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special issue on economic prospects for Central, East and Southeast Europe

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Private Consumption and Flourishing Exports Keep the Region on High Growth Track

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Summary

Fast economic growth – in excess of 5% per year – continues in most New EU Member States (NMS). Growth in Bulgaria and Romania (which joined the EU on 1 January 2007) was also accelerating throughout 2006. Everywhere, except Hungary, GDP growth has been driven predominantly by domestic demand. External trade, which significantly boosted GDP growth in a number of NMS in 2005, has been losing significance and continues to be a drag on growth in Bulgaria and Romania. wiiw growth forecasts of the GDP in individual NMS in 2007 and 2008 are looking very good. It is expected that household consumption will continue to rise strongly. Rising employment and wages (strengthening under the impact of emerging labour shortages) will be supportive. Rising remittances of migrant workers would be adding to fast rising consumer spending. Gross fixed capital investment is expected to remain strong in most NMS. With the exception of Hungary, fiscal policies will not interfere with real growth. The slight deceleration of growth in the EU-15 expected in 2007 is not likely to restrict the growth of both NMS exports and their overall GDP too much as further gains on industrial unit labour costs are expected. Given the ongoing structural changes and quality improvements in production and exports, the NMS should continue to gain market shares even despite further currency appreciation. However, growth in imports responding to growing domestic demand will be reducing the contribution of trade to GDP growth. This contribution is likely to be negative in the 'old' NMS, but small. In Bulgaria and Romania, the contributions of external trade to growth will be negative and large. Unlike the 'old' NMS, these two countries will be running very high current account deficits and rely on rising private foreign debt in order to finance consumption and investments.

The risk of making big errors in growth forecasts for the 'old' NMS is fairly low. Their fundamentals are nowadays much sounder than in the past (Hungary being temporarily an exception). The rates of inflation are quite low and firmly under control. Interest rate differentials vs. the major international currencies are also low, falling, or even negative. Incentives for potentially destabilizing speculative capital inflows (and outflows) are therefore weak. Nominal currency appreciation is likely to continue, signifying the NMS' economic strength rather than potential weakness. The estimates of GDP growth rates for Bulgaria and Romania may be less certain. Both countries are growing turbulently. But, as in the Baltic countries, their growth is to a large extent induced by booming household consumption which is credit-driven and fed by excessive imports. Yet the experience of the Baltic countries indicates that such a type of growth can go on for a very long time. However, there are many examples of such debt-financed expansions coming to a rather sticky end. Thus, it might come as no surprise were the rising debt burden to put a lid on further expansion in Bulgaria and Romania.

The Balkan economies continue to grow despite political risks and external shocks. Consumption is the main source of growth, with investments also increasingly contributing. High exports are accompanied by high imports and external balances remain strongly negative. Price and exchange rate stability, however, remain manageable because of strong growth of productivity and downward pressure on wages from excess supply of labour. The expectation of sustained growth is supporting growth of foreign investments in privatized assets but also increasingly in green-field projects. Fast rising prices of assets and declining interest rates due to strong credit expansion are proving worrisome for the central banks, which fear asset bubbles and weaknesses in the banking sector. These challenges are met with a tightening of monetary policy, which has led to some moderation of growth rates. Overall prospects are positive for growth and stability in the short and medium run.

The main risks to positive expectations emanate from remaining political problems and from doubts about the process of EU integration and accession. The major political risk is connected with the upcoming decision on the Kosovo status. If that risk is managed well and if other political problems are addressed that will make it possible for all the countries in the region to either sign association agreements with the EU or continue or start negotiations on membership in the EU, rather positive economic news should be coming out steadily from the Balkans. That would also help the region to address the serious social risks, especially those connected with high or very high unemployment.

Overall, prospects for growth are good in the short and medium run and prospects for stability are risky in the short run and good in the medium run. The region as a whole should be included in the EU by 2015, except perhaps for Kosovo and Turkey.

Russian economic growth was once more over 6% in 2006, the cumulated GDP has increased by more than 40% since 2000. GDP growth is driven by the surging private consumption, recently also by investments. Owing to sluggish exports and booming imports, the contribution of real net exports to GDP growth has been negative already since 2003. The economic outlook remains positive with both consumption and investments (including FDI) growing rapidly. However, wiiw expects growth to settle between 5% and 6% in the coming years. With more oil and gas money as well as power consolidation at home, Russia's self-confidence will grow further.

In Ukraine, GDP growth accelerated markedly in 2006; macroeconomic imbalances were largely avoided and the 'gas price shock' reasonably well digested. Foreign debt increased by some 25%, reaching 47% of GDP by the end of the year – mainly caused by the banking sector's rapidly growing external borrowing, possibly associated with the growing presence of foreign banks. Inflation apart, the country's short-term economic outlook is good. In 2007-2008 we expect economic growth close to 6%. Despite the persistent stand-off between the president and the prime minister, the country is now living through a period of its greatest political stability since the 'orange revolution'.

In China, GDP grew by 10.7%, driven by investment and an exploding trade surplus but supported by private consumption as well. For 2007-08, prospects remain good but a slight deceleration of growth may occur, due to a certain slowing down of investment and measures to contain the trade surplus.

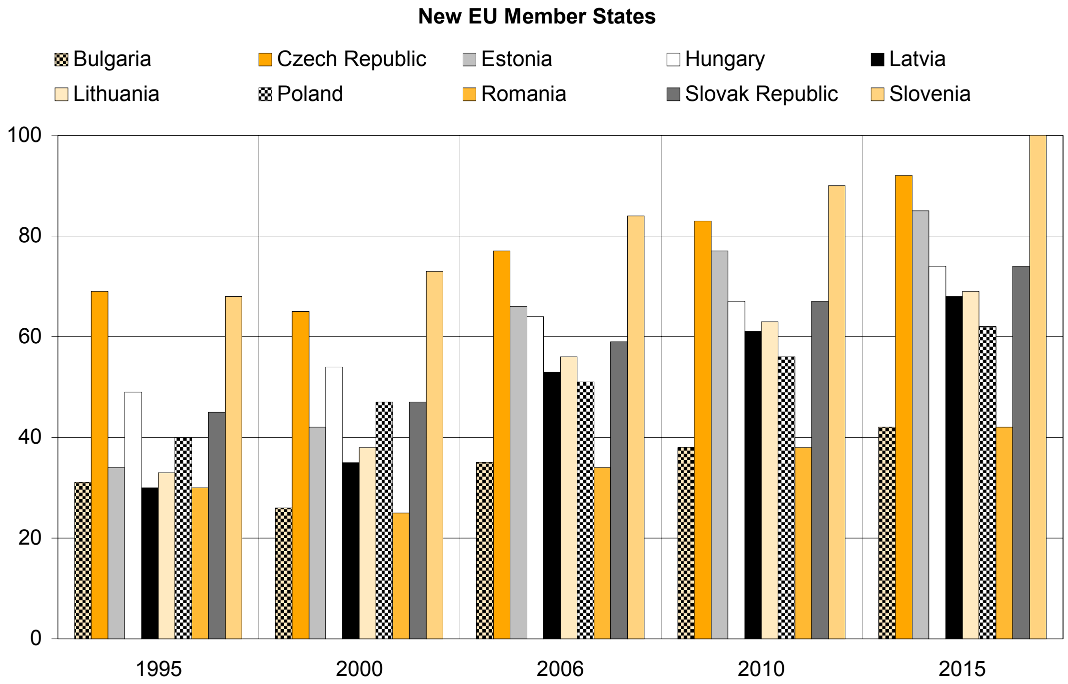
Keywords: *Central and East European new EU member states, Southeast Europe, Balkans, former Soviet Union, China, Turkey, GDP, industry, productivity, labour market, foreign trade, exchange rates, inflation, fiscal deficits, EU integration*

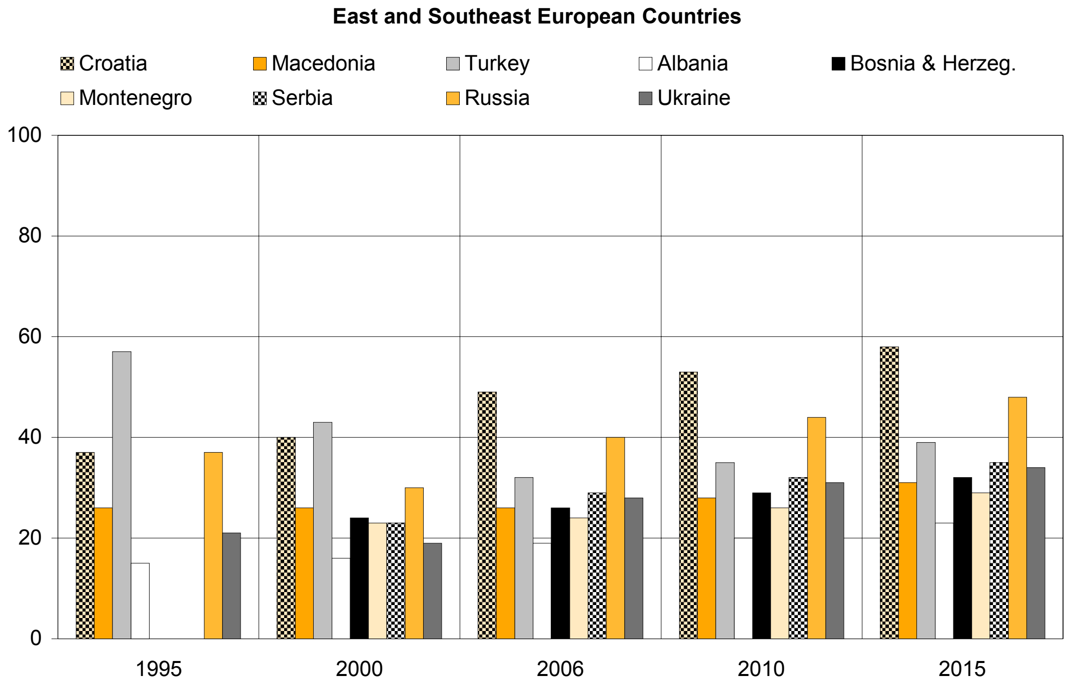
JEL classification: *O52, O57, P24, P27, P33, P52*

Figure I

Real per capita GDP in transition countries

European Union (25) average = 100





Remark: Projection assuming a 3 percentage points growth differential with respect to the EU-15 after 2006

Source: National statistics, Eurostat, wiiw estimates.

Table I

Overview developments 2005-2006 and outlook 2007-2008

	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			
	2005	**2006**	**2007**	**2008**	**2005**	**2006**	**2007**	**2008**	**2005**	**2006**	**2007**	**2008**	**2005**	**2006**	**2007**	**2008**
			forecast				**forecast**				**forecast**				**forecast**	
Czech Republic	6.1	5.9	5	5	1.9	2.5	2.5	3	7.9	7.3	6.7	6.5	-2.1	-4.4	-4.4	-4.0
Hungary	4.2	4.0	2.7	3.1	3.6	3.9	6.3	3.5	7.2	7.5	7.9	7.8	-6.8	-6.2	-4.9	-4.1
Poland	3.5	5.8	5.3	5	2.1	1.0	1.8	2	17.8	15	14	13	-1.7	-1.9	-2.0	-2.0
Slovak Republic	6.0	7.5	7	7	2.7	4.5	3	2	16.2	13.5	12	11	-8.6	-7.3	-4.9	-5.1
Slovenia	4.0	5	4.5	4.4	2.5	2.5	2.6	2.3	6.6	6.3	6	6	-2.0	-2.6	-2.2	-1.5
NMS-5 2)3)	*4.4*	*5.6*	*4.9*	*4.8*	*2.4*	*2.1*	*2.8*	*2.5*	*14.1*	*12.1*	*11.5*	*10.8*	*-3.2*	*-3.6*	*-3.3*	*-3.1*
Bulgaria	5.5	6.2	6	5.5	5.0	7.3	5	5	10.1	9	8	7	-11.3	-15.8	-13.5	-13.3
Romania	4.1	7.5	6.5	6	9.0	6.6	6	6	7.1	7	7	7	-8.7	-10.7	-12.7	-11.0
Estonia	10.5	11.5	9.5	8.4	4.1	4.4	4.2	4.6	7.9	5.8	5	4.5	-10.5	-12.9	-10.5	-9.6
Latvia	10.2	11.7	8.9	8	6.7	6.8	5.8	5.4	8.7	6.7	6.2	6	-12.4	-15.8	-17.4	-16.6
Lithuania	7.5	7.4	7	6.5	2.7	3.8	4.6	3.3	8.3	5.8	5	5	-7.0	-8.8	-9.4	-9.1
NMS-10 2)3)	*4.7*	*6.2*	*5.4*	*5.2*	*3.6*	*3.2*	*3.5*	*3.2*	*11.9*	*10.3*	*9.8*	*9.3*	*-4.6*	*-5.5*	*-5.6*	*-5.2*
EU-15 3)	*1.5*	*2.6*	*2.2*	*2.3*	*2.1*	*2.2*	.	.	*7.9*	*7.5*	*7.2*	*6.9*	*-0.12*	*-0.67*	.	.
EU-25 2)3)	*1.8*	*2.9*	*2.5*	*2.6*	*2.1*	*2.2*	*2.2*	*1.9*	*8.8*	*8.0*	*7.6*	*7.3*	*-0.31*	*-0.87*	.	.
EU-27 2)3)	*1.8*	*3.0*	*2.6*	*2.6*	*2.3*	*2.3*	*2.3*	*2.0*	*8.7*	*8.0*	*7.6*	*7.3*	*-0.39*	*-0.99*	.	.
Croatia	4.3	4.5	4.4	4.4	3.3	3.2	3	2.9	12.7	11.5	11	10.5	-6.4	-8.9	-8.1	-7.3
Macedonia	3.8	3.5	4	4	0.5	3.2	3	3	37.3	36	35	35	-1.4	2.0	-1.9	-1.8
Turkey	7.4	5.0	5.5	6.5	8.2	9.6	7	5	10.3	9.8	9.5	9	-6.4	-8.9	-8.4	-7.6
Albania 4)	5.6	4.8	5	5.5	2.4	2.3	2	2	14.2	13.9	14	14	-7.4	-10.5	-8.5	-6.5
Bosnia and Herzegovina 4)5)	5.5	5.3	5.7	5.5	2.9	7.4	4	2	44.2	31.1	30	30	-21.8	-19.8	-17.5	-15.8
Montenegro	4.3	4.5	5	5	2.3	3.0	3	3	30.3	30	30	30	-9.1	-17.1	-15.0	-15.0
Serbia	6.2	5.8	5	5	16.2	11.6	10	10	20.8	22	23	24	-8.6	-9.8	-9.9	-9.5
Russia	6.4	6.7	5.4	5	12.5	9.8	8	7	7.2	7.2	7	6.5	10.9	9.8	6.5	5.2
Ukraine	2.6	7	6	5.5	13.5	9.1	10	8	7.2	6.6	6.5	6.4	3.1	0.0	-2.1	-2.7
China	10.4	10.7	10.5	10	1.8	1.5	1.8	1.6	.	.	.	.	7.2	7.6	7.9	7.5

Note: NMS: The New EU Member States

1) LFS - Labour Force Survey. - 2) wiiw estimate. - 3) Current account data include flows within the region. - 4) Unemployment rate by registration, end of period. - 5) From 2006 data based on first LFS April 2006.

Source: wiiw (February 2007); Eurostat; forecasts for EU-15 and the Baltic States: European Commission (Autumn 2006).

Table II **Central and East European new EU member states (NMS-10): an overview of economic fundamentals, 2006**

	Bulgaria	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Romania	Poland	Slovak Republic	Slovenia	*NMS-10* [1]	*EU-15*	*EU-27* [2]
GDP in EUR at exchange rates, EUR bn	24.54	113.62	13.01	90.44	15.64	23.66	93.49	269.03	43.84	29.71	*716.97*	*10771.58*	*11507.91*
GDP in EUR at PPP, EUR bn	65.42	192.92	21.71	159.06	29.89	46.49	182.56	480.67	78.42	41.52	*1298.65*	*10321.76*	*11644.12*
GDP in EUR at PPP, EU-25=100	0.6	1.7	0.2	1.4	0.3	0.4	1.8	4.2	0.7	0.4	*11.4*	*90.6*	*102.2*
GDP in EUR at PPP, per capita	8500	18790	16160	15790	13060	13700	8460	12600	14550	20670	*12709*	*26469*	*23603*
GDP in EUR at PPP per capita, EU-25=100	32	77	66	64	53	56	36	51	59	84	*52*	*108*	*96*
GDP at constant prices, 1990=100	109.5	129.9	155.2	138.7	115.7	110.4	119.3	157.3 [3]	137.7	149.7	*141.8*	*138.0*	*138.8*
GDP at constant prices, 2000=100	135.2	126.6	170.3	128.5	165.0	155.1	141.8	122.7	134.5	124.4	*130.1*	*111.0*	*112.8*
Industrial production real, 1990=100	85.5	119.8	110.3	216.6	70.6	69.3	82.2	185.6 [3]	133.6	111.0	*149.0*	.	*129.8*
Industrial production real, 2000=100	161.3	147.6	169.0	143.1	150.4	179.8	134.0	143.2	143.6	123.8	*143.9*	.	*110.8*
Population - thousands, average	7700	10266	1343	10067	2289	3393	21584	38140	5390	2009	*102180*	*389956*	*493322*
Employed persons - LFS, thousands, average	3100	4810	646	3932	1092	1502	9150	14600	2300	960	*42092*	*169814*	*212013*
Unemployment rate - LFS, in %	9.0	7.3	5.8	7.5	6.7	5.8	7.0	15.0	13.5	6.3	*10.3*	*7.5*	*8.0*
Public sector expenditures, EU-def., in % of GDP	38.1	43.6	32.3	49.9	39.5	34.0	38.2	43.5	36.5	48.0	*43.0*	*47.1*	*46.8*
Public sector revenues, EU-def., in % of GDP	41.7	40.1	34.8	43.4	38.5	33.0	36.8	39.8	33.1	46.4	*40.1*	*45.2*	*44.9*
Price level, EU-27=100 (PPP/exch. rate)	38	59	60	57	52	51	51	56	56	72	*55*	*104*	*99*
Compensation per employee [4], monthly, in EUR	317	970	853	1012	544	654	673	758	721	1664	*765*	*3217*	*2743*
Compensation per employee, monthly, EU-27=100	11.5	35.4	31.1	36.9	19.8	23.9	24.5	27.6	26.3	60.7	*27.9*	*117.3*	*100.0*
Exports of goods in % of GDP	48.8	66.5	58.7	64.0	30.3	47.7	27.7	34.8	76.4	57.2	*47.4* [5]	*27.9* [5]	*29.1* [5]
Imports of goods in % of GDP	70.4	65.0	74.4	63.9	53.8	60.7	40.2	35.9	81.0	60.9	*51.5* [5]	*28.3* [5]	*29.7* [5]
Exports of services in % of GDP	15.9	8.2	21.0	11.7	13.3	11.3	6.3	6.1	9.8	11.8	*8.5* [5]	*8.3* [5]	*8.4* [5]
Imports of services in % of GDP	13.5	7.7	14.4	10.6	9.6	8.2	6.0	5.4	8.7	8.9	*7.4* [5]	*7.6* [5]	*7.6* [5]
Current account in % of GDP	-15.8	-4.4	-12.9	-6.2	-15.8	-8.8	-10.7	-1.9	-7.3	-2.6	*-5.5* [5]	*-0.7* [5]	*-1.0* [5]
FDI stock per capita in EUR	1800	5500	9700	5800	2600	2400	1400	2300	3000	3000	*2900*	.	.

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

1) wiiw estimates. - 2) wiiw estimates, except: employed persons, budget and compensation per employee. - 3) 1989=100, which in the Polish case is the appropriate reference year. - 4) Gross wages plus indirect labour costs, whole economy, national account concept. - 5) NMS-10, EU-15 and EU-27 data include flows within the region.

Source: wiiw, AMECO, Eurostat.

Table III

Southeast Europe: an overview of economic fundamentals, 2006

	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	33.73	4.96	309.95	7.15	9.10	1.76	25.46	*716.97*	*10771.58*	*11507.91*
GDP in EUR at PPP, EUR bn	53.43	13.03	494.53	14.52	20.28	3.74	53.76	*1298.65*	*10321.76*	*11644.12*
GDP in EUR at PPP, EU-27=100	0.5	0.1	4.2	0.1	0.2	0.03	0.5	*11.4*	*90.6*	*102.2*
GDP in EUR at PPP, per capita	12030	6400	6780	4610	6460	5990	7230	*12709*	*26469*	*23603*
GDP in EUR at PPP per capita, EU-27=100	51	27	29	20	27	25	31	*52*	*108*	*96*
GDP at constant prices, 1990=100	112.5	101.0	184.2	154.3	457.2 [3]	.	.	*141.8*	*138.0*	*138.8*
GDP at constant prices, 2000=100	131.3	110.8	129.7	138.9	133.7	118.0	136.5	*130.1*	*111.0*	*112.8*
Industrial production real, 1990=100	85.0	55.0	205.1	54.5	.	.	.	*149.0*	*.*	*129.8*
Industrial production real, 2000=100	132.5	104.1	133.8	152.4	161.4	115.4	111.7	*143.9*	*.*	*110.8*
Population - thousands, average	4442	2038	72974	3150	3844	625	7440	*102180*	*389956*	*493322*
Employed persons - LFS, thousands, average	1548	570	22247	932 [4]	813 [5]	180	2700	*42095*	*169814*	*212013*
Unemployment rate - LFS, in %	11.5	36.0	9.8	13.9 [4]	31.0 [5]	30.0	22.0	*10.3*	*7.5*	*8.0*
Public sector expenditures, nat. def., in % of GDP	49.0	32.4 [7]	38.1 [6][7]	28.3 [7]	41.6 [7]	27.2 [7]	42.6 [7]	*43.0* [6]	*47.1* [6]	*46.8* [6]
Public sector revenues, nat. def., in % of GDP	44.9	32.7 [7]	37.0 [6][7]	24.8 [7]	44.2 [7]	25.4 [7]	41.2 [7]	*40.1* [6]	*45.2* [6]	*44.9* [6]
Price level, EU-27=100 (PPP/exch. rate)	63	38	63	49	45	47	47	*55*	*104*	*100*
Average gross monthly wages, EUR at exchange rate	903	375	676 [8]	227 [9]	447	377	378 [10]	*765* [8]	*3217* [8]	*2743* [8]
Average gross monthly wages, EUR at PPP	1430	986	1079 [8]	460 [9]	996	803	798 [10]	*1389* [8]	*3082* [8]	*2775* [8]
Exports of goods in % of GDP	24.9	38.3	23.5	8.7	29.7	30.1	19.6	*47.4* [11]	*27.9* [11]	*29.1* [11]
Imports of goods in % of GDP	50.1	57.9	34.5	32.9	73.6	69.4	39.9	*51.5* [11]	*28.3* [11]	*29.7* [11]
Exports of services in % of GDP	25.2	7.5	6.0	16.9	9.9	25.3	6.5	*8.5* [11]	*8.3* [11]	*8.4* [11]
Imports of services in % of GDP	8.9	9.1	3.0	18.5	4.4	11.4	6.6	*7.4* [11]	*7.6* [11]	*7.6* [11]
Current account in % of GDP	-8.9	2.0	-8.9	-10.5	-19.8	-17.1	-9.8	*-5.5* [11]	*-0.7* [11]	*-1.0* [11]
FDI stock per capita in EUR	4100	1000	.	600	800	1600	900	*2900*	*.*	*.*

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

1) wiiw estimates. - 2) wiiw estimates, except: employed persons, budget and compensation per employee. - 3) 1995=100. - 4) Employment and unemployment by registration, end of year. - 5) Figures based on the first LFS April 2006. - 6) EU definition: expenditures and revenues according to ESA'95, excessive deficit procedure. - 7) Year 2005; for Serbia year 2004. - 8) Gross wages plus indirect labour costs, whole economy, national account concept. - 9) Public sector. - 10) Including various allowances. - 11) NMS-10, EU-15 and EU-27 data include flows within the region.

Source: wiiw, AMECO, Eurostat.

Part A: The new EU member states

*Leon Podkaminer**

Strong domestic demand fuels growth and employment

Favourable external conditions likely to worsen in 2007

The world economy has been growing steadily for the past three years. The US GDP rose cumulatively by close to 11% during that period, and even that of Japan by 7.8%. For a long time, the eurozone was not part to the global boom. Unlike other OECD countries, the eurozone had long suffered from the effects of the slump in 2002. However, the more definite recovery which set in a year ago is expected to increase the GDP growth rate in the eurozone by some 2.6% in 2006 (over and above the cumulative 3.4% growth in 2004-2005), bringing the cumulative GDP growth to an unimpressive 6.1%.

The prospects for 2007 are generally considered less promising. The course that the United States is currently pursuing is fraught with uncertainty. This is reflected in the comparatively broad variance in GDP growth forecasts for 2007 (2.1-2.9%) recently published by major analytical institutions such as the OECD, The World Bank, the IMF and the European Commission. By way of contrast, opinion is much more unanimous on the GDP growth rate in the eurozone for 2007: the current forecasts range from 1.9 to 2.4%. The growth slowdown looming in the eurozone and (to a lesser degree) in the USA seems to have been precipitated by the monetary tightening that started first in the USA (as far back as mid-2004) and was then taken up in the eurozone in late 2005. Although policy interest rates are nominally higher in the United States, they are definitely higher in real terms when applied in the eurozone. This is due to the FED being much less averse to inflation. Moreover, whereas the US FED has responded to the signs of a slowdown in growth by keeping its interest rates unchanged (since mid-2006), the European Central Bank would not appear ready to rethink its position. Despite some pretty clear indications of an approaching growth slowdown and flagging inflation, the ECB continues to raise interest rates every two months. In due time, this policy is likely to bear particularly unwelcome repercussions for Germany. (German inflation is the second lowest in the eurozone.) Thus, the ECB interest rates are in effect higher (in real terms) in Germany than almost anywhere else. Moreover, the higher VAT rate (as of 1 January 2007) is likely to have a negative impact on German private consumption (which has been virtually stagnant for many years). All in all, the German economy, whose performance is of vital importance to both the EU as a whole and the new member states (NMS) (not only on account of Germany's 'arithmetical' weight, but primarily because of the role assumed by its foreign trade), is currently exposed to additional pressures. Weaker growth in Germany is likely to have a negative impact on growth throughout the EU – including the NMS. Of course, numerous domestic developments in the NMS (ongoing structural changes, quality improvements and low unit costs) should limit the latter's vulnerability. Nonetheless, in all probability the NMS GDP growth rates forecast for 2007 need to be rounded down, simply on account of the drop in performance in the eurozone.

In theory, current developments in the eurozone (as well as in the USA and Japan) should also incur some positive side-effects for the NMS. Higher interest rates in the euro area (and elsewhere) imply a lower interest rate spread for NMS currencies against the euro and other major international

* K. Laski, P. Havlik as well as the authors of the country reports provided valuable comments on this overview.

currencies. This, in turn, should reduce the inflows of capital that exploit interest rate differentials and so contribute to the appreciation of domestic currencies. In practice however, narrowing interest rate spreads have not prevented most NMS currencies from appreciating markedly. This situation may not change radically in the immediate future – especially as the NMS are expected to continue receiving major inflows of FDI and high transfers (for instance, from 'Brussels').

Energy prices on the world market that are expected to stabilize at fairly moderate levels will help to lower inflation and improve external balances in the NMS. At the same time, the NMS will benefit from the continuing robust growth expected in Russia, Ukraine and other CIS countries.

Bulgaria and Romania join the EU and Slovenia the euro club

On 1 January 2007, both Bulgaria and Romania were admitted into the European Union. The two countries are quite poor, even when compared to the least affluent of the earlier NMS (see Table II). They add but little (approx. 2.4%) to the entire GDP of EU-25, yet much more (6.3%) to the Union's total population. Both are well integrated into the EU. Their share of trade with the remaining EU is very high. Both have attracted large amounts of foreign direct investment from the 'old' EU. Moreover, the legions of migrant workers from both countries have already contributed to the prosperity of the 'old' EU (particularly, its southern flank). The long-term economic prospects of both countries look good. Aided by generous EU financing, both countries will continue to restructure. It is expected that in the course of time, they will gradually catch up with their more affluent EU counterparts. The medium-term prospects are, of course, less certain. The currently rapid growth in both countries is not without its problems. Expanding consumption is to a large extent supported by a credit boom. Not unlike the Baltic countries, this is coupled with truly massive current account deficits and snowballing private foreign debt. Part A of the wiiw Research Reports (on the economic prospects of Central, Eastern and South-east Europe), which now covers Bulgaria and Romania as well, will probably have every opportunity to report on developments more exciting than those recently observed in the 'older' New Member States.

1 January 2007 will also go down in history as the day Slovenia joined the euro club: the pinnacle of the remarkably steady and balanced path which the country has followed since declaring independence back in 1991. Of course, given that Slovenia already had a highly developed economy in 1991 and by now its development level is comparable to that of Greece, this success does not really come as a surprise. Nonetheless, it is interesting to note that unlike many other NMS, Slovenia has been less 'reform-oriented'. Privatization in Slovenia has been less radical and more gradual than elsewhere. The policy it pursued included such distinctive features as foreign direct investment being less welcome, tax systems less innovative and real appreciation of currency barely tolerated. Of course, with the country's full integration into the EU now complete, some specifically Slovene policy elements will disappear. For example, Slovenia's manufacturing sector will have to cope with the real appreciation of its currency (the euro). This may create tensions, deserving of reporting and analysis. Under these circumstances, Slovenia's economy remains a potentially fascinating subject.

Sources of growth: the lead role of consumption and investment

All five NMS in Central Europe have grown over the past five quarters (since the fourth quarter of 2005): some of them quite rapidly. In the third quarter of 2006, growth accelerated sharply in Slovakia and also rose in both Slovenia and Poland. In the Czech Republic growth decelerated at a gentle pace (see Figure 1). Growth in Hungary has been moderate and steady (showing little variation over time) since the early 2000s (see Table 1). What appears to be a solid performance, however, is deceptive. As is now commonly known, large external and internal imbalances have been building up behind a facade of respectable stability. Growth in Bulgaria and Romania (the most recent EU member states as of 1 January 2007) also accelerated throughout 2006, especially so in Romania. Finally, growth in the Baltic countries (not shown in Figure 1) has traditionally been steadiest – and most rapid – with quarterly GDP growth rates regularly in excess of 11% in Estonia and Latvia, and about 7-8% in Lithuania. More recently GDP growth everywhere (except Hungary) has been driven predominantly by domestic demand (consumption plus fixed capital formation plus change in inventories). External trade that contributed significantly (and positively) to growth in 2005 (in the Czech Republic, Slovenia and Poland) has been losing in significance. Trade continues to be a drag on growth in Bulgaria and Romania (as well as in the Baltic countries).

Table 1

Gross domestic product

real change in % against preceding year

	2000	2001	2002	2003	2004	2005	2006 1)	2007 forecast	2008 forecast	Index 1995=100 2006
Czech Republic	3.6	2.5	1.9	3.6	4.2	6.1	5.9	5	5	136.3
Hungary 2)	5.2	4.1	4.3	4.1	4.9	4.2	4.0	2.7	3.1	156.5
Poland	4.2	1.1	1.4	3.8	5.3	3.5	5.8	5.3	5	159.6
Slovak Republic	0.7	3.2	4.1	4.2	5.4	6.0	7.5	7	7	159.3
Slovenia	4.1	2.7	3.4	2.7	4.4	4.0	5	4.5	4.4	154.2
NMS-5 3)	*4.0*	*2.1*	*2.3*	*3.8*	*5.0*	*4.4*	*5.6*	*4.9*	*4.8*	*153.6*
Bulgaria	5.4	4.1	4.9	4.5	5.7	5.5	6.2	6	5.5	129.7
Romania 2)	2.1	5.7	5.1	5.2	8.4	4.1	7.5	6.5	6	132.8
Estonia	7.9	10.6	8.0	7.1	8.1	10.5	11.5	9.5	8.4	223.2
Latvia 2)	6.9	8.0	6.5	7.2	8.6	10.2	11.7	8.9	8	217.4
Lithuania 2)	3.9	6.4	6.7	10.6	7.0	7.5	7.4	7	6.5	190.3
NMS-10 3)	*3.9*	*3.0*	*3.1*	*4.3*	*5.7*	*4.7*	*6.2*	*5.4*	*5.2*	*151.8*

Notes: 1) Preliminary. - 2) From 2001 (from 2003 for Romania) new GDP accounting methodology (FISIM reallocation). - 3) wiiw estimate.

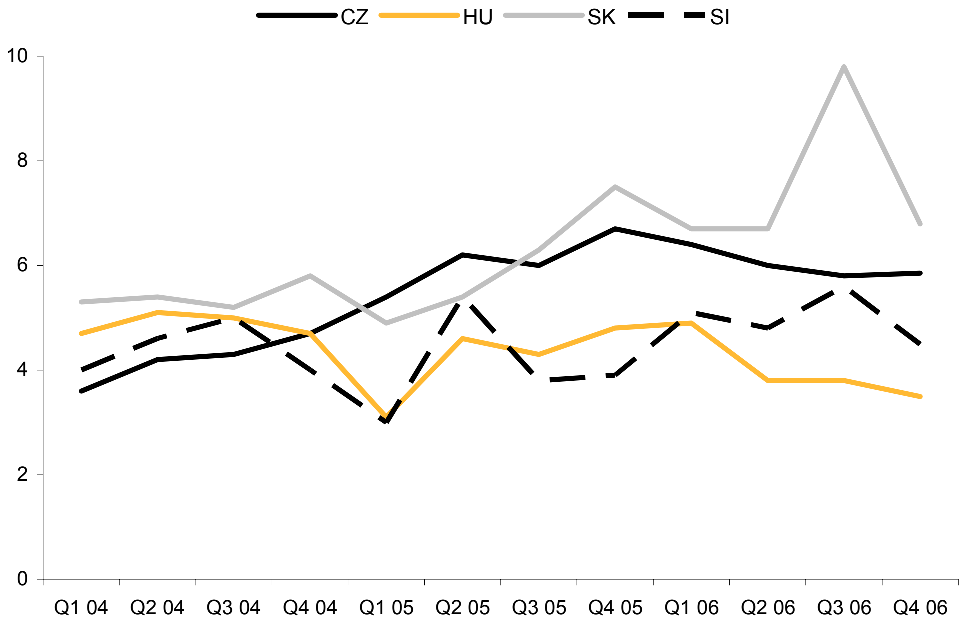
Source: wiiw Database incorporating national statistics, forecast: wiiw and European Commission (2006) Baltic states.

It is expected that rapid GDP growth will be maintained in 2007. Some minor deceleration is expected in the Czech Republic, Slovakia, Poland and Romania, reflecting the impact of worsening trade balances (primarily rising imports). The impact of the 'austerity package' on private consumption and investment, however, is expected to result in a more substantial growth slowdown in Hungary in 2007. Growth in 2008 is also expected to slow down in Bulgaria and Romania (but not in the remaining NMS). As for predicting growth in Bulgaria and Romania in 2008, the possible margin of error would seem to be larger than for the other NMS. In order to assess the trends underlying overall GDP growth in the NMS (and the inherent risks), it may be useful to examine recent trends in terms of the countries' gross fixed capital formation, private consumption and external trade.

Figure 1

Quarterly GDP, 2004-2006

real change in % against preceding year



Source: wiiw Monthly Database incorporating national statistics.

Gross fixed capital formation

Growth in gross fixed capital formation (termed investment for short) accelerated strongly throughout 2006 in Poland and Slovenia. Acceleration of investment was reported to be less pronounced in the Czech Republic and growth slowed down progressively in Slovakia. As can be seen in Table 2, investment was generally buoyant throughout the Baltic countries, as well as in Romania and Bulgaria. A marked expansion of investment may – up to a point – be interpreted as testifying to 'healthy fundamentals': robust (upcoming) growth of aggregate demand, high levels of capacity utilization, satisfactory profitability levels, low costs of capital and a good legal/institutional environment. In practice, one is well advised to doubt the soundness of protracted investment booms: they tend to be financed by excessively expanding debt and/or are based on exuberant expectations of future sales and profits. Poland's protracted investment boom in the late 1990s (accompanied by runaway current account deficits and qualitative deterioration of bank assets) was followed in the early 2000s by several years of acute investment contraction – as well as overall GDP stagnation. The present instances of investment acceleration in Poland and Slovenia are relatively 'young'. As such they have not had time enough to grow to an excessive degree. However, the protracted investment booms in the Baltic countries, Romania and Bulgaria have been accompanied by some disquieting developments: very high current account deficits as well as dynamically expanding credit extended to the private sector (primarily to households). (As discussed below, the rapid expansion of household loans has also boosted the consumption boom in the Baltic countries, Bulgaria and Romania.)

Table 2

Gross fixed capital formation

real change in % against preceding year

	2000	2001	2002	2003	2004	2005	2006 [1)]	2007	2008	in % of GDP 2005
								forecast		
Czech Republic	5.1	6.6	5.1	0.4	4.7	1.3	7	6	4	24.9
Hungary [2)]	7.7	5.1	10.1	2.1	7.7	5.6	2.0	3	4	22.7
Poland	2.7	-9.7	-6.3	-0.1	6.4	6.5	16.7	15	10	18.2
Slovak Republic	-9.6	12.9	0.3	-2.3	5.0	17.5	8	10	8	26.0
Slovenia	1.8	0.4	0.9	7.0	7.9	1.5	10.5	7	7	24.4
Bulgaria	15.4	23.3	8.5	13.9	13.5	19.0	18	15	15	23.8
Romania [2)]	5.5	10.2	8.2	8.5	10.8	13.1	13	12	10	23.1
Estonia	14.3	9.7	24.1	7.0	13.5	12.7	14.5	12.9	11.4	31.1
Latvia [2)]	10.2	11.4	13.0	12.3	23.8	18.6	18.5	11.7	8.6	29.8
Lithuania [2)]	-9.0	13.5	11.1	14.0	16.0	9.4	12.1	9.7	9.5	22.4

Notes: 1) Preliminary. - 2) From 2001 (from 2003 for Romania) new GDP accounting methodology (FISIM reallocation).

Source: wiiw Database incorporating national statistics, forecast: wiiw and European Commission (2006) for Baltic states.

Of course, this does not mean that these countries are doomed, sooner or later, to a 'hard landing'. Moreover, a moderate level of investment (and pace of expansion) is in itself no guarantee of good GDP growth prospects. In Hungary investment had, until recently, grown at a steady pace. Today, however, Hungary's growth prospects are not looking particularly good. It is interesting to observe that the reassessment of Hungary's medium-term prospects brought about an abrupt change in investors' moods. In the first quarter of 2006 investment rose an impressive 10.2% – more or less following the trend of a few earlier quarters. However, in the second and third quarters of 2006 investment had already contracted by some 3.3% and 4%, respectively. The contraction of investment in Hungary is a relatively natural development, given the emergence of expectations of 'hard times ahead'. It may be observed that the fiscal austerity measures planned by the Hungarian government were directly targeted towards household incomes, living standards and private (as well as public) consumption. They were not intended to harm private capital formation, at least not directly. Nonetheless, whereas growth in private consumption in Hungary did not slow down much throughout 2006, it was private investment which responded promptly and decisively to the mere *prospects* of incomes and consumer demand possibly sagging in the future. Interestingly, investment contraction was *followed, not preceded,* by a rise in nominal policy interest rates. Thus, the recent investment developments in Hungary would be hard to square with the conventional textbook explanation and its emphasis on the more or less direct importance that monetary policy means for business investment. Of course, it could be argued that private investment in Hungary responded to properly anticipated *future* interest rates. But this is not a very convincing argument: the interest rate hikes were quite small (see Figure 6). Moreover, they left the interest rates very low in *real* terms (e.g. much lower than in 2004 when investment expanded by 8%). Of course, interest rates must be of some direct importance to private investment – as the cost of capital. One problem with this reasoning is that big business can (and often does) borrow abroad – at interest rates that might have little to do with domestic policy interest rates. Secondly, even if borrowing abroad is not all that significant, it is difficult to relate recent investment trends in the NMS to recent trends in their official policy interest rates. For example, investment in the Czech Republic and Slovakia has been fluctuating quite sharply despite remarkably stable (and low) interest rates. Obviously, some other factors, whose role may often be more direct and weightier than that of interest rates, should be also considered. The strength of upcoming demand seems to be the most important of those factors. Business investment is likely to be high when sales prospects are good and current production capacities reasonably utilized. Cheap credit is not likely to be conducive to high investment when sales prospects are bad and/or much of the existing capital stock is idling. Cheap (or otherwise) credit may in essence be indirectly important to private investment – via its impact on household borrowing and spending.

Over the period 2007-2008, investment is expected to rise markedly in Poland, Slovakia, Romania and Bulgaria (see Table 2). However, investment growth forecasts for Bulgaria and Romania seem more uncertain than for other countries.

Household consumption

Growth in household consumption generally accelerated in 2006 (see Table 3). Only in Hungary did growth in consumption slow down markedly, responding to the actual (and even more the anticipated) burden of the austerity package announced by the government. It is tempting to relate the present deceleration of consumption growth in Hungary to the unfettered consumption boom that the country experienced over the period 2001-2003. Growth in consumption slowed down slightly in Slovenia, yet remained high by the country's own standards. Judging by recent experience, growth rates in Poland and the Czech Republic have also been on the high side. Finally, an 'explosive' expansion of household consumption was to be observed in Slovakia, Bulgaria and Romania.

Table 3

Consumption of households

real change in % against preceding year

	2000	2001	2002	2003	2004	2005	2006 1)	2007 forecast	2008 forecast	in % of GDP 2005
Czech Republic	1.3	2.3	2.2	6.0	2.5	2.8	4	4.5	4	49.0
Hungary 2)	4.4	6.3	10.6	8.3	2.9	3.7	2.0	-0.3	1	53.7
Poland	3.0	2.2	3.3	1.9	4.3	1.8	5.2	5	4	61.9
Slovak Republic	0.9	5.4	5.2	0.1	3.8	7.2	7	7	5	56.4
Slovenia	0.7	2.3	1.3	3.5	2.8	3.6	3	3	3	53.8
Bulgaria	4.9	4.6	3.4	7.1	4.9	7.4	7	6	5.5	69.6
Romania 2)	-0.8	6.9	5.3	8.5	14.1	9.8	12	10	8	66.9
Estonia	8.8	7.1	10.9	6.8	7.0	7.9	14	12	11	49.6
Latvia 2)	6.3	7.3	7.4	8.2	8.8	11.5	13	11	9	61.4
Lithuania 2)	5.9	3.7	5.9	12.7	9.7	10.4	12	10	9	64.9

Notes: 1) Preliminary. - 2) From 2001 (from 2003 for Romania) new GDP accounting methodology (FISIM reallocation).
Source: wiiw Database incorporating national statistics, forecast: wiiw and European Commission (2006) for Baltic states.

In Slovakia a kind of a cyclical pattern can be discerned, with periods of sharply accelerating consumption interspersed with periods of stagnation. The present (2005-2006) consumption expansion in Slovakia is broadly similar to the earlier period (2001-2002). To some extent, this pattern may be a reflection of the 'political business cycle', with fiscal relief preceding elections, and fiscal strictures thereafter. Such cycles have also been observed in Hungary. (The present fiscal restraint in Hungary belongs to the most recent cycle of that kind). Generally speaking, growth in household consumption has been supported by rises in real wages and employment. At the same time, household propensity to save is seen to be lessening (most possibly reflecting more optimistic expectations). In most 'old' NMS (notably Poland) the well-being of (and consumption by) farmers has been rising fast on account of generous subsidies from ‘Brussels'. Everywhere (but especially in Poland, Romania, Bulgaria, Latvia and Lithuania) the rising remittances of migrant workers also support rising household consumption (and housing investment). The factors underpinning the recent strong growth in consumption will remain influential in the coming two years.

Table 3 suggests that Bulgaria and Romania are similar to each other (and different from other NMS). In both countries consumption is rising at a very rapid rate – despite the very high share of private consumption already evident in the GDP. However, Bulgaria and Romania are quite different in one important respect. A period of protracted and remarkable expansion in Romania has been paralleled by an equally impressive rise in average real wages. Over the six-year period (2002-2006) the average real wage in Romania rose by 8.2% per annum – and household consumption by 9.4%. Over the same period the Bulgarian average real wage rose modestly, by 2.5% per annum, yet household consumption soared by 5.7%. Clearly, unlike Romania, consumption growth in Bulgaria could have hardly been driven by a rise in wage incomes.[1] The gap between the growth rates for average real wages and household consumption is still large in Bulgaria – even allowing for changes in the level of (paid) employment. Consequently, consumption growth in Bulgaria appears to be

1 Household consumption is more than twice the level of employees' compensation (gross) in Bulgaria.

driven primarily by non-wage incomes (e.g. distributed profits or other property income), the expansion of which has been much more pronounced than that of wages.[2] Rising consumption is also supported by rising credit (discussed below). Slovakia and Poland seem to have been following a pattern somewhat similar to that of Bulgaria: the average real wages rose by 2.9% and 2.1% p.a. and household consumption by 4.7% and 4.7%, respectively. In Slovenia, the rise in average wages has been keeping close pace with that of consumption (2.1% vs. 2.7%). The Czech Republic displays a different pattern altogether, with average wages moving upwards ahead of household consumption: (4.4% vs. 3.3% per annum, respectively). Finally, the real wage growth rate is – on average – roughly equal to the consumption growth rate: 5.8% vs. 5.6%. (However, in the case of Hungary where both rates have fluctuated in a somewhat volatile manner over time, their averages for relatively short periods do not offer much reliable information.)

The role of household credit

In all countries household credit can still be seen to be expanding rapidly. This bolsters both investment in housing and current consumption. To some extent, household credit also fuels speculation in various assets (e.g. on the stock exchanges or real estate markets). Of course, booms in household credit can sometimes pose a threat to financial stability – especially if households incur high debts despite high interest rates. However, with the exception of Bulgaria (and the Baltic countries), the stock of household credit relative to GDP is still lower than what would be considered normal, given those countries' GDP levels. The current (2006) household credit/GDP ratios for Slovakia, the Czech Republic, Poland, Slovenia and Hungary are about 14.3%, 16.8%, 18.0%, 18.3% and 19.8%, respectively. By comparison, the ratio for the euro area is over 50%. As befits a relatively poor country, Romania still has a ratio of about only 12% (but it too is rapidly rising). However, despite being the poorest of all NMS, Bulgaria has a relatively high (given its GDP level) ratio of about 23%. Moreover, the in ratio Bulgaria is still soaring.[3] Very high – and rapidly rising – levels of household indebtedness have also been registered in Estonia and Latvia. By the end of the third quarter of 2006, the Estonian household debt/GDP ratio reached 38% (up from 31% at end-2005).

It is no coincidence that with respect to household borrowing, Bulgaria and the Baltic countries have a rather atypical pattern in common. Of all the NMS, only those countries have a currency board regime. Their monetary authorities cannot control (directly and effectively) the minimum interest rates. Nor can they pursue other monetary policy targets (money aggregates or the amount of credit extended). At best, they can impose tighter prudential regulation or higher reserve requirements. Invariably those measures have only a temporary effect. (Besides, they may have unwelcome side-effects, such as a rise in direct borrowing abroad).

The countries’ currency board regime is a factor that is probably conducive to the somewhat abnormal household debt pattern. In all likelihood, that pattern may have been reinforced by skewed

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2 The position of labour has been much weaker in Bulgaria than elsewhere. For example, in 2000 the per capita GDP in Bulgaria was higher than in Romania by 6.3%. Yet even then the average wage in Romania was higher than in Bulgaria: by 9% in purchasing power parity terms, and by 23% at the current exchange rates. By 2006 wages in Romania had become higher than in Bulgaria by 29% and 75%, respectively. These massive gains in the wage levels have not slowed down Romania's growth relative to that of Bulgaria. By 2006 Romania had caught up with Bulgaria in terms of per capita GDP level (see the Appendix: Selected Indicators of Competitiveness). The very fact that labour in Romania fares much better than in Bulgaria may be due to the militancy of the former's Trade Unions (hardly visible in Bulgaria).

3 The ratios for the five 'old' NMS rise approximately 10% per year. The Bulgarian ratio rises much faster. At end-2005 it stood at about 16.5%. In 2003 it was, reportedly, only 7% (ECB Monthly Bulletin 11/2006, p. 99).

changes in income distribution. Banks may be expected to increase their lending on a most energetic scale when the incomes and wealth of their particularly creditworthy customers – the prosperous business class – are rising particularly fast. As already mentioned, this seems to be the case in Bulgaria. Moreover, there is every reason to believe that the polarization of income and wealth levels has been much more pronounced in the Baltic countries than in the five NMS in Central Europe. Taxation in the Baltic countries is of the 'flat tax' variety; it naturally favours the rich. (As a result general government revenue is much lower in the Baltic countries than in the five NMS in Central Europe. In 2005 the unweighted average general government revenue/GDP ratio was 34.9% in the former and about 40% in the latter[4]). Thus, the abnormal pace of credit expansion in the Baltic countries may well have been associated with the pattern of change in income distribution.

While the moderately rapid rise in household credit observed in the five 'old' NMS in Central Europe tends on the whole to play a positive role in generating overall growth, the turbulent, rapid and protracted credit growth observed in Bulgaria, Romania and the Baltic countries must evoke mixed feelings. First, extremely fast growth in household credit often ends in a financial or banking crisis (because fierce inter-bank competition tends to lower the lending standards and/or asset bubbles fed by excessive credit suddenly burst). Secondly, and perhaps more importantly, growth of this kind appears to be mirrored by massive trade and current account deficits. Thus, large portions of credit-financed consumption (and investment in housing by the nouveaux riches) may end up increasing: (a) borrowing abroad; (b) the private portion of the national foreign debt; and (c) imports. The ultimate social cost of the present import-fed consumption-smoothing among the wealthier classes in the low-income countries may turn out to be inordinately high.

External trade

External trade (in goods and non-factor services) which is counted in the national account statistics continues to rise strongly in real terms (mostly double-digit rates), with respect to both exports and imports. Table 4 shows how external trade as a whole has contributed to overall GDP growth rates (as well as to total consumption, gross fixed investment and 'other items'). Before taking a closer look at Table 4, it may be useful to recall the manner in which contributions to the GDP growth rates are calculated (see Box 1).

As can be seen (Table 4), external trade contributes positively to GDP growth in all five 'old' NMS. In Bulgaria and Romania (as well as in the three Baltic countries, not analysed here) foreign trade is a drag on growth. In fact, GDP growth in both countries has been depressed on account of external trade performance for quite some time (at least since 2000). 2002 is the sole exception. In that year, the positive contributions that trade made to overall growth coincided with low growth rates – by the two countries' standards – in household consumption. Of course, the household consumption growth rates are reflected in the contributions of consumption to the GDP growth rates (reported in Table 4). It is therefore comes as no surprise that the particularly high positive contributions of consumption are synchronous with the appreciable negative contributions of trade.[5]

4 It goes without saying that budgetary spending is also particularly low in the Baltic countries (average ratio was 34.3% of the GDP in 2005). Those worse-off in the five NMS in Central Europe can count on more public support as general government spending in those countries is much more generous (on average accounting for 44.3% of the GDP).

5 In actual fact, the negative correlation between the contributions of consumption and trade, calculated for the pooled data for Bulgaria and Romania, is quite high (-0.63). The correlation between the contributions of consumption and external trade calculated for the pooled data for the five 'old' NMS from Table 4 is lower (-0.58).

Box 1

Calculation of contributions to the GDP growth rate: an example

In the first three quarters of 2005, consumption (private plus public) accounted for 70% of the Czech GDP; gross fixed investment for 25.1%; exports for 73.1%; and imports for 68.9%. The real GDP growth rate (1-3Q 2006 over 1-3 Q2005) was 6.1%. Consumption, investment, exports and imports rose in real terms by 2.5%, 6.7%, 13.4% and 12.5%, respectively. To the 6.1% GDP growth rate consumption contributed 1.7 percentage points (1.7 = 0.025 x 70%); investment 1.7 p.p. (1.7 = 0.067 x 25.1%); exports 9.8 p.p. (9.8 = 0.134 x 73.1%); and imports (minus) 8.6 p.p. (8.6 = 0.125 x 68.9%). The trade balance contributed 1.2 p.p. (= 9.8 p.p. – 8.6 p.p.). The sum of the contributions of consumption, investment and the trade balance was 4.6 p.p. Other items (change in stocks and statistical discrepancy) contributed a further 1.5 p.p. The sum of all contributions is, by construction, equal to the original 6.1% reported as the overall GDP growth rate.

At present, external trade contributes largely and negatively to the GDP growth rates in Bulgaria and Romania; this simply mirrors the high contribution of consumption. In other words, to a large extent the rapidly rising domestic demand (primarily the demand for consumption) leaks out of Bulgaria and Romania. It thus contributes to faster growth among the two countries' trading partners – to the detriment of growth in domestic output.

In the first three quarters of 2006 the contribution of external trade to growth in Slovakia took a positive turn (and quite a large turn at that) – without reducing growth in domestic consumption or investment. After several years of high foreign direct investment in export-oriented manufacturing, a quantum leap in output is to be seen. Of course, the current situation in Slovakia must be considered short-lived. At some time in the future, the new FDI capacities' growth in output will quieten down, whereafter the composition of the various contributions to GDP growth will probably become similar to those observed elsewhere[6].

The contributions of external trade, though still positive in Slovenia, Poland and the Czech Republic, have been rapidly diminishing in size. This development is clearly related to much faster investment growth (in Poland's case, private consumption as well). The speed of the recent changes in Slovenia and Poland (as well as in the Czech Republic) may suggest that further acceleration of growth in domestic demand could result in the contributions of trade in those countries turning negative. In other words, the recent strength displayed by those three countries' external trade may be gradually exhausted. Of course, this does not mean that export growth will perforce come to a halt. On the contrary, there is every reason to expect imports to grow at a much faster rate in response to rapidly growing domestic demand.

In the first three quarters of 2006, external trade became the main force behind overall GDP growth in Hungary. The contribution of domestic demand was negative (on account of the strong contraction in inventories, stagnation of investment and anaemic growth in consumption). However, the improvement in trade's contribution was primarily due to the major differential that emerged between the export and import growth rates (16% and 9% respectively, in real terms). Of course, this sudden decline in Hungarian import propensity points to stagnation in domestic demand (rather than permanent structural change).

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[6] Ideally, comparable to the composition observed in Ireland for instance, where domestic demand contributed 4.4 percentage points to the average GDP growth of 6.3% (1999-2005), with external trade adding another 1.9 percentage points.

Table 4

Contributions (percentage points) to the GDP growth rates

	2000	2001	2002	2003	2004	2005	2005 I-III Q	2006 I-III Q
Czech Republic								
GDP growth rate (%)	**3.6**	**2.5**	**1.9**	**3.6**	**4.2**	**6.1**	**5.9**	**6.1**
Consumption	0.8	1.9	2.6	4.8	0.6	1.7	1.7	1.7
Gross fixed investment	1.4	1.8	1.5	0.1	1.3	0.3	0.2	1.7
Trade balance	0.0	-1.1	-2.2	-0.9	1.3	4.0	3.9	1.2
Other items*	1.4	-0.1	0.0	-0.4	1.0	0.1	0.1	1.5
Hungary								
GDP growth rate (%)	**5.2**	**4.1**	**4.3**	**4.1**	**4.9**	**4.2**	**4.0**	**4.2**
Consumption	.	3.6	6.5	5.5	2.1	2.5	2.3	0.6
Gross fixed investment	.	1.2	2.5	0.5	1.9	1.4	1.7	0.0
Trade balance	.	2.1	-2.4	-2.7	0.7	4.1	4.4	5.0
Other items*	.	-2.8	-2.3	0.8	0.2	-3.8	-4.4	-1.4
Poland								
GDP growth rate (%)	**4.2**	**1.1**	**1.4**	**3.8**	**5.3**	**3.5**	**3.2**	**5.5**
Consumption	2.2	1.8	2.4	2.1	3.3	2.1	1.9	3.8
Gross fixed investment	0.7	-2.3	-1.3	0.0	1.2	1.2	0.6	2.2
Trade balance	1.0	2.6	0.5	1.1	-0.8	1.1	2.0	0.3
Other items*	0.3	-1.0	-0.2	0.6	1.6	-0.9	-1.3	-0.8
Slovenia								
GDP growth rate (%)	**4.1**	**2.7**	**3.4**	**2.7**	**4.4**	**4.0**	**4.0**	**5.2**
Consumption	0.9	2.0	1.4	2.2	2.1	2.3	2.4	2.4
Gross fixed investment	0.5	0.1	0.3	1.9	2.2	0.4	-0.1	2.9
Trade balance	2.7	1.8	1.1	-2.3	-0.9	2.1	2.9	0.1
Other items*	0.0	-1.2	0.6	0.9	1.0	-0.8	-1.2	-0.2
Slovak Republic								
GDP growth rate (%)	**0.7**	**3.2**	**4.1**	**4.2**	**5.4**	**6.0**	**5.5**	**7.8**
Consumption	1.2	3.9	4.0	0.9	2.7	3.7	3.9	4.2
Gross fixed investment	-2.2	3.3	0.1	-0.6	1.3	4.4	3.6	2.0
Trade balance	0.4	-5.2	-0.3	6.0	-0.9	-2.7	-1.5	1.1
Other items*	1.3	1.2	0.3	-2.1	2.3	0.6	-0.5	0.5
Bulgaria								
GDP growth rate (%)	**5.4**	**4.1**	**4.9**	**4.5**	**5.7**	**5.5**	**5.6**	**6.3**
Consumption	5.0	3.9	3.1	5.7	4.5	5.9	6.2	5.3
Gross fixed investment	2.4	3.9	1.6	2.6	2.7	4.0	3.5	4.1
Trade balance	-0.5	-3.4	0.8	-5.1	-2.2	-5.8	-6.3	-4.3
Other items*	-1.5	-0.3	-0.6	1.3	0.7	1.4	2.2	1.2
Romania								
GDP growth rate (%)	**2.1**	**5.7**	**5.1**	**5.2**	**8.4**	**4.1**	**4.3**	**7.8**
Consumption	1.3	5.5	4.2	7.0	10.3	7.5	9.0	10.0
Gross fixed investment	1.0	1.9	1.6	1.8	2.4	2.9	1.9	3.1
Trade balance	-2.4	-3.4	0.9	-3.9	-4.9	-5.4	-6.6	-5.7
Other items*	2.2	1.7	-1.6	0.3	0.6	-0.9	0.0	0.4

* Other items include change in stocks and statistical discrepancies.

Source: Eurostat, wiiw estimates incorporating national sources for Czech Republic, Poland, Bulgaria and Romania.

Faster growth in industrial production

The slowdown in industrial growth observed in 2005 proved short-lived (see Figure 2 and Table 5). Throughout 2006, industrial production rose at quite respectable rates.

Table 5

Gross industrial production

real change in % against preceding year

	2000	2001	2002	2003	2004	2005	2006 [1)]	2007 forecast	2008 forecast	Index 1995=100 2006
Czech Republic	1.5	6.7	1.9	5.5	9.6	6.7	10	8	8	157.1
Hungary	18.1	3.6	2.8	6.4	7.4	7.0	10	8	9	241.2
Poland [2)]	6.7	0.6	1.1	8.3	12.6	3.7	11.3	8	7	197.9
Slovak Republic	8.4	7.6	6.7	5.3	4.2	3.6	10	12	10	167.7
Slovenia	6.2	2.9	2.4	1.4	4.8	3.3	7	5	4.5	138.4
NMS-5 [3)]	*7.4*	*3.2*	*2.1*	*6.7*	*9.9*	*4.9*	*10.5*	*8.2*	*7.7*	*187.7*
Bulgaria	8.3	1.5	6.5	14.1	13.8	8.4	5.9	5	6	126.1
Romania	7.1	8.3	4.3	3.1	5.3	2.0	7.1	6	6	119.1
Estonia	14.6	8.9	8.2	10.9	10.5	9.1	7.3	8	7.5	229.7
Latvia	4.7	9.2	8.4	9.1	6.0	5.6	4.0	4.5	5	184.2
Lithuania	2.2	16.0	3.1	16.1	10.8	7.3	8.9	7.5	7	201.3
NMS-10 [3)]	*7.3*	*4.3*	*2.9*	*6.8*	*9.4*	*4.7*	*9.6*	*7.7*	*7.3*	*171.8*

Notes: 1) Preliminary. - 2) Sales. - 3) wiiw estimate.

