was positive in 2009, after several 'negative' years. Whereas manufacturing output and construction fell at double-digit rates, agriculture, trade and other services served as supply-side growth stabilizers. Preliminary figures indicate a 40% decline in FDI inflows and a reduction of the current account surplus (to about 3.8% of GDP). At the same time, CPI inflation slowed down (the GDP deflator even fell below 3%) and the unemployment rate increased by about 2 percentage points. After the managed and costly depreciation at the turn of 2008/2009, the rouble has been strengthening since mid-2009 again as oil prices, export revenues and foreign exchange reserves started to recover.

Due to the crisis the majority of the ambitious investment plans was discarded and the budget planning had to be thoroughly revised. Similar to the USA, Western Europe and China, the Russian government adopted various rescue and stimulus packages already in the fall of 2008. The aim was to improve the liquidity of the banking sector and restore confidence, to support the exchange rate and domestic consumption. The revised federal budget for 2009 entailed a huge fiscal stimulus as it reckoned with a nominal rise of expenditure by 7% despite falling revenues. As a result, the budget shifted from a surplus (5% of GDP in 2008) to a deficit of 5% of GDP. In sum, the costs of various anti-crisis measures may add up to 10% of GDP but their effects are hard to measure; judging by the sharp fall in consumption and investment, they have been rather disappointing. Critics point to the usual 'Russian'dangers of misappropriation and corruption; they also expect that mainly the large (or well-connected) banks and companies stand to gain disproportionately. It is wondered – so far with some justification – whether the money really reached those companies facing the liquidity squeeze. Indeed, the steep fall in investments during 2009 (by at least 20%) indicates not only tightened credit, but a deterioration of business confidence and the correction of the housing bubble (construction dropped by 16%). The share of investment (gross capital formation) fell to 20% of GDP in 2009 – a rather low figure compared to other transition countries and definitely insufficient for the urgently needed development of infrastructure and modernization of capital stocks.

From this perspective, the government's long-term strategic target of economic diversification and modernization is obviously getting out of reach. President Dmitry Medvedev returned to the modernization agenda in a policy declaration from September 2009. In his address ('Russia Forward') Mr. Medvedev enumerated five priority areas for overcoming Russia's 'historic' ills (the latter identified as in economic backwardness, widespread corruption and paternalist feelings in the society). Medvedev's priority modernization areas for Russia are:

(1) efficient production, transport and use of energy;

(2) development of nuclear technologies;

(3) development of global information technologies;

(4) development of ground- and space-based infrastructure for the transmission of information services;

(5) production of medical equipment, diagnostic tools and pharmaceuticals required for the treatment of viral, cardiovascular, cancer and neurological diseases.

The above modernization fields are allegedly backed by specific implementation plans which also count with the participation of foreign companies and researchers. The chances for the success of an 'innovation development' scenario have never been particularly high and we share the scepticism of other observers regarding the actual outcomes of the announced modernization plans. The success chances have diminished in the aftermath of the war with Georgia in August 2008 at the latest. The collapse of the oil price and the effects of the global crisis have radically curtailed financial resources initially earmarked for modernization programmes. At the same time, the limits of the resource-based growth scenario has become even more obvious. The deterioration of relations with the EU (as well as with Georgia, Ukraine and recently also with Belarus) represents another growth bottleneck as it also has serious repercussions for the future path of Russian economic reforms. It may strengthen the inward-looking, autarkic development strategy which is doomed to fail.[38]

The accession to WTO, one of the few potential modernization drivers, was postponed once again in June 2009, this time after the agreement about forming a Customs Union with Belarus and Kazakhstan had been finalized.[39] However, the Customs Union (formally in force since January 2010) is apparently not working – at least judging by the oil price and export tariff disputes between Russia and Belarus in January 2009.

The Russian authorities, as well as the IMF, OECD, the World Bank and others (including wiiw) have been busily revising GDP forecasts for 2009 downwards in the course of last year. In mid-2009 the range of GDP growth forecasts for the year 2009 fluctuated between -2% and -10%, largely depending on assumptions regarding the level of oil prices. The preliminary official estimate of the GDP decline in 2009 (-7.9%) turned out even lower than the revised wiiw forecast from autumn

[38] On the other hand, new privatization initiatives (e.g. in the exploration of the Yamal gas deposits) were launched as well. In external relations, Russia has become increasingly assertive. Dangers of escalating external conflicts (e.g. a confrontation with Ukraine over the Crimea) are being recognized.

[39] Russia has never been too enthusiastic about joining the WTO (in fact, the recently envisaged Industrial Policy tools could well be in conflict with WTO rules).

(which reckoned with GDP contracting by about 6-7%), largely as a consequence of sharply falling exports and reduced investments (stocks in particular).

Nevertheless, fragile signs of recovery have been visible already since late summer 2009. These include a modest increase in output, rising export revenues (thanks to higher oil prices), improving consumer confidence and the stabilization of inflation. Indeed, GDP growth resumed in the fourth quarter of last year, not least thanks to statistical base effects, with modest (up to 4% per year) growth acceleration possible in 2010-2012. The domestic financial market is likely to stabilize and even recover fairly soon, yet the investment climate (including financing conditions) will remain challenging. After the huge contraction of foreign trade in 2009, both exports and imports are expected to resume growth again (this forecast reckons with an oil price of 70-80 USD per barrel). A GDP growth slowdown thus appears inevitable in the medium term, before any (highly uncertain) modernization and diversification efforts start to bear fruit.

The wiiw forecast for 2010-2012 is based on the assumption of modestly recovering oil prices (Urals costing around USD 70-80 per barrel) and no abrupt policy changes or external shocks. Both private consumption and investment are expected to grow faster than GDP; real exports will continue to be sluggish at best since the volumes of exported oil and gas will hardly increase, while imports will grow at a faster rate – roughly in line with private consumption and investment. This implies a small negative contribution of real net exports to GDP growth and, in nominal terms, a gradual reduction of the trade and current account surpluses. In fact, the current account surplus will gradually diminish (below 3% of GDP). GDP growth will not exceed 5% and inflation will remain stubbornly close to 10% in both 2010 and thereafter. Unemployment has been on the rise during 2009, albeit not dramatically. Apart from a few ‘monocities’ which depend on the fate of a single big plant (such as the troubled car factory Avtovaz in Togliatti), the employment effects of the crisis have so far been rather modest. They are being mitigated by demography as the domestic labour supply is diminishing. In fact, labour shortages are likely to reappear soon and will definitely put a brake on economic growth already in the medium run. Needless to say, another wave of the crisis cannot be ruled out either.

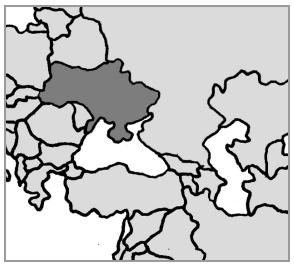
Table RU

Russia: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average [2]	143821	143114	142487	142115	141956	141000	140000	139500	139000
Gross domestic product, RUB bn, nom.	17048.1	21625.4	26903.5	33111.4	41256.0	39016.1	42500	47000	51000
annual change in % (real)	7.2	6.4	7.7	8.1	5.6	-7.9	3.4	4	4.3
GDP/capita (EUR at exchange rate)	3300	4300	5500	6700	8000	6300	.	.	.
GDP/capita (EUR at PPP - wiiw)	9200	10000	11100	12400	13200	12400	.	.	.
Consumption of households, RUB bn, nom.	8405.6	10590.0	12887.9	15900.9	19752.8	20979.5	.	.	.
annual change in % (real)	12.1	11.8	11.4	13.7	10.7	-8.1	4	5	4
Gross fixed capital form., RUB bn, nom.	3130.5	3836.9	4980.6	6982.5	9200.3	7863.2	.	.	
annual change in % (real)	12.6	10.6	18.0	21.1	10.6	-18.2	5	7	10
Gross industrial production									
annual change in % (real)	8.0	5.1	6.3	6.3	2.1	-10.8	5	5	5
Gross agricultural production									
annual change in % (real)	3.0	2.3	3.6	3.4	10.8	1.2	.	.	.
Construction industry									
annual change in % (real)	10.1	10.5	18.1	18.2	12.8	-16.0	.	.	.
Employed persons - LFS, th, average	67274.8	68169.0	68855.0	70570.5	70965.0	69400	69000	69000	68700
annual change in %	.	1.3	1.0	2.5	0.6	-2.2	-0.6	0	-0.4
Unemployed persons - LFS, th, average	5674.8	5262.8	5312.0	4589.0	4791.0	6420	6400	6000	6000
Unemployment rate - LFS, in %, average	7.8	7.2	7.2	6.1	6.3	8.5	8.5	8	8
Reg. unemployment rate, in %, end of period	2.6	2.5	2.3	2.0	2.0	2.9	.	.	.
Average gross monthly wages, RUB	6739.5	8554.9	10633.9	13593.4	17226.3	18785.0	.	.	.
annual change in % (real, gross)	10.6	12.6	13.3	17.0	10.3	-2.8	.	.	.
Consumer prices, % p.a.	11.0	12.5	9.8	9.1	14.1	11.8	6	7.5	8
Producer prices in industry, % p.a. [3]	24.0	20.7	12.4	14.1	21.4	-7.2	5	7	10
General governm.budget, nat.def., % GDP									
Revenues	31.9	39.7	39.5	40.4	38.8	35.5	.	.	.
Expenditures	27.4	31.5	31.1	34.4	33.9	40.9	.	.	.
Deficit (-) / surplus (+), % GDP	4.5	8.1	8.4	6.0	4.9	-5.4	-5	-3	0
Public debt, nat.def., in % of GDP [4]	21.6	14.9	8.6	7.2	5.7	8.1	10	10	10
Base rate of NB % p.a., end of per.	13	12	11	10	13	9	.	.	.
Current account, EUR mn [5]	47867	67858	75474	56266	69871	34200	40000	35000	32000
Current account in % of GDP	10.1	11.1	9.6	5.9	6.2	3.9	4.2	3.4	2.9
Exports of goods, BOP, EUR mn [5]	147358	195545	241960	258930	321792	218000	260000	275000	300000
annual growth rate in %	22.5	32.7	23.7	7.0	24.3	-32	19	6	9
Imports of goods, BOP, EUR mn [5]	78327	100608	130948	163282	199148	139000	170000	200000	225000
annual growth rate in %	16.4	28.4	30.2	24.7	22.0	-30	22	18	13
Exports of services, BOP, EUR mn [5]	16564	20028	24791	28798	35008	30000	35000	38000	42000
annual growth rate in %	15.4	20.9	23.8	16.2	21.6	-14	17	9	11
Imports of services, BOP, EUR mn [5]	26774	31077	35643	43151	52101	45000	55000	60000	70000
annual growth rate in %	11.6	16.1	14.7	21.1	20.7	-14	22	9	17
FDI inflow, EUR mn [5]	12422	10336	23675	40237	49732	30000	35000	45000	50000
FDI outflow, EUR mn [5]	11085	10240	18454	33547	35911	25000	35000	40000	45000
Gross reserves of NB, excl. gold, EUR mn	88663	148094	224306	318840	292483	290431	.	.	.
Gross external debt, EUR mn	156687	216553	237687	321743	340234	327409	.	.	.
Gross external debt in % of GDP	34.8	34.2	30.7	34.9	34.2	36.4	.	.	.
Average exchange rate RUB/EUR	35.81	35.26	34.11	35.01	36.43	44.14	45	46	46
Purchasing power parity RUB/EUR, wiiw [6]	12.92	15.06	16.99	18.80	22.09	22.35	.	.	.

1) Preliminary and wiiw estimates. - 2) Resident population. - 3) Domestic output prices. - 4) wiiw estimate. - 5) Converted from USD with the average exchange rate. - 6) wiiw estimates based on the 2005 International Comparison Project benchmark.

Source: wiiw Database incorporating national statistics. Forecasts by wiiw.



Vasily Astrov

Ukraine:
Fiscal and other concerns

Ukraine's economy has been hit hard by the falling steel prices and the global credit crunch since September 2008. In 2009, the GDP contracted by an estimated 13.5%, industrial production fell by more than 20%, and construction output by as much as 50%. Across sectors only agriculture – whose output was flat – proved resilient to the crisis, owing to a very high (46 million tons) grain harvest for the second year in a row. Within industry, manufacturing suffered the most (-45% year-on-year in gross output terms), not least due to the collapse in investment demand at home (-44% in the first nine months of 2009) and in Russia, where the bulk of Ukrainian machinery is exported. In contrast, the metals and chemicals industries, which had recorded huge output losses at the early stages of the crisis (late 2008-early 2009), started recovering in the last quarter of 2009 in response to the favourable world market trends. Viewed from the demand side, fixed capital investments plunged the most, reflecting reduced profits, the credit crunch and government budget cuts, which fell primarily on capital expenditures. However, private consumption declined markedly as well (by an estimated 14%) against the background of rising unemployment (to some 9.5% of the labour force), falling real wages (by nearly 9% year-on-year), and the virtual lack of access to household credit. Government consumption fell too, albeit not as strongly, while the dynamics of net exports was strongly positive.

The combined effect of a pronounced devaluation (by 60-70% against the US dollar and the euro) and the deep domestic recession has made imports increasingly unaffordable. The latter plunged faster than exports, and the current account deficit fell dramatically, to EUR 1.4 billion in 2009 (from EUR 8.7 billion the year before). This small deficit was comfortably financed by the (net) inflows of foreign direct investment worth EUR 3.2 billion, representing largely the funding of Ukrainian subsidiaries of foreign banks by parent structures. However, FDI apart, the capital balance proved highly negative: net capital outflows, representing notably external debt repayments by banks and the flight to foreign cash by households, summed up to EUR 11.7 billion. The resulting external financing gap of EUR 9.8 billion was partly covered from the existing foreign exchange reserves and partly from the arriving IMF 'stand-by' funds: in November 2008 Ukraine secured an IMF 'stand-by' stabilization package worth USD 16.4 billion, of which some USD 6 billion (EUR 4.3 billion) were transferred in 2009. As a result, the share of public debt in Ukraine's gross external debt increased (at the expense of private debt), although the overall *level* of indebtedness remained nearly unchanged at above EUR 70 billion.

Initially, the IMF package was aimed at facilitating the repayment of external debts. However, as macroeconomic policy concerns were shifting to the fiscal side, the arriving IMF funds were

increasingly used for fiscal purposes.[40] Following the deep economic recession, in 2009 the revenues of the consolidated budget were down by 18.5%, and expenditures by 16.4% in real (CPI-deflated) terms, resulting in a reported deficit of just 2.3% of GDP. However, this figure does not include the costs of banks recapitalization and the quasi-fiscal deficits of the state-owned energy company Naftohaz (also covered from the budget) and of the Pension Fund (in excess of the allocation envisaged in the 2009 budget law). According to the presidential secretariat, taking into account the latter expenditures, the overall budget deficit in 2009 totalled UAH 81.5 billion (8.5% of GDP) – the figure which largely squares with the officially reported public net borrowing needs of UAH 67.1 billion (7% of GDP). The IMF package apart, financing a budget deficit of this size has been a challenge under Ukraine's circumstances, given the still high CDS spreads (currently hovering at around 10%), the blocked access to international capital markets, and the nearly absent privatization revenues (a mere EUR 70 million in 2009) – not to mention political risks. Therefore, the government has resorted to domestic borrowing – typically at high interest rates, reaching up to 30% p.a. in hryvnia terms in October 2009 (although the bulk of newly issued government bonds reportedly ended up in the hands of the National Bank). As a result, public domestic debt in 2009 more than doubled, bringing the total public (including publicly-guaranteed) debt to nearly 32% of GDP, up from 20% the year before. Although this figure appears rather low by international standards, the high yields on government bonds, coupled with uncertainty over the fiscal plans for 2010 and over the prospects of the IMF 'stand-by' programme, give rise to concerns over the sustainability of public finances in the medium term.

