Wiener Institut für
Internationale
Wirtschaftsvergleiche

The Vienna Institute
for International
Economic Studies

wiiw Research Reports | 325

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

Leon Podkaminer, Vladimir Gligorov et al.

Strong Growth, Driven by Exports in the NMS and by Consumption in the Future EU Members

February 2006

Leon Podkaminer,
Vladimir Gligorov et al.

Strong Growth, Driven by Exports in the NMS and by Consumption in the Future EU Members

Contents

Part B: Southeast European countries

Country reports

Country reports

Tables and Figures

Part A

Part B

Tables and Figures (Country reports)

Tables (Appendix)

The authors of this report wish to thank Boriana Assenova, Sebastian Leitner, Beate Muck, Renate Prasch, Hana Rusková, Monika Schwarzhappel and Barbara Swierczek (all wiiw) for their excellent statistical support.

Summary

In 2005 most of the new EU member states (NMS) performed even better than in 2004. Apparently, the NMS have successfully managed the EU accession and gained the ability to grow fast despite the anaemic performance of the old EU, and despite the ongoing cost deflation in Germany. Only in Poland was growth markedly slower than in 2004 (but much higher than in the euro area all the same). But even Poland's slowdown cannot be linked to the weakening growth in the old EU.

In 2006 the NMS are expected to perform quite well again, even if growth in the old EU remains unimpressive and prices of energy stay fairly high. The recovery in the old EU forecast for 2007 is supposed to be supporting firm growth in the NMS. In addition, by 2007 fairly high EU transfers should be allowing for a significant expansion of investment in the NMS public and private sectors.

Net exports contributed strongly to GDP growth in all NMS (except Lithuania) in 2005. FDI inflows reached a record high. Also in 2006-07 net exports are expected to contribute positively to growth, yet less significantly. Rising private consumption and investment should be playing a stronger role than in 2005.

In the course of 2005 growth in industrial production resumed, but it was much less buoyant than in 2004. With continuing appreciation of the domestic currencies, the exchange-rate adjusted unit labour costs are growing, as yet without adversely affecting exports, which continue to expand at double-digit rates. This is a sign of success of the ongoing restructuring of the industrial sector. Interestingly, employment, also in industry, rose in 2005 (except in Hungary). This somewhat lowered the unemployment rates. Still, unemployment continues to be very high in Poland and Slovakia.

After a temporary acceleration in 2004, inflation slowed down in 2005 to very low levels and is no longer a serious problem. Despite this the National Banks in Poland and Hungary maintain rather high interest rates. Hungary and Slovakia (which decided to enter the ERM-2 in late 2005) will have to start consolidating their public finances. In both countries the consolidations may be postponed to 2007 for political reasons.

In Southeast Europe, growth has on average remained strong, though it has come down in Serbia and Montenegro, the two best performers in 2004. Rising consumption was the main contributor to GDP growth. That was partly the consequence of the increased soundness of the banking system, but also of the improved expectations of growth in the short and medium term.

In the next two years growth should continue, though the volatility is still significant in this region and there are also short-term policy measures that could slow down the recovery. An expectation is that significant inflows of foreign investments will start to translate into growing industrial production, which has been lagging behind in the past. Also, employment is still declining, though unemployment rates have stabilized or are declining.

Exports of goods and services grew strongly throughout the region, while imports expanded even more in Romania, Bulgaria and Albania. In the rest, net exports contributed positively to GDP growth. In some cases, a reversal can be expected in the next two years.

Price stability and fiscal balance have mostly been preserved, except in the case of Serbia, which has seen accelerating inflation, and Romania, where deceleration has been interrupted. In other countries, exchange rate based price stability continues to work.

The downside to that is a growing concern throughout the region that credit expansion is threatening the external balance and price stability. Thus, the restrictiveness of the monetary policy has been *increased. This trend will continue. That may sap growth while not necessarily slowing down inflation or closing the current account deficit.*

Thus, the region is still facing policy challenges and that adds to the volatility rather than to the sustainability of its growth prospects.

Russia's GDP increased by about 6% in 2005. The main driver of growth was rising domestic demand while the contribution of real net exports to GDP growth was again negative. Due to significant improvements in the terms of trade, Russian domestic absorption could grow much faster than GDP. The pace of structural reforms slowed down substantially and state interventions in the economy are increasing. wiiw reckons with GDP growth of about 6% in the coming years, disinflation will be slow. Sustainable and broader-based long-term growth would require more investments and economic restructuring.

The slowdown of economic growth in Ukraine in 2005 has been spectacular, reflecting the weak investment demand and the deterioration of foreign trade. By and large, the country's economy remains hostage to the political uncertainty ahead of the parliamentary elections in March 2006.

In China, GDP grew by nearly 10% driven by both external and domestic demand. A slight growth deceleration is expected for 2006-07 as the government intends to slow down investment expansion and as exports of some products to the USA and the EU will be restricted.