Source: wiiw Database incorporating national statistics, forecast: wiiw.

In the five 'old' NMS, gross value-added (GVA) in industry has in general continued to rise much more rapidly than gross industrial output. Particularly strong (and protracted) growth in real industrial GVA was to be observed in the Czech Republic and Slovakia. Over the past seven quarters (first quarter 2005 to fourth quarter 2006) industrial GVA has increased on average by 12.7% (quarter over the same quarter of the previous year). For Hungary, Poland and Slovenia the same indicator is much lower: 5.1%, 3.9% and 3.5%, respectively (nonetheless still higher than in the euro area: 1.8%). Moreover in 2006, the growth in industrial GVA in the latter three countries also accelerated to 9.2%, 6.1% and 6.9% respectively[7]. Thus more recently, industrial GVA has not only been rising faster than total industrial output, but also faster than overall GDP[8].

Today the reasons for the continuing strength of industry in the NMS (and the manufacturing sector in particular) are quite well understood. The structural transformation of manufacturing, aided by massive inflows of foreign direct investment, has been of central importance. Production facilities capable of supplying more sophisticated ('higher tech') goods are being extended while low-tech branches gradually contract. Outstanding export performance (see comments below) is the best proof of the growing strength of manufacturing in the NMS.

7 In Poland growth in industrial GVA accelerated still more in the fourth quarter of 2006. According to the preliminary estimates, the growth rate for 2006 as a whole was 7.7%.

8 Spreads between the growth rates of gross output and GVA reflect primarily improvements in the efficient use of intermediate production inputs (e.g. energy). The aggregate efficiency gains involve changes in the technologies utilised in individual activities, as well as the discontinuation of particularly input-intensive activities.

Figure 2

Source: wiiw Monthly Database incorporating national statistics.

The acceleration of industrial production growth in the NMS is closely correlated to improvements in labour productivity (see Table 6, Figures 2 and 3). Moreover, in Bulgaria and Romania labour productivity growth has been much more dynamic recently than industrial production. Industry in both countries continues to divest itself of labour. A decline in industrial employment can also be seen in Slovenia and Hungary. The continual cutbacks in Hungarian industrial employment do not seem to be related to the current slowdown in GDP; they are much more part of a longer-term restructuring process. It would seem that the process has come to an end (at least for the time being) in Slovakia and Poland (as far back as 2004), as well as in the Czech Republic (2005). Since then, the industry in those three countries has registered a growing demand for labour (especially skilled labour).

Table 6

Labour productivity in industry

change in % against preceding year

	2000	2001	2002	2003	2004	2005	2006 [1)]	Index 1995=100 2006
Czech Republic [2)]	9.5	5.8	5.8	9.5	10.5	8.2	9.6 I-XI	220.0
Hungary [3)]	17.7	4.8	4.6	10.2	10.7	11.2	12.2 I-XI	302.0
Poland [4)]	13.6	4.6	6.6	9.7	11.7	3.9	10.2 I-XI	252.3
Slovak Republic	11.9	6.5	6.5	4.7	3.8	0.5	11.7 I-XI	182.2
Slovenia	8.4	3.5	5.6	3.6	6.2	5.2	9.3 I-X	185.5
Bulgaria [5)]	18.2	2.1	5.2	10.3	12.8	8.8	8.9 I-IX	164.8
Romania	13.8	6.7	5.0	5.4	11.8	5.4	11.1 I-XI	191.4
Estonia	17.6	15.3	10.3	11.8	10.2	9.1	11.1	290.4
Latvia	.	6.9	7.7	6.4	6.9	5.0	3.4	.
Lithuania	5.5	19.3	5.9	5.9	9.0	7.5	8.2	207.2

Notes: 1) Preliminary. - 2) Enterprises with 100 and more, from 1997 with 20 and more employees. From 2001 calculated with sales. - 3) Enterprises with more than 10, from 1999 with more than 5 employees. - 4) For 2006 enterprises more than 9 employees. - 5) In 2006 enterprises with more than 10 employees.

Source: wiiw Database incorporating national statistics.

The growing demand for labour in Poland and the Czech Republic appears to be quite troublesome. In Poland the business sector reports growing shortages of labour (primarily, but not exclusively, skilled labour); in the Czech Republic the number of foreigners employed is growing rapidly. It is natural to assume that the tight labour market will push wages upwards. Wages are certainly rising in all NMS, but not ahead of productivity. In general, industrial productivity continues to outstrip industrial wages; unit labour costs (ULCs) in industry (the share of wages in total output) thus continue to decline (or at worst stagnate, as in Bulgaria).

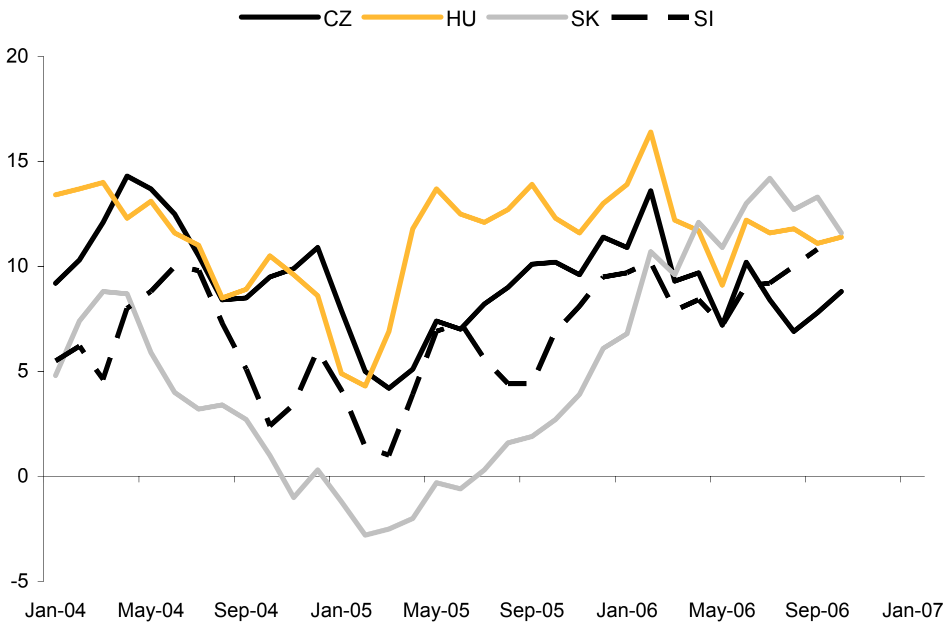
Unit labour costs adjusted for exchange rates and purchasing power parities (which are commonly[9] used in analyses of a country's external competitiveness) have been rising recently, albeit rather modestly, in the Czech Republic, Romania and Poland (see Figure 4). However, it would appear that these gains have come about as a result of the nominal appreciation of those countries' currencies (see Figure 6). Conversely, falling exchange rate-adjusted unit labour costs in Hungary mirror the nominal depreciation of the country's currency over the longer term (dating back to September 2005).

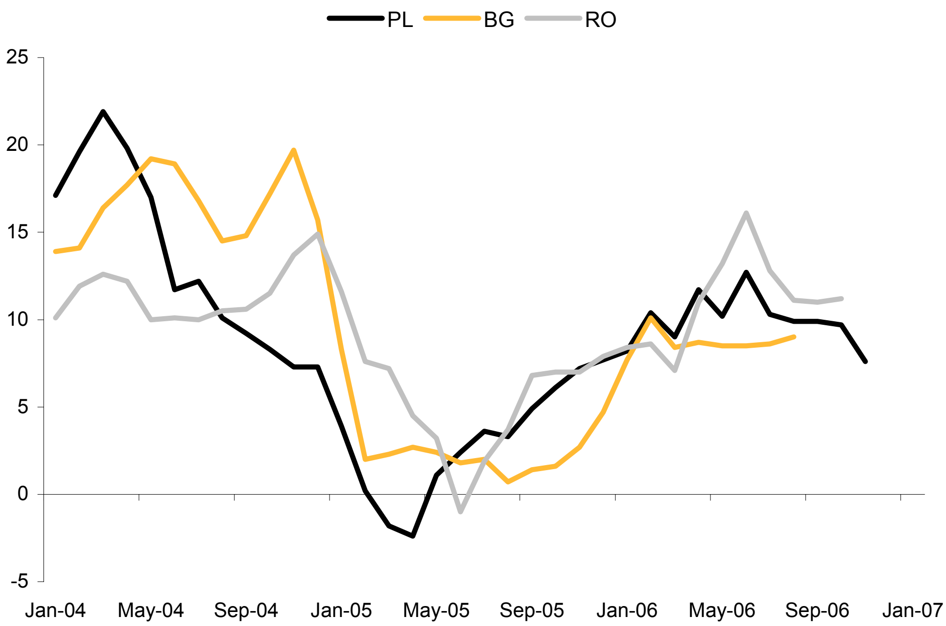
9 Also by wiiw. See the Appendix to this Report, Tables A/1 and A/2.

Figure 3

Labour productivity in industry, 2004-2006

3-month moving average, year-on-year, in %



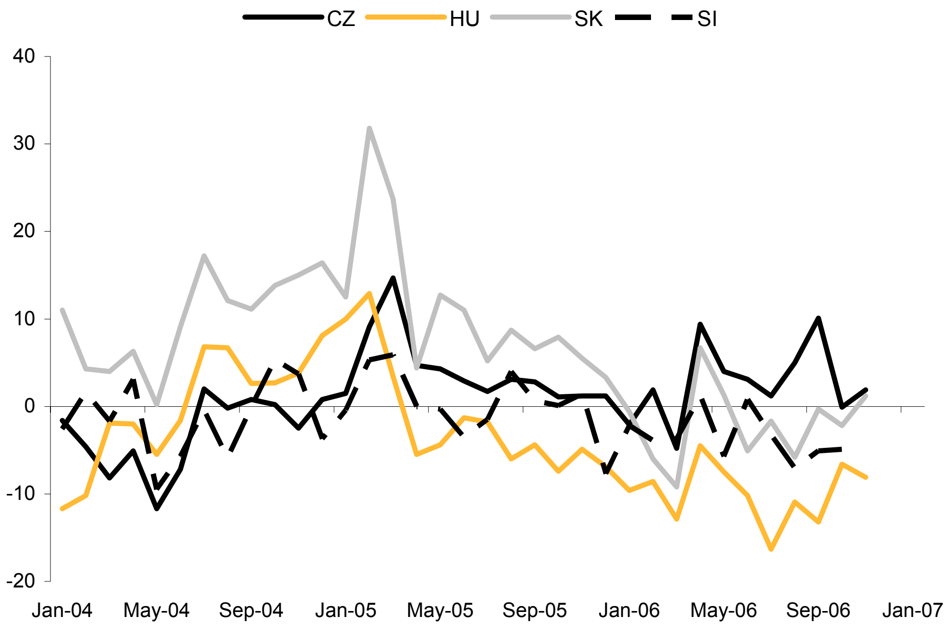


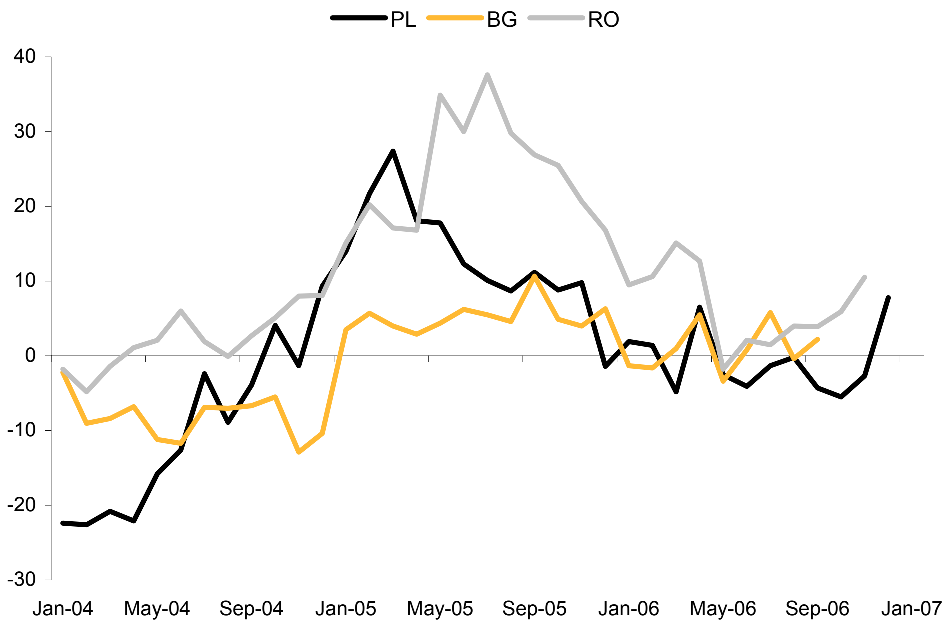
Source: wiiw Monthly Database incorporating national statistics.

Figure 4

Unit labour costs in industry, 2004-2006

EUR-adjusted, year-on-year, growth in %





Source: wiiw Monthly Database incorporating national statistics.

It may be worth reiterating that rising unit labour costs in industry (including those that are exchange rate-adjusted) need not hint at deterioration in foreign trade performance. Of course, if a rise in ULCs is to be of no consequence for exports, the goods produced must display an appropriately marked improvement in terms of quality and price. In the NMS overall foreign trade performance (and export performance, in particular) suggests that those improvements are indeed taking place: however, not at a uniform speed across countries and groups of industries. This development has been extensively documented[10]. Finally, it must be repeated that changes in ULCs still bear particular relevance for the traditional labour-intensive activities in the NMS. Quite obviously, they are of greater relevance for Bulgaria and Romania than for the 'old' NMS. On the other hand, it must be realized that the low-tech, labour-intensive activities in the NMS are increasingly exposed to fiercer price competition with exports originating in Asia. It is doubtful though whether wage restraint alone will suffice to beat Chinese competition in such commodities as standard textile products. Of course, wage restraint may help to 'steal business' from the low-tech manufacturing in the 'old' EU. Fig 2

Faster expansion of foreign trade in goods[11]

Once again 2006 was a very eventful year for external trade in the NMS. Total merchandise exports and imports, in current euro terms, grew by more than 20%. Exports rose faster than imports (or at approximately the same speed) in the Czech Republic, Hungary, Poland, Slovenia, Slovakia and Bulgaria (see Table 7). Export structures continue to change quite swiftly. Exports of machinery and transport equipment (the prime specialization of the Czech Republic, Slovakia and Poland) have accelerated[12]. Import growth still outstripped export growth in Romania (and of course in the Baltic countries). It must be remembered that the high prices that NMS pay for the large quantities of crude oil and natural gas they import inflated their import bills in 2006[13]. Despite energy prices exacting their toll, the positive trade balance in the Czech Republic rose still further, while the Hungarian trade deficit continued to decline. In the remaining NMS, trade deficits increased (relatively little in Poland and Slovenia, but substantially so in the other countries).

In general, NMS exports to the EU-27 (other than those of the Baltic countries) rose slightly faster than their total exports (see Table 8). At the same time, imports from the EU-27 grew less dynamically than their total imports. This is a natural development as imports of oil, gas and other raw materials originate outside the EU-27. (Cheap textiles and other standard consumer goods also come from overseas).

The Czech Republic, Poland, Hungary and Slovakia are running large, and rapidly rising, trade surpluses vis-à-vis the EU-27. Their combined trade surplus rose from some 18 billion euro in 2005 to about 27.6 billion in 2006. The Bulgarian and Slovene trade deficits vis-à-vis the EU-27 are roughly constant; the deficits of Romania and the Baltic countries, however, shot up rapidly once again in 2006.

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10 See e.g. M. Landesmann and J. Wörz, 'CEECs' Competitiveness in the Global Context', *wiiw Research Reports*, No. 327, May 2006, or the previous wiiw report on current developments in the CEEC (*wiiw Research Reports*, No. 328, July 2006).

11 This section deals with transactions in goods captured by customs statistics. It does not cover transactions in non-factor services. Moreover, it is concerned with the transactions measured at current prices (euro). The contributions of external trade to GDP growth, discussed earlier, correspond to trade in both goods and non-factor services (expressed at constant prices).

12 According to provisional data, during the first three quarters of 2006, the value of machinery and transport equipment exports rose more rapidly than total exports (by 23.7% in the Czech Republic, 25.4% in Poland and 36.2% in Slovakia).

13 During the first three quarters of 2006, the value of fuel product imports rose only 18.4% in Poland, but 34.2% in Slovenia, 36.2% in the Czech Republic, 48.9% in Slovakia and 58.8% in Hungary.

Table 7

Foreign trade of the new EU member states, EUR million

(based on customs statistics)

		2000	2001	2002	2003	2004	2005	2006 [1)]	2005	2006
									change in %	
Czech	Exports	31483	37251	40726	43051	53995	62738	75700	16.2	20.7 I-XI
Republic	Imports	34876	40675	43025	45243	54824	61441	74100	12.1	20.6 I-XI
	Balance	-3393	-3424	-2298	-2192	-829	1297	1600	.	.
Hungary	Exports	30545	34082	36523	38041	44630	50093	58000	12.2	15.8 I-XI
	Imports	34856	37654	39939	42189	48550	52996	60100	9.2	13.4 I-XI
	Balance	-4312	-3572	-3417	-4149	-3920	-2903	-2100	.	.
Poland	Exports	34383	40375	43400	47511	60014	71740	88200	19.5	23.0 I-XI
	Imports	53122	56223	58307	60288	71812	81530	99300	13.5	21.8 I-XI
	Balance	-18739	-15848	-14907	-12777	-11798	-9791	-11100	.	.
Slovakia [2)]	Exports	12880	14115	15270	19318	22427	25743	33174	15.7	28.7
	Imports	13860	16488	17517	19923	23686	27713	35648	18.0	28.5
	Balance	-980	-2372	-2247	-606	-1259	-1969	-2474	.	.
Slovenia	Exports	9505	10349	10966	11288	12786	14397	16700	12.6	16.0 I-XI
	Imports	10996	11345	11578	12242	14146	15804	18400	11.7	16.3 I-XI
	Balance	-1491	-997	-612	-954	-1360	-1408	-1700	.	.
NMS-5	*Exports*	*118795*	*136172*	*146885*	*159209*	*193852*	*224711*	*271774*	*16.0*	20.9
	Imports	*147709*	*162385*	*170367*	*179885*	*213018*	*239484*	*287548*	*12.5*	20.1
	Balance	*-28915*	*-26213*	*-23481*	*-20677*	*-19166*	*-14774*	*-15774*	.	.
Bulgaria	Exports	5253	5714	6063	6668	7985	9466	12100	18.6	27.9 I-XI
	Imports	7085	8128	8411	9611	11620	14668	18300	26.2	24.7 I-XI
	Balance	-1832	-2414	-2348	-2942	-3635	-5201	-6200	.	.
Romania	Exports	11273	12722	14675	15614	18935	22255	25851	17.5	16.2
	Imports	14235	17383	18881	21201	26281	32569	40746	23.9	25.1
	Balance	-2962	-4661	-4206	-5588	-7346	-10313	-14895	.	.
Estonia	Exports	3445	3698	3642	4003	4769	6193	7564	29.9	22.1
	Imports	4615	4799	5080	5716	6703	8164	10170	21.8	24.6
	Balance	-1170	-1101	-1437	-1713	-1934	-1970	-2606	.	.
Latvia	Exports	2020	2233	2418	2560	3204	4110	4610	28.3	12.2
	Imports	3453	3913	4287	4635	5670	6925	8754	22.1	26.4
	Balance	-1433	-1680	-1868	-2076	-2467	-2815	-4143	.	.
Lithuania	Exports	3837	4775	5524	6158	7478	9490	11284	26.9	18.9
	Imports	5644	6762	7941	8526	9958	12498	15153	25.5	21.2
	Balance	-1807	-1987	-2416	-2368	-2480	-3008	-3869	.	.
NMS-10	*Exports*	*144623*	*165314*	*179208*	*194211*	*236222*	*276225*	*333182*	17.0	20.6
	Imports	*182742*	*203369*	*214966*	*229574*	*273250*	*314307*	*380670*	15.1	21.1
	Balance	*-38119*	*-38055*	*-35757*	*-35363*	*-37028*	*-38082*	*-47488*	.	.

Notes: 1) Preliminary. - 2) From 2005 refer to trade excluding value of goods for repair.

Source: wiiw Database incorporating national statistics.

Table 8

Foreign trade of the new EU member states with EU-27

(based on customs statistics)

		2002	2003	2004	2005	2006 [1]	2005	2006 [1]	2005	2006 [1]
				EUR mn					share of EU-27 in % of total	
Czech	Exports	34902	37585	47041	53638	64600	14.0	20.5 [I-XI]	85.5	85.3
Republic	Imports	31191	32477	39625	43954	52300	10.9	18.9 [I-XI]	71.5	70.6
	Balance	3712	5108	7416	9684	12300	.	.	.	.
Hungary [2]	Exports	30850	32006	37107	40484	45900	9.1	13.5 [I-X]	80.8	79.1
	Imports	25950	27206	35620	37095	41800	4.1	12.7 [I-X]	70.0	69.6
	Balance	4900	4800	1487	3389	4100	.	.	.	.
Poland	Exports	35205	38912	48279	56394	69900	16.8	24.0 [I-XI]	78.6	79.3
	Imports	40644	41975	49457	53968	63000	9.1	16.7 [I-XI]	66.2	63.4
	Balance	-5440	-3063	-1178	2426	6900	.	.	.	.
Slovakia [3]	Exports	13648	16583	19450	22469	28900	16.5	28.5 [I-XI]	87.3	87.1
	Imports	12874	14914	17609	19891	24600	14.1	23.8 [I-XI]	71.8	69.0
	Balance	774	1669	1841	2578	4300	.	.	.	.
Slovenia [2]	Exports	7523	7695	8701	10003	11900	15.0	19.2 [I-X]	69.5	71.3
	Imports	8974	9366	11759	12959	15000	10.2	15.4 [I-X]	82.0	81.5
	Balance	-1451	-1671	-3058	-2957	-3100	.	.	.	.
NMS-5	*Exports*	*122128*	*132781*	*160577*	*182988*	*221200*	*14.1*	20.9	*81.4*	*81.4*
	Imports	*119633*	*125940*	*154070*	*167867*	*196700*	*9.1*	17.2	*70.1*	*68.4*
	Balance	*2495*	*6842*	*6508*	*15121*	*24500*	.	.	.	.
Bulgaria	Exports	3763	4214	4971	5704	7100	14.7	24.9 [I-XI]	60.3	58.7
	Imports	4852	5550	6626	7832	9300	18.2	19.1 [I-XI]	53.4	50.8
	Balance	-1088	-1337	-1655	-2128	-2200	.	.	.	.
Romania	Exports	10834	11753	14170	15636	18228	10.3	16.6	70.3	70.5
	Imports	12876	14453	17347	20568	25783	18.6	25.4	63.2	63.3
	Balance	-2042	-2700	-3177	-4931	-7555	.	.	.	.
Estonia [2]	Exports	2975	3299	3823	4818	4904	26.0	1.8	77.8	64.8
	Imports	3490	3704	5211	6211	7405	19.2	19.2	76.1	72.8
	Balance	-515	-405	-1389	-1393	-2501	.	.	.	.
Latvia [2]	Exports	1880	2032	2477	3143	3462	26.9	10.1	76.5	75.1
	Imports	3321	3503	4289	5213	6670	21.5	28.0	75.3	76.2
	Balance	-1440	-1471	-1812	-2070	-3209	.	.	.	.
Lithuania [2]	Exports	3830	3867	5023	6230	7085	24.0	13.7	65.7	62.8
	Imports	4511	4780	6333	7433	9260	17.4	24.6	59.5	61.1
	Balance	-681	-914	-1310	-1203	-2174	.	.	.	.
NMS-10	*Exports*	*145410*	*157946*	*191041*	*218520*	*261980*	*14.5*	19.9	*79.1*	*78.6*
	Imports	*148682*	*157930*	*193876*	*215124*	*255118*	*11.1*	18.6	*68.4*	*67.0*
	Balance	*-3272*	*16*	*-2835*	*3396*	*6862*	.	.	.	.

Notes: 1) Preliminary. - 2) From 2004 dispatches and arrivals according to Intrastat methodology. - 3) From 2005 data refer to trade excluding value of goods for repair.

Source: wiiw Database incorporating national statistics.

Table 9

Intra-NMS-10 foreign trade (trade among the new EU member states)

(based on customs statistics)

		2001	2002	2003	2004	2005	2006 [1]	2005	2006 [1]	2005	2006 [1]
					EUR mn					share of NMS-10 in & of EU-27	
Czech Republic	Exports	6121	7045	7519	10167	12235	15000	20.3	22.6	22.8	23.2
	Imports	4719	5288	5673	7395	8498	11200	14.9	31.8	19.3	21.4
	Balance	1403	1757	1846	2773	3737	3800	.	.	.	
Hungary [2]	Exports	2270	3408	3998	5510	7685	10300	39.5	34.0	19.0	22.4
	Imports	2607	3483	3999	5282	6303	7900	19.3	25.3	17.0	18.9
	Balance	-337	-75	-2	227	1382	2400	.	.	.	
Poland	Exports	4473	5385	6241	7812	9764	13400	25.0	37.2	17.3	19.2
	Imports	4446	4673	5113	6604	7583	8900	14.8	17.4	14.1	14.1
	Balance	27	712	1128	1208	2181	4500	.	.	.	
Slovakia [3]	Exports	4143	4401	4849	6071	7601	9800	26.1	28.9	33.8	33.9
	Imports	3695	4060	4683	5919	7081	9000	20.6	27.1	35.6	36.6
	Balance	448	341	166	152	520	800	.	.	.	
Slovenia [2]	Exports	776	1014	1100	1262	1476	2000	17.0	35.5	14.8	16.8
	Imports	964	1103	1132	1384	1619	2000	17.0	23.5	12.5	13.3
	Balance	-187	-89	-32	-122	-142	0	.	.	.	
NMS-5 [4]	*Exports*	*17783*	*21254*	*23706*	*30822*	*38763*	*50500*	*25.9*	*30.3*	*21.2*	*22.8*
	Imports	*16431*	*18607*	*20600*	*26584*	*31085*	*39000*	*17.1*	*25.5*	*18.5*	*19.8*
	Balance	*1353*	*2647*	*3106*	*-5763*	*-3074*	*-600*	.	.	.	.
Bulgaria	Exports	338	387	444	639	827	1100	29.4	33.0	14.5	15.5
	Imports	629	623	783	1030	1393	1800	35.2	29.2	17.8	19.4
	Balance	882	-236	-340	-391	-566	-700	.	.	.	.
Romania	Exports	985	970	1181	1771	2415	3195	36.3	32.3	15.4	17.5
	Imports	1716	1843	2230	2783	3630	4470	30.4	23.1	17.7	17.3
	Balance	1352	-874	-1049	-1012	-1216	-1275	.	.		
Estonia [2]	Exports	438	499	563	854	1077	1281	26.0	19.0	22.3	26.1
	Imports	465	550	651	1089	1369	1804	25.7	31.8	22.0	24.4
	Balance	-27	-50	-88	-235	-292	-523	.	.	.	.
Latvia [2]	Exports	387	420	449	734	1204	1450	64.1	20.4	38.3	41.9
	Imports	918	1051	1141	1640	2188	2765	33.4	26.4	42.0	41.4
	Balance	-531	-631	-692	-906	-984	-1315	.	.	.	.
Lithuania	Exports	1110	1089	1214	1619	2206	2843	36.3	28.9	35.4	40.1
	Imports	720	920	1011	1857	2295	3095	23.6	34.8	30.9	33.4
	Balance	390	169	203	-238	-89	-251	.	.	.	
NMS-10 [4]	*Exports*	*21043*	*24619*	*27558*	*36440*	*46491*	*60370*	*27.7*	*29.9*	*21.3*	*23.0*
	Imports	*20880*	*23594*	*26417*	*34983*	*41960*	*52934*	*20.1*	*26.2*	*19.5*	*20.7*
	Balance	*163*	*1025*	*1141*	*1457*	*4531*	*7436*	.	.	.	.

Notes: 1) Preliminary. - 2) From 2004 dispatches and arrivals according to Intrastat methodology. - 3) From 2005 data refer to trade excluding value of goods for repair. - 4) Positive balance is due to valuation effects (exports:fob, imports:cif).

Source: wiiw Database incorporating national statistics.

As in the earlier post-accession years, trade among individual NMS continued to intensify in 2006. Individual NMS exports to and imports from the other NMS are rising far more rapidly than exports to and imports from the EU-27; much of that trade is intra-industry in character. This is a natural tendency given their higher overall growth, their geographical proximity and the burgeoning co-operative links between multinationals affiliates located in various NMS. As can be seen, Poland and the Czech Republic emerge as the major net exporters to the remaining NMS (see Table 9).

As unemployment drops, labour shortages emerge

In most NMS, unemployment is relatively low; levels are dropping consistently, albeit unspectacularly. Only in Hungary is a temporary (and rather marginal) rise in unemployment to be expected. This development is quite natural given the recent (and upcoming) economic growth slowdown.[14] Currently, unemployment in Poland and Slovakia is still in double digits (see Table 10); however, in both countries the unemployment rate is plummeting.

Table 10

Unemployment, LFS definition, annual averages

	in 1000 persons	rate in %							
	2006 1)	**2001**	**2002**	**2003**	**2004**	**2005**	**2006** 1)	**2007**	**2008**
								forecast	
Czech Republic 2)	380	8.1	7.3	7.8	8.3	7.9	7.3	6.7	6.5
Hungary	317	5.7	5.8	5.9	6.1	7.2	7.5	7.9	7.8
Poland	2500	18.2	19.9	19.6	19.0	17.8	15	14	13
Slovak Republic	360	19.2	18.5	17.4	18.1	16.2	13.5	12	11
Slovenia	64	6.4	6.4	6.7	6.3	6.6	6.3	6	6
NMS-5 3)	*3621*	*14.5*	*15.3*	*15.1*	*14.9*	*14.1*	*12.2*	*11.5*	*10.8*
Bulgaria	310	19.7	17.8	13.7	12.0	10.1	9	8	7
Romania	700	6.4	8.4	7.0	8.0	7.1	7	7	7
Estonia	40	12.6	10.3	10.0	9.6	7.9	5.8	5	4.5
Latvia	79	13.1	12.0	10.6	10.4	8.7	6.7	6.2	6
Lithuania	93	17.4	13.8	12.4	11.4	8.3	5.8	5	5
NMS-10 3)	*4843*	*13.0*	*13.8*	*13.0*	*12.9*	*11.9*	*10.4*	*9.8*	*9.3*

Notes: 1) Preliminary. - 2) From 2002 weighted according to census 2001. - 3) wiiw estimate.

Source: wiiw Database incorporating national statistics, forecast: wiiw and European Commission (2006) for Baltic States.

Even though there are no precise figures, it is believed that large numbers of young workers (primarily from Poland and the Baltic countries) have migrated to the western part of the EU (mostly the United Kingdom and Ireland). This may have had some (probably limited) impact on the drop in unemployment rates. Similarly, it is commonly assumed that rather large numbers of Romanians and Bulgarians have been moving to the EU (the south-west flank – Italy and Spain). The direct impact of these migration flows on domestic unemployment is also difficult to measure.

[14] The elasticity of employment with respect to GDP growth has been low in the past. Relatively high GDP growth has been needed in order to generate new jobs (see P. Havlik, 'Structural Change, Productivity and Employment in the New EU Member States', *wiiw Research Reports*, No. 313, January 2005).

In both Poland and Slovakia, falling unemployment rates relate directly to the growing demand for labour: rising employment (see Table 11). As can be seen, the demand for labour also remains strong in the Baltic countries. Relatively low growth rates of employment (e.g. in the Czech Republic or Romania) do not necessarily reflect weak demand for labour. To some extent they may indicate the complete antithesis: a labour shortage.

Table 11

Employment, LFS definition, annual averages

	in 1000 persons	change in % against preceding year						**Index 2000=100**
	2006 [1]	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2006** [1]
Czech Republic [2]	4810	0.4	0.3	-0.7	-0.6	1.2	1.0	101.7
Hungary	3932	0.3	0.1	1.3	-0.5	0.0	0.8	102.0
Poland	14600	-2.2	-3.0	-1.2	1.3	2.3	3.4	100.5
Slovak Republic	2300	1.0	0.2	1.8	0.3	2.1	3.8	109.4
Slovenia	960	1.7	-0.7	-1.4	5.1	0.6	1.2	106.5
NMS-5 [3]	*26602*	*-1.0*	*-1.6*	*-0.5*	*0.7*	*1.7*	*2.5*	*101.9*
Bulgaria	3100	-3.4	1.5	3.5	3.1	2.0	4.0	110.9
Romania	9150	-0.6	-11.5	-0.1	-0.7	-0.1	0.0	87.1
Estonia	646	0.9	1.4	1.5	0.2	2.0	6.4	112.9
Latvia	1092	2.2	2.8	1.8	1.1	1.8	5.4	116.0
Lithuania	1502	-3.3	4.0	2.3	-0.1	2.6	1.9	107.5
NMS-10 [3]	*42092*	*-1.0*	*-3.5*	*0.1*	*0.5*	*1.3*	*2.2*	*99.4*

Notes: 1) Preliminary. - 2) From 2002 weighted according to census 2001. - 3) wiiw estimate.

Source: wiiw Database incorporating national statistics, forecast: wiiw and European Commission (2006) for Baltic States.

That this may be the case is proven by developments on the labour market in Poland. As already mentioned, despite the relatively high unemployment reported for Poland, firms are finding it increasingly difficult to hire the employees they urgently need. The current growth in output is constrained by labour shortages. The paradoxical coexistence of labour shortages and an excess supply of labour is not necessarily a matter of false statistical reporting. It must be borne in mind that extreme levels of unemployment have persisted for an inordinately long period of time in Poland. Possibly, this has resulted in a large proportion of those afflicted being virtually unemployable (on account of depreciating motivations and skills). Large regional variances in the availability of jobs and affordable housing may also be preventing a more efficient matching of supply and demand on the labour market.[15] The Polish experience suggests that other NMS may soon start reporting labour shortages. (Indeed, labour shortages are already surfacing in the Czech Republic, Bulgaria and Romania.) This may have far-reaching macro--consequences – not only on account of labour bottlenecks limiting production growth. The stronger position that employees are now assuming may well prove conducive to a higher share of income going to labour. Last, but not least, more expensive labour may accelerate the shift towards labour-saving technology. Of course, these are all long-term consequences of a tightening labour market, whereas the further decline in unemployment rates (especially in Poland and Slovakia) expected to occur in the period 2007-2008 is more a medium-term outcome.

15 The regional disparities across the NMS are analysed in M. Landesmann and R. Römisch, 'Economic Growth, Regional Disparities and Employment in the EU-27', *wiiw Research Reports*, No. 333, December 2006.

Fiscal deficits remain a low priority

Traditionally, the general government budget balances have been positive in Bulgaria and Estonia. The remaining Baltic countries (which also have currency board regimes) registered minor deficits. Deficits have also been traditionally low in Slovenia, the most recent member (as of 1 January 2007) of the euro club (see Table 12). In 2006 (and earlier years) Romania, whose fiscal behaviour has been closely monitored by the IMF, also reported a low deficit. Romania's entry into the EU, however, seems to have lessened any say that the IMF might have on the country's fiscal conduct. The result has manifested itself in much higher deficits that are expected in the years to come.

Table 12

General government budget balance in % of GDP[1)]

	2000	2001	2002	2003	2004	2005	2006 [2)]	2007 forecast	2008 forecast
Czech Republic	-3.7	-5.7	-6.8	-6.6	-2.9	-3.6	-3.5	-3.6	-3.2
Hungary [3)]	-3.0	-3.5	-8.2	-6.3	-5.3	-6.5	-9.7	-6.5	4.0
Poland [4)]	-1.5	-3.7	-3.2	-4.7	-3.9	-4.4	-3.7	-3.3	-3.2
Slovak Republic	-11.8	-6.5	-7.7	-3.7	-3.0	-3.1	-3.4	-3.0	-2.9
Slovenia	-3.9	-4.3	-2.5	-2.8	-2.3	-1.4	-1.6	-1.6	-1.5
Bulgaria	-0.6	-0.6	-0.7	0.0	1.7	3.2	3.7	1	1
Romania	3.2	-2.1	-2.0	-1.5	-1.5	-1.5	-1.8	-3.0	-3.0
Estonia	-0.2	-0.3	0.4	2	2.3	2.3	2.5	1.6	1.3
Latvia	-2.8	-2.1	-2.3	-1.2	-0.9	0.1	-1.0	-1.2	-1.2
Lithuania	-3.2	-2.1	-1.5	-1.3	-1.5	-0.5	-1.0	-1.2	-1.3

Notes: 1) EU definition: net lending (+) or net borrowing (-) according to ESA'95, excessive deficit procedure. - 2) Preliminary. - 3) From 2006 wiiw. - 4) From 2005 wiiw.

Source: Eurostat; forecasts by European Commission, Hungary and Poland by wiiw.

In keeping with their reputation for fiscal laxness, the Hungarian authorities managed to produce yet another huge deficit in 2006. Given the very high (and potentially even higher) level of Hungarian public debt (about 68% of the GDP), decisive action was long overdue. A programme is being currently implemented to reduce the deficit, yet progress in terms of Hungarian public finances will at best be rather slow.

The government deficits in Poland, the Czech Republic and Slovakia hover above the magical mark of 3% of GDP. The governments in those countries are preoccupied with things they consider more important (viz. staying in power). Deficits are assumed to be falling in proportion to GDP, primarily as a result of high GDP growth. This is a winning strategy, provided growth remains high well beyond 2008. The governments now largely ignore the Convergence Programmes (whereby the NMS pledged to consolidate their public finances in a comparatively short period of time). Quite predictably, this provokes angry comments from the European Commission. Those comments, however, do not appear to be taken very seriously. Things will only change, once the governments in question start appreciating the benefits of switching to the euro. At the moment neither the Polish nor the Czech authorities are keen on adopting the euro anytime soon. Now set on the road to the euro (by entering the Exchange Rate Mechanism), Slovakia may be more likely to adopt the euro (possibly in 2009).

Low inflation in the 'old' NMS and exchange rates getting stronger all the time

In 2006 consumer price inflation in Poland, the Czech Republic and Slovenia was lower than the Maastricht inflation reference value (set at 2.8% for 2006) – see Table 13.

Table 13

Consumer price inflation

change in % against preceding year

	2000	2001	2002	2003	2004	2005	2006 1)	2007 forecast	2008 forecast
Czech Republic	3.9	4.7	1.8	0.1	2.8	1.9	2.5	2.5	3
Hungary	9.8	9.2	5.3	4.7	6.8	3.6	3.9	6.3	3.5
Poland	10.1	5.5	1.9	0.8	3.5	2.1	1.0	1.8	2
Slovak Republic	12.0	7.1	3.3	8.5	7.5	2.7	4.5	3	2
Slovenia	8.9	8.4	7.5	5.6	3.6	2.5	2.5	2.6	2.3
Bulgaria	10.3	7.4	5.8	2.3	6.1	5.0	7.3	5	5
Romania	45.7	34.5	22.5	15.3	11.9	9.0	6.6	6	6
Estonia	4.0	5.8	3.6	1.3	3.0	4.1	4.4	4.2	4.6
Latvia	2.6	2.5	1.9	2.9	6.2	6.7	6.8	5.8	5.4
Lithuania	1.0	1.3	0.3	-1.2	1.2	2.7	3.8	4.6	3.3

Producer prices in industry

change in % against preceding year

	2000	2001	2002	2003	2004	2005	2006 1)	2007 forecast	2008 forecast
Czech Republic	4.9	2.8	-0.5	-0.4	5.7	3.0	1.6	2.5	2
Hungary	11.6	5.2	-1.8	2.4	3.5	4.3	6.8	7	4.5
Poland	7.8	1.6	1.0	2.6	7.0	0.7	2.3	1.5	2
Slovak Republic	10.8	6.5	2.1	8.3	3.4	4.7	8.4	5	4
Slovenia	7.6	8.9	5.1	2.5	4.3	2.7	2.3	2.2	2
Bulgaria	17.5	3.8	1.2	4.9	6.0	6.9	9.4	6	5
Romania	53.4	38.1	23.0	19.5	19.1	10.5	11.6	8	8
Estonia	4.9	4.4	0.4	0.2	2.9	2.1	4.3	4.5	4.5
Latvia	0.6	1.7	1.0	3.2	8.6	7.8	10.3	8	7
Lithuania	16.0	-3.0	-2.8	-0.5	6.0	11.5	7.4	7	6

Note: 1) Preliminary.

Source: wiiw Database incorporating national statistics, forecast: wiiw and European Commission (2006) for Baltic States.

Inflation in both Slovakia and Hungary is, to a large extent, tax-driven (i.e. it follows on from the administrations having increased: (a) regulated prices for public utilities; and (b) indirect tax rates). In the Czech Republic inflation was also largely tax-driven. Moreover, inflation in Hungary seems to have been affected by the prolonged weakening of the Hungarian forint that set in as from January 2005 (see Figure 6). Other currencies (that generally strengthened in nominal terms) helped to cushion the impact of the high prices of imported energy. Of course, those currencies rigidly pegged to the euro (Bulgaria and the Baltic countries) could not offset rising energy prices in the same way. No doubt, at least part of the relatively high inflation (in terms of both consumer and producer prices) in the currency board countries reflects higher energy prices. Otherwise, the relatively high inflation in those countries (and in Romania as well) would have to be related to the rapid rise in domestic demand. The explosive rise in domestic loans in those countries seems to be an important factor in their inflation. It is worth repeating that under the currency board arrangements as applied in the Baltic countries and Bulgaria, the monetary authorities have no effective control over interest rates or money aggregates. The only effective way of cutting back on the rise in loans would be to engineer a recession (by means of fiscal overkill). The experience of many countries, however, has shown that engineering a recession in that manner does not necessarily check inflation in a reasonably short time[16].

Differences in inflation are not reflected in the interest rates administered by the national banks (see Figure 5[17]). Despite lower inflation in Poland, the Polish National Bank set interest rates higher than those in the Czech Republic or even Slovakia (where inflation is now running at over 4%). Most probably, the Czech and Slovak central banks are more concerned about the prospects of their currencies growing even stronger. However, despite keeping their interest rates low, neither the Czech Republic nor Slovakia was able to pre-empt nominal appreciation that bore a distinct similarity to the appreciation in two high-interest rate countries: Poland and Romania (see Figure 6).

Concern over nominal appreciation most probably derives from the deeply ingrained, instinctive fear of real appreciation as a decisive factor behind the loss of external competitiveness. This fear is, of course, justified by long experience of many less developed countries having suffered setbacks or crises directly attributable to excessive real appreciation. However, the problem is that the recent experience of the NMS would seem to suggest that strong and protracted real appreciation might be indicative of a rise, rather than a drop, in external competitiveness. As can be seen in the upper part of Figure 7, the Czech currency has been strengthening in real terms for some time now. As already discussed, this has not eroded the competitiveness of the Czech economy. Conversely, in Hungary the real depreciation of the forint did not enhance the country's competitiveness all that much (in 2005).

Clearly, the validity of earlier concerns over the detrimental effects of runaway appreciation seems to be confirmed, for instance, by the recent performance of Romania (see the bottom part of Figure 7). On the other hand, the marked deterioration of Romania's trade balance can be attributed, at least partly, to the runaway expansion of credit-driven consumption. More or less the same holds true for Bulgaria, where real appreciation appears to be even more moderate than in Poland.

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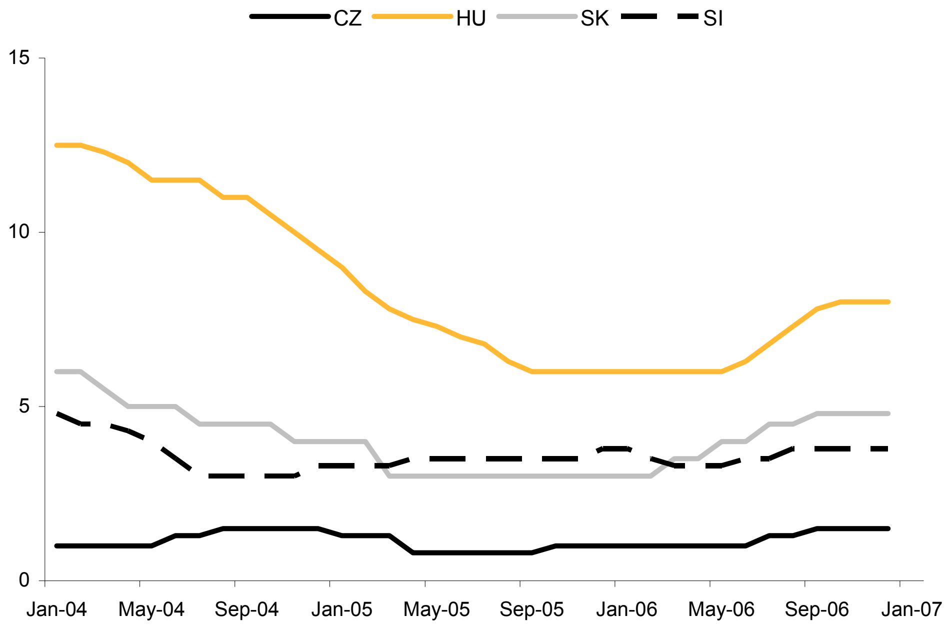
16 The (largely) fiscal shock therapy applied to Poland in 1990 pushed the economy into a 30-month recession which reduced GDP by some 20%, cumulatively. By the time production stopped falling (in mid-1992), inflation was running at about 3% per month.

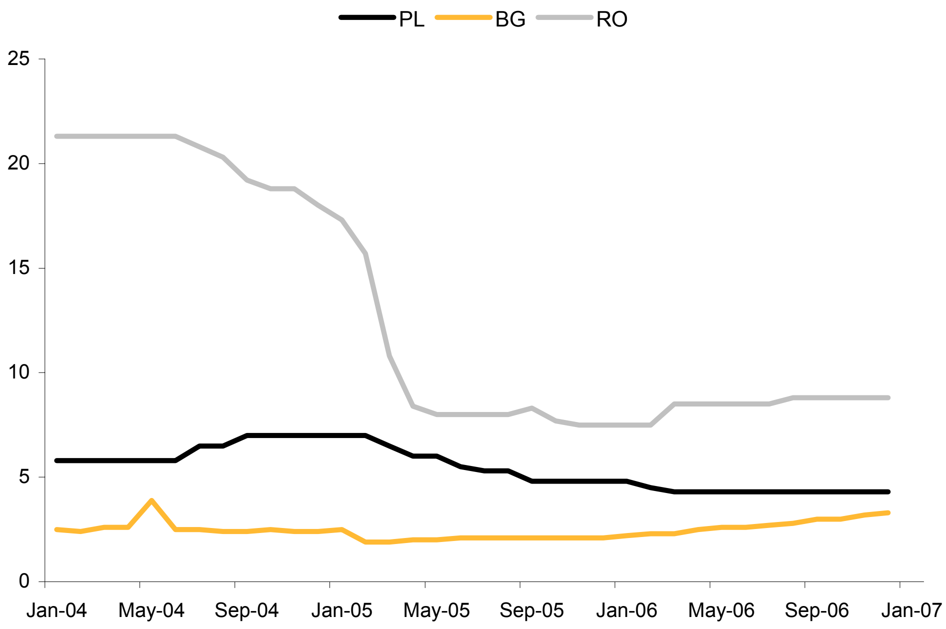
17 Figure 5 features the leading CB interest rate for Slovenia and Bulgaria. It must be remembered, however, that in Bulgaria this rate serves primarily as a 'yardstick' for orientation; it is not used as a policy instrument. Since 1 January 2007 Slovenia has adopted the euro as its currency. The policy interest rate for the eurozone, including Slovenia, is decided by the ECB in Frankfurt.

Figure 5

Minimum interest rates, 2004-2006

nominal NB leading rate in % p.a.



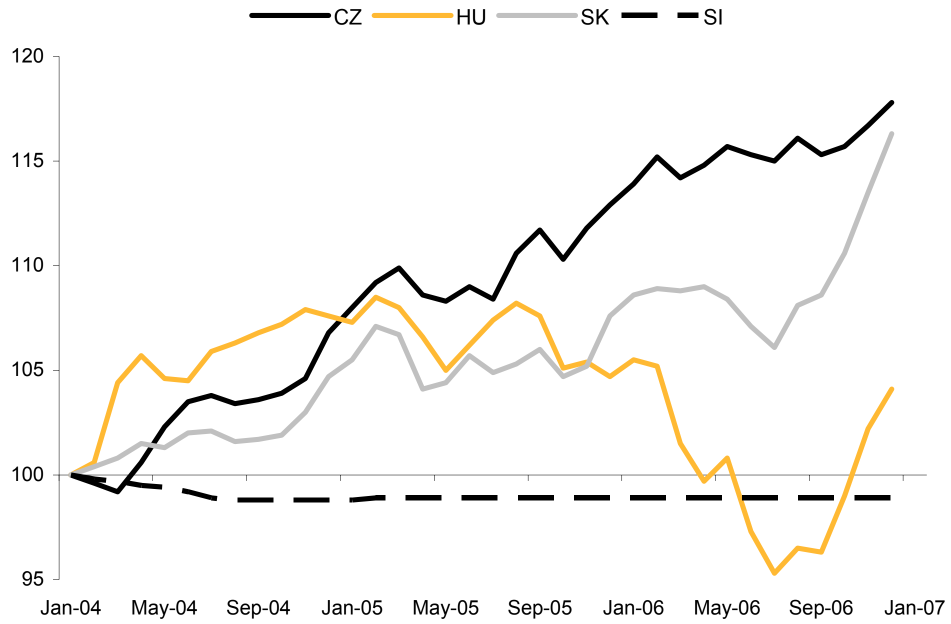


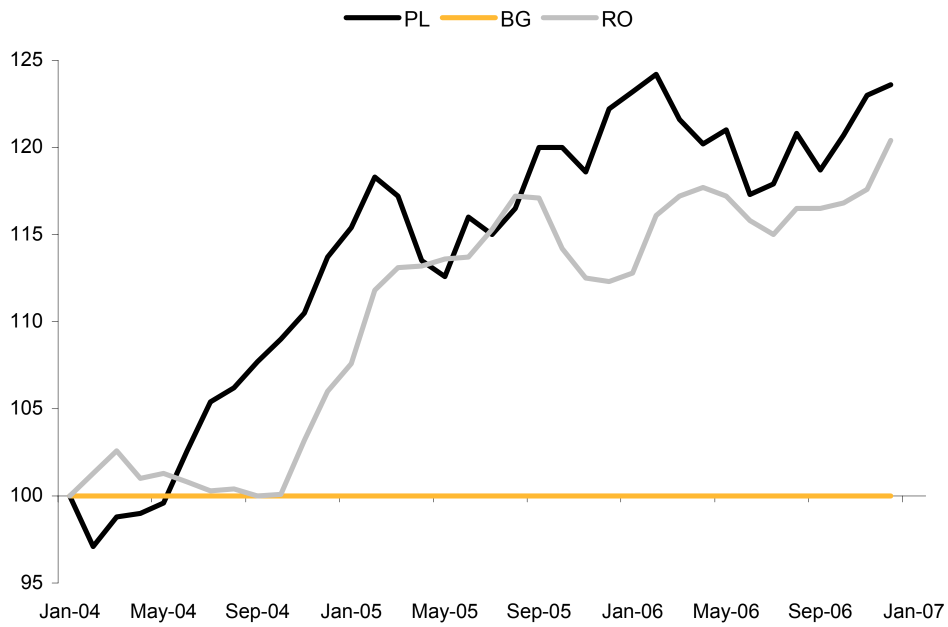
Source: wiiw Monthly Database incorporating national statistics.

Figure 6a

Nominal exchange rates*, 2004-2006

NCU per EUR, monthly average, January 2004 = 100



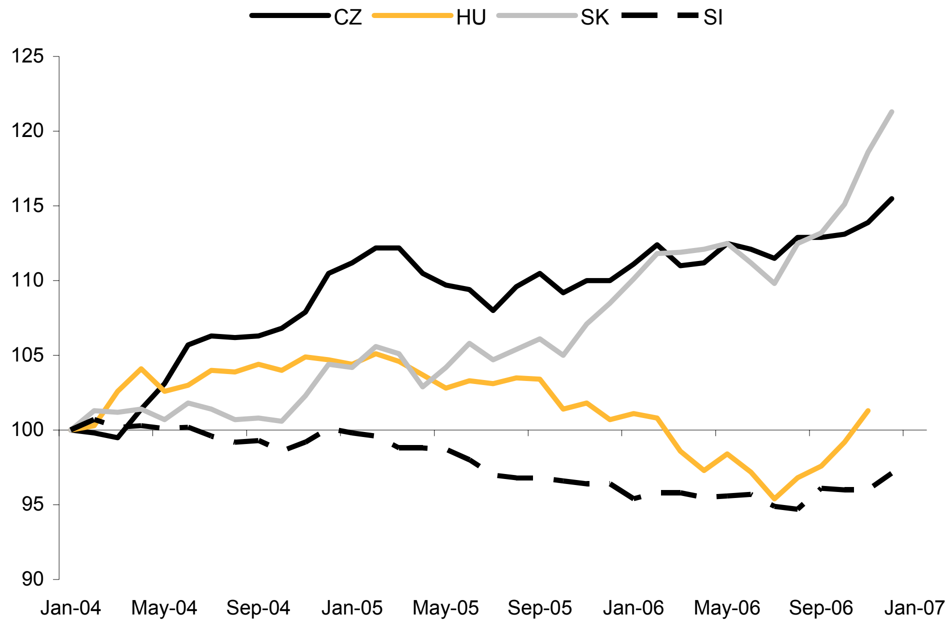


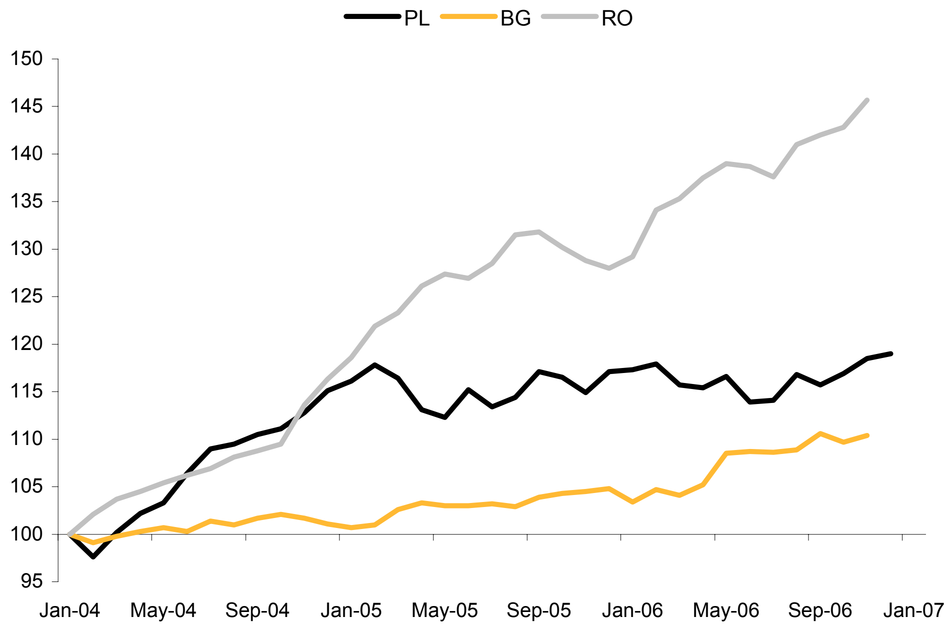
* Increasing line indicates appreciation.
Source: wiiw Monthly Database incorporating national statistics.

Figure 6b

Real appreciation*, 2004-2006

NCU per EUR, PPI-deflated, in % against January 2004





* Increasing line indicates appreciation.
Source: wiiw Monthly Database incorporating national statistics.

Stable foreign financial position of the 'old' NMS

All the NMS continue to receive large inflows of foreign direct investment (see Table 14). Furthermore, all of them (except Slovenia) benefit from sizeable (and rising) EU transfers.

Table 14

FDI inflow to NMS

EUR million

	2000	2001	2002	2003	2004	2005	2006 [1]	2006 [1] in % CA	2006 [1] stock
Czech Republic	5404	6296	9012	1863	4007	8837	5100	102	57000
Hungary	2998	4391	3185	1888	3633	5559	4500	71	58000
Poland	10334	6372	4371	4067	10292	7703	11200	224	88000
Slovakia	2089	1768	4397	593	1016	1694	3500	109	16000
Slovenia	149	412	1722	271	665	445	264	34	6000
NMS-5	*20974*	*19239*	*22687*	*8680*	*19614*	*24238*	*24600*	*126*	*225000*
Bulgaria	1103	903	980	1851	2728	2326	4015	104	14000
Romania	1147	1294	1212	1946	5183	5213	9000	90	30000
Estonia	425	603	307	822	776	2349	1400	81	13000
Latvia	447	147	269	260	563	503	1300	54	6000
Lithuania	412	499	772	160	623	807	800	37	8000
NMS-10	*24508*	*22685*	*26226*	*13719*	*29486*	*35435*	*41100*	*104*	*296000*

1) wiiw estimate.
Note: CA means current account deficit.
Source: National Banks of respective countries.

Current account deficits in the five 'old' NMS are currently manageable: in most cases, they are set to fall. It may be added that to an ever increasing degree, the current account deficits represent income earned – repatriated or reinvested – on foreign direct investment. By way of contrast, the huge current account deficits in Romania, Bulgaria and the Baltic countries seem to be disquietingly persistent. Moreover, foreign debt in Bulgaria and the Baltic countries is also large – and rising fast (see Table 15). Of course, large amounts of FDI are still flowing into those countries. On the other hand, this does not preclude a rapid rise in foreign (primarily private) debt.

Given the narrowing spreads between the interest rates of Poland and the Czech Republic, the risk of high inflows of 'speculative' capital gambling on exchange rate movements seems to be rather low. Hungary remains vulnerable; especially, if the Hungarian National Bank fails to respond promptly to the improved overall economic situation (assuming such an improvement takes place). Otherwise, Slovakia seems too small to attract large destabilizing inflows, while Slovenia no longer has a currency of its own to defend.

The situation in the remaining countries is more precarious. Clearly, neither the Baltic countries nor Bulgaria will have to concern themselves with the prospects of undue nominal appreciation or depreciation. By definition, they will hardly have to face either. Instead, they have every reason to worry about the level of private foreign debt – and about the stability of their banking systems. This should also be of concern to Romania. Moreover, Romania must now be considered a relatively risky place on two counts: its size (large enough to be noticed internationally) and its high interest rates (large enough to attract financial arbitrageurs).