After the devaluation-driven spike at the beginning of 2009, consumer price inflation has subsequently been subsiding throughout the year and reached 12.3% by December (corresponding to 15.9% in average annual terms). This trend is hardly surprising against the background of weak domestic demand and would have been even more pronounced, had it not been for the upward adjustments of excise taxes on tobacco and tobacco products, and of some administratively set tariffs such as those for transport. Despite the falling inflation, the monetary policy remained tight, as the National Bank raised its reserve requirements and lowered the discount rate only marginally. Also, repeated foreign exchange interventions to defend the exchange rate and the resulting losses of forex reserves constrained the growth of the monetary base. In 2009, the latter grew by only 1.4% in nominal terms, corresponding to an 11% decline in real (CPI-adjusted) terms. The contraction of broad money balances (M3) was even more pronounced (by 17.1% in real terms), indicating that the lending activity remains virtually frozen. According to the National Bank, the share of non-performing loans surged rapidly in the first months of the crisis (from 3% in September 2008), but subsequently declined marginally (to 9.3% on 1 February 2010), although the IMF estimate puts the figure at as much as 30%.

[40] The IMF programme was suspended, though, by the end of 2009 in response to the government's reluctance to implement one of the conditionalities – the agreed hikes in domestic gas tariffs for households ahead of the presidential elections, and following the 20% increase in the minimum wages and pensions as of November 2009. However, in January 2010 the IMF allowed the government to draw on the National Bank's foreign exchange reserves (originally received from the IMF) in order to provide Naftohaz with enough funds to pay its monthly bill to the Russian Gazprom for the imported natural gas.

Generally, the prospects for the real economy have improved: for 2010 we expect GDP growth of about 3%, with a gradual acceleration in the years to come.[41] This growth will be driven largely by recovering exports (particularly those of metals and chemicals). In the last few months of 2009, the exports dynamics was encouraging, aided by the pick-up of global metals prices and the country's sharply improved competitiveness following the 60% currency depreciation. Also, producer prices in industry picked up markedly (on a monthly basis) – an indicator to be interpreted favourably in Ukrainian circumstances. For 2010, exports are projected to grow faster than imports, resulting in the already modest current account deficit (1.6% of GDP in 2009) shrinking still further. At the same time, the ongoing credit crunch, rising unemployment and falling real wages will continue to depress domestic demand, which is unlikely to start recovering strongly before 2011. The inflationary pressures are likely to subside, although the pace of disinflation will be constrained by the likely hikes in domestic energy tariffs (more on that, see below).

The persistent political instability has played a significant role in the way the global economic crisis has affected Ukraine's economy. The infighting between the (outgoing) president Yushchenko and the (probably also outgoing) prime-minister Tymoshenko has hampered a consolidated policy response, most visibly manifested in the lack of coordination between the government and the National Bank (which is subordinated to the president). The victory of the leader of the pro-Russian opposition Party of Regions, Viktor Yanukovych, in the second round of the presidential elections on 7 February 2010 *per se* does not necessarily put an end to the stalemate, as long as the president and the prime-minister represent different political camps and the frequency of government rotations potentially remains high. Therefore, the key challenge for the new president will be the formation of a loyal government, which would require either a re-shuffling of the current parliament coalition around Ms. Tymoshenko or early parliamentary elections.

In any case, the new government will have to cope with a number of pressing issues, including coming up with a realistic budget for 2010. The latter is also a prerequisite for the resumption of the IMF 'stand-by' programme suspended last year. Meanwhile, the hikes in public expenditures on wages and pensions enacted in November 2009 are unlikely to be revoked. In order to keep the budget deficit in check, the government will almost certainly need to resort to offsetting measures, e.g. an upward revision of domestic gas tariffs for households and communal enterprises – a long-standing demand of the IMF. Another challenge for the new authorities will be to mend relations with Russia, which have suffered dramatically under the presidency of Viktor Yushchenko. The foreign policy course of the new president will be more pragmatic and more Russia-friendly, which implies that the new Ukrainian administration might adopt a less forthcoming stance in negotiations with the EU, e.g. in the current negotiations over a deep free trade agreement. On the other hand, Mr. Yanukovych is reportedly favouring the creation of a Ukraine-EU-Russia gas consortium, which should operate the country's gas pipeline network. The latter should increase Ukraine's reliability for the energy transit from Russia to the EU, although Mr. Yanukovych is also advocating a re-negotiation of the gas supply contract with Russia concluded in January 2009 by the Tymoshenko government. Among other likely economic policy priorities of Mr. Yanukovych – who draws his

[41] According to the National Bank's estimate, in January 2010 real GDP was up by 7.5% in year-on-year terms.

support not least from the export-oriented heavy industry – are currency undervaluation and tax cuts: by 2011, the VAT is planned to be cut from 20% to 17%, and the corporate profit tax from 25% to 19%. The accession to Russia-Belarus-Kazakhstan Customs Union is also under consideration.

In the medium and long run, the country's economic policy challenges include the need for modernization and diversification away from the narrow specialization on metals and chemicals, raising the energy efficiency, and economic integration with its important neighbouring export markets. For that, Ukraine needs to attract substantial amounts of investment and find the appropriate political balance between the EU and Russia. Besides, a broad range of institutional reforms in the areas of privatization, liberalization, competition policy and the rule of law, which have nearly stalled over the years due to the persistent political stalemate and vested interests, need to be advanced – although the latter will be more difficult without the 'carrot' of future EU membership, which is not on the agenda.

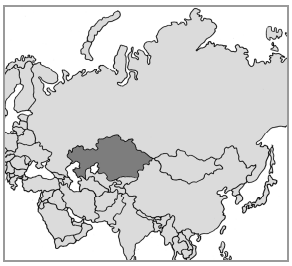
Table UA

Ukraine: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average	47452	47105	46788	46509	46258	46060	45800	45600	45400
Gross domestic product, UAH mn, nom.	345113	441452	544153	720731	949864	952300	1098600	1262800	1445700
annual change in % (real)	12.1	2.7	7.3	7.9	2.1	-13.5	3	4.5	6
GDP/capita (EUR at exchange rate)	1100	1500	1800	2200	2700	1900	.	.	.
GDP/capita (EUR at PPP - wiiw)	4500	4700	5200	5800	6000	5300	.	.	.
Consumption of households, UAH mn, nom.	180956	252624	319383	423174	576565	574700	.	.	.
annual change in % (real)	13.5	16.6	15.9	17.2	11.8	-14	1.5	4	6
Gross fixed capital form., UAH mn, nom.	77820	96965	133874	198348	258176	185500	.	.	
annual change in % (real)	20.5	3.9	21.2	23.9	1.9	-38	3.0	10	10
Gross industrial production									
annual change in % (real)	12.5	3.1	6.2	10.2	-3.1	-21.9	5	7	8
Gross agricultural production									
annual change in % (real)	19.7	0.1	2.5	-6.5	17.1	0.1	.	.	.
Construction industry									
annual change in % (real)	17.2	-6.6	9.9	15.6	-16.0	-48.2	.	.	.
Employed persons - LFS, th, average	20295.7	20680.0	20730.4	20904.7	20972.3	20100	20200	20300	20400
annual change in %	0.7	1.9	0.2	0.8	0.3	-4.2	0.5	0.5	0.5
Unemployed persons - LFS, th, average	1906.7	1600.8	1515.0	1417.6	1425.1	2000	.	.	
Unemployment rate - LFS, in %, average	8.6	7.2	6.8	6.4	6.4	9.5	9	8.5	8
Reg. unemployment rate, in %, end of period	3.5	3.1	2.7	2.3	3.0	1.9	.	.	.
Average gross monthly wages, UAH [2]	589.6	806.2	1041.4	1351.0	1806.0	1906.0	.	.	.
annual change in % (real, gross)	17.0	20.4	18.4	15.0	6.8	-8.9	.	.	.
Consumer prices, % p.a.	9.0	13.5	9.1	12.8	25.2	15.9	12	10	8
Producer prices in industry, % p.a. [3]	20.5	16.7	9.6	19.5	35.5	6.5	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	26.5	30.4	31.6	30.5	31.4	30.3	.	.	.
Expenditures	29.7	32.2	32.3	31.6	32.8	32.6	.	.	.
Deficit (-) / surplus (+)	-3.2	-1.8	-0.7	-1.1	-1.5	-2.3	-7	-3	-3
Public debt, nat.def., in % of GDP	24.7	17.7	14.8	12.3	19.9	31.7	35	35	35
Discount rate of NB, % p.a., end of period	9.0	9.5	8.5	8.0	12.0	10.3	.	.	.
Current account, EUR mn [4]	5560	2030	-1289	-3849	-8721	-1391	0	-200	-500
Current account in % of GDP	10.6	2.9	-1.5	-3.7	-7.1	-1.6	0	-0.2	-0.3
Exports of goods, BOP, EUR mn [4]	26906	28093	31048	36383	46274	28971	31900	35100	38600
annual growth rate in %	-7.1	4.4	10.5	17.2	27.2	-37.4	10	10	10
Imports of goods, BOP, EUR mn [4]	23895	29004	35188	44100	57270	32791	34800	38300	42100
annual growth rate in %	-27.1	21.4	21.3	25.3	29.9	-42.7	6	10	10
Exports of services, BOP, EUR mn [4]	6325	7503	9000	10337	12228	9867	10900	12000	13200
annual growth rate in %	37.0	18.6	19.9	14.9	18.3	-19.3	10	10	10
Imports of services, BOP, EUR mn [4]	5329	6054	7305	8571	11039	7998	8500	9400	10300
annual growth rate in %	35.5	13.6	20.7	17.3	28.8	-27.5	6	10	10
FDI inflow, EUR mn [4]	1380	6263	4467	7220	7457	4000	4000	.	.
FDI outflow, EUR mn [4]	3	221	-106	491	690	700	.	.	.
Gross reserves of NB excl. gold, EUR mn	6977	16058	16587	21634	21847	17824	.	.	.
Gross external debt, EUR mn	22528	33504	41391	54421	72105	75000	.	.	.
Gross external debt in % of GDP	47.1	45.3	50.6	56.0	82.4	90.2	.	.	.
Average exchange rate UAH/EUR	6.609	6.389	6.335	6.918	7.708	10.868	11	10.5	10
Purchasing power parity UAH/EUR, wiiw [5]	1.631	1.986	2.227	2.656	3.415	3.900	.	.	.

1) Preliminary and wiiw estimates. - 2) Excluding small enterprises. - 3) Domestic output prices. - 4) Converted from USD with the average exchange rate. - 5) wiiw estimates based on the 2005 International Comparison Project benchmark.

Source: wiiw Database incorporating national statistics. Forecasts by wiiw.



Olga Pindyuk

Kazakhstan:
Anti-crisis policies and higher oil prices help to avoid recession

According to our estimates, Kazakhstan's GDP increased by 0.5% in real terms in 2009, thus making it one of the few countries in the region which recorded positive economic growth last year. Kazakhstan managed to avoid recession on the back of high oil prices – in December 2009, the monthly average OPEC basket was USD 74 per barrel, up 92% as compared with December 2008.

State support has also been crucial in mitigating the impact of the crisis on the country's economy. In 2009, the state allocated USD 14 billion (about 10% of GDP) from the National Oil Fund to different anti-crisis policies (in particular to support the financial sector, SMEs, construction and real estate). The assets of the National Oil Fund decreased by about 10% to USD 24.4 billion in the course of 2009. In 2010-2012, the government intends to restrict the usage of National Oil Fund resources – annual transfers in the amount of about KZT 1000 billion (about USD 7 billion) are envisaged, thus they are going to decline steadily in relative terms.

At the same time increasing fiscal revenues will allow to avoid a tightening of the fiscal policy. For instance, starting from the beginning of 2010, the pension size was increased by 25%; the government has also announced quite ambitious plans of public investment projects.

However, the efficient anti-crisis policy also means increased state intervention in the economy and rapidly growing concentration of state property. For example, after Alliance Bank, which announced default on debt obligations earlier in 2009, reached an agreement with the investors on the debt restructuring, on 30 December 2009, the government forced it to sell 100% of its shares to the state for the symbolic price of KZT 1 (EUR 0.005). According to IMF estimates, by now the balance sheet of Samruk-Kazyna (a state company created to manage the anti-crisis programme) is more than 50% of GDP (about USD 50 billion). The share of state property in the economy is expected to further increase, in particular due to the active state policy of gaining greater control over energy reserves – by acquiring stakes from existing foreign investors. Following last year's experience of the state company KazMunajgas muscling into the Kashagan oilfield project after a dispute with the foreign investors, the government is negotiating the purchase of a stake in the Karachaganak oil deposit amid the tax dispute with the shareholders.

Such high concentration of property in one state company not only may cause problems with efficiency of its operation, but also strengthens the position of the authoritarian power in the country. Kazakhstan has been dominated for almost 20 years by President Nazarbayev, who will keep his post until his death; the Parliament consists of one pro-presidential party. In order to secure its

position, the authoritarian regime has been turning to restricting the freedom of speech by adopting censorship laws, closing down opposition mass media, and imprisoning opposition leaders. In 2010, Kazakhstan became the first country defined by Freedom House as 'not free' to chair the Organization for Security and Cooperation in Europe (OSCE). The first initiative of the new chairman, firmly backed by Russia, was proposition to shift the focus of the OSCE from protection of human rights and democratic freedoms to international security and cooperation.

In 2010-2012, Kazakhstan's economy is expected to continue its recovery. However, due to the structural issues caused by the crisis (particularly in the banking and construction sectors), growth will not be as fast as in the pre-crisis period. According to our forecast, GDP will grow by 3% in 2010 and further speed up to about 5% in 2011-2012. The oil sector will remain the major driving force of the economy. We assume in our forecast that in 2010-2012, world oil prices will further go up to around USD 75-80 per barrel. A revival of global demand for key commodities exported by Kazakhstan will allow the country to increase its exports at double-digit rates in 2010-2011.

Another sector that will play an increasingly important role in the economy is agriculture. The sector recorded the highest growth in the economy in 2009, 13.8% year-on-year, its share in gross value-added reached 14.2% in January-September 2009, 2.6 percentage points up compared with the same period in 2008. A rapid increase in exports allowed Kazakhstan to raise its share in the world trade of wheat flour to 18%; the country continues to be the biggest global wheat flour exporter. Steadily growing world demand for food during the forecasted period, strong comparative advantages of Kazakhstan in agricultural production (primarily vast arable land), and state investment into the modernization of agricultural technologies and the transport and storage infrastructure will allow the sector to grow fast in future. The risks to the forecast are primarily related to the weather, which impacts harvests significantly and which can be quite unstable.

The 'Republican Budget for 2010-2012' adopted by the Parliament of Kazakhstan is based on conservative assumptions of oil prices (USD 50 per barrel in 2010 and USD 60 per barrel in 2011-2012) and GDP growth (from 2.4% in 2010 to 3.9% in 2012). According to the law, the state budget deficit will reach 4.1% of GDP in 2010, 3.8% in 2011, and 3.5% in 2012. However, we find the underlying scenario too pessimistic and forecast that higher budget revenues will let the state budget deficit decrease more significantly – to 2% in 2012.

Banking sector activity remains sluggish as banks continue to be very restrictive with loans issuance. During the final quarter of 2009, the outstanding loans value decreased by 4.8%; non-performing loans continue to accumulate. Apart from providing liquidity to the banking sector, the government tried to strengthen it by raising minimum capital requirements for banks, starting from 1 October 2009, by more than three times to KZT 5 billion (about EUR 24 million). More than one third of banks do not reach the new requirement threshold, thus mergers and acquisitions are expected in the sector.

On the positive side, the dynamics at the deposits market has been reviving: deposits of households increased by 3.7% during the fourth quarter of 2009. However, the size of the domestic deposit

market is not big enough to replace the lost external financing source. In order to facilitate corporate borrowing on international financial markets, the government wants to create a benchmark for a securities prices comparison by issuing about USD 500 million dollar-denominated securities at the beginning of 2010 (after the last issuance of international bonds in 2000).

In the area of foreign trade the major developments are related to the creation of a customs union between Russia, Belarus and Kazakhstan, which came into force starting from 1 January 2010. This decision appears to be driven primarily by political motives on the part of Kazakhstan as the country's benefits derived from the customs union seem doubtful. It illustrates the increasing pressure on Astana from Moscow, which strives to maintain control over the region.

The import tariffs of the customs union are to be harmonized by large with the existing Russian ones. This would mean that in Kazakhstan, the most open economy among the three, more than 30% of customs tariff positions have to be raised, in particular on many items of machinery and equipment, vehicles, fertilizers, wood, medicine and medical equipment, meat, and footwear – most of which are not produced in Kazakhstan. Since imports from Russia and Belarus account for about one third of Kazakhstan's imports, import substitution is not likely to be big enough to offset the increase in prices of imported products. A transition period before the implementation of the new tariffs is envisaged in Kazakhstan, which might give the country the possibility to re-negotiate certain tariff positions in order to reduce the potential damage.