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

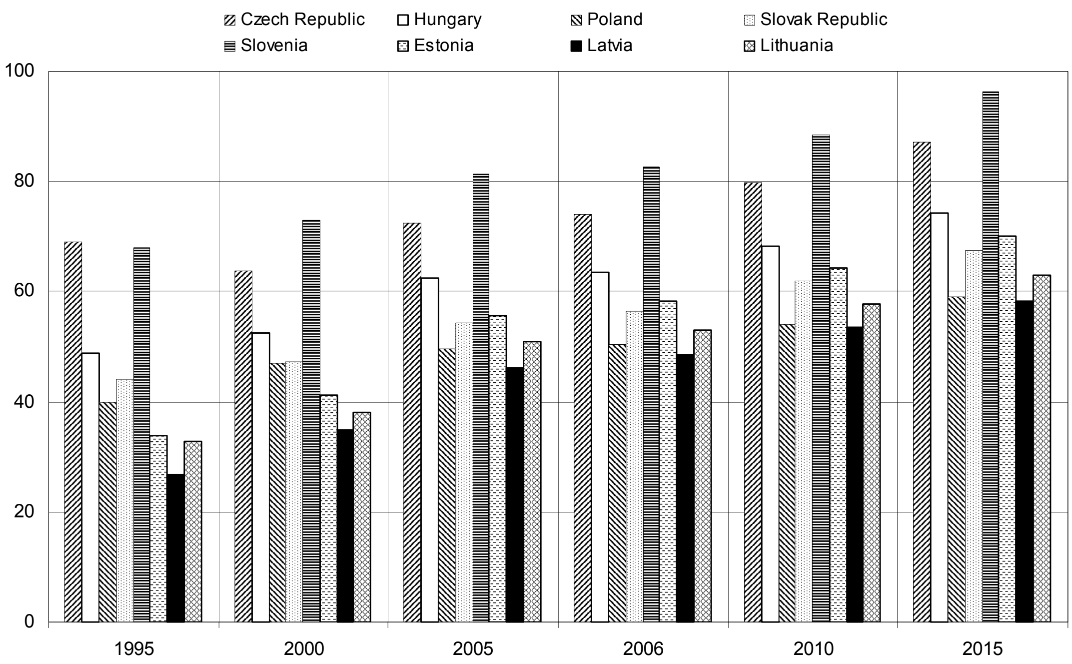
JEL classification: *O52, O57, P24, P27, P33, P52*

Figure I

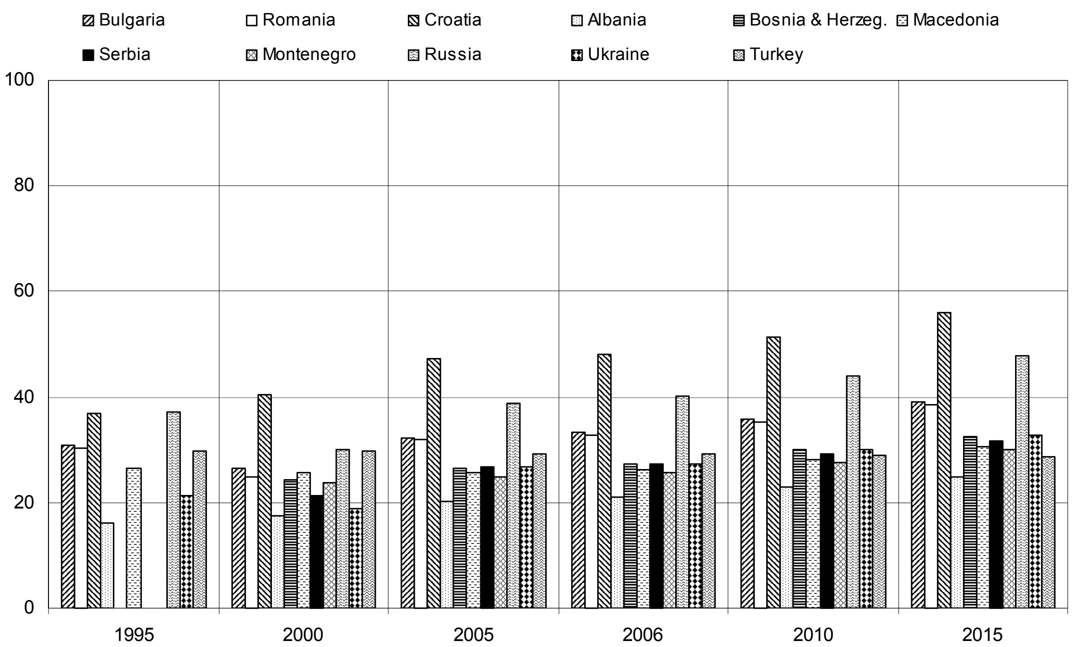
Real per capita GDP in transition countries

European Union (25) average = 100

New EU Member States



East and Southeast European Countries



Projection assuming a 2 percentage points growth differential to the EU after 2006.

Source: National statistics, Eurostat, wiiw estimates.