Table 15

Foreign financial position

in % of GDP, end of period

	Gross external debt			Reserves of National Bank (excluding gold) [1)]			Current account			
	2004	**2005**	**2006**	**2004**	**2005**	**2006**	**2005**	**2006**	**2007**	**2008**
Czech Republic	38.1	38.9	35.4	24.0	25.1	20.9	-2.1	-4.4	-4.4	-4.0
Hungary	67.0	74.7	94.9	14.2	17.7	18.1	-6.8	-6.2	-4.9	-4.1
Poland	46.6	45.9	43.9	12.7	14.2	13.1	-1.7	-1.9	-2.0	-2.0
Slovak Republic	51.5	59.6	51.2	32.4	34.3	23.3	-8.6	-7.3	-4.9	-5.1
Slovenia	58.4	71.0	74.9	24.6	24.7	18.0	-2.0	-2.6	-2.2	-1.5
Bulgaria	64.2	70.5	78.6	32.9	31.8	33.9	-11.3	-15.8	-13.5	-13.3
Romania	35.7	38.8	41.7	17.8	21.2	22.8	-8.7	-10.7	-12.7	-11.0
Estonia	78.3	86.0	94.0	14.0	14.8	16.3	-10.5	-12.9	-10.5	-9.6
Latvia	88.9	100.7	113.7	12.7	14.8	21.0	-12.4	-15.8	-17.4	-16.6
Lithuania	42.5	50.8	57.1	14.3	15.2	18.2	-7.0	-8.8	-9.4	-9.1

Notes: 1) Forex reserves, SDR and reserve position with the IMF. Including gold for the Czech Republic and Slovakia. Figures for Hungary, Estonia, Latvia and Lithuania correspond to total reserves of the country.

Source: wiiw Database incorporating national statistics, forecast: wiiw and European Commission (2006) for Baltic States.

General outlook for the region: continuing high growth in 2007 and 2008

The point estimates for the rates of growth of the GDP of individual NMS in both 2007 and 2008 look very good. It is expected that household consumption will continue to rise strongly. Rising employment and wages (strengthening under the impact of emerging labour market bottlenecks and outright shortages) will support consumption. In a number of countries, rising remittances on the part of migrant workers will add to the rapid rise in consumer spending. Gross fixed capital investment is also expected to remain strong, at least in some countries. Furthermore, with the exception of Hungary, fiscal policies will not impinge substantially on real growth. The deceleration of growth in the EU-15 expected in 2007 is likely to restrict growth in terms of both NMS exports and overall GDP. However, the scale of any eventual deterioration in exports is likely to be very minor, all the more as further gains in terms of industrial unit labour costs will be secured. Given the ongoing structural changes and quality improvements in both production and exports, the NMS should increase their market shares – even despite continuing real appreciation.

Growth in imports responding to growing domestic demand will reduce the overall contribution of trade to the GDP growth. In case of the 'old' NMS, these contributions are for the most part likely to be negative, albeit minor. However, the contributions of external trade to growth in Bulgaria and Romania will be negative – and large. Unlike the 'old' NMS, those two countries will run up huge current account deficits and rely on rising private foreign debt.

The risk of making major errors when forecasting growth for the 'old' NMS is comparatively low. Their fundamentals are much sounder than in the past (Hungary being an exception for the time being). Their relatively modest inflation is firmly under control. Interest rate differentials vs. the major international currencies are low and falling (or even negative, as in the Czech Republic). Clearly, incentives for potentially destabilizing speculative capital inflows (and outflows) are weak. Nominal appreciation of their currencies is likely to continue. This, however, is more a sign of strength than of potential weakness. Of course, appreciation may go too far and too fast, spurring too swift a rise in imports. The risk of that happening does not seem very high, at least not in the period 2007-2008. Perhaps at a later stage, when growth in wages has picked up speed enough to support a consumption boom, appreciation will become a problem.

The point estimates of GDP growth rates for Bulgaria and Romania may be less certain than for the 'old' NMS. Both countries display symptoms of turbulent growth. However, as in the Baltic countries, their growth is to a large extent induced by rapidly rising household consumption. The problem is that the expanding consumption is credit-driven and fed by excessive imports. The experience of the Baltic countries indicates that this type of growth can under certain circumstances go on for a very long time. However, there are many examples of debt-financed expansions coming to a rather sticky end. Thus, it might ultimately come as no surprise, were the rising debt burden to put the lid on current expansion in Bulgaria and Romania.

Several major NMS (Poland, Hungary and the Czech Republic) are far from politically stable. It is comforting to notice that political instability has not had any negative impact on economic performance in either Poland or the Czech Republic – at least thus far. (In Hungary the correlation between political instability and economic performance has been running in the 'wrong direction'. Political instability was caused by bad economic performance, not vice versa.)

The present general outlook for an entire region comprising seven diverse countries cannot convey the wealth of information and analysis to be found in the individual country reports whose brief summaries are given below.

Bulgaria

Expansion has been picking up. The situation on the labour market continues to improve; public finances report a large surplus. Massive flows of FDI keep pouring into the country. The current account deficit, however, is truly massive and private debt (also foreign) is growing far too rapidly.

The Czech Republic

Growth is likely to remain strong – but arguably less buoyant than the previous year. Rising private consumption supported by rising wages and employment will be combined with a more pronounced rise in imports. Exports, however, are also likely to remain strong, even if the Czech currency continues its slow nominal appreciation.

Hungary

In 2007, the main engine of economic growth will be net exports. Growth will slow down; public finances will continue to stabilize, with the general government balance turning out to be somewhat better than the cautious target set in the Convergence Programme. Foreign balances are expected to undergo a remarkable improvement. The forint may well maintain its currently strong position, unless serious political unrest emerges, threatening to suspend the stabilization process and hold up the reform measures already launched.

Poland

Conditions are conducive to a further acceleration of growth in fixed investment. Private consumption is expected to firm up under the impact of rising wages and employment. Continuing rapid growth of domestic demand will strengthen imports. Trade will no longer contribute positively to growth.

Romania

Economic growth will remain robust although less impressive than in 2006. The current account deficit will expand further, while FDI will decline from its record level in the absence of new large privatization projects. Exchange rate volatility and slower disinflation may be the result.

Slovakia

Despite the ongoing nominal appreciation of the Slovak currency, rising FDI-led exports are gradually becoming a major driving force behind the strong GDP growth. Supported by increasing employment and wages, strong private demand and investment expansion will also fuel high growth.

Slovenia

Robust domestic demand will keep GDP growth at close to 4.5% in 2007. Thereafter some impetus may also come from stronger export growth. However, a slowdown in the EU-15 would probably restrict growth in terms of exports and GDP. Restructuring of the country's manufacturing sector will continue, particularly in the labour-intensive branches.

Country reports

Anton Mihailov

Bulgaria: entering the EU in high gear

Bulgaria's entry into the EU coincided with the tenth anniversary of the peak of a severe economic and financial crisis, and the contrasts could not have been starker. In the winter of 1996/97 the economy was in shatters: ruined public finances, a disintegrating banking system, failing currency and hyperinflation. At the moment of Bulgaria's entry into the EU, its economy is in excellent shape after nine years of uninterrupted and recently accelerating growth (GDP grew by more than 50% between 1998 and 2006). Indeed, Bulgaria is turning into a success story, hardly imaginable ten years ago, but achieved at the price of particularly painful transformation reforms.

In recent years Bulgaria experienced a pre-accession boom, similarly to other EU entrants in the past. In 2006, the pace of economic expansion picked up further, the rate of GDP growth reaching its highest level in more that two decades. Also in 2006, Bulgaria's GDP finally surpassed its 1988 level, the highest pre-transition benchmark. Given that the country's population in this period shrank by more than 1 million people, the level of GDP per capita is now already considerably higher than it was at the end of the 1980s.

Economic growth in 2006 was underpinned by an export-led surge in manufacturing. Actually, value-added produced in industry grew even faster than gross industrial production (the corresponding year-on-year rates for the first three quarters of 2006 were 9.8% and 6.7%, respectively), the increasing value-added content likely suggesting quality upgrading of products. Another positive development has been the lasting surge in manufacturing productivity, which during the past several years outpaced by a large margin the growth in real wages. The implied decline in real unit labour costs suggests a significant improvement in international competitiveness. Therefore it is not surprising that the FDI-led revival in Bulgaria's manufacturing in recent years (real gross manufacturing output doubled between 2000 and 2006) has been matched by a strong surge in exports and increased openness of the economy. The value of total merchandise exports (in current euro terms) in 2006 was twice as large as that in 2002; during the same four-year period, the share of exports in GDP increased from 36.7% to 48.9%.

Robust domestic demand has been an important pillar of Bulgaria's economic revival and continued to provide strong support to economic activity in 2006. Real private consumption and fixed investment grew at similar rates to those recorded in 2005 despite a considerable slowdown in the pace of credit expansion in most recent months. The buoyant domestic demand added further steam also to merchandise imports, which grew (in euro value terms) by 25% in 2006, reaching some 70% of GDP.

The situation in the labour market continued to improve and in 2006 the unemployment rate fell to single digits, comparable to the EU average rate. The rise in total employment during the past several years exceeded the reduction in the number of unemployed, suggesting an increasing economy-wide activity rate, thanks to new entrants to the labour market and comebacks from inactivity of previously discouraged people. There are growing shortages of high-skilled labour as well as of certain specific skill categories (in particular construction workers and operatives in the tourist industry). At the same time, the pool of unemployed remains relatively large, comprising mostly persons with low or inadequate skills. The mounting labour market tensions are already exerting upward pressures on wages. Nevertheless, so far there are no wage-related concerns regarding competitiveness, given the rapid growth in productivity.

In terms of the actual outturn, the fiscal stance remained rather tight in 2006, partly under the continuing pressure by the IMF (the precautionary agreement was extended to March 2007) but also due to positive developments that are not easy to envisage *ex ante*. Thus in recent years (2006 included), the actual fiscal revenue has persistently exceeded the *ex ante* projections, despite concomitant reductions in the statutory tax burden, largely due to ongoing continuous improvements in tax collection. While there is probably little room left for further improvements in the efficiency of tax collection, such 'windfall fiscal gains' have allowed the government to retire large amounts of public debt prior to its maturity. Upon EU accession, there will be a major changeover in the administration of VAT (possibly with negative implications on collection): most of it was until now collected by the customs offices, which will no longer perform this function with respect to intra-EU imports.

The large current account deficit appears as one of the few adverse features that taint this seemingly rosy picture. So far the Bulgarian authorities (and, for that matter, their advisors from the IMF) have not been able – despite numerous attempts – to come up with effective policy instruments to arrest its widening; it is not clear whether such measures can at all be conceived, given Bulgaria's macroeconomic policy framework. Actually, so far there have not been any visible negative macroeconomic implications of this deficit (moreover, in 2006 it was fully matched by inward FDI), apart from the accumulated private foreign debt, which amounted to slightly over 50% of GDP at the end of 2006. Perhaps the main focus of future public policies in this area should be on prudential measures related to the prevention of excessive and unjustifiable risks associated with such borrowing.

Bulgaria has all the potential to remain on a fast-track catch-up path, provided that politicians avoid the traps of policy complacency. This is probably the greatest risk for Bulgaria's policy makers after the EU entry, when they may be tempted to see their long-term mission as accomplished, and when they will no longer be under the scrutiny of the IMF's watchful eye. As clearly seen by the experience of some of the new EU members of the 2004 wave, the risks of policy complacency are real and not insignificant.

In any case, the short-term outlook for the Bulgarian economy is positive. In 2007 GDP is expected to continue to grow at a rate similar to that seen in 2006. The situation in the labour market should continue to improve further, in terms of both growing employment and falling unemployment rates. The expected wage rises could add to the inflationary pressures, with the rate of inflation remaining relatively high by EU standards. The general government budget will likely remain in surplus, but one of a smaller magnitude compared to 2006.

Table BG

Bulgaria: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 [1)]	2007	2008
								forecast	
Population, th pers., end of period	8149.5	7891.1	7845.8	7801.3	7761.0	7718.8	7680	.	.
Gross domestic product, BGN mn, nom.	26752.8	29709.2	32335.1	34546.6	38275.3	41948.1	48000	53500	59000
annual change in % (real)	5.4	4.1	4.9	4.5	5.7	5.5	6.2	6	5.5
GDP/capita (EUR at exchange rate)	1674	1920	2101	2258	2515	2771	3190	.	.
GDP/capita (EUR at PPP - wiiw)	5320	5840	6090	6740	7230	7730	8500	.	.
Gross industrial production									
annual change in % (real)	8.3	1.5	6.5	14.1	13.8	8.4	5.9	5	6
Gross agricultural production									
annual change in % (real)	-9.9	1.1	5.3	-9.9	6.6	-6.0	0.6	.	.
Construction output total									
annual change in % (real)	8.0	14.2	2.7	5.6	35.2	1.0	.	.	.
Actual final consump.of househ., BGN mn, nom.	20687.8	23009.1	24822.9	26846.0	29324.5	33066.7	37000	.	.
annual change in % (real)	4.9	4.6	3.4	7.1	4.9	7.4	7	6	5.5
Gross fixed capital form., BGN mn, nom.	4206.0	5415.2	5908.5	6694.4	7969.4	9971.1	12000	.	.
annual change in % (real)	15.4	23.3	8.5	13.9	13.5	19.0	18	15	15
LFS - employed persons, th, avg.	2794.7	2698.8	2739.6	2834.8	2922.5	2980.0	3100	3200	3300
annual change in %	-2.8	-3.4	1.5	3.5	3.1	2.0	4	3	3
Reg. employees in industry, th pers., avg.	662.0	658.4	666.8	689.5	695.8	693.0	.	.	.
annual change in %	-8.4	-0.5	1.3	3.4	0.9	-0.4	.	.	.
LFS - unemployed, th pers., average	566.8	663.9	592.4	448.7	399.7	334.2	310	280	250
LFS - unemployment rate in %, average	16.9	19.7	17.8	13.7	12.0	10.1	9	8	7
Reg. unemployment rate in %, end of period	17.9	17.3	16.3	13.5	12.2	10.7	9.1	8.5	7.5
Average gross monthly wages, BGN	224.5	240.0	257.6	273.3	292.4	323.7	355	.	.
annual change in % (real, gross)	1.3	-0.5	1.5	3.7	0.8	5.4	2.2	.	.
Consumer prices, % p.a.	10.3	7.4	5.8	2.3	6.1	5.0	7.3	5	5
Producer prices in industry, % p.a.	17.5	3.8	1.2	4.9	6.0	6.9	9.4	6	5
General governm. budget, nat.def., % GDP									
Revenues	41.4	39.8	38.7	40.7	41.4	42.9	41.7	.	.
Expenditures	42.0	40.4	39.4	40.7	39.7	39.7	38.1	.	.
Deficit (-) / surplus (+), % GDP	-0.6	-0.6	-0.7	0.0	1.7	3.2	3.7	1	1
Public debt in % of GDP [2)]	73.6	66.2	53.2	46.2	38.8	29.9	25	21	17
Gross external debt in % of GDP	86.9	78.6	65.1	60.2	64.2	70.5	.		
Base rate of NB % p.a., end of period	4.7	4.7	3.4	2.9	2.4	2.1	3.3	.	.
Current account, EUR mn	-761.4	-855.2	-402.5	-972.3	-1131.3	-2427.0	-3878.8	-3700	-4000
Current account in % of GDP	-5.6	-5.6	-2.4	-5.5	-5.8	-11.3	-15.8	-13.5	-13.3
Gross reserves of NB excl. gold, EUR mn	3390.6	3734.0	4247.1	4981.0	6443.0	6815.7	8309.0	.	.
Gross external debt, EUR mn	11882.7	11934.9	10768.9	10640.6	12571.6	15110.7	18726.5 [XI]	.	.
Gross external debt in % of GDP	86.9	78.6	65.1	60.2	64.2	70.5	.	.	.
FDI inflow, EUR mn	1103.3	903.4	980.0	1850.5	2727.5	2326.0	4015.0	4000	3800
FDI outflow, EUR mn	3.5	10.8	28.9	23.3	-165.6	249.1	88.2	.	.
Exports of goods, BOP, EUR mn	5253.1	5714.2	6062.9	6668.2	7984.9	9466.3	11982.6	14000	15700
annual growth rate in %	40.7	8.8	6.1	10.0	19.7	18.6	26.6	17	12
Imports of goods, BOP, EUR mn	6533.0	7492.6	7940.9	9093.8	10938.4	13809.2	17267.6	19800	22000
annual growth rate in %	37.8	14.7	6.0	14.5	20.3	26.2	25.0	15	11
Exports of services, BOP, EUR mn	2366.2	2428.7	2455.0	2728.7	3261.8	3482.9	3897.0	4250	4700
annual growth rate in %	40.3	2.6	1.1	11.1	19.5	6.8	11.9	10	11
Imports of services, BOP, EUR mn	1818.6	2097.7	1949.6	2176.0	2569.3	2805.3	3317.6	3750	4200
annual growth rate in %	31.7	15.3	-7.1	11.6	18.1	9.2	18.3	14	12
Average exchange rate BGN/USD	2.124	2.185	2.077	1.733	1.575	1.574	1.559	.	.
Average exchange rate BGN/EUR (ECU)	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956
Purchasing power parity BGN/USD	0.541	0.561	0.582	0.555	0.574	0.588	0.608	.	.
Purchasing power parity BGN/EUR	0.616	0.643	0.675	0.655	0.681	0.701	0.734	.	.

Note: The term ‘industry’ refers to NACE classification C+D+E.

1) Preliminary. - 2) According to ESA'95, excessive deficit procedure.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Leon Podkaminer

The Czech Republic: after record trade surplus, growth to slow down

The impressive performance of the Czech economy has continued, with 5.8% GDP growth reported for the third quarter of 2006. However, this official estimate is likely to be eventually subject to a downward revision, which appears to be a regular practice of the Czech statistical office. In December 2006 the CZSO lowered its GDP growth estimates for the three preceding quarters, with the highest revision for the first quarter of 2006, substituting 6.4% for the proud 7.1% initially announced. Since the beginning of 2006 private consumption has been growing steadily at about 4%, definitely faster than in the recent past. Government consumption fell in both the second and third quarters of 2006. In part the decline in government consumption is a 'base effect' of high one-off purchases of weaponry for the army in 2005 (but possibly also on account of the prolonged formation of the new government). Private consumption has been contributing about 2 percentage points (p.p.) to overall GDP growth in the first three quarters of 2006. The nation-wide wage bill rose 4.4% (in real terms). However, the gross mixed income of the household sector (i.e. of the small family businesses) has been contracting in real terms. Growth in real disposable income of the entire household sector has been lagging behind the real growth in household consumption (since 2003). This tendency is accompanied by a progressively declining saving rate of the household sector. Very low interest rates on household deposits (about 1%) do not encourage saving while much higher interest rates on loans (above 5%) do not deter a sustained rise in lending to households. The ratio of bank debt to households' disposable income (close to 33%) is quite low by international standards. A further rise in lending (primarily supporting households' housing investment) is to be expected in the future.

Growth in the gross operating surplus of the corporate sector has been accelerating. In the first three quarters of 2006 the surplus rose over 8% nominally (close to an estimated 7% in real terms[18]). The dynamics of gross operating surplus corresponds to the dynamics of gross fixed capital formation (investment), which rose in real terms by about 6.7% in the first three quarters of 2006. The contribution of rising fixed investment to GDP growth was moderate (estimated at about 1.7 p.p.).

Inventories have continued to rise for the fourth quarter running. Their impact on GDP growth recorded in the first three quarters of 2006 matches that of fixed investment (1.7 p.p.). The data available do not say anything on the composition of inventories. However, some indirect evidence indicates that the share of 'work in progress' in the rising inventories may be rather low. The implication would be that rising inventories represent primarily accumulating stocks of finished products (but perhaps also of raw materials). Should the inventories become excessive, in due time they may require de-stocking which would then suppress overall GDP growth.

The contribution of foreign trade (goods and non-factor services) to GDP growth fell to about 0.9 p.p. in the first three quarters of 2006 (down from about 4.1 p.p. in the same period of 2005). This dramatic change in the role of foreign trade in generating overall growth happened quite abruptly. Throughout 2005 exports grew about 5 p.p. faster than imports (in real terms). But in the first quarter

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18 The price deflator for gross capital formation was about 1% in 2006. It may be worth noticing that in current euro terms the gross operating surplus of the corporate sector rose by 13.7%. (On average the Czech koruna strengthened, nominally, by 5.3% vs. the euro in 2006.)

of 2006 that differential narrowed to about 2 p.p., followed by 1 p.p. in the third. Moreover, it should be remembered that in 2005 the one-off purchases of arms inflated the recorded imports (and of course lowered the size of the trade surplus that would have been recorded in absence of those purchases). In 2006 the dynamics of 'regular' imports (disregarding the effects of imports of arms) appears to be higher than the real growth of exports. Despite this, the trade surplus was record high in nominal terms.

It must be stressed that the change in the role of trade involves an acceleration of imports. There are no signs of a slowdown in the growth of exports, which continue to rise at double-digit rates. Such a speed of export growth is a sign of advanced structural change in the export sector, with a further rise in the share of medium-high-tech goods (such as machinery, and electrical and transport equipment, produced primarily by FDI firms). Of course, the ability of exports to expand at double-digit rates will depend on the presence of proper production capacities. At present the average level of capacity utilization is very high (close to 87%). This may limit growth of exports for a while. The completion of new FDI manufacturing projects (e.g. car factories) currently under way will add to export capacities in 2008 and beyond.

The ongoing improvements in labour productivity and falling unit labour costs, which seem to have been strongest in the export-oriented sectors, may be insufficient in the more traditional sectors supplying price-elastic, lower-tech products. The continuous nominal appreciation of the Czech koruna not only affects negatively exports of such products (e.g. textiles, food, beverages and tobacco), but also encourages their higher imports. While rising imports of competitively priced consumer goods will support further beneficial structural changes, at the same time they will be limiting the overall contribution of foreign trade to GDP growth, and GDP growth itself.

Employment has been growing steadily, if slowly, with the unemployment rate falling. In actual fact employment (and output) could have been higher provided more labour had been available. That the demand for labour in some segments of the economy already exceeds its supply is confirmed by the fact that the registered employment of foreigners rose by about 18% within one year.[19] (Of course, the number of unregistered working foreigners has probably risen even faster.) Interestingly, emerging labour shortages do not seem to be strengthening growth in wages. Wages follow a rising trend, without outpacing labour productivity. In fact wages lag behind aggregate output: the share of employees' compensation in the GDP is falling consistently, if not very strongly. (In 2003 that share stood at 43.8%, in 2006 it probably reached 43%.) One possible reason why labour shortages do not translate into more pronounced wage hikes may have something to do with the presence of a reserve army of employable foreigners, who stand ready to displace native employees, should these demand too much. Besides, the constant pressure from low-price imports of standard goods may be disciplining both business and workers. The latter may believe that easy success in getting higher wages may come at a higher risk of unemployment in the near future. Even if such unemployment were to be reasonably temporary, it may nonetheless be considered too painful.

The reasons underlying the fairly slow drift in wages explain, to a large extent, also the relatively low inflation. Despite very high levels of capacity utilization, producer price inflation slowed down in 2006

[19] Compensation of foreign workers reported by the balance of payments amounted to 0.6% of the GDP in 2005 and (an estimated) 1% in 2006.

Table CZ

Czech Republic: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 [1)]	2007	2008
								forecast	
Population, th pers., mid-year	10272.5	10224.2	10200.8	10201.7	10206.9	10234.1	10266	.	.
Gross domestic product, CZK bn, nom. [2)]	2189.2	2352.2	2464.4	2577.1	2781.1	2970.3	3220	3470	3750
annual change in % (real) [2)]	3.6	2.5	1.9	3.6	4.2	6.1	5.9	5	5
GDP/capita (EUR at exchange rate) [2)]	5985	6750	7841	7933	8540	9745	11068	.	.
GDP/capita (EUR at PPP - wiiw) [2)]	13020	13730	14580	15390	16380	17290	18790	.	.
Gross industrial production									
annual change in % (real) [3)]	1.5	6.7	1.9	5.5	9.6	6.7	10	8	8
Gross agricultural production									
annual change in % (real)	-4.5	2.5	-4.4	-7.6	14.9	-4.8	.	.	.
Construction industry									
annual change in % (real)	5.3	9.6	2.5	8.9	9.7	4.2	6	.	.
Consumption of households, CZK bn, nom. [2)]	1134.7	1206.9	1248.1	1317.4	1391.1	1454.4	.	.	.
annual change in % (real) [2)]	1.3	2.3	2.2	6.0	2.5	2.8	4	4.5	4
Gross fixed capital form., CZK bn, nom. [2)]	612.5	659.3	677.8	687.5	729.3	740.9	.	.	.
annual change in % (real) [2)]	5.1	6.6	5.1	0.4	4.7	1.3	7	6	4
LFS - employed persons, th, avg. [4)]	4731.6	4750.2	4764.9	4733.2	4706.6	4764.0	4810	.	.
annual change in %	-0.7	0.4	0.3	-0.7	-0.6	1.2	1	1	1
LFS - employed pers. in industry, th, avg. [4)]	1429.4	1470.6	1463.1	1424.7	1409.0	1422.0	1490	.	.
annual change in %	-2.7	2.9	-0.1	-2.6	-1.1	0.9	5	.	.
LFS - unemployed, th pers., average	454.5	421.0	374.1	399.1	425.9	410.2	380	.	.
LFS - unemployment rate in %, average [4)]	8.8	8.1	7.3	7.8	8.3	7.9	7.3	6.7	6.5
Reg. unemployment rate in %, end of period	8.8	8.9	9.8	10.3	9.5	8.9	7.7	7.5	7.5
Average gross monthly wages, CZK [5)]	13614	14793	15866	16917	18041	19024	20200	.	.
annual change in % (real, gross)	2.4	3.8	5.4	6.5	3.7	3.4	3.6	3.6	3.6
Consumer prices, % p.a.	3.9	4.7	1.8	0.1	2.8	1.9	2.5	2.5	3
Producer prices in industry, % p.a.	4.9	2.8	-0.5	-0.4	5.7	3.0	1.6	2.5	2
General governm. budget, EU-def., % GDP [6)]									
Revenues	38.1	38.7	39.5	40.7	41.5	40.4	40.1	40.2	40.5
Expenditures	41.8	44.5	46.3	47.3	44.4	44.1	43.6	43.8	43.8
Deficit (-) / surplus (+)	-3.7	-5.7	-6.8	-6.6	-2.9	-3.6	-3.5	-3.6	-3.2
Public debt, EU-def., in % of GDP [6)]	18.2	26.3	28.5	30.1	30.7	30.4	30.9	30.8	31.0
Discount rate, % p.a., end of period	5.0	3.8	1.8	1.0	1.5	1.0	1.5	.	.
Current account, EUR mn	-2945	-3652	-4426	-5044	-5245	-2071	-5000	-5500	-5500
Current account in % of GDP	-4.8	-5.3	-5.5	-6.2	-6.0	-2.1	-4.4	-4.4	-4.0
Gross reserves of NB incl. gold, EUR mn	14159	16400	22614	21340	20884	25054	23755	.	.
Gross external debt, EUR mn	23285	25368	25738	27624	33212	38818	40995 IX	.	.
Gross external debt in % of GDP	37.9	36.8	32.2	34.1	38.1	38.9	.	.	.
FDI inflow, EUR mn	5404	6296	9012	1863	4007	8837	5100	.	.
FDI outflow, EUR mn	47	185	219	183	817	688	1300	.	.
Exports of goods, BOP, EUR mn	31483	37251	40711	43051	53995	62961	75600	85000	95000
annual growth rate in %	27.8	18.3	9.3	5.7	25.4	16.6	20	12	12
Imports of goods, BOP, EUR mn	34876	40675	43026	45243	54824	61606	73900	84000	95000
annual growth rate in %	32.0	16.6	5.8	5.2	21.2	12.4	20	13	13
Exports of services, BOP, EUR mn	7436	7913	7501	6882	7790	8662	9300	.	.
annual growth rate in %	12.5	6.4	-5.2	-8.3	13.2	11.2	7	.	.
Imports of services, BOP, EUR mn	5904	6211	6792	6466	7397	8011	8700	.	.
annual growth rate in %	7.6	5.2	9.4	-4.8	14.4	8.3	9	.	.
Average exchange rate CZK/USD	38.59	38.04	32.74	28.23	25.70	23.95	22.60	.	.
Average exchange rate CZK/EUR (ECU)	35.61	34.08	30.81	31.84	31.90	29.78	28.34	28.0	27.5
Purchasing power parity CZK/USD	14.37	14.57	14.27	13.89	14.03	14.08	14.02	.	.
Purchasing power parity CZK/EUR	16.37	16.76	16.57	16.41	16.63	16.79	16.69	.	.

Note: The term ‘industry’ refers to NACE classification C+D+E.

1) Preliminary. - 2) According to ESA'95 (FISIM-adjusted and real change based on previous year prices). - 3) According to new calculation. - 4) From 2002 weighted according to census 2001. - 5) Enterprises with more than 20 employees, including part of the Ministry of Defence and the Ministry of the Interior. - 6) According to ESA'95, excessive deficit procedure.

Source: wiiw Database incorporating national statistics; Eurostat; European Commission (Autumn 2006); wiiw forecasts.

(also on account of the nominal appreciation of the Czech koruna). Consumer price inflation was somewhat higher than in 2005. However, approximately one third of the current inflation is the direct effect of rising indirect taxes and regulated prices (utilities). Interestingly, higher oil prices did not seem to have secondary impacts.

In September 2006 the Czech National Bank responded to higher inflation by raising its interest rates by 0.5 p.p. Despite this interest rates are quite low, and unlikely to rise significantly either in 2007 or 2008. Yields on ten-year government bonds are lower than in the euro area. Despite this the Czech currency keeps strengthening nominally.

The political situation remains unstable. The new government installed in December 2006 does not have any solid parliamentary backing and is unlikely to serve the full term. This will certainly limit its ability to consolidate public finances. The general government deficit in 2007 will probably surpass the 4% of GDP mark, in violation of the 3.3% target set in the 2005 Convergence Programme. Increased social spending is mandated by new pieces of legislation. Besides, a part of the deficit seems to result from the old obligations incurred in the aftermath of the banking crisis of 1996. Despite high deficits, public debt remains quite low (less than 30% of the GDP). Given the low interest rates on the government debt and quite fast economic growth, the fiscal situation is not really bad. Nonetheless, it will take time before the Czech Republic can be admitted into the Exchange Rate Mechanism. (The Czech authorities are not in a hurry to join the eurozone anyway.)

Summing up, GDP growth is likely to slow down somewhat in 2007, primarily on account of a stronger rise in imports. Besides one can expect some adjustments following the very strong accumulation of inventories. Supply bottlenecks (labour shortages, very high levels of capacity utilization) may also restrict export growth, at least temporarily. But the ‘fundamentals’ remain solid: positive structural changes go on, labour productivity growth remains strong, wage hikes are moderate, and inflation and interest rates are very low. Moreover, despite continuing currency appreciation, foreign trade will continue to generate respectable surpluses. There is only one cloud overshadowing this otherwise rosy picture: the income of foreign investors, which is larger than the trade surpluses, is rising even faster than the latter.

Sándor Richter

Hungary: first impacts of the austerity programme

The general government deficit in 2006 was somewhat smaller (below 10% of the GDP) than forecast by the government in the updated Hungarian convergence programme: tax revenues were higher than assumed during the elaboration of the economic policy measures aimed at achieving a turn in fiscal policy. Growth of domestic demand has been decelerating, in parallel with exports expanding at a considerably higher rate than imports.

The GDP grew by 4.2% in the first three quarters, with no substantial deceleration over the year. With more effects from the austerity package to be expected for the last quarter, annual growth may have amounted to 4%. Significant shifts, however, took place in the components of growth. The growth rate of household consumption halved over the year and fell below 1% in the third quarter.

This is in line with the required rearrangement set out in the updated convergence programme. But there was also a surprising decline in gross fixed capital formation: while in the first quarter the expansion was close to 10%, it dropped below zero in the second and third quarters. Thus net export figured as the real engine of growth in 2006.

Industry managed to preserve its growth momentum. Based on rapidly increasing export sales, industrial output expanded by an estimated 10% in 2006. Transport vehicles, with a share of more than one quarter in manufacturing exports, may have recorded a foreign sales expansion of up to 30%; the other Hungarian 'flagship' branch, the manufacture of electrical and optical equipment, providing 40% of manufacturing exports, may have increased by 13%. Labour productivity in industry was more than 10% higher than in the previous year. The good news is that the industrial growth rate in two 'problem regions', Northern Hungary and the Northern Great Plain, was above the national average. The bad news is the decline of investment in the manufacturing sector (by 6% in the first three quarters of the year).

Value-added produced in agriculture and construction declined. Apart from output also investments fell in these two sectors in 2006. In the services sector output expanded; the most rapid expansion took place in financial intermediation and real estate, renting and business services.

The foreign trade performance has remained impressive. In the first eleven months the growth rate of exports of goods surpassed that of imports by 4 percentage points in real terms. Due to a nearly 2% deterioration in the terms of trade, caused by higher energy prices, the difference between export and import growth rates is smaller in current euro terms but still considerable. In 2006 the trade deficit was 26% less than in 2005. The services trade surplus increased in the first three quarters of 2006, with an export growth rate close to 3 percentage points higher than that of imports. In tourism, the main component in services trade, the balance improved as a result of a substantial drop in Hungarian tourists' spending abroad.

The current account position improved in the third quarter. The deficit was 22% smaller in the first three quarters of 2006 than it was in the respective period of the previous year. The net financing requirement of the economy (the current account and the capital account combined) amounted to EUR 3.7 billion, 12% less than in the first three quarters of 2005.

The exchange rate of the forint has shown a curious cycle in the past 12 months. Starting with a HUF/EUR rate of 250-253 in early 2006, it weakened to above 260 in mid-March and further to 280 in the summer. In a turnaround, the forint strengthened to below 270 in mid-October and below 260 in mid-November, only to return to its level just a year earlier in January 2007. While the autumn turnaround in the exchange rate development is understandable due to the submission (and approval) of the updated Hungarian convergence programme to the EU and a partial restoration of confidence of international investors, the current strength of the forint cannot be easily explained. The convergence programme itself reckoned with an exchange rate of 272.5 HUF/EUR throughout the period 2007-2009. The possible explanation is that with the stabilization programme in place and the street demonstrations over, the forint exchange rate is again driven by global factors with an impact on all currencies of the region rather than by home-made factors.

Table HU

Hungary: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 [1]	2007	2008
								forecast	
Population, th pers., end of period	10200.3	10174.9	10142.4	10116.7	10097.5	10076.6	10067	.	.
Gross domestic product, HUF bn, nom. [2]	13150.8	15274.9	17203.7	18935.7	20712.3	22026.8	23900	26200	28000
annual change in % (real) [2]	5.2	4.1	4.3	4.1	4.9	4.2	4.0	2.7	3.1
GDP/capita (EUR at exchange rate) [2]	4953	5841	6970	7374	8142	8803	8979	.	.
GDP/capita (EUR at PPP - wiiw) [2]	10530	11860	12720	13230	13930	14670	15790	.	.
Gross industrial production									
annual change in % (real)	18.1	3.6	2.8	6.4	7.4	7.0	10	8	9
Gross agricultural production									
annual change in % (real)	-6.5	15.8	-4.1	-4.5	22.9	-8.5	.	.	.
Construction industry									
annual change in % (real)	7.9	7.7	17.5	2.2	6.8	18.8	-1.6	.	.
Consumption of households, HUF bn, nom. [2]	6689.2	7901.6	9076.6	10229.7	11003.8	11827.0	.	.	.
annual change in % (real) [2]	4.4	6.3	10.6	8.3	2.9	3.7	2.0	-0.3	1
Gross fixed capital form., HUF bn, nom. [2]	3179.8	3499.7	3941.5	4156.0	4631.2	4995.3	.	.	.
annual change in % (real) [2]	7.7	5.1	10.1	2.1	7.7	5.6	2.0	3	4
LFS - employed persons, th, avg.	3856.2	3868.3	3870.6	3921.9	3900.4	3901.5	3932	.	.
annual change in %	1.2	0.3	0.1	1.3	-0.5	0.0	0.8	.	.
Reg. employees in industry, th pers., avg. [3]	844.8	833.9	817.9	801.8	785.4	762.9	751	.	.
annual change in %	1.3	-1.3	-1.9	-2.0	-2.0	-2.9	-1.5	.	.
LFS - unemployed, th pers., average	263.7	234.1	238.8	244.5	252.9	303.9	317	.	.
LFS - unemployment rate in %, average	6.4	5.7	5.8	5.9	6.1	7.2	7.5	7.9	7.8
Reg. unemployment rate in %, end of period	8.6	8.0	8.0	8.3	9.1	9.3	9.0	.	.
Average gross monthly wages, HUF [3]	87645	103553	122482	137193	145521	158343	170600	.	.
annual change in % (real, net)	1.5	6.4	13.6	9.2	-1.0	6.3	3.2	0	1
Consumer prices, % p.a.	9.8	9.2	5.3	4.7	6.8	3.6	3.9	6.3	3.5
Producer prices in industry, % p.a.	11.6	5.2	-1.8	2.4	3.5	4.3	6.8	7	4.5
General governm. budget, EU-def., % GDP [4]									
Revenues	43.6	44.0	43.0	42.8	43.5	43.4	.	.	.
Expenditures	46.5	47.4	51.2	49.1	48.8	49.9	.	.	.
Deficit (-) / surplus (+)	-3.0	-3.5	-8.2	-6.3	-5.3	-6.5	-9.7	-6.5	-4
Public debt, EU-def., in % of GDP [4]	55.4	52.2	54.0	55.8	56.3	57.7	.	.	.
Refinancing rate, % p.a., end of period	11.0	9.8	8.5	12.5	9.5	6.0	8.0	.	.
Current account, EUR mn	-4352.4	-3576.5	-4929.2	-5933.0	-6915.5	-6002.3	-5600	-5000	-4600
Current account in % of GDP	-8.6	-6.0	-7.0	-7.9	-8.4	-6.8	-6.2	-4.9	-4.1
Reserves total, excl. gold, EUR mn	12038.4	12163.7	9887.4	10108.3	11670.9	15678.4	16349.2	.	.
Gross external debt, EUR mn	32571.5	37387.0	38559.3	46041.1	55150.1	66297.6	75958.5 [IX]	.	.
Gross external debt in % of GDP	64.4	62.8	54.5	61.6	67.0	74.7	.	.	.
FDI inflow, EUR mn	2998.4	4390.7	3185.1	1887.5	3633.3	5558.9	4500	.	.
FDI outflow, EUR mn	664.4	398.5	295.7	1463.4	892.1	1422.0	1000	.	.
Exports of goods, BOP, EUR mn	31277.5	34697.1	36820.7	37906.9	44779.1	50119.9	57900	65700	73600
annual growth rate in %	30.0	10.9	6.1	2.9	18.1	11.9	16	13.5	12
Imports of goods, BOP, EUR mn	34457.1	37192.8	39024.1	40804.5	47232.3	51579.9	57800	63600	70000
annual growth rate in %	32.0	7.9	4.9	4.6	15.8	9.2	12	10	10
Exports of services, BOP, EUR mn	6429.2	7864.7	7820.0	8122.5	8769.5	10313.0	10600	11870	13300
annual growth rate in %	30.9	22.3	-0.6	3.9	8.0	17.6	3	12	12
Imports of services, BOP, EUR mn	5194.8	6203.3	7233.1	8074.6	8532.5	9584.5	9600	10400	11200
annual growth rate in %	26.9	19.4	16.6	11.6	5.7	12.3	0	8	8
Average exchange rate HUF/USD	282.27	286.54	258.00	224.44	202.63	199.66	210.51	.	.
Average exchange rate HUF/EUR (ECU)	260.04	256.68	242.97	253.51	251.68	248.05	264.27	255	250
Purchasing power parity HUF/USD	107.37	109.89	114.72	119.60	124.05	124.90	126.39	.	.
Purchasing power parity HUF/EUR	122.35	126.47	133.11	141.31	147.12	148.89	150.26	.	.

Note: The term ‘industry’ refers to NACE classification C+D+E.

1) Preliminary. - 2) According to ESA'95, from 2001 FISIM-adjusted and real change based on previous year prices. - 3) Enterprises with more than 5 employees. - 4) According to ESA'95, excessive deficit procedure.

Source: wiiw Database incorporating national statistics; Eurostat; wiiw forecasts.

The public finance reform started with breaking old taboos. First, the system of subsidization of household gas consumption was changed. Earlier, each household's consumption had been subsidized. In the new system principally each household pays the full price for the whole amount of gas consumed, but low-income families may apply for subsidy. The new regime tries to focus support on the most needy strata of the society, but due to the unreliable income statements and the high share of unreported incomes the new system is far from being fair in practice, with administrative costs much higher than under the old system. Second, a fee for medical checks was introduced, support for operating costs of hospitals was cut and subsidies on medicine were reduced. Though curbing the ever increasing costs in the healthcare sector is seen as unavoidable, there are emotionally heated debates concerning each detail of the changes announced and the reforms have come under fire from all directions. The unsatisfactory impact assessment, the missing reconciliation with those involved and the miserable communication of the targets and means of the reform leave the impression that implementation according to the original plans cannot be seen as guaranteed.

2007 is supposed to bring about further public finance reforms. The pension system is planned to be reconsidered in terms of contributions, retirement age and indexation of benefits. Decisions will have to be made about the new institutional system of health insurance and the reform of invalidity pensions. The principles of a tax on real estate will have to be elaborated and discussed together with the abolition of the local sales tax, both changes being of utmost importance for the financing of local governments.

In 2007 household consumption will marginally decline, in line with real wages. There will be a considerable decrease in public consumption. Gross fixed capital formation will moderately increase, but the main driving force of growth will be net export, as exports are expected to rise faster than imports by about 3 percentage points. Exports of goods and services may surpass the value of imports for the first time since transition began. Nevertheless, this positive development may only moderate the deceleration of economic growth, to about 2.7% from 4% in 2006. Inflation will be high in the first half of the year due to price rises related to the economic policy measures introduced in the second half of 2006, but it will decline by the end of the year so that average annual inflation will amount to about 6-6.5%. Unemployment will be somewhat higher than in 2006. The stabilization in public finances will continue, the general government balance is likely to be somewhat better (6.5% of the GDP) than the cautiously set target of the convergence programme. The forint may keep its currently strong position unless serious political unrest appears and the suspension of the stabilization and the launched reforms becomes a real danger.

Leon Podkaminer

Poland: investment expansion gathers momentum

GDP growth accelerated further to an estimated 6.3% in the fourth quarter of 2006. Private consumption contributed 3.4 percentage points (p.p.) to the overall GDP growth during the first three quarters of the year, with gross fixed investment and foreign trade adding another 2.2 and 0.3 p.p. respectively.

Growth of private consumption in the whole year 2006 (about 5.2%) has continued to lag behind the rising nation-wide wage bill and total social security spending (in real terms up around 7% and 6% respectively). The gap between rising disposable incomes and private consumption seems to be reflecting households' increasing housing investment (which has been additionally boosted by a truly massive expansion of housing credit to the household sector).

Growth of gross fixed investment (in firms employing over 50 persons) speeded up sharply, from 7.7% in the first quarter of 2006 to 19.8% in the third. Larger firms' investments in machinery, tools and installations rose by 23%, and in buildings and structures by about 5%. Concurrently, a strong contraction in inventories has continued at the national level.

The acceleration of growth of domestic demand to 6.1% in the third quarter of 2006, combined with a further appreciation of the Polish currency, proved sufficient to reduce the contribution of foreign trade to GDP growth by 1 p.p. In the third quarter of 2006 the longer-term tendency for exports to rise faster than imports was reversed. In the entire year 2006 the contribution of foreign trade to GDP growth was about 0 (down from 1.1 p.p. in 2005).

There are good grounds to expect the current investment expansion to continue. First, despite its recent impressive growth rates, the share of investment in the GDP is still relatively low, even by Polish standards.[20] Second, the economy is currently running at record levels of utilization of productive capacities. The average (employment-weighted) level of capacity utilization in the corporate sector has reached over 85%. (Capacity utilization in the construction sector as well as in industrial firms delivering primarily capital goods approaches 90%, in export-oriented firms it is close to 87%.) Third, profitability has been very high and generally rising across all sectors and branches (excluding the loss-making tobacco industry). Net profits of the entire corporate sector rose from PLN 40 billion in the first three quarters of 2005 to PLN 50.7 billion in the same period of 2006. All liquidity indicators for the corporate sector are looking very good, with record low numbers of firms in financial distress. (At end-2006 some 95% of firms fully observed their credit obligations, compared to e.g. 75% in late 2002.[21] In actual fact some 40% of the firms polled judge their own money balances to be much in excess of current needs.) Quite obviously, the financing of investment outlays is generally not a problem, at least to the bulk of (larger-scale) enterprises. Those firms, primarily smaller and medium-sized ones, that are less blessed with high own financial resources have quite easy access to relatively cheap (and abundant) credit or, alternatively, try to seek funds by going public.[22] Last but not least, firms are generally very satisfied with the strength of demand: only about 6% of firms report insufficient demand (vs. 12% one year ago, 24% two years ago). Demand is generally expected to remain very strong in the coming months. This is evidenced by record levels of new orders placed. All in all, the conditions for a further expansion of investment activities are highly favourable.

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[20] In the late 1990s the GDP share of gross fixed investment stood at about 24%. Currently it is around 20%.

[21] See the report on the business climate in the first quarter of 2007 (accessible on the web page of the National Bank of Poland, www.nbp.pl/publikacje/koniumktura).

[22] Despite relatively low (by Polish standards) interest rates on bank loans (on average about 5.8%), bank credit is currently the dominant source of financing new investment projects for only about one third of firms. It is worth noting that banks have good grounds to be satisfied with the current situation as well. In the first three quarters of 2006 commercial banks made PLN 8 billion net profit (up from 6.6 billion a year earlier). Net interest income (interest revenue minus interest costs) totalled a handsome PLN 13.7 billion.

Table PL

Poland: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 [1]	2007	2008
								forecast	
Population, th pers., end of period	38254	38248	38219	38191	38174	38157	38122	.	.
Gross domestic product, PLN mn, nom. [2]	744622	779205	807860	842120	923248	980666	1047900	1123300	1203100
annual change in % (real) [2]	4.2	1.1	1.4	3.8	5.3	3.5	5.8	5.3	5
GDP/capita (EUR at exchange rate) [2]	4853	5553	5480	5013	5333	6384	7054	.	.
GDP/capita (EUR at PPP - wiiw) [2]	9390	9600	9980	10210	11050	11670	12600	.	.
Gross industrial production (sales)									
annual change in % (real)	6.7	0.6	1.1	8.3	12.6	3.7	11.3	8	7
Gross agricultural production									
annual change in % (real)	-5.6	5.8	-1.9	-0.8	7.5	-4.2	-1.8	.	.
Construction output total									
annual change in % (real)	1.0	-6.4	-0.3	0.9	-7.0	1.5	12.0 [3]	.	.
Consumption of households, PLN mn, nom. [2]	469306	497809	531100	543203	583690	607270	.	.	
annual change in % (real) [2]	3.0	2.2	3.3	1.9	4.3	1.8	5.2	5	4
Gross fixed capital form., PLN mn, nom. [2]	176739	161277	151472	153758	167158	178391	210300	.	.
annual change in % (real) [2]	2.7	-9.7	-6.3	-0.1	6.4	6.5	16.7	15	10
LFS - employed persons, th, avg. [4]	14526.0	14207.0	13782.0	13616.8	13794.8	14115.3	14600	.	.
annual change in %	-1.6	-2.2	-3.0	0.6	1.3	2.3	3.4	.	.
Reg. employees in industry, th pers., avg.	2955.0	2820.6	2670.5	2639.1	2663.1	2426.0	2481.8 [3]	.	.
annual change in %	-5.8	-4.5	-5.3	-1.2	0.9	1.1	2.3 [3]	.	.
LFS - unemployed, th pers., average [4]	2785.0	3170.0	3431.0	3328.5	3230.3	3045.3	2500		
LFS - unemployment rate in %, average [4]	16.1	18.2	19.9	19.6	19.0	17.8	15	14	13
Reg. unemployment rate in %, end of period [4]	15.1	17.5	18.0	20.0	19.1	17.6	14.9	13	12.5
Average gross monthly wages, PLN	1893.7	2045.1	2097.8	2185.0	2273.4	2360.6	2480	.	.
annual change in % (real, gross)	1.0	2.5	0.7	3.4	0.7	1.8	4	.	.
Consumer prices, % p.a.	10.1	5.5	1.9	0.8	3.5	2.1	1.0	1.8	2
Producer prices in industry, % p.a.	7.8	1.6	1.0	2.6	7.0	0.7	2.3	1.5	2
General governm. budget, EU-def., % GDP [5]									
Revenues	39.6	40.1	41.0	39.9	38.7	39.1	39.8	40.2	39.2
Expenditures	41.1	43.8	44.2	44.6	42.6	43.5	43.5	43.5	42.4
Deficit (-) / surplus (+)	-1.5	-3.7	-3.2	-4.7	-3.9	-4.4	-3.7	-3.3	-3.2
Public debt, EU-def., % of GDP [5]	36.8	36.7	39.8	43.9	41.9	42	42	42.1	41.5
Discount rate of NB % p.a., end of period	21.5	14.0	7.5	5.8	7.0	4.8	4.3	4.4	.
Current account, EUR mn	-10788	-6006	-5399	-4108	-8670	-4130	-5000	-5500	-6000
Current account in % of GDP	-5.8	-2.8	-2.6	-2.1	-4.3	-1.7	-1.9	-2.0	-2.0
Gross reserves of NB excl. gold, EUR mn	28555	29031	27367	26000	25904	34536	35235	.	.
Gross external debt, EUR mn	74670	81461	81045	84818	94881	111904	121546 [IX]	.	.
Gross external debt in % of GDP	40.2	38.4	38.7	44.3	46.6	45.9	.	.	.
FDI inflow, EUR mn	10334	6372	4371	4067	10292	7703	11200	.	.
FDI outflow, EUR mn	18	-97	228	269	636	2493	1500	.	.
Exports of goods, BOP, EUR mn	39022	46537	49338	53836	65847	77562	93500	108500	119400
annual growth rate in %	38.3	19.3	6.0	9.1	22.3	17.8	21	16	10
Imports of goods, BOP, EUR mn	52349	55094	57039	58913	70399	79804	96600	113000	126600
annual growth rate in %	23.6	5.2	3.5	3.3	19.5	13.4	21	17	12
Exports of services, BOP, EUR mn	11320	10914	10545	9850	10815	13077	16300	18300	19600
annual growth rate in %	44.2	-3.6	-3.4	-6.6	9.8	20.9	25	12	7
Imports of services, BOP, EUR mn	9773	10021	9690	9408	10033	11541	14400	16100	17200
annual growth rate in %	49.1	2.5	-3.3	-2.9	6.6	15.0	25	12	7
Average exchange rate PLN/USD	4.35	4.09	4.08	3.89	3.65	3.23	3.10	.	.
Average exchange rate PLN/EUR (ECU)	4.01	3.67	3.86	4.40	4.53	4.03	3.90	4.05	4.0
Purchasing power parity PLN/USD	1.82	1.84	1.83	1.83	1.85	1.85	1.81	.	.
Purchasing power parity PLN/EUR	2.07	2.12	2.12	2.16	2.19	2.20	2.18	.	.

Note: The term ‘industry’ refers to NACE classification C+D+E.

1) Preliminary. - 2) According to ESA'95 (FISIM-adjusted and real change based on previous year prices; revision in government sector, shadow economy, etc.). - 3) Enterprises with more than 9 employees. - 4) From 2003 according to census May 2002. - 5) According to ESA'95 excessive deficit procedure; from 2005 wiiw.

Source: wiiw Database incorporating national statistics; Eurostat; wiiw forecasts.

The high levels of capacity utilization happen to coincide with intensifying shortages of labour. About half of firms in the corporate sector report difficulties in finding properly qualified employees, 28% of firms report more or less permanent vacancies. Shortage of labour is quoted as a barrier to growth by about 11% of firms (up from 2% a year ago). Thus, the registered increase in employment (by about 3.4% in 2006) must have been restricted by the availability of labour. These facts might be hard to reconcile with the still high (though falling) unemployment levels. However, one must bear in mind that very high unemployment has persisted for a very long time. Possibly, this has made a large proportion of the afflicted virtually unemployable (on account of depreciated skills and motivations). Also, large regional variations in the availability of jobs as well as of affordable housing may be preventing a more efficient matching of labour supply with labour demand. Finally, it can be argued that the sizeable (though hard to quantify) migrations of Polish workers (primarily to Great Britain and Ireland) have been conducive to the emergence of labour shortages. Firms' standard short-term response to the symptoms of labour shortages involves, first of all, wage hikes. So far the growth of wages has been quite moderate. Nonetheless, about one third of firms (with about half of total employment) plan to raise wages in the immediate future. But the wage hikes planned remain fairly moderate (with a median value of about 5%[23]). Perhaps surprisingly, high labour costs remain a concern to only about 5% of the firms polled. (This stands in stark contrast to opinions voiced by politicians and economists, also populating international economic and financial institutions, to whom rising wages represent a major risk – next only to deficit spending.)

With moderate wage increases (combined with further strong gains in labour productivity and in unit labour costs), the very low CPI inflation (1%) recorded in 2006 is not entirely surprising. Inflation may well rise somewhat in 2007, especially as growth in consumer demand is likely to catch up with the growth of household incomes. However, the cost pressures will remain weak (energy prices are likely to weaken, or at worst stabilize, the exchange rates are likely to remain quite strong). Most importantly, much of the investment now underway is likely to further enhance productivity and/or lower costs.

At the end of 2006 the interest rate on ten-year Treasury bonds in Poland (about 5.2%) was much higher than the average long-term rate in the euro area (about 4.1%) – with inflation much higher in the latter area. The interest rate differential is still positive even vs. the US dollar (where the yield on long-term bonds is about 4.7%). This anomalous situation, reflecting primarily the (past) policy orientation of the National Bank of Poland[24], has been 'helping' to strengthen the Polish zloty vs. the euro and the dollar. Given the fact that the successor (as of January 2007) to Leszek Balcerowicz as the Head of the National Bank is unlikely to inherit the latter's hawkish temperament, the interest rate policy may be expected to be less impulsive than in the past. This may be slowing down the pace of zloty appreciation in the future.

The strong zloty has not been, as yet, affecting growth of exports negatively. Exports expand very strongly. The share of unprofitable exports is low by historical standards (about 6%, compared to e.g. 12% at end-2001). The exports' insensitivity to the strong zloty reflects the ongoing structural change (away from production and exports of lower-quality, price-elastic goods to more

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[23] See www.nbp.pl/publikacje/koniunktura.

[24] One often attributes high levels of long-term interest rates to high public sector borrowing. (Thus, in the last instance, to large fiscal deficits.) The idea behind this is that at low interest rates, public debt would not attract sufficient amounts of private capital. Because in Poland private demand for Treasury bonds is usually several times their supply, it is hard to take the 'fiscal theory' of interest rates seriously.

sophisticated, price-inelastic ones). Structural improvements seem to be correlated with the rising share of firms specializing in export production. Many large FDI firms (viz. networked suppliers of parts and components) belong to this category. It is quite obvious that such highly specialized export-oriented firms need not worry too much about (moderate) changes in the exchange rates. The situation is different on the import side. The strong zloty is of course having a positive impact on the corporate sectors' total costs (as the imported intermediate inputs constitute about 20% of all material costs). But the problem is that at the current levels of the exchange rates producers supplying primarily the domestic market express fears about intensified foreign competition, especially vs. imports invoiced in US dollar. All in all, the corporate sector identifies the levels (and volatility) of the exchange rates as restricting growth much more than any other single factor. Indirectly, this would seem to indicate that the 'captains of business' favour an early adoption of the euro. Interestingly however, the corporate sector's opinion is not shared by the present authorities at all. The authorities' kind of patriotism seems to be incompatible with giving up the national currency.

The internal (and occasionally external) policy directed by the Kaczynski brothers remains turbulent and chaotic. But it meets its goal of de facto subordinating all state institutions, including the judiciary, the Ombudsman office, public media, the National Bank, state-owned firms etc. The 'Fourth Republic' whose contours seem to be emerging out of the unending political turmoil bears some semblance to the systems popular in Europe in the inter-war period. However, the re-activation of some form of 'guided democracy' is unlikely to be ultimately successful – if only because of the Polish society's proven anti-authoritarian instincts. As far as the current economic policy is concerned, the authorities' record is not that bad, if only because inaction on economic matters seems to be a virtue now. Despite the wholesale purge running throughout the administration, the policies have remained much the same. Only as far as privatization is concerned there is a definite change: for practical purposes the process has come to a halt. Besides, good luck is clearly on the side of the current rulers. For example, the budget deficit, helped by the unanticipated acceleration in GDP growth, was lower than planned in 2006. Falling unemployment and rising transfers 'from Brussels' are helpful too. Moreover, despite widespread criticism (voiced also abroad[25]) of the style of managing the economy, foreign direct investment is pouring into the country.

Summing up, strong investment and consumption will be pulling up GDP growth in 2007-2008. Trade will cease to contribute positively to growth, though the expansion of exports will continue.

Gábor Hunya

Romania: economic boom with growing foreign imbalance

Romania entered the European Union on 1 January 2007 after a year of impressive economic growth of about 7.5%, an appreciating currency and year-end inflation reduced to below 5%. The prospects for further economic growth are bright, at least in the short run. But the widening current account deficit and the wage drift pose problems which increase currency risk and inflationary pressure. These may call for austerity measures in the future.

25 The criticisms notwithstanding, Poland's Fitch and Moody's ratings have been upgraded recently.

Private consumption has been the main driving force of economic growth while also investments have been buoyant. The former contributed 9.4% to the GDP growth rate of 7.8% in the first three quarters of 2006 while gross fixed capital formation added 3.1%. Net exports contributed 4.6% on the negative side. The expansion of construction surpassed that of all other economic sectors, reflecting stepped-up spending on roads, shopping centres and office buildings. Also industrial output grew faster than the year before, in particular in the export sectors of car manufacturing and the furniture industry. Agriculture recovered from the previous year's slump which supported the food industry and tempered inflation.

The budget deficit in 2006 exceeded 1% of GDP, according to provisional data (national methodology). The budget deficit ceiling was set to 2.5% of GDP after the government had increased the deficit target twice during the year to support infrastructure investment expenditure. Lack of administrative and construction capacities prohibited the realization of this plan.

Wage increases continued to outpace productivity growth in the economy as a whole and also in manufacturing. The wage drift fuelled private consumption and imports but not inflation. The consumer price index declined significantly, to below 7%, and the year-end pace of 4.9% hit the National Bank target.

The current account and foreign trade deficits continued to be of concern. There was a remarkable expansion of exports by some 20%, but imports grew even faster, by about 25%. The trade deficit has hardly been mitigated by other items in the current account, as trade in services was nearly balanced and the deficit on incomes was balanced by the surpluses in current transfers. The current account deficit was close to 11% of GDP; 90% of it could be financed by FDI. The latter reached an all-time high, mainly due to privatization revenues and profit reinvestments rather than to new greenfield projects.

The progress of privatization has slowed down again. At the beginning of June 2006, the privatization agency (AVAS) had in its portfolio 441 companies, of which 64 were majority state-owned including only 22 large companies. Little progress was achieved through the year due to cumbersome procedures and, in many cases, the unattractive situation of the companies offered for sale. The plan for 2007 includes the privatization of 62 companies including large companies in the utilities sector. The natural gas producer Romgaz is certainly the biggest remaining chunk, and in the banking sector this is the savings bank, CEC. There was a half-hearted attempt to sell CEC, but the price offered was declared unsatisfactory in December 2006 and the bank remained in public hands. The privatization of Romgaz is in stand-by; both President Basescu and the opposition leaders consider that it is not a priority. The energy sector is understood as sensitive. It is widely quoted that many EU countries maintain a national stronghold on energy companies, such as Gaz de France, which bought part of the gas distributor Distrigaz in Romania. Four energy distribution companies are in the 2007 privatization plan of AVAS, but no government decision has been passed yet. AVAS is also left with minority shares in a number of companies. According to the 2007 plans, in 95 cases the majority owner would buy them, while in 265 cases the shares will be offered on the Bucharest stock exchange. If these plans are successful, 2007 will be the year of the largest amount of stock exchange privatization.