Another disadvantage incurred by the newly created customs union is prolonging the duration of the country's WTO accession process. Kazakhstan started the process in 1996 and intensified it in the middle of the 2000s. At the beginning of 2008 Kazakhstan signed bilateral protocols with 20 out of 39 members of the Working Party, including Canada, China, Norway, South Korea and Switzerland; negotiations with the EU and USA came to their final stage. However, the onset of the financial crisis brought about a halt in the accession process, and the coming changes in customs tariffs will mean that the country will have to restart negotiations on WTO accession basically from scratch.

The potential benefits for Kazakhstan may be linked to increased FDI as the country has the most favourable tax regime among the three, thus foreign investors attracted by the bigger size of the market can be inclined to choose it for their investment.

Unless the risk of import price increases materializes, inflation is expected to remain one-digit during the forecasted period and to gradually slow down to 6% in 2012. No devaluation pressure is expected. The National Bank of Kazakhstan announced that it would widen the current corridor of KZT/USD 150 ±5 to 150 ±15, thus suggesting the potential for KZT appreciation – caused by stronger export performance and increased capital inflow into the economy.

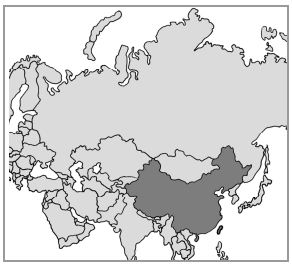
Table KZ

Kazakhstan: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, th pers., average	15013	15147	15308	15484	15674	15890	15900	16100	16200
Gross domestic product, KZT bn, nom.	5870	7591	10214	12763	16053	15700	17300	19600	21900
annual change in % (real)	9.6	9.7	10.7	8.7	3.3	0.5	3	5	4.5
GDP/capita (EUR at exchange rate)	2300	3000	4200	4900	5800	4800	5500	6400	7100
GDP/capita (EUR at PPP - wiiw)	6500	7300	8200	9000	9300	9100	.	.	.
Consumption of households, KZT bn, nom.	3054	3686	4547	5468	6871	7600	8600	9700	10700
annual change in % (real)	14.1	10.9	12.7	11.0	6.3	3	5	6	4
Gross fixed capital form., KZT bn, nom.	1472	2123	3084	3857	4309	3300	4100	4700	5300
annual change in % (real)	22.5	28.1	29.7	17.3	1.0	-1.5	3	7	6
Gross industrial production									
annual change in % (real)	10.4	4.8	7.0	4.5	2.1	1.7	7	5	4
Gross agricultural production									
annual change in % (real)	-0.5	7.3	7.0	8.4	-5.6	13.8	6	8	5
Construction industry									
annual change in % (real)	17.9	47.4	28.6	5.7	1.8	-4.9	5	7	8
Employed persons - LFS, th, average	7181.8	7261.0	7403.5	7631.8	7857.2	7904.9	7940	7980	8060
annual change in %	2.8	1.1	2.0	3.1	3.0	0.6	0.5	0.5	1
Unemployed persons - LFS, th, average	658.8	640.7	625.4	578.8	557.8	554.7	.	.	.
Unemployment rate - LFS, in %, average	8.4	8.1	7.8	7.3	6.6	6.6	6.5	6.4	6.2
Reg. unemployment rate, in %, end of period	1.6	1.3	1.1	0.8	0.7	0.6	.	.	.
Average gross monthly wages, KZT	28329	34060	40790	53238	60734	66460	.	.	.
annual change in % (real, gross)	14.6	11.7	10.3	17.8	-2.5	3	.	.	.
Consumer prices, % p.a.	6.9	7.6	8.6	10.8	17.1	7.3	7.5	6.5	6
Producer prices in industry, % p.a.	16.7	23.7	18.4	12.4	36.9	-22.2	8	7	6
General governm.budget, nat.def., % GDP									
Revenues and grants	24.6	28.1	27.9	22.6	25.1	22.3	.	.	.
Expenditures and net lending	22.1	22.3	20.4	24.3	27.2	25.5	.	.	.
Deficit (-) / surplus (+), % GDP	2.5	5.8	7.5	-1.7	-2.1	-3.1	-4.0	-3.0	-2.0
Public debt in % of GDP	3.9	9.3	11.3	7.2	8.3	10.4	9	8	7
Base rate of NB % p.a., end of period	7.0	8.0	9.0	9.0	10.5	7.0	.	.	.
Current account, EUR mn [2]	270	-848	-1525	-5355	4742	-3000	-3000	-3700	-4500
Current account in % of GDP	0.8	-1.8	-2.4	-7.0	5.2	-3.9	-3.4	-3.6	-3.9
Exports of goods, BOP, EUR mn [2]	16581	22734	30881	35309	48905	29900	37300	41700	47200
annual growth rate in %	41.4	37.1	35.8	14.3	38.5	-39	25	12	13
Imports of goods, BOP, EUR mn [2]	11120	14442	19216	24288	26128	21200	-25400	-29200	-33900
annual growth rate in %	31.3	29.9	33.1	26.4	7.6	-19	-220	15	16
Exports of services, BOP, EUR mn [2]	1617	1790	2237	2596	2978	3000	3500	3900	4400
annual growth rate in %	6.6	10.7	25.0	16.1	14.7	1	17	11	13
Imports of services, BOP, EUR mn [2]	4111	6021	6947	8491	7474	7100	-8100	-8900	-9900
annual growth rate in %	23.6	46.5	15.4	22.2	-12.0	-5	-214	10	11
FDI inflow, EUR mn [2]	3346	1583	4958	7440	9882	9200	10100	10600	10800
FDI outflow, EUR mn [2]	-1029	-117	-309	2369	2590	2700	2700	2800	2800
Gross reserves of NB excl. gold, EUR mn	6810	5965	14525	11970	13711	16184	.	.	.
Gross external debt, EUR mn	24013	36643	56252	65436	76417	79464	.	.	.
Gross external debt in % of GDP	69.1	79.9	87.2	86.0	84.3	104.1	.	.	.
Average exchange rate KZT/EUR	169.04	165.42	158.27	167.75	177.04	205.67	196	189	189
Purchasing power parity KZT/EUR, wiiw [3]	59.92	68.78	81.24	91.09	110.40	108.64	.	.	.

1) Preliminary and wiiw estimates. - 2) Converted from USD with the average exchange rate. - 3) Based on ICP benchmark results 2005 and wiiw estimates.

Source: National statistics (National Bank, Agency of Statistics etc.). Forecasts by wiiw.



Waltraut Urban

China:
On the cusp of double-digit growth

China's economy expanded at a rate of 8.7% in 2009, exceeding the government's growth target of 8% as well as most forecasts made earlier in the year. Further on, GDP growth in 2008 was revised upwards (9.6%) after more detailed information on the services sector had become available and therefore the level of GDP in 2008 was also higher than previously assumed. The fast growth of the economy despite a big slump in exports was due to the massive stimulus measures taken by the Chinese government, driving investment in fixed assets and supporting private consumption, which largely compensated for the loss of foreign demand.

Despite great uncertainties still ahead, economists seem to have reached a certain consensus that the Chinese economy will grow at a moderately faster rate this year than in 2009. However, the question is to which extent the government will continue to prop up economic growth: some sectors have already shown signs of overheating by the end of last year, but others, such as the export-oriented light industries, are still operating below pre-crisis capacity levels. In November 2009, the government had pledged to maintain its pro-growth fiscal policy and to follow a moderately expansionary monetary policy in face of the still fragile global recovery. Meanwhile, however, the global outlook has further improved and signs of an asset bubble in China have appeared, foreign trade is expanding and both producer and consumer prices have ceased to fall. As a reaction, the People's Bank of China has already begun to tighten its monetary policy in January this year, by raising the reserve ratio and using open-market policy to siphon liquidity while leaving interest rates untouched. Under the assumption of external demand recovering but staying below pre-crisis levels, persistent proactive fiscal policy and a moderately tight monetary policy, we expect China's GDP to grow by 9.5% in 2010. Current IMF estimates (10%) and OECD projections from November last year (10.2%) are higher, but recent World Bank forecasts for China come up to 9% only. In a new report of the Chinese Academy of Social Sciences (CASS), GDP is expected to increase by 11.6% in 2010 if the Chinese government continues to fully implement the current fiscal and monetary stimulus measures, but growth may fall to 7.7% if the government exits the stimulus policies.[42]

In 2011, given the further recovery of the world economy, we expect most government stimulus measures to phase out and exports to take over again as an engine of growth. Also, China's budget deficits and public debt are relatively small by international standards and fiscal consolidation will not have a similarly negative impact on private demand as assumed for many European countries and the US. We thus expect a slight acceleration of GDP growth. Finally, in 2012, with the global

[42] 'China's GDP to expand 11.6% in 2010: CASS', *China Knowledge*, 7 January 2010.

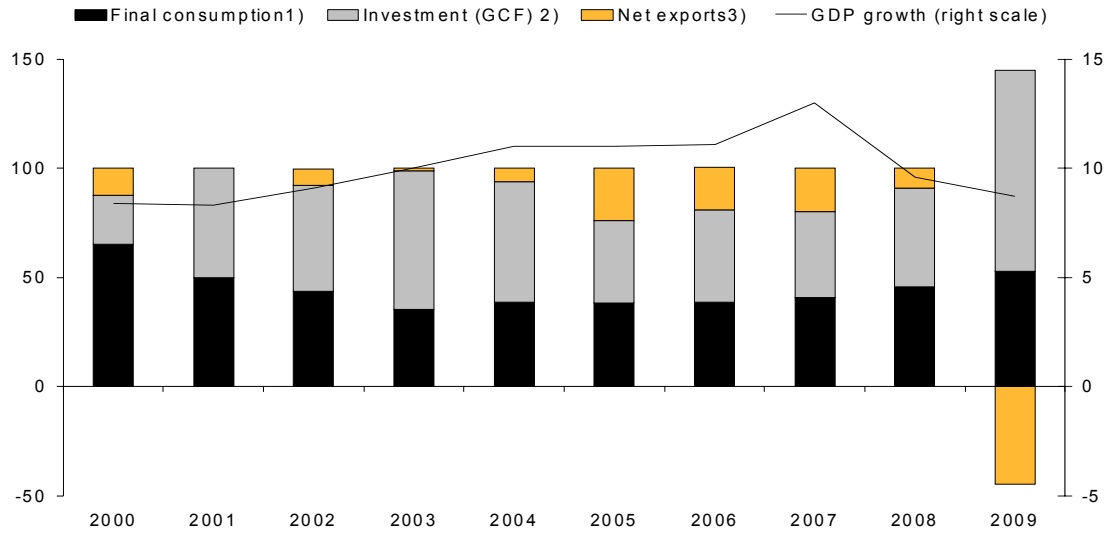
economy still in good shape, China's economy might reach a double-digit growth rate again, similar to the years before the crisis, probably at about 11%.

However, if the Chinese government is going to take its plans to switch from quantitative to more qualitative growth more seriously in the upcoming Five Year Plan 2011-2015, growth rates in 2011 and 2012 may be lower. Further on, the medium- to long-term development has to be seen in the light of China's attempts to gradually rebalance its growth pattern away from excessive investment and exports towards final consumption. The latter contributed only around 40% to GDP growth in the last couple of years, compared to 50-70% until the year 2000 (see Figure 1). But during the crisis, this trend was reversed.

Figure 1

Contribution of the main demand components to GDP growth

in %



Notes: 1) Private consumption and government consumption. - 2) Gross capital formation, including fixed capital formation and change in inventories. - 3) Net exports of goods and services

Source China Statistical Yearbook, 2009; *China Daily*, 3 February 2010.

Investment in fixed assets, the main driver of GDP growth in 2009, increased at a rate of 30% (in nominal terms), 6 percentage points faster than in 2008.[43] The acceleration of growth was even more impressive when taking into account that the 2008 investment figures where inflated while in 2009, the prices for investment in fixed assets declined by about 2%. Investment growth was pushed up by government-funded infrastructure projects such as railways, roads, water supply etc., but e.g.

[43] The investment in fixed assets as reported here and in the Table on China's Selected Economic Indicators given below is not identical with gross fixed capital formation according to the national accounts, but derived from surveys and may include investments not yet completed.

health care and social welfare as well. Manufacturing investment rose particularly fast in branches catering for the domestic market, such as non-metal mineral products including cement, glass and other construction materials (47%), different types of machinery (40-50%), medical and pharmaceutical products (42%) and transport equipment (34%), but was relatively weak in export-oriented light industries such as textiles, clothing, shoes and communication equipment. An important exception to this rule is the steel industry, struggling with overcapacities despite an enormous surge in domestic demand. For this year, we expect government-backed investment to stay high, but to increase at a slower pace than last year. However, with the global economy recovering, export-oriented industries will invest more while domestic market-oriented industries will continue to expand fast.

Real estate investment has recovered rapidly after a deep slump at the beginning of 2009 and expanded at about 18% over the year as a whole. But property sales increased even faster (42%) and property prices surged, raising consumer discontent and fears that an asset bubble was building up, driven by excess liquidity and speculation.[44] To contain this development, the government has already introduced several countermeasures.[45] Nevertheless, we expect real estate investment to remain robust during the years to come, because of persistent high demand backed by ongoing urbanization, rising incomes and high economic growth. The inflow of foreign direct investment in 2009 reached more or less the same amount (EUR 65 billion) as in the previous year (EUR 63 billion), but it has shown signs of picking up recently[46] (this observation is based on the data available, covering equity investment in the non-financial sector only). Given the acceleration of growth this year, we expect FDI to increase again, probably at a rate of 5-10%. Altogether, we thus expect investment in fixed assets to rise strongly but at a slower pace than last year, probably reaching 25% (in nominal terms).

Final consumption also expanded very fast and its contribution to GDP growth was significantly higher than last year, surpassing the 50% benchmark for the first time since 2001 (see Figure 1). Private consumption, the major component of final consumption, was backed by the relatively fast rise in real wages (14%) and the high growth of per capita net incomes of rural households in real terms (9%). Unemployment seems to have increased temporarily only. Altogether real incomes seem to have risen faster than GDP in 2009. On top comes a certain 'wealth affect' as the Chinese stock market gained 70% throughout the year and there exist far more than 100 million private stock holders in China. But household consumption was also supported directly by government measures in order to make up for the slump in external demand. These measures include subsidies for farmers

[44] According to the National Bureau of Statistics, property prices, measured in yuan per sqm, were up 24% across the nation on average. But in Shanghai, for instance, property prices surged 69% according to E-House (China) Holdings Ltd., a property-data provider.

[45] Interest rate discounts introduced at the end of 2008 to encourage residential housing sales were cancelled; lending to second-time buyers has undergone tightening; the minimum holding period for property purchasers to qualify for tax-exempt status when selling homes was extended from two to five years, and some provinces are experimenting with new types of property taxes (*China Daily*, 26 January, 2010).

[46] This observation is based on data already available for 2009, covering equity investment in the non-financial sector only.

when buying household appliances such as TV sets, washing machines, microwaves and mobile phones; various measures to promote car sales such as tax reductions and subsidies for farmers and buyers of environmentally friendly cars; and the introduction of consumer credits for durable goods, travel and education. As a consequence, retail trade turnover expanded by 17% (in real terms), and for the first time after a long period, sales in rural areas grew faster than sales in the cities. Vehicles sales rose by 45%, the highest growth rate ever, and with 13.5 million vehicle sold China has become the largest automobile market in the world, followed by the USA (10.4 million). The prospects for consumption this year remain bright as employment is further improving and the government has decided to continue with its support policies for the rural population. Retail trade may expand by 17.5% (in real terms).