Table I

Overview developments 2004-2005 and outlook 2006-2007

	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			
	2004	**2005**	**2006**	**2007**	**2004**	**2005**	**2006**	**2007**	**2004**	**2005**	**2006**	**2007**	**2004**	**2005**	**2006**	**2007**
			forecast				**forecast**				**forecast**				**forecast**	
Czech Republic	4.7	5.0	4.5	4.7	2.8	1.9	2.8	2.5	8.3	8.0	7.5	7.5	-5.2	-2.5	-2.8	-2.2
Hungary	4.6	4.2	4.2	4.0	6.8	3.6	2	3	6.1	7.2	7.2	7.3	-8.8	-7.9	-8.0	-7.7
Poland	5.3	3.2	3.8	4.2	3.5	2.1	2.5	2.5	19.0	18.0	17.5	17	-4.1	-1.5	-1.5	-1.4
Slovak Republic	5.5	5.6	6.0	6.5	7.5	2.7	3	3	18.1	16	15	14	-3.5	-5.9	-4.7	-4.2
Slovenia	4.2	3.8	3.9	3.9	3.6	2.5	2.4	2.3	6.3	6.3	6	5.8	-2.1	-0.7	-0.7	-0.3
NMS-5 [2)3)]	*5.0*	*3.9*	*4.2*	*4.4*	.	.	.	.	*14.9*	*14.2*	*13.7*	*13.4*	*-5.0*	*-3.2*	*-3.1*	*-2.8*
Estonia	7.8	8.4	7.2	7.4	3.0	4.1	3.3	2.6	9.6	8.0	7	6.5	-12.7	-10.7	-7.9	-7.2
Latvia	8.3	9.1	7.7	7.1	6.2	6.7	6	4.8	10.4	9.2	9	8.5	-13.1	-13.2	-10.8	-10.1
Lithuania	7.0	7.0	6.2	5.8	1.2	2.7	2.8	2.9	11.4	8.4	7.5	7	-7.7	-7.5	-7.2	-7.0
NMS-8 [2)3)]	*5.2*	*4.3*	*4.4*	*4.6*	.	.	.	.	*14.4*	*13.6*	*13.1*	*12.8*	*-5.5*	*-3.7*	*-3.5*	*-3.3*
EU-15 [3)]	*2.3*	*1.4*	*2.0*	*2.2*	*2.0*	*2.3*	*2.2*	*1.9*	*8.1*	*7.9*	*7.7*	*7.4*	*0.57*	*-0.18*	.	.
EU-25 [2)3)]	*2.6*	*1.7*	*2.2*	*2.4*	*2.1*	*2.3*	*2.2*	*1.9*	*9.0*	*8.7*	*8.5*	*8.1*	*0.29*	*-0.34*	.	.
Bulgaria	5.6	5.5	5.3	5	6.1	5.0	6	4	12.0	10	9	8	-8.5	-14.0	-11.8	-9.6
Croatia	3.8	3.9	3.7	3.8	2.1	3.3	3	2.5	13.8	13.1	13	12.8	-5.2	-7.3	-6.0	-5.3
Romania	8.3	4	4.5	4.5	11.9	9.0	8	7	8.0	7.0	7	7	-8.7	-9.1	-8.5	-8.5
Turkey	8.9	5.8	6.0	6.0	10.6	7.7	5.5	4.5	10.3	10	9.7	9.3	-5.2	-6.2	-6.5	-6.5
Albania [4)]	6.0	5.5	5.5	6.0	2.9	2.4	2.5	2	14.4	14	14	14	-4.7	-5.9	-5.0	-4.5
Bosnia and Herzegovina [4)]	6.0	6.5	6	6	0.7	2.9	2	1	43.9	46	46	46	-22.5	-22.0	-20.0	-18.4
Macedonia	4.1	3.6	4	4	-0.4	0.6	2	2	37.2	37.5	37	37	-7.7	-1.1	-4.1	-3.9
Montenegro	3.7	4	5	5	2.4	2.5	3	3	27.7	28	28	28	-9.3	-9.1	-9.0	-7.9
Serbia	9.3	6.5	4	4	11.4	16.2	15	15	18.5	20	22	23	-12.3	-9.1	-10.0	-10.0
Russia	7.2	6.4	6.2	6	11.0	12.5	10	8	8.2	7.6	7.5	7	9.9	11.3	8.3	5.9
Ukraine	12.1	2.4	5	6	9.0	13.5	10	9	8.6	8	8	8	10.5	3.2	0.6	-0.6
China	9.5	9.9	9.7	9.5	3.9	1.8	2.0	1.8	.	.	.	.	3.6	5.0	3.8	2.6

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.

Source: wiiw (February 2006); Eurostat; forecasts for EU-15 and the Baltic States: European Commission (Autumn 2005).

Table II **Central and East European new EU member states (NMS-8): an overview of economic fundamentals, 2005**

	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Slovak Republic	Slovenia	*NMS-8* [1]	*EU-15*	*EU-25* [2]
GDP in EUR at exchange rates, EUR bn	99.38	10.26	88.69	12.09	19.98	240.40	37.32	27.75	*535.87*	*10248.63*	*10803.35*
GDP in EUR at PPP, EUR bn	172.27	17.35	146.09	24.62	40.53	440.79	68.03	37.81	*947.50*	*9762.36*	*10803.35*
GDP in EUR at PPP, EU-25=100	1.6	0.2	1.4	0.2	0.4	4.1	0.6	0.4	*8.8*	*90.4*	*100.0*
GDP in EUR at PPP, per capita	16840	12900	14490	10700	11850	11550	12630	18900	*13101*	*25164*	*23229*
GDP in EUR at PPP per capita, EU-25=100	72	56	62	46	51	50	54	81	*56*	*108*	*100*
GDP at constant prices, 1990=100	121.0	129.7	131.8	100.8	102.3	148.3 [3]	130.8	141.9	*140.2*	*136.8*	*137.4*
GDP at constant prices, 2000=100	118.2	142.4	122.1	145.7	143.7	115.6	126.4	117.9	*120.0*	*108.1*	*109.0*
Industrial production real, 1990=100	115.7	101.4	197.8	66.1	67.3	167.0 [3]	120.9	103.2	*160.3*	*121.0*	*124.1*
Industrial production real, 2000=100	142.5	155.4	130.7	140.6	163.8	128.8	129.9	115.1	*133.2*	*101.8*	*104.5*
Population - thousands, average	10232	1345	10065	2301	3419	38165	5387	2001	*72915*	*387956*	*462017*
Employed persons - LFS, thousands, average	4764	610	3902	1030	1475	14200	2210	950	*29137*	*173446* [4]	*202006* [4]
Unemployment rate - LFS, in %	8.0	8.0	7.2	9.2	8.4	18.0	16.0	6.3	*13.6*	*7.9*	*8.7*
Public sector expenditures, EU-def., in % of GDP	45.0	39.6	49.5	36.4	34.8	45.0	40.8	47.2	*44.9*	*48.1*	*47.9*
Public sector revenues, EU-def., in % of GDP	41.8	40.8	43.4	35.2	32.8	41.8	37.0	45.4	*41.2*	*45.4*	*45.2*
Price level, EU-25=100 (PPP/exch. rate)	58	59	61	49	49	55	55	73	*57*	*105*	*100*
Compensation per employee,[5] monthly, in EUR	895	758	996	474	583	743	664	1608	*808*	*3139*	*2807*
Compensation per employee, monthly, EU-25=100	31.9	27.0	35.5	16.9	20.8	26.5	23.7	57.3	*28.8*	*111.8*	*100.0*
Exports of goods in % of GDP	63.8	60.6	55.9	34.9	46.7	31.8	67.0	52.1	*46.4* [6]	*27.7* [6]	*28.6* [6]
Imports of goods in % of GDP	61.9	74.4	57.3	54.0	57.8	31.8	71.0	55.5	*47.8* [6]	*27.3* [6]	*28.4* [6]
Exports of services in % of GDP	8.7	24.1	10.6	14.0	11.9	5.4	9.4	11.5	*8.2* [6]	*8.4* [6]	*8.4* [6]
Imports of services in % of GDP	8.2	16.3	10.7	10.2	8.0	4.7	8.3	8.4	*7.2* [6]	*7.9* [6]	*7.9* [6]
Current account in % of GDP	-2.5	-10.7	-7.9	-13.1	-7.4	-1.5	-5.9	-0.7	*-3.7* [6]	*-0.2* [6]	*-0.3* [6]
FDI stock per capita in EUR	4900	7400	5000	1700	1500	1800	2400	3000	*2900*	.	.