Table RO

Romania: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 1)	2007	2008
								forecast	
Population, th pers., mid-year 2)	22435.2	22408.4	21794.8	21733.6	21673.3	21623.8	21584	.	.
Gross domestic product, RON mn, nom. 3)	80377.3	116768.7	151475.1	197564.8	246371.7	287186.3	329500	372000	420000
annual change in % (real) 3)	2.1	5.7	5.1	5.2	8.4	4.1	7.5	6.5	6
GDP/capita (EUR at exchange rate) 3)	1795	2002	2224	2420	2805	3665	4331	.	.
GDP/capita (EUR at PPP - wiiw) 3)	5000	5460	6060	6510	7400	8010	8460	.	.
Gross industrial production									
annual change in % (real)	7.1	8.3	4.3	3.1	5.3	2.0	7.1	6	6
Gross agricultural production									
annual change in % (real)	-14.8	22.7	-3.5	7.5	18.1	.	.	.	.
Construction output total									
annual change in % (real)	2.8	9.0	10.0	9.8	9.2	9.8	19.3	.	.
Consumption of households, RON mn, nom. 3)	55387.4	80336.9	102671.0	128150.4	164054.1	192020.5	.	.	.
annual change in % (real) 3)	-0.8	6.9	5.3	8.5	14.1	9.8	12	10	8
Gross fixed capital formation, RON mn, nom. 3)	15194.7	24115.4	32283.6	42293.0	53291.8	66356.8	.	.	.
annual change in % (real) 3)	5.5	10.2	8.2	8.5	10.8	13.1	13	12	10
LFS - employed persons, th, avg. 4)	10508.0	10440.0	9234.3	9222.5	9157.6	9146.6	9150	.	.
annual change in %	-0.3	-0.6	.	-0.1	-0.7	-0.1	0.04	.	.
Reg. employees in industry, th pers., avg.	1873.0	1901.0	1891.0	1848.0	1741.0	1704.0	.	.	.
annual change in %	-5.9	1.5	-0.5	-2.3	-5.8	-2.1	-3.7	.	.
LFS - unemployed, th pers., average 4)	775.0	711.0	845.3	691.8	799.5	704.5	700	.	.
LFS - unemployment rate in %, average 4)	6.9	6.4	8.4	7.0	8.0	7.1	7	7	7
Reg. unemployment rate in %, end of period	10.5	8.8	8.4	7.4	6.3	5.9	5.2	5	5
Average gross monthly wages, RON	284.0	422.0	532.1	663.8	818.3	957.5	1150	.	.
annual change in % (real, net)	4.2	5.1	2.4	10.8	10.6	13.1	9.6	.	.
Consumer prices, % p.a.	45.7	34.5	22.5	15.3	11.9	9.0	6.6	6	6
Producer prices in industry, % p.a.	53.4	38.1	23.0	19.5	19.1	10.5	11.6	8	8
General governm. budget, EU-def., % GDP 5)									
Revenues	43.8	36.7	37.6	36.5	36.8	36.8	.	.	.
Expenditures	40.6	38.8	39.6	38.1	38.3	38.2	.	.	.
Deficit (-) / surplus (+)	3.2	-2.1	-2	-1.5	-1.5	-1.5	-1.8	-3.0	-3.0
Public debt, EU-def., % of GDP 5)	23.9	23.2	25.0	21.5	18.8	15.9	13.7	.	.
Discount rate, % p.a., end of period 6)	35.0	35.0	20.4	20.4	18.0	7.5	8.8	.	.
Current account, EUR mn	-1494	-2488	-1623	-3060	-5099	-6888	-10000	-13500	-13000
Current account in % of GDP	-3.7	-5.5	-3.3	-5.8	-8.4	-8.7	-10.7	-12.7	-11.0
Gross reserves of NB excl. gold, EUR mn	2655	4445	5877	6374	10848	16796	21310	.	.
Gross external debt, EUR mn 7)	12098	14788	16200	17835	21698	30736	30600	.	.
Gross external debt in % of GDP	30.0	33.0	33.4	33.9	35.7	38.8	33	.	.
FDI inflow, EUR mn	1147	1294	1212	1946	5183	5213	9000	6000	6000
FDI outflow, EUR mn	-14	-18	18	36	56	-24	20	.	.
Exports of goods, BOP, EUR mn	11273	12722	14675	15614	18935	22255	25850.5	30720	35330
annual growth rate in %	41.3	12.9	15.4	6.4	21.3	17.5	16.2	15	15
Imports of goods, BOP, EUR mn	13140	16045	17427	19569	24258	30061	37609.2	45100	51870
annual growth rate in %	43.4	22.1	8.6	12.3	24.0	23.9	25.1	20	15
Exports of services, BOP, EUR mn	1910	2273	2468	2671	2903	4102	5870	7630	9160
annual growth rate in %	48.4	19.0	8.6	8.2	8.7	41.3	43	30	20
Imports of services, BOP, EUR mn	2170	2402	2463	2609	3116	4451	5610	7240	8690
annual growth rate in %	31.0	10.7	2.5	5.9	19.4	42.8	26	29	20
Average exchange rate RON/USD	2.1693	2.9061	3.3055	3.3200	3.2637	2.9137	2.8090	.	.
Average exchange rate RON/EUR (ECU)	1.9956	2.6027	3.1255	3.7556	4.0532	3.6234	3.5245	3.50	3.55
Purchasing power parity RON/USD	0.6293	0.8324	0.9893	1.1811	1.2962	1.3917	1.4960	.	.
Purchasing power parity RON/EUR	0.7161	0.9548	1.1473	1.3955	1.5371	1.6590	1.8049	.	.

Notes: On 1 July 2005 the new Romanian leu was introduced (1 RON = 10000 ROL). Data in this table are presented in new leu (RON). - The term 'industry' refers to NACE classification C+D+E.

1) Preliminary. - 2) From 2002 according to census March 2002. - 3) According to ESA'95, from 2003 FISIM-adjusted. - 4) From 2002 break in methodology. - 5) According to ESA'95, excessive deficit procedure. - 6) From February 2002 reference rate of NB. - 7) From 2000 including balance of medium- and long-term deposits of foreign banks with resident banks, short-term deposits and FDI intercompany loans.

Source: wiiw Database incorporating national statistics; Eurostat; European Commission (Autumn 2006); wiiw forecasts.

In 2007 and 2008 Romania will be confronted with growing tensions. The current account deficit will expand further, while FDI will decline in the absence of new large privatization projects. Wages are set to expand: an 18% rise has been promised to public sector employees in 2007, and qualified labour in the private sector which is becoming short will also demand more. While foreign financing uncertainties may bring more volatility to the exchange rate, wages too may fuel inflation. In addition, the government budget will be more expansionary than in recent years. The question is when and how these tensions will trigger an appropriate stabilization policy. For 2007 our forecast is based on continuing economic expansion, but for 2008 we reckon with a soft austerity programme. A currency crisis cannot be ruled out in a worst-case scenario if stabilization needs are not responded to in time.

Zdenek Lukas

Slovakia: very high growth, few changes in policy

Backed by the booming economy, the new left-leaning government of Robert Fico (in office since June 2006) has basically continued to pursue the economic policy designed and implemented by the former centre-right government. In that era (1998-2006) Slovakia gained a reputation as a reform pioneer with domestic austerity policies geared to achieve fiscal stability and a better external balance. Attracting foreign investment was instrumental in sustaining strong economic growth. Whereas foreign investors applauded the previous government, most Slovaks could not conceal their disappointment. Although the standard of living rose on the country average, the gap between the rich and the poor and between the rich western and the poor eastern regions widened. Social disparities were an important factor in the election victory of the social democrats, who pledged to pursue a socially balanced policy. Despite minor changes in economic policy, the new government has not lost touch with the economic fundamentals established by the earlier policy makers.

The recent spending increases have focused on poor people and young families. At the end of 2006 an extra payment was given to Slovak pensioners. Starting with 2007, the government has increased one-time payments for first-born children (by EUR 300 to about EUR 430); the circle of people on supplementary benefits has widened. Under the booming economy and high budget revenues, it is quite easy to finance these items. However, the new cabinet has also raised budgetary expenditures on agriculture by one half in 2007, and those on the Government Office by 150%. On the other hand, spending on establishing a 'knowledge economy' – i.e. expenditures on education and research and development – is to rise less than the growth of total budgetary expenditures. In March 2006, the former government had introduced new measures to implement the Action Plan for R&D and Innovation, covering the period 2006 to 2010; the current policymakers, however, have not considered this as a priority although Slovakia lacks in particular investment into education and a broader application of IT. Besides, the government intends to weaken the financial position of all six profit-oriented healthcare insurance companies, of which two are state-owned. The government seeks to ban health insurers from making profit: any net profit should be completely re-invested into the heavily undercapitalized healthcare system. The Slovak healthcare system is facing an alarming lack of personnel because higher salaries paid abroad have resulted in an exodus of healthcare staff.

Changes in the widely discussed and bashed flat-tax system have been less radical than announced before the June elections. The core issue, the VAT rate on medicine, has dropped from 19% to

10%. Individuals with incomes considerably exceeding the average (personal monthly incomes between SKK 47,600 and SKK 80,000) have now to pay higher taxes than under the tax scheme valid up until the end of 2006. On the whole, this modification has (moderately) affected only a marginal circle of people; for instance, individuals earning around SKK 80,000 (EUR 2200) per month, which is equivalent to 4.4 times the average gross monthly wage, are now paying about SKK 1500 (EUR 40) more taxes than earlier. Foreign direct investors have not been affected by the recent tax changes.

The economy is growing strongly, and growth is even accelerating. In the third quarter of 2006, GDP grew by 9.8% as against 6.7% in the second quarter. Supported by rising real wages and credits to private households, private consumption rose by 6.5%. Gross fixed capital formation and rising inventories, mostly of 'work in progress', were another driving force behind the economic expansion. The increase in work in progress has been driven by rising industrial investment, in particular FDI. In the entire year 2006 GDP grew by about 7.5%. As exports are starting to gather momentum, foreign trade is again contributing positively to overall GDP growth, following two years of negative contribution (GDP concept). That holds true despite the persistent appreciation of the domestic currency: following several stages of appreciation, on 4 January 2007 the Slovak koruna hit a new record against the euro of 34.32 SKK/EUR. [26] The export goods produced by the new FDI-led manufacturing plants that are coming now on stream seem to be sufficiently competitive to withstand the ongoing appreciation.

On the supply side, the GDP growth in 2006 followed chiefly from an increase in gross value-added in services (such as retailing, hotels and restaurants) and in industry. Gross industrial production was up by 10% in 2006, accompanied by a 2% rise in industrial employment. Industrial labour productivity rose by about 8%, more than average industrial gross monthly wages (up some 6%). As a result, unit labour costs (ULCs) in industry dropped by about 2% in SKK terms. However, accounting for the 3.5% appreciation of the Slovak koruna in 2006 on average, ULCs rose by about 2% in euro terms. Foreign investment enterprises in machinery and equipment and in the automobile industry registered the highest rates of production increases (by around 25%). Two new car makers, PSA Peugeot Citroën and KIA (a Hyundai associate), started production last year.

Based on the commitment to the EU, the first reactor of the nuclear power station in Western Slovakia (Jaslovské Bohunice) was closed at the end of 2006. This implies that Slovakia must now import electricity.

Rising prices of energy, healthcare and housing rents and increased consumer borrowing have had an impact on inflation. The inflation rate (CPI) rose to 4.5% in 2006, compared with 2.7% in 2005. Despite the socially motivated increase in budgetary expenditures, the general government budget probably ended 2006 with a deficit below 3% of GDP. This is mostly due to the strong GDP growth and higher tax revenues collected. But the risk of overheating is moderate. Headline inflation, excluding energy and unprocessed foodstuffs, has been nearly unchanged during the past several months while the country's external position is gradually improving.

[26] Slovakia was admitted into the ERM-II already in November 2005. The central exchange rate parity was set at SKK 38.455 to the euro, with a +/-15% fluctuation band. The lower compulsory intervention rate is SKK 32.6868/EUR and the upper intervention rate is SKK 44.2233/EUR.

Table SK

Slovak Republic: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 1)	2007 forecast	2008 forecast
Population, th pers., mid-year	5400.7	5379.8	5378.8	5379.0	5382.2	5386.7	5390	.	.
Gross domestic product, SKK bn, nom. 2)	941.3	1020.6	1111.5	1212.7	1355.3	1471.1	1630	1800	1960
annual change in % (real) 2)	0.7	3.2	4.1	4.2	5.4	6.0	7.5	7	7
GDP/capita (EUR at exchange rate) 2)	4093	4380	4839	5434	6288	7077	8133	.	.
GDP/capita (EUR at PPP - wiiw) 2)	9520	10150	10990	11500	12360	13410	14550	.	.
Gross industrial production									
annual change in % (real)	8.4	7.6	6.7	5.3	4.2	3.6	10	12	10
Gross agricultural production									
annual change in % (real)	-12.3	9.9	1.5	-2.4	5.6	-6.0	.	.	.
Construction industry									
annual change in % (real)	-0.4	0.8	4.1	6.0	5.7	14.7	16	.	.
Consumption of households, SKK bn, nom. 2)	524.3	583.7	634.3	676.9	754.4	829.8	.	.	.
annual change in % (real) 2)	0.9	5.4	5.2	0.1	3.8	7.2	7	7	5
Gross fixed capital form., SKK bn, nom. 2)	242.3	291.0	303.5	302.8	327.1	394.6	.	.	.
annual change in % (real) 2)	-9.6	12.9	0.3	-2.3	5.0	17.5	8	10	8
LFS - employed persons, th, avg.	2101.7	2123.7	2127.0	2164.6	2170.4	2216.2	2300	.	.
annual change in %	-1.4	1.0	0.2	1.8	0.3	2.1	4	.	.
LFS - employed pers. in industry, th, avg.	615.3	628.8	640.9	634.1	641.3	649.1	660	.	.
annual change in %	-2.4	2.2	1.9	-1.1	1.1	1.2	2	.	.
LFS - unemployed, th pers., average	485.2	508.0	486.9	459.2	480.7	427.5	360	.	.
LFS - unemployment rate in %, average	18.6	19.2	18.5	17.4	18.1	16.2	13.5	12	11
Reg. unemployment rate in %, end of period	17.9	18.6	17.5	15.6	13.1	11.4	9.4	8	7
Average gross monthly wages, SKK 3)	11430	12365	13511	14365	15825	17274	18800	.	.
annual change in % (real, gross) 3)	-4.5	1.0	5.8	-2.0	2.5	6.3	3.9	.	.
Consumer prices, % p.a.	12.0	7.1	3.3	8.5	7.5	2.7	4.5	3	2
Producer prices in industry, % p.a.	10.8	6.5	2.1	8.3	3.4	4.7	8.4	5	4
General governm. budget, EU-def., % GDP 4)									
Revenues	39.8	36.8	35.7	35.6	35.9	33.9	33.1	32.4	32.1
Expenditures	51.7	43.3	43.3	39.4	38.9	37.1	36.5	35.4	35.0
Deficit (-) / surplus (+)	-11.8	-6.5	-7.7	-3.7	-3.0	-3.1	-3.4	-3.0	-2.9
Public debt in % of GDP 4)	49.9	49.2	43.3	42.7	41.6	34.5	33.0	31.6	31.0
Discount rate, % p.a., end of period	8.8	8.8	6.5	6.0	4.0	3.0	4.8	.	.
Current account, EUR mn 5)	-761	-1950	-2043	-244	-1214	-3288	-3200	-2500	-3000
Current account in % of GDP	-3.4	-8.3	-7.8	-0.8	-3.6	-8.6	-7.3	-4.9	-5.1
Gross reserves of NB incl. gold, EUR mn	4391	4748	8824	9717	10954	13067	10164 XI	.	.
Gross external debt, EUR mn	11637	12516	12655	14654	17421	22705	23075 IX	.	.
Gross external debt in % of GDP	52.7	53.1	48.6	50.1	51.5	59.6	.	.	.
FDI inflow, EUR mn	2089	1768	4397	593	1016	1694	3500	.	.
FDI outflow, EUR mn	23	39	5	20	-114	126	400	.	.
Exports of goods, BOP, EUR mn 5)	12879	14115	15270	19359	22248	25743	33500	45000	50000
annual growth rate in %	34.1	9.6	8.2	26.8	14.9	15.7	30	34	11
Imports of goods, BOP, EUR mn 5)	13860	16488	17517	19924	23485	27713	35500	46000	50500
annual growth rate in %	30.4	19.0	6.2	13.7	17.9	18.0	28	30	10
Exports of services, BOP, EUR mn 5)	2436	2779	2958	2912	3000	3542	4300	.	.
annual growth rate in %	25.8	14.1	6.4	-1.5	3.0	18.1	20	.	.
Imports of services, BOP, EUR mn 5)	1961	2244	2474	2703	2785	3285	3800	.	.
annual growth rate in %	13.2	14.5	10.3	9.2	3.0	18.0	16	.	.
Average exchange rate SKK/USD	46.20	48.35	45.34	36.77	32.26	31.02	29.70	.	.
Average exchange rate SKK/EUR (ECU)	42.59	43.31	42.70	41.49	40.05	38.59	37.23	35.0	33.5
Purchasing power parity SKK/USD	16.07	16.26	16.21	16.59	17.19	17.09	17.10	.	.
Purchasing power parity SKK/EUR	18.30	18.70	18.80	19.60	20.38	20.37	20.81	.	.

Note: The term 'industry' refers to NACE classification C+D+E.

1) Preliminary. - 2) According to ESA'95 FISIM-adjusted. - 3) From 2006 including incomes of armed forces. Growth rates based on comparable data. - 4) According to ESA'95, excessive deficit procedure. - 5) Calculated from USD.

Source: wiiw Database incorporating national statistics; Eurostat; European Commission (Autumn 2006); wiiw forecasts.

The strong economic expansion has been reflected in rising employment. Following a 2% increase in 2005, employment (LFS) rose by nearly 4% in 2006. The unemployment rate (LFS) dropped by 1.9 percentage points in 2005 and by 2.7 percentage points in 2006, to 13.5%. Demand for labour has been on the rise in both domestic and foreign-owned companies; in particular new foreign greenfield investment has already created many new jobs. However, with foreign investors focusing on the country's more developed western regions, the eastern parts of Slovakia with high unemployment are falling further behind. Regional disparities remain large or are even widening.

Slovakia continues to attract FDI. After rising to EUR 1.7 billion in 2005, FDI inflows increased even more strongly in 2006, to more than EUR 3 billion. The majority of investors has targeted car manufacturing (Volkswagen, PSA Peugeot-Citroën and KIA Hyundai). Another significant FDI influx is associated with the entry of foreign investors to the electronics (Samsung), electrical engineering, metal processing and wood and paper industries.

Exports are gradually becoming a major driving force behind Slovakia's economic expansion. Supported by strong private demand and investment expansion, GDP growth will remain high and reach about 7% in the years to come. Along with rising labour demand the unemployment rate will continue to decline. On the basis of the current development of oil prices, a decline in fuel prices can be expected. Besides, the central bank is ready to tighten its monetary policy. The inflation rate may go down in the near future. The government intends to drive the fiscal deficit below the Maastricht-defined ceiling of 3% of GDP this year in order to qualify for euro adoption by 2009. Strong GDP growth and high tax revenues will support this ambition. The current account deficit, at more than 7% of GDP in 2006, is expected to decline thanks to strongly expanding exports.

Hermine Vidovic

Slovenia: smooth entry into the eurozone

Slovenia's economic performance in 2006 turned out much stronger than expected at the beginning of the year. GDP expanded by close to 5%, the best result since 1999. In the third quarter growth even accelerated to 5.6%, primarily driven by domestic demand. Following a year of near-stagnation, gross fixed capital formation expanded by 10.5% mostly due to rising investment – backed by strong enterprise lending. Private and government consumption grew by slightly more than 3% each. While adding positively to GDP growth in the first two quarters, the contribution of foreign trade turned negative in the third quarter of the year.

On 1 January 2007 Slovenia adopted the euro as the first of the new member states joining the EU in 2004. Although the introduction of the euro is broadly accepted by the population, a recent survey found that about 40% of Slovenians are concerned about inflation. In order to make price hikes in the course of euro adoption visible, the Slovenian Statistical Office has compared monthly price rises over the past five years since April 2006 and found 'unusual fluctuations' especially in December. These were registered in particular for prices of services in restaurants and coffee shops, up 3.2% in December alone, while the reference values for the years 2002-2005 ranged between zero and 0.3%. Unusual price rises and upward rounding of prices was also recorded for personal services, furniture and furnishings, toilet articles and cosmetic products, household textiles, computer equipment, etc. The average annual consumer price inflation stood at 2.5% in 2006.

Industrial output expanded significantly and was up 7% in 2006. Capital goods production increased the most (12%), while the production of intermediate and consumer goods performed below average. Output growth of manufacturing slightly exceeded the average industrial growth, with the most favourable results achieved for the manufacture of electrical and optical equipment, chemicals and basic metals. On the negative side, output of transport equipment declined and the production of the food and textile industries continued its downward trend.

The labour market impact of GDP growth was still limited. Employment grew by 1%, with strong rises in construction, real estate and business activities, financial services and other community and social services. In manufacturing, however, job losses continued. The unemployment rate obtained from the Labour Force Survey fell slightly again and ranges among the lowest in the EU-25. The decline of registered unemployment to a historical low was to a large part caused by the deletion of a growing number of people from the register.

Foreign trade was buoyant in 2006: both exports and imports rose by 16% each, and the trade deficit widened as compared to 2005. A regional breakdown obtained from the customs statistics for the period January to September indicates an above-average export expansion to the EU, particularly to Austria but also to the new EU member states. As in 2005, exports to the successor states of the former Yugoslavia grew below average and even fell in trade with Bosnia and Herzegovina and Macedonia. The current account deteriorated as against 2005 and the deficit to GDP ratio stood at 2.6%; this deterioration is primarily the result of the higher trade deficit as well as the worsening of the income balance due to growing payments of dividends, profits and interests as well as a deterioration of the current transfer balance. In addition, changes in the statistics have contributed to this result: following a methodological change in the data compilation, substantial revisions were made for factor incomes and current transfers for the period 2002 to 2005; this had substantial implications for the current account as a whole since both items were underestimated. Hence, the current account deficit for the whole period under consideration has deteriorated, e.g. in 2005 from an earlier EUR 300 million to EUR 550 million. Outward FDI developed dynamically; as in the past few years, Slovenia has remained a net exporter of FDI.

In anticipation of the euro introduction the Slovenian government had adopted its first Stability Programme for the period 2006-2009 (replacing the Convergence Programme) in accordance with the provisions of the Stability and Growth Pact in December 2006. Accordingly the estimated general government deficit – based on the ESA 95 methodology – is 1.5% of the GDP in 2007, 1.6% in 2008 and 1% in 2009. Priorities of the programme are, among other things, substantial investments into infrastructure, railways in particular, and investments into the information infrastructure and education. Budgetary expenditures for active labour market policy measures are envisaged to significantly increase employment, upgrade the educational level of the active population and reduce structural disparities on the labour market. In addition privatization should speed up. In the framework of a comprehensive tax reform initiated in late 2005 the Slovenian parliament approved a package of seven tax laws in autumn 2006, providing fewer personal income tax rates and a gradual reduction of the corporate income tax rate from 25% to 20% by 2010. The original idea of introducing a flat tax has been given up. Slovenian officials expect that the country will remain a net recipient of EU funds over the programme period. Slovenia's net budgetary position vis-à-vis the EU budget is anticipated to stand at plus 0.43 percentage points.

Table SI

Slovenia: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 [1)]	2007 forecast	2008 forecast
Population, th pers., mid-year	1990.3	1992.0	1995.7	1996.8	1997.0	2001.1	2008.5	.	
Gross domestic product, EUR-SIT mn, nom. [2)]	17945.0	20028.2	22347.9	24259.5	26171.7	27625.4	29700	31800	33900
annual change in % (real) [2)]	4.1	2.7	3.4	2.7	4.4	4.0	5	4.5	4.4
GDP/capita (EUR at exchange rate) [2)]	10538	11094	11862	12458	13148	13805	14795	.	.
GDP/capita (EUR at PPP - wiiw) [2)]	14610	15400	16040	16840	18150	19220	20670	.	.
Gross industrial production									
annual change in % (real) [3)]	6.2	2.9	2.4	1.4	4.8	3.3	7	5	4.5
Gross agricultural production									
annual change in % (real)	1.0	-4.3	13.4	-12.7	19.3	.	.	.	.
Construction output, in effect. working time									
annual change in % (real) [4)]	-1.2	-2.1	-3.4	-1.7	2.5	3.0	13.8 I-XI	.	.
Consumption of households, EUR-SIT mn,nom. [2)]	10078.0	11090.9	12115.9	13217.9	14034.5	14854.3	15682.4		
annual change in % (real) [2)]	0.7	2.3	1.3	3.5	2.8	3.6	3	3	3
Gross fixed capital form., EUR-SIT mn, nom. [2)]	4585.6	4835.1	5055.6	5646.2	6412.7	6748.7	7643.9		
annual change in % (real) [2)]	1.8	0.4	0.9	7.0	7.9	1.5	10.5	7	7
LFS - employed persons, th, avg.	901	916	910	897	943	949	960	.	.
annual change in %	1.7	1.7	-0.7	-1.4	5.1	0.6	1.2	.	.
Reg. employees in industry, th pers., avg. [5)]	241.6	243.5	246.1	242.2	239.7	239.3	235.3 I-X	.	.
annual change in %	-0.5	0.8	1.1	-1.6	-1.0	-1.7	-1.9 I-X	.	.
LFS - unemployed, th pers., average	68.0	63.0	62.0	64.8	64.0	67.0	64.0	.	.
LFS - unemployment rate in %, average	7.0	6.4	6.4	6.7	6.3	6.6	6.3	6	6
Reg. unemployment rate in %, end of period	12.0	11.8	11.3	11.0	10.1	10.2	8.6 XI	8.5	8.1
Average gross monthly wages, EUR-SIT [6)]	800	895	982	1057	1117	1157	1208 I-XI	.	.
annual change in % (real, net) [6)]	1.4	3.1	2.1	1.8	2.1	3.5	2.5 I-XI	.	.
Consumer prices, % p.a.	8.9	8.4	7.5	5.6	3.6	2.5	2.5	2.6	2.3
Producer prices in industry, % p.a.	7.6	8.9	5.1	2.5	4.3	2.7	2.3	2.2	2
General governm. budget, EU-def., % GDP [7)]									
Revenues	44.3	44.8	45.5	45.3	45.1	45.8	46.4	45.4	44.8
Expenditures	48.2	49.1	48.0	48.0	47.4	47.2	48.0	47.0	46.4
Deficit (-) / surplus (+), % GDP	-3.9	-4.3	-2.5	-2.8	-2.3	-1.4	-1.6	-1.6	-1.5
Public debt in % of GDP [7)]	27.6	28.3	29.1	28.5	28.7	28.0	28.4	28.0	27.6
Discount rate % p.a., end of period [8)]	10.0	7.8	7.3	5.0	3.3	3.8	3.8	.	.
Current account, EUR mn	-583.0	38.0	247.2	-195.7	-719.7	-547.5	-772.8	-700	-500
Current account in % of GDP	-2.8	0.2	1.0	-0.8	-2.7	-2.0	-2.6	-2.2	-1.5
Gross reserves of NB excl. gold, EUR mn	3435.8	4907.5	6701.5	6798.2	6464.0	6824.1	5341.6	.	.
Gross external debt, EUR mn	9490	10386	11524	13225	15343	19614	22518.3 XI	.	.
Gross external debt in % of GDP	45.2	47.0	48.7	53.2	58.4	71.0	.	.	.
FDI inflow, EUR mn	149.1	412.4	1721.7	270.5	665.2	444.9	264.2	.	.
FDI outflow, EUR mn	71.7	161.2	165.8	421.3	441.0	503.4	567.8	.	.
Exports of goods, BOP, EUR mn	9574.2	10454.3	11081.6	11417.1	12932.8	14599.2	16991.4	19000	20800
annual growth rate in %	18.2	9.2	6.0	3.0	13.3	12.9	16.4	12	9
Imports of goods, BOP, EUR mn	10801.2	11138.7	11346.6	11959.9	13941.6	15625.1	18102.7	20000	22000
annual growth rate in %	16.6	3.1	1.9	5.4	16.6	12.1	15.9	10	10
Exports of services, BOP, EUR mn	2051.5	2177.6	2439.5	2464.9	2782.6	3209.7	3508.5	.	.
annual growth rate in %	16.3	6.1	12.0	1.0	12.9	15.3	9.3	.	.
Imports of services, BOP, EUR mn	1562.3	1642.1	1819.7	1924.7	2095.0	2354.1	2651.5	.	.
annual growth rate in %	8.9	5.1	10.8	5.8	8.8	12.4	12.6	.	.
Average exchange rate EUR-SIT/USD	0.929	1.013	1.003	0.864	0.803	0.804	0.797	.	.
Average exchange rate EUR-SIT/EUR	0.856	0.906	0.944	0.975	0.997	1.000	1.000	1.000	1.000
Purchasing power parity EUR-SIT/USD	0.542	0.569	0.602	0.610	0.609	0.603	0.593	.	
Purchasing power parity EUR-SIT/EUR	0.617	0.653	0.698	0.721	0.722	0.718	0.716	.	.

Notea: Slovenia has introduced the euro from 1 January 2007. For statistical purposes all time series in SIT as well as the exchange rates and PPP rates have been divided by the conversion factor 239.64 (SIT per EUR) to EUR-SIT. - The term 'industry' refers to NACE classification C+D+E.

1) Preliminary. - 2) According to ESA'95 (FISIM-adjusted and real change based on previous year prices). - 3) From July 2005 new methodology. - 4) From 2004 construction put in place; units with at least 20 employees. - 5) From January 2005 data from Statistical Register of Employment, years before from Monthly Report on Earnings. - 6) From January 2005 including legal persons with 1 or 2 employees in private sector. - 7) According to ESA'95, excessive deficit procedure. - 8) From 2001 main refinancing rate.

Source: wiiw Database incorporating national statistics; Eurostat; European Commission (Autumn 2006); wiiw forecasts.

Economic prospects for the coming years are promising. Robust domestic demand, particularly housing and motorway investments, will keep GDP growth at close to 4.5% in 2007. Thereafter some impetus may also come from stronger export growth. Together with maintaining a moderate level of the trade deficit and with rising inflows of EU structural funds, the current account should gradually improve over the coming years. However, a slowdown in the EU-15 would probably restrict growth in terms of exports and GDP.

Part B: Southeast European countries

*Vladimir Gligorov **

Strong growth despite political uncertainties

Introduction

Growth has remained strong in the Western Balkans and Turkey. Consumption is the main driving force, although investments have been a contributory factor. It is difficult to assess the contribution of net exports due to insufficient data and because both exports and imports have been growing. Foreign direct investment has also increased throughout the region, mostly linked to privatization, although increasing amounts of funds are being invested in green-field projects. Price stability still poses no serious problems, despite the volatile prices of imported oil and gas. Fiscal balances have been improving, although some doubts persist about the sustainability of those improvements in certain instances. Monetary policy remains an issue throughout the region, both in countries with fixed exchange rates and in countries with flexible exchange rates. Trade liberalization is moving ahead; however, more as a good intention than in reality. The regional free-trade area, CEFTA, will only come into being once the agreement signed last December has been finally ratified (estimated completion date mid-2007). Similarly, the process of EU association and accession moves on, albeit rather slowly.

The political shocks incurred by the independence of Montenegro and the subsequent parliamentary elections, as well as events in Bosnia and Herzegovina, have borne few economic consequences. The outcome of the elections in Serbia on 21 January 2007 was somewhat more problematic, coming as they did amid a political crisis that may well deepen with the imminent resolution of the Kosovo issue. In Kosovo itself, the situation is potentially unstable as impatience builds up in anticipation of the looming announcement of the province's independence. To date, the persistent political uncertainty and growing political risks have failed to dent the growth and development of the economies in the region. None the less, the risks are still there, as are the risks of macroeconomic mismanagement. In the case of Turkey, global ructions will also have to be taken into account, although the country would seem to have weathered the shock of mid-2006 reasonably well.

The prospects for the region as a whole continue to be positive, despite the political and policy risks. In the absence of any major political instability being brought about by the change in the status of Kosovo, economic developments should continue to improve and relatively high growth rates should be sustained over the medium term. EU integration prospects should thus continue to improve for the Western Balkans, though not necessarily so for Turkey. In summary, the region's short-term prospects hinge on the remaining political risks being resolved, especially those emanating from the emergence of an independent Kosovo. Risks also persist with respect to short-term policy challenges, especially those governed by shifts in monetary policy. In the medium term, however, the region is still set to continue to recover and develop, all the more so as various reforms processes will pick up speed as relations with the EU improve. The EU will also bring additional financial resources, in the form of public transfers and private investments.

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* K. Laski, M. Landesmann, P. Havlik and wiiw staff provided comments. Statisticians and editors are to be thanked coping with hard-to-find data and with a busy author.

Robust GDP and productivity

Growth has been relatively strong and sustained in the Balkans since 2000: the turnaround year for the region as whole (see Table 1), which is about five years after the NMS. Growth has in fact accelerated in more recent years. Some of the regional laggards have improved their performance, whereas other countries have displayed certain weaknesses. It is important that: (a) Serbia continues to post high growth rates; (b) Croatia performs better than perhaps expected; and (c) Bosnia and Herzegovina (B&H) continues to enjoy high growth rates, despite the country's persistent institutional and constitutional problems. In addition, Montenegro has improved its economic performance after declaring independence, while Macedonia, traditionally a problem country when it comes to growth, has registered a growth rate close to 4% for the third year running. Only in Albania has growth continued to slow down due to continuing problems with energy shortages.

Table 1

Gross domestic product

real change in % against preceding year

	1995	2000	2001	2002	2003	2004	2005	2006 1)	2007 Forecast	2008 Forecast	Index 1990=100 2006	Index 2000=100 2006
Croatia	6.8	2.9	4.4	5.6	5.3	3.8	4.3	4.5	4.4	4.4	112.5	131.3
Macedonia	-1.1	4.5	-4.5	0.9	2.8	4.1	3.8	3.5	4	4	101.0	110.8
Turkey	7.2	7.4	-7.5	7.9	5.8	8.9	7.4	5.0	5.5	6.5	184.2	129.7
Candidate countries	*7.0*	*6.9*	*-6.5*	*7.5*	*5.7*	*8.3*	*7.0*	*4.9*	*5.4*	*6.3*	*172.5*	*129.2*
Albania	8.9	6.5	7.1	4.3	5.8	6.2	5.6	4.8	5	5.5	154.3	138.9
Bosnia and Herzegovina	50.0	5.5	4.5	5.5	3.0	6.0	5.5	5.3	5.7	5.5	.	133.7
Montenegro	.	.	-0.2	1.7	2.4	4.2	4.3	4.5	5	5	.	118.0
Serbia	.	4.5	4.8	4.2	2.5	8.4	6.2	5.8	5	5	.	136.5
Potential candidate countries	.	.	*4.9*	*4.5*	*3.1*	*7.3*	*5.8*	*5.5*	*5.2*	*5.2*	.	*135.3*

Notes: 1) Preliminary.

Source: wiiw Database incorporating national statistics, forecast: wiiw

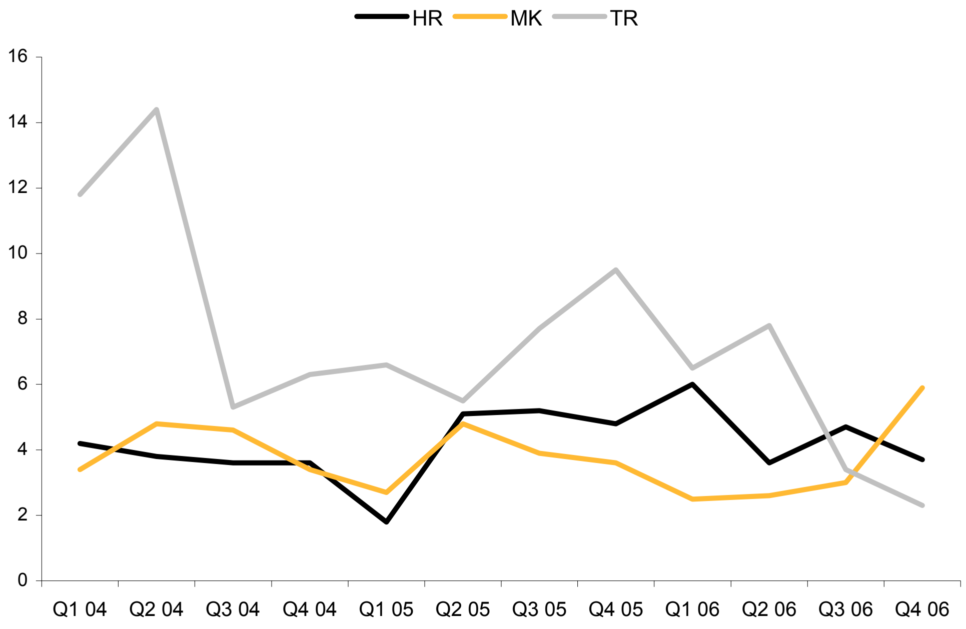
Growth in most countries is driven by domestic demand; this could raise some issues. Those concerns, however, do not seem to be fully warranted. In some cases, it has led to both fiscal and monetary policy instruments being used to achieve a certain tightening of domestic demand. As a result, in some countries quarterly growth rates have shown a certain measure of slowdown, as can be seen in Figure 1.

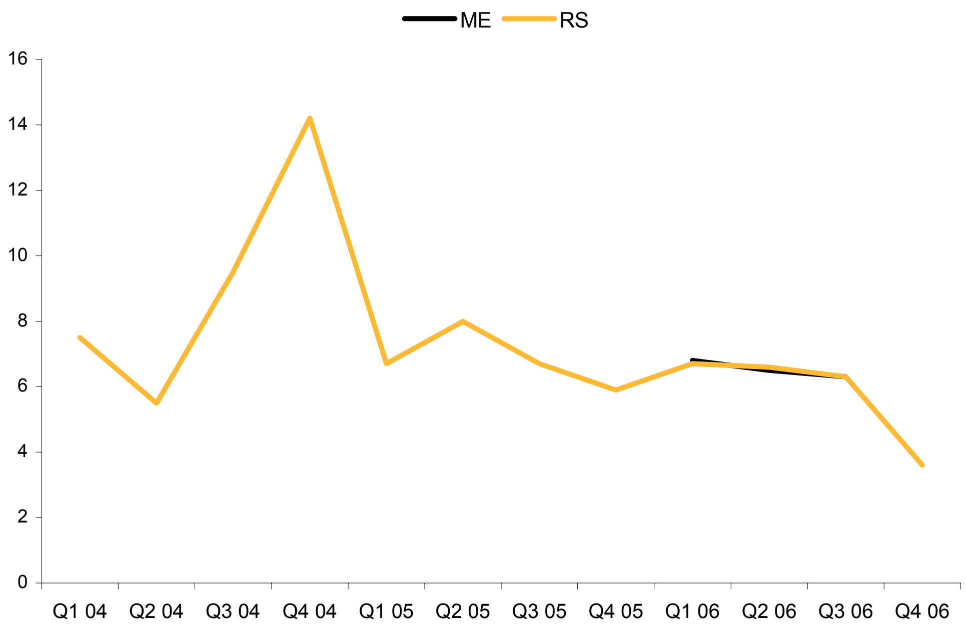
In most cases, this tightening does not seem to be altogether justified, at least not on the usual grounds that inflation would otherwise accelerate. Not only is the rate of inflation rather low throughout most of the region, but productivity has also been increasing rather impressively. Since 2000, practically all the growth in the region has been driven by gains in productivity. That has led to improved competitiveness as well as price stability. Indeed, the picture that emerges from Figure 2 is one of rather strong deflationary pressures at play in most countries' economies. Similar to trends observed previously in other transition economies, growth is based on the more efficient use of

Figure 1

Quarterly GDP, 2004-2006

real change in % against preceding year





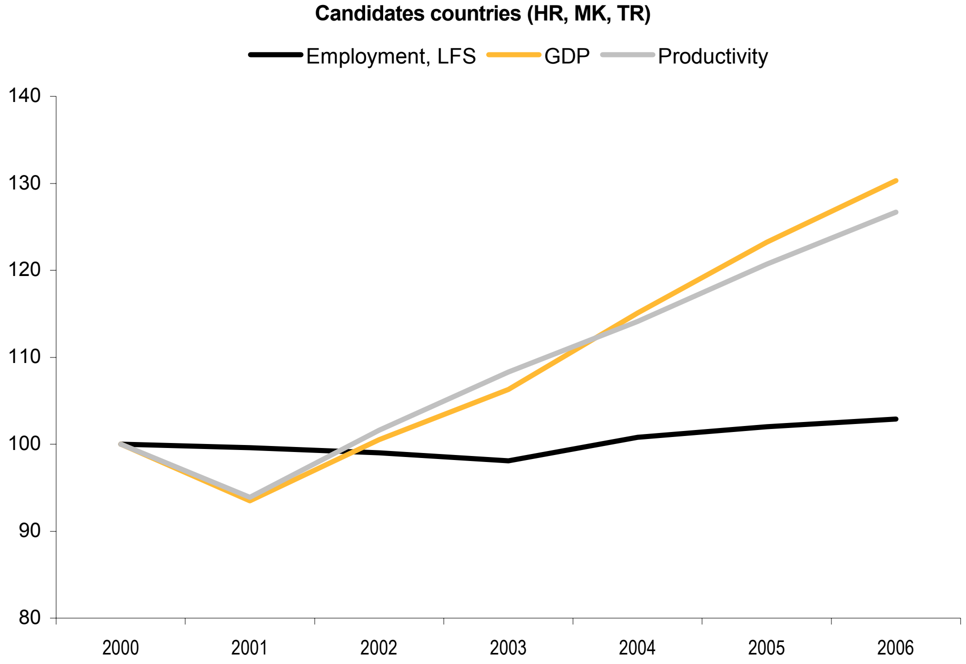
Note: HR (Croatia), MK (Macedonia), TR (Turkey) are candidate countries; AL (Albania), BA (Bosnia and Herzegovina), ME (Montenegro), RS (Serbia) are potential candidate countries.

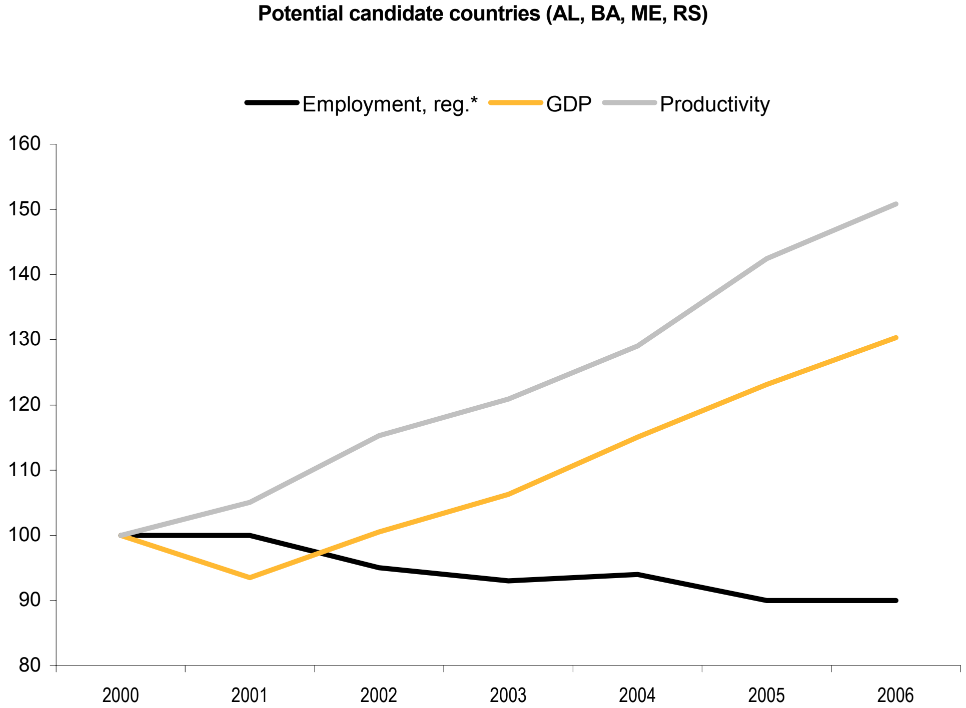
Source: wiiw Monthly Database incorporating national statistics.

Figure 2

GDP, employment, productivity 2000-2006

2000 = 100





* Serbia data are based on LFS.

Source: wiiw Monthly Database incorporating national statistics.

labour: more precisely it tends to save labour. Consequently, pressure to increase wages should not be expected; hence, price stability should not be a matter of great concern. As the second panel of Figure 2 shows, the potential candidate countries are still shedding labour. In principle, of course, the causes of inflationary pressures could lie elsewhere; some of them are discussed below. In general, however, inflation should not be difficult to keep under control, as a relatively strong downward pressure on wages exists owing to an excess supply of labour.

In addition to consumption, investments have also grown, such as in Croatia, even though in most other cases the share of investment in the GDP is still relatively low. In Serbia, some uncertainty prevails about the investment figures; however, the share would still seem to be below 18% of GDP. In Bosnia and Herzegovina the figure seems to be around 20%, although here again there is some uncertainty about the data. In most cases, however, to the extent that the figures are available, data would indicate that the rate of investment is indeed growing. In some cases, as in both Montenegro and Serbia, public investments are also on the increase, and should be increased in Albania, while in most other countries private investments have also shown a noticeable increase. An indirect indication of improved investment climate is the growth of the private sector in Serbia, which has been fairly pronounced over the past couple of years. Also, the strong growth of construction throughout the region indicates a strong increase in private investments.

Table 2

Gross industrial production

real change in % against preceding year

	1995	2000	2001	2002	2003	2004	2005	2006 [1]	2007	2008	Index 1990=100 2006	Index 2000=100 2006
									Forecast			
Croatia [2]	0.3	1.7	6.0	5.4	4.1	3.7	5.1	4.5	4.4	4.5	85.0	132.5
Macedonia [3]	-10.7	3.0	-2.9	-4.8	4.1	-2.2	7.0	3.4	5	5	55.0	104.1
Turkey	12.1	6.1	-8.7	9.5	8.7	9.8	5.5	6.3	6	9	205.1	133.8
Albania [4]	6.0	1.3	6.1	-5.1	29.0	14.1	1.3	1.5	2	3	54.5	152.4
Bosnia and Herzegovina [5]	.	7.9	4.9	5.7	5.1	12.1	10.8	11.5	11	11	.	161.4
Montenegro	.	4.2	-0.7	0.6	2.4	13.8	-1.9	1.0	3	3	.	115.4
Serbia	.	11.4	0.1	1.8	-3.0	7.1	0.8	4.7	5	5	.	111.7

Notes: 1) Preliminary. - 2) Enterprises with more than 20 employees. - 3) Excluding small enterprises. - 4) According to gross value added. - 5) wiiw estimates based on weighted averages for the two entities (Federation BH and Republika Srpska).

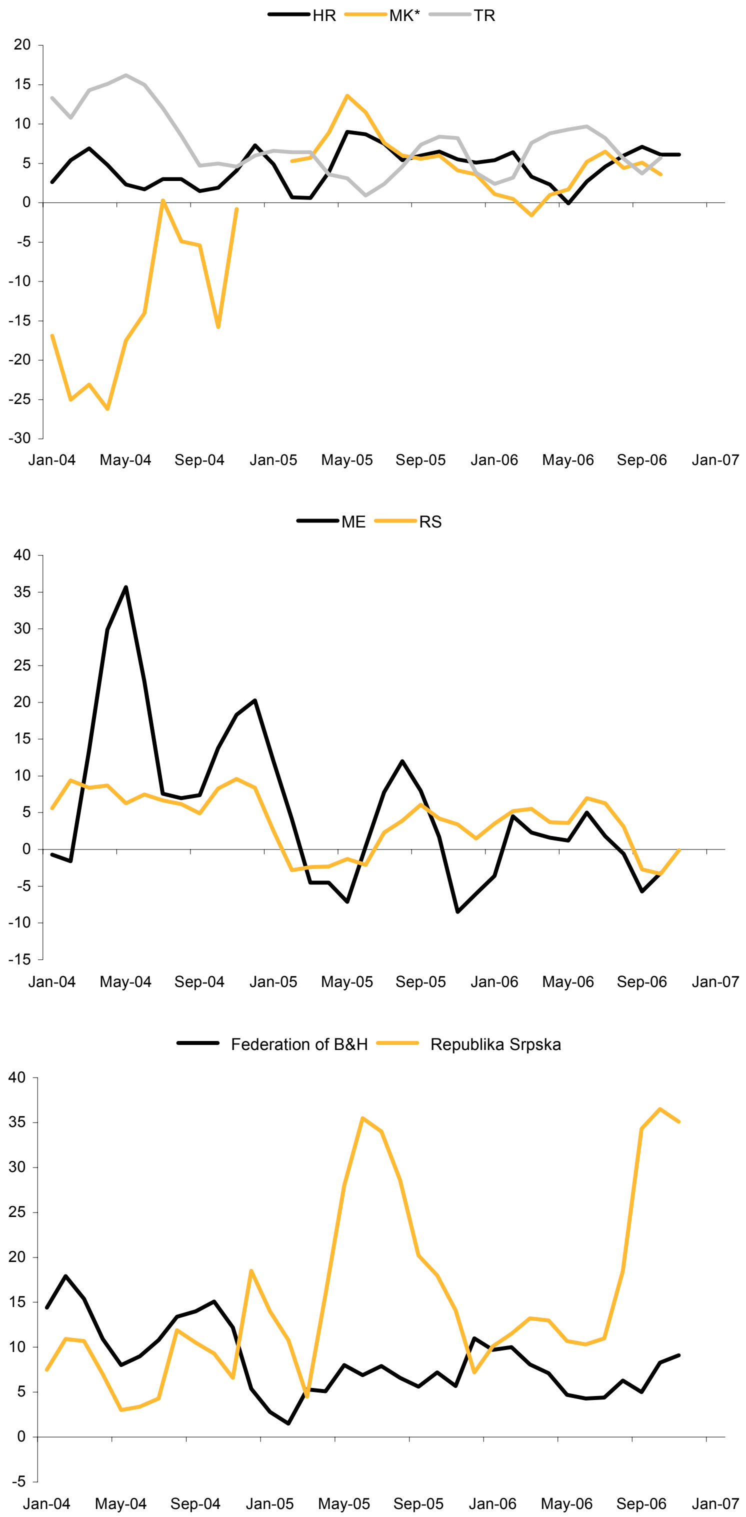
Source: wiiw Database incorporating national statistics, forecast: wiiw.

Overall good growth performance still does not feature all that prominently in industrial production growth. As can be seen in Table 2 and Figure 3, industrial production is growing at around 5% in the candidate countries, yet in effect it is still stagnating in both Serbia and Montenegro. Somewhat divergent trends can be observed in the two entities in Bosnia and Herzegovina; industrial production is recovering quite strongly in Republika Srpska, yet somewhat less convincingly in the Federation.

Figure 3

Gross industrial production in Southeast Europe, 2004-2006

year-on-year growth in %, 3-month moving average



* From 2005 new methodology.

Source: wiiw Monthly Database incorporating national statistics.

Figure 4

Labour productivity in industry, 2004-2006

year-on-year in %, 3-month moving average

Source: wiiw Monthly Database incorporating national statistics.

A noticeable feature of transition in the Balkans to date has been its failure to lead to re-industrialization, unlike events in the transition economies of Central Europe. However unconvincing industrial growth might be, except in Turkey and to an extent Croatia, labour productivity growth can be seen to be relatively strong and persistent (see Table 3 and Figure 4).

Table 3

Labour productivity in industry

change in % against preceding year

	1995	2000	2001	2002	2003	2004	2005	2006 [1]	Index 1990=100 2006	Index 2000=100 2006
Croatia [2]	6.6	4.3	9.6	9.6	7.7	5.7	3.6	5.8 I-XI	210.8	149.9
Macedonia [3]	1.2	5.0	-0.2	1.4	10.8	4.6	11.9	6.8 I-X	166.1	140.2
Turkey [4]		8.8	-1.2	10.1	7.4	8.2	5.6	6.8 I-IX	.	142.7
Albania										
Bosnia and Herzegovina	.	10.2	12.7	4.2	17.3	14.4	11.6	.	.	.
Montenegro [3]	.	8.1	2.2	5.3	6.0	.	.	.	.	.
Serbia	.	16.9	4.1	12.7	10.9	12.5	9.0	12.4 I-X	.	179.3

Notes: 1) Preliminary. - 2) Enterprises with more than 20 employees. - 3) Excluding small enterprises. - 4) In manufacturing industry.

Source: wiiw Database incorporating national statistics.

Another indication of the region having entered the transition phase is the emergence of stronger incentives and competitive pressures to increase the efficiency of resource allocation. This trend can also be detected in the service sector. In Bosnia and Herzegovina, for instance, productivity growth in both the sector of market services and private industry has consistently outstripped wage growth since 2000. Similar developments are discernible in other countries, too; however, there may be some variances when it comes to services in those countries where tourism plays a significant role.

Trade and regional integration expand

In the past couple of years, exports have been growing faster than GDP in practically all countries in the region. Export growth has been particularly strong in Serbia: a growth rate of over 25% in 2006. Exports are also expanding in Bosnia and Herzegovina, as well as in Croatia. In Serbia, GDP growth is also driven by net exports, as import growth is slower than export growth, while the situation is perhaps not altogether clear in the other countries. To a certain extent, export growth is helped by the improvement of trade and business relations within the region. Business people cherish high hopes of the regional free-trade area, CEFTA, spurring trade and investment throughout the region as soon as it comes into being. This is particularly true of the countries with larger and somewhat stronger economies, such as Serbia and Croatia. Other countries, such as Bosnia and Herzegovina, fear that further liberalization of regional trade will be to the detriment of their production and export activities. As far as current developments are concerned, that does not seem to be the case.

Although exports are growing as can be seen in Table 4, trade deficits are chronically high or very high as shown in Figure 5.

Table 4

Foreign trade of Southeast European countries, EUR million

(based on customs statistics)

		1999	2000	2001	2002	2003	2004	2005	2006 [1)]	2005 change in %	2006 [1)] change in %
Croatia [2)]	Exports	4027	4818	5210	5187	5468	6453	7065	8300	9.5	16.9 I-XI
	Imports	7324	8588	10232	11325	12546	13343	14935	17100	11.9	14.8 I-XI
	Balance	-3297	-3770	-5022	-6137	-7079	-6890	-7870	-8800	.	.
Macedonia	Exports	1117	1431	1292	1181	1209	1348	1641	1912	21.7	16.5
	Imports	1665	2266	1891	2111	2039	2358	2595	2997	10.0	15.5
	Balance	-548	-835	-599	-931	-831	-1010	-954	-1085	.	.
Albania	Exports	330	279	343	359	396	487	530	600	8.9	15.7 I-X
	Imports	1085	1185	1480	1589	1643	1849	2111	2500	14.2	16.2 I-X
	Balance	-756	-906	-1137	-1231	-1247	-1363	-1581	-1900	.	.
Bosnia and Herzegovina	Exports	589	1115	1153	1068	1188	1441	1934	2640	34.2	36.5
	Imports	2491	3452	3748	4115	4253	4758	5715	5818	20.1	1.8
	Balance	-1902	-2338	-2595	-3046	-3066	-3317	-3781	-3178	.	.
Montenegro	Exports	.	.	204	210	271	452	434	500	-3.9	15.0
	Imports	.	.	594	593	630	869	940	1180	8.3	25.0
	Balance	.	.	-390	-383	-359	-416	-506	-680	.	.
Serbia	Exports	1270	1674	1897	2193	2441	2853	3617	5092	26.8	40.8
	Imports	2694	3559	4754	5919	6603	8679	8470	10448	-2.4	23.3
	Balance	-1424	-1885	-2858	-3726	-4162	-5826	-4853	-5356	.	.

Notes: 1) Preliminary. - 2) From 2000 according to new methodology.

Source: wiiw Database incorporating national statistics.

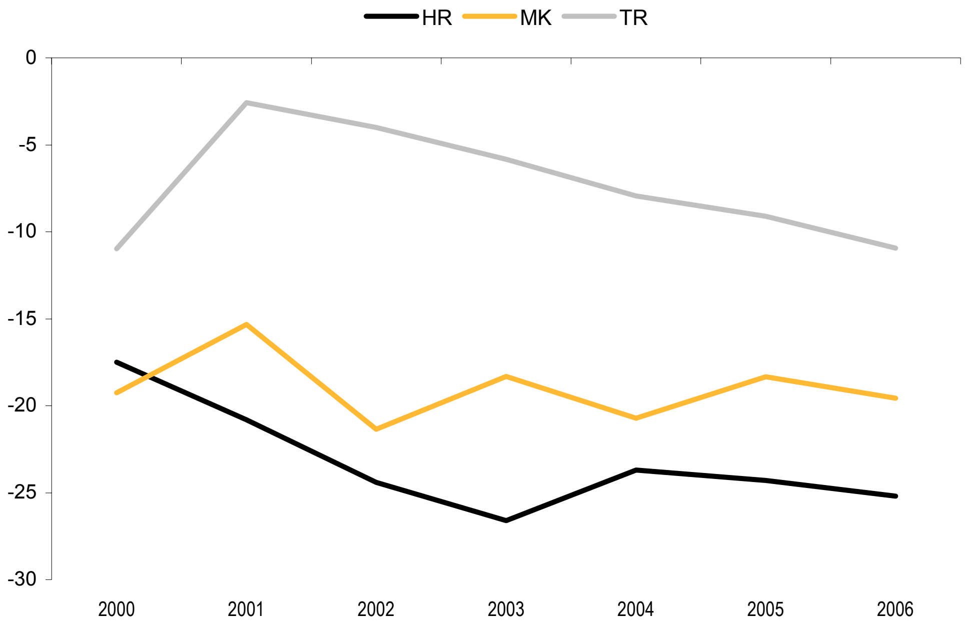
These high trade deficits are a reflection of the rather weak recovery of industrial production; however, they are also a consequence of the increasing inflow of foreign investment. For instance, the deterioration of the trade balance in Montenegro can be attributed to the comparatively large inflow of foreign investment. Similarly, the volatility of the trade and current account deficits in Turkey is the consequence of volatile foreign investments. On the other hand, even with the increased inflows of foreign investments, the trade deficits in Serbia and Bosnia and Herzegovina have improved. In other countries, trade deficits have essentially remained at very high levels in terms of GDP (see Table 9 below).

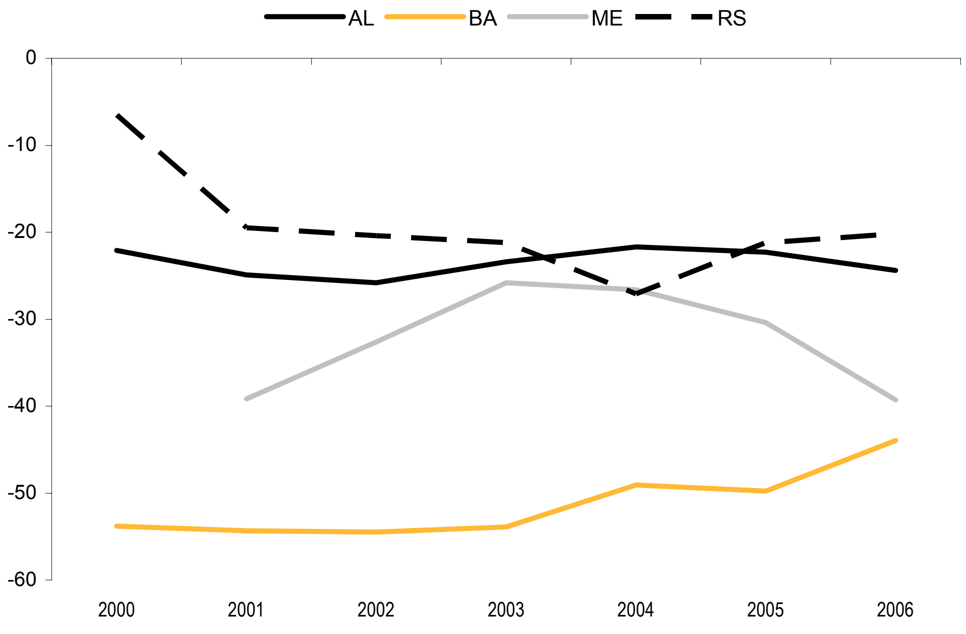
In a number of countries in the Balkans, tourism is an important factor; trade in services thus contributes positively to the overall current account positions. In addition, as the region stabilized and political and economic developments improved, the inflow of remittances can also be seen to have increased appreciably. It is difficult to judge the extent to which the increase is due to better statistical coverage or to improvements in the banking system, e.g. greater trust in the banks' ability to handle private transfers. For all that, however, at least part of those greater inflows should be genuine increases.