The foreign sector's contribution to last year's GDP growth was negative, for the first time since 1993, and was the largest negative contribution to growth (-45%) since China's economic reform and opening-up in 1978. Both exports and imports fell at double-digit rates in terms of US dollar and at 11.7% and 6.7% respectively measured in euro, due to the global financial and economic crisis. The trade balance shrank from EUR 202 billion to EUR 140 billion. However, exports and imports started to rise again at the end of 2009 and the worst seems to be over now. In fact, export-oriented light industries concentrated in the south of China, which had released millions of migrant workers in the spring of last year, have problems finding enough workers to fulfil their new orders. For the current year we expect Chinese exports to rise by 10% (lower bound). This is significantly less than before the crisis as China's major markets for final goods, namely Europe, the USA and Japan, are still depressed. However, fresh opportunities will arise from the 'China – ASEAN Free Trade Area' which came into force in January 2010 and from trade with other fast recovering economies. China's high economic growth compared to its major trading partners will lead to imports rising faster than exports, probably by 14%, which will cause a further decline in the trade surplus as well as the surplus on the current account. Most probably, this development will be supported by a gradual appreciation of the Chinese currency versus the US dollar.

In 2011, the global economy is expected to recover further, but growth will still stay below pre-crisis levels. China's exports are most likely to rise again faster (25%) than imports (20%), but at a somewhat slower pace than before the crisis, and the trade surplus will grow again. However, 2011 will be the year when the new Five Year Plan (2011-2015) will become effective, which will probably hold new efforts with respect to the transformation from an export-led development to more domestic market-oriented growth. Further on, as China is now the largest exporter worldwide and unemployment in the advanced economies is going to be a longer-term issue, protectionist pressure on Chinese exports is expected to intensify. Also, China might decide to revalue its currency, in the face of domestic inflation and rising raw material prices, in particular prices for oil. All this may dampen China's export growth in 2012, but lower import growth as well because of the high share of imports for processing trade.

Table CN

China: Selected Economic Indicators

	2004	2005	2006	2007	2008	2009 [1]	2010	2011 Forecast	2012
Population, mn pers., end of period	1299.9	1307.6	1314.5	1321.3	1328.0	1335.0	1342	1349	1356
Gross domestic product, CNY bn, nom.	15987.8	18321.7	21192.4	25730.6	31405.0	33540	38000	43000	48700
annual change in % (real)	10.1	10.4	11.6	13.0	9.6	8.7	9.5	9.8	11
GDP/capita (EUR at exchange rate)	1100	1400	1600	1900	2300	2600	.	.	.
GDP/capita (EUR at PPP - wiiw)	3000	3400	3900	4500	4900	5300	.	.	.
Retail trade turnover, CNY bn	5950.1	6717.7	7641.0	8921.0	10848.8	12530	.	.	.
annual change in % (real)	13.3	12.9	13.8	13.0	15.7	16.9	17.5	17	16
Total investment in fixed assets, CNY bn	7047.7	8877.4	10999.8	13732.4	17282.8	22500	.	.	.
annual change in % (nominal)	26.8	26.0	23.9	24.8	25.9	30.1	25	23	20
Industrial value added									
annual change in % (real)	11.5	11.6	12.9	14.9	9.5	9.5	9.5	11	12
Agricultural value added									
annual change in % (real)	6.3	5.2	5.0	3.7	5.5	4.2	.	.	.
Construction value added									
annual change in % (real)	8.1	12.6	13.7	12.8	7.1	9.5	.	.	.
Employment total -reg., mn, end of period	752.0	758.3	764.0	769.9	774.8	767.0	770	778	784
annual change in %	1.0	0.8	0.8	0.8	0.6	-1.0	0.3	1.0	0.8
Staff and workers, mn, end of period [2]	105.8	108.5	111.6	114.3	115.2	115.1	.	.	.
annual change in %	0.8	2.6	2.9	2.39	0.8	0.4	.	.	.
Reg. unemploym.rate (urban), in %, end of per. [3]	4.2	4.2	4.1	4	4.2	4.3	4.3	4.2	4.2
Average gross annual wages, CNY [4]	16024	18364	21001	24932	29229	33029	.	.	.
annual change in % (real) [5]	10.5	12.8	12.7	13.6	11.0	14.1	.	.	.
Consumer prices, % p.a.	3.9	1.8	1.5	4.8	5.9	-0.7	3.5	3	2
Producer prices in industry, % p.a.	6.1	4.9	3.0	3.1	6.9	-6.4	.	.	.
General government budget, nat.def., % GDP									
Revenues	16.5	17.3	18.3	19.9	19.5	19.8	.	.	.
Expenditures	17.8	18.5	19.1	19.3	19.9	22.8	.	.	.
Deficit (-) / surplus (+)	-1.3	-1.2	-0.8	0.6	-0.4	-3.0	-2.8	-2.0	-1.0
Public debt, nat.def., in % of GDP [6]	18.5	17.8	16.5	20.2	16.9	24	.	.	.
Base rate of NB % p.a., end of period [7]	3	3.3	3.3	3.3	2.8	2.8	.	.	.
Current account, EUR bn	51.4	128.8	198.8	271.4	289.5	210	150	250	300
Current account in % of GDP	3.6	7.2	9.4	11.0	9.4	6.1	3.7	5.2	5.2
Exports of goods total, EUR bn [8]	435.5	609.3	771.0	888.9	971.9	861.4	950	1180	1390
annual change in %	12.5	39.9	26.5	15.3	9.3	-11.4	10.3	24.2	17.8
Imports of goods total, EUR bn [8]	411.9	527.8	629.7	697.8	769.4	721.4	820	990	1130
annual change in %	12.9	28.1	19.3	10.8	10.3	-6.2	13.7	20.7	14.1
Trade balance of goods, EUR bn [8]	23.6	81.6	141.2	191.1	202.5	140.0	130	190	260
Exports of services, BOP, EUR bn	45.8	59.5	73.2	89.2	99.9	88.2	.	.	.
annual growth rate in %	11.0	29.8	23.0	21.9	12.0	-11.7	.	.	.
Imports of services, BOP, EUR bn	52.9	67.0	80.2	95.0	108.0	100.8	.	.	.
annual growth rate in %	8.3	26.6	19.7	18.4	13.7	-6.7	.	.	.
FDI inflow, EUR bn [9]	40.3	63.3	62.1	101.0	100.4	*65*	*71*	.	.
FDI outflow, EUR bn [9]	1.3	9.0	16.8	12.4	36.3	43	.	.	.
Gross reserves of NB excl. gold, EUR bn	447.7	694.2	810.0	1038.2	1384.0	1665.2	.	.	.
Gross external debt, EUR bn	167.8	238.2	245.4	253.8	266.5	268.5	.	.	.
Gross external debt in % of GDP	11.8	12.6	12.1	11.0	8.3	7.9	.	.	.
Average exchange rate CNY/USD	8.277	8.206	7.972	7.604	6.945	6.831	6.6	6.4	6
Average exchange rate CNY/EUR	11.276	10.261	10.02	10.418	10.223	9.564	9.2	9.0	8.4
Purchasing power parity CNY/USD, wiiw [10]	3.433	3.450	3.462	3.615	3.943	3.828	.	.	.
Purchasing power parity CNY/EUR, wiiw [10]	4.075	4.120	4.149	4.348	4.820	4.788	.	.	.

Note: CNY: ISO code for the Chinese yuan.

1) Preliminary and wiiw estimates. - 2) Staff and workers (on duty) refer to persons who work in state-owned enterprises, urban collectives, shareholding ownership and foreign invested enterprises. - 3) Ratio of registered urban unemployed in per cent of urban employed and unemployed. - 4) Average gross annual wages of staff and workers, defined as: total wages of staff and workers on duty per average number of staff and workers on duty. - 5) Staff and workers cost of living index is used as deflator for calculating real wage. For 2009 the consumer price index was used as a deflator. - 6) Central government debt only according to CIA Factbook. - 7) Overnight rate. - 8) According to customs statistics. - 9) Net investments drawn from the Chinese balance of payments. Data for 2009 are gross equity investments in the non-financial sector as given by the Chinese Ministry of Commerce. - 10) wiiw estimates based on the 2005 International Comparison Project benchmark (World Bank).

Source: National statistics (National Bureau of Statistics, Central Bank, China Daily etc.). Forecasts by wiiw.

Appendix

Selected indicators of competitiveness

Table A/1

GDP per capita at current PPPs (EUR), from 2012 at constant PPPs

	1991	1995	2000	2005	2008	2009	2010	2011	2012	2015 projection [1]	2020
Bulgaria	4400	4700	5300	7700	10300	10000	10000	10300	10700	12000	14600
Cyprus	10700	13000	16900	20400	24000	23300	23300	23600	24500	27600	33500
Czech Republic	8800	10100	13000	17100	20200	19500	19700	20200	20900	23500	28600
Estonia	5500	5300	8600	13900	16900	14800	14600	14900	15500	17400	21200
Hungary	6800	7600	10500	14200	16100	15300	15300	15800	16400	18500	22500
Latvia	6500	4600	7000	10900	14400	11900	11400	11500	11700	13200	16000
Lithuania	7200	5200	7500	11900	15500	13500	13100	13400	13800	15600	18900
Malta	9500	12700	15900	17500	19100	18300	18400	18600	19300	21700	26400
Poland	4500	6100	9100	11500	14100	14600	15000	15500	16000	18000	21800
Romania	4000	4500	5000	7900	12000	11400	11400	11700	12200	13700	16600
Slovakia	5800	6900	9600	13500	18100	17400	17600	18100	18800	21200	25800
Slovenia	8500	9800	15200	19700	22800	21100	21300	21700	22200	25000	30400
NMS-12	5400	6300	8600	11700	14800	14400	14500	14900	15400	17300	21000
Croatia	7000	6700	9400	12700	15500	14800	14700	15000	15400	17300	21000
Macedonia	4300	4000	5100	6400	8200	8100	8100	8300	8500	9600	11600
Turkey	3700	4300	7600	9100	10900	10400	10800	11100	11700	13200	16000
Albania	1500	2000	3500	5000	6500	6900	7000	7300	7700	8600	10500
Bosnia & Herzeg.	.	.	3900	5100	7000	6900	6800	6900	7100	8000	9700
Montenegro	.	.	5600	6900	10700	10300	10200	10400	10700	12000	14600
Serbia	.	.	6100	7200	9300	10100	10100	10300	10600	11900	14500
Kazakhstan	.	3100	4200	7300	9300	9100	9400	9900	10300	11500	14000
Russia	7600	5300	6600	10000	13200	12400	12800	13300	13900	15700	19100
Ukraine	4600	2600	2800	4700	6000	5300	5500	5700	6000	6700	8200
China	750	1300	2100	3400	4900	5300	5800	6400	7100	8000	9700
Austria	18800	19700	25000	28000	30900	29300	29600	30000	30600	32400	35800
Germany	18100	18900	22600	26300	29000	27400	27700	28200	28800	30600	33700
Greece	12300	12300	16000	20600	23600	23000	22900	23100	23600	25100	27600
Portugal	10300	11000	14900	17300	19000	18200	18300	18500	18900	20100	22100
Spain	12800	13400	18500	22900	25700	24200	24000	24200	24700	26200	28900
USA	21500	23400	30600	35800	38800	37000	37800	38600	39400	41800	46200
EU-27 average	13700	14600	19000	22500	25100	23700	23900	24300	24800	26300	29000

European Union (27) average = 100

	1991	1995	2000	2005	2008	2009	2010	2011	2012	2015 projection [1]	2020
Bulgaria	32	32	28	34	41	42	42	42	43	46	50
Cyprus	78	89	89	91	96	98	97	97	99	105	116
Czech Republic	64	69	68	76	80	82	82	83	84	89	99
Estonia	40	36	45	62	67	62	61	61	63	66	73
Hungary	50	52	55	63	64	65	64	65	66	70	78
Latvia	47	32	37	48	57	50	48	47	47	50	55
Lithuania	53	36	39	53	62	57	55	55	56	59	65
Malta	69	87	84	78	76	77	77	77	78	83	91
Poland	33	42	48	51	56	62	63	64	65	68	75
Romania	29	31	26	35	48	48	48	48	49	52	57
Slovakia	42	45	51	60	72	73	74	74	76	81	89
Slovenia	62	68	80	88	91	89	89	89	90	95	105
NMS-12	39	43	45	52	59	61	61	61	62	66	72
Croatia	51	46	49	56	62	62	62	62	62	66	72
Macedonia	31	27	27	28	33	34	34	34	34	37	40
Turkey	27	29	40	40	43	44	45	46	47	50	55
Albania	11	14	18	22	26	29	29	30	31	33	36
Bosnia & Herzeg.	.	.	21	23	28	29	28	28	29	30	33
Montenegro	.	.	29	31	43	43	43	43	43	46	50
Serbia	.	.	32	32	37	43	42	42	43	45	50
Kazakhstan	.	21	22	32	37	38	39	41	42	44	48
Russia	55	36	35	44	53	52	54	55	56	60	66
Ukraine	34	18	15	21	24	22	23	23	24	25	28
China	5	9	11	15	20	22	24	26	29	30	33
Austria	137	135	132	124	123	124	124	123	123	123	123
Germany	132	129	119	117	116	116	116	116	116	116	116
Greece	90	84	84	92	94	97	96	95	95	95	95
Portugal	75	75	78	77	76	77	77	76	76	76	76
Spain	93	92	97	102	102	102	100	100	100	100	100
USA	157	160	161	159	155	156	158	159	159	159	159
EU-27 average	100	100	100	100	100	100	100	100	100	100	100

1) Projection assuming a 2 percentage point growth differential with respect to the EU from 2012.

Sources: National statistics, Eurostat, wiiw estimates.