NMS-8: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia. PPP: Purchasing power parity.

Notes. 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) 1-3Q2005. - 5) Gross wages plus indirect labour costs, whole economy, national account concept. - 6) NMS-8, EU-15 and EU-25 data include flows within the region.

Source: wiiw, AMECO, Eurostat.

Table III

Southeast European countries: an overview of economic fundamentals, 2005

	Albania	Bosnia and Herzegovina	Bulgaria	Croatia	Macedonia	Montenegro	Romania	Serbia	Turkey	*NMS-8* [1]	*EU-15*	*EU-25* [2]
GDP in EUR at exchange rates, EUR bn	6.74	7.51	21.37	30.03	4.63	1.64	76.59	19.83	293.23	*535.87*	*10248.63*	*10803.35*
GDP in EUR at PPP, EUR bn	14.80	17.65	57.98	48.84	12.17	3.65	160.97	47.01	492.11	*947.50*	*9762.36*	*10803.35*
GDP in EUR at PPP, EU-25=100	0.1	0.2	0.5	0.5	0.1	0.03	1.5	0.4	4.6	*8.8*	*90.4*	*100.0*
GDP in EUR at PPP, per capita	4710	6140	7490	11000	5980	5790	7440	6210	6830	*13101*	*25164*	*23229*
GDP in EUR at PPP per capita, EU-25=100	20	26	32	47	26	25	32	27	29	*56*	*108*	*100*
GDP at constant prices, 1990=100	148.1	438.3 [3]	103.0	105.8	97.3	.	110.8	.	173.0	*140.2*	*136.8*	*137.4*
GDP at constant prices, 2000=100	130.1	128.2	127.2	123.5	106.8	112.0	131.6	131.0	121.7	*120.0*	*108.1*	*109.0*
Industrial production real, 1990=100	44.7	.	83.6	81.4	53.1	.	76.3	.	187.0	*160.3*	*121.0*	*124.1*
Industrial production real, 2000=100	117.7	145.0	157.7	126.7	100.5	117.2	124.5	107.2	123.6	*133.2*	*101.8*	*104.5*
Population - thousands, average	3143	3845	7746	4439	2035	630	21624	7570	72065	*72915*	*387956*	*462017*
Employed persons - LFS, thousands, average	931 [4]	626 [5]	3000	1566	540	185	9160	2900 [6]	22138	*29137*	*173446* [7]	*202006* [7]
Unemployment rate - LFS, in %	14.0 [4]	46.0 [5]	10.0	13.1	37.5	28.0	7.0	20.0 [6]	10	*13.6*	*7.9*	*8.7*
Public sector expenditures, nat. def., in % of GDP	28.5 [8]	39.7 [8]	40.7	.	31.7	.	30.7 [8]	45.8 [8]	32.6 [8]	*44.9*	*48.1*	*47.9*
Public sector revenues, nat. def., in % of GDP	23.6 [8]	41.5 [8]	43.0	.	32.7	.	29.6 [8]	44.3 [8]	24.6 [8]	*41.2*	*45.4*	*45.2*
Price level, EU-25=100 (PPP/exch. rate)	46	43	37	61	38	45	48	42	60	*57*	*105*	*100*
Average gross monthly wages, EUR at exchange rate	217 [9]	404	164	844	347	326	268	307 [10]	606 [11]	*808* [11]	*3139* [11]	*2806.67* [11]
Average gross monthly wages, EUR at PPP	477 [9]	949	444	1373	910	726	563	728 [10]	1017 [11]	*28.8* [11]	*111.8* [11]	*100.0* [11]
Exports of goods in % of GDP	8.0	28.0	44.5	24.0	32.4	20.1	29.4	18.5	20.8	*46.4* [12]	*27.7* [12]	*28.6* [12]
Imports of goods in % of GDP	29.7	81.2	63.6	49.6	51.8	54.9	39.2	43.1	28.6	*47.8* [12]	*27.3* [12]	*28.4* [12]
Exports of services in % of GDP	13.7	10.4	16.8	26.6	8.6	18.3	5.0	6.6	7.2	*8.2* [12]	*8.4* [12]	*8.4* [12]
Imports of services in % of GDP	15.7	4.9	14.0	9.0	9.1	7.3	5.7	6.6	3.1	*7.2* [12]	*7.9* [12]	*7.9* [12]
Current account in % of GDP	-5.9	-22.0	-14.0	-7.3	-1.1	-9.1	-9.1	-9.1	-6.2	*-3.7* [12]	*-0.2* [12]	*-0.3* [12]
FDI stock per capita in EUR	500	400	1100	2500	600	600	800	600	400	*2900*	.	.