Figure 5

Trade deficit, 2000-2006

in % of GDP





Source: wiiw Database

Figure 6

Current account, 2000-2006

in % of GDP

Source: wiiw Database

Finally, decreases in aid flows, in some cases rather sharp decreases, have not led to deterioration in the funding of public expenditures or to problems in financing imports. In the case of Bosnia and Herzegovina, aid no longer plays all that an important role; however, the reduced inflow of aid-related resources has been more than offset by increased foreign investments. Indeed, in the next couple of years, the inflows of foreign investments are expected to increase markedly.

Developments in the current account are similar to those in the trade balance. In one case, however, the difference is quite dramatic. As can be seen in Figure 6, the Macedonian current account has improved rather strongly, culminating in a surplus. This swing of about 10% percentage points in terms of GDP has been attributed almost exclusively to the massive increase in private transfers. The extent to which that is a statistical artefact is hard to say. The improvement in the current account deficit of Bosnia and Herzegovina is consistent with the improvement of its trade balance; the same applies to Serbia as well. In all other cases, deterioration of current accounts is also aligned with similar developments in the trade balance. Only in the case of Croatia has the current account deficit deteriorated while the trade balance has not: both figures being expressed as percentages of GDP.

Bubble fears

The region as a whole has remained rather stable in terms of prices. The sole exception is Turkey: in any event, a somewhat separate case. Even in the case of Turkey, the surge in inflation is not that strong given the exchange rate depreciation and the volatility of the capital markets. In the rest of the region, inflation can be observed to have picked up speed in Bosnia and Herzegovina; however, that is due to: (a) the introduction of VAT at the beginning of the last year; and (b) the relatively pronounced impact of higher oil prices. The expectations are that inflation will slow down this year. The only other country facing an inflation problem is Serbia. As can be seen in the second panel of Figure 7, inflation has been accelerating for the past couple of years, only to sharply decelerate in the second half of last year. As this is an interesting case, it should be entered into in greater detail.

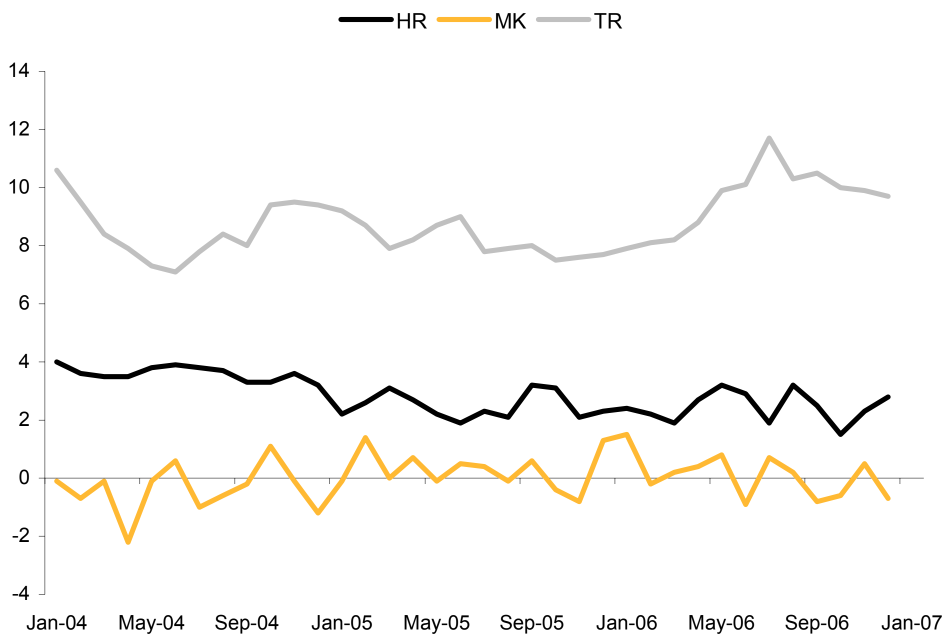
The inflation pressure had its origins in rather lax fiscal policy backed by an exchange rate policy directed towards steady, though slow, currency depreciation during 2005. They combined to build up inflationary expectations that were running at around 20% year-on-year at the beginning of 2006. In anticipation of massive inflows of foreign investment, due to planned privatizations, and in the wake of the early elections, the government and the central bank decided to let the dinar appreciate; that led to a rather sharp drop in inflation. In addition, the government decided to defer increases in regulated prices and in the second half of the year used the drop in oil prices to reduce sharply the price of oil and gasoline. That was also intended as a ploy to secure votes for the governing parties in the upcoming parliamentary elections.

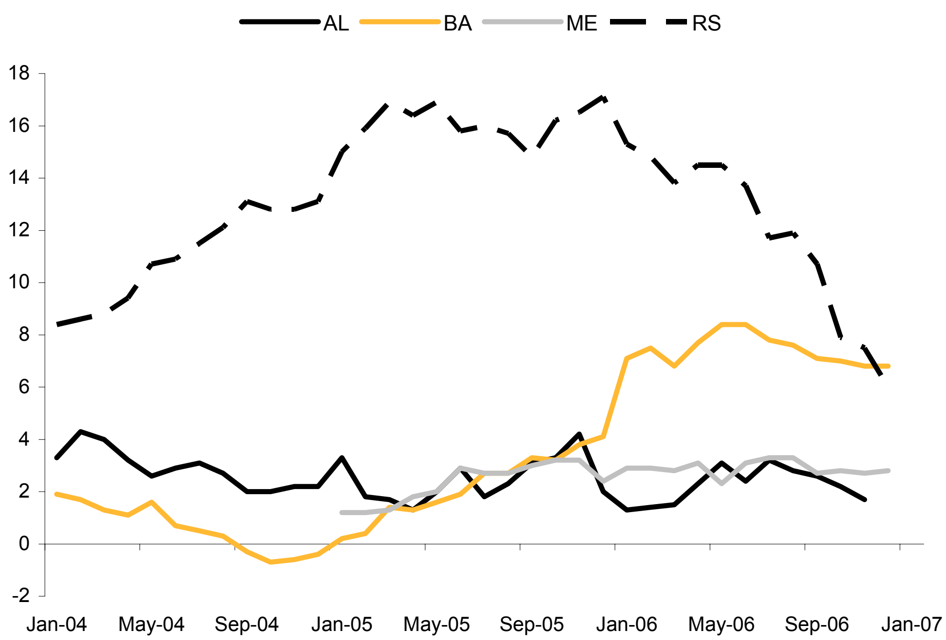
All those measures led to a rather sharp decline in the inflation rate. Year on year, however, inflation was still running at close to 12% (cost of living index) and over 13% (producer prices). It will probably remain at that or a slightly lower level this year given the corrections that will have to be made to administered prices. Moreover, the outcome of the elections was not all that decisive. This, in turn, may lead to the formation of a weak government that will have to tread gently on the spending of public revenues. It may also have to coerce the central bank into playing along, if by no other means than appointing a new governor.

Figure 7

Consumer price inflation, 2004-2006

year-on-year growth in %





Source: wiiw Monthly Database incorporating national statistics.

Table 5

Consumer price inflation

change in % against preceding year

	1995	2000	2001	2002	2003	2004	2005	2006 [1]	2007 forecast	2008 forecast
Croatia [2]	2.0	6.2	4.9	1.7	1.8	2.1	3.3	3.2	3	2.9
Macedonia	15.7	5.8	5.5	1.8	1.2	-0.4	0.5	3.2	3	3
Turkey	89.0	54.9	54.4	45.0	25.3	8.6	8.2	9.6	7	5
Albania	7.8	0.1	3.1	5.2	2.2	3.0	2.4	2.3	2	2
Bosnia and Herzegovina [3]	.	4.9	3.2	1.3	1.1	0.7	2.9	7.4	4	2
Montenegro	.	20.2	21.8	16.0	6.7	2.4	2.3	3.0	3	3
Serbia	.	79.6	93.3	16.6	9.9	11.4	16.2	11.6	10	10

Notes: 1) Preliminary. - 2) Up to 2001 retail prices. - 3) Costs of living.

Source: wiiw Database incorporating national statistics, forecast: wiiw.

Table 6

Producer prices in industry

change in % against preceding year

	1995	2000	2001	2002	2003	2004	2005	2006 [1]	2007 forecast	2008 forecast
Croatia	0.7	9.7	3.6	-0.4	1.9	3.5	3.0	2.9	2.5	2.4
Macedonia	4.7	10.7	2.0	-0.9	-0.3	0.9	3.2	4.5	4	4
Turkey [2)3)]	81.0	56.1	66.7	48.3	23.8	14.6	5.9	9.7	7	5
Albania [2]	.	6.5	-7.2	5.1	1.8	12.2	4.9	0.4 [I-IX]	.	.
Montenegro	.	.	.	14.5	4.5	5.8	2.1	2.0	3	3
Serbia	.	102.6	87.7	8.8	4.6	9.1	14.2	13.3	10	10

Notes: 1) Preliminary. - 2) In manufacturing industry. - 3) Wholesale prices.

Source: wiiw Database incorporating national statistics.

Though inflation is generally low and is expected to remain low (see Tables 5 and 6), fears abound that bubbles are bulging in many of the countries in the region. The data on real estate prices are not readily available; however, some sources have claimed, for instance, that within a year the real estate prices along the Montenegrin coast have caught up with those on the more developed Croatian coast. Similarly, real estate prices in Belgrade and Novi Sad, the capital of the province of Vojvodina in the north, are increasing significantly. Central banks in the region as a whole are keeping a close watch on the falling interest rates on debt and the sharp rise in equity markets.

It is hard to argue that a real estate bubble is building up in the Balkans. It is more likely that the prices are recovering from the very low level to which they had previously slumped, especially in areas that were beset by political conflicts or posed too great an investment risk on account of the precarious political situation in the country or region. The current leap in prices is thus most probably due to rapid recovery, rather than overinvestment. Moreover, as the banks are sound and stand relatively firm in the region as a whole, the central banks are falling prey to undue fear of a Ponzi scheme developing in the banking sector.

The bubble scare has come about not because the banks are offering too high an interest rate to attract deposits, but because they have been asking too low an interest rate on their loans. The fear is that all this will lead to households and enterprises accumulating unsustainable debts. If indeed the banks are incorrectly pricing the risks they face, it is difficult to determine the error of their ways. By most prudential standards, the banks' balance sheets can be declared to be quite sound. One possible culprit could be the exchange rate and the central banks' related monetary policy.

Monetary policy and exchange rates

Despite most of the region being on fixed exchange rates, monetary policy is actively pursued, although in some cases it takes a somewhat unorthodox turn. It is unorthodox in the way its targets and instruments are chosen. In those cases where the exchange rates are more or less left to float, developments are slightly more dramatic, as can be seen from Figure 8. Turkey has experienced a sharp depreciation of its currency, together with an increase in interest rates. On the other hand, as already mentioned, Serbia has experienced a rather sharp appreciation of its currency. As an initial response, the Serbian central bank also put up its interest rate on short-term bonds and introduced punishing reserve requirements (as much as 60%) on foreign deposits. Albania, which also adheres to a floating exchange rate regime, has experienced slowing real appreciation and even some depreciation by the end of 2006.

In the other cases, some real appreciation occurred as a consequence of a slight acceleration in inflation; however, the stability of real exchange rates has been essentially preserved. In the case of Macedonia, this has been achieved via a welcome relaxation of its monetary policy. In the past, the Macedonian central bank strove mostly to keep the exchange rate stable; its denar has been strictly fixed to the euro since 1997. It did that by keeping interest rates very high, even though prices for the most part took a deflationary tack. With the dramatic improvement in the current account, the central bank has relaxed its monetary policy significantly (Figure 9 does not reflect that adequately). This has borne mostly positive consequences for growth and the overall soundness of the financial system.

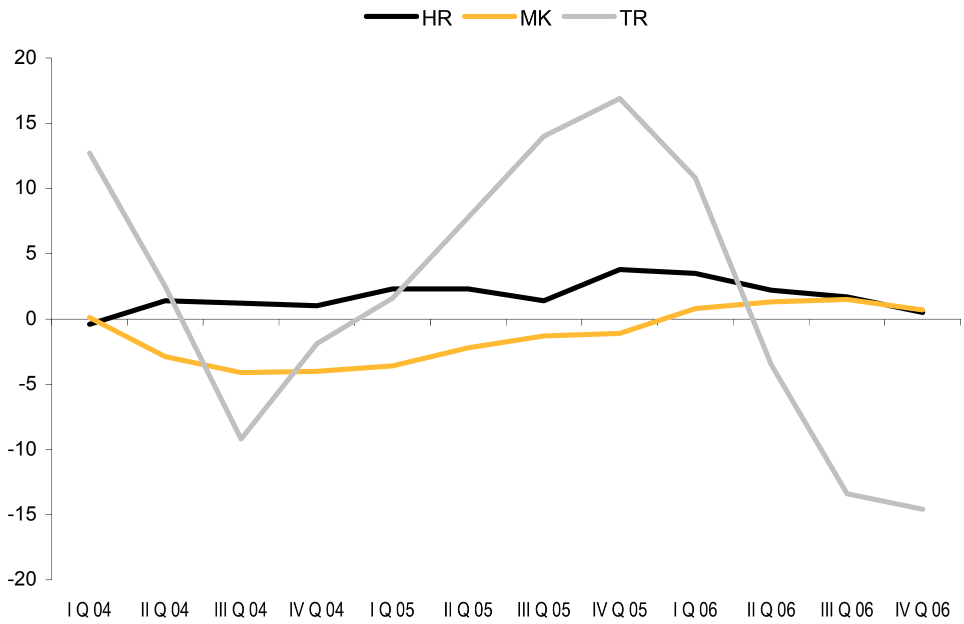
The story of the Croatian central bank is quite different. Despite having presided over a decade of price stability, its credibility has remained close to zero. The lack of trust is borne out by the massive deposits in euros, rather than in domestic currency, in Croatian banks (around 80%). Thus, rather than worrying about inflation which has kept level with the euro zone for quite a while, the central bank has become worried about the accumulation of foreign debt and the soundness of the banking system. As a result, it has intervened extensively to keep the exchange rate at a stable level, at the same time requiring banks to impose punitive reserve rates on their foreign currency deposits. As these measures proved ineffective, the central bank has now introduced quantitative restrictions on the amount of credit that banks and bank-like institutions can extend (12% per year). These restrictions on both the liabilities and assets of the banks have been extended to leasing companies; they may well be extended still further as the new measures are unlikely to be all that effective.

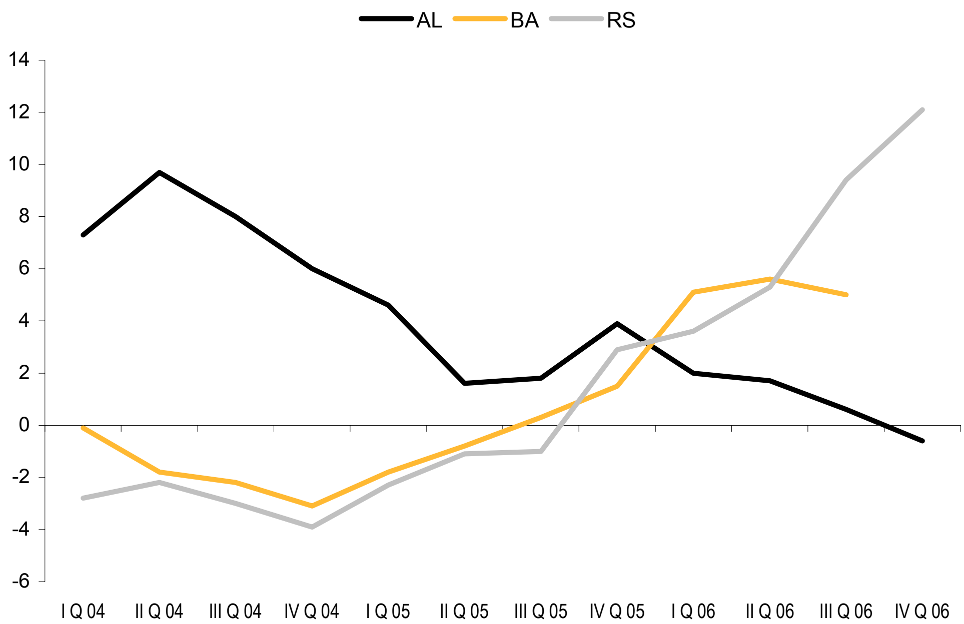
Unlike the Croatian central bank, which acts more as a financial watchdog, the Serbian central bank has finally found its vocation, at least in its public declarations. It is now determined to focus solely on the rate of inflation and resort to one single standard monetary instrument: using the interest rate to steer the money market. Officially, it is shifting towards inflation targeting. However, it has not yet abandoned the idea of extracting high reserve requirements from the commercial banks and other

Figure 8

Real appreciation*, 2004-2006

EUR per NCU, CPI-deflated, year-on-year growth in %



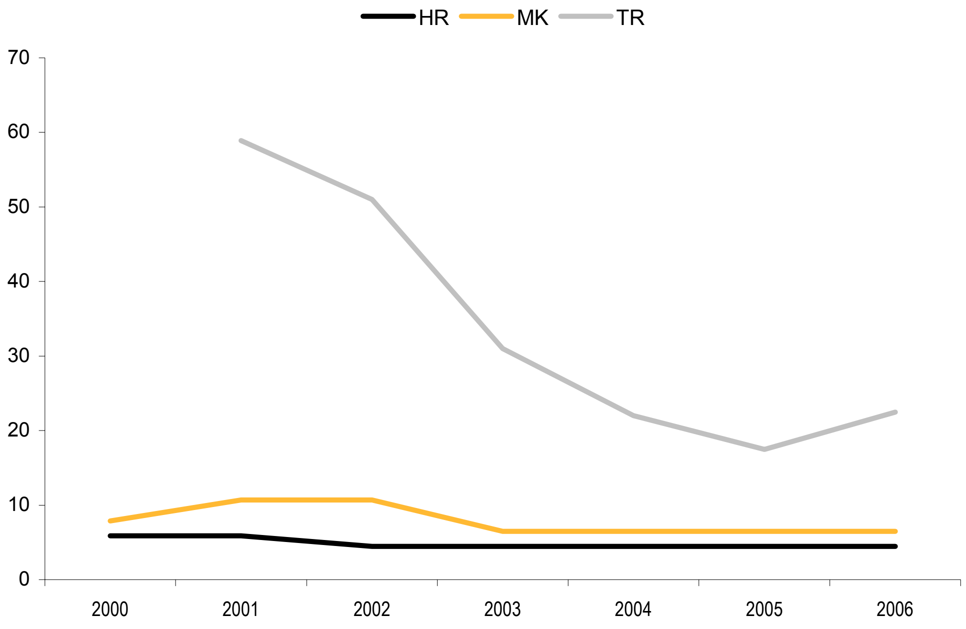


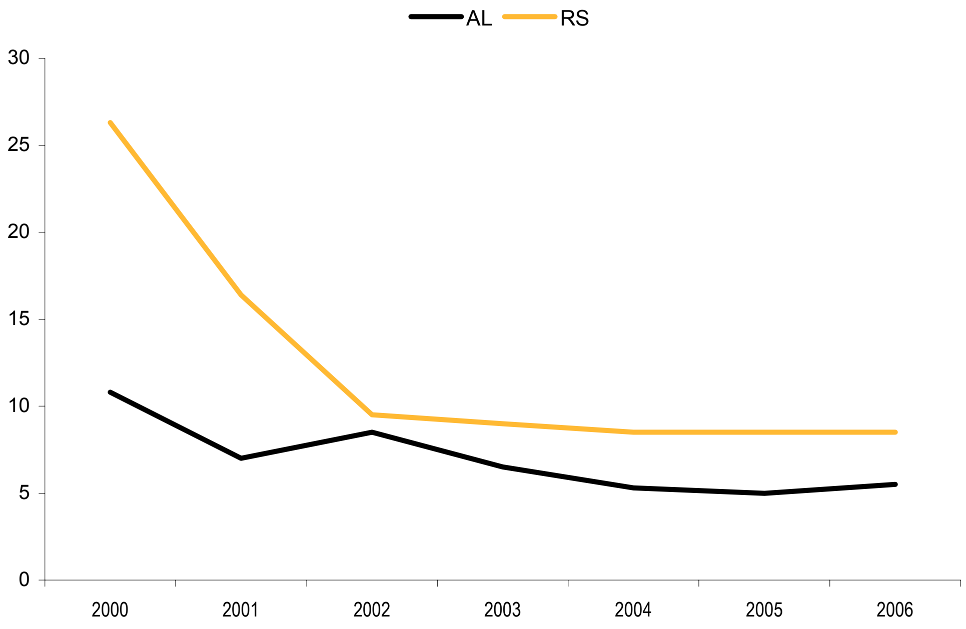
* Increasing line indicates real appreciation. Serbia: based on end-of-month exchange rates.
Source: wiiw Monthly Database incorporating national statistics.

Figure 9

Minimum interest rates, 2000-2006

nominal NB leading rate in % p.a.





Note: AL data 2006 refer to November 2006.

Source: wiiw Monthly Database incorporating national statistics.

bank-like institutions, and it still intervenes heavily in the foreign exchange market. It has yet to indicate clearly the type of inflation it is in fact targeting. As a consequence, it is difficult to know whether it will in fact ever move towards inflation targeting. Once again it may even fall back on a fixed exchange rate policy that was all but reintroduced at the beginning of the year.

The more general problem with the monetary policy is that the direction in which it should in fact move is not altogether clear. If, given that to all appearances labour markets are not restricted and the wage-earners' bargaining power is weak owing to marked increases in productivity, it can be correctly claimed that the economy faces no real inflationary pressures, the reason for the tendency among central banks in the Balkans to adopt somewhat restrictive monetary policies is far from obvious. Also, as can be seen in Table 7, the monetization of the region is still rather low. In other words, the manner in which the higher interest rate policy might actually work remains obscure. Two concerns are usually mentioned in this connection, both of which are worth discussing here.

One worry is that it incurs the risk of a bubble developing as interest rates on loans go down. Thus, higher interest rates should keep the asset values down and so help to lower both investment and consumption levels. However, as more capital accounts are opened thanks mostly to the ever growing presence of foreign banks, the resultant higher interest rates and low asset prices will merely attract larger inflows of foreign credit and investment. Under such circumstances, it is doubtful whether monetary policy can be a very effective foil against bubbles.

The other argument is that credit is expanding far beyond what is warranted by these countries' level of development. The logic of that argument hinges on the assumption that unavailability of credit is not a cause of underdevelopment in the first place. If, however, as Schumpeter argued, credit expansion spurs development, the relatively rapid growth of credit in the transition countries in the Balkans should be a welcome sign of risks lessening and opportunities for faster development increasing.

The final argument is that tight credit policy keeps a tight rein on fiscal policy. That argument is hardly applicable to the Balkans as the fiscal picture is relatively good there (see Table 8). In the sense of it possibly being a problem, improvement is probably beyond the reach of monetary policy. Bosnia and Herzegovina is a case in point. It relies on a currency board arrangement and is thus unable to pursue any orthodox monetary policy. The central bank has voiced concerns over credit expansion and its potential to undermine the currency board arrangement; like many other central banks in the region, it has started stepping up reserve requirements. A closer look at the economy of Bosnia and Herzegovina reveals that the risks lie elsewhere. On tracking the productivity and wage developments in various sectors, it appears that only in the relatively large public sector are wages increasing at a faster, indeed much faster, rate than productivity. In private industry and market services, wages are lagging far behind productivity. Thus, it is public spending that is threatening the stability of the exchange rate. As the government cannot, does not and (given the fiscal surplus) need not borrow from the central bank, monetary policy can in fact do nothing to curb public spending.

Table 7

Money supply, end of period

		National currency unit, bn								in % of GDP							
		1999	2000	2001	2002	2003	2004	2005	2006 [1)]	1999	2000	2001	2002	2003	2004	2005	2006 [1)]
Croatia																	
	GDP	142	153	166	181	198	213	229	247	100	100	100	100	100	100	100	100
	Currency outside banks	6.0	6.6	8.5	9.7	10.6	11.0	12.2	14.6	4.2	4.4	5.1	5.3	5.3	5.1	5.3	5.9
	M1, Narrow money	13.9	18.0	23.7	30.9	33.9	34.6	38.8	48.5	9.8	11.8	14.3	17.0	17.1	16.2	16.9	19.6
	Broad money	56.7	73.1	106.1	116.1	128.9	139.9	154.6	182.5	40.0	47.9	64.0	64.1	65.0	65.8	67.5	73.9
Macedonia																	
	GDP	209	236	234	244	251	265	284	303	100	100	100	100	100	100	100	100
	Currency outside banks	8.2	9.5	14.1	14.1	14.2	14.2	14.4	16.2	3.9	4.0	6.0	5.8	5.6	5.3	5.1	5.3
	M1, Narrow money	19.7	22.4	25.3	26.4	27.3	27.6	29.7	34.7	9.4	9.5	10.8	10.8	10.8	10.4	10.4	11.5
	Broad money	35.1	43.7	71.6	65.0	76.7	89.7	103.9	112.6 [IX]	16.8	18.5	30.6	26.6	30.5	33.8	36.6	37.1 [IX]
Albania																	
	GDP	481	533	590	629	694	752	822	880	100	100	100	100	100	100	100	100
	Currency outside banks	81.3	99.2	119.1	130.8	125.2	138.1	149.7	146.3 [XI]	16.9	18.6	20.2	20.8	18.0	18.4	18.2	16.6 [XI]
	M1, Narrow money	103.0	124.0	142.9	152.7	144.7	172.8	227.7	226.9 [XI]	21.4	23.3	24.2	24.3	20.9	23.0	27.7	25.8 [XI]
	Broad money	292.9	328.1	394.3	416.7	448.4	507.2	578.0	638.0 [XI]	60.9	61.6	66.8	66.3	64.6	67.4	70.3	72.5 [XI]
Bosnia and Herzegovina																	
	GDP	10	11	12	13	13	15	16	18	100	100	100	100	100	100	100	100
	Currency outside banks	0.5	0.7	1.7	1.7	1.6	1.7	1.7	2.0	5.3	6.0	14.1	13.7	12.0	11.4	11.0	11.1
	M1, Narrow money	1.1	1.4	2.7	3.0	3.1	3.5	4.1	5.1	11.3	12.9	22.6	23.8	23.4	24.1	26.1	28.5
	Broad money [2)]	2.2	2.5	4.7	5.1	5.5	6.8	8.1	10.1	22.2	22.6	39.2	40.1	41.2	46.6	51.3	56.6
Serbia																	
	GDP	210	398	784	1020	1172	1431	1750	2140	100	100	100	100	100	100	100	100
	Currency outside banks	6.7	10.9	25.3	43.7	43.0	45.2	53.7	68.4	3.2	2.7	3.2	4.3	3.7	3.2	3.1	3.2
	M1, Narrow money	14.8	27.0	58.2	93.8	99.5	111.2	144.9	200.0	7.0	6.8	7.4	9.2	8.5	7.8	8.3	9.3
	Broad money [3)]	24.9	65.2	125.4	191.5	244.9	323.1	459.4	571.3 [IX]	11.9	16.4	16.0	18.8	20.9	22.6	26.3	26.7 [IX]

1) Preliminary. -2) Intermediate money M2 (M1+Quasy money). -3) Excluding frozen foreign currency saving deposits of households.

Source: wiiw Database incorporating national statistics.

Table 8

General government budget balance, in % of GDP 1)

	2000	2001	2002	2003	2004	2005	2006 2)	2007 forecast	2008 forecast
Croatia	-6.5	-6.7	-5.0	-6.2	-4.8	-4.1	-3	-3	-2.5
Macedonia 3)	2.3	-6.3	-5.0	-1.1	0.0	0.2	-0.6	-1	-1
Turkey	.	-33.0	-12.9	-11.3	-5.7	-1.2	-0.5	-1.8	.
Albania	-7.5	-6.9	-6.0	-4.9	-5.1	-3.4	-3	-3	-4
Bosnia and Herzegovina	-6.4	-3.2	-0.1	0.8	1.7	2.6	2	0	0
Montenegro 4)	-6.0	-3.1	-2.8	-3.1	-2.1	-1.8	-1.6	-1	-1

Notes: 1) National definition; for Turkey EU definition: net lending (+) or net borrowing (-) according to ESA'95, excessive deficit procedure; for Croatia IMF definition. - 2) Preliminary. - 3) From 2001 excluding privatization revenues, 2005 data projected. - 4) Central government budget deficit.

Source: wiiw Database incorporating national statistics, AMECO; wiiw forecasts.

Although the relationship between the central bank and the fiscal authorities elsewhere in the Balkans is not the same as in Bosnia and Herzegovina, in principle the differences are not all that significant. Thus, monetary policy can do relatively little to curb fiscal policy, short of not supporting the stability of the exchange rate. This in essence is the policy adopted by the Turkish central bank. In the wake of the sharp drop in the exchange rate, it has put up its interest rate; the latter increase, however, is disproportionately smaller than the former depreciation. If the central bank had wanted to prevent a decline in the exchange rate, it would have had to increase its interest rates much more dramatically; that would have brought about a switch from a large surplus in the fiscal balance to a deficit. In view of the rather prudent fiscal policy that the Turkish government is pursuing at the moment, depreciating the currency seems the right course of action to take. It will increase the stock of foreign debt, thus dissuading the government from engaging in additional borrowing, while a stronger interest rate hike would have had the opposite effect by increasing the need for debt financing.

External balances

Overall debt development has been an issue in a number of countries. It has also been a concern of the IMF, although it now plays a less prominent role since it no longer runs stringent programmes in the region (Turkey is an exception). Croatia and Serbia have reported major increases in foreign debt and its tendency to increase in terms of GDP and exports. As can be seen in Tables 9 and 10, debts are accumulating, despite the increase in foreign reserves. To an ever greater degree, however, it is the private sector share of those debts that is increasing. For their part, governments have been reducing their exposure to foreign debt. This raises two issues: (a) that of determining an acceptable level of debt for a transition economy with extensive foreign ownership in its banking and industry sectors; and (b) that of assessing the threat to exchange rate stability posed by the accumulation of private debt.

As to the first issue, it would appear that investors have raised the debt acceptance levels for those transition economies that are closely integrated with EU markets. Thus, although the level of Croatian debt has now surpassed 85% of GDP, the investment rating of its debt has not gone down. This may have been a problem for Croatia in a different way: due to the high level of foreign debt, moving to a higher rate of growth may be risky as it leads to a widening of the current account deficit and thus to further growth of foreign debt. Serbia's debt to GDP ratio is significantly lower; however, it has been increasing each year and will continue to do so as long as the rating agencies continue to downgrade their rating of the investment risks.

Table 9

Net capital flows

EUR million

	Croatia					Macedonia				
	2003	**2004**	**2005**	***1-9/05***	***1-9/06***	**2003**	**2004**	**2005**	***1-10/05***	***1-10/06***
Capital inflow transfer	**4213**	**2385**	**3854**	***2383***	***3826***	**200**	**344**	**410**	**178**	**199**
Capital transfer	72	23	51	*8*	*-154*	-6	-4	-2	*-0.1*	*-0.3*
FDI	1678	708	1229	*1157*	*1658*	85	126	78	*70*	*269*
Portfolio	869	245	-1077	*-1015*	*38*	3	12	189	*31*	*47*
Other capital (loans)	1593	1409	3740	*2321*	*2285*	118	210	144	*77*	*-116*
Financial derivatives	.	.	-88	*-88*	*0*	.	.	.	.	.
Destination of capital inflow	**3101**	**1447**	**2816**	***888***	***1950***	**177**	**350**	**399**	**172**	**189**
Current account	1866	1404	1995	*485*	*1177*	132	334	66	*26*	*-93*
Increase reserves	1236	43	822	*403*	*773*	45	16	334	*147*	*282*
Errors & omissions	**-1112**	**-938**	**-1038**	***-1495***	***-1876***	**-23**	**6**	**-11**	*-6*	*-10*

	Albania					Bosnia & Herzegovina				
	2003	**2004**	**2005**	***1-9/05***	***1-9/06***	**2003**	**2004**	**2005**	***1-9/05***	***1-9/06***
Capital inflow transfer	**318**	**415**	**440**	***220***	***293***	**1333**	**1498**	**1775**	***1112***	***926***
Capital transfer	139	106	99	*75*	*144*	411	401	367	*262*	*224*
FDI	158	269	222	*158*	*198*	338	533	420	*279*	*267*
Portfolio	-20	5	-2	*-7*	*23*	.	.	.	.	.
Other capital (loans)	41	35	120	*-6*	*-71*	584	565	988	*570*	*435*
Financial derivatives	.	.	.	.	.	.	.	.	.	.
Destination of capital inflow	**449**	**521**	**617**	***315***	***532***	**1600**	**1829**	**2135**	***1406***	***1126***
Current account	360	288	492	*271*	*411*	1439	1483	1758	*1158*	*785*
Increase reserves	88	233	125	*45*	*121*	162	346	378	*248*	*341*
Errors & omissions	**131**	**106**	**177**	*96*	*238*	**268**	**329**	**359**	*294*	*200*

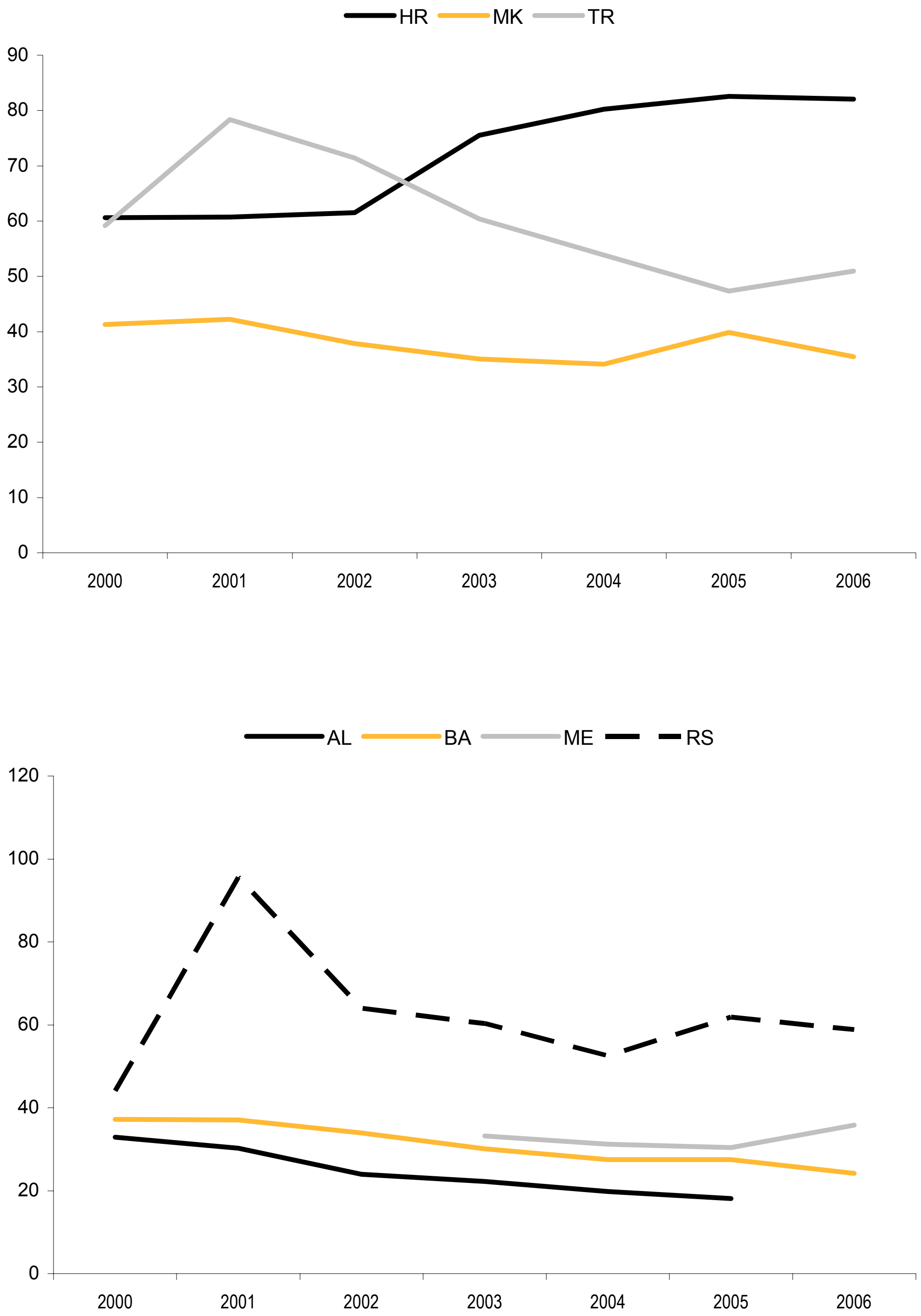
	Montenegro					Serbia				
	2003	**2004**	**2005**	***1-6/05***	***1-6/06***	**2003**	**2004**	**2005**	***1-11/05***	***1-11/06***
Capital inflow transfer	**-42**	**36**	**366**	**260**	**241**	**2227**	**2474**	**3809**	.	**6732**
Capital transfer	.	.	.	.	*-13.2*	.	.	.	.	*675*
FDI	39	51	381	*228*	*149*	1204	777	1247	.	*2741*
Portfolio	1	6	5	*6*	*4*	.	.	.	.	.
Other capital (loans)	-82	-20	-20	*26*	*102*	1023	1697	2562	.	*3316*
Financial derivatives	.	.	.	.	.	.	.	.	.	.
Destination of capital inflow	**43**	**97**	**328**	**267**	**216**	**2116**	**2639**	**3443**	.	**6575**
Current account	102	120	154	*157*	*286*	1301	2279	1812	.	*2285*
Increase reserves	-59	-22	174	*110*	*-70*	815	360	1631	.	*4290*
Errors & omissions	**85**	**61**	**-38**	***7***	***25***	**-111**	**166**	**-366**	.	**-157**

Source: wiiw Database incorporating national bank statistics.

Figure 10

Share of total foreign debt in GDP, 2000-2006

in per cent

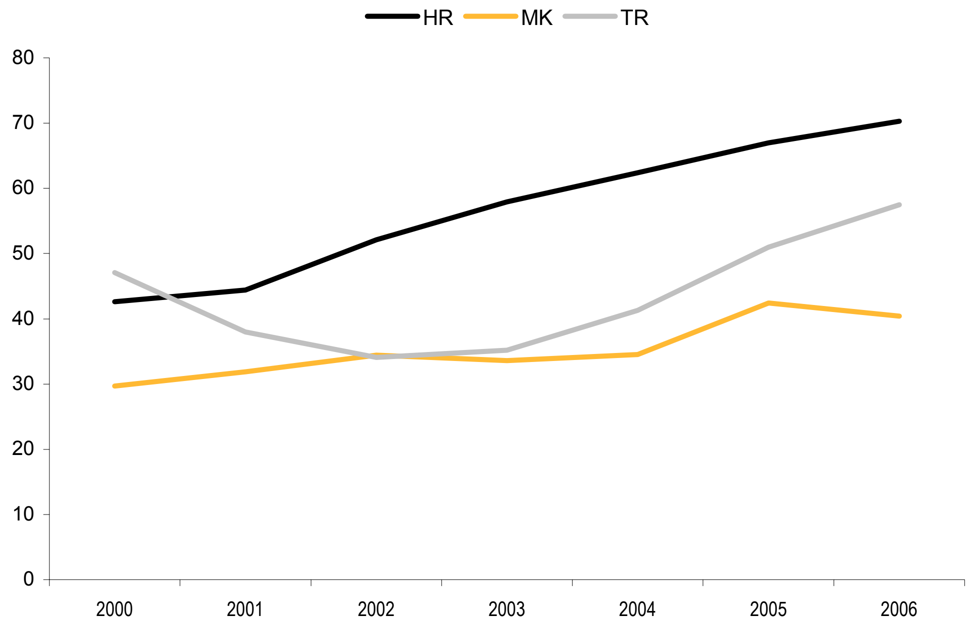


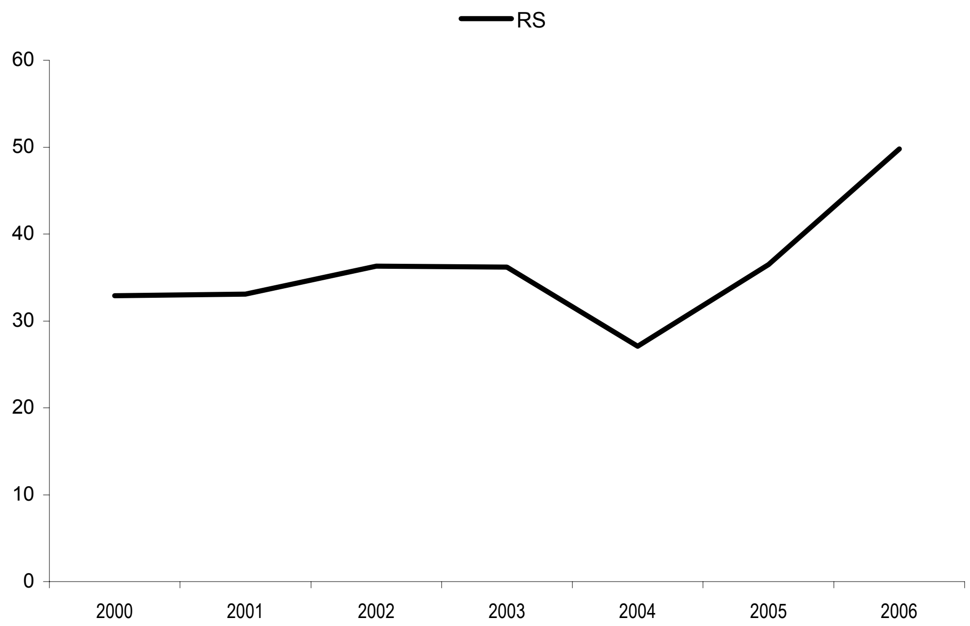
Source: National Banks of the respective countries.

Figure 11

Share of private foreign debt in total foreign debt, 2000-2006

in per cent





Note: HR, RS data 2006 refer to October 2006, TR data 2006 refer to September 2006.

Source: National Banks of the respective countries.

As for the second issue, exchange rate stability, the pressure is directed more towards appreciation than depreciation. Both the Serbian and (especially) Croatian central banks intervene in the foreign exchange markets in order to prevent their currencies from appreciating. Clearly the investors feel that the exchange rate is undervalued in terms of asset prices and, in the case of household loans, in terms of current wage levels (Croatia perhaps being an exception).

The issue of sustainability may thus turn out to be important, if the banks' assessments prove to be distorted as a result of some of the relevant relative prices being strongly skewed.

Table 10

Foreign financial position

EUR billion, end of period

	Gross external debt [1]			Reserves of National Bank (excluding gold) [2]			Current account			
	2004	2005	2006	2004	2005	2006	2005	2006	2007 forecast	2008 forecast
Croatia	22.8	25.5	29.0	6.4	7.4	9.0 XI	-2.0	-3.0	-2.9	-2.8
Macedonia	1.5	1.8	1.8	0.7	1.0	1.4 IX	-0.1	0.1	-0.1	-0.1
Turkey	130.5	137.5	157.9 IX	29.0	40.6	46.4 XI	-18.6	-27.6	-28.0	-30.0
Albania	1.2	1.2	.	1.0	1.2	1.3 XI	-0.5	-0.8	-0.7	-0.6
Bosnia & Herzegovina	2.1	2.2	2.2	1.8	2.1	2.9	-1.8	-1.8	-1.8	-1.7
Montenegro	0.5	0.5	0.6	.	.	.	-0.2	-0.3	-0.3	-0.3
Serbia	10.4	13.1	15.0	3.0	4.8	9.0	-1.8	-2.5	-2.8	-3.0

Notes: 1) General government foreign debt for BiH; Macedonia medium- and long-term; Gross external public debt for Montenegro. - 2) Albania: including gold; refer to total foreign assets of Bank of Albania.

Source: wiiw Database incorporating national statistics, forecast: wiiw.

Social risks

The rather positive picture created by productivity growth has a dark side: the low level of employment. It also has an even darker side: the high level of unemployment (see Table 11). The countries in the Balkans fall into different categories when it comes to the dynamics of unemployment. Croatia is gradually reducing its unemployment rate, although the employment rate is not really growing. Serbia, on the other hand, is undergoing a marked drop in employment and a rise in unemployment. Similar developments might well occur in Bosnia and Herzegovina, but not in Macedonia and Montenegro. Albania is also slowly reducing its rate of unemployment, probably on account of the large numbers of emigrants.

The case of Serbia is perhaps indicative of some of the ongoing processes in the region. Data on employment and unemployment point to a pronounced increase in employment in the private sector and a rather steep drop in both the public sector and agriculture. Since the private sector is smaller than the public sector in terms of employment, it follows that the overall level of employment is going down and that of unemployment is going up. Similar developments are to be expected in Bosnia and Herzegovina, where the public sector is still very large.

The social impact and sustainability of these developments are difficult to assess. In transition countries, political stridency tends to act as a substitute for social conflict. Governments thus tend to be weak and populist parties tend to secure significant shares of the vote. However, in some cases, viz. Serbia, social protest in the form of strikes and demonstrations serves as a bargaining tool in wage negotiations and has proven quite effective. In other cases, social protest has played more of a minor role for different reasons in different countries. Thus, some social risks still obtain in Serbia as the state sector undergoes further downsizing.

Table 11

Unemployment, LFS definition, annual averages

	in 1000 persons						rate in %				
	2001	**2002**	**2003**	**2004**	**2005**	**2006** 1)	**2004**	**2005**	**2006** 1)	**2007**	**2008**
										forecast	
Croatia	277	266	256	250	229	208	13.8	12.7	11.5	11	10.5
Macedonia	263	263	316	309	324	320	37.2	37.3	36	35	35
Turkey 2)	1967	2464	2493	2498	2520	2440	10.3	10.3	9.8	9.5	9
Albania 3)	181	172	163	157	155	150	14.4	14.2	13.9	14	14
Bosnia & Herzegovina 3)4)	422	442	460	486	508	367	43.2	44.2	31.1	30	30
Montenegro 5)	58	58	.	72	78	77	27.7	30.3	30	30	30
Serbia 6)	433	460	500	665	720	760	18.5	20.8	22	23	24

Notes: 1) Preliminary. - 2) Civilian Labour Force. - 3) Unemployment by registration, end of period. - 4) From 2006 data based on the first LFS April 2006. - 5) From 2004 according to ILO and EUROSTAT, census 2003. - 6) 2004 according to ILO and EUROSTAT, census 2002.

Source: wiiw Database incorporating national statistics, forecast: wiiw.

The Kosovo issue

Economies are improving in the Balkans, even though political risks persist. The major residual uncertainty is due to be resolved this spring when the decision is taken on the political status of Kosovo. The current time table requires that the plan proposed by the UN mediator, Marti Ahtisaari, be presented to the Security Council by the end of March. The Security Council is expected to vote in April on a new resolution in favour of adopting the plan or a variant thereof. Thereafter, the new EU and NATO missions will take up operations in Kosovo; the country will adopt a new constitution and file for membership in the international financial institutions, as well as in the United Nations. The financial institutions will act swiftly and accept Kosovo as a member; the World Bank in particular is expected to play a vital role in the reconstruction and recovery of the economy in Kosovo. UN Membership is expected to follow in September or soon thereafter.

The risk is that Serbia will not concur with this plan and Russia will support Serbia's insistence that Kosovo be granted internal, but not full external sovereignty. That may lead to a prolongation of the whole process with every possibility of the security situation in the province collapsing. On the other hand, political stability in Serbia may be put to a serious test if the independence of Kosovo is accepted by the UN or the EU and the United States, whereupon new early elections with a rather uncertain outcome would be the likely upshot. The EU, the United States and the more moderate parties that aspire to constituting the very core of the Serbian government are hoping for an outcome whereby the Kosovo independence process moves ahead as planned, with the Serbian government surviving, yet voicing its profound disagreement with the same.

Other political imponderables

The region has no lack of other political risks and uncertainties, although they are not as challenging as the Kosovo issue. Montenegro faces problems related to the adoption of the new, post-independence constitution and the impact it will have on parliamentary procedure. In Macedonia, the largest Albanian party is boycotting parliament as it objects to the smaller Albanian party having joined the governing coalition. In Bosnia and Herzegovina, the government in the Federation (one of the two political entities) has yet to be formed, six months after elections were held. Furthermore, the constitutional reform process is still being stalled. Tensions may well increase when the International Court of Justice in The Hague announces, as is expected, its verdict that Serbia and Montenegro were guilty or somewhat culpable of genocide during the war in Bosnia and Herzegovina in the first half of the nineties. Republika Srpska, the other political entity in Bosnia and Herzegovina, will reject that verdict and possibly retaliate by cooperating even less than it does now in strengthening the functionality of the common state.

All these political shocks – and some relatively minor issues such as the upcoming parliamentary elections in Croatia – should prove manageable, but there is every risk of one or the other issue getting out of hand. If indeed, as expected, all the necessary decisions and changes are adopted and implemented, political stability should be strengthened and regional security improved. That should result in an improvement in the rather positive economic developments that have taken place to date.

EU integration prospects

Stability and progress in the Balkans are closely linked to EU integration. All the countries in the region are at some stage or other in the association or accession process; the speed of both the individual and overall processes is of essential importance to the region's economic development and political stability. At present, the process is moving along at a relatively slow pace. It is expected that Stabilization and Association Agreements (SAA) will be signed with Bosnia and Herzegovina, Serbia and Montenegro in the course of the year. Kosovo will also be included in the process during this year. Croatia will continue to negotiate for membership, with a view to joining the EU around 2010. Macedonia will most probably not start to negotiate this year, although the process may pick up speed in the wake of the decision on Kosovo as that would prove a stabilizing factor for the region as a whole. The next step should be taken in early 2008 during the Slovene presidency. All the SAA countries are expected to apply for membership and Slovenia is expected to lobby heavily for a positive response by the EU. Certainly, the negotiations with Macedonia should start by then, at the latest.

The prospects of Turkey's negotiations for membership with the EU will depend on political developments in the EU; the outlook cannot be considered positive at this point in time. No new moves in favour of including Turkey in the EU have emerged in any shape or form. Purportedly, enthusiasm for EU integration is waning in Turkey, and it is certainly absent in the EU. Whereas economic and even security-related considerations favour membership, the general public in the EU is not prepared to accept the idea and people in Turkey are quite dismayed. The short-term and even medium-term economic developments should not be affected by the slowdown of EU enlargement in the Balkans. The long-term consequences, however, may well prove negative, if Turkey's bid to join the EU is stalled indefinitely.

Overall prospects

In the short term, the economies in the region should continue to post good data. Growth should continue and most probably accelerate in some cases, viz. Macedonia. Price and exchange rate stability should not pose any problems. Exports should continue to grow, as should foreign investments. Political and social stability should be preserved, although some risks might arise in connection with the independence of Kosovo. EU integration should proceed at a pace that targets 2015 as the year for completing the enlargement process in the Balkans, with the exception of Kosovo. Turkey's accession, however, still seems to be shrouded in doubt.

The highlights of the country-specific forecasts are presented below (for more details see the attached country reports):

Albania

Chronic energy shortages have continued to drive the growth rate down, but improvements are expected in the medium run with the increase of supply capacities. Stability of prices and the exchange rate is not threatened as fiscal performance continues to improve despite political squabbles.

Bosnia and Herzegovina

Strong growth is expected to persist over the medium run. The prospects will improve if the Association Agreement with the EU is signed this year as expected. Foreign investments and private transfers will continue to spur growth, but growing exports will also play a part. Political risks are not negligible, but should prove to be manageable.

Croatia

The prospects of entering the EU have decisively improved Croatia's international standing. Economic prospects remain good provided that Croatia does not slip into a severe debt crisis. Driven primarily by domestic demand, GDP growth may be sustained at the current level in the coming two years. The current account deficit will remain substantial, implying a further increase in foreign debt.

Macedonia

Growth should accelerate somewhat due to more relaxed fiscal and monetary policies. The decisive turnaround depends on an increase in foreign investments, which are yet to materialize. Political stability should be strengthened after advances in the Kosovo issue have been achieved and after the start of negotiations with the EU, the latter depending on the government's ability to implement the necessary constitutional and other institutional reforms.

Montenegro

The economy should continue to recover with investments in tourism and infrastructure and private consumption being the main sources. Political stability is not threatened though the state building process has still a long way to go. A Stabilization and Association Agreement with the EU should be signed this year, with positive effects for stability and investments.

Serbia

This year growth depends on the resolution of the political crisis, which is in part connected with the pending decision of the UN Security Council on the status of Kosovo. With that and with the resumption of negotiations with the EU, investments should increase significantly as should private consumption. If also price and exchange rate stability are achieved, Serbia will post high growth rates in the medium run. In the short run, however, political risks are still rather significant.

Turkey

Growth should accelerate and stability should be improved over the medium run. The risks connected with the possible reduction of emerging markets' attractiveness to investors are not altogether negligible. In the longer run, a disappointment in the prospects for EU accession may have important negative consequences.

Country reports

Mario Holzner

Albania: periodic evils

The end of the year 2006 and early 2007 was again marked by the two periodic evils that Albania is facing every now and then: energy and political crises. While the first is still continuing the latter at least has been solved for the moment. These two crises are the reason for reduced economic growth prospects for 2006 and 2007. For both years the real GDP growth rate is not expected to exceed 5%. Given more favourable conditions in 2008 the growth rate may approach the average mid-term target of 6%. Still due to the lasting shortcomings in physical and institutional infrastructure, Albania is missing out on an even higher potential growth path. This is given its kick-off from very low levels of economic activity.

The political crisis that shook the country for the past months was based on a recurring pattern of political agitation with changed roles. Now that the left-wing parties are in opposition and the right-wing parties in government, they still behave in the same non-cooperative manner as at the time when it was the other way around. This time the bone of contention was the electoral reform in view of the forthcoming local elections. A massive lack of will for consensus over fundamental democratic rules blocked the political process. The political deadlock peaked when the opposition decided to boycott the upcoming local elections. Only thanks to the effort made by the president of the republic and representatives of the European Commission, the US State Department and the OSCE that, finally, in mid-January 2007, a compromise was reached and the path to local elections was opened. Against the background of Albania's will for integration both the EU and NATO were irritated by the surprisingly severe dispute of the country's political elites. Also the blatant immaturity of the Albanian political agents was unhelpful in furthering the much-needed process of addressing the country's major economic obstacles: ailing physical and institutional infrastructure. It is also due to this that FDI is trickling in only slowly.

The energy crisis which re-appeared in late 2006 is a repetition of similar events at the end of 2005 and earlier years. Once again a drought hitting the purely hydropower-dependent country caused electricity cuts of up to 12 hours a day in the cities and 20 hours a day in the rural areas. Electricity imports are limited due to the weak state of the domestic power grid, as well as because of shortages in power supply in other countries of the region. With the accession of Bulgaria to the EU, that country had to close down most units of its nuclear power plant in Kozloduj due to security issues. This also affects electricity supply in Albania. Allegedly the current electricity crisis in Albania is the worst in the past 16 years.

As a consequence GDP growth for 2006 is expected to drop below 5%, which is about one percentage point lower as compared to the expectations a year ago. The energy crisis has also its impact on the current account. The deficit is widening strongly and is expected to rise above 10% of GDP due to heavy increases particularly in fuel and electricity imports. Provided more favourable weather conditions for hydropower generation and an improvement in the technical condition of the electricity transmission facilities occur, the economic situation in 2007 and 2008 should gradually improve. GDP is expected to grow by 5% and 5.5% respectively. The current account deficit may

Table AL

Albania: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 [1)]	2007	2008
								forecast	
Population, th pers., end of period	3063.3	3084.1	3102.8	3119.5	3135.0	3150.0	3150	.	.
Gross domestic product, ALL mn, nom.	532977	590282	628527	694018	752367	822035	880000	950000	1030000
annual change in % (real)	6.5	7.1	4.3	5.8	6.2	5.6	4.8	5	5.5
GDP/capita (EUR at exchange rate)	1316	1496	1535	1622	1884	2106	2270	.	.
GDP/capita (EUR at PPP - wiiw)	3310	3580	3740	3940	4100	4420	4610	.	.
Gross industrial production									
annual change in % (real) [2)]	1.3	6.1	-5.1	29.0	14.1	1.3	1.5	2	3
Gross agricultural production									
annual change in % (real) [2)]	6.6	2.7	2.1	3.2	6.2	0.9	3.5	3.5	3
Construction output total									
annual change in % (real) [2)]	46.5	32.7	21.5	23.6	7.7	15.1	10	11	12
Consumption of households, ALL mn, nom.	371522	422651	455952	508108	.	.	.	.	.
in % of GDP	69.7	71.6	72.2	72.9	.	.	.	.	.
Gross fixed capital form., ALL mn, nom.	112958	151156	143914	160210	.	.	.	.	.
in % of GDP	21.2	25.6	22.8	23.0	.	.	.	.	.
Reg. employment total, th pers., end of per. [3)]	1068.2	1063.0	920.1	926.2	931.2	932.0	932	.	.
annual change in % [3)]	0.3	-0.5	0.1	0.7	0.5	0.1	0	.	.
Reg. unemployed, th pers., end of period	215.1	180.5	172.4	163.0	157.0	155.0	150	.	.
Reg. unemployment rate in %, end of period	16.8	16.4	15.8	15.0	14.4	14.2	13.9	14	14
Average gross monthly wages, ALL [4)]	14963	17218	19659	21325	24393	26808	27900	.	.
annual change in % (real, gross) [4)]	17.7	11.6	8.1	6.0	11.2	7.3	2.6 I-IX	.	.
Consumer prices, % p.a.	0.1	3.1	5.2	2.2	3.0	2.4	2.3	2	2
Producer prices in manufacturing ind., % p.a.	6.5	-7.2	5.1	1.8	12.2	4.9	0.4 I-IX	.	.
General governm. budget, nat.def., % GDP									
Revenues	24.5	24.7	24.6	24.1	24.5	24.8	.	.	.
Expenditures	32.0	31.5	30.6	29.0	29.6	28.3	.	.	.
Deficit (-) / surplus (+), % GDP	-7.5	-6.9	-6.0	-4.9	-5.1	-3.4	-3	-3	-4
Public debt in % of GDP	42.6	41.0	41.4	40.4	37.8	38.1	.	.	.
Refinancing base rate, % p.a., end of period	10.8	7.0	8.5	6.5	5.3	5.0	5.5 XI	.	.
Current account, EUR mn [5)]	-176.8	-243.3	-445.6	-400.0	-287.8	-492.0	-750	-660	-550
Current account in % of GDP	-4.4	-5.3	-9.4	-7.9	-4.9	-7.4	-10.5	-8.5	-6.5
Gross reserves of BoA incl. gold, EUR mn [6)]	691.5	863.5	813.0	812.7	1005.2	1201.6	1290 XI	.	.
Gross external debt, EUR mn	1321.0	1391.0	1140.0	1122.0	1169.0	1200.0	.	.	.
Gross external debt in % of GDP	32.9	30.3	24.0	22.2	19.8	18.1	.	.	.
FDI inflow, EUR mn [5)]	155.0	231.5	142.9	157.8	278.4	224.2	270	.	.
Exports of goods, BOP, EUR mn [5)]	277.5	340.2	350.5	397.9	485.6	530.2	620	700	800
annual growth rate in %	7.3	22.6	3.0	13.5	22.0	9.2	17	13	14
Imports of goods, BOP, EUR mn [5)]	1166.8	1486.5	1574.5	1578.3	1762.3	2006.9	2350	2400	2450
annual growth rate in %	32.6	27.4	5.9	0.2	11.7	13.9	17	2	2
Exports of services, BOP, EUR mn [5)]	485.8	595.9	619.6	637.8	807.5	967.3	1210	1400	1600
annual growth rate in %	94.3	22.7	4.0	2.9	26.6	19.8	25	16	14
Imports of services, BOP, EUR mn [5)]	466.1	496.2	624.9	711.8	848.0	1107.7	1320	1450	1600
annual growth rate in %	200.1	6.5	25.9	13.9	19.1	30.6	19	10	10
Average exchange rate ALL/USD	143.7	143.5	140.2	121.9	102.8	99.9	98.1	.	.
Average exchange rate ALL/EUR (ECU)	132.6	128.5	132.4	137.5	127.7	124.2	123.1	122	122
Purchasing power parity ALL/USD, wiiw [7)]	46.2	46.9	46.9	47.9	49.5	49.7	49.3	.	.
Purchasing power parity ALL/EUR, wiiw [7)]	52.6	53.7	54.3	56.6	58.7	59.3	60.6	.	.