Table A/2

Indicators of macro-competitiveness, 2005-2012

EUR-based, annual averages

	2005	2006	2007	2008	2009 prelim.	2010	2011 forecast	2012
Czech Republic								
Producer price index, 2000=100	101.7	101.8	104.5	104.9	103.5	105.1	107.2	109.8
Consumer price index, 2000=100	110.4	112.7	116.0	123.3	124.1	125.9	128.4	131.7
GDP deflator, 2000=100	113.4	114.7	118.6	120.8	121.5	123.3	125.8	128.9
Exchange rate (ER), NC/EUR	29.78	28.34	27.77	24.95	26.44	26	25.5	25
ER nominal, 2000=100	83.7	79.6	78.0	70.1	74.3	73.0	71.6	70.2
Real ER (CPI-based), 2000=100	118.9	124.8	128.1	146.2	137.5	140.1	143.4	147.0
Real ER (PPI-based), 2000=100	113.3	113.9	116.7	122.7	118.6	121.0	123.9	127.1
PPP, NC/EUR	17.09	17.23	17.17	17.55	17.39	17.5	17.5	17.6
Price level, EU27 = 100	57	61	62	70	66	67	69	71
Average monthly gross wages, NC	18992	20219	21694	23542	24150	24800	25800	27200
Average monthly gross wages, EUR (ER)	638	713	781	944	914	950	1010	1090
Average monthly gross wages, EUR (PPP)	1111	1173	1264	1341	1388	1420	1470	1540
GDP nominal, NC bn	2984	3222	3535	3689	3560	3650	3820	4050
Employed persons - LFS, th., average	4764	4828	4922	5003	4930	4860	4860	4910
GDP per employed person, NC	626335	667420	718297	737430	722110	751000	786000	824800
GDP per empl. person, NC at 2000 pr.	552324	581883	605647	610455	594329	608900	624700	640000
Unit labour costs, NC, 2000=100	116.9	118.1	121.7	131.1	138.1	138.4	140.4	144.4
Unit labour costs, ER adj., 2000=100	139.7	148.3	156.1	187.0	186.0	189.5	195.9	205.7
Unit labour costs, PPP adj., Austria=100	40.6	41.8	43.1	50.3	46.9	48.1	49.4	51.5
Hungary								
Producer price index, 2000=100	115.1	122.6	123.0	128.7	134.5	138.2	140.8	143.4
Consumer price index, 2000=100	132.8	138.1	149.1	158.1	164.5	170.7	176.7	182.5
GDP deflator, 2000=100	133.9	139.1	147.4	153.0	158.4	162.7	165.8	168.8
Exchange rate (ER), NC/EUR	248.05	264.26	251.35	251.51	280.33	275	270	265
ER, nominal 2000=100	95.4	101.6	96.7	96.7	107.8	105.8	103.8	101.9
Real ER (CPI-based), 2000=100	125.4	119.8	132.8	135.8	125.5	131.1	136.1	140.4
Real ER (PPI-based), 2000=100	112.4	107.4	110.9	109.1	106.2	109.9	112.3	114.4
PPP, NC/EUR	153.53	157.74	161.97	163.81	167.09	169.6	170.1	170.2
Price level, EU27 = 100	62	60	64	65	60	62	63	64
Average monthly gross wages, NC	158343	171351	185017	198964	196000	200400	209500	220700
Average monthly gross wages, EUR (ER)	638	648	736	791	699	730	780	830
Average monthly gross wages, EUR (PPP)	1031	1086	1142	1215	1173	1180	1230	1300
GDP nominal, NC bn	21989	23755	25408	26543	25700	26400	27700	29200
Employed persons - LFS, th., average	3902	3930	3926	3879	3775	3770	3810	3850
GDP per employed person, NC	5635932	6044653	6471418	6842102	6807947	7002700	7270300	7584400
GDP per empl. person, NC at 2000 pr.	4209060	4345545	4390378	4471962	4297675	4303400	4385900	4492300
Unit labour costs, NC, 2000=100	148.5	155.7	166.4	175.7	180.1	183.9	188.6	194.0
Unit labour costs, ER adj., 2000=100	155.7	153.2	172.2	181.6	167.0	173.9	181.7	190.4
Unit labour costs, PPP adj., Austria=100	40.4	38.7	42.5	43.7	37.7	39.5	41.0	42.6
Poland								
Producer price index, 2000=100	112.8	114.8	117.2	120.0	124.7	127.2	129.7	132.3
Consumer price index, 2000=100	114.4	115.9	118.9	123.9	128.8	132.2	135.5	138.9
GDP deflator, 2000=100	113.5	115.2	119.7	123.3	127.7	131.1	134.5	137.9
Exchange rate (ER), NC/EUR	4.023	3.896	3.784	3.512	4.328	4.1	4.1	4.1
ER, nominal, 2000=100	100.4	97.2	94.4	87.6	108.0	102.3	102.3	102.3
Real ER (CPI-based), 2000=100	102.7	105.1	108.5	117.5	98.2	105.0	105.9	106.4
Real ER (PPI-based), 2000=100	104.8	105.2	108.1	112.3	98.3	104.6	105.0	105.2
PPP, PLZ/EUR	2.232	2.264	2.277	2.360	2.408	2.44	2.47	2.49
Price level, EU27 = 100	55	58	60	67	56	60	60	61
Average monthly gross wages, NC	2361	2476	2673	2942	3103	3250	3460	3710
Average monthly gross wages, EUR (ER)	587	636	706	838	717	790	840	900
Average monthly gross wages, EUR (PPP)	1058	1094	1174	1247	1288	1330	1400	1490
GDP nominal, NC bn	983	1060	1177	1273	1340	1410	1490	1580
Employed persons - LFS, th., average	14116	14594	15241	15800	15800	15720	15800	16120
GDP per employed person, NC	69661	72637	77211	80561	84810	89700	94300	98000
GDP per empl. person, NC at 2000 pr.	61375	63053	64504	65338	66414	68400	70100	71100
Unit labour costs, NC, 2000=100	104.1	106.3	112.1	121.9	126.4	128.6	133.6	141.2
Unit labour costs, ER adj., 2000=100	103.7	109.3	118.8	139.1	117.1	125.7	130.6	138.0
Unit labour costs, PPP adj., Austria=100	43.5	44.6	47.4	54.0	42.7	46.1	47.6	49.9

(Table A/2 ctd.)

(Table A/2 ctd.)

	2005	2006	2007	2008	2009 prelim.	2010	2011 forecast	2012
Slovakia								
Producer price index, 2000=100	123.1	126.7	125.0	128.1	119.6	120.8	123.2	125.7
Consumer price index, 2000=100	132.9	138.5	141.1	146.7	148.0	150.3	153.3	156.3
GDP deflator, 2000=100	124.5	128.2	129.6	133.3	134.7	137.3	141.3	146.9
Exchange rate (ER), NC/EUR	1.2813	1.2359	1.1211	1.0377	1.0000	1.0	1.0	1.0
ER, nominal, 2000=100	90.6	87.4	79.3	73.4	70.7	70.7	70.7	70.7
Real ER (CPI-based), 2000=100	132.1	139.7	153.3	166.1	172.3	172.6	173.3	173.3
Real ER (PPI-based), 2000=100	126.6	129.1	137.3	143.1	144.0	143.7	144.3	144.5
PPP NC/ EUR	0.6757	0.6815	0.6768	0.6865	0.6835	0.69	0.70	0.71
Price level, EU27 = 100	53	55	60	66	68	69	70	71
Average monthly gross wages, NC	573	623	669	723	730	760	800	850
Average monthly gross wages, EUR (ER)	448	504	596	697	730	760	800	850
Average monthly gross wages, EUR (PPP)	849	914	988	1053	1068	1100	1150	1190
GDP nominal, NC mn	49280	55046	61547	67221	64500	66400	70400	76100
Employed persons - LFS, th., average	2215	2302	2358	2434	2360	2310	2310	2330
GDP per employed person, NC	22246	23909	26105	27621	27331	28700	30500	32700
GDP per empl. person, NC at 2000 pr.	17869	18650	20143	20721	20290	20900	21600	22300
Unit labour costs, NC, 2000=100	125.4	130.5	129.7	136.3	140.6	142.1	144.7	148.9
Unit labour costs, ER adj., 2000=100	138.4	149.3	163.6	185.8	198.8	200.9	204.6	210.6
Unit labour costs, PPP adj., Austria=100	32.5	34.1	36.6	40.5	40.6	41.3	41.8	42.7
Slovenia								
Producer price index, 2000=100	117.5	120.2	125.5	130.3	128.5	127.2	129.7	132.3
Consumer price index, 2000=100	131.0	134.3	139.3	147.0	148.3	150.5	153.5	156.6
GDP deflator, 2000=100	129.8	132.4	138.1	143.4	144.6	146.8	149.7	152.7
Exchange rate (ER), NC/EUR	1.0000	0.9998	1.0000	1.0000	1.0000	1.0	1.0	1.0
ER, nominal, 2000=100	116.9	116.9	116.9	116.9	116.9	116.9	116.9	116.9
Real ER (CPI-based), 2000=100	101.0	101.3	102.7	104.5	104.4	104.6	105.0	105.0
Real ER (PPI-based), 2000=100	93.7	91.6	93.5	91.4	93.6	91.5	91.9	92.1
PPP, NC/EUR	0.7302	0.7462	0.7755	0.8057	0.8004	0.80	0.81	0.81
Price level, EU27 = 100	73	75	78	81	80	80	81	81
Average monthly gross wages, NC	1157	1213	1285	1391	1435	1470	1530	1600
Average monthly gross wages, EUR (ER)	1157	1213	1285	1391	1435	1470	1530	1600
Average monthly gross wages, EUR (PPP)	1585	1625	1657	1727	1793	1830	1900	1980
GDP nominal, NC mn	28750	31050	34568	37135	34460	35330	36760	38430
Employed persons - LFS, th., average	949	961	985	996	981	966	966	976
GDP per employed person, NC	30288	32304	35087	37281	35127	36600	38100	39400
GDP per empl. person, NC at 2000 pr.	23335	24399	25407	25998	24293	24900	25400	25800
Unit labour costs, NC, 2000=100	127.2	127.5	129.7	137.3	151.5	151.4	154.5	159.0
Unit labour costs, ER adj., 2000=100	108.8	109.1	111.0	117.4	129.6	129.5	132.2	136.1
Unit labour costs, PPP adj., Austria=100	65.2	63.5	63.2	65.1	67.5	67.8	68.7	70.3
Bulgaria								
Producer price index, 2000=100	123.3	138.1	148.7	164.9	154.3	157.3	161.8	166.1
Consumer price index, 2000=100	130.9	140.6	151.2	169.3	173.5	177.0	182.3	187.7
GDP deflator, 2000=100	123.6	134.1	144.7	161.1	168.4	171.7	176.6	181.4
Exchange rate (ER), NC/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2000=100	100.2	100.2	100.2	100.2	100.2	100.2	100.2	100.2
Real ER (CPI-based), 2000=100	117.7	123.7	130.0	140.4	142.5	143.5	145.5	146.9
Real ER (PPI-based), 2000=100	114.7	122.7	129.3	135.0	131.1	132.1	133.7	134.9
PPP, NC/EUR	0.7152	0.7455	0.7873	0.8468	0.8721	0.88	0.89	0.90
Price level, EU27 = 100	37	38	40	43	45	45	45	46
Average monthly gross wages, NC	324	360	431	525	585	600	640	680
Average monthly gross wages, EUR (ER)	166	184	220	268	299	310	330	350
Average monthly gross wages, EUR (PPP)	453	483	548	619	671	680	720	760
GDP nominal, NC mn	42797	49361	56520	66728	66197	67500	71500	76000
Employed persons - LFS, th.,average	2981.9	3110.0	3252.6	3360.7	3250	3100	3150	3180
GDP per employed person, NC	14352	15872	17377	19855	20368	21800	22700	23900
GDP per empl. person, NC at 2000 pr.	11612	11836	12009	12325	12095	12700	12900	13200
Unit labour costs, NC, 2000=100	118.9	129.8	153.1	181.5	206.3	201.5	211.6	219.7
Unit labour costs, ER adj., 2000=100	118.6	129.6	152.8	181.1	205.9	201.1	211.2	219.3
Unit labour costs, PPP adj., Austria=100	19.0	20.1	23.3	26.8	28.6	28.1	29.3	30.2

(Table A/2 ctd.)

(Table A/2 ctd.)

	2005	2006	2007	2008	2009 prelim.	2010	2011 forecast	2012
Romania								
Producer price index, 2000=100	254.3	278.5	299.4	345.3	351.5	369.1	383.9	403.1
Consumer price index, 2000=100	231.7	247.0	259.2	279.7	295.3	307.1	316.3	329.0
GDP deflator, 2000=100	270.2	298.8	339.2	390.9	410.5	431.0	448.3	470.7
Exchange rate (ER), NC/EUR	3.6209	3.5258	3.3353	3.6826	4.2399	4.2	4.1	4.0
ER, nominal, 2000=100	181.8	177.0	167.4	184.9	212.8	210.8	205.8	200.8
Real ER (CPI-based), 2000=100	114.9	123.1	133.3	125.7	114.2	118.3	122.9	128.4
Real ER (PPI-based), 2000=100	130.4	140.1	155.8	153.1	140.6	147.3	154.4	163.3
PPP, NC/EUR	1.6989	1.7600	1.8621	1.9869	2.0552	2.13	2.18	2.25
Price level, EU27 = 100	47	50	56	54	48	51	53	56
Average monthly grross wages, NC	968	1146	1396	1742	1900	1960	2040	2160
Average monthly gross wages, EUR (ER)	267	325	419	473	448	470	500	540
Average monthly gross wages, EUR (PPP)	570	651	750	877	924	920	930	960
GDP nominal, NC mn	288955	344651	416007	514654	501500	526600	564100	616000
Employed persons - LFS, th., average	9115	9291	9353	9369	9250	9150	9150	9200
GDP per employed person, NC	31702	37094	44477	54931	54216	57600	61700	67000
GDP per empl. person, NC at 2000 pr.	11733	12414	13112	14052	13208	13400	13800	14200
Unit labour costs, NC, 2000=100	223.9	250.5	288.9	336.4	390.3	396.9	401.1	412.7
Unit labour costs, ER adj., 2000=100	123.2	141.5	172.5	182.0	183.4	188.2	194.9	205.6
Unit labour costs, PPP adj., Austria=100	35.6	39.8	47.5	48.7	46.1	47.6	49.0	51.2
Estonia								
Producer price index, 2000=100	110.3	114.9	124.3	134.3	135.3	131.2	129.9	132.5
Consumer price index, 2000=100	119.0	124.3	132.7	146.7	147.0	142.6	141.2	144.0
GDP deflator, 2000=100	123.9	133.4	146.9	156.7	157.0	152.3	150.8	153.8
Exchange rate (ER), NC/EUR	15.647	15.647	15.647	15.647	15.647	15.65	15.65	15.65
ER, nominal, 2000=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2000=100	107.2	109.6	114.3	121.9	121.0	115.9	112.9	112.9
Real ER (PPI-based), 2000=100	102.8	102.3	108.3	110.1	115.2	110.4	107.5	107.7
PPP, NC/EUR	9.377	9.992	10.625	11.104	10.960	10.50	10.23	10.25
Price level, EU27 = 100	60	64	68	71	70	67	65	66
Average monthly gross wages, NC	8073	9407	11336	12912	12150	10600	10200	10700
Average monthly gross wages, EUR (ER)	516	601	725	825	777	680	650	680
Average monthly gross wages, EUR (PPP)	861	941	1067	1163	1109	1010	1000	1040
GDP nominal, NC mn	174956	206996	244504	251493	216700	207000	209000	221700
Employed persons - LFS, th., average	607.4	646.3	655.3	656.5	595.0	590	600	610
GDP per employed person, NC	288041	320278	373117	383081	364202	350800	348300	363400
GDP per empl. person, NC at 2000 pr.	232404	240161	253942	244406	231917	230300	231000	236300
Unit labour costs, NC, 2000=100	119.2	134.4	153.2	181.3	179.7	157.9	151.5	155.4
Unit labour costs, ER adj., 2000=100	119.2	134.4	153.2	181.3	179.7	157.9	151.5	155.4
Unit labour costs, PPP adj., Austria=100	39.1	42.8	47.8	55.0	51.2	45.2	43.1	43.9
Latvia								
Producer price index, 2000=100	122.5	135.1	156.9	174.8	166.8	158.0	153.9	153.4
Consumer price index, 2000=100	122.1	130.2	143.3	165.2	170.5	162.0	157.2	157.2
GDP deflator, 2000=100	128.6	141.4	170.0	196.2	202.4	191.7	186.7	186.1
Exchange rate (ER), NC/EUR	0.6962	0.6962	0.7001	0.7027	0.7057	0.703	0.703	0.703
ER, nominal, 2000=100	124.5	124.5	125.2	125.7	126.2	125.7	125.7	125.7
Real ER (CPI-based), 2000=100	88.4	92.2	98.6	109.2	111.2	104.7	100.0	98.0
Real ER (PPI-based), 2000=100	91.7	96.6	109.2	114.1	112.5	105.8	101.4	99.3
PPP, NC/EUR	0.3605	0.3999	0.4681	0.4999	0.5081	0.48	0.46	0.45
Price level, EU27 = 100	52	57	67	71	72	68	65	64
Average monthly gross wages, NC	246	302	398	479	455	400	380	380
Average monthly gross wages, EUR (ER)	353	434	568	682	645	570	540	540
Average monthly gross wages, EUR (PPP)	682	756	849	958	895	840	830	850
GDP nominal, NC mn	9059.1	11171.7	14779.8	16274.5	13600	12300	12100	12300
Employed persons - LFS, th., average	1033.7	1087.1	1118.0	1124.5	980.0	900	900	930
GDP per employed person, NC	8764	10277	13220	14473	13878	13700	13400	13200
GDP per empl. person, NC at 2000 pr.	6815	7268	7776	7376	6856	7100	7200	7100
Unit labour costs, NC, 2000=100	121.7	140.5	172.6	219.2	224.0	190.2	178.2	180.7
Unit labour costs, ER adj., 2000=100	97.8	112.8	137.9	174.5	177.5	151.4	141.8	143.8
Unit labour costs, PPP adj., Austria=100	31.9	35.7	42.8	52.7	50.3	43.1	40.1	40.4

(Table A/2 ctd.)

(Table A/2 ctd.)