NMS-8: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia. PPP: Purchasing power parity - wiiw estimates for Albania, Bosnia and Herzegovina, Macedonia, Montenegro, Serbia.

Notes: 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) Employees and unemployment (by registration), end of year. - 6) October. - 7) 1-3Q2005. - 8) Year 2004. - 9) Public sector. - 10) Including various allowances. - 11) Gross wages plus indirect labour costs, whole economy, national account concept. - 12) NMS-8, EU-15 and EU-25 data include flows within the region.

Source: wiiw, AMECO, Eurostat.

Part A: The new EU member states

*Leon Podkaminer**

Export-led expansion, modestly rising employment

Weak performance of the euro area does not affect the NMS

The world economy, excluding the EU-25, performed very well in 2005, with GDP rising by some 5%. Traditionally, growth was very high in China and also in most other 'emerging markets'. Interestingly, the exponential increases in energy prices have not disturbed growth in the USA and Japan. The US GDP increased quite remarkably, by an estimated 3.6%, and Japan's by 2.8% in 2005.

After a short-lived and unimpressive acceleration in the year 2004, growth in the euro area has faltered again. The European Commission's Autumn 2005 forecast envisions 1.3% GDP growth for the euro area in 2005. The whole EU-25 performed slightly better (1.7% growth) according to wiiw estimates. The poor performance of Germany, which grew by just about 0.7% in 2005, has continued. Germany's internal policies continue to be subordinated to the goal of strengthening its external competitiveness. This is achieved through sustained cuts in labour costs, and progressing flexibilization of the labour market. In effect German domestic demand appears to be contracting, while exports (and export surpluses) break new records. This policy, which has so far failed to speed up overall growth in Germany, is having negative effects on other euro area countries (such as Italy). These countries cannot withstand the German cost/wage competition. The general orientation of the economic policy of the new German government will remain unchanged, at least for the next two years. One must therefore expect rather weak growth in Germany – and in its major euro area partners. Moreover, fiscal and monetary policies are highly unlikely to generate significant growth impulses. One still does not see any constructive reassessment of the effects of the orthodoxy underlying the (in)actions of the European Central Bank, or of the wisdom of the provisions of the Growth and Stability Pact. Nonetheless, growth in the euro area (and generally in the EU-15) may accelerate, by about 0.5 percentage points, in 2006 – if the rest of the world continues to grow fast and provided the world market prices of energy and other raw materials stabilize.

In 2005 most of the new EU member states (NMS) performed even better than in 2004 (and of course much better than the euro area countries). Only in Poland was growth markedly slower than in 2004 (but much higher than in the euro area all the same). But even Poland's slowdown cannot be linked to the weakening growth in the old EU. In fact Poland's net exports to the EU improved significantly in 2005, producing a surplus. Apparently, the NMS have successfully managed the accession to the EU and gained the ability to grow fast despite the anaemic performance of the old EU, and despite the ongoing cost deflation in Germany. In 2006 and 2007 the NMS are expected to perform quite well again, even if growth in the old EU remains unimpressive and prices of energy stay fairly high.

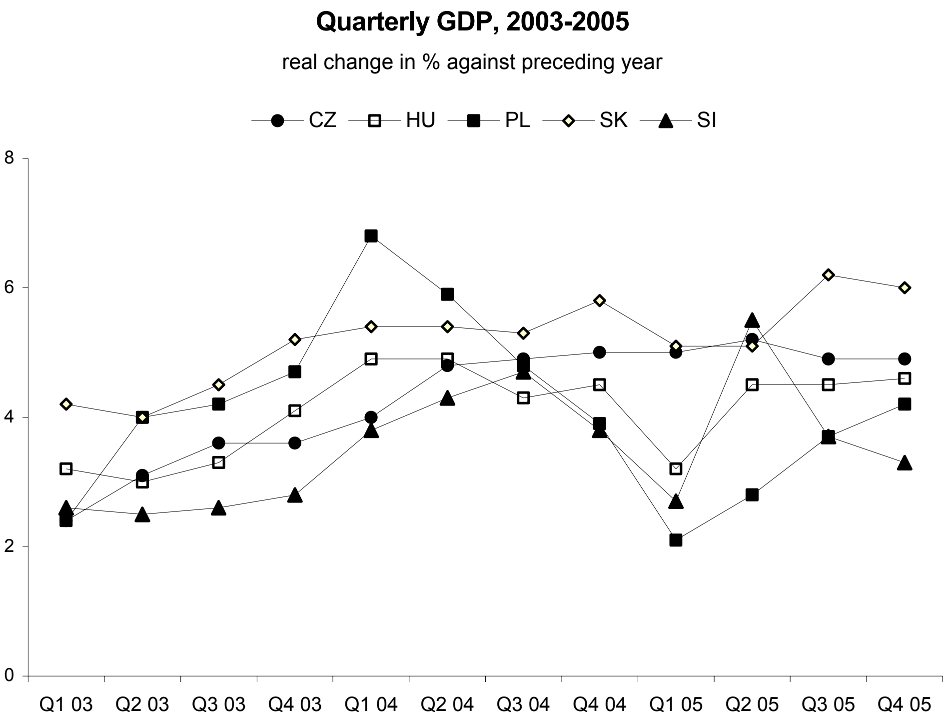
---

* K. Laski, P. Havlik, M. Landesmann (all wiiw) as well as the authors of the country reports provided valuable comments on the draft of this overview.