1) Preliminary. - 2) According to gross value-added. - 3) From 2002 according to census April 2001. - 4) Public sector only. - 5) Until 2003 calculated from USD. - 6) Refer to total foreign assets of Bank of Albania. - 7) wiiw estimates incorporating data of World Development Indicators 2006.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

somewhat decrease, to levels below 9% and 7% of GDP respectively. It is encouraging that negotiations on the construction of a thermopower plant near the town of Vlora have been completed. The value of investment is USD 120 million with a capacity of generating 120 MWh per year. The project will be co-financed by the World Bank and the EBRD. The facility is expected to be completed within the next 18 months. Once in operation, the power plant is envisaged to reduce electricity imports by 30%. Other thermopower projects are expected to be completed by the end of the decade. By then Albania should have overcome this severe bottleneck for economic growth.

Summing up, the overall growth prospects of the Albanian economy appear to be favourable given the expected improvements in physical and institutional infrastructure. Strong growth of domestic demand and a vibrant construction sector – both fuelled by remittances from Albanians working abroad – are at the core of the country's economic performance. However, an improved business climate should also attract more FDI to the export sector, making this sector an engine of economic growth as well.

Zlatko Bosnić

Bosnia and Herzegovina: economic performance better than its reputation

It is a broadly shared guess that the economy of Bosnia and Herzegovina (BiH) is growing continuously by slightly over 5% per year. The statistical office calculates nominal GDP values by aggregating the gross domestic products of the two entities Federation of Bosnia and Herzegovina (FBiH) and Republika Srpska (RS). The contributions of the individual industries to GDP are the basis of these calculations; estimates of demand-related categories such as private consumption and investment and also estimates based on income categories are lacking. A calculation of the GDP deflator is also lacking, thus an official real GDP growth rate does not exist either. New efforts to change this situation are under way, also aimed at improving the preconditions for future cooperation with the EU and gradual integration. Already in the past several years, the EU has funded projects designed to improve national accounting and statistics. Forthcoming new projects are of a larger scale. The problem is that the key to success will consist in achievements in terms of harmonization of methodologies of the two entities. Nobody will be able to push this through easily. The best strategy would be to equip a state-level institution – or a consortium of such institutions – with sufficient capacity and authority to produce official and reliable state-level figures. Such an institution, however, would only be able to raise confidence in its data if it combines methodological strength with visible independence from political influences.

Within an important segment of the corporate sector, enterprises enjoy a protected position on the domestic market whereas foreign markets play hardly any role. Electricity production and distribution as well as telecommunications are prominent examples. Compared to EU countries these sectors have a higher share in the GDP and enjoy more political influence. Their managements live in symbiosis with the political sphere. This remains the case also in Republika Srpska, where the government sold the telecommunications company to its Serbian equivalent. In another type of companies managers are interested in unrestricted access to foreign input markets and at the same time also in borderless access to sales markets. Yet this type of internationally competitive enterprises is underdeveloped in BiH; their influence on politics is limited. Regarding tradables, BiH is weak in producing, but strong in importing. In the past several years, export revenues covered merely about one third of import expenditures; more recently, the ratio has started moving closer to 50%. This means that an important gradual improvement is going on. The metal sector plays a positive role in this context – Aluminium Mostar and Mittal Steel in Zenica play a key role, with many small and medium-sized companies expanding as well. Some of them are producing inputs for EU-based car makers. This type of activity could face hard times in the future, as tough international competition is likely to challenge the traditional centres of European car industry. As a rule, the metal industry has not yet reached pre-war production volumes. The production of tradables remains limited mainly to semi-finished goods. This is also visible in wood processing, which is another traditional stronghold of BiH manufacturing. Particularly weak is the food industry: BiH imports most of the food that people consume. Other countries' (including the EU) subsidizing practices are one of the reasons, whereas exports suffer from the fact that the government has never developed supportive institutional settings.

Wages in BiH are higher than elsewhere in the Balkans, disregarding Croatia. The same is true for average household incomes. True, remittances from family members working outside the country contribute to this fact. However, also the citizens of neighbouring countries enjoy such support. Much of the money transfers enters the country through unofficial channels, so that the balance of payments registers large amounts of money under the errors and omissions section. A recent IMF study has articulated doubts about the accuracy of the central bank's balance of payments figures. Better monitoring practices would probably produce evidence that imbalances are less dramatic than present figures are suggesting.

Likewise, improved monitoring practices on the labour market would produce evidence that BiH is not such an extreme outlier as currently published figures would indicate. A recent labour force survey concluded that in April 2006 the rate of unemployment was 31% instead of around 45% as registration-based figures suggest. The latter figure seems to reflect an exaggerated number of unemployed persons as well as an underestimation of the number of employed persons. Even the result of the labour force survey has raised doubts; in fact, the rate of unemployment could be significantly below 30%. In any case, the number of persons with a regular job is low relative to the number of citizens. Consequently, the population faces serious social security problems, and official labour is burdened with high contributions to the social security system.

When on 1 January 2006 the government introduced a uniform value-added tax rate of 17%, the poorer segment of the population faced a substantial decline in real incomes. Previously, for most of their consumption the rate of indirect taxation had been significantly below 17% if not even zero. The price index performed a one-off jump and then stabilized at the new higher level. In the absence of hikes in energy prices, it might even have fallen in the course of the year 2006. The rate of inflation for 2006 was 7.1%. In real terms, the official economy's wages hardly exceeded the level of 2005. In 2007, inflation will again be moderate whereas wages will start growing again. The public sector profited from the new tax system in terms of higher revenues, whereas ruling politicians lost in terms of popularity. The elections of October 2006 changed the political landscape. Milorad Dodik (from the Independent Social Democrats Party) now holds an absolute majority in the parliament of Republika Srpska and an unchallenged position as RS prime minister. In addition, his party-fellow Nikola Spiric has become prime minister on the state level, or, as this position is called officially, chairperson of the Council of Ministers.

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 [1]	2007	2008
								forecast	
Population, th pers., mid-year	3781	3798	3828	3832	3843	3844	3844	.	
Gross domestic product, BAM mn, nom.	10908.0	11909.0	12650.0	13324.0	14658.0	15749.0	17800	19600	21100
annual change in % (real)	5.5	4.5	5.5	3.0	6.0	5.5	5.3	5.7	5.5
GDP/capita (EUR at exchange rate)	1475	1603	1690	1778	1950	2095	2368	.	.
GDP including NOE, BAM mn, nom. [2]	14160	15410	16170	16954	17980	19320	21800	.	.
GDP/capita, incl. NOE (EUR at PPP - wiiw)	4860	5120	5320	5460	6180	6150	6460	.	.
Gross industrial production									
annual change in % (real) [3]	7.9	4.9	5.7	5.1	12.1	10.8	11.5	11	11
Net agricultural production, total									
annual change in % (real)	-21.7	8.2	7.9	-7.5	20.3	-3.1	.	.	.
LFS - employed persons, th, avg. [4]	.	.	.	.	.	.	813		
Reg employees total, th pers., end of period	640.6	625.6	637.7	634.0	638.4	642.4	651.6 [x]	.	.
annual change in %	1.5	-2.3	1.9	-0.6	0.7	0.6	1.2 [x]	.	.
LFS - unemployed, th pers., average [4]	.	.	.	.	.	.	366.8	.	.
LFS - unemployment rate in %, average [4]	.	.	.	.	.	.	31.1	30	30
Reg. unemployment rate in %, end of period	39.7	40.3	40.9	42.0	43.2	44.2	45.6 [x]	.	.
Average gross monthly wages, BAM	539	598	660	717	748	798	874	.	.
annual change in % (real, net) [5]	3.4	15.4	-0.6	7.3	3.6	3.5	1.8	.	.
Consumer prices, % p.a. [6]	4.9	3.2	1.3	1.1	0.7	2.9	7.4	4	2
General governm. budget, nat.def., % GDP									
Revenues	49.5	45.7	40.6	45.2	43.5	44.2	.	.	.
Expenditures	55.9	48.9	40.7	44.4	41.8	41.6	.	.	.
Deficit (-) / surplus (+), % GDP	-6.4	-3.2	-0.1	0.8	1.7	2.6	2	0	0
Public debt in % of GDP	.	.	34.8	30.6	28.1	31.7	.	.	.
Current account, EUR mn [7]	-429.5	-833.3	-1252.7	-1438.7	-1482.7	-1757.6	-1800	-1750	-1700
Current account in % of GDP	-7.7	-13.7	-19.4	-21.1	-19.8	-21.8	-19.8	-17.5	-15.8
Gross reserves of CB excl. gold, EUR mn	522.2	1378.7	1260.0	1421.7	1767.8	2145.3	2900	.	.
Gross external public debt, EUR mn	2073.6	2260.2	2193.4	2052.3	2061.4	2217.9	2200	.	.
Gross external public debt in % of GDP	37.2	37.1	33.9	30.1	27.5	27.5	24	.	.
FDI inflow, EUR mn	158.6	132.8	281.8	337.6	534.0	420.6	350	.	.
FDI outflow, EUR mn	.	.	.	.	1.2	1.0	.	.	.
Exports of goods, BOP, EUR mn [7]	1226.3	1268.1	1168.6	1303.0	1677.0	2087.3	2700	3400	4200
annual growth rate in %	57.1	3.4	-7.9	11.5	28.7	24.5	29	26	24
Imports of goods, BOP, EUR mn [7]	4226.7	4576.4	4692.2	4974.1	5354.5	6092.9	6700	6800	7000
annual growth rate in %	9.1	8.3	2.5	6.0	7.6	13.8	10	1	3
Exports of services, BOP, EUR mn [7]	488.4	555.9	552.0	636.3	725.3	817.0	900	1000	1100
annual growth rate in %	12.2	13.8	-0.7	15.3	14.0	12.6	10	11	10
Imports of services, BOP, EUR mn [7]	285.6	301.4	320.2	339.2	349.3	371.9	400	430	460
annual growth rate in %	6.9	5.5	6.3	5.9	3.0	6.5	8	8	7
Average exchange rate BAM/USD	2.119	2.186	2.077	1.734	1.576	1.573	1.567	.	.
Average exchange rate BAM/EUR (ECU)	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.96	1.96
Purchasing power parity BAM/USD, wiiw [8]	0.678	0.692	0.685	0.686	0.638	0.685	0.713	.	.
Purchasing power parity BAM/EUR, wiiw [8]	0.771	0.793	0.794	0.811	0.757	0.817	0.878	.	.

1) Preliminary. - 2) GDP figures including the Non-Observed Economy (NOE) are based on IMF estimates. - 3) wiiw estimates based on weighted averages for the two entities (Federation BH and Republika Srpska). - 4) Data based on the first LFS April 2006. - 5) wiiw calculation. - 6) Costs of living. - 7) Converted from the national currency . - 8) Rough estimates based on World Bank and wiiw; price level presumably higher.

Source: wiiw Database incorporating national statistics, IMF; wiiw forecasts.

In economic terms, Bosnia and Herzegovina has become a ‘normal’ country, and by Balkan standards the citizens are on average not that poor. Economic activities are expanding continuously, and this is likely to go on further. Also in terms of financial stability the situation is quite satisfactory. Inflation will be low again in 2007; interest rates are high, but declining. The government’s budget is more or less balanced, and public debt is low compared to the GDP; this may change, as there are plans to acknowledge different types of claims as payables. The currency is stable thanks to a well-functioning currency board arrangement. The performance could be even better, would the government – or the many governments the country has – be supportive to the corporate sector in general and to the producers of tradables in particular. Then, much more foreign direct investment could flow into the country and would upgrade all kinds of skills and establish new links to the world economy.

Hermine Vidovic

Croatia: widening external imbalances

Croatia’s GDP grew by about 4.5% in 2006, at a slightly higher rate than in the year before. The main driver of growth was rising domestic demand, supported by strong household and enterprise lending. Investment spending increased significantly, up by nearly 12% in the first three quarters of the year; this was also reflected in the strong recovery of construction activities. Household consumption grew at almost the same rate as in 2005 (3%), while government consumption was up only 1.4%. Conversely, foreign trade contributed negatively to GDP growth. Average annual consumer price inflation remained almost unchanged, at 3.2%, as compared to a year earlier.

Industrial output grew significantly in the first quarter of the year (6.1%), slowed down thereafter and rebounded somewhat towards the end of the year. In the whole year 2006 industrial production increased by 4.5%. Output of capital goods developed quite well, expanding by 14.5%. Manufacturing grew in line with overall industrial production; the most outstanding results were achieved in the manufacture of radio, television and communication equipment, machinery and equipment, and tanning and dressing of leather. Output contracted in eleven out of 23 reporting branches, of which most pronouncedly in the chemical and clothing industries.

According to Labour Force Survey data both employment and unemployment fell in the first half of the year; the unemployment rate stood at 11.8% and reached its lowest value since the late 1990s. The relative success in reducing unemployment is, however, tempered by the fact that at the same time activity and employment rates declined as well, indicating that a growing number of people have exited from the labour market.

Despite exports rising faster than imports, the trade deficit reached a record high of about EUR 8.8 billion in 2006, some EUR 1 billion more than a year earlier. A regional breakdown of trade derived from customs statistics reveals that exports to the EU-25, particularly those to the new EU member states, developed above average, but also exports to Sweden and the UK showed a strong dynamism (ship deliveries). Exports to the successor states of the former Yugoslavia performed less favourable than in earlier years; a considerable export expansion was reported only in trade with Serbia. In the year as a whole the current account ended up with an estimated

Table HR

Croatia: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 [1]	2007	2008
								forecast	
Population, th pers., mid-year	4437	4437	4443	4442	4439	4442	4442	.	.
Gross domestic product, HRK mn, nom.	152519	165640	181231	198422	212826	229031	247000	265900	286200
annual change in % (real)	2.9	4.4	5.6	5.3	3.8	4.3	4.5	4.4	4.4
GDP/capita (EUR at exchange rate)	4502	4998	5507	5906	6397	6968	.	.	
GDP/capita (EUR at PPP - wiiw)	8100	8630	9380	9930	10570	11270	.	.	
Gross industrial production [2]									
annual change in % (real)	1.7	6.0	5.4	4.1	3.7	5.1	4.5	4.4	4.5
Gross agricultural production									
annual change in % (real)	-10.0	8.5	7.7	-15.9	11.9	-8.7	.	.	.
Construction industry, hours worked [2]									
annual change in % (real)	-9.1	3.6	12.8	22.8	2.0	-0.8	9.9 I-XI	.	.
Consumption of households, HRK mn, nom.	89637	98054	108027	115081	122100	130576	139201	.	.
annual change in % (real)	4.2	4.5	7.7	4.6	3.9	3.4	3.3	3	3
Gross fixed capital form., HRK mn, nom.	33281	36984	44105	56662	60866	65391	74907	.	.
annual change in % (real)	-3.8	7.1	13.9	24.7	4.4	4.8	11	9	9
LFS - employed persons, th, avg. [3]	1553	1469	1528	1537	1563	1573	1548 I-VI	.	.
annual change in %	4.1	-5.4	.	0.6	1.7	0.7	-1.1 I-VI	.	.
Reg. employees in industry, th pers., avg.	291.9	287.2	281.0	282.6	281.7	278.9	276.1	.	.
annual change in %	-2.5	-1.6	-2.2	0.6	-0.3	-1.0	-1.0	.	.
LFS - unemployed persons, average [3]	298.0	277.0	266.0	256.0	249.5	229.0	208.0	.	.
LFS - unemployment rate in %, average [3]	16.1	15.9	14.8	14.3	13.8	12.7	11.5	11	10.5
Reg. unemployment rate in %, end of period	22.3	23.1	21.3	18.7	18.5	17.8	17.0	16.5	16
Average gross monthly wages, HRK	4869	5061	5366	5623	5985	6248	6613 I-XI	.	.
annual change in % (real, net)	3.4	1.6	3.1	3.8	3.7	1.6	1.8 I-XI	.	.
Consumer prices, % p.a. [4]	6.2	4.9	1.7	1.8	2.1	3.3	3.2	3	2.9
Producer prices in industry, % p.a.	9.7	3.6	-0.4	1.9	3.5	3.0	2.9	2.5	2.4
General governm. budget, IMF-def., % GDP									
Revenues	46.2	44.0	46.3	45.1	45.4	44.9	.	.	.
Expenditures	52.7	50.7	51.4	51.3	50.2	49.0	.	.	.
Deficit (-) / surplus (+), % GDP	-6.5	-6.7	-5.0	-6.2	-4.8	-4.1	-3	-3	-2.5
Public debt in % of GDP% [5]	48.9	50.3	50.7	51.2	52.0	52.7	52	53	54
Discount rate % p.a., end of period	5.9	5.9	4.5	4.5	4.5	4.5	4.5	.	.
Current account, EUR mn	-477.9	-817.6	-2095.3	-1865.7	-1404.2	-1994.5	-3000	-2900	-2800
Current account in % of GDP	-2.4	-3.7	-8.6	-7.1	-4.9	-6.4	-8.9	-8.1	-7.3
Gross reserves of NB excl. gold, EUR mn	3783.2	5333.6	5651.3	6554.1	6436.2	7438.4	8983.7 XI	.	.
Gross external debt, EUR mn	12109.3	13458.3	15054.8	19810.6	22780.7	25540.8	29000	.	.
Gross external debt in % of GDP	60.6	60.7	61.5	75.5	80.2	82.5	86	.	.
FDI inflow, EUR mn	1138.5	1502.5	1196.8	1784.5	990.4	1421.1	2000	.	.
FDI outflow, EUR mn	0.2	173.3	601.3	106.1	281.9	191.9	100	.	.
Exports of goods, BOP, EUR mn	4969.3	5318.8	5293.1	5571.7	6603.1	7216.6	8400	9300	10500
annual growth rate in %	20.2	7.0	-0.5	5.3	18.5	9.3	16	11	13
Imports of goods, BOP, EUR mn	8468.7	9922.6	11253.4	12545.9	13330.9	14738.3	16900	18900	21100
annual growth rate in %	17.0	17.2	13.4	11.5	6.3	10.6	15	12	12
Exports of services, BOP, EUR mn	4442.0	5481.3	5832.3	7565.9	7636.7	8052.6	8500	.	.
annual growth rate in %	26.6	23.4	6.4	29.7	0.9	5.4	6	.	.
Imports of services, BOP, EUR mn	1971.5	2178.5	2547.5	2632.9	2867.8	2734.9	3000	.	.
annual growth rate in %	0.3	10.5	16.9	3.4	8.9	-4.6	10	.	.
Average exchange rate HRK/USD	8.28	8.34	7.86	6.70	6.04	5.95	5.84	.	.
Average exchange rate HRK/EUR (ECU)	7.63	7.47	7.41	7.56	7.50	7.40	7.32	7.4	7.4
Purchasing power parity HRK/USD	3.73	3.77	3.75	3.81	3.82	3.84	3.83	.	.
Purchasing power parity HRK/EUR	4.24	4.33	4.35	4.50	4.54	4.58	4.62	.	.

Note: The term 'industry' refers to NACE classification C+D+E.

1) Preliminary. - 2) Enterprises with more than 20 employees. - 3) From 2002 according to census March 2001. - 4) Until 2001 retail prices. - 5) Including guarantees.

Source: wiiw Database incorporating national statistics; IMF; wiiw forecasts.

EUR 3 billion deficit or more than 8% of the GDP. As in previous years the widening trade deficit was only partly offset by rising earnings from services. In addition, the deficit of the income balance deteriorated and the transfer balance was negative for the first time. As for FDI inflows, 2006 turned out to be the most successful year so far. Already in the first three quarters of the year the FDI inflow reached EUR 1.76 billion, more than in the whole year 2005. This amount does not yet include the inflow due to the sale of the pharmaceutical company Pliva to the US-based company Barr (recorded value of about USD 2 billion) as well as the sale of further stakes of the oil company INA.

Croatia's foreign debt continued to rise despite several attempts of the National Bank to curb credit growth. Having repeatedly increased the marginal reserve requirement on new bank borrowing from abroad, the National Bank has imposed a credit growth limit of 12% a year on commercial banks in 2007. Banks whose lending exceeds this limit will have to buy low-yield central bank securities. However, as experience has shown, this step may further restrict banks' external borrowing but will not have any decisive impact on enterprise borrowing, which reports the strongest growth. By the end of 2006 foreign debt stood at close to EUR 29 billion or 85.5% of the GDP. Since December last year the external debt structure by debtors has changed considerably: the portion of government and banks' debt has been declining while the share of 'other sectors' (mainly enterprises) has been on the rise. The contraction of the government's foreign debt is mainly caused by the shift of budget financing from external to domestic sources.

Thanks to higher than anticipated revenues a downward revision of the general government deficit from the originally planned 3.2% to 3% of the expected GDP was made possible in July last year. According to the Ministry of Finance, this was due to an improvement in the collection of revenues coupled with the establishment of a Financial Police at the beginning of 2006. The 2007 budget adopted in December last year anticipates a further reduction of the fiscal deficit to 2.8%, down from 3% in 2006, and is based on the assumption of 4.6% GDP growth and an inflation rate of 3.2%. The main priorities of the new (election-year) budget include a balanced regional development, education and science, infrastructure, the promotion of entrepreneurship and assistance for disadvantaged persons.

In November 2006 the Croatian government submitted its (third) Pre-accession Economic Programme for the period 2007-2009 to the EU. Apart from further fiscal consolidation and reducing external imbalances it focuses on structural reforms, such as the further restructuring and privatization of Croatian companies, e.g. in the shipbuilding sector (to be completed by 2010), steel and aluminium industries and the restructuring of the Croatian railways.

The prospects of entering the EU have decisively improved Croatia's international standing, which is reflected in the country's rating improvements by the most important rating agencies. In general, economic prospects remain positive provided that Croatia does not slip into a severe debt crisis. Driven primarily by domestic demand, GDP growth may be sustained at the current level in the period 2007-2009. This supports a gradual increase in employment and a further reduction of the unemployment rate. The current account deficit will remain substantial in the years to come, implying a further increase in foreign debt.

Vladimir Gligorov

Macedonia: low taxes are the key

Growth was again disappointing last year, though official figures are challenged by government officials and are somewhat doubted by the IMF as well. The latter believes that growth was perhaps above 4% in 2006, while the government suggests that it may be as high as 6%. The government also expects a speed-up in growth in the next couple of years.

If growth has been as fast as 4%, that is still rather low by the current standards of the region; if it has been lower than that, as the official data suggest, then the claim that it has again disappointed would be justified. The relatively low rate of growth of industrial production would support that feeling. There are, however, indications that consumption is increasing, both public and private. Investments have also posted some growth, though not a very convincing one. The contribution of net exports has probably been slightly positive, though the trade deficit has remained relatively high.

The surprising development in the last couple of years has been a dramatic improvement in the current account. From a deficit of close to 8% of GDP in 2004 it moved to a surplus of 2% of GDP in 2006. The turnaround was entirely due to an increase in private transfers. There is uncertainty whether the balance of payments accounting is appropriate, partly because of the lack of transparency in some of the positions, which leads to a large role played by errors and omissions. In any case, increased private transfers – remittances and perhaps what are in fact investments – seem to be a fact.

Whatever improvement in the growth performance has occurred in the past year or so, it has been somewhat helped by the more relaxed monetary policy and also by slightly increased public expenditures. On the strength of the much improved current account, the central bank saw no more need to worry about the sustainability of the exchange rate, which is in Macedonia a strict peg to the euro, and has lowered the interest rates and allowed the banks to increase their credit activity.

Also, the previous government was able to convince the IMF that a fiscal deficit of 0.6% of GDP is not going to lead to a catastrophe of one kind or another. The new government is budgeting a deficit of 1% of GDP for the year 2007. It intends to put some money into infrastructure and into human capital development. The IMF has continued to voice dissatisfaction with the speed of reforms, though not with Macedonia's fiscal policy any more.

In mid-year parliamentary elections were held, resulting in a change in government. The new government is a coalition of four parties; one Macedonian and one Albanian party are the backbone of it. Though the coalition is rather stable, it has faced political problems immediately after coming to power. The root of its political problems is the fact that the Albanian party in the governing coalition is smaller, in terms of votes that it received in the elections, than the main rival Albanian party. The latter has requested to be included in the government instead of the smaller Albanian party. In the meantime it has decided to leave the parliament and to participate in the local government where it holds the majority, such as in city councils or other local bodies.

Table MK

Macedonia: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 [1)]	2007	2008
Population, th pers., mid-year [2)]	2026.4	2034.9	2020.2	2026.8	2032.5	2035	2038	.	.
Gross domestic product, MKD mn, nom.	236389	233841	243970	251486	265257	284226	303305	325000	348000
annual change in % (real)	4.5	-4.5	0.9	2.8	4.1	3.8	3.5	4	4
GDP/capita (EUR at exchange rate)	1921	1887	1981	2025	2128	2279	2432	.	.
GDP/capita (EUR at PPP - wiiw)	5140	4990	5200	5330	5660	6110	6400	.	.
Gross industrial production									
annual change in % (real) [3)]	3.0	-2.9	-4.8	4.1	-2.2	7.0	3.4	5	5
Gross agricultural production									
annual change in % (real)	1.0	-10.2	-2.3	4.5	6.8	2.2	.	.	
Construction output, value added									
annual change in % (real)	-1.1	-14.4	0.6	13.3	7.4	-6.8	.	.	.
Consumption of households, MKD mn, nom.	175965	163788	188179	191873	209075	222890	.	.	.
annual change in % (real)	11.2	-11.6	12.5	-1.5	8.0	.	.	.	.
Gross fixed capital form., MKD mn, nom.	38332	34716	40448	42110	47286	48868	.	.	.
annual change in % (real)	-1.5	-8.6	17.6	1.1	10.9	.	.	.	.
LFS - employed persons, th. avg.	549.8	599.3	561.3	545.1	523.0	545.3	570	.	.
annual change in %	0.8	9.0	-6.3	-2.9	-4.1	4.3	4.5	.	.
Reg. employees in industry, th pers., avg.	114.4	122.5	110.9	106.7	101.5	97.6	94.6 [x]	.	.
annual change in %	-4.5	-4.8	-9.5	-3.8	-4.9	-3.9	-3.7 [x]	.	.
LFS - unemployed, th pers., average	261.7	263.2	263.5	315.9	309.3	323.9	320	.	.
LFS - unemployment rate in %, average	32.3	30.5	31.9	36.7	37.2	37.3	36	35	35
Reg. unemployment rate in %, end of period	.	.	.	.	.	.	.	.	.
Average gross monthly wages, MKD	17958	17886	19025	19950	20771	21330	22950	.	.
real growth rate, % (net wages)	-0.3	-1.9	5.0	3.6	4.4	2.2	4.2	.	.
Consumer prices, % p.a.	5.8	5.5	1.8	1.2	-0.4	0.5	3.2	3	3
Producer prices in industry, % p.a.	10.7	2.0	-0.9	-0.3	0.9	3.2	4.5	4	4
Central governm. budget, nat.def., % GDP [4)]									
Revenues	43.9	34.4	34.9	33.4	33.2	32.7	.	.	.
Expenditures	41.5	40.8	40.0	34.5	33.2	32.4	.	.	.
Deficit (-) / surplus (+), % GDP	2.3	-6.3	-5.0	-1.1	0.0	0.2	-0.6	-1	-1
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	7.9	10.7	10.7	6.5	6.5	6.5	6.5	.	.
Current account, EUR mn [5) 6)]	-78.5	-272.1	-379.9	-132.1	-334.2	-65.5	100	-100	-100
Current account in % of GDP	-2.0	-7.1	-9.5	-3.2	-7.7	-1.4	2.0	-1.9	-1.8
Gross reserves of NB, excl. gold, EUR mn	461.5	845.5	692.8	718.4	665.2	1041.4	1377.9 [IX]	.	.
Gross external debt, EUR mn [7)]	1606.8	1621.4	1513.2	1439.4	1475.7	1849.1	1758.4	.	.
Gross external debt in % of GDP	41.3	42.2	37.8	35.1	34.1	39.9	35.5	.	.
FDI inflow, EUR mn [6)]	189.4	493.2	82.6	85.4	126.5	80.3	280	.	.
FDI outflow, EUR mn [6)]	-0.7	1.0	0.1	0.3	0.9	2.2	-0.1	.	.
Exports of goods, BOP, EUR mn [6)]	1433	1291	1181	1208	1347	1640	1900	2100	2300
annual growth rate in %	28.3	-9.9	-8.5	2.3	11.5	21.7	16	10	10
Imports of goods, BOP, EUR mn [6)]	2182	1879	2035	1959	2243	2491	2870	3300	3800
annual growth rate in %	37.9	-13.9	8.3	-3.7	14.5	11.0	15	15	15
Exports of services, BOP, EUR mn [6)]	344	273	269	290	329	379	370	.	.
annual growth rate in %	34.2	-20.5	-1.6	7.8	13.4	15.4	-2	.	.
Imports of services, BOP, EUR mn [6)]	291	295	292	299	372	407	450	.	.
annual growth rate in %	34.2	1.3	-0.8	2.2	24.7	9.2	11	.	.
Average exchange rate MKD/USD	65.89	68.04	64.74	54.30	49.41	49.29	48.79	.	.
Average exchange rate MKD/EUR (ECU)	60.73	60.91	60.98	61.26	61.34	61.30	61.19	62	62
Purchasing power parity MKD/USD	19.94	20.07	20.03	19.69	19.46	19.19	19.29	.	.
Purchasing power parity MKD/EUR	22.69	23.02	23.23	23.27	23.08	22.87	23.27	.	.

Note: The term ‘industry’ refers to NACE classification C+D+E.

1) Preliminary. - 2) From 2002 according to census November 2002; 2005, 2006 wiiw estimate. - 3) Enterprises with more than 10 employees, from 2004 new methodology. - 4) Revenues excluding privatization incomes, expenditures excluding financing items. 2005 data projected. - 5) Including grants. - 6) Converted from USD. - 7) Medium- and long-term debt.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

While the IMF has been critical of the lack of reforms, the EU has been critical of the lack of progress in institutional development. Macedonia is a candidate country, but the EU is not happy with the speed of its constitutional and reforms in the institutions of the rule of law. Thus, the date of the start of negotiations has not been determined and is unlikely to be set in the near future.

The new government seems undisturbed by the criticisms of both the IMF and the EU: it is confident that it has the right programme of reforms and expects that it will bring the economy up to a higher and sustained rate of growth. The key to reforms is a significant reduction in tax rates. Income taxes have been reduced to 12% and should be reduced to 10% in the course of 2007. Similarly, the VAT rate is planned to be brought down to 12%. In addition, and to the dissatisfaction of the IMF, the government plans to give additional tax breaks to foreign investors with the introduction of new free tax zones. The government expects a significant boost for investments and to the growth rate.

It is too early to assess the prospects of these new fiscal policy measures. It is also not altogether certain that it was the tax burden that was the main reason for the disappointing inflow of foreign and every other investment. In any case, growth of 4% to 5% per year in the medium run should not be difficult to achieve given that the growth in the region continues to be strong and Macedonia depends quite strongly on the economic growth and political stability in the region. The speed-up of EU integration, which is very important for Macedonia, will depend much more on other reforms, which are yet to be implemented, and on political stability, which depends on the resolution of the challenge to the legitimacy of the parliament and the government.

Vladimir Gligorov

Montenegro: the fruits of independence

The first year of independence has proved to be quite successful. The uncertainties that surrounded the May 2006 referendum were resolved with the results coming out in favour of independence and with the calm post-referendum political developments. The ruling coalition won the parliamentary elections in September 2006 and had no difficulties in forming the government. Surprisingly, the long-time prime minister and sometime president of Montenegro, Milo Djukanović, stepped down and was replaced by another prominent member of his Democratic Party of Socialists, Željko Sturanović. Altogether, the political transition went on quite smoothly.

The integration of Montenegro into the international community also went quite quickly and with no hiccups. Most importantly, the EU resumed the negotiations on the Stabilization and Association Agreement (SAA), which had been discontinued early in 2006 due to Serbia's non-cooperation with the Hague Tribunal. Once Montenegro had declared independence, the European Commission drafted a new mandate for negotiations, which should be concluded with the signing of the SAA in the first half of 2007.

The economy reacted favourably to independence, though the results of the referendum were in accordance with the expectations. The fears that there might be negative consequences for tourism or that there may be sudden capital flight due to increased uncertainty about the ability of Montenegro to govern itself, proved to be unfounded. Quite to the contrary, the stock exchange

Table ME

Montenegro: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 [1)]	2007 forecast	2008
Population th pers., mid-year [2)]	612.5	614.8	617.1	620.3	622.1	623.3	625	.	.
Gross domestic product, EUR mn, nom. [3)]	1022.2	1244.8	1301.5	1392.0	1565.1	1690.0	1759.0	2000	2000
annual change in % (real)	.	-0.2	1.7	2.4	4.2	4.3	4.5	5	5
GDP/capita (EUR at exchange rate)	1669	2025	2109	2244	2516	2711	2814	.	.
GDP/capita (EUR at PPP - wiiw)	4640	4710	4910	4990	5350	5650	5990	.	.
Gross industrial production [4)]									
annual change in % (real)	4.2	-0.7	0.6	2.4	13.8	-1.9	1.0	3	3
Net agricultural production								.	.
annual change in % (real)	-5.0	6.9	5.9	1.0	3.8	-0.9	.		
Construction industry								.	.
annual change in % (real)	.	.	.	.	.	.	.	.	.
Consumption of households, EUR mn, nom.	721.7	938.3	1067.3	1024.8	1137.3	.	.	.	.
real growth rate, %	.	4.7	6.4	.	.	.	.	.	.
Gross fixed capital form., EUR mn, nom.	179.8	226.7	198.9	200.8	286.1	.	.		
real growth rate, %	.	16.7	-16.1	.	.	.	.	.	.
LFS - employed persons, th, Oct [5)]	230.3	214.4	220.6	.	187.3	178.8	179.6	.	.
annual change in %	.	-6.9	2.9	.	.	-4.5	0.5	.	.
Reg. employees in industry, th pers., avg.	.	36.7	35.8	34.1	.	.	.	.	.
annual change in %	.	.	-2.3	-5.0	.	.	.	.	.
LFS - unemployed, th pers., average [5)]	54.9	57.5	57.7	.	71.8	77.8	77	.	.
LFS - unemployment rate in %, Oct. [5)]	19.3	23.7	20.7	.	27.7	30.3	30	30	30
Reg. unemployment rate in %,end of period [6)]	.	.	.	32.9	29.3	25.2	15	15	15
Average gross monthly wages, EUR [7)]	151	176	251	271	303	326	377	.	.
annual change in % (real, net)	1.0	8.0	.	9.3	9.1	6.7	12.0	.	.
Consumer prices, % p.a.	20.2	21.8	16.0	6.7	2.4	2.3	3.0	3	3
Producer prices in industry, % p.a.	.	.	14.5	4.5	5.8	2.1	2	3	3
Central governm. budget, nat.def., % GDP [8)]								.	.
Revenues	.	17.8	17.7	24.2	23.8	25.4	.	.	.
Expenditures	.	20.8	20.5	27.4	25.9	27.2	.	.	.
Deficit (-) / surplus (+), % GDP	-6.0	-3.1	-2.8	-3.1	-2.1	-1.8	-1.6	-1	-1.
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	.	.	.	.	.	.	.	.	.
Current account, EUR mn [9)]	.	-195.4	-163.4	-102.1	-119.6	-154.0	-300	-300	-300
Current account in % of GDP	.	-15.7	-12.6	-7.3	-7.6	-9.1	-17.1	-15.0	-15.0
Gross reserves of NB, excl. gold, EUR mn	.	.	.	.	.	.	.	.	.
Gross external public debt, EUR mn	.	.	893.6	461.5	488.6	513.3	630	.	.
Gross external public debt in % of GDP	.	.	68.7	33.2	31.2	30.4	36	.	.
FDI net, EUR mn	.	10.6	89.2	38.7	50.6	381.2	350	.	.
Exports of goods, BOP, EUR mn [10)]	.	235.4	322.6	270.6	452.1	460.6	530	610	700
annual growth rate in %	.	.	37.1	-16.1	.	1.9	15	15	15
Imports of goods, BOP, EUR mn [10)]	.	722.9	747.3	629.9	868.6	974.3	1220	1470	1760
annual growth rate in %	.	.	3.4	-15.7	.	12.2	25	20	20
Exports of services, BOP, EUR mn	.	150.2	171.7	191.3	249.5	329.8	445	.	.
annual growth rate in %	.	.	14.3	11.4	30.4	32.2	35	.	.
Imports of services, BOP, EUR mn	.	53.4	71.7	79.7	101.4	134.3	201	.	.
annual growth rate in %	.	.	34.3	11.1	27.2	32.5	50	.	.
Average exchange rate USD/EUR	0.92	0.90	0.94	1.13	1.24	1.24	1.26	.	.
Purchasing power parity USD/EUR, wiiw [11)]	0.32	0.38	0.37	0.38	0.40	0.40	0.38	.	.
Purchasing power parity EUR/EUR, wiiw [11)]	0.36	0.43	0.43	0.45	0.47	0.48	0.47	.	.

Note: From 2002 the term 'industry' refers to NACE classification C+D+E.

1) Preliminary. - 2) From 2003 according to census November 2003; 2006 wiiw estimate. - 3) Including non-observed economy. - 4) Excluding small private enterprises and arms industry. - 5) From 2004 according to census 2003 and revisions based on ILO and Eurostat methodology. - 6) In % of unemployed plus employment (excluding individual farmers). - 7) From 2002 including various allowances and new personal income tax system. - 8) Revenues excluding grants, expenditures excluding net lending. - 9) Including all transactions with Serbia. - 10) From 2004 including trade with Serbia and Kosovo based on customs statistics (before on ITRS). - 11) Estimate based on a 45% price level (EU-25=100) in 2003 and extrapolation with GDP deflator.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

reported significant advances and foreign investments were at an all-time high. Also, the tourist season was very good, though the potential for growth is much greater. All in all, GDP growth was rather strong, historically speaking, at around 4.5%.

Data on consumption and investment are not available, so it is not easy to pin down the sources of growth. Fiscal data indicate improvements in revenue collection and a further narrowing of the fiscal deficit. Public expenditure did increase, ahead of the referendum and the elections that followed, so that has certainly contributed to growth. Private investments in services have also gone up, according to indirect evidence from real estate prices and the performance of the stock exchange. Private consumption must have also increased, though it is hard to say by how much precisely.

The sharp deterioration of the trade balance and the current account indicate that the increased inflow of foreign investments has gone into imports. Also, private transfers such as remittances might have increased, as has been true of the Balkan region as a whole. Finally, credit expansion by the increasingly more active and confident banks, which are mostly private and foreign-owned, has contributed to private consumption and investment. These positive financial developments have been supported by price stability, with inflation being at a level that is quite comparable to that in the EU. Montenegro uses the euro, which has contributed positively to the expectations about inflation.

Unlike services, industrial production has continued to struggle. Growth has been 1% for the whole year. Given that de-industrialization has been rather severe in Montenegro, the continuing lack of vitality in this sector highlights problems with competitiveness. As in other economies in the Balkans with a large tourist sector, the emergence of the Dutch disease can be suspected. Data on wages and incomes do not necessarily confirm that, but it is questionable how reliable those are. It is also true that there are significant regional differences in this very small country, which are partly the consequence of its geography. Montenegro is very mountainous and its infrastructure is not developed enough for that not to be a problem for industrial development. Investments in roads and in the improvement of the railroads are being made, but that will take time.

The new government of Mr Sturanović is facing pressures to speed up reforms. As administrative capacity is not very high, both the design of reforms and their implementation are not easy tasks. Technical assistance from the USA has been helpful and it is to be expected that the EU will increase its presence too now that the country is nearing its firs contractual relationship with the Union. For a number of years, the soundness of the fiscal sector was the main concern. With the aid and assistance of USAID, significant improvements have been achieved. The ministry of finance is confident that it will balance the general budget in the near future. Due to the fact that the country uses the euro, the main internal policy risks are associated with fiscal policy. With the elections over and with the prospects for growth improving, the risks to fiscal destabilization are very low indeed.

The prospects for growth in the short and medium run are quite good. Foreign investments should continue to flow into the country due to speeding up privatizations and the growth of tourism. The key challenge will be the turnaround in industrial production and an increase in employment. In the next couple of years, significant advances in administrative capacity have to be made in order to speed up the process of EU integration.

Vladimir Gligorov

Serbia: stability at risk

Recovery continues in Serbia, but economic and political stability is at risk. Growth has been strong, at 5.8% in 2006, but has been slowing down in the past few years. It has been driven by private consumption and by exports. Investments, however, have been lagging, though there is some uncertainty about the accuracy of the data. In terms of sectors, services are growing faster than industry and agriculture. In fact, both industry and agriculture have been basically stagnant over the past few years. That is probably the consequence of slow privatization and of slow restructuring of the large state enterprises.

While the economy is growing, employment has been declining, rather sharply in the last couple of years. Employment in the private sector is increasing while that in the state sector and in agriculture is falling. The net effect is negative, because the private sector is still small in terms of employment. Unemployment is also increasing and reached an estimated 22% in 2006 (registered unemployment is higher). The labour force survey is conducted only once a year, in October, and the results for 2006 have not yet been published. It is to be expected that employment will see a further decline in the medium run, and the unemployment rate may go above 25% in the same period.

Throughout the past year, inflation was the main policy concern. Initially it accelerated and decisive anti-inflationary measures were taken only in May and June. The central bank reversed its exchange rate policy of measured depreciation and let the dinar appreciate rather sharply. At the same time, the government practically froze the prices it controls, which is about 45% of all prices, by the central bank's account. Finally, the central bank hiked both the interest rates and the reserve requirement on foreign deposits to an astonishing 60%. All these measures had a political side to them, as they were intended to boost the chances of the governing coalition in the upcoming elections and also to secure the positions of the governing bodies of the central bank in view of growing criticism and open calls by some parties to sack the governor. Their efforts at putting inflation under control were helped by the declining oil prices that made it possible for the government to lower prices of gasoline several times and especially sharply just before the parliamentary elections.

Ahead of the elections, the government came out with a National Investment Plan (NIP) that targets infrastructure, education, health, agriculture, small and medium-size enterprises and just about everything else. Its stated intention was to use the large inflows of foreign investments, which may have topped EUR 4 billion on a net basis in 2006, to pay for these vast public investments. Concerns were voiced by the IMF and the central bank that these significant increases in public investments could speed up inflation and threaten macroeconomic stability. It was also argued that it would be better to use the growing privatization receipts to pay back the foreign debt. The latter policy was adopted and much of the debt to the IMF and to some other creditors has been paid back ahead of time. As for the NIP, not too much of the money was spent immediately and it did not have an all that important, let alone decisive, influence on the elections.

The elections were held on 21 January 2007 and the opposition Radical Party came out as the winner with 28% of the votes. The Democratic Party, which is in opposition in the parliament while its leader is the president of the republic, came in second with just over 23%. The ruling Democratic Party of Serbia of the prime minister (together with two coalition partners) was third with close to 17% of the votes cast. Three more parties or coalitions made it into the parliament, as did several parties that are representing minorities. These electoral results open up a number of possibilities to put together a ruling coalition. The problem, however, is the incongruence of the political and the ideological distribution of the votes.

Politically, a coalition of the two democratic parties, of the president and of the prime minister, with the support of one of the smaller parties, e.g. that of the finance minister, would be the natural one. Ideologically, however, the Democratic Party of Serbia is closer to the Radical Party than to the other Democratic Party. Thus, the natural ruling coalition, from the ideological point of view, would be the one of the Democratic Party of Serbia and the Radical Party. That coalition is even more likely because of the fact that the main post-election issue is neither the economy nor transition and EU integration, but how to handle the impending independence of the province of Kosovo. On that issue, the strongly nationalist Democratic Party of Serbia and the Radical Party see eye to eye. They may call for a government of national unity, which will be an impossible one for the Democratic Party to join. In that context, the two ideologically close parties could form a patriotic coalition to 'save the nation' and reject the independence of Kosovo. Their problem will be to come up with a foreign policy in the face of the rather cold reception they would get in the EU and the USA.

With this sharp conflict between the politically realistic and the desirable, instability is rather likely whichever way the governing coalition is formed. The political crisis, in the sense of inability to put together a government, or to guarantee its stability once it is formed, may be a prolonged one and new early elections may be called for. In the meantime, economic instability may increase too. It is hard to predict the form that these two instabilities may take, but investments could suffer as well as consumption. Similarly to the year 2003, after the assassination of Prime Minister Djindjić, growth may slow down sharply and that may have consequences for the outcome of the parliamentary elections if those were to be held again later in the year.

The political crisis, if it were to last, could present problems to the regional integration too. The regional free trade area, CEFTA, that has been agreed upon in December 2006 should be ratified by all member states, which are essentially those from the Western Balkans, in order to come into being in May 2007. Serbia has a problem with CEFTA because it is required under that agreement to reduce the protection of its tobacco industry. This issue needs to be resolved before the parliament could ratify the treaty. The Serbian business community, except for the influential producers of cigarettes, has signalled that it is very much in favour of this regional agreement. If there are delays in its adoption and implementation, that will also deepen the economic instability.

This is not the end of the story. As the independence of Kosovo is all but certain now, as it should be formalized during this year, the outcome of the political crisis in Serbia can be at the expense of the pro-European and pro-reform forces. If such an outcome is to be avoided, the pro-democratic and pro-European parties need to be much more determined than they are at the moment, and that may be the risk they are not ready to take. Thus there are turbulent times ahead. At the moment, the business community shows little fear that the political crisis may get out of hand. The main challenges, however, are yet to be faced.

Table RS

Serbia: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 [1]	2007 forecast	2008 forecast
Population, th pers., mid-year [2]	7516.3	7503.4	7500.0	7480.6	7463.2	7450	7440	.	
Gross domestic product, RSD mn, nom.	397656	783897	1020117	1171564	1431313	1750000	2139800	2471000	2854000
annual change in % (real)	4.5	4.8	4.2	2.5	8.4	6.2	5.8	5	5
GDP/capita (EUR at exchange rate)	1007	1757	2242	2408	2643	2833	3424	.	.
GDP/capita (EUR at PPP - wiiw)	4680	5020	5380	5530	6170	6690	7230	.	.
Gross industrial production [3]									
annual change in % (real)	11.4	0.1	1.8	-3.0	7.1	0.8	4.7	5	5
Gross agricultural production									
annual change in % (real)	-18.6	27.9	-2.1	-11.4	26.0	-3.4	.	.	.
Construction output total									
annual change in % (real) [4]	16.8	-14.3	-7.4	10.8	3.5	2.0	.	.	.
Consumption of households, RSD mn, nom.	305988	644394	819739	885658	998540	1221531	1475003	.	.
annual change in % (real)	.	.	.	.	.	.	.	.	.
Gross fixed capital form., RSD mn, nom.	48842	81293	120502	188875	253333	301962	383907	.	.
annual change in % (real)	.	.	.	.	.	.	.		
LFS - employed persons, th. Oct [5]	3093.7	3105.6	3000.2	2918.6	2930.8	2733.4	2700	.	.
annual change in %	-0.3	0.4	-3.4	-2.7	0.4	-6.7	-1.2	.	.
Reg. employees in industry, th pers., avg.	.	704.5	648.1	605.3	562.2	536.1	493.3	.	.
annual change in %	.	.	-8.0	-6.6	-7.1	-4.7	-8.0	.	.
LFS - unemployed, th pers., Oct [5]	425.6	432.7	459.6	500.3	665.4	719.9	760	.	.
LFS - unemployment rate in %, Oct [5]	12.1	12.2	13.3	14.6	18.5	20.8	22	23	24
Reg. unemployment rate in %,end of period [6]	.	.	30.5	31.9	26.4	27.1	28	29	30
Average gross monthly wages, RSD [7]	3799	8691	13260	16612	20555	25514	31745	.	.
annual change in % (real, net)	5.5	16.5	29.9	13.6	10.1	6.4	11.4	.	.
Consumer prices, % p.a.	79.6	93.3	16.6	9.9	11.4	16.2	11.6	10	10
Producer prices in industry, % p.a.	102.6	87.7	8.8	4.6	9.1	14.2	13.3	10	10
General governm. budget, nat.def., % GDP									
Revenues	.	35.3	39.9	40.3	41.2	.	.	.	.
Expenditures	.	36.8	43.2	44.2	42.6	.	.	.	.
Deficit (-) / surplus (+), % GDP	.	-1.5	-3.3	-4.0	-1.4	1.4	-0.6	-2	-2
Public debt in % of GDP	.	.	.	.	.			.	.
Discount rate, % p.a., end of period	26.3	16.4	9.5	9.0	8.5	8.5	8.5	.	.
Current account, EUR mn [8]	-167	-318	-1323	-1301	-2279	-1812	-2500	-2800	-3000
Current account in % of GDP	-0.6	-2.4	-7.9	-7.2	-11.6	-8.6	-9.8	-9.9	-9.5
Gross reserves of NB, excl. gold, EUR mn	429.9	1138.6	2076.8	2728.2	3008.0	4753.7	9000	.	.
Gross external debt, EUR mn	11658.6	12608.9	10767.6	10858.3	10354.5	13064.0	15000	.	.
Gross external debt in % of GDP	44.1	95.6	64.0	60.3	52.5	61.9	59	.	.
FDI net, EUR mn [8]	55	184	504	1204	777	1247	2100	.	.
Exports of goods, BOP, EUR mn [8)9)]	1794	2032	2348	2599	2997	3664	5000	5750	6300
annual growth rate in %	.	13.3	15.5	10.7	15.3	22.2	36	15	10
Imports of goods, BOP, EUR mn [8)9)]	3519	4608	5774	6413	8341	8130	10150	12200	14600
annual growth rate in %	.	31.0	25.3	11.1	30.1	-2.5	25	20	20
Exports of services, BOP, EUR mn [8)9)]	459	685	795	906	1171	1289	1650	.	.
annual growth rate in %	.	49.3	16.0	13.9	29.3	10.1	28	.	.
Imports of services, BOP, EUR mn [8)9)]	305	413	657	720	1020	1287	1680	.	.
annual growth rate in %	.	35.2	59.1	9.5	41.7	26.2	30	.	.
Average exchange rate RSD/USD	16.40	66.36	64.40	57.58	58.38	66.71	66.82	.	.
Average exchange rate RSD/EUR (ECU)	15.04	59.46	60.68	65.05	72.57	82.91	84.06	87	90
Purchasing power parity RSD/USD, wiiw	9.90	18.20	21.80	24.00	26.20	29.40	32.30	.	.
Purchasing power parity RSD/EUR, wiiw	11.30	20.80	25.30	28.30	31.10	35.10	39.80	.	.

Note: The new ISO code for the Serbian dinar is RSD. - From 2004 the term 'industry' refers to NACE classification C+D+E.

1) Preliminary. - 2) From 2002 according to census 2002. wiiw estimate in 2005 and 2006 . - 3) From 2004 according to NACE and new weighting system. - 4) Gross value-added. - 5) From 2004 according to census 2002 and revisions based on ILO and Eurostat methodology. - 6) Until 2003 jobseekers, rate in per cent of labour force excluding farmers. - 7) From 2002 including various allowances. - 8) Converted from USD. - 9) From 2006 including trade with Montenegro.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Michael Landesmann

Turkey: high interest rates slow down growth

Turkey's economic growth has slowed down considerably in the third and fourth quarters of 2006. While GDP growth was 7.2% in the first half year of 2006, it declined to 3.4% in the third quarter and the estimate is of a further slowdown to just under 2% in the fourth quarter. This brings the annual growth rate for 2006 to 5%, down from the high growth rates in the previous two years (2004: 8.9%, 2005: 7.4%). Hence the energetic response by the Central Bank to the May-June turbulence in international financial markets which hit Turkey temporarily quite strongly (the Turkish lira devalued initially by about 20% vis-à-vis the euro) by increasing interest rates in a number of steps above the 20% mark, has taken its toll in terms of a slowdown in economic growth.

The decline in GDP growth was mainly driven by the considerable slowdown in private sector consumption expenditure (it had risen by 9.4% in the first half of the year and only by 1.3% in the third quarter). Most dramatic was the decline in expenditures on durable goods by 8.9% in the third quarter, while expenditures on non-durable goods held up. Also private investment slowed down from high growth rates in the first half of the year to 13% in the third quarter. There was also a slowdown of industrial production from August onwards to monthly growth rates of 4.3% compared to 7% over the January-August period.

Apart from high nominal interest rates one has to consider developments in inflation rates in order to understand the developments in domestic expenditure components. The deviation of actual price movements from inflation targets set by the Central Bank which wanted to achieve a 5% inflation rate by the end of year 2006 are of course the main reason for the strong interest rate hikes initiated by the Central Bank from May onwards. CPI inflation, which had come down to 7.7% by end-year 2005, nudged up to 9% by May 2006, peaked at 11.7% in July in the wake of the strong devaluation and ended the year at 9.7% growth. Even more dramatic were developments in producer prices (strongly affected by the volatility in energy prices and then the pass-through of devaluation): PPI inflation rates declined to 4.9% in April 2006 and then rose to 9.2% by the end of the year. The inflation developments together with stable nominal wage growth led to almost stationary real wage growth over the year 2006 (0.1% for the year as a whole) with modest positive real wage growth in the first half-year (0.3 and 0.4% in the first two quarters) and negative growth in the second half of the year. Hence the high real interest rate regime in the second half of the year plus stationary real wage income developments explain well the slowdown in domestic demand components.

Very important are developments in the Turkish current accounts which have long been recognized as being the most problematic aspect with regard to the sustainability of the otherwise remarkable economic growth performance since the crisis in 2001. It is well known that the Turkish trade performance is characterized by a strong deficit in goods trade and – because of tourism – a surplus in services trade. Overall developments on the trade accounts in 2006 are worrying: while there was strong export growth in goods (18% in 2006 as compared to 14.6% in 2005, all in current euro terms) there was also strong import growth (+21% in 2006). As the export-import coverage ratio in goods trade is only about 60%, the deficit in goods trade has increased from EUR 26.4 billion in 2005 to EUR 33.9 billion in 2006. Also, there was a fall in the net surplus on services trade in 2006 (EUR 9.3 billion as compared to 11.2 billion in 2005) because of the birds flu scare in the early booking season. Given that the income accounts also contribute a deficit (due to profit repatriation from multinationals which is not compensated by the amounts of transfers sent back home by

Turkish expatriates) the overall current account situation continued to deteriorate (in per cent of GDP: from 3.3% in 2003 to 5.2% in 2004 to 6.4% in 2005 and 8.9% in 2006). One might very well argue that there were special circumstances in 2006: very high energy prices, bad tourism incomes, a poor harvest, the terms-of-trade deterioration due to the devaluation – but there is no denying that the current accounts situation puts the Turkish economy in a vulnerable position.

The long-run prospects are good as there are very substantial foreign direct investment inflows (EUR 15.6 billion in 2006 as compared to 7.8 billion in 2005 and 2.3 billion in 2004) and there is evidence of significant industrial diversification, restructuring and qualitative upgrading which will continue to support the export performance in the future. But in the short run there is a severe imbalance in the current accounts. The strong nominal devaluation in May/June was a step in the right direction, but in the meantime there was a slight nominal appreciation and the high inflation differentials with the main trading partners has left only a modest real depreciation of 6.5% by December 2006 (compared to end 2005). On top of that there is the danger that the high interest rates to be earned in Turkey make speculative inflows attractive and this adds an appreciation pressure. The ease by which the current account deficit is being financed through international capital flows (only about 40% of these are accounted for by foreign direct investment) and the fact that international reserves are increasing indicate that this process is well on its way. Given the high interest rate differential, there is a strong incentive to borrow in foreign currency and there is evidence that the increase in foreign debt stemmed mostly from the private sector (which reached a level of USD 110.5 billion at the end of the third quarter as compared to the foreign debt stock of the public sector of USD 67 billion). Overall gross external debt in per cent of GDP has increased – after some years of decline – from 47.3% in 2005 to 51% in 2006, most of which is accounted for by changes in the exchange rates.

Turkey’s monetary policy hence has to perform a tightrope act over the next year and we believe that there is a good chance that it will not work out. At some point there will be a response by international investors to enforce a further devaluation. This in turn will generate another pass-through to inflation. Although there was a spectacular performance of fiscal consolidation over the past few years bringing down the general budget deficit to 0.5% of GDP in 2006 (with a primary surplus of over 6.1%!) there is likely to be some loosening of fiscal spending in the year of both parliamentary and presidential elections. This in turn will spur the Central Bank to maintain its restrictive monetary stance as the inflation record in 2006 has been thrown off the intended course. Hence, with the Central Bank keeping its eye firmly on the narrow reputation track for maintaining monetary stability, the fiscal authorities being affected by the election cycle, the private sector having a strong inducement to avoid high domestic interest rates and borrowing abroad and international short-term capital flows exploiting high interest rate differentials, this could be an unstable mix leading to a further devaluation experience. We, in fact, project such a devaluation and this together with the slower GDP growth rate might bring about a modest turnaround in the current account situation.

Another vital longer-run issue for Turkey is the utilization of the one resource which makes Turkey so attractive from an overall European perspective: the favourable demographic situation and the relatively young and growing labour force.