	2005	2006	2007	2008	2009 prelim.	2010	2011 forecast	2012
Lithuania								
Producer price index, 2000=100	110.9	119.1	127.4	150.5	130.2	126.3	127.5	130.0
Consumer price index, 2000=100	104.7	108.6	115.0	127.7	133.0	129.0	130.3	132.9
GDP deflator, 2000=100	108.3	115.3	125.1	137.2	134.2	130.2	131.5	134.0
Exchange rate (ER), NC/EUR	3.4528	3.4528	3.4528	3.4528	3.4528	3.45	3.45	3.45
ER, nominal, 2000=100	93.4	93.4	93.4	93.4	93.4	93.4	93.4	93.4
Real ER (CPI-based), 2000=100	100.9	102.5	106.0	113.6	117.2	112.3	111.6	111.6
Real ER (PPI-based), 2000=100	110.7	113.5	118.8	132.1	118.6	113.8	113.1	113.2
PPP, NC/EUR	1.7748	1.8658	1.9790	2.1335	2.0560	1.97	1.96	1.96
Price level, EU27 = 100	51	54	57	62	60	57	57	57
Average monthly gross wages, NC	1276	1496	1802	2174	2080	1900	1900	1980
Average monthly gross wages, EUR (ER)	370	433	522	630	602	550	550	570
Average monthly gross wages, EUR (PPP)	719	802	911	1019	1012	960	970	1010
GDP nominal, NC mn	72060	82793	98669	111190	92450	87000	89600	94100
Employed persons - LFS, th., average	1474	1499	1534	1520	1420	1380	1420	1450
GDP per employed person, NC	48891	55232	64313	73151	65106	63000	63100	64900
GDP per empl. person, NC at 2000 pr.	45144	47903	51409	53317	48514	48400	48000	48400
Unit labour costs, NC, 2000=100	95.3	105.2	118.2	137.4	144.5	132.3	133.4	137.9
Unit labour costs, ER adj., 2000=100	102.0	112.6	126.5	147.1	154.7	141.7	142.9	147.7
Unit labour costs, PPP adj., Austria=100	30.7	33.0	36.2	41.0	40.5	37.3	37.4	38.3
Croatia								
Producer price index, 2000=100	112.1	115.3	119.3	129.3	128.8	132.0	135.3	138.0
Consumer price index, 2000=100	114.6	118.2	121.6	129.1	132.2	135.5	138.8	141.6
GDP deflator, 2000=100	120.0	124.1	129.1	137.3	140.5	144.1	147.7	150.6
Exchange rate (ER), NC/EUR	7.4000	7.3228	7.3360	7.2232	7.3398	7.3	7.3	7.3
ER, nominal, 2000=100	96.9	95.9	96.1	94.6	96.1	95.6	95.6	95.6
Real ER (CPI-based), 2000=100	106.5	108.6	109.0	113.3	113.1	115.1	116.1	116.1
Real ER (PPI-based), 2000=100	107.8	107.1	108.1	112.0	114.0	116.1	117.1	117.4
PPP, NC/EUR	4.6745	4.7861	4.7223	4.9838	5.0274	5.09	5.14	5.15
Price level, EU27 = 100	63	65	64	69	68	70	70	71
Average monthly gross wages, NC	6248	6634	7047	7544	7700	7890	8210	8540
Average monthly gross wages, EUR (ER)	844	906	961	1044	1049	1080	1120	1170
Average monthly gross wages, EUR (PPP)	1337	1386	1492	1514	1532	1550	1600	1660
GDP nominal, NC mn	264368	286341	314223	342159	329300	334200	349400	365300
Employed persons - LFS, th., average	1573	1586	1615	1636	1600	1590	1590	1610
GDP per employed person, NC	168066	180543	194626	209169	205813	210200	219700	226900
GDP per empl. person, NC at 2000 pr.	140102	145485	150777	152385	146444	145900	148800	150600
Unit labour costs, NC, 2000=100	104.2	106.6	109.2	115.7	122.9	126.4	128.9	132.5
Unit labour costs, ER adj., 2000=100	107.5	111.1	113.6	122.3	127.8	132.1	134.8	138.6
Unit labour costs, PPP adj., Austria=100	54.9	55.1	55.2	57.8	56.7	58.9	59.8	61.0
Macedonia								
Producer price index, 2000=100	104.9	112.6	115.4	127.3	119.0	122.7	126.3	130.3
Consumer price index, 2000=100	108.8	112.3	114.8	124.4	123.4	127.1	130.9	134.8
GDP deflator, 2000=100	113.0	117.8	126.8	136.1	134.7	138.9	143.0	147.4
Exchange rate (ER), NC/EUR	61.30	61.19	61.18	61.27	61.32	61.2	61.2	61.2
ER, nominal, 2000=100	100.9	100.8	100.7	100.9	101.0	100.8	100.8	100.8
Real ER (CPI-based), 2000=100	97.1	98.2	98.2	102.4	100.5	102.4	103.9	104.9
Real ER (PPI-based), 2000=100	96.9	99.5	99.8	103.4	100.3	102.4	103.8	105.1
PPP, NC/EUR	21.95	21.93	22.51	23.86	23.27	23.7	24.0	24.3
Price level, EU27 = 100	36	36	37	39	38	39	39	40
Average monthly gross wages, NC [1)]	21330	23036	24136	26229	29900	30800	32700	35400
Average monthly gross wages, EUR (ER)	348	376	395	428	488	500	530	580
Average monthly gross wages, EUR (PPP)	972	1050	1072	1099	1285	1300	1360	1450
GDP nominal, NC mn	286619	310915	354322	398491	387000	399000	419000	445000
Employed persons - LFS, th., average	545.3	570.4	590.2	609.0	640	650	660	670
GDP per employed person, NC	525662	545079	600308	654321	604688	613800	634800	664200
GDP per empl. person, NC at 2000 pr.	465285	462558	473429	480906	448914	442000	444000	450500
Unit labour costs, NC, 2000=100	109.8	119.2	122.1	130.6	159.5	166.8	176.3	188.1
Unit labour costs, ER adj., 2000=100	108.7	118.3	121.1	129.4	157.9	165.5	175.0	186.7
Unit labour costs, PPP adj., Austria=100	36.6	38.7	38.8	40.3	46.2	48.7	51.1	54.2

1) From 2009 including allowances for food and transport (hence unit labour costs increase).

(Table A/2 ctd.)

(Table A/2 ctd.)

	2005	2006	2007	2008	2009	2010	2011	2012
					prelim.		forecast	
Albania								
Producer price index, 2000=100	116.9	117.8	121.9	129.8	127.2	125.9	128.4	133.6
Consumer price index, 2000=100	116.9	119.7	123.2	127.4	130.2	132.8	136.8	140.9
GDP deflator, 2000=100	117.1	120.3	125.0	131.1	134.9	140.4	146.9	155.4
Exchange rate (ER), NC/EUR	124.19	123.08	123.63	122.80	132.06	140	135	125
ER, nominal, 2000=100	93.7	92.8	93.2	92.6	99.6	105.6	101.8	94.3
Real ER (CPI-based), 2000=100	112.5	113.7	113.8	114.3	107.5	102.1	107.4	117.1
Real ER (PPI-based), 2000=100	116.3	113.0	113.9	114.9	108.7	100.3	104.4	115.2
PPP, NC/EUR	52.10	51.21	52.68	52.94	53.70	55.2	56.9	59.1
Price level, EU27 = 100	42	42	43	43	41	39	42	47
Average monthly gross wages, NC	19993	21842	27350	29000	31900	32500	34500	37700
Average monthly gross wages, EUR (ER)	161	177	221	236	242	230	260	300
Average monthly gross wages, EUR (PPP)	384	427	519	548	594	590	610	640
GDP nominal, NC bn	815	882	971	1100	1180	1240	1350	1500
Employed persons - LFS, th., June [2)]	932	934	1188	1103	1110	1050	1070	1120
GDP per employed person, NC	874565	944974	817319	997280	1063063	1181000	1261700	1339300
GDP per empl. person, NC at 2000 pr.	746563	785247	653935	760894	787838	841400	858800	861600
Unit labour costs, NC, 2000=100	98.3	102.1	153.6	139.9	148.7	141.8	147.5	160.7
Unit labour costs, ER adj., 2000=100	105.0	110.0	164.7	151.1	149.3	134.3	144.9	170.4
Unit labour costs, PPP adj., Austria=100	22.7	23.1	33.8	30.2	28.0	25.3	27.2	31.7
Bosnia and Herzegovina								
Producer price index, 2000=100	.	.	.	.	.	.	.	.
Consumer price index, 2000=100	109.7	116.5	118.3	127.2	126.7	126.7	127.9	129.2
GDP deflator, 2000=100	118.1	124.8	134.0	144.4	144.0	144.2	145.8	147.4
Exchange rate (ER), NC/EUR	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96
ER, nominal, 2000=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2000=100	98.9	102.7	101.9	105.6	104.2	102.9	102.3	101.3
Real ER (PPI-based), 2000=100	.	.	.	.	.	.	.	.
PPP, NC/EUR	0.8574	0.8752	0.8981	0.9232	0.9067	0.90	0.89	0.89
Price level, EU27 = 100	44	45	46	47	46	46	46	45
Average monthly gross wages, NC	796	869	954	1112	1200	1190	1200	1220
Average monthly gross wages, EUR (ER)	407	444	488	569	614	610	610	620
Average monthly gross wages, EUR (PPP)	929	992	1062	1205	1323	1330	1340	1380
GDP nominal, NC mn	16927.9	19121.1	21758.8	24716.6	23900	23700	24200	25200
Employed persons - LFS, th., April [3)]	641.5	811.0	849.6	890.2	859.2	820	820	820
GDP per employed person, NC	26386	23577	25611	27764	27816	28900	29500	30700
GDP per empl. person, NC at 2000 pr.	22344	18892	19110	19226	19322	20000	20200	20800
Unit labour costs, NC, 2000=100	121.6	156.8	170.3	197.4	211.9	203.0	202.7	200.1
Unit labour costs, ER adj., 2000=100	121.6	156.8	170.3	197.4	211.9	203.0	202.7	200.1
Unit labour costs, PPP adj., Austria=100	31.3	39.2	41.7	47.0	47.4	45.6	45.3	44.4
Montenegro								
Producer price index, 2001=100	118.0	122.2	132.6	151.2	145.1	151.5	158.1	162.7
Consumer price index, 2001=100	129.7	133.5	139.2	149.5	155.4	160.1	164.9	169.9
GDP deflator, 2001=100	123.3	134.5	151.6	163.3	167.1	174.4	182.0	187.4
Real ER (CPI-based), 2001=100	119.4	120.3	122.5	126.9	130.7	132.9	134.7	136.1
Real ER (PPI-based), 2001=100	111.2	110.1	116.9	125.4	125.0	128.9	132.4	133.9
PPP, NC/EUR	0.4197	0.4076	0.4284	0.4573	0.4611	0.48	0.49	0.49
Price level, EU27 = 100	42	41	43	46	46	48	49	49
Average monthly gross wages, NC	326	377	497	609	640	660	690	720
Average monthly gross wages, EUR (PPP)	778	926	1160	1332	1388	1390	1410	1460
GDP nominal, NC mn	1815.0	2149.0	2680.5	3085.6	3000	3100	3300	3500
Employed persons - LFS, th., average	178.8	178.4	217.4	218.8	215	215	220	220
GDP per employed person, NC	10150	12048	12330	14102	13953	14400	15000	15900
GDP per empl. person, NC at 2000 pr.	6846	7451	6765	7185	6946	6900	6900	7100
Unit labour costs, NC, 2000=100	146.2	155.3	225.3	259.9	282.5	293.3	306.6	311.0
Unit labour costs, PPP adj., Austria=100	31.9	32.9	46.8	52.5	53.6	55.9	58.1	58.5

2) Until 2006 registered employment data. - 3) Until 2005 registered employees.

(Table A/2 ctd.)

(Table A/2 ctd.)

	2005	2006	2007	2008	2009	2010	2011	2012
					prelim.		forecast	
Serbia								
Producer price index, 2000=100	266.1	301.5	319.3	358.9	379.0	405.1	422.8	435.3
Consumer price index, 2000=100	320.6	358.2	383.2	428.1	464.0	491.8	511.5	532.0
GDP deflator, 2000=100	341.8	381.2	425.4	476.1	509.5	544.6	568.4	585.2
Exchange rate (ER), NC/EUR	82.91	84.19	79.98	81.47	94.12	100	110	115
ER, nominal, 2000=100	157.8	160.2	152.2	155.0	179.1	190.3	209.3	218.8
Real ER (CPI-based), 2000=100	183.1	197.1	216.9	229.4	213.2	210.0	195.4	190.6
Real ER (PPI-based), 2000=100	157.2	167.6	182.8	189.8	180.1	179.1	167.2	161.8
PPP, NC/EUR	31.72	34.42	37.66	41.04	39.30	41.5	42.6	43.1
Price level, EU27 = 100	38	41	47	50	42	42	39	38
Average monthly gross wages, NC	25514	31745	38744	45674	44147	46800	49650	52670
Average monthly gross wages, EUR (ER)	308	377	484	561	469	470	450	460
Average monthly gross wages, EUR (PPP)	804	922	1029	1113	1123	1130	1160	1220
GDP nominal, NC bn	1688	1980	2363	2791	2900	3100	3300	3500
Employed persons - LFS, th., average	2733	2631	2656	2822	2616	2560	2560	2560
GDP per employed person, NC	617482	752744	889716	989076	1108378	1210900	1289100	1367200
GDP per empl. person, NC at 2000 pr.	180644	197487	209128	207728	217532	222300	226800	233600
Unit labour costs, NC, 2000=100	461.7	525.5	605.7	718.8	663.5	688.3	715.7	737.1
Unit labour costs, ER adj., 2000=100	292.7	328.0	397.9	463.7	370.4	361.7	341.9	336.8
Unit labour costs, PPP adj., Austria=100	30.5	33.3	39.5	44.8	33.6	33.0	31.0	30.3
Russia								
Producer price index, 2000=100	230.2	258.7	295.1	358.3	332.6	349.2	373.7	411.0
Consumer price index, 2000=100	200.1	219.7	239.7	273.5	305.8	324.1	348.4	376.3
GDP deflator, 2000=100	219.8	253.9	289.1	341.1	350.3	369.0	392.4	408.2
Exchange rate (ER), NC/EUR	35.264	34.112	35.014	36.425	44.140	45	46	46
ER, nominal, 2000=100	135.5	131.1	134.5	139.9	169.6	172.9	176.7	176.7
Real ER (CPI-based), 2000=100	133.1	147.8	153.5	162.4	148.4	152.3	157.6	166.9
Real ER (PPI-based), 2000=100	158.4	175.8	191.1	209.9	166.9	169.9	175.0	189.1
PPP, NC/EUR	15.061	16.990	18.798	22.091	22.349	23.3	24.4	24.9
Price level, EU27 = 100	43	50	54	61	51	52	53	54
Average monthly gross wages, NC	8555	10634	13593	17226	18785	20710	23380	26260
Average monthly gross wages, EUR (ER)	243	312	388	473	426	460	510	570
Average monthly gross wages, EUR (PPP)	568	626	723	780	841	890	960	1060
GDP nominal, NC bn	21625	26904	33111	41256	39016	42500	47000	51000
Employed persons - LFS, th., average	68169	68855	70571	70965	69400	69000	69000	68700
GDP per employed person, NC	317232	390727	469196	581357	562192	615900	681200	742400
GDP per empl. person, NC at 2000 pr.	144315	153871	162298	170436	160506	166900	173600	181900
Unit labour costs, NC, 2000=100	299.3	349.0	422.9	510.4	591.0	626.6	680.1	729.0
Unit labour costs, ER adj., 2000=100	221.0	266.3	314.4	364.7	348.5	362.4	384.8	412.5
Unit labour costs, PPP adj., Austria=100	27.2	31.9	36.8	41.6	37.3	39.0	41.2	43.8
Ukraine								
Producer price index, 2000=100	169.4	185.7	221.9	300.6	320.2	358.6	394.5	426.0
Consumer price index, 2000=100	147.0	160.4	180.9	226.5	262.5	265.6	292.2	315.6
GDP deflator, 2000=100	179.1	205.6	252.3	325.7	377.5	422.8	465.1	502.3
Exchange rate (ER), NC/EUR	6.389	6.335	6.918	7.708	10.868	11	10.5	10
ER, nominal, 2000=100	127.0	126.0	137.6	153.3	216.1	218.7	208.8	198.9
Real ER (CPI-based), 2000=100	104.2	112.2	113.2	122.8	100.0	98.7	111.9	124.4
Real ER (PPI-based), 2000=100	124.3	131.2	140.5	160.8	126.1	137.9	156.4	174.2
PPP, NC/EUR	1.9861	2.2266	2.6562	3.4150	3.8996	4.32	4.67	4.96
Price level, EU27 = 100	31	35	38	44	36	39	45	50
Average monthly gross wages, NC	806	1041	1351	1806	1906	1960	2240	2560
Average monthly gross wages, EUR (ER)	126	164	195	234	175	180	210	260
Average monthly gross wages, EUR (PPP)	406	468	509	529	489	450	480	520
GDP nominal, NC mn	441452	544153	720731	949864	952300	1098600	1262800	1445700
Employed persons - LFS, th., average	20680	20730	20905	20972	20100	20200	20300	20400
GDP per employed person, NC	21347	26249	34477	45291	47378	54400	62200	70900
GDP per empl. person, NC at 2000 pr.	11921	12769	13663	13905	12549	12900	13400	14100
Unit labour costs, NC, 2000=100	247.7	298.8	362.2	475.8	556.3	556.6	612.3	665.1
Unit labour costs, ER adj., 2000=100	195.0	237.2	263.3	310.4	257.4	254.4	293.3	334.4
Unit labour costs, PPP adj., Austria=100	27.7	32.8	35.6	40.9	31.9	31.6	36.2	41.0

(Table A/2 ctd.)