Export-led expansion continues

Fast GDP growth triggered by the upcoming EU accession in the first half of 2004 was slowing down in Poland, Hungary and Slovenia in the second half of that year. This 'post-accession slowdown' did not take place in Slovakia and the Czech Republic. In the second quarter of 2005 strong growth resumed also in Poland, Hungary and Slovenia, though in the latter country the acceleration proved temporary (see Figure 1).

Figure 1



Source: wiiw Monthly Database incorporating national statistics.

In 2005 household consumption increased generally at a lower pace than the overall GDP. Only in Slovakia (and probably Lithuania) did consumption surge ahead of the GDP. In Poland and the Czech Republic the moderate rates of growth of consumption reflect rather modest gains in household incomes (particularly in wages).

Gross fixed capital formation (termed investment for short) expanded at a generally lower rate than in 2004. Only in Slovakia did investment rise very strongly – but this only after several years of stagnation or even recession. Growth rates of investment continue to be very high in the Baltic countries (though only in Estonia one expects an acceleration). Interestingly, generally low (and falling) interest rates and an improved financial position of the private corporate sector (as in the Czech Republic and Poland) prove to be insufficient to boost the sector's investment. Conversely, quite strong investment in Hungary has not been affected by the much higher interest rates prevailing in that country. (Firms and households find it easy to draw cheaper credits denominated in foreign exchange.) The weak link between interest rates and the corporate sector's financial standing on the one hand and the rate of growth of investment on the other is not surprising. Weak investment growth despite seemingly strong profits and low interest rates should be expected under excess capacities, heightened uncertainties, or pessimistic demand prospects. No doubt some of these factors have restricted higher investment growth in individual countries (most obviously in Poland). Besides, the behaviour of the entire gross fixed investment aggregate is affected by the investments of the non-corporate sector – parts of the residential (housing) investment of the household sector, as well as public investment e.g. in infrastructure.[1] In the coming years (especially in 2007 and beyond) the correlation between the corporate sector's financial standing/interest rates and overall investment will become even weaker. Large and rising transfers from the EU budget to all NMS (excepting perhaps Slovenia) will then be financing various investment projects (in the private as well as in the public

Table 1

Gross domestic product

real change in % against preceding year

	1995	2000	2001	2002	2003	2004	2005 1)	2006 forecast	2007 forecast	Index 1990=100 2005	Index 2000=100 2005
Czech Republic	5.9	3.9	2.6	1.5	3.2	4.7	5.0	4.5	4.7	121.0	118.2
Hungary	1.5	5.2	4.3	3.8	3.4	4.6	4.2	4.2	4.0	131.8	122.1
Poland	7.0	4.2	1.1	1.4	3.8	5.3	3.2	3.8	4.2	167.7	115.6
Slovak Republic	5.8	2.0	3.8	4.6	4.5	5.5	5.6	6.0	6.5	130.8	126.4
Slovenia	4.1	4.1	2.7	3.5	2.7	4.2	3.8	3.9	3.9	141.9	117.9
NMS-5 2)	5.5	4.1	2.2	2.2	3.6	5.0	3.9	4.2	4.4	145.1	118.1
Estonia	4.5	7.9	6.5	7.2	6.7	7.8	8.4	7.2	7.4	129.7	142.4
Latvia	-0.8	6.9	8.0	6.4	7.2	8.3	9.1	7.7	7.1	100.8	145.7
Lithuania	3.3	3.9	6.4	6.8	10.5	7.0	7.0	6.2	5.8	102.3	143.7
NMS-8 2)	5.3	4.2	2.5	2.5	4.0	5.2	4.3	4.4	4.6	140.2	120.0

1) Preliminary. - 2) wiiw estimate.

Source: wiiw Database incorporating national statistics, forecast: wiiw, and European Commission (2005) for Baltic countries.

Table 2

Gross fixed capital formation

real change in % against preceding year

	1995	2000	2001	2002	2003	2004	2005 1)	2006 forecast	2007 forecast	Index 1990=100 2005	Index 2000=100 2005
Czech Republic	19.8	4.9	5.4	3.4	4.7	5.3	3	5	5	142.6	123.8
Hungary	-4.3	7.7	5.9	9.3	2.5	8.4	8.5	7	8	201.2	139.5
Poland	16.5	2.7	-9.7	-6.3	-0.1	6.3	6.2	6	6	222.2	95.4
Slovak Republic	0.6	-7.2	13.9	-0.6	-1.5	2.5	12	15	15	104.5	128.1
Slovenia	16.8	1.8	0.4	0.9	7.1	5.9	2	3	3.5	219.5	117.1
Estonia	5.6	14.3	13.0	17.2	8.5	6.0	8.3	6.5	6.1	.	165.0
Latvia	8.7	10.2	11.4	13.0	10.9	17.3	16.5	10	9.5	95.1	190.8
Lithuania	14.9	-9.0	13.5	11.1	14.0	12.3	10.1	8.2	8	.	177.7

1) Preliminary.

Source: wiiw Database incorporating national statistics, forecast: wiiw, and European Commission (2005) for Baltic countries.

[1] Unfortunately, data on the composition of investment tend to be available only upon very long delays.