Table TR

Republic of Turkey: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 [1)]	2007	2008
Population, th pers., mid-year [2)]	67420	68365	69302	70231	71152	72065	72974	.	.
Gross domestic product, YTL mn, nom.	124583	178412	277574	359763	430511	487202	560700	632900	707700
annual change in % (real)	7.4	-7.5	7.9	5.8	8.9	7.4	5.0	5.5	6.5
GDP/capita (EUR at exchange rate)	3215	2367	2782	3022	3405	4030	4250	.	.
GDP/capita (EUR at PPP - wiiw)	6000	5370	5650	5740	6140	6470	6780	.	.
Gross industrial production									
annual change in % (real)	6.1	-8.7	9.5	8.7	9.8	5.5	6.3	6	9
Gross agricultural production									
annual change in % (real)	3.9	-6.5	6.9	-2.5	2.0	5.6	.	.	.
Construction industry									
annual change in % (real)	0.2	-10.6	-5.6	-9.0	4.6	21.5	.	.	.
Consumption of households,YTL mn, nom.	89098	128513	184420	239586	284631	328561	.	.	.
annual change in % (real)	6.2	-9	2.1	6.6	10.1	8.8	5.5	5	6
Gross fixed capital form., YTL mn, nom.	27848	32409	46043	55618	76722	95307	.	.	.
annual change in % (real)	16.9	-31.5	-1.1	10.0	32.4	24.0	13.5	8	15
LFS - employed persons, th, avg.	21580	21524	21354	21147	21791	22046	22247 [I-IX]	.	.
LFS - employed pers. in agricult. th, avg.	7769	8089	7458	7165	7400	6493	6155 [I-IX]	.	.
LFS - employed pers. in industry th, avg. [3)]	5174	4884	4912	4811	5017	5452	5564 [I-IX]	.	.
LFS - employed pers. in services th, avg.	8637	8551	8984	9171	9374	10101	10528 [I-IX]	.	.
LFS - unemployed, th pers. average	1497	1967	2464	2493	2498	2520	2440	.	.
LFS - unemployment rate in %, average	6.5	8.4	10.3	10.5	10.3	10.3	9.8	9.5	9
Reg. unemployment rate in %, average	3.3	3.2	1.9	2.5	.	.	.	.	.
Average gross wages in manuf.industry (YTL/Hour)	1.48	1.95	2.68	3.30	3.74	4.20	4.70	.	.
annual change in % (real)	0.8	-14.6	-5.4	-1.9	2.5	2.0	0.1	1	.
Consumer prices, % p.a. [4)]	54.9	54.4	45.0	25.3	8.6	8.2	9.6	7	5
Wholesale prices in manufacturing, % p.a. [4)]	56.1	66.7	48.3	23.8	14.6	5.9	9.7	7	5
General governm. budget, EU-def., % GDP [5)]									
Revenues	.	.	25.9	24.4	31.2	37.0	.	.	.
Expenditures	.	.	38.8	35.7	36.9	38.1	.	.	.
Deficit (-) / surplus (+)	.	-33	-12.9	-11.3	-5.7	-1.2	-0.5	-1.8	.
Public debt, EU-def., in % of GDP [5)]	.	104.4	93.0	85.1	76.9	69.6	.	.	.
Discount rate % p.a., end of period [6)]	204.9	58.9	51.0	31.0	22.0	17.5	22.5	18	15
Current account, EUR mn [7)]	-10629	3787	-1613	-7106	-12550	-18602	-27600	-28000	-30000
Current account in % of GDP	-4.9	2.3	-0.8	-3.3	-5.2	-6.4	-8.9	-8.4	-7.6
Gross reserves of CB, excl. gold, EUR mn	23996	20975	28370	29725	28962	40604	46392 [XI]	.	.
Gross external debt, EUR mn	128250	126820	137678	128141	130460	137511	157901 [IX]	.	.
Gross external debt in % of GDP	59.2	78.4	71.4	60.4	53.9	47.3	.	.	.
FDI inflow, EUR mn [7)]	1063	3742	1203	1549	2282	7868	15600	.	.
FDI outflow, EUR mn [7)]	942	555	185	441	691	868	710	.	.
Exports of goods, BOP, EUR mn [7)]	33248	38376	42464	45279	53927	61818	72900	87000	106000
annual change in %	23.0	15.4	10.7	6.6	19.1	14.6	18	20	22
Imports of goods, BOP, EUR mn [7)]	57013	42543	50171	57667	73132	88269	106800	124000	146000
annual change in %	55.8	-25.4	17.9	14.9	26.8	20.7	21	16	18
Exports of services, BOP, EUR mn [7)]	21054	16969	14843	15868	18441	20766	18700	22000	24000
annual growth rate in %	37.3	-19.4	-12.5	6.9	16.2	12.6	-10	15	10
Imports of services, BOP, EUR mn [7)]	8753	6773	6504	6580	8159	9546	9400	10000	11000
annual growth rate in %	5.3	-22.6	-4.0	1.2	24.0	17.0	-2	8	10
Average exchange rate YTL/USD	0.6221	1.2308	1.5236	1.4987	1.4293	1.3480	1.4407	1.51	1.43
Average exchange rate YTL/EUR (ECU)	0.5748	1.1024	1.4397	1.6949	1.7771	1.6771	1.8090	1.89	1.80
Purchasing power parity YTL/USD	0.2711	0.4240	0.6115	0.7549	0.8315	0.8768	0.9215	.	.
Purchasing power parity YTL/EUR	0.3081	0.4859	0.7084	0.8920	0.9861	1.0452	1.1338	.	.

Note: The term 'industry' refers to NACE classification C+D+E.

1) Preliminary. - 2) 2004 and 2005 SIS projections. - 3) Industry including construction. - 4) From 2004 new methodology. - 6) According to ESA'95, excessive deficit procedure. - 7) CBRT interest rate - overnight, lending. - 8) Converted from USD.

Source: CBRT-EDDS (Central Bank of Turkey, Electronic Data Distribution System), SIS (State Institute of Statistics), SPO (State Planning Organization), UT (Undersecretary of Treasury), Eurostat; wiiw forecasts.

There was positive employment growth in 2006 (in line with the previous years of about 1.5% per annum) and the rate of unemployment has fallen to just below 10%, but at the same time the employment rate (those employed in per cent of those of working age) has actually fallen and remains at a very low level (44.3% in 2006; it was 44.8% in 2005). Hence relatively high output growth over the past years goes along with relatively slow employment growth and even a tendency of people of working age to leave the labour force (‘discouraged workers’). Underlying these developments are strong structural shifts in the employment structure, with agricultural employment accounting now for about 28% of the labour force (down from 35% in 2002), while the share of non-farm employment has increased. This shift has a number of implications: there is less scope for unpaid family employment (which is common in agriculture), the qualification demands in non-farm labour jobs are higher and hence there is a skill mismatch to which the Turkish educational system has to respond; further – especially in industry – there is high productivity growth (and hence low employment elasticity of output growth). These underlying features of the Turkish labour market situation are likely to prevail for the years to come. The slowdown in growth in the short run will not be beneficial to improve the labour market situation over the next year.

Part C: Russia and Ukraine; China

Country reports

Peter Havlik

Russian Federation: growth peak is already over

Russian economic growth was once more over 6% in 2006 – according to the first official estimate 6.7%. Since the year 2000, the cumulated GDP growth has exceeded 40%. In 2006, GDP growth was again driven by the surging private consumption. The latter expanded by 11% in real terms, its share in GDP is now close to 50%. Investment grew even slightly faster, by 13%, yet its contribution to GDP growth was smaller owing to a lower share (21%) in GDP. The volume of exports is rising slowly, by about 3% in 2006, while that of imports expands at double-digit annual rates. The contribution of real net exports to GDP growth has been negative already since 2003. However, the boom in nominal export revenues continued in 2006 for the third consecutive year. Thanks to the high energy prices (the average price of Urals oil was 21% higher than in 2005) export revenues increased by 25% and exceeded EUR 240 billion in 2006. The sizeable (+30%) expansion of imports notwithstanding, the trade surplus reached EUR 112 billion (more than 15% of GDP); the current account ran a record surplus of almost EUR 77 billion (10% of GDP). Given significant improvements in the terms of trade, Russian domestic absorption has been growing much faster than GDP in the past couple of years – even with rising trade and current account surpluses. Also the government budget is enjoying huge surpluses (close to 8% of GDP in both 2005 and 2006) and the foreign exchange reserves exceeded EUR 240 billion at the end of 2006. In the Stabilization Fund, established in 2004 and fed from a portion of windfall energy export revenues, nearly EUR 70 billion were accumulated. The Fund's assets are being invested mainly in dollar- and euro-denominated government bonds (each 45% of the Fund, the rest in British pounds) and the operations are managed by the Central Bank. The possibility to invest the Fund's assets in equities is under consideration.

The real sector of the economy remains sluggish. The growth of industry, agriculture and transport was again unimpressive in 2006, only the construction sector is benefiting from rising investment, in particular in housing. However, market services (trade, telecommunications, financial intermediation and the real estate) are booming. Domestic consumer and investment demand is increasingly covered by imports. The latter are surging not only because of better quality, but more and more also due to deteriorating price competitiveness of domestic producers. The sizeable rouble appreciation (especially against the euro), in both nominal and even more so real terms, fosters the import substitution even more. Domestic production costs are rising as wages grow much faster than labour productivity; unit labour costs (ULCs) are soaring. According to wiiw estimates, Russian ULCs (euro-adjusted) have been rising by about 25% on average during the past five years: this implies that they more than trebled between the years 2000 and 2005. In 2006, ULC growth has continued as a combined result of rising nominal wages (+24%), rouble appreciation (+6%) and only modest productivity growth (5%, all figures year on year).

Symptoms of a Russian Dutch disease variety are thus becoming apparent as the bulk of export revenues originates from resource-based industries (revenues from energy exports already account for nearly two thirds of the total; metals exports account for a big part of the rest). The related huge foreign exchange inflows strengthen the appreciation pressure and boost money supply (M2 increased by more than 30% during the year) – even though half of them is being sterilized by the Stabilization Fund. Both the record foreign exchange inflows (with the related money supply expansion) and the strong growth of consumer demand keep inflationary pressures alive. Nevertheless, the average consumer price inflation dropped below 10% in 2006, for the first time since transition had started. wiiw expects consumer price inflation to remain close to 10% next year as well. Growing incomes and employment (and declining unemployment) make Russia attractive to foreign migrant workers who help to mitigate the effects of adverse demographic trends. However, last year's crackdown on the Georgian minority and the recent tightening of registration rules for migrant workers (not to mention the pogroms on Chechens in Northern Russia) is not only extremely disturbing but will have adverse economic effects as well (such as labour shortages in construction and higher prices at food markets in cities).

Reforms have stalled in the past couple of years. Economic policy decisions are being increasingly overshadowed by politics – both apparently related to the looming issue of Putin's successor in 2008. With presidential elections approaching, the domestic political climate is becoming rougher. In this context, the assassinations of prominent journalists and bankers are tragic enough. Yet the above-mentioned conflict with Georgia (which might easily escalate over the secession from Georgia demanded by Abkhazia and South Ossetia and could even spread near to the EU border over a similar demand by Transnistria) has potentially even graver consequences for Russia – as well as for the EU. The latter is concerned mainly with energy supplies, which were interrupted at the beginning of 2007, this time due to the price dispute with Belarus. With growing economic strength, Russian external policies are becoming also more assertive. In particular, the Kremlin is gaining confidence that it can regain a foothold in the former Soviet republics (or at least prevent a more intensive involvement of the EU in this region). The strategy seems to bear some fruit, such as in Ukraine but also elsewhere, as the influence of Russian investments is rapidly increasing.[27] Meanwhile, Gazprom, Rosneft and other large state-owned (or controlled) corporations are going global while consolidating their control over domestic assets and strategic resources. Russian energy and metals giants acquire assets abroad, not least in the former Soviet republics. Simultaneously, the inflows of FDI to Russia are rising fast (in 2006 FDI inflows more than doubled in USD terms), thanks to both returning Russian offshore capital and the country's improved credit rating. The repeatedly delayed WTO accession now seems to be imminent after a deal with the USA has been completed. The future of EU–Russian relations after the expiry of the Partnership and Cooperation Agreement is unclear, but energy will doubtlessly play a dominant role.

Broadly speaking, the economic outlook remains positive with both consumption and investments (including FDI) growing rapidly. But taking into account the negative contribution of real net exports to GDP, wiiw expects growth to settle between 5% and 6% in the coming years. With more money and power consolidation at home, Russia's self-confidence will grow further. However, sustainable and broader-based long-term growth will require even more investment as well as the related economic restructuring and substantial improvements in the transparency of legal regulations.

[27] Without much notice in the West, Russian capital already dominates energy and telecommunication sectors on the post-Soviet space – see 'Russian Investment in the CIS', by P. Vahtra and P. Zashev, INDEUNIS Working Paper (WP3), 2006, available at http://indeunis.wiiw.ac.at/.

Table RU

Russia: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 [1]	2007	2008
								forecast	
Population, th pers., end of period [2]	146304	145649	144964	144168	143474	142754	142000	141500	141000
Gross domestic product, RUB bn, nom.	7305.6	8943.6	10830.5	13243.2	17048.1	21614.7	26621.3	31000	35000
annual change in % (real)	10.0	5.1	4.7	7.3	7.2	6.4	6.7	5.4	5
GDP/capita (EUR at exchange rate)	1915	2345	2514	2641	3310	4288	5486	.	.
GDP/capita (EUR at PPP - wiiw)	5970	6440	6940	7510	8280	9040	9890	.	.
Gross industrial production [3]									
annual change in % (real)	11.9	2.9	3.1	8.9	8.3	4.0	3.9	4	3.5
Gross agricultural production									
annual change in % (real)	7.7	7.5	1.5	1.4	3.1	2.0	2.8	.	.
Construction output total									
annual change in % (real)	17.0	9.9	2.7	14.4	10.1	10.5	14.5	.	.
Consumption of households, RUB bn, nom.	3295.2	4318.1	5408.4	6540.1	8405.6	10625.8	12880.0	.	.
annual change in % (real)	7.3	9.5	8.5	7.5	12.1	12.7	10.7	11	10
Gross fixed capital form., RUB bn, nom.	1232.0	1689.3	1938.8	2432.3	3130.5	3848.4	4795.4	.	.
annual change in % (real)	18.1	10.2	2.8	12.8	12.6	8.3	13.7	10.5	8
LFS - employed persons, th, avg.	65070	65123	66659	66432	67275	68169	68872	.	.
annual change in %	3.4	0.1	2.4	-0.3	1.3	1.3	1.0	.	.
Reg. employment in industry, th pers., avg. [4]	14543	14692	14534	14345	14301	14593	.	.	.
annual change in % [4]	1.7	1.0	-1.1	-1.3	-0.3	-0.9	.	.	.
LFS - unemployed, th pers., average	7699.5	6423.7	5698.3	5959.2	5674.8	5262.8	5336.0	.	.
LFS - unemployment rate in %, average	10.6	9.0	7.9	8.2	7.8	7.2	7.2	7	6.5
Reg. unemployment rate in %, end of period	1.4	1.6	2.1	2.3	2.6	2.5	2.3	.	.
Average gross monthly wages, RUB	2223.4	3240.4	4360.3	5498.5	6739.5	8550.2	10736.0	.	.
annual change in % (real, gross)	20.9	19.9	16.2	10.9	10.7	10.2	13.5	.	.
Consumer prices, % p.a.	20.8	21.6	16.0	13.6	11.0	12.5	9.8	8	7
Producer prices in industry, % p.a.	46.6	19.1	11.8	15.6	24.0	20.7	12.4	11	9
General governm.budget, nat.def., % GDP									
Revenues	28.7	30.0	32.5	31.3	31.9	39.7	39.4 I-IX	.	.
Expenditures	26.8	27.1	31.6	29.9	27.4	31.6	28.3 I-IX	.	.
Deficit (-) / surplus (+), % GDP	1.9	3.0	0.9	1.3	4.5	8.1	11.1 I-IX	.	.
Public debt, nat.def., in % of GDP [5]	57.1	44.1	37.0	28.6	21.7	14.9	.	.	.
Refinancing rate of NB % p.a., end of per.	25	25	21	16	13	12	11	.	.
Current account, EUR mn [6]	50618	37885	30788	31330	47457	66971	76685	60000	55000
Current account in % of GDP	18.0	11.1	8.4	8.2	10.0	10.9	9.8	6.5	5.2
Gross reserves of NB, excl. gold, EUR mn	26139	37026	42290	58531	88663	148094	244190	.	.
Gross external debt, EUR mn	172903	169530	147067	148776	157423	217647	211696 IX	.	.
Gross external debt in % of GDP	61.6	49.5	40.3	39.0	33.1	35.5	.	.	.
FDI inflow, EUR mn [6]	2933	3069	3660	7041	12422	11910	23000	.	.
FDI outflow, EUR mn [6]	3433	2828	3736	8606	11085	9890	14000	.	.
Exports of goods, BOP, EUR mn [6]	113510	113744	113468	120265	147357	195709	242487	252000	260000
annual growth rate in %	60.1	0.2	-0.2	6.0	22.5	32.8	23.9	4	3
Imports of goods, BOP, EUR mn [6]	48483	60022	64470	67304	78327	100682	130508	150000	170000
annual growth rate in %	30.7	23.8	7.4	4.4	16.4	28.5	29.6	15	13
Exports of services, BOP, EUR mn [6]	10337	12773	14393	14359	16373	19818	24144	26000	.
annual growth rate in %	21.5	23.6	12.7	-0.2	14.0	21.0	21.8	8	.
Imports of services, BOP, EUR mn [6]	17540	22967	24848	23997	27131	31670	36818	42000	.
annual growth rate in %	40.0	30.9	8.2	-3.4	13.1	16.7	16.3	14	.
Average exchange rate RUB/USD	28.13	29.17	31.35	30.69	28.81	28.30	27.34	27	26.5
Average exchange rate RUB/EUR (ECU)	26.03	26.13	29.65	34.69	35.81	35.22	34.08	33.7	33.1
Purchasing power parity RUB/USD, wiiw	7.17	8.15	9.27	10.35	12.09	13.98	15.66	.	.
Purchasing power parity RUB/EUR, wiiw	8.34	9.52	10.74	12.20	14.31	16.70	18.90	.	.

Note: The term 'industry' refers to NACE classification C+D+E.

1) Preliminary. - 2) Resident population. - 3) From 2001 according to NACE. - 4) From 2005 according to NACE. - 4) wiiw estimate. - 5) Converted from USD to EUR at the official cross exchange rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Vasily Astrov

Ukraine: riding on the wave of high steel prices

The country's recent economic performance has been very encouraging. Growth accelerated markedly, while macroeconomic imbalances were largely avoided and the 'gas price shock' reasonably well digested. According to preliminary data, in 2006 the economy grew at a solid 7%, up from 2.7% in 2005. This acceleration largely reflected a pick-up in metals production (+8.9% in output terms) and construction (+9.8%), both these branches having contracted in 2005. (Still, it was retail and wholesale trade and transport which recorded the highest value-added increase in 2006, while agricultural output stayed nearly flat.) The impressive turnaround in construction activity was due to the recovery in fixed capital formation (+11.4% in the first nine months of 2006), resulting partly from under-investment under the first 'orange' government back in 2005 and reflecting the generally improved business climate. Also, there is evidence that the rising investment is partly motivated by energy-saving considerations following the 'gas price shock' in January 2006. In turn, the expanding metals production translated into exports performing unexpectedly well. At the same time, the growth of imports, though impressive, was somewhat contained by a decline in oil prices in the second half of the year. (Unlike for gas, Ukraine is paying the 'world market price' for its oil imports from Russia). As a result, the 2006 current account must have been largely in balance.

Judging by these indicators, the country's current growth path is increasingly resembling that observed in 2000-2004, i.e. prior to the 'orange revolution'. Its salient features were the high overall dynamics, the pivotal role of the industrial sector as the growth locomotive, and the generally high saving ratios mirrored in both thriving domestic investment and strong external surpluses. The role of industry reflected not least the favourable developments in the world steel markets, while the high propensity to save was related to the prevailing weak social protection and unequal income distribution. With both these factors seemingly at work again (a marked recovery of steel prices to the 2004 levels after a major dip in 2005 and the arguably pro-'oligarchic' government of Prime Minister Viktor Yanukovych in place), it is little surprise that current developments present certain resemblance to the 'pre-orange' period. The important difference, however, is that in 2006 the contribution of consumption to growth was very high. In the first nine months, private consumption was up by a record-high 19% year-on-year, backed by impressive real wage growth (18.6% for the year as a whole) – the legacy of the 'orange' governments. However, the average figure disguises marked changes in the monthly dynamics. In fact, wage restraint has been increasingly visible since the Yanukovych government took office in August, and by December 2006, the growth in real wages plunged to just 11.7% year-on-year.

In 2006 the consolidated government budget recorded a 0.7% deficit which, in the absence of sizeable privatization revenues, was covered largely by external borrowing. At the same time, domestic public debt fell by some 13%. As a result, three quarters of the country's public debt are now denominated in foreign currency. The government strategy to borrow in foreign rather than domestic currency makes sense given the lower interest rates on foreign currency-denominated bonds[28] and the stable exchange rate outlook (if anything, rather an appreciation of the hryvnia could be expected). While *public* foreign debt increased by 12.6% in dollar terms in 2006, *overall*

[28] For instance, the government placed a CHF 384 million worth of 12-year 3.5% bonds in September 2006, followed by a USD 1 billion issue of 10-year 6.58% bonds in November. This is to be compared to the 9% p.a. yield on domestic 2-year bonds placed in October.

debt expanded, according to some estimates, by 24% and reached 47% of GDP by the end of the year. The main driving force behind has been the banking sector's rapidly growing external borrowing, possibly associated with the growing presence of foreign banks. The rising overall level of external debt and the substitution of public debt by private are well in line with the earlier experience of other transition countries and is in itself a welcome development reflecting lower risk perceptions on the part of foreign creditors.

Another manifestation of lower risk perceptions has been the growing inflow of FDI. In January-September 2006 alone, Ukraine received nearly EUR 2.9 billion in FDI – much more than the EUR 2.2 billion (net of the revenues from the Kryvorizhstal privatization which was in many ways exceptional) received in 2005 as a whole. The principal target of FDI has been the banking sector. As a result, 13 of the 30 biggest banks are now majority foreign-owned, and the share is set to grow further, not least due to the newly adopted law which allows foreign banks to open branches in Ukraine following the country's WTO accession.[29]

While the impact of the January 2006 'gas price shock' on the real economy was negligible, inflation picked up somewhat. In 2006, consumer prices of 'electricity, gas and water' increased by 85.7% on an end-year basis. However, food prices – dominating the CPI basket – were flat; thus, the end-year consumer inflation stood at a 'mere' 11.6% (up from 10.3% the year before). The inflationary pressure is likely to stay stubbornly high, particularly as a result of further ongoing and forthcoming energy price hikes. Following the renewed hike in the border price of imported gas from USD 95 to USD 130 per th cm as of 1 January 2007, the price for industrial consumers has been raised accordingly, to some USD 143 per th cm (without VAT and transport costs). By contrast, gas tariffs charged to households are still much lower, starting from USD 62 per th cm and depending on the volumes consumed. However, further upward adjustments will be unavoidable, thus fuelling overall inflation. Also, consumer inflation will be increasingly affected by the spillovers from the recent surge in producer prices (+14.1% on an end-year basis). In the medium term, the border price of gas will rise further – given Gazprom's current strategy of bringing its export prices in line with the West European levels, and notwithstanding the marked improvement in Russia-Ukraine relations over the past few months (and the associated restraint from the EU).

Inflation apart, the country's short-term economic prospects are good. In 2007-2008, we expect economic growth ranging between 5.5% and 6% – barred any major downturn in the world metals markets. Exports and particularly investments are likely to perform well. However, the growth of private consumption is likely to slow down somewhat due to greater wage restraint, and despite booming consumer credit. Although the slowdown of consumption will have a dampening effect on imports, the latter will be inflated by the higher gas prices, so that a further deterioration of the country's external position can be hardly avoided. Still, the current account deficit this year should remain relatively modest at some 2% of GDP. After a dip last year, large-scale privatization in 2007 is likely to receive a new boost, with Ukrtelekom and the Odessa Port Plant (the leading fertilizer producer) featuring on the list. In fact, privatization revenues are expected to cover two-thirds of the planned 2.6% central budget deficit. At the same time, the moratorium on the free sale of agricultural land has been prolonged until 2008.

[29] Generally, unlike subsidiaries, bank branches operate subject to regulations of the 'home' country. However, foreign banks will be only allowed to open branches in Ukraine after the fulfilment of certain criteria (such as compliance with the Basle prudential regulations and cooperation with FATF) and will need a National Bank permission.

Table UA

Ukraine: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 [1]	2007	2008
								forecast	
Population, th pers., end of period	48923.2	48457.1	48003.5	47622.4	47280.8	46929.5	46638.7	46300	46000
Gross domestic product, UAH mn, nom.	170070	204190	225810	267344	345113	424741	496000	578300	658900
annual change in % (real)	5.9	9.2	5.2	9.6	12.1	2.6	7	6	5.5
GDP/capita (EUR at exchange rate)	688	872	931	928	1100	1411	1670	.	.
GDP/capita (EUR at PPP - wiiw)	3770	4250	4630	5130	5930	6260	6870	.	.
Gross industrial production									
annual change in % (real)	13.2	14.3	7.0	15.8	12.5	3.1	6.2	5	4.5
Gross agricultural production									
annual change in % (real)	9.8	10.2	1.2	-11.0	19.7	-0.1	0.4	.	.
Construction output total									
annual change in % (real)	0.4	3.5	-5.8	26.5	17.2	-6.6	9.8	.	.
Consumption of households, UAH mn, nom.	92406	112260	124560	146301	180956	238961	221919 I-IX	.	.
annual change in % (real)	2.5	9.6	9.5	11.5	13.5	16.6	19.0 I-IX	.	.
Gross fixed capital form., UAH mn, nom.	33427	40211	43289	55075	77820	93357	80854 I-IX	.	.
annual change in % (real)	12.4	6.2	3.4	22.5	20.5	-0.3	11.4 I-IX	15	15
LFS - employed persons, th, avg. [2]	20175.0	19971.5	20091.2	20163.3	20295.7	20680.0	20880.8 I-IX	.	.
annual change in %	1.1	-1.0	0.6	0.4	0.7	1.9	0.6 I-IX	.	.
Reg. employees in industry, th pers., avg. [3]	3445.0	3811.0	3578.1	3416.0	3408.3	3415.8	3350.4	.	.
annual change in %	-12.4	-6.2	-6.1	-4.5	-0.2	0.2	-1.6	.	.
LFS - unemployed, th pers., average [2]	2655.8	2455.0	2140.7	2008.0	1906.7	1600.8	1460	.	.
LFS - unemployment rate in %, average [2]	11.6	10.9	9.6	9.1	8.6	7.2	6.6	6.5	6.4
Reg. unemployment rate in %, end of period	4.2	3.7	3.8	3.6	3.5	3.1	2.5	2.4	2.3
Average gross monthly wages, UAH [3]	230.1	311.1	376.4	462.3	589.6	806.2	1042.9	.	.
annual change in % (real, gross)	1.1	20.7	20.0	16.7	17.0	20.4	18.6	.	.
Consumer prices, % p.a.	28.2	12.0	0.8	5.2	9.0	13.5	9.1	10	8
Producer prices in industry, % p.a.	20.8	8.7	3.0	7.6	20.5	16.7	9.5	11	8
General governm. budget, nat.def., % GDP									
Revenues	28.9	26.9	27.4	28.2	26.5	31.6	34.6	.	.
Expenditures [4]	28.3	27.2	26.7	28.4	29.7	33.4	35.4	.	.
Deficit (-) / surplus (+), % GDP	0.6	-0.3	0.7	-0.2	-3.2	-1.8	-0.7	-2.6 [5]	.
Public debt in % of GDP	45.3	36.5	33.5	29.0	24.7	18.4	17.2 XI	.	.
Refinancing rate of NB % p.a., end of period	27.0	12.5	7.0	7.0	9.0	9.5	8.5	.	.
Current account, EUR mn [6]	1602	1565	3360	2559	5560	2030	0	-2000	-3000
Current account in % of GDP	4.7	3.7	7.5	5.8	10.6	3.1	0	-2.1	-2.7
Gross reserves of NB excl. gold, EUR mn [7]	1453	3353	4088	5386	6838	16165	16587	.	.
Gross external debt, EUR mn [8]	12759	13785	12247	19055	22528	32671	35295 IX	.	.
Gross external debt in % of GDP	37.7	32.5	27.3	42.9	43.1	49.1	.	.	.
FDI inflow, EUR mn [6]	644	884	734	1261	1380	6263	4000	.	.
FDI outflow, EUR mn [6]	1	26	-5	12	3	221	0	.	.
Exports of goods, BOP, EUR mn [6]	17008	19074	19770	21013	26906	28093	31500	34700	36400
annual growth rate in %	37.2	12.1	3.6	6.3	28.0	4.4	12	10	5
Imports of goods, BOP, EUR mn [6]	16165	18853	19018	20555	23895	29004	34800	40000	44000
annual growth rate in %	32.8	16.6	0.9	8.1	16.3	21.4	20	15	10
Exports of services, BOP, EUR mn [6]	4111	4459	4958	4615	6325	7503	9000	10350	11400
annual growth rate in %	13.0	8.5	11.2	-6.9	37.0	18.6	20	15	10
Imports of services, BOP, EUR mn [6]	3433	3995	3743	3934	5329	6054	7500	9000	10800
annual growth rate in %	59.3	16.4	-6.3	5.1	35.5	13.6	24	20	20
Average exchange rate UAH/USD	5.440	5.372	5.327	5.333	5.319	5.125	5.050	5	5
Average exchange rate UAH/EUR (ECU)	5.029	4.814	5.030	6.024	6.609	6.389	6.335	6	6
Purchasing power parity UAH/USD, wiiw	0.849	0.912	0.943	0.997	1.117	1.301	1.378	.	.
Purchasing power parity UAH/EUR, wiiw	0.917	0.987	1.013	1.091	1.227	1.442	1.542	.	.

Note: The term ‘industry’ refers to NACE classification C+D+E.

1) Preliminary. - 2) From 2000 revised data according to census 2001. - 3) Excluding small enterprises. - 4) From 2004 including lending minus repayments. - 5) Central budget deficit passed by Parliament in December 2006. - 6) Converted from USD. - 7) Useable. - 8) Up to 2002 long-term debt only.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Political developments appear to have only a minor impact on the economy these days. Despite the persistent stand-off between the president and the prime minister, the country is now living through a period of its greatest political stability since the 'orange revolution'. Prime Minister Yanukovych has been generally successful in consolidating his power grip, while President Yushchenko looks increasingly weak and isolated. He has been outmanoeuvred by both Mr Yanukovych and Ms Tymoshenko and has largely lost control even over his own party. Also, he has been often facing a constitutional, i.e. a two-thirds, parliamentary majority against him, as the faction of Ms Tymoshenko – though formally in opposition – has opted to cooperate with the ruling coalition on several occasions. At the moment, the chances of President Yushchenko to be re-elected in 2009 appear slim, although the three years left represent still a long time to go, particularly by Ukrainian standards.

Waltraut Urban

China: economic growth higher than expected

In 2006, the Chinese GDP rose at a rate of 10.7%, faster than in 2005 (10.4%) and also faster than generally expected. Growth was driven by investment (24%) and an exploding export surplus (USD 177 billion) but supported by private consumption as well. Inflation remained low (1.5%). For 2007, prospects remain good, but a slight deceleration of growth may occur due to the measures taken by the Chinese government to curb excessive investment and its attempts to reduce the trade surplus, together with a certain slowdown expected for the world economy. Thus, China's GDP is likely to grow by 10.5% in 2007 and 10% in 2008.

The economic expansion peaked in the second quarter of 2006, when GDP growth reached 11.3%, the highest rate since 1995. In the third quarter growth slowed down to 10.4%, but it picked up again during the last months of the year, mainly due to accelerating export growth but also to domestic sales gaining momentum. Investment growth, however, decelerated throughout the second half of the year, coming down from 30% in the first six months to a rate of 24% for the year as a whole, which is slightly lower than in 2005 (26%). Nevertheless, with investment growth surpassing that of GDP, the already high share of investment in GDP has risen further and reached an incredible 52% in 2006.

Investment in fixed assets rose fastest in industry (33%), followed by real estate (28%), utilities (17%) and transport services (12%). Within utilities, investment in water supply grew fastest. In the field of transportation, investment in railways more than doubled compared to the previous year. Regarding real estate, the debate continues whether or not there exists an investment bubble. To prevent the build-up of a bubble, the Chinese government started already in 2005 to introduce various measures to curb investment in this sector, introducing special taxes and various regulations limiting the accessibility to loans. Last year, a ban on leasing land from farmers for construction and restrictions on the acquisition of real estate by foreigners were introduced. Finally, a land appreciation tax was announced, to be collected from the beginning of February 2007. However, any potential crash in the real estate sector is unlikely to happen before the Olympic Games in Beijing in 2008 and the World Exhibition in Shanghai in 2010. For the current year, the expansion of total investment in fixed assets is expected to be somewhat slower as the investment cycle seems to have peaked already.

Chinese exports rose by 27% in 2006, reaching USD 961 billion, while imports increased by 20% to USD 792 billion. The resulting trade surplus of USD 177 billion was more than 70% higher than the already huge surplus the year before (USD 102 billion).[30] The current account surplus amounted to USD 200 billion (7.7% of GDP) in 2006; it increased less than the trade surplus, as the deficit in the balance for services has widened.

Exports soared particularly during the second half of the year, despite several trade disputes with the United States and the EU and a certain revaluation of the Chinese currency. Imports, on the other hand, dragged especially in the last quarter of the year, and one has to wait and see whether this is due to a deceleration of demand for inputs because of less orders for future exports or whether the existing trend for substituting local sources for foreign inputs has accelerated. Although China's largest trade surplus is with the US and the EU, export growth was highest to countries within the region and to various less developed countries such as India (60%), Iran (34%), Angola (140%) and countries in Latin America (52%) – often related to raw material imports from there. Chinese exports expanded particularly fast in product groups such as cotton, steel and copper products, garments and clothing, mobile phones, TV sets, digital cameras, electronic components and various mechanical and electrical equipment. Car exports more than doubled, although from a very small basis.

To contain the excessive trade surplus, the Chinese government has recently propagated a 'program to encourage imports': Existing restrictions on imports will be relaxed and the government promised specific tax and financial incentives (import loans) for certain imports. According to Chinese experts, the imports to be encouraged should include energy, resources and key technologies & equipment. On the export side, the policy of reducing tax incentives for energy-intensive exports and low value-added processing trade (which together make up half of the trade deficit) will be continued. Regarding the revaluation of the Chinese currency, the policy of gradual adjustment of the exchange rate will be maintained. Yet, in 2006 the yuan appreciated by only 3.5% versus the US dollar and even depreciated versus the euro by about 1.5%. However, in case of a mounting trade surplus, a transition to a more flexible exchange rate system is not excluded by the Central Bank. For 2007, taking into account the expected moderate slowing down of the world economy as well as the government's trade policy and probably an increasing number of dumping charges and technical barriers from China's trading partners, a certain deceleration of export growth accompanied by an acceleration of import growth may be expected – but the trade surplus will rise further, although to a lesser degree than last year.[31]

Foreign currency reserves increased by USD 247 billion last year and in February 2006 China surpassed Japan as the world's largest reserve holder. At the end of 2006, Chinese reserves stood at USD 1066 billion. The lion's share of the rise came from the trade surplus, the second largest factor contributing to the increase was foreign direct investment.

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[30] However, Chinese officials have some doubts whether these data may not exaggerate the trade surplus. Firstly, Chinese companies are suspected to over-report exports in order to get higher tax refunds and, secondly, as the yuan is under appreciation pressure, some foreign trade enterprises may report lower import prices of raw materials and higher export prices of finished products to inflate their 'official' foreign exchange earnings. But it was difficult to gauge the right figures. Mirror statistics from the US and the EU available so far confirm a strong increase in the trade deficit with China.

[31] Given the already existing huge imbalance between exports and imports, the trade surplus will widen further, even if exports and imports grow at the same rate. If, for instance, both imports and exports rise at a rate of 23% in 2007, the resulting trade surplus will amount to USD 218 billion, 40 billion more than in 2006.

Although the 2006 inflow of FDI to China was very high by international standards (USD 69.1 billion), it did not reach the record level of the year before (USD 72.4 billion). By way of contrast, outward investment was more than 30% higher than in 2005. Thus, the net inflow of FDI came down from USD 60 billion in 2005 to USD 53 billion in 2006. A substantial part of Chinese *outward* investment was directed towards the acquisition of natural resources in Africa, Latin America and central Asia, but included investment in the advanced industrialized countries as well.[32] The most prominent deal was probably the take-over of the Hong Kong and Macao retail operations of the Bank of America by the China Construction Bank (CCB), worth USD 1.25 billion, in June 2006. A closer look at *inward* investment shows that the record level of 2005 had been largely due to an investment boom in the financial sector in the run-up to China's opening up the financial sector on 11 December 2006, according to WTO rules. While in 2005 FDI in the financial sector accounted for USD 12.1 billion, it was only 6.1 billion in 2006.

New rules for foreign direct investment: China's attitude towards FDI seems to have turned more choosy recently. In September 2006, new rules for mergers & acquisitions by foreign enterprises were issued, as a reaction to the increasing number of M&As. They allow share swaps in M&As, but stipulate that any M&A which could result in a monopoly must receive government approval. The new rules on foreign-funded banks, effective as of 11 December 2006, are relatively restrictive, e.g. regarding capital requirements. Also in December, as part of the new guidelines for state-owned enterprise reform, a list of 'key sectors' was published, specifying those sectors in which the state should be the sole owner, or have a majority share, such as power generation and distribution, oil, petrochemicals and natural gas, telecommunications and armaments; the state must have a controlling stake in the coal, aviation and shipping industries. Further on, the blueprint for the new five-year plan (2007-2012) puts unprecedented emphasis on the quality of FDI that China should absorb and there were new guidelines issued by the National Development and Reform Commission, putting a preference on FDI in high-tech, advanced manufacturing, in energy saving and environmental protection, modern agriculture and service industries. Finally, the Chinese government has drafted a law to unify income tax rates for domestic and foreign companies at a rate of 25%. (So far, a preferential rate of 17% was applied for foreign enterprises as compared to 33% for domestic companies.) The new regulations may deter some but not many potential investors and the trend towards more investment in service industries at the expense of manufacturing will continue. For 2007, a slightly lower inflow of FDI, but a further acceleration of outward investment can be expected.

Data on aggregate private consumption for the year 2006 are not yet available, but retail trade turnover, which may be used as a proxy for consumer demand, expanded at a rate of 12.9% (in real terms), slightly faster than the year before (12.1%). This was supported by a relatively strong rise of incomes, including the low end such as minimum wages and rural incomes. But the gap between the urban and the rural population has widened further. Per capita disposable incomes of rural households rose by 7% and those of city-dwellers by 10%. In 2007, wages will continue to rise rapidly, backed by a further strong increase in productivity.

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[32] Such as the joint venture of the China Minmetals Corporation with Chile's Codelco, the World's largest copper producer; the investment of China's National Offshore Corporation in a Nigerian Oilfield; the acquisition by the China National Petroleum Corporation of a 20% stake in a joint oil and gas exploration in Uzbekistan's Aral sea; the acquisition by China's Suntech Solar Holdings of a 67% stake in MSK, the largest solar panel producer in Japan, with the option to acquire more shares later.

Table CN

China: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 [1]	2007	2008
								forecast	
Population, mn pers., end of period	1267.4	1276.3	1284.5	1292.3	1299.9	1307.6	1315.5	.	.
Gross domestic product, CNY bn, nom.	9921.5	10965.5	12033.3	13582.3	15987.8	18308.5	20940	23600	26400
annual change in % (real)	8.0	7.5	8.3	9.5	9.5	10.4	10.7	10.5	10
GDP/capita (USD at exchange rate)	946	1038	1132	1270	1486	1706	1990	.	.
GDP/capita (USD at PPP - wiiw)	4506	4966	5475	6161	6933	7822	8893	.	.
Industrial value added [2]									
annual change in % (real)	9.9	8.9	9.9	12.5	11.1	11.4	.	.	.
Agricultural value added									
annual change in % (real)	2.4	2.5	2.9	2.5	6.0	5.2	.	.	.
Retail trade turnover, CNY bn	3415.3	4305.54	4813.6	5251.6	5950.1	6717.7	7638	.	.
annual change in % (real)	11.1	10.9	10.6	9.2	10.5	12.1	12.9	.	.
Total investment in fixed assets, CNY bn	3291.8	3723.4	4350.0	5556.7	7047.7	8877.4	10987	.	.
annual change in % (nominal)	10.3	13.1	16.8	27.7	26.8	26.0	23.8	.	.
Employment total, mn pers., end of period	720.9	730.3	737.4	744.3	752.0	758.3	.	.	.
annual change in %	1.0	1.3	1.0	0.9	1.0	0.8	.	.	.
Staff and workers, mn pers., end of period [3]	112.6	107.9	105.6	104.6	105.8	108.5	109.5 I-IX	.	.
annual change in %	-4.3	-4.2	-2.2	-0.7	0.8	2.6	3.7 I-IX	.	.
Unemployment rate (urban) in %, end of per. [4]	3.1	3.6	4.0	4.5	4.2	4.2	4.1	4.3	4.5
Average gross annual wages, CNY [5]	9371	10870	12422	14040	16024	18364	18626 I-IX	.	.
annual change in % (real) [6]	11.1	15.2	15.5	12.0	10.5	12.8	12.1 I-IX	.	.
Retail prices, % p.a.	-1.5	-0.8	-1.8	-0.1	2.8	0.8	0.8	.	.
Consumer prices, % p.a.	0.4	0.7	-0.8	1.2	3.9	1.8	1.5	1.8	1.6
General government budget, nat.def., % GDP									
Revenues	13.5	14.9	15.7	16.0	16.5	17.3	18.0	.	.
Expenditures	16.0	17.2	18.3	18.1	17.8	18.4	19.4	.	.
Deficit (-) / surplus (+), % GDP	-2.5	-2.3	-2.6	-2.2	-1.3	-1.1	-1.4	.	.
Refinancing rate of NB % p.a., end of per. [7]	3.2	3.2	2.7	2.7	3.3	3.3	3.3	.	.
Current account, USD bn	20.5	17.4	35.4	45.9	70.0	161.0	200	250	280
Current account in % of GDP	1.7	1.3	2.4	2.8	3.6	7.2	7.6	7.9	7.5
Gross reserves of NB excl. gold, USD bn	165.6	212.2	286.4	403.3	609.9	818.9	1066	.	.
Gross external debt, USD bn	145.7	170.1	171.7	194.0	223.0	280.0	.	.	.
Gross external debt in % of GDP	12.2	12.8	11.8	11.8	11.5	12.5	.	.	.
FDI inflow, gross, USD bn	40.7	46.9	52.8	53.3	60.6	72.4	69.1	.	.
FDI outflow, gross, USD bn	2.2	7.1	2.8	1.8	2.1	12.3	16.1	.	.
Exports of goods total, USD bn [8]	249.2	266.2	325.6	438.4	593.4	762.0	969.1	.	.
annual change in %	27.8	6.8	22.3	34.6	35.4	28.4	27.2	.	.
Imports of goods total, USD bn [8]	225.1	243.6	295.3	412.8	561.3	660.1	791.6	.	.
annual change in %	35.8	8.2	21.2	39.9	36.0	17.6	20.0	.	.
Trade balance of goods, USD bn [8]	24.1	22.6	30.3	25.5	32.1	101.9	177.5	.	.
Average exchange rate CNY/USD	8.278	8.277	8.277	8.277	8.277	8.206	7.999	7.5	7.1
Average exchange rate CNY/EUR	7.648	7.347	7.753	9.366	11.276	10.261	9.971	.	.
Purchasing power parity CNY/USD, wiiw [9]	1.737	1.730	1.711	1.706	1.774	1.790	1.790	.	.
Purchasing power parity CNY/EUR, wiiw	1.975	1.983	1.982	2.016	2.104	2.134	2.202	.	.

Note: CNY: ISO code for the Chinese yuan.

1) Preliminary. - 2) Including construction. - 3) Staff and workers (on duty) refer to persons who work in state-owned enterprises, urban collectives, shareholding ownership and foreign invested enterprises. - 4) Ratio of registered urban unemployed in per cent of urban employed and unemployed. - 5) 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. - 6) Staff and workers cost of living index is used as deflator for calculating real wage. - 7) Overnight rate. - 8) According to customs statistics. - 9) Purchasing power parity, ICP method; see Ren Ruoen, *The Vienna Institute Monthly Report* 1996/2.

Sources: China Statistical Yearbook; China Monthly Statistics; China Daily etc.; wiiw forecasts.

Government expenditures for the year 2006 have not been published so far, but according to preliminary reports revenues are higher than expected and the deficit will range between 290 and 300 billion yuan (29-30 billion euro); from this we may guess that fiscal policy in 2006 was relatively expansive and it will most probably remain that way in 2007 as well.

Despite rapid growth of the economy, price inflation stayed low, pointing to sufficient production capacities and strong competition on the domestic market. Retail prices rose by 0.8% and consumer prices by 1.5%; producer prices for industrial goods increased by about 3% year on year. The slight acceleration of inflation in the last quarter of 2006 was due to a rise in food prices, in particular food imports, a trend which may continue in 2007. We therefore expect a slightly higher inflation this year.

The monetary authorities coped successfully with the difficult task to neutralize the inflow of foreign currency from the huge current account surplus and to keep money growth (M2) close to the target of 16% (16.9%). For this purpose, the reserve requirement ratio was raised three times and the reference interest rate was increased twice in the course of the year. In 2007, monetary policy will remain restrictive to contain loans and thus investment growth. In fact, the reserve ratio was raised again in January this year.

Proper information on the supply side of the Chinese economy in 2006 is not yet available. However, data on industrial value-added during the first eleven months of the year, including companies with annual sales revenue over 5 million yuan (500,000 euro), reveal a slightly faster expansion of industrial activity (16.8%) than in the same period the year before (16.4%), which is roughly in line with the slightly higher growth of the overall GDP in 2006. We therefore assume no dramatic shifts in the sectoral contribution to growth in 2006.

Summing up, the general character of growth in 2007 and 2008 will not be much different from that observed last year. However, investment growth may somewhat decelerate as the investment cycle seems to have peaked already. The export surplus will remain huge, but will grow less dramatically than this year, due to the expected slowing down of the world economy and certain policy measures to retard exports and promote imports. Growth of private consumption will remain high, based on a continuous high rise of wages backed by strong productivity growth. The fiscal policy will remain expansive, probably focusing less on investment and more on social expenditure. Inflation will not be a problem, but the monetary policy will remain tight in order to contain investment growth. Altogether, we expect the Chinese economy to grow by 10.5% in 2007 and 10% in 2008.

Appendix

Selected Indicators of Competitiveness

Table A/1

GDP per capita at current PPPs (EUR), from 2007 at constant PPPs

	1991	1995	2000	2004	2005	2006	2007	2008	2009	2010	2015
							projection assuming 5% p.a. GDP growth and zero population growth p.a.				
Bulgaria	4764	4782	5319	7226	7731	8496	9006	9501	9976	10475	13369
Cyprus	11011	12744	16531	19897	20858	21655	22478	23354	24522	25748	32862
Czech Republic	9149	10048	13018	16381	17285	18792	19731	20718	21754	22841	29152
Estonia	5688	5249	8245	12193	14052	16162	17697	19184	20143	21150	26993
Hungary	7289	7524	10527	13929	14666	15792	16218	16721	17557	18435	23528
Latvia	6882	4576	7002	9902	11257	13055	14217	15355	16122	16928	21605
Lithuania	8172	5070	7603	11099	12199	13704	14663	15616	16397	17217	21973
Malta	9801	12421	15682	16203	16529	17074	17432	17816	18707	19642	25069
Poland	4531	6167	9386	11050	11672	12603	13271	13935	14631	15363	19607
Romania	4116	4644	5003	7395	8005	8458	9008	9548	10026	10527	13436
Slovak Republic	6023	6825	9524	12355	13409	14548	15567	16656	17489	18364	23437
Slovenia	9523	9779	14613	18154	19215	20670	21601	22465	23588	24767	31610
NMS-12	5595	6318	8648	11083	11820	12793	13484	14185	14894	15639	19960
Croatia	5979	5682	8103	10571	11270	12027	12569	13147	13804	14494	18499
Macedonia	4316	4026	5141	5656	6107	6396	6652	6918	7264	7627	9734
Turkey	7287	8770	8589	6944	7440	7784	8212	8746	9183	9642	12306
Albania	1861	2247	3313	4101	4415	4609	4839	5105	5361	5629	7184
Bosnia & Herzeg.	.	.	4857	6183	6154	6463	6831	7207	7567	7946	10141
Montenegro	.	.	4636	5353	5649	5988	6287	6602	6932	7279	9289
Serbia	.	.	4682	6167	6692	7226	7588	7967	8365	8784	11210
Russia	8133	5679	5973	8283	9044	9893	10427	10948	11496	12071	15405
Ukraine	5792	3276	3771	5930	6255	6874	7287	7687	8072	8475	10817
							projection assuming 2% p.a. GDP growth and zero population growth p.a.				
Germany	17589	18669	22457	25226	25817	27009	27549	28100	28662	29235	32278
Greece	10822	10993	14619	18481	19730	20819	21235	21660	22093	22535	24880
Spain	12465	13565	18525	21939	22985	24035	24516	25006	25506	26016	28724
Austria	18378	19684	25235	28024	28880	30211	30815	31432	32060	32702	36105
Portugal	10527	11737	16146	16294	16685	17120	17463	17812	18168	18532	20460
USA	21389	23374	30548	33600	35219	36791	37526	38277	39042	39823	43968
EU(15) average	15951	17182	22065	24651	25389	26469	26998	27538	28089	28651	31633
EU(25) average	14288	15472	20098	22705	23461	24559	25271	26004	26758	27534	31765
EU(27) average	13617	14772	19147	21782	22534	23603	24312	25041	25792	26566	30797

European Union (25) average = 100

	1991	1995	2000	2004	2005	2006	2007	2008	2009	2010	2015
Bulgaria	33	31	26	32	33	35	36	37	37	38	42
Cyprus	77	82	82	88	89	88	89	90	92	94	103
Czech Republic	64	69	65	72	74	77	78	80	81	83	92
Estonia	40	34	42	54	60	66	70	74	75	77	85
Hungary	51	49	54	61	63	64	64	64	66	67	74
Latvia	48	30	35	44	48	53	56	59	60	61	68
Lithuania	57	33	38	49	52	56	58	60	61	63	69
Malta	69	80	78	71	70	70	69	69	70	71	79
Poland	32	40	47	49	50	51	53	54	55	56	62
Romania	29	30	25	33	34	34	36	37	37	38	42
Slovak Republic	42	45	47	54	57	59	62	64	65	67	74
Slovenia	67	68	73	80	82	84	85	86	88	90	100
NMS-12	39	41	43	49	50	52	53	55	56	57	63
Croatia	42	37	40	47	48	49	50	51	52	53	58
Macedonia	30	26	26	25	26	26	26	27	27	28	31
Turkey	51	57	43	31	32	32	32	34	34	35	39
Albania	13	15	16	18	19	19	19	20	20	20	23
Bosnia & Herzeg.	.	.	24	27	26	26	27	28	28	29	32
Montenegro	.	.	23	24	24	24	25	25	26	26	29
Serbia	.	.	23	27	29	29	30	31	31	32	35
Russia	57	37	30	36	39	40	41	42	43	44	48
Ukraine	41	21	19	26	27	28	29	30	30	31	34
Germany	123	121	112	111	110	110	109	108	107	106	102
Greece	76	71	73	81	84	85	84	83	83	82	78
Spain	87	88	92	97	98	98	97	96	95	94	90
Austria	129	127	126	123	123	123	122	121	120	119	114
Portugal	74	76	80	72	71	70	69	68	68	67	64
USA	150	151	152	148	150	150	148	147	146	145	138
EU(15) average	112	111	110	109	108	108	107	106	105	104	100
EU(25) average	100	100	100	100	100	100	100	100	100	100	100
EU(27) average	95	95	95	96	96	96	96	96	96	96	97

Sources: National statistics, Eurostat, wiiw estimates.

Table A/2

Indicators of macro-competitiveness, 1999-2006

EUR based, annual averages

	1999	2000	2001	2002	2003	2004	2005	2006 prelim.
Czech Republic								
Producer price index, 2000=100	95.3	100.0	102.8	102.3	101.9	107.7	110.9	112.7
Consumer price index, 2000=100	96.2	100.0	104.7	106.6	106.7	109.7	111.8	114.5
GDP deflator, 2000=100	98.5	100.0	104.9	107.8	108.8	112.7	113.5	116.2
Exchange rate (ER), CZK/EUR	36.88	35.61	34.08	30.81	31.84	31.90	29.78	28.34
ER nominal, 2000=100	103.6	100.0	95.7	86.5	89.4	89.6	83.6	79.6
Real ER (CPI-based), 2000=100	105.6	100.0	93.4	84.7	89.1	88.7	83.1	78.8
Real ER (PPI-based), 2000=100	104.2	100.0	94.2	85.1	88.8	86.1	81.6	79.9
PPP, CZK/EUR	16.33	16.37	16.76	16.57	16.41	16.63	16.79	16.69
Price level, EU(25)=100	44	46	49	54	52	52	56	59
Average monthly gross wages, CZK	12797	13614	14793	15866	16917	18041	19024	20200
Average monthly gross wages, EUR (ER)	347	382	434	515	531	565	639	713
Average monthly gross wages, EUR (PPP)	784	832	883	957	1031	1085	1133	1210
GDP nominal, CZK mn	2080797	2189169	2352214	2464432	2577110	2781060	2970261	3220000
Employed persons - LFS, th., average [1]	4764.1	4731.6	4750.2	4764.9	4733.2	4706.6	4764.0	4810
GDP per employed person, CZK	436766	462670	495182	517205	544481	590885	623480	669439
GDP per empl. person, CZK at 2000 pr.	443352	462670	472166	479645	500256	524274	549363	576024
Unit labour costs, CZK, 2000=100	98.1	100.0	106.5	112.4	114.9	116.9	117.7	119.2
Unit labour costs, ER adj., 2000=100	94.7	100.0	111.2	129.9	128.5	130.5	140.7	149.8
Unit labour costs, PPP adj., Austria=100	29.32	31.09	34.08	38.72	37.64	38.96	41.30	42.96
Hungary								
Producer price index, 2000=100	89.6	100.0	105.2	103.3	105.8	109.5	114.2	122.0
Consumer price index, 2000=100	91.1	100.0	109.2	115.0	120.4	128.6	133.2	138.4
GDP deflator, 2000=100	91.1	100.0	108.4	117.1	123.8	129.1	131.8	137.5
Exchange rate (ER), HUF/EUR	252.80	260.04	256.68	242.97	253.51	251.68	248.05	264.27
ER, nominal 2000=100	97.2	100.0	98.7	93.4	97.5	96.8	95.4	101.6
Real ER (CPI-based), 2000=100	104.7	100.0	92.4	84.8	86.1	81.8	79.5	83.3
Real ER (PPI-based), 2000=100	104.0	100.0	94.9	91.0	93.2	91.5	90.4	94.2
PPP, HUF/EUR	114.50	122.35	126.47	133.11	141.31	147.12	148.89	150.26
Price level, EU(25)=100	45	47	49	55	56	58	60	57
Average monthly gross wages, HUF	77187	87645	103553	122482	137193	145521	158343	170600
Average monthly gross wages, EUR (ER)	305	337	403	504	541	578	638	646
Average monthly gross wages, EUR (PPP)	674	716	819	920	971	989	1063	1135
GDP nominal, HUF mn	11393499	13150766	15274862	17203730	18935672	20712284	22026763	23900000
Employed persons - LFS, th., average [2]	3809.3	3856.2	3868.3	3870.6	3921.9	3900.4	3901.5	3932
GDP per employed person, HUF	2990969	3410291	3948727	4444719	4828188	5310297	5645717	6078332
GDP per empl. person, HUF at 2000 pr.	3281843	3410291	3641730	3795985	3899991	4113640	4285174	4421891
Unit labour costs, HUF, 2000=100	91.5	100.0	110.6	125.5	136.9	137.6	143.8	150.1
Unit labour costs, ER adj., 2000=100	94.1	100.0	112.1	134.4	140.4	142.2	150.7	147.7
Unit labour costs, PPP adj., Austria=100	26.05	27.79	30.70	35.80	36.76	37.94	39.54	37.88
Poland								
Producer price index, 2000=100	92.8	100.0	101.6	102.6	105.3	112.7	113.4	116.1
Consumer price index, 2000=100	90.8	100.0	105.5	107.5	108.4	112.2	114.5	115.7
GDP deflator, 2000=100	93.2	100.0	103.5	105.8	106.3	110.7	113.6	114.7
Exchange rate (ER), PLN/EUR	4.227	4.011	3.669	3.856	4.398	4.534	4.025	3.895
ER, nominal, 2000=100	105.4	100.0	91.5	96.1	109.6	113.0	100.4	97.1
Real ER (CPI-based), 2000=100	113.9	100.0	88.6	93.3	107.6	109.5	97.3	95.2
Real ER (PPI-based), 2000=100	108.9	100.0	91.1	94.2	105.3	103.8	95.7	94.7
PPP, PLZ/EUR	1.999	2.074	2.121	2.118	2.160	2.188	2.202	2.180
Price level, EU(25)=100	47	52	58	55	49	48	55	56
Average monthly gross wages, PLN [3]	1697	1894	2045	2098	2185	2273	2361	2480
Average monthly gross wages, EUR (ER)	401	472	557	544	497	501	586	637
Average monthly gross wages, EUR (PPP)	849	913	964	991	1011	1039	1072	1138
GDP nominal, PLN mn	666308	744622	779205	807860	842120	923248	980666	1047900
Employed persons - LFS, th., average [4]	14757	14526	14207	13782	13617	13795	14115	14600
GDP per employed person, PLN	45152	51261	54847	58617	61844	66927	69476	71774
GDP per empl. person, PLN at 2000 pr.	48426	51261	52987	55385	58189	60483	61181	62579
Unit labour costs, PLN, 2000=100	94.9	100.0	104.5	102.5	101.6	101.7	104.4	107.3
Unit labour costs, ER adj., 2000=100	90.0	100.0	114.2	106.7	92.7	90.0	104.1	110.5
Unit labour costs, PPP adj., Austria=100	39.35	43.90	49.41	44.88	38.34	37.94	43.13	44.75

1) From 2002 according to census 2001. - 2) From 1999 according to census 2001. - 3) From 1999 broader wage coverage. - 4) From 2003 according to census 2002.

(Table A/2 ctd.)

(Table A/2 ctd.)