(Table A/2 ctd.)

	2005	2006	2007	2008	2009	2010	2011	2012
					prelim.		forecast	
Austria								
Producer price index, 2000=100	110.0	113.2	117.8	125.4	116.1	116.9	118.4	120.1
Consumer price index, 2000=100	110.7	112.4	114.9	118.5	119.1	120.7	122.5	124.6
GDP deflator, 2000=100	108.5	110.3	112.6	114.8	116.8	117.5	119.0	120.7
Real ER (CPI-based), 2000=100	99.8	99.1	98.9	98.5	98.0	98.0	97.9	97.6
Real ER (PPI-based), 2000=100	102.5	100.8	102.7	102.8	98.8	98.3	98.1	97.7
PPP, NC/EUR	1.0583	1.0515	1.0651	1.0917	1.1213	1.11	1.11	1.11
Price level, EU27 = 100	106	105	107	109	112	111	111	111
Average monthly gross wages, EUR	2639	2736	2822	2913	3007	3040	3100	3170
Average monthly gross wages, EUR (PPP)	2494	2602	2650	2669	2681	2732	2783	2858
GDP nominal, NC mn	243585	256162	270782	281867	277075	282900	291100	301000
Employed persons - LFS, th., average	3824	3928	4028	4090	4078	4070	4080	4100
GDP per employed person, NC	63692	65209	67227	68916	67948	69500	71300	73400
GDP per empl. person, NC at 2000 pr.	58721	59146	59730	60028	58161	59100	59900	60800
Unit labour costs, NC, 2000=100	106.0	109.0	111.4	114.4	121.9	121.3	122.0	122.9
Unit labour costs, PPP adjusted	0.56	0.57	0.59	0.60	0.64	0.64	0.64	0.65

NC = national currency (including euro-fixed series for euro area countries – SK, SI, AT). ER = Exchange Rate, PPP = Purchasing Power Parity, Price level: PPP/ ER.

PPP rates have been taken from Eurostat based on the benchmark results 2005. For Albania, Bosnia and Herzegovina, Montenegro and Serbia available data 2005-2008 have been extrapolated by wiiw with GDP deflators. Russia and Ukraine are estimated by wiiw using the OECD PPP benchmark results 2005 and extrapolation with GDP price deflators.

Real exchange rates: Increasing values mean real appreciation.

Sources: wiiw Database incorporating national and Eurostat statistics; WIFO; Eurostat; Purchasing power parities, 2005 benchmark year, OECD November 2007; wiiw estimates and forecasts.

Table A/3

Indicators of macro-competitiveness, 2005-2012

annual changes in %

	2005	2006	2007	2008	2009 prelim.	2010	2011 forecast	2012	2005-09 average
Czech Republic									
GDP deflator	-0.4	1.1	3.4	1.9	0.6	1.5	2.0	2.4	1.3
Exchange rate (ER), EUR/NC	7.1	5.1	2.1	11.3	-5.6	1.7	2.0	2.0	3.8
Real ER (CPI-based)	6.5	5.0	2.6	14.1	-6.0	1.9	2.4	2.5	4.3
Real ER (PPI-based)	3.3	0.5	2.5	5.2	-3.4	2.0	2.4	2.6	1.6
Average gross wages, NC	5.3	6.5	7.3	8.5	2.6	2.7	4.0	5.4	6.0
Average gross wages, real (PPI based)	4.8	6.3	4.6	8.1	4.0	1.2	2.0	2.9	5.5
Average gross wages, real (CPI based)	3.6	4.3	4.2	2.1	1.9	1.2	2.0	2.9	3.2
Average gross wages, EUR (ER)	12.7	11.9	9.5	20.8	-3.2	4.0	6.3	7.9	10.1
Employed persons (LFS)	1.2	1.3	1.9	1.6	-1.4	-1.4	0.0	1.0	0.9
GDP per empl. person, NC at 2000 prices	5.1	5.4	4.1	0.8	-2.6	2.5	2.6	2.4	2.5
Unit labour costs, NC at 2000 prices	0.2	1.1	3.1	7.7	5.4	0.2	1.4	2.9	3.4
Unit labour costs, ER (EUR) adjusted	7.3	6.2	5.2	19.8	-0.6	1.9	3.4	5.0	7.4
Hungary									
GDP deflator	2.1	3.9	6.0	3.8	3.5	2.7	1.9	1.9	3.9
Exchange rate (ER), EUR/NC	1.5	-6.1	5.1	-0.1	-10.3	1.9	1.9	1.9	-2.1
Real ER (CPI-based)	2.8	-4.5	10.9	2.2	-7.6	4.5	3.8	3.2	0.6
Real ER (PPI-based)	0.5	-4.4	3.2	-1.6	-2.6	3.5	2.1	1.9	-1.0
Average gross wages, NC	8.8	8.2	8.0	7.5	-1.5	2.2	4.5	5.3	6.1
Average gross wages, real (PPI based)	5.5	1.5	7.7	2.8	-5.8	-0.5	2.6	3.4	2.2
Average gross wages, real (CPI based)	5.1	4.0	0.0	1.4	-5.3	-1.5	1.0	2.0	1.0
Average gross wages, EUR (ER)	10.4	1.6	13.5	7.5	-11.6	4.4	6.8	6.4	3.9
Employed persons (LFS)	0.0	0.7	-0.1	-1.2	-2.7	-0.1	1.1	1.0	-0.7
GDP per empl. person, NC at 2000 prices	3.5	3.2	1.0	1.9	-3.9	0.1	1.9	2.4	1.1
Unit labour costs, NC at 2000 prices	5.2	4.8	6.9	5.6	2.5	2.1	2.6	2.9	5.0
Unit labour costs, ER (EUR) adjusted	6.7	-1.6	12.4	5.5	-8.0	4.1	4.5	4.8	2.7
Poland									
GDP deflator	2.6	1.5	3.9	3.0	3.6	2.7	2.6	2.6	2.9
Exchange rate (ER), EUR/NC	12.5	3.3	3.0	7.7	-18.8	5.6	0.0	0.0	0.9
Real ER (CPI-based)	12.5	2.4	3.2	8.3	-16.4	6.9	0.9	0.5	1.5
Real ER (PPI-based)	8.6	0.4	2.8	3.8	-12.4	6.4	0.4	0.2	0.4
Average gross wages, NC	3.8	4.9	7.9	10.1	5.5	4.7	6.5	7.2	6.4
Average gross wages, real (PPI based)	3.3	3.0	5.8	7.5	1.5	2.7	4.4	5.1	4.2
Average gross wages, real (CPI based)	1.7	3.5	5.2	5.6	1.4	2.1	3.9	4.6	3.5
Average gross wages, EUR (ER)	16.8	8.3	11.1	18.6	-14.4	10.2	6.3	7.1	7.4
Employed persons (LFS)	2.3	3.4	4.4	3.7	0.0	-0.5	0.5	2.0	2.8
GDP per empl. person, NC at 2000 prices	1.3	2.7	2.3	1.3	1.6	3.0	2.5	1.4	1.8
Unit labour costs, NC at 2000 prices	2.5	2.1	5.5	8.7	3.8	1.7	3.9	5.7	4.5
Unit labour costs, ER (EUR) adjusted	15.4	5.4	8.6	17.1	-15.8	7.3	3.9	5.7	5.4
Slovakia									
GDP deflator	2.4	3.0	1.1	2.9	1.1	1.9	2.9	3.9	2.1
Exchange rate (ER), EUR/NC	3.7	3.7	10.2	8.0	3.8	0.0	0.0	0.0	5.8
Real ER (CPI-based)	4.3	5.8	9.7	8.3	3.7	0.2	0.4	0.0	6.3
Real ER (PPI-based)	3.0	2.0	6.4	4.2	0.6	-0.2	0.4	0.2	3.2
Average gross wages, NC	9.2	8.6	7.4	8.1	1.0	4.1	5.3	6.3	6.8
Average gross wages, real (PPI based)	5.6	5.5	8.9	5.5	8.1	3.1	3.2	4.2	6.7
Average gross wages, real (CPI based)	6.2	4.2	5.4	4.0	0.0	2.6	3.2	4.2	3.9
Average gross wages, EUR (ER)	13.2	12.6	18.4	16.8	4.8	4.1	5.3	6.3	13.0
Employed persons (LFS)	2.1	3.9	2.4	3.2	-3.0	-2.1	0.0	0.9	1.7
GDP per empl. person, NC at 2000 prices	4.5	4.4	8.0	2.9	-2.1	3.0	3.3	3.2	3.5
Unit labour costs, NC at 2000 prices	4.5	4.1	-0.6	5.1	3.1	1.1	1.9	2.9	3.2
Unit labour costs, ER (EUR) adjusted	8.3	7.9	9.6	13.5	7.0	1.1	1.9	2.9	9.2
Slovenia									
GDP deflator	1.6	2.0	4.3	3.8	0.8	1.5	2.0	2.0	2.5
Exchange rate (ER), EUR/NC	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1
Real ER (CPI-based)	0.0	0.3	1.3	1.8	-0.1	0.2	0.4	0.0	0.7
Real ER (PPI-based)	-2.4	-2.2	2.1	-2.3	2.4	-2.2	0.4	0.2	-0.5
Average gross wages, NC	3.6	4.8	5.9	8.3	3.1	2.4	4.1	4.6	5.1
Average gross wages, real (PPI based)	1.7	2.4	1.5	4.3	4.6	3.5	2.0	2.5	2.9
Average gross wages, real (CPI based)	1.1	2.2	2.1	2.6	2.2	0.9	2.0	2.5	2.1
Average gross wages, EUR (ER)	3.3	4.8	5.9	8.3	3.1	2.4	4.1	4.6	5.1
Employed persons (LFS)	0.7	1.3	2.5	1.1	-1.5	-1.5	0.0	1.0	0.8
GDP per empl. person, NC at 2000 prices	3.8	4.6	4.1	2.3	-6.6	2.5	2.0	1.6	1.6
Unit labour costs, NC at 2000 prices	-0.2	0.2	1.7	5.8	10.4	-0.1	2.0	3.0	3.5
Unit labour costs, ER (EUR) adjusted	-0.5	0.3	1.7	5.8	10.4	-0.1	2.0	3.0	3.5

(Table A/3 ctd.)

Table A/3 (ctd.)

	2005	2006	2007	2008	2009 prelim.	2010	2011 forecast	2012	2005-09 average
Bulgaria									
GDP deflator	3.7	8.5	7.9	11.3	4.5	2.0	2.8	2.7	7.2
Exchange rate (ER), EUR/NC	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	3.7	5.1	5.1	8.0	1.5	0.7	1.4	1.0	4.6
Real ER (PPI-based)	3.5	7.0	5.3	4.4	-2.9	0.8	1.2	0.9	3.4
Average gross wages, NC	10.7	11.3	19.7	21.6	11.6	2.5	6.7	6.3	14.9
Average gross wages, real (PPI based)	2.6	-0.6	11.1	9.7	19.3	0.6	3.7	3.5	8.2
Average gross wages, real (CPI based)	4.4	3.6	11.3	8.7	8.9	0.5	3.6	3.2	7.3
Average gross wages, EUR (ER)	10.6	11.3	19.7	21.6	11.6	3.6	6.5	6.1	14.9
Employed persons (LFS)	2.0	4.3	4.6	3.3	-3.3	-4.6	1.6	1.0	2.1
GDP per empl. person, NC at 2000 prices	4.2	1.9	1.5	2.6	-1.9	5.0	1.6	2.3	1.7
Unit labour costs, NC at 2000 prices	6.2	9.2	18.0	18.5	13.7	-2.3	5.0	3.8	13.0
Unit labour costs, ER (EUR) adjusted	6.1	9.2	18.0	18.5	13.7	-2.3	5.0	3.8	13.0
Romania									
GDP deflator	12.2	10.6	13.5	15.2	5.0	5.0	4.0	5.0	11.2
Exchange rate (ER), EUR/NC	11.9	2.7	5.7	-9.4	-13.1	0.9	2.4	2.5	-0.9
Real ER (CPI-based)	19.4	7.1	8.3	-5.7	-9.2	3.6	3.9	4.5	3.5
Real ER (PPI-based)	16.2	7.4	11.2	-1.7	-8.2	4.7	4.9	5.7	4.6
Average gross wages, NC	18.3	18.4	21.8	24.8	9.1	3.2	4.1	5.9	18.3
Average gross wages, real (PPI based)	9.4	8.1	13.3	8.2	7.1	-1.8	0.1	0.8	9.2
Average gross wages, real (CPI based)	8.4	11.1	16.1	15.6	3.3	-0.8	1.1	1.8	10.8
Average gross wages, EUR (ER)	32.3	21.6	28.8	13.0	-5.3	4.9	6.4	8.0	17.3
Employed persons (LFS)	-0.5	1.9	0.7	0.2	-1.3	-1.1	0.0	0.5	0.2
GDP per empl. person, NC at 2000 prices	4.6	5.8	5.6	7.2	-6.0	1.5	3.0	2.9	3.3
Unit labour costs, NC at 2000 prices	13.0	11.9	15.3	16.4	16.0	1.7	1.1	2.9	14.5
Unit labour costs, ER (EUR) adjusted	26.5	14.9	21.9	5.5	0.8	2.6	3.5	5.5	13.5
Estonia									
GDP deflator	5.5	7.6	10.2	6.7	0.2	-3.0	-1.0	2.0	6.0
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	1.9	2.2	4.3	6.7	-0.8	-4.2	-2.6	0.0	2.8
Real ER (PPI-based)	-2.2	-0.5	5.8	1.7	4.6	-4.2	-2.6	0.2	1.8
Average gross wages, NC	10.8	16.5	20.5	13.9	-5.9	-12.8	-3.8	4.9	10.8
Average gross wages, real (PPI based)	8.9	11.9	11.4	5.4	-6.6	-10.0	-2.8	2.8	6.0
Average gross wages, real (CPI based)	6.4	11.6	12.9	3.0	-6.1	-10.1	-2.8	2.8	5.3
Average gross wages, EUR (ER)	10.8	16.5	20.5	13.9	-5.9	-12.4	-4.4	4.6	10.8
Employed persons (LFS)	2.0	6.4	1.4	0.2	-9.4	-0.8	1.7	1.7	0.0
GDP per empl. person, NC at 2000 prices	7.3	3.3	5.7	-3.8	-5.1	-0.7	0.3	2.3	1.4
Unit labour costs, NC at 2000 prices	3.3	12.8	14.0	18.3	-0.8	-12.1	-4.1	2.5	9.3
Unit labour costs, ER (EUR) adjusted	3.3	12.8	14.0	18.3	-0.8	-12.1	-4.1	2.5	9.3
Latvia									
GDP deflator	10.1	10.0	20.2	15.4	3.2	-5.3	-2.6	-0.3	11.6
Exchange rate (ER), EUR/NC	-4.5	0.0	-0.6	-0.4	-0.4	0.4	0.0	0.0	-1.2
Real ER (CPI-based)	0.0	4.3	6.9	10.8	1.8	-5.8	-4.5	-2.0	4.7
Real ER (PPI-based)	-0.9	5.3	13.0	4.4	-1.3	-6.0	-4.1	-2.1	4.0
Average gross wages, NC	16.5	23.0	31.5	20.5	-5.0	-12.1	-5.0	0.0	16.6
Average gross wages, real (PPI based)	7.9	11.6	13.2	8.1	-0.4	-7.2	-2.5	0.3	8.0
Average gross wages, real (CPI based)	9.0	15.5	19.5	4.5	-8.0	-7.5	-2.1	0.0	7.6
Average gross wages, EUR (ER)	11.3	23.0	30.8	20.0	-5.4	-11.6	-5.3	0.0	15.2
Employed persons (LFS)	1.6	5.2	2.8	0.6	-12.9	-8.2	0.0	3.3	-0.8
GDP per empl. person, NC at 2000 prices	9.0	6.6	7.0	-5.1	-7.0	3.6	1.4	-1.4	1.9
Unit labour costs, NC at 2000 prices	6.9	15.4	22.9	27.0	2.2	-15.1	-6.3	1.4	14.5
Unit labour costs, ER (EUR) adjusted	2.2	15.4	22.2	26.5	1.8	-14.7	-6.3	1.4	13.1
Lithuania									
GDP deflator	6.7	6.5	8.5	9.7	-2.2	-3.0	1.0	2.0	5.7
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Real ER (CPI-based)	0.5	1.6	3.4	7.2	3.2	-4.2	-0.6	0.0	3.1
Real ER (PPI-based)	7.3	2.5	4.7	11.2	-10.2	-4.1	-0.6	0.2	2.8
Average gross wages, NC	11.0	17.2	20.5	20.6	-4.3	-8.7	0.0	4.2	12.6
Average gross wages, real (PPI based)	-0.5	9.2	12.6	2.1	10.6	-5.8	-1.0	2.2	6.7
Average gross wages, real (CPI based)	8.2	12.9	13.9	8.6	-8.1	-5.8	-1.0	2.2	6.8
Average gross wages, EUR (ER)	11.0	17.2	20.5	20.6	-4.3	-8.7	0.0	3.6	12.6
Employed persons (LFS)	2.6	1.7	2.3	-0.9	-6.6	-2.8	2.9	2.1	-0.2
GDP per empl. person, NC at 2000 prices	5.0	6.1	7.3	3.7	-9.0	-0.2	-0.8	0.8	2.4
Unit labour costs, NC at 2000 prices	5.8	10.4	12.3	16.3	5.1	-8.4	0.8	3.3	9.9
Unit labour costs, ER (EUR) adjusted	5.8	10.4	12.3	16.3	5.1	-8.4	0.8	3.3	9.9

(Table A/3 ctd.)