Table 3

Contributions (percentage points) to the GDP growth rates

	2000	2001	2002	2003	2004	1-3 Q 2004	1-3 Q 2005
Czech Republic							
GDP growth rate (%)	**3.9**	**2.6**	**1.5**	**3.2**	**4.7**	**4.6**	**5.0**
Consumption	1.5	2.2	2.4	3.2	1.1	1.2	1.7
Gross fixed investm.	1.3	1.5	0.9	1.3	1.4	1.6	0.8
Trade Balance	-0.1	-1.4	-2.0	-0.4	1.5	0.7	4.4
Other items*	1.2	0.3	0.2	-0.9	0.7	1.1	-1.9
Hungary 1)							
GDP growth rate (%)	**5.2**	**4.3**	**3.8**	**3.4**	**4.6**	**4.7**	**4.1**
Consumption	3.1	3.9	6.9	6.2	2.3	2.8	1.4
Gross fixed investm.	1.9	1.4	2.2	0.6	2.1	2.7	1.9
Trade Balance	0.6	1.9	-2.2	-3.0	1.7	1.3	3.8
Other items*	-0.4	-2.9	-3.1	-0.4	-1.5	-2.1	-3.0
Poland							
GDP growth rate (%)	**4.2**	**1.1**	**1.4**	**3.8**	**5.3**	**5.8**	**2.9**
Consumption	2.2	1.8	2.4	2.1	3.3	3.9	1.8
Gross fixed investm.	0.7	-2.3	-1.3	0.0	1.1	0.8	0.6
Trade Balance	1.0	2.6	0.5	1.1	-0.7	-1.1	2.1
Other items*	0.3	-1.0	-0.2	0.6	1.6	2.2	-1.6
Slovenia							
GDP growth rate (%)	**4.1**	**2.7**	**3.5**	**2.7**	**4.2**	**4.3**	**4.0**
Consumption	0.9	2.1	1.4	2.2	2.3	2.3	2.4
Gross fixed investm.	0.5	0.1	0.2	1.6	1.4	1.3	0.5
Trade Balance	2.6	1.7	1.1	-2.0	-0.4	-0.6	2.8
Other items*	0.1	-1.2	0.8	0.9	0.9	1.3	-1.7
Slovak Republic							
GDP growth rate (%)	**2.0**	**3.8**	**4.6**	**4.5**	**5.5**	**5.4**	**5.5**
Consumption	-0.2	3.6	4.2	0.2	2.2	2.0	3.1
Gross fixed investm.	-2.1	3.6	-0.2	-0.4	0.6	0.8	2.7
Trade Balance	1.5	-3.7	-0.4	5.5	-1.2	-0.2	0.8
Other items*	2.8	0.3	1.0	-0.8	3.9	2.8	-1.1
Estonia							
GDP growth rate (%)	**7.9**	**6.5**	**7.2**	**6.7**	**7.8**	**8.3**	**9.3**
Consumption	5.3	4.2	7.5	5.8	4.1	3.6	5.3
Gross fixed investm.	3.9	3.7	5.2	2.8	2	1.4	3.5
Trade Balance	-2.1	-2.5	-3.2	-5.7	-1.4	0.3	1.5
Other items*	0.8	1.1	-2.3	3.8	3.1	3.0	-1.0
Latvia							
GDP growth rate (%)	**6.9**	**8**	**6.4**	**7.2**	**8.3**	**.**	**.**
Consumption	3.1	5.2	5	5.5	6.3	.	.
Gross fixed investm.	2.4	2.8	3.3	2.9	4.4	.	.
Trade Balance	3.0	-4.0	-0.2	-4.6	-4.7	.	.
Other items*	-1.6	4.0	-1.7	3.4	2.3	.	.
Lithuania							
GDP growth rate (%)	**3.9**	**7.2**	**6.8**	**10.5**	**7.0**	**6.9**	**6.9**
Consumption	5.1	2.6	4.1	8.7	7.6	8.0	6.9
Gross fixed investm.	-1.9	2.5	2.2	2.9	2.6	3.0	2.1
Trade Balance	1.8	0.5	-0.1	-2.4	-6.8	-8.0	-2.8
Other items*	-1.1	1.6	0.6	1.3	3.6	3.9	0.7
Euro zone							
GDP growth rate (%)	**3.8**	**1.9**	**0.9**	**0.7**	**2.1**	**.**	**.**
Consumption	2.3	1.5	1.0	1.0	1.1	.	.
Gross fixed investm.	1.1	0.1	-0.4	0.2	0.5	.	.
Trade Balance	0.5	0.7	0.5	-0.6	0.1	.	.
Other items*	-0.1	-0.4	-0.2	0.1	0.4	.	.

* Other items include change in stocks and statistical discrepancies.

1) From 2001 FISIM-adjusted.

Source: Eurostat, wiiw estimates incorporating national sources.

sectors). This is likely to magnify overall investment growth – and hence add, *ceteris paribus*, to GDP growth as well, even if the financial standing of the corporate sector should worsen.

In order to assess properly the actual significance of changes in individual components of GDP growth, the *contributions* of those components have to be calculated. Table 3 shows those contributions to recent GDP growth rates in the NMS. (It should be recalled that the data for 2005 are preliminary and will certainly be revised at a later date.)

As can be seen, individual items of expenditure have recently played different roles in generating growth in aggregate demand (and GDP) across the individual NMS. In the first three quarters of 2005, total consumption (private and public combined) contributed quite significantly to overall GDP growth in all NMS. Investment played generally a subordinate role in the Czech Republic, Poland and Slovenia, but quite an important one in Slovakia, Hungary (and the three Baltic states).

Foreign trade has been an important source of growth in the Czech Republic, Hungary, Poland and Slovenia. Importantly, the role of foreign trade as a contributor to overall growth has increased, compared with 2004. (The same tendency comes to the fore in the Baltic states. According to provisional estimates the contribution of foreign trade may have become positive in Estonia and neutral in Latvia. In Lithuania the contribution is perhaps still negative, although much less so than in 2004.)

Industry: less buoyant growth

After a sudden acceleration in the first half of 2004, growth of gross industrial production decelerated gradually to quite low levels in the first months of 2005. Growth, resumed later in 2005, was much more moderate than in 2004. In most countries (excluding Hungary) it was even more moderate than in 2003 (see Figure 2).