	1999	2000	2001	2002	2003	2004	2005	2006 prelim.
Slovak Republic								
Producer price index, 2000=100	90.2	100.0	106.5	108.7	117.8	121.8	127.5	138.2
Consumer price index, 2000=100	89.3	100.0	107.1	110.6	120.0	129.0	132.5	138.5
GDP deflator, 2000=100	91.2	100.0	105.0	109.9	115.1	122.0	124.9	128.9
Exchange rate (ER), SKK/EUR	44.12	42.59	43.31	42.70	41.49	40.05	38.59	37.23
ER, nominal, 2000=100	103.6	100.0	101.7	100.3	97.4	94.0	90.6	87.4
Real ER (CPI-based), 2000=100	113.8	100.0	97.0	94.5	86.3	79.2	75.9	71.6
Real ER (PPI-based), 2000=100	110.1	100.0	96.6	92.7	83.7	79.9	76.9	71.5
PPP, SKK/EUR	17.91	18.30	18.70	18.80	19.60	20.38	20.37	20.81
Price level, EU(25)=100	41	43	43	44	47	51	53	56
Average monthly gross wages, SKK	10728	11430	12365	13511	14365	15825	17274	18800
Average monthly gross wages, EUR (ER)	243	268	286	316	346	395	448	505
Average monthly gross wages, EUR (PPP)	599	625	661	719	733	776	848	903
GDP nominal, SKK mn	852169	941314	1020595	1111484	1212665	1355262	1471131	1632000
Employed persons - LFS, th., average	2132.1	2101.7	2123.7	2127.0	2164.6	2170.4	2216.2	2300
GDP per employed person, SKK	399685	447882	480574	522559	560226	624430	663808	709565
GDP per empl. person, SKK at 2000 pr.	438328	447882	457541	475642	486819	511811	531493	550537
Unit labour costs, SKK, 2000=100	95.9	100.0	105.9	111.3	115.6	121.2	127.4	133.8
Unit labour costs, ER adj., 2000=100	92.6	100.0	104.1	111.0	118.7	128.9	140.5	153.1
Unit labour costs, PPP adj., Austria=100	23.24	25.20	25.86	26.82	28.18	31.18	33.44	35.60
Slovenia								
Producer price index, 2000=100	92.9	100.0	108.9	114.5	117.3	122.4	125.7	128.5
Consumer price index, 2000=100	91.8	100.0	108.4	116.5	123.1	127.5	130.7	133.9
GDP deflator, 2000=100	94.9	100.0	108.7	117.3	124.0	128.1	130.0	133.2
Exchange rate (ER), EUR-SIT/EUR	0.8080	0.8556	0.9063	0.9440	0.9752	0.9968	1.0000	1.0000
ER, nominal, 2000=100	94.4	100.0	105.9	110.3	114.0	116.5	116.9	116.9
Real ER (CPI-based), 2000=100	100.9	100.0	99.9	98.8	98.5	99.3	99.3	99.0
Real ER (PPI-based), 2000=100	97.4	100.0	98.4	97.0	98.3	98.5	100.6	102.8
PPP, SIT/EUR	0.5954	0.6170	0.6528	0.6980	0.7213	0.7219	0.7185	0.7156
Price level, EU(25)=100	74	72	72	74	74	72	72	72
Average monthly gross wages, EUR-SIT	723	800	895	982	1057	1117	1157	1210
Average monthly gross wages, EUR (ER)	895	935	988	1041	1083	1120	1157	1210
Average monthly gross wages, EUR (PPP)	1214	1296	1372	1407	1465	1547	1610	1691
GDP nominal, EUR-SIT mn	16354	17945	20028	22348	24259	26172	27625	29700
Employed persons - LFS, th., average	886	901	916	910	897	943	949	960
GDP per employed person, EUR-SIT	18458	19917	21865	24558	27045	27754	29110	30938
GDP per empl. person, EUR-SIT at 2000 pr.	19457	19917	20111	20943	21810	21664	22394	23235
Unit labour costs, EUR-SIT, 2000=100	92.5	100.0	110.9	116.8	120.6	128.3	128.7	129.7
Unit labour costs, ER adj., 2000=100	98.0	100.0	104.7	105.9	105.8	110.2	110.1	111.0
Unit labour costs, PPP adj., Austria=100	64.94	66.56	68.64	67.55	66.37	70.40	69.17	68.14
Bulgaria								
Producer price index, 2000=100	85.1	100.0	103.8	105.0	110.1	116.7	124.8	136.5
Consumer price index, 2000=100	90.7	100.0	107.4	113.6	116.2	123.4	129.6	139.0
GDP deflator, 2000=100	93.7	100.0	106.7	110.7	113.1	118.6	123.0	132.5
Exchange rate (ER), BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
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	108.2	100.0	95.2	91.8	91.5	88.1	85.7	81.6
Real ER (PPI-based), 2000=100	112.7	100.0	97.5	95.8	91.8	88.6	86.7	82.8
PPP, BGN/EUR	0.5922	0.6156	0.6431	0.6747	0.6552	0.6807	0.7010	0.7337
Price level, EU(25)=100	30	31	33	34	34	35	36	38
Average monthly gross wages, BGN	201	225	240	258	273	292	324	355
Average monthly gross wages, EUR (ER)	103	115	123	132	140	150	166	182
Average monthly gross wages, EUR (PPP)	339	365	373	382	417	430	462	484
GDP nominal, BGN mn	23790	26753	29709	32335	34547	38275	41948	48000
Employed persons - LFS, th.,average	2875.3	2794.7	2698.8	2739.6	2834.8	2922.5	2980.0	3100
GDP per employed person, BGN	8274	9573	11008	11803	12187	13097	14077	15484
GDP per empl. person, BGN at 2000 pr.	8828	9573	10317	10661	10771	11043	11448	11687
Unit labour costs, BGN, 2000=100	97.1	100.0	99.2	103.0	108.2	112.9	120.6	129.5
Unit labour costs, ER adj., 2000=100	97.1	100.0	99.2	103.0	108.2	112.9	120.6	129.5
Unit labour costs, PPP adj., Austria=100	16.40	16.96	16.58	16.75	17.29	18.39	19.31	20.28

(Table A/2 ctd.)

(Table A/2 ctd.)

	1999	2000	2001	2002	2003	2004	2005	2006 prelim.
Romania								
Producer price index, 2000=100	65.2	100.0	138.1	169.9	203.0	241.8	267.2	296.5
Consumer price index, 2000=100	68.6	100.0	134.5	164.8	190.0	212.5	231.6	246.8
GDP deflator, 2000=100	69.3	100.0	137.4	169.6	210.3	242.0	270.9	289.2
Exchange rate (ER), RON/EUR	1.6296	1.9956	2.6027	3.1255	3.7556	4.0532	3.6234	3.5245
ER, nominal, 2000=100	81.7	100.0	130.4	156.6	188.2	203.1	181.6	176.6
Real ER (CPI-based), 2000=100	116.7	100.0	99.1	99.2	105.4	103.8	87.0	81.2
Real ER (PPI-based), 2000=100	120.1	100.0	95.5	92.7	93.8	86.9	73.5	67.4
PPP, RON/EUR	0.5109	0.7161	0.9548	1.1473	1.3955	1.5371	1.6590	1.8049
Price level, EU(25)=100	31	36	37	37	37	38	46	51
Average monthly grross wages, RON	192	284	422	532	664	818	958	1125
Average monthly gross wages, EUR (ER)	118	142	162	170	177	202	264	319
Average monthly gross wages, EUR (PPP)	376	397	442	464	476	532	577	623
GDP nominal, RON mn	54573.0	80377.3	116768.7	151475.1	197564.8	246371.7	287186.3	329500
Employed persons - LFS, th., average [5)]	10535.0	10508.0	10440.0	9234.3	9222.5	9157.6	9146.6	9150
GDP per employed person, RON	5180	7649	11185	16404	21422	26904	31398	36011
GDP per empl. person, RON at 2000 pr.	7472	7649	8138	9670	10186	11119	11589	12454
Unit labour costs, RON, 2000=100	69.3	100.0	139.7	148.2	175.5	198.2	222.5	243.3
Unit labour costs, ER adj., 2000=100	84.8	100.0	107.1	94.6	93.3	97.6	122.5	137.7
Unit labour costs, PPP adj., Austria=100	25.87	30.63	32.32	27.77	26.91	28.69	35.43	38.93
Estonia								
Producer price index, 2000=100	95.3	100.0	104.4	104.8	105.0	108.1	110.3	115.1
Consumer price index, 2000=100	96.2	100.0	105.8	109.6	111.0	114.4	119.1	124.3
GDP deflator, 2000=100	94.9	100.0	105.3	109.3	111.8	114.2	121.9	128.6
Exchange rate (ER), EEK/EUR	15.647	15.647	15.647	15.647	15.647	15.647	15.647	15.647
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	102.1	100.0	96.6	95.2	95.8	95.0	93.2	91.3
Real ER (PPI-based), 2000=100	100.6	100.0	96.9	95.9	96.3	95.7	98.0	98.3
PPP, EEK/EUR	8.141	8.230	8.687	8.854	8.794	8.917	9.149	9.374
Price level, EU(25)=100	52	53	56	57	56	57	58	60
Average monthly gross wages, EEK [6)]	4440	4907	5510	6144	6723	7287	8073	9300
Average monthly gross wages, EUR (ER)	284	314	352	393	430	466	516	594
Average monthly gross wages, EUR (PPP)	545	596	634	694	764	817	882	992
GDP nominal, EEK mn	81776	92938	108218	121372	132904	146694	173062	203500
Employed persons - LFS, th., average	579.3	572.5	577.7	585.5	594.3	595.5	607.4	646
GDP per employed person, EEK	141163	162337	187326	207297	223631	246337	284923	314967
GDP per empl. person, EEK at 2000 pr.	148748	162337	177962	189667	200087	215798	233731	244996
Unit labour costs, EEK, 2000=100	98.7	100.0	102.4	107.2	111.2	111.7	114.3	125.6
Unit labour costs, ER adj., 2000=100	98.7	100.0	102.4	107.2	111.2	111.7	114.3	125.6
Unit labour costs, PPP adj., Austria=100	35.94	36.54	36.88	37.54	38.27	39.19	39.42	42.35
Latvia								
Producer price index, 2000=100	99.4	100.0	101.7	102.7	106.0	115.1	124.1	136.9
Consumer price index, 2000=100	97.5	100.0	102.5	104.4	107.5	114.1	121.8	130.1
GDP deflator, 2000=100	97.3	100.0	101.7	105.4	109.1	116.6	127.4	140.3
Exchange rate (ER), LVL/EUR	0.6237	0.5600	0.5627	0.5826	0.6449	0.6711	0.7028	0.7028
ER, nominal, 2000=100	111.4	100.0	100.5	104.0	115.2	119.8	125.5	125.5
Real ER (CPI-based), 2000=100	112.1	100.0	100.2	103.9	114.0	114.1	114.4	109.4
Real ER (PPI-based), 2000=100	107.4	100.0	99.9	101.9	109.9	107.7	109.4	103.7
PPP, LVL/EUR	0.2787	0.2820	0.2867	0.2954	0.3062	0.3241	0.3451	0.3678
Price level, EU(25)=100	45	50	51	51	47	48	49	52
Average monthly gross wages, LVL	141	150	159	173	192	211	246	295
Average monthly gross wages, EUR (ER)	226	267	283	297	298	314	350	420
Average monthly gross wages, EUR (PPP)	506	530	555	586	629	651	712	802
GDP nominal, LVL mn	4265.0	4685.7	5219.9	5758.3	6392.8	7421.4	8937.3	11000
Employed persons - LFS, th., average	968.5	941.1	962.1	989.0	1006.9	1017.7	1035.9	1092
GDP per employed person, LVL	4404	4979	5426	5822	6349	7292	8628	10073
GDP per empl. person, LVL at 2000 pr.	4525	4979	5335	5526	5818	6254	6774	7182
Unit labour costs, LVL, 2000=100	103.7	100.0	99.2	104.2	110.2	112.3	120.8	136.8
Unit labour costs, ER adj., 2000=100	93.2	100.0	98.8	100.2	95.7	93.7	96.3	109.0
Unit labour costs, PPP adj., Austria=100	32.25	34.76	33.83	33.39	31.33	31.27	31.58	34.95

5) Methodological break in 2001/2002. – 6) From 1999 excluding compensations from Health Insurance Fund.

(Table A/2 ctd.)

(Table A/2 ctd.)

	1999	2000	2001	2002	2003	2004	2005	2006 prelim.
Lithuania								
Producer price index, 2000=100	86.2	100.0	97.0	94.3	93.8	99.4	110.9	119.1
Consumer price index, 2000=100	99.0	100.0	101.3	101.6	100.4	101.6	104.3	108.3
GDP deflator, 2000=100	99.0	100.0	99.6	99.8	98.7	101.4	107.4	114.9
Exchange rate (ER), LTL/EUR	4.2712	3.6990	3.5849	3.4605	3.4528	3.4528	3.4528	3.4528
ER, nominal, 2000=100	115.5	100.0	96.9	93.6	93.3	93.3	93.3	93.3
Real ER (CPI-based), 2000=100	114.4	100.0	97.8	96.1	98.9	99.8	99.3	97.8
Real ER (PPI-based), 2000=100	128.4	100.0	101.1	99.8	100.6	97.1	91.1	88.7
PPP, LTL/EUR	1.7638	1.7112	1.6676	1.6607	1.6049	1.6375	1.7067	1.7567
Price level, EU(25)=100	41	46	47	48	46	47	49	
Average monthly gross wages, LTL	987	971	982	1014	1073	1149	1290	1500
Average monthly gross wages, EUR (ER)	231	262	274	293	311	333	373	434
Average monthly gross wages, EUR (PPP)	560	567	589	611	668	702	756	854
GDP nominal, LTL mn	43359	45526	48563	51948	56772	62440	71084	81700
Employed persons – LFS, th., average	1456.5	1397.8	1351.8	1405.9	1438.0	1436.3	1473.9	1502
GDP per employed person, LTL	29770	32570	35925	36950	39480	43473	48228	54394
GDP per empl. person, LTL at 2000 pr.	30079	32570	36087	37043	40020	42864	44893	47324
Unit labour costs, LTL, 2000=100	110.1	100.0	91.3	91.8	89.9	90.0	96.4	106.3
Unit labour costs, ER adj., 2000=100	95.4	100.0	94.2	98.2	96.3	96.4	103.2	113.9
Unit labour costs, PPP adj., Austria=100	30.10	31.69	29.43	29.82	28.76	29.32	30.89	33.31
Croatia								
Producer price index, 2000=100	91.2	100.0	103.6	103.2	105.1	108.8	112.1	115.3
Consumer price index, 2000=100	94.2	100.0	104.9	106.7	108.6	110.9	114.6	118.2
GDP deflator, 2000=100	95.5	100.0	104.0	107.8	112.1	115.8	119.5	123.3
Exchange rate (ER), HRK/EUR	7.5796	7.6350	7.4690	7.4068	7.5634	7.4952	7.4002	7.3226
ER, nominal, 2000=100	99.3	100.0	97.8	97.0	99.1	98.2	96.9	95.9
Real ER (CPI-based), 2000=100	103.5	100.0	95.3	94.9	97.0	96.2	93.9	92.0
Real ER (PPI-based), 2000=100	104.4	100.0	95.5	94.6	95.3	93.3	93.5	94.1
PPP, HRK/EUR	4.1789	4.2423	4.3255	4.3488	4.4983	4.5353	4.5752	4.6232
Price level, EU(25)=100	55	56	58	59	59	61	62	63
Average monthly gross wages, HRK	4551	4869	5061	5366	5623	5985	6248	6613
Average monthly gross wages, EUR (ER)	600	638	678	724	743	799	844	903
Average monthly gross wages, EUR (PPP)	1089	1148	1170	1234	1250	1320	1366	1430
GDP nominal, HRK mn	141579	152519	165640	181231	198422	212826	229031	247000
Employed persons – LFS, th., average	1492.0	1553.0	1469.0	1528.0	1536.5	1562.5	1573.0	1548
GDP per employed person, HRK	94892	98209	112757	118607	129139	136209	145601	159561
GDP per empl. person, HRK at 2000 pr.	99339	98209	108400	110039	115229	117615	121858	129403
Unit labour costs, HRK, 2000=100	92.4	100.0	94.2	98.4	98.4	102.6	103.4	103.1
Unit labour costs, ER adj., 2000=100	93.1	100.0	96.3	101.4	99.4	104.6	106.7	107.5
Unit labour costs, PPP adj., Austria=100	58.69	63.32	60.06	61.54	59.27	63.55	63.77	62.79
Macedonia								
Producer price index, 2000=100	90.3	100.0	102.0	101.1	100.8	101.7	104.9	109.7
Consumer price index, 2000=100	94.5	100.0	105.5	107.4	108.7	108.2	108.8	112.3
GDP deflator, 2000=100	92.4	100.0	103.6	107.1	107.5	108.9	112.5	116.0
Exchange rate (ER), MKD/EUR	60.62	60.73	60.91	60.98	61.26	61.34	61.30	61.19
ER, nominal, 2000=100	99.8	100.0	100.3	100.4	100.9	101.0	100.9	100.8
Real ER (CPI-based), 2000=100	103.6	100.0	97.2	97.5	98.7	101.4	103.0	101.8
Real ER (PPI-based), 2000=100	105.9	100.0	99.5	99.9	101.3	102.8	104.0	103.9
PPP, MKD/EUR	21.61	22.69	23.02	23.23	23.27	23.08	22.87	23.27
Price level, EU(25)=100	36	37	38	38	38	38	37	38
Average monthly gross wages, MKD [7)]	16468	17958	17886	19025	19950	20771	21330	22950
Average monthly gross wages, EUR (ER)	272	296	294	312	326	339	348	375
Average monthly gross wages, EUR (PPP)	762	791	777	819	857	900	933	986
GDP nominal, MKD mn	209010	236389	233841	243970	251486	265257	284226	303305
Employed persons – LFS, th., average	545.2	549.8	599.3	561.3	545.1	523.0	545.3	570
GDP per employed person, MKD	383348	429919	390185	434620	461351	507189	521274	532114
GDP per empl. person, MKD at 2000 pr.	414910	429919	376587	405687	429253	465791	463366	458599
Unit labour costs, MKD, 2000=100	95.0	100.0	113.7	112.3	111.3	106.8	110.2	119.8
Unit labour costs, ER adj., 2000=100	95.2	100.0	113.4	111.8	110.3	105.7	109.2	118.9
Unit labour costs, PPP adj., Austria=100	34.01	35.87	40.07	38.45	37.28	36.40	36.97	39.36

7) Until 1999 wiiw estimate.

(Table A/2 ctd.)

(Table A/2 ctd.)

	1999	2000	2001	2002	2003	2004	2005	2006 prelim.
Albania								
Producer prices, manufact.ind., 2000=100	93.9	100.0	92.8	97.5	99.3	111.4	116.8	117.3
Consumer price index, 2000=100	99.9	100.0	103.1	108.5	110.9	114.2	116.9	119.6
GDP deflator, 2000=100	96.0	100.0	103.4	105.6	110.2	112.5	116.4	118.9
Exchange rate (ER), ALL/EUR	146.96	132.58	128.47	132.36	137.51	127.67	124.19	124.11
ER, nominal, 2000=100	110.8	100.0	96.9	99.8	103.7	96.3	93.7	93.6
Real ER (CPI-based), 2000=100	108.8	100.0	96.0	96.0	99.5	91.6	88.9	88.8
Real ER (PPI-based), 2000=100	113.2	100.0	105.7	103.0	105.7	89.5	86.7	90.3
PPP, ALL/EUR	51.487	52.550	53.716	54.280	56.649	58.658	59.250	60.615
Price level, EU(25)=100	35	40	42	41	41	46	48	49
Average monthly gross wages, ALL [8]	12708	14963	17218	19659	21325	24393	26808	27900
Average monthly gross wages, EUR (ER)	86	113	134	149	155	191	216	225
Average monthly gross wages, EUR (PPP)	247	285	321	362	376	416	452	460
GDP nominal, ALL mn	480581	532977	590282	628527	694018	752367	822035	880000
Reg. employment total, th., average [9]	1075	1067	1066	920	923	929	932	932
GDP per employed person, ALL	447009	499675	553946	683075	751765	810111	882382	944206
GDP per empl. person, ALL at 2000 pr.	491423	527497	565517	683075	720307	760409	800519	838546
Unit labour costs, ALL, 2000=100	89.9	98.6	105.8	100.0	102.9	111.5	116.4	115.6
Unit labour costs, ER adj., 2000=100	80.9	98.4	109.0	100.0	99.0	115.6	124.0	123.3
Unit labour costs, PPP adj., Austria=100	21.86	26.69	29.13	26.00	25.31	30.09	31.76	30.86
Bosnia and Herzegovina								
Producer price index, 2000=100	.	.	.	.	.	.	.	.
Consumer price index, 2000=100	95.3	100.0	103.2	104.5	105.7	106.4	109.5	117.6
GDP deflator, 2000=100	94.3	100.0	104.5	105.2	107.6	102.8	113.7	122.0
Exchange rate (ER), BAM/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	102.9	100.0	99.0	99.8	100.6	102.1	101.3	96.4
Real ER (PPI-based), 2000=100	.	.	.	.	.	.	.	.
PPP, BAM/EUR	0.748	0.771	0.793	0.794	0.811	0.757	0.817	0.878
Price level, EU(25)=100	38	39	41	41	41	39	42	45
Average monthly gross wages, BAM	503	539	598	660	717	748	798	874
Average monthly gross wages, EUR (ER)	257	276	306	337	367	382	408	447
Average monthly gross wages, EUR (PPP)	672	699	754	831	884	989	977	996
GDP nominal, BAM mn	9752.0	10908.0	11909.0	12650.0	13324.0	14658.0	15749.0	17800
Reg. employees total, th., average	641.1	635.7	633.1	631.7	635.9	636.2	640.4	650
GDP per employed person, BAM	15211	17158	18811	20027	20955	23039	24592	27385
GDP per empl. person, BAM at 2000 pr.	16127	17158	18004	19039	19482	22411	21631	22441
Unit labour costs, BAM, 2000=100	99.3	100.0	105.7	110.4	117.2	106.2	117.4	124.0
Unit labour costs, ER adj., 2000=100	99.3	100.0	105.7	110.4	117.2	106.2	117.4	124.0
Unit labour costs, PPP adj., Austria=100	28.15	28.47	29.66	30.11	31.42	29.04	31.56	32.56
Montenegro								
Producer price index, 2001=100	.	.	100.0	114.5	119.7	126.6	129.3	131.9
Consumer price index, 2000=100	83.2	100.0	121.8	141.2	150.7	154.3	157.9	162.6
GDP deflator, 2000=100	.	100.0	122.0	125.5	131.0	141.4	146.4	145.8
PPP, EUR/EUR	.	0.36	0.43	0.43	0.45	0.47	0.48	0.47
Price level, EU(25)=100	.	36	43	43	45	47	48	47
Average monthly gross wages, EUR	.	151	176	251	271	303	326	377
Average monthly gross wages, EUR (PPP)	.	419	410	585	602	644	680	803
GDP nominal, EUR mn	.	1022.2	1244.8	1301.5	1392.0	1565.1	1690.0	1759.0
Reg. employment total, th., average [10]	145.6	140.8	141.1	140.1	142.7	143.5	144.3	150
GDP per employed person, EUR	.	7262	8821	9290	9756	10908	11708	11727
GDP per empl. person, EUR at 2000 pr.	.	7262	7229	7405	7446	7715	7999	8044
Unit labour costs, EUR, 2000=100	.	100.0	117.3	163.3	175.2	188.9	196.4	225.8
Unit labour costs, ER adj., 2000=100	.	100.0	117.3	163.3	175.2	188.9	196.4	225.8
Unit labour costs, PPP adj., Austria=100	.	17.19	19.87	26.92	28.37	31.18	31.88	35.82

8) Excluding private sector. - 9) From 2002 according to census 2001. - 10) Excluding individual farmers.

(Table A/2 ctd.)

(Table A/2 ctd.)

	1999	2000	2001	2002	2003	2004	2005	2006 prelim.
Serbia								
Producer price index, 2000=100	49.4	100.0	187.7	204.2	213.6	233.1	266.1	301.5
Consumer price index, 2000=100	55.7	100.0	193.3	225.4	247.7	275.9	320.6	357.8
GDP deflator, 2000=100	55.3	100.0	188.0	234.8	263.0	296.4	341.2	394.3
Exchange rate (ER), RSD/EUR	11.74	15.04	59.46	60.68	65.05	72.57	82.91	84.06
ER, nominal, 2000=100	78.0	100.0	395.3	403.5	432.5	482.5	551.3	558.9
Real ER (CPI-based), 2000=100	137.5	100.0	209.0	186.7	185.7	190.0	190.8	177.2
Real ER (PPI-based), 2000=100	151.6	100.0	213.0	198.7	204.8	214.2	224.1	209.7
PPP, RSD/EUR	6.4	11.3	20.8	25.3	28.3	31.1	35.1	39.8
Price level, EU(25)=100	55	75	35	42	44	43	42	47
Average monthly gross wages, RSD [11]	1992	3799	8691	13260	16612	20555	25514	31745
Average monthly gross wages, EUR (ER)	79	72	146	219	255	283	308	378
Average monthly gross wages, EUR (PPP)	311	336	418	524	587	661	727	798
GDP nominal, RSD mn	210232	397656	783897	1020117	1171564	1431313	1750000	2139800
Employed persons - LFS, th., average	3103	3094	3106	3000	2919	2931	2733	2700
GDP per employed person, RSD	67758	128538	252414	340014	401414	488362	640225	792519
GDP per empl. person, RSD at 2000 pr.	122622	128538	134245	144836	152601	164763	187639	200978
Unit labour costs, RSD, 2000=100	55.0	100.0	219.0	309.8	368.3	422.1	460.1	534.4
Unit labour costs, ER adj., 2000=100	114.9	100.0	193.6	268.3	297.5	305.7	291.6	334.1
Unit labour costs, PPP adj., Austria=100	16.72	14.61	27.86	37.56	40.95	42.86	40.21	45.03
Russia								
Producer price index, 2000=100	68.2	100.0	119.1	133.0	153.8	190.7	230.2	258.7
Consumer price index, 2000=100	82.8	100.0	121.6	141.1	160.2	177.9	200.1	219.7
GDP deflator, 2000=100	72.6	100.0	116.5	134.7	153.5	183.5	219.5	253.6
Exchange rate (ER), RUB/EUR	26.239	26.029	26.130	29.647	34.686	35.814	35.218	34.079
ER, nominal, 2000=100	100.8	100.0	100.4	113.9	133.3	137.6	135.3	130.9
Real ER (CPI-based), 2000=100	119.5	100.0	84.4	84.2	88.4	84.0	75.0	67.6
Real ER (PPI-based), 2000=100	141.7	100.0	85.3	86.1	87.6	74.7	63.6	57.2
PPP, RUB/EUR	6.035	8.343	9.518	10.740	12.200	14.240	16.690	18.050
Price level, EU(25)=100	23	32	36	36	35	40	47	53
Average monthly gross wages, RUB	1523	2223	3240	4360	5499	6740	8550	10736
Average monthly gross wages, EUR (ER)	58	85	124	147	159	188	243	315
Average monthly gross wages, EUR (PPP)	252	266	340	406	451	473	512	595
GDP nominal, RUB mn	4823234	7305646	8943582	10830535	13243240	16966400	21598000	26600000
Employed persons - LFS, th., average	62945	65070	65123	66659	66432	67275	68169	68872
GDP per employed person, RUB	76626	112273	137334	162477	199350	252195	316830	386224
GDP per empl. person, RUB at 2000 pr.	105513	112273	117901	120598	129841	137438	144318	152275
Unit labour costs, RUB, 2000=100	72.9	100.0	138.8	182.6	213.8	247.6	299.2	356.0
Unit labour costs, ER adj., 2000=100	72.3	100.0	138.2	160.3	160.5	180.0	221.1	271.9
Unit labour costs, PPP adj., Austria=100	10.50	14.59	19.87	22.42	22.06	25.21	30.45	36.61
Ukraine								
Producer price index, 2000=100	82.8	100.0	108.7	112.0	120.5	145.2	169.4	185.5
Consumer price index, 2000=100	78.0	100.0	112.0	112.9	118.8	129.5	147.0	160.4
GDP deflator, 2000=100	81.2	100.0	109.9	115.6	124.9	143.8	172.5	188.3
Exchange rate (ER), UAH/EUR	4.393	5.029	4.814	5.030	6.024	6.609	6.389	6.335
ER, nominal, 2000=100	87.4	100.0	95.7	100.0	119.8	131.4	127.0	126.0
Real ER (CPI-based), 2000=100	109.9	100.0	87.3	92.4	107.3	110.2	95.9	89.1
Real ER (PPI-based), 2000=100	101.2	100.0	89.1	89.8	100.6	93.7	81.1	76.8
PPP, UAH/EUR	0.7680	0.9170	0.9874	1.0127	1.0907	1.2265	1.4415	1.5423
Price level, EU(25)=100	17	18	21	20	18	19	23	24
Average monthly gross wages, UAH	178	230	311	376	462	590	806	1043
Average monthly gross wages, EUR (ER)	40	46	65	75	77	89	126	165
Average monthly gross wages, EUR (PPP)	231	251	315	372	424	481	559	676
GDP nominal, UAH mn	130442	170070	204190	225810	267344	345113	424741	496000
Employed persons - LFS, th., average	20048.2	20175.0	19971.5	20091.2	20163.3	20295.7	20680.0	20800
GDP per employed person, UAH	6506	8430	10224	11239	13259	17004	20539	23846
GDP per empl. person, UAH at 2000 pr.	8010	8430	9299	9725	10620	11827	11905	12665
Unit labour costs, UAH, 2000=100	81.2	100.0	122.5	141.8	159.4	182.6	248.0	301.6
Unit labour costs, ER adj., 2000=100	92.9	100.0	128.0	141.7	133.1	138.9	195.2	239.4
Unit labour costs, PPP adj., Austria=100	10.59	11.44	14.43	15.55	14.35	15.26	21.09	25.28

11) Until 2000 wiiw estimate.

(Table A/2 ctd.)

(Table A/2 ctd.)

	1999	2000	2001	2002	2003	2004	2005	2006 prelim.
Austria								
Producer price index, 2000=100	96.2	100.0	101.5	101.1	102.7	107.7	110.0	113.2
Consumer price index, 2000=100	97.7	100.0	102.7	104.5	106.0	108.2	110.7	112.4
GDP deflator, 2000=100	98.3	100.0	101.8	103.2	104.6	106.4	108.4	109.8
Exchange rate (ER), EUR-ATS/EUR	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000
PPP, EUR-ATS/EUR	1.0644	1.0394	1.0540	1.0560	1.0375	1.0294	1.0319	1.0471
Price level, EU(25)=100	106	104	105	106	104	103	103	105
Average monthly gross wages, EUR-ATS	2334	2390	2428	2483	2532	2580	2622	2695
Average monthly gross wages, EUR (ER)	2334	2390	2428	2483	2532	2580	2622	2695
Average monthly gross wages, EUR (PPP)	2193	2299	2303	2351	2440	2507	2541	2574
GDP nominal, EUR-ATS mn	200025	210392	215878	220841	226243	235819	245103	256132
Employed persons - LFS, th., average 12)	3665.9	3685.0	3712.4	3763.5	3795.4	3744.0	3824.4	3927.7
GDP per employed person, EUR-ATS	54563	57094	58150	58679	59610	62986	64089	65212
GDP per empl. person, EUR-ATS at 2000 pr.	55527	57094	57143	56850	56988	59180	59120	59408
Unit labour costs, EUR, 2000=100	100.4	100.0	101.5	104.3	106.1	104.2	105.9	108.4
Unit labour costs, ER adj., 2000=100	100.4	100.0	101.5	104.3	106.1	104.2	105.9	108.4
Unit labour costs, PPP adjusted	0.52	0.52	0.53	0.54	0.55	0.54	0.55	0.57

12) From 2004 new methodology.

ER = Exchange Rate, PPP = Purchasing Power Parity, Price level: PPP / ER.

EUR-ATS: ATS divided by fixed parity before 1999 (1€ = 13.7603 ATS). EUR-SIT: SIT divided by fixed parity (1 € = 239.64 SIT)

For the 10 new EU member states and 3 candidate countries PPPs are taken from Eurostat. For the rest of the countries PPPs have been estimated by wiiw using the OECD benchmark PPPs for 2002 and extrapolated with GDP price deflators. PPPs for Albania, Bosnia and Herzegovina, Montenegro and Serbia are estimates of wiiw.

Sources: National statistics; WIFO; Eurostat; Purchasing power parities and real expenditures, 2002 benchmark year, OECD 2005; wiiw estimates.

Table A3

Indicators of macro-competitiveness, 1999-2006

annual changes in %

	1999	2000	2001	2002	2003	2004	2005	2006 prelim.	2000-06 average
Czech Republic									
GDP deflator	2.8	1.5	4.9	2.8	0.9	3.6	0.7	2.4	2.4
Exchange rate (ER), CZK/EUR	2.0	-3.4	-4.3	-9.6	3.3	0.2	-6.6	-4.8	-3.7
Real ER (CPI-based)	1.1	-5.3	-6.6	-9.4	5.3	-0.5	-6.4	-5.1	-4.1
Real ER (PPI-based)	0.4	-4.0	-5.8	-9.7	4.4	-3.0	-5.2	-2.1	-3.7
Average gross wages, CZK	8.4	6.4	8.7	7.3	6.6	6.6	5.4	6.2	6.7
Average gross wages, real (PPI based)	7.4	1.4	5.7	7.8	7.0	0.9	2.4	4.5	4.2
Average gross wages, real (CPI based)	6.2	2.4	3.8	5.4	6.5	3.7	3.5	3.6	4.1
Average gross wages, EUR (ER)	6.3	10.2	13.5	18.6	3.2	6.4	13.0	11.6	10.8
Employed persons (LFS) [1]	-2.1	-0.7	0.4	0.8	-0.7	-0.6	1.2	1.0	0.2
GDP per empl. person, CZK at 2000 pr.	3.5	4.4	2.1	1.1	4.3	4.8	4.8	4.9	3.7
Unit labour costs, CZK at 2000 prices	4.8	1.9	6.5	6.1	2.2	1.8	0.6	1.3	2.9
Unit labour costs, ER (EUR) adjusted	2.7	5.6	11.2	17.4	-1.1	1.6	7.8	6.4	6.8
Hungary									
GDP deflator	8.4	9.7	8.4	8.0	5.7	4.3	2.1	4.3	6.0
Exchange rate (ER), HUF/EUR	4.9	2.9	-1.3	-5.3	4.3	-0.7	-1.4	6.5	0.6
Real ER (CPI-based)	-3.5	-4.5	-7.6	-8.2	1.6	-5.1	-2.8	4.8	-3.2
Real ER (PPI-based)	-0.8	-3.9	-5.1	-4.2	2.5	-1.9	-1.2	4.3	-1.4
Average gross wages, HUF	13.9	13.5	18.2	18.3	12.0	6.1	8.8	7.7	12.0
Average gross wages, real (PPI based)	8.4	1.7	12.3	20.4	9.4	2.5	4.3	0.9	7.2
Average gross wages, real (CPI based)	3.5	3.4	8.2	12.3	7.0	-0.7	5.0	3.7	5.5
Average gross wages, EUR (ER)	8.6	10.4	19.7	25.0	7.4	6.8	10.4	1.1	11.3
Employed persons (LFS) [2]	0.6	1.2	0.3	0.1	1.3	-0.5	0.0	0.8	0.5
GDP per empl. person, HUF at 2000 pr.	3.6	3.9	5.8	4.2	2.7	5.5	4.2	3.2	4.2
Unit labour costs, HUF at 2000 prices	10.0	9.3	11.7	13.5	9.0	0.6	4.5	4.4	7.5
Unit labour costs, ER (EUR) adjusted	4.9	6.2	13.1	19.9	4.5	1.3	6.0	-2.0	6.8
Poland									
GDP deflator	6.1	7.3	3.5	2.2	0.4	4.1	2.6	1.0	3.0
Exchange rate (ER), PLN/EUR	7.7	-5.1	-8.5	5.1	14.1	3.1	-11.2	-3.2	-1.2
Real ER (CPI-based)	1.6	-12.2	-11.4	5.3	15.4	1.7	-11.2	-2.1	-2.5
Real ER (PPI-based)	1.3	-8.2	-8.9	3.5	11.8	-1.4	-7.8	-1.1	-2.0
Average gross wages, PLN [3]	10.6	11.6	8.0	2.6	4.2	4.0	3.8	5.1	5.6
Average gross wages, real (PPI based)	30.3	3.5	6.3	1.6	1.5	-2.8	3.1	2.7	2.2
Average gross wages, real (CPI based)	28.3	1.3	2.4	0.7	3.3	0.5	1.7	4.0	2.0
Average gross wages, EUR (ER)	27.8	17.6	18.1	-2.4	-8.7	0.9	17.0	8.6	6.8
Employed persons (LFS) [4]	-3.9	-1.6	-2.2	-3.0	0.6	1.3	2.3	3.4	0.1
GDP per empl. person, PLN at 2000 pr.	8.7	5.9	3.4	4.5	3.2	3.9	1.2	2.3	3.5
Unit labour costs, PLN at 2000 prices	1.7	5.4	4.5	-1.9	0.9	0.1	2.7	2.7	2.0
Unit labour costs, ER (EUR) adjusted	-5.6	11.1	14.2	-6.6	-11.5	-2.9	15.6	6.1	3.2
Slovak Republic									
GDP deflator	7.5	9.7	5.0	4.6	4.7	6.0	2.4	3.2	5.1
Exchange rate (ER), SKK/EUR	11.4	-3.5	1.7	-1.4	-2.8	-3.5	-3.6	-3.5	-2.4
Real ER (CPI-based)	1.9	-12.2	-3.0	-2.6	-8.7	-8.3	-4.1	-5.7	-6.4
Real ER (PPI-based)	6.2	-9.1	-3.4	-4.0	-9.8	-4.5	-3.8	-6.9	-6.0
Average gross wages, SKK	7.2	6.5	8.2	9.3	6.3	10.2	9.2	8.8	8.3
Average gross wages, real (PPI based)	2.8	-3.8	1.6	7.0	-1.8	6.5	4.3	0.4	1.9
Average gross wages, real (CPI based)	-3.0	-4.9	1.0	5.8	-2.0	2.5	6.3	4.2	1.8
Average gross wages, EUR (ER)	-3.7	10.4	6.4	10.8	9.4	14.1	13.3	12.8	11.0
Employed persons (LFS)	-3.0	-1.4	1.0	0.2	1.8	0.3	2.1	3.8	1.1
GDP per empl. person, SKK at 2000 pr.	3.4	2.2	2.2	4.0	2.3	5.1	3.8	3.6	3.3
Unit labour costs, SKK at 2000 prices	3.7	4.3	5.9	5.1	3.9	4.8	5.1	5.1	4.9
Unit labour costs, ER (EUR) adjusted	-6.9	8.0	4.1	6.6	6.9	8.6	9.1	8.9	7.4
Slovenia									
GDP deflator	6.4	5.4	8.7	7.9	5.7	3.3	1.5	2.4	5.0
Exchange rate (ER), EUR-SIT/EUR	4.0	5.9	5.9	4.2	3.3	2.2	0.3	0.0	3.1
Real ER (CPI-based)	-0.9	-0.9	-0.1	-1.1	-0.3	0.8	0.0	-0.3	-0.3
Real ER (PPI-based)	1.2	2.6	-1.6	-1.5	1.4	0.2	2.1	2.2	0.8
Average gross wages, EUR-SIT	9.6	10.6	11.9	9.7	7.5	5.7	3.6	4.6	7.6
Average gross wages, real (PPI based)	7.3	2.8	2.8	4.4	4.9	1.3	0.9	2.2	2.8
Average gross wages, real (CPI based)	3.3	1.6	3.3	2.1	1.8	2.0	1.1	2.0	2.0
Average gross wages, EUR (ER)	5.4	4.5	5.7	5.3	4.1	3.4	3.3	4.6	4.4
Employed persons (LFS)	-1.7	1.7	1.7	-0.7	-1.4	5.1	0.6	1.2	1.2
GDP per empl. person, EUR-SIT at 2000 pr.	7.2	2.4	1.0	4.1	4.1	-0.7	3.4	3.8	2.6
Unit labour costs, EUR-SIT at 2000 prices	2.2	8.1	10.9	5.4	3.3	6.4	0.2	0.8	4.9
Unit labour costs, ER (EUR) adjusted	-1.7	2.1	4.7	1.2	0.0	4.1	-0.1	0.8	1.8

1) From 2002 according to census 2001. - 2) From 1999 according to census 2001. - 3) From 1999 broader wage coverage. - 4) From 2003 according to census 2002.

(Table A/3 ctd.)

Table A3 (ctd.)

	1999	2000	2001	2002	2003	2004	2005	2006 prelim.	2000-06 average
Bulgaria									
GDP deflator	3.7	6.7	6.7	3.8	2.2	4.8	3.7	7.7	5.1
Exchange rate (ER), BGN/EUR	-0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	-2.2	-7.6	-4.8	-3.5	-0.3	-3.8	-2.7	-4.7	-4.0
Real ER (PPI-based)	-4.1	-11.3	-2.5	-1.7	-4.1	-3.5	-2.2	-4.4	-4.3
Average gross wages, BGN	9.7	11.7	6.9	7.3	6.1	7.0	10.7	9.7	8.5
Average gross wages, real (PPI based)	6.7	-5.0	3.0	6.1	1.1	0.9	3.6	0.2	1.4
Average gross wages, real (CPI based)	6.9	1.2	-0.4	1.4	3.7	0.8	5.4	2.2	2.0
Average gross wages, EUR (ER)	10.6	11.7	6.9	7.3	6.1	7.0	10.7	9.7	8.5
Employed persons (LFS)	-5.3	-2.8	-3.4	1.5	3.5	3.1	2.0	4.0	1.1
GDP per empl. person, BGN at 2000 pr.	8.0	8.4	7.8	3.3	1.0	2.5	3.7	2.1	4.1
Unit labour costs, BGN at 2000 prices	1.6	3.0	-0.8	3.9	5.0	4.4	6.8	7.4	4.2
Unit labour costs, ER (EUR) adjusted	2.4	3.0	-0.8	3.9	5.0	4.4	6.8	7.4	4.2
Romania									
GDP deflator	47.8	44.2	37.4	23.4	24.0	15.0	12.0	6.7	22.6
Exchange rate (ER), ROL/EUR	63.1	22.5	30.4	20.1	20.2	7.9	-10.6	-2.7	11.7
Real ER (CPI-based)	13.2	-14.3	-0.9	0.0	6.2	-1.4	-16.2	-6.7	-5.1
Real ER (PPI-based)	12.2	-16.8	-4.5	-2.9	1.1	-7.3	-15.4	-8.4	-7.9
Average gross wages, ROL	45.7	47.8	48.6	26.1	24.8	23.3	17.0	17.5	28.7
Average gross wages, real (PPI based)	0.9	-3.7	7.6	2.5	4.4	3.5	5.9	5.8	3.7
Average gross wages, real (CPI based)	0.0	1.5	10.5	2.9	8.2	10.2	7.3	10.3	7.2
Average gross wages, EUR (ER)	-10.7	20.7	13.9	5.0	3.8	14.2	30.9	20.8	15.3
Employed persons (LFS) [5)]	-0.6	-0.3	-0.6	.	-0.1	-0.7	-0.1	0.0	-0.3
GDP per empl. person, ROL at 2000 pr. [5)]	0.1	2.4	6.4	.	5.3	9.2	4.2	7.5	5.8
Unit labour costs, ROL at 2000 prices [5)]	45.6	44.4	39.7	.	18.4	12.9	12.3	9.3	22.1
Unit labour costs, ER (EUR) adjusted [5)]	-10.7	17.9	7.1	.	-1.4	4.6	25.6	12.4	10.7
Estonia									
GDP deflator	4.5	5.4	5.3	3.8	2.3	2.1	6.8	5.5	4.4
Exchange rate (ER), EEK/EUR	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	-2.9	-2.0	-3.4	-1.5	0.6	-0.8	-1.9	-2.1	-1.6
Real ER (PPI-based)	-0.3	-0.6	-3.1	-1.0	0.4	-0.6	2.4	0.3	-0.3
Average gross wages, EEK [6)]	10.4	10.5	12.3	11.5	9.4	8.4	10.8	15.2	11.1
Average gross wages, real (PPI based)	11.8	5.4	7.6	11.1	9.2	5.3	8.5	10.4	8.2
Average gross wages, real (CPI based)	6.9	6.3	6.1	7.6	8.0	5.2	6.4	10.3	7.1
Average gross wages, EUR (ER)	11.4	10.5	12.3	11.5	9.4	8.4	10.8	15.2	11.1
Employed persons (LFS)	-4.5	-1.2	0.9	1.4	1.5	0.2	2.0	6.4	1.6
GDP per empl. person, EEK at 2000 pr.	5.0	9.1	9.6	6.6	5.5	7.9	8.3	4.8	7.4
Unit labour costs, EEK at 2000 prices	5.1	1.3	2.4	4.6	3.7	0.5	2.3	9.9	3.5
Unit labour costs, ER (EUR) adjusted	6.0	1.3	2.4	4.6	3.7	0.5	2.3	9.9	3.5
Latvia									
GDP deflator	4.4	2.8	1.7	3.6	3.6	6.9	9.2	10.1	5.4
Exchange rate (ER), LVL/EUR	-5.7	-10.2	0.5	3.5	10.7	4.1	4.7	0.0	1.7
Real ER (CPI-based)	-6.8	-10.8	0.2	3.7	9.7	0.1	0.3	-4.3	-0.3
Real ER (PPI-based)	-2.4	-6.9	-0.1	1.9	7.9	-2.0	1.6	-5.2	-0.5
Average gross wages, LVL	5.8	6.1	6.3	8.8	11.3	9.6	16.5	20.0	11.1
Average gross wages, real (PPI based)	10.2	5.4	4.6	7.7	7.8	0.9	8.1	8.8	6.2
Average gross wages, real (CPI based)	3.3	3.4	3.7	6.8	8.1	3.2	9.2	12.4	6.6
Average gross wages, EUR (ER)	12.2	18.1	5.8	5.1	0.5	5.3	11.2	20.0	9.2
Employed persons (LFS)	-1.8	-2.8	2.2	2.8	1.8	1.1	1.8	5.4	1.7
GDP per empl. person, LVL at 2000 pr.	6.6	10.0	5.7	3.6	5.3	7.5	8.3	6.0	6.6
Unit labour costs, LVL at 2000 prices	-0.8	-3.6	0.6	5.0	5.7	1.9	7.6	13.2	4.2
Unit labour costs, ER (EUR) adjusted	5.2	7.4	0.1	1.5	-4.5	-2.0	2.7	13.2	2.5
Lithuania									
GDP deflator	-0.6	1.0	-0.5	0.2	-1.1	2.8	5.9	7.0	2.2
Exchange rate (ER), LTL/EUR	-4.9	-13.4	-3.1	-3.5	-0.2	0.0	0.0	0.0	-3.0
Real ER (CPI-based)	-4.6	-12.6	-2.2	-1.8	3.0	0.9	-0.5	-1.5	-2.2
Real ER (PPI-based)	-7.1	-22.1	1.1	-1.3	0.9	-3.5	-6.2	-2.6	-5.2
Average gross wages, LTL	6.2	-1.7	1.2	3.2	5.8	7.2	12.2	16.3	6.2
Average gross wages, real (PPI based)	4.4	-15.2	4.3	6.2	6.3	1.1	0.6	8.3	1.4
Average gross wages, real (CPI based)	5.4	-2.7	-0.1	2.9	7.1	5.9	9.2	12.1	4.8
Average gross wages, EUR (ER)	11.7	13.5	4.4	6.9	6.0	7.2	12.2	16.3	9.4
Employed persons (LFS)	-8.8	-4.0	-3.3	4.0	2.3	-0.1	2.6	1.9	0.4
GDP per empl. person, LTL at 2000 pr.	7.8	8.3	10.0	2.6	8.0	7.1	4.7	5.4	6.6
Unit labour costs, LTL at 2000 prices	-1.5	-9.2	-8.0	0.6	-2.1	0.0	7.1	10.3	-0.4
Unit labour costs, ER (EUR) adjusted	3.6	4.8	-5.1	4.2	-1.9	0.0	7.1	10.3	2.7

5) In 2002 no comparable growth rates available due to methodological break in employment. Average 2000-2006 is calculated without 2002. - 6) From 1999 excluding compensations from Health Insurance Fund.

(Table A/3 ctd.)

Table A3 (ctd.)

	1999	2000	2001	2002	2003	2004	2005	2006 prelim.	2000-06 average
Croatia									
GDP deflator	3.8	4.7	4.0	3.6	4.0	3.3	3.2	3.2	3.7
Exchange rate (ER), HRK/EUR	6.2	0.7	-2.2	-0.8	2.1	-0.9	-1.3	-1.0	-0.5
Real ER (CPI-based)	3.1	-3.3	-4.7	-0.5	2.3	-0.9	-2.4	-2.0	-1.7
Real ER (PPI-based)	2.9	-4.2	-4.5	-1.0	0.8	-2.1	0.2	0.6	-1.5
Average gross wages, HRK	10.2	7.0	3.9	6.0	4.8	6.4	4.4	5.8	5.5
Average gross wages, real (PPI based)	7.4	-2.5	0.3	6.5	2.8	2.8	1.4	2.9	2.0
Average gross wages, real (CPI based)	5.7	0.7	-0.9	4.3	2.9	4.3	1.0	2.6	2.1
Average gross wages, EUR (ER)	3.7	6.2	6.3	6.9	2.6	7.4	5.7	7.0	6.0
Employed persons (LFS)	-3.4	4.1	-5.4	4.0	0.6	1.7	0.7	-1.6	0.5
GDP per empl. person, HRK at 2000 pr.	2.6	-1.1	10.4	1.5	4.7	2.1	3.6	6.2	3.8
Unit labour costs, HRK at 2000 prices	7.4	8.2	-5.8	4.4	0.1	4.3	0.8	-0.3	1.6
Unit labour costs, ER (EUR) adjusted	1.1	7.4	-3.7	5.3	-2.0	5.2	2.1	0.7	2.1
Macedonia									
GDP deflator	2.8	8.2	3.6	3.4	0.3	1.3	3.3	3.1	3.3
Exchange rate (ER), MKD/EUR	-0.7	0.2	0.3	0.1	0.5	0.1	-0.1	-0.2	0.1
Real ER (CPI-based)	1.1	-3.5	-2.8	0.4	1.2	2.7	1.6	-1.1	-0.3
Real ER (PPI-based)	-1.2	-5.6	-0.5	0.4	1.3	1.5	1.2	-0.1	-0.3
Average gross wages, MKD	2.9	9.0	-0.4	6.4	4.9	4.1	2.7	7.6	4.9
Average gross wages, real (PPI based)	3.0	-1.5	-2.4	7.3	5.2	3.2	-0.5	3.0	2.0
Average gross wages, real (CPI based)	3.6	3.1	-5.6	4.5	3.6	4.5	2.2	4.3	2.3
Average gross wages, EUR (ER)	3.6	8.8	-0.7	6.3	4.4	4.0	2.8	7.8	4.7
Employed persons (LFS)	1.0	0.8	9.0	-6.3	-2.9	-4.1	4.3	4.5	0.6
GDP per empl. person, MKD at 2000 pr.	3.3	3.6	-12.4	7.7	5.8	8.5	-0.5	-1.0	1.4
Unit labour costs, MKD at 2000 prices	-0.4	5.2	13.7	-1.3	-0.9	-4.1	3.2	8.7	3.4
Unit labour costs, ER (EUR) adjusted	0.4	5.0	13.4	-1.4	-1.4	-4.2	3.3	8.9	3.2
Albania									
GDP deflator	1.8	4.1	3.4	2.1	4.4	2.1	3.5	2.2	3.1
Exchange rate (ER), ALL/EUR	-12.9	-9.8	-3.1	3.0	3.9	-7.2	-2.7	-0.1	-2.4
Real ER (CPI-based)	-12.2	-8.1	-4.0	0.0	3.6	-7.9	-2.9	-0.2	-2.9
Real ER (PPI-based)	-15.8	-11.7	5.7	-2.5	2.6	-15.3	-3.1	4.1	-3.2
Average gross wages, ALL	10.4	17.7	15.1	14.2	8.5	14.4	9.9	4.1	11.9
Average gross wages, real (PPI based)	7.5	10.5	24.0	8.6	6.5	2.0	4.8	3.7	8.4
Average gross wages, real (CPI based)	10.0	17.7	11.6	8.5	6.1	11.1	7.3	1.7	9.1
Average gross wages, EUR (ER)	26.8	30.5	18.8	10.8	4.4	23.2	13.0	4.1	14.6
Registered employment, total [7)]	-1.9	-0.8	-0.1	-0.1	-6.9	0.6	0.3	0.0	-1.0
GDP per empl. person, ALL at 2000 pr.	15.4	7.3	7.2	4.4	13.6	5.6	5.3	4.8	6.8
Unit labour costs, ALL at 2000 prices	-4.4	9.7	7.3	9.4	-4.5	8.4	4.4	-0.6	4.7
Unit labour costs, ER (EUR) adjusted	9.8	21.6	10.8	6.2	-8.1	16.7	7.3	-0.6	7.3
Bosnia and Herzegovina									
GDP deflator	8.1	6.0	4.5	0.7	2.3	-4.4	10.6	7.3	3.7
Exchange rate (ER), BAM/EUR	-0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	-5.0	-2.9	-1.0	0.8	0.8	1.4	-0.7	-4.8	-0.9
Real ER (PPI-based)	.	.	.	.	.	.	.	.	.
Average gross wages, BAM	10.8	7.2	10.9	10.4	8.6	4.3	6.7	9.5	8.2
Average gross wages, real (PPI based)	.	.	.	.	.	.	.	.	.
Average gross wages, real (CPI based)	4.9	2.2	7.5	9.0	7.5	3.6	3.7	2.0	5.0
Average gross wages, EUR (ER)	10.8	7.2	10.9	10.4	8.6	4.3	6.7	9.5	8.2
Registered employees, total	.	-0.8	-0.4	-0.2	0.7	0.1	0.7	1.5	0.2
GDP per empl. person, BAM at 2000 pr.	.	6.4	4.9	5.7	2.3	15.0	-3.5	3.7	4.8
Unit labour costs, BAM at 2000 prices	.	0.7	5.7	4.4	6.2	-9.3	10.5	5.5	3.2
Unit labour costs, ER (EUR) adjusted	.	0.7	5.7	4.4	6.2	-9.3	10.5	5.5	3.2
Montenegro									2001-05
GDP deflator	.	.	22.0	2.8	4.4	7.9	3.5	-0.4	6.5
Average gross wages, EUR	.	.	16.8	42.6	7.8	11.7	7.8	15.6	16.5
Average gross wages, real (PPI based)	.	.	.	24.5	3.2	5.6	5.6	13.3	.
Average gross wages, real (CPI based)	.	.	-4.1	23.0	1.1	9.1	5.4	12.2	7.4
Registered employment, total	.	-3.3	0.2	-0.7	1.8	0.6	0.6	3.9	1.1
GDP per empl. person, EUR	.	.	21.5	5.3	5.0	11.8	7.3	0.2	8.3
GDP per empl. person, EUR at 2000 pr.	.	.	-0.4	2.4	0.6	3.6	3.7	0.6	1.7
Unit labour costs, ER (EUR) adjusted	.	.	17.3	39.3	7.2	7.8	4.0	14.9	14.5

7) From 2002 according to census 2001.

(Table A/3 ctd.)

Table A3 (ctd.)

	1999	2000	2001	2002	2003	2004	2005	2006 prelim.	2000-06 average
Serbia									
GDP deflator	.	81.0	88.0	24.9	12.1	12.7	15.1	15.6	32.4
Exchange rate (ER), RSD/EUR	.	28.2	295.3	2.1	7.2	11.6	14.2	1.4	32.5
Real ER (CPI-based)	.	-27.3	109.0	-10.7	-0.5	2.3	0.5	-7.2	3.7
Real ER (PPI-based)	.	-34.0	113.0	-6.7	3.1	4.6	4.6	-6.4	4.7
Average gross wages, RSD	.	90.7	128.8	52.6	25.3	23.7	24.1	24.4	48.5
Average gross wages, real (PPI based)	.	-5.9	21.9	40.2	19.8	13.4	8.7	9.8	14.7
Average gross wages, real (CPI based)	.	6.2	18.4	30.9	14.0	11.1	6.8	11.5	13.9
Average gross wages, EUR (ER)	.	-8.8	102.2	49.5	16.9	10.9	8.6	22.7	25.0
Employed persons (LFS)	.	-0.3	0.4	-3.4	-2.7	0.4	-6.7	-1.2	-2.0
GDP per empl. person, RSD at 2000 pr.	.	4.8	4.4	7.9	5.4	8.0	13.9	7.1	7.3
Unit labour costs, RSD at 2000 prices	.	81.9	119.0	41.4	18.9	14.6	9.0	16.2	38.4
Unit labour costs, ER (EUR) adjusted	.	-13.0	93.6	38.6	10.9	2.7	-4.6	14.6	16.5
Russia									
GDP deflator	72.4	37.7	16.5	15.7	14.0	19.5	19.6	15.5	19.6
Exchange rate (ER), RUB/EUR	137.2	-0.8	0.4	13.5	17.0	3.3	-1.7	-3.2	3.8
Real ER (CPI-based)	29.2	-16.3	-15.6	-0.2	5.0	-5.0	-10.7	-9.9	-7.8
Real ER (PPI-based)	48.3	-29.4	-14.7	0.9	1.8	-14.8	-14.8	-10.0	-12.1
Average gross wages, RUB	44.8	46.0	45.7	34.6	26.1	22.6	26.9	25.6	32.2
Average gross wages, real (PPI based)	-8.9	-0.4	22.4	20.4	9.1	-1.2	5.1	11.7	9.3
Average gross wages, real (CPI based)	-22.0	20.9	19.9	16.0	11.0	10.4	12.8	14.4	15.0
Average gross wages, EUR (ER)	-38.9	47.2	45.2	18.6	7.8	18.7	29.0	29.8	27.3
Employed persons (LFS)	7.7	3.4	0.1	2.4	-0.3	1.3	1.3	1.0	1.3
GDP per empl. person, RUB at 2000 pr.	-1.2	6.4	5.0	2.3	7.7	5.9	5.0	5.5	5.4
Unit labour costs, RUB at 2000 prices	46.5	37.2	38.8	31.6	17.1	15.8	20.8	19.0	25.4
Unit labour costs, ER (EUR) adjusted	-38.2	38.3	38.2	15.9	0.1	12.1	22.9	23.0	20.8
Ukraine									
GDP deflator	27.4	23.1	9.9	5.1	8.0	15.2	20.0	9.1	12.8
Exchange rate (ER), UAH/EUR	58.7	14.5	-4.3	4.5	19.8	9.7	-3.3	-0.8	5.4
Real ER (CPI-based)	30.9	-9.0	-12.7	5.8	16.1	2.8	-13.0	-7.1	-3.0
Real ER (PPI-based)	20.3	-1.2	-10.9	0.9	11.9	-6.9	-13.4	-5.3	-3.9
Average gross wages, UAH	16.0	29.6	35.2	21.0	22.8	27.6	36.7	29.4	28.8
Average gross wages, real (PPI based)	-11.5	7.3	24.4	17.5	14.1	5.9	17.2	18.1	14.8
Average gross wages, real (CPI based)	-5.4	1.1	20.7	20.0	16.7	17.0	20.5	18.6	16.2
Average gross wages, EUR (ER)	-26.9	13.3	41.2	15.8	2.5	16.3	41.4	30.5	22.2
Employed persons (LFS)	-12.8	0.6	-1.0	0.6	0.4	0.7	1.9	0.6	0.5
GDP per empl. person, UAH at 2000 pr.	14.5	5.2	10.3	4.6	9.2	11.4	0.7	6.4	6.8
Unit labour costs, UAH at 2000 prices	1.3	23.2	22.5	15.7	12.5	14.5	35.8	21.6	20.6
Unit labour costs, ER (EUR) adjusted	-36.2	7.6	28.0	10.7	-6.1	4.4	40.5	22.6	14.5
Austria									
GDP deflator	0.6	1.8	1.8	1.4	1.3	1.7	1.9	1.3	1.6
Exchange rate (ER), EUR-ATS/EUR	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Average gross wages, EUR-ATS	2.3	2.4	1.6	2.3	2.0	1.9	1.6	2.8	2.1
Average gross wages, real (PPI based)	3.1	-1.5	0.1	2.7	0.4	-2.8	-0.5	-0.1	-0.3
Average gross wages, real (CPI based)	1.7	0.0	-1.1	0.5	0.6	-0.2	-0.7	1.3	0.0
Average gross wages, EUR (ER)	3.2	2.4	1.6	2.3	2.0	1.9	1.6	2.8	2.1
Employed persons (LFS) 8)	1.1	0.5	0.7	1.4	0.8	0.0	2.1	2.7	1.2
GDP per empl. person, EUR-ATS at 2000 pr.	2.2	2.8	0.1	-0.5	0.2	2.4	-0.1	0.5	0.8
Unit labour costs, EUR-ATS at 2000 prices	0.1	-0.4	1.5	2.8	1.7	-0.5	1.7	2.3	1.3
Unit labour costs, ER (EUR) adjusted	1.0	-0.4	1.5	2.8	1.7	-0.5	1.7	2.3	1.3

8) From 2004 new methodology.

Note: In terms of real exchange rates a minus sign means real appreciation.

ER = Exchange Rate, PPI = Producer price index, CPI = Consumer price index.

Sources: National statistics and wiiw estimates.

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