Table A/3 (ctd.)

	2005	2006	2007	2008	2009 prelim.	2010	2011 forecast	2012	2005-09 average
Croatia									
GDP deflator	3.3	3.4	4.0	6.3	2.4	2.5	2.5	2.0	3.9
Exchange rate (ER), EUR/NC	1.3	1.1	-0.2	1.6	-1.6	0.5	0.0	0.0	0.4
Real ER (CPI-based)	2.4	2.0	0.3	4.0	-0.2	1.7	0.9	0.0	1.7
Real ER (PPI-based)	0.2	-0.7	1.0	3.6	1.8	1.9	0.9	0.2	1.2
Average gross wages, NC	4.4	6.2	6.2	7.1	2.1	2.5	4.1	4.0	5.2
Average gross wages, real (PPI based)	1.4	3.2	2.7	-1.2	2.5	0.0	1.5	2.0	1.7
Average gross wages, real (CPI based)	1.0	2.9	3.2	0.9	-0.3	0.0	1.5	2.0	1.5
Average gross wages, EUR (ER)	5.7	7.3	6.0	8.7	0.4	2.9	3.7	4.5	5.6
Employed persons (LFS)	0.7	0.8	1.8	1.3	-2.2	-0.6	0.0	1.3	0.5
GDP per empl. person, NC at 2000 prices	3.5	3.8	3.6	1.1	-3.9	-0.4	2.0	1.2	1.6
Unit labour costs, NC at 2000 prices	0.9	2.2	2.5	5.9	6.2	2.8	2.0	2.8	3.5
Unit labour costs, ER (EUR) adjusted	2.2	3.3	2.3	7.6	4.5	3.4	2.0	2.8	4.0
Macedonia									
GDP deflator	3.8	4.3	7.6	7.3	-1.0	3.1	3.0	3.1	4.4
Exchange rate (ER), EUR/NC	0.1	0.2	0.0	-0.1	-0.1	0.2	0.0	0.0	0.0
Real ER (CPI-based)	-1.6	1.2	-0.1	4.3	-1.8	1.9	1.4	1.0	0.4
Real ER (PPI-based)	-0.8	2.7	0.3	3.6	-3.0	2.1	1.3	1.3	0.5
Average gross wages, NC [1]	2.7	8.0	4.8	8.7	9.0	3.0	6.2	8.3	6.6
Average gross wages, real (PPI based)	-0.5	0.7	2.2	-1.5	16.6	-0.1	3.1	5.0	3.3
Average gross wages, real (CPI based)	2.2	4.6	2.4	0.3	9.9	0.0	3.1	5.1	3.8
Average gross wages, EUR (ER)	2.8	8.2	4.8	8.5	9.1	2.5	6.0	9.4	6.6
Employed persons (LFS)	4.3	4.6	3.5	3.2	5.1	1.6	1.5	1.5	4.1
GDP per empl. person, NC at 2000 prices	-0.2	-0.6	2.4	1.6	-6.7	-1.5	0.5	1.5	-0.7
Unit labour costs, NC at 2000 prices	2.8	8.6	2.4	7.0	16.8	4.6	5.7	6.7	7.4
Unit labour costs, ER (EUR) adjusted	2.9	8.8	2.4	6.8	16.7	4.8	5.7	6.7	7.4
Albania									
GDP deflator	2.7	2.7	3.9	4.9	3.0	4.0	4.7	5.8	3.4
Exchange rate (ER), EUR/NC	2.8	0.9	-0.4	0.7	-7.0	-5.7	3.7	8.0	-0.7
Real ER (CPI-based)	3.0	1.1	0.1	0.4	-5.9	-5.0	5.1	9.1	-0.3
Real ER (PPI-based)	3.6	-2.9	0.8	0.9	-5.4	-7.7	4.1	10.3	-0.6
Average gross wages, NC [1]	5.0	9.2	25.2	6.0	10.0	1.9	6.2	9.3	10.9
Average gross wages, real (PPI based)	0.1	8.4	21.0	-0.4	12.2	2.9	4.1	5.1	8.0
Average gross wages, real (CPI based)	2.6	6.7	21.6	2.6	7.6	-0.1	3.1	6.1	8.0
Average gross wages, EUR (ER)	8.0	10.2	24.7	6.7	2.3	-4.8	13.0	15.4	10.1
Employed persons (LFS) [2]	0.3	0.2	1.8	-7.2	0.6	-5.4	1.9	4.7	-0.9
GDP per empl. person, NC at 2000 prices	5.4	5.2	4.1	16.4	3.5	6.8	2.1	0.3	6.8
Unit labour costs, NC at 2000 prices	-0.3	3.9	20.2	-8.9	6.2	-4.6	4.0	8.9	3.8
Unit labour costs, ER (EUR) adjusted	2.5	4.8	19.7	-8.3	-1.2	-10.0	7.9	17.6	3.1
Bosnia and Herzegovina									
GDP deflator	3.2	5.7	7.4	7.8	-0.3	0.2	1.1	1.1	4.7
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	0.8	3.9	-0.8	3.7	-1.4	-1.3	-0.6	-1.0	1.2
Real ER (PPI-based)	.	.	.	.	.	.	.	.	.
Average gross wages, NC	6.5	9.1	9.8	16.6	7.9	-0.8	0.8	1.7	9.9
Average gross wages, real (PPI based)	.	.	.	.	.	.	.	.	.
Average gross wages, real (CPI based)	3.4	2.7	8.2	8.5	8.3	-0.8	-0.2	0.7	6.2
Average gross wages, EUR (ER)	6.5	9.1	9.8	16.6	7.9	-0.8	0.8	1.7	9.9
Employed persons (LFS) [3]	0.5	1.1	4.8	4.8	-3.5	-4.6	0.0	0.0	1.5
GDP per empl. person, NC at 2000 prices	3.4	5.7	1.2	0.6	0.5	3.5	1.0	3.0	2.3
Unit labour costs, NC at 2000 prices	3.0	3.2	8.6	15.9	7.3	-4.2	-0.2	-1.3	7.5
Unit labour costs, ER (EUR) adjusted	3.0	3.2	8.6	15.9	7.3	-4.2	-0.2	-1.3	7.5
Montenegro									
GDP deflator	4.3	9.1	12.7	7.7	2.3	4.4	4.4	3.0	7.2
Real ER (CPI-based)	0.1	0.8	1.8	3.6	3.0	1.7	1.4	1.0	1.9
Real ER (PPI-based)	-1.9	-1.0	6.2	7.3	-0.3	3.1	2.7	1.1	2.0
Average gross wages, NC	7.8	15.6	31.7	22.5	5.1	3.1	4.5	4.3	16.1
Average gross wages, real (PPI based)	5.6	11.6	21.4	7.5	9.5	-1.2	0.2	1.3	11.0
Average gross wages, real (CPI based)	5.4	12.2	26.4	14.1	1.0	0.1	1.5	1.3	11.5
Employed persons (LFS)	-4.5	-0.3	21.9	0.6	-1.7	0.0	2.3	0.0	2.8
GDP per empl. person, NC	13.9	18.7	2.3	14.4	-1.1	3.2	4.2	6.0	9.4
GDP per empl. person, NC at 2000 prices	9.1	8.8	-9.2	6.2	-3.3	-0.7	0.0	2.9	2.1
Unit labour costs, NC at 2000 prices	-1.2	6.2	45.1	15.4	8.7	3.8	4.5	1.4	13.8
Unit labour costs, ER (EUR) adjusted	-1.2	6.2	45.1	15.4	8.7	3.8	4.5	1.4	13.8

1) In 2009 wiiw estimate (including allowances for food and transport). - 2) Until 2007 registered employment data. - 3) Until 2006 registered employees.

(Table A/3 ctd.)

Table A/3 (ctd.)

	2005	2006	2007	2008	2009 prelim.	2010	2011 forecast	2012	2005-09 average
Serbia									
GDP deflator	15.5	11.5	11.6	11.9	7.0	6.9	4.4	3.0	11.5
Exchange rate (ER), NC/EUR	-12.5	-1.5	5.3	-1.8	-13.4	-5.9	-9.1	-4.3	-5.1
Real ER (CPI-based)	-0.4	7.6	10.0	5.8	-7.1	-1.5	-6.9	-2.5	3.0
Real ER (PPI-based)	-4.0	6.6	9.1	3.8	-5.1	-0.6	-6.6	-3.3	1.9
Average gross wages, NC	24.1	24.4	22.0	17.9	-3.3	6.0	6.1	6.1	16.5
Average gross wages, real (PPI based)	8.7	9.8	15.2	4.9	-8.5	-0.8	1.7	3.0	5.7
Average gross wages, real (CPI based)	6.8	11.4	14.1	5.5	-10.8	0.0	2.0	2.0	5.0
Average gross wages, EUR (ER)	8.6	22.5	28.5	15.7	-16.3	0.2	-4.3	2.2	10.6
Employed persons (LFS)	-6.7	-3.8	1.0	6.3	-7.3	-2.2	0.0	0.0	-2.2
GDP per empl. person, NC at 2000 prices	13.2	9.3	5.9	-0.7	4.7	2.2	2.0	3.0	6.4
Unit labour costs, NC at 2000 prices	9.6	13.8	15.3	18.7	-7.7	3.7	4.0	3.0	9.5
Unit labour costs, ER (EUR) adjusted	-4.1	12.1	21.3	16.5	-20.1	-2.4	-5.5	-1.5	4.0
Russia									
GDP deflator	19.2	15.5	13.8	18.0	2.7	5.3	6.3	4.0	13.7
Exchange rate (ER), NC/EUR	1.6	3.4	-2.6	-3.9	-17.5	-1.9	-2.2	0.0	-4.1
Real ER (CPI-based)	11.8	11.1	3.8	5.8	-8.6	2.6	3.5	5.9	4.5
Real ER (PPI-based)	17.8	11.0	8.7	9.8	-20.5	1.8	3.0	8.1	4.4
Average gross wages, NC	26.9	24.3	27.8	26.7	9.0	10.2	12.9	12.3	22.8
Average gross wages, real (PPI based)	5.2	10.6	12.1	4.4	17.5	5.0	5.5	2.1	9.8
Average gross wages, real (CPI based)	12.8	13.2	17.2	11.1	-2.5	4.0	5.0	4.0	10.1
Average gross wages, EUR (ER)	28.9	28.5	24.5	21.8	-10.0	8.1	10.9	11.8	17.7
Employed persons (LFS)	1.3	1.0	2.5	0.6	-2.2	-0.6	0.0	-0.4	0.6
GDP per empl. person, NC at 2000 prices	5.0	6.6	5.5	5.0	-5.8	4.0	4.0	4.8	3.2
Unit labour costs, NC at 2000 prices	20.9	16.6	21.2	20.7	15.8	6.0	8.5	7.2	19.0
Unit labour costs, ER (EUR) adjusted	22.8	20.5	18.1	16.0	-4.4	4.0	6.2	7.2	14.1
Ukraine									
GDP deflator	24.6	14.8	22.8	29.1	15.9	12.0	10.0	8.0	21.3
Exchange rate (ER), NC/EUR	3.5	0.8	-8.4	-10.3	-29.1	-1.2	4.8	5.0	-9.5
Real ER (CPI-based)	14.9	7.7	0.9	8.4	-18.6	-1.3	13.4	11.2	2.0
Real ER (PPI-based)	16.0	5.6	7.1	14.4	-21.6	9.3	13.4	11.4	3.3
Average gross wages, NC	36.7	29.2	29.7	33.7	5.5	2.8	14.3	14.3	26.4
Average gross wages, real (PPI based)	17.2	17.9	8.6	-1.3	-0.9	-8.2	3.9	5.8	7.9
Average gross wages, real (CPI based)	20.5	18.4	15.0	6.8	-8.9	1.6	3.9	5.8	9.8
Average gross wages, EUR (ER)	41.4	30.3	18.8	20.0	-25.1	2.6	16.7	23.8	14.5
Employed persons (LFS)	1.9	0.2	0.8	0.3	-4.2	0.5	0.5	0.5	-0.2
GDP per empl. person, NC at 2000 prices	0.8	7.1	7.0	1.8	-9.7	2.8	3.9	5.2	1.2
Unit labour costs, NC at 2000 prices	35.7	20.6	21.2	31.4	16.9	0.0	10.0	8.6	25.0
Unit labour costs, ER (EUR) adjusted	40.3	21.6	11.0	17.9	-17.1	-1.2	15.3	14.0	13.1
Austria									
GDP deflator	2.1	1.6	2.1	2.0	1.8	0.6	1.3	1.4	1.9
Real ER (CPI-based)	0.1	-0.7	-0.2	-0.4	-0.5	0.0	-0.1	-0.3	-0.3
Real ER (PPI-based)	-1.9	-1.7	1.9	0.1	-3.8	-0.5	-0.3	-0.4	-1.1
Average gross wages, NC	2.3	3.6	3.2	3.2	3.2	1.1	2.0	2.3	3.1
Average gross wages, real (PPI based)	0.2	0.7	-0.9	-3.0	11.4	0.4	0.7	0.8	1.6
Average gross wages, real (CPI based)	0.0	2.1	0.9	0.0	2.7	-0.2	0.5	0.5	1.2
Employed persons (LFS)	2.1	2.7	2.5	1.5	-0.3	-0.2	0.2	0.5	1.7
GDP per empl. person, NC at 2000 prices	0.3	0.7	1.0	0.5	-3.1	1.6	1.4	1.5	-0.1
Unit labour costs, NC at 2000 prices	2.0	2.9	2.2	2.7	6.5	-0.5	0.6	0.7	3.3
Unit labour costs, ER (EUR) adjusted	2.0	2.9	2.2	2.7	6.5	-0.5	0.6	0.7	3.3

NC = national currency (including euro-fixed series for euro area countries – SK, SI, AT). ER = Exchange Rate, PPI = Producer price index, CPI = Consumer price index. Positive growth of real exchange rates means real appreciation.

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