Table 4

Gross industrial production

real change in % against preceding year

	1995	2000	2001	2002	2003	2004	2005 [1]	2006 forecast	2007 forecast	Index 1990=100 2005	Index 2000=100 2005
Czech Republic	8.7	1.5	10.6	4.8	5.8	9.9	5.7	6	6	115.7	142.5
Hungary	4.6	18.1	3.6	2.8	6.4	7.4	7.5	8	7	197.8	130.7
Poland [2]	9.7	6.7	0.6	1.1	8.3	12.6	3.8	7	7	220.3	128.8
Slovak Republic	8.3	8.4	7.6	6.7	5.3	4.2	3.1	7	8	120.9	129.9
Slovenia	2.0	6.2	2.9	2.4	1.4	4.8	2.8	2.5	2	103.2	115.7
NMS-5 [3]	8.3	7.4	4.1	2.8	6.8	10.0	4.7	6.7	6.6	172.2	131.2
Estonia	1.9	14.6	8.9	8.2	10.9	8.0	10.1	5	5.5	101.4	155.4
Latvia	-3.7	4.7	9.2	8.4	6.5	6.0	5.2	8.7	8.1	66.1	140.6
Lithuania	5.3	2.2	16.0	3.1	16.1	10.8	6.5	6	5.9	67.3	163.8
NMS-8 [3]	7.9	7.2	4.6	3.0	7.2	10.0	4.9	6.7	6.6	160.3	133.2

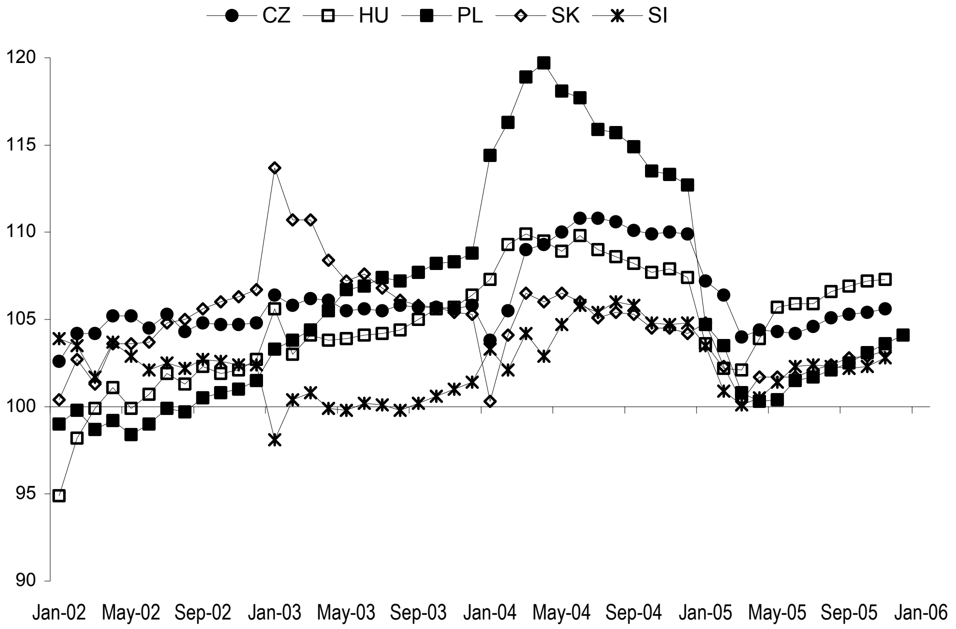
1) Preliminary. - 2) Sales. - 3) wiiw estimate.

Source: wiiw Database incorporating national statistics, forecast: wiiw, and European Commission (2005) for the Baltic countries.

Figure 2

NMS-5: Gross industrial production, 2002-2005

annual growth, cumulated



Source: wiiw Monthly Database incorporating national statistics.

Table 5

Labour productivity in industry

change in % against preceding year

	1995	2000	2001	2002	2003	2004	2005 1)	Index 1990=100 2005	Index 2000=100 2005
Czech Republic 2)	10.6	9.5	5.5	5.8	9.5	10.4	8.0 I-XI	191.8	145.7
Hungary 3)	10.2	17.7	4.8	4.6	10.2	10.8	10.5 I-X	345.7	147.9
Poland 4)	6.3	13.6	4.6	6.6	9.7	11.7	2.9	331.5	140.6
Slovak Republic	4.0	11.9	6.5	6.5	4.7	3.8	0.1 I-XI	153.4	123.4
Slovenia	6.3	8.4	3.5	5.6	3.6	6.2	4.3 I-X	204.7	125.4
Estonia	8.4	17.6	15.3	10.3	11.8	.	.	.	.
Latvia	.	.	6.9	7.7	6.4	4.7	.	.	.
Lithuania	.	5.5	19.3	5.9	5.9	9.0	.	.	.

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 2005 enterprises more than 9 employees.

Source: wiiw Database incorporating national statistics.

Weaker growth of gross industrial production is not necessarily a bad omen. It must be remembered that the aggregate figures for the industrial sector cannot properly account for the ongoing upgrading of industrial output with rising shares of high valued-added activities. Shrinking output of the 'light industries' (textiles, apparel, leather products) is one example of the ongoing structural changes that may depress the indices of industrial production. Under intense restructuring, growing strength of industry may coexist with unimpressively low values of production indices. Of course, one has also to keep in mind the fact that under fast technical progress the indices of *gross* production may be particularly ill suited for measuring the dynamics of the gross value-added generated in industry. (For example, with falling unit intermediate input requirements, the aggregate industrial gross value-added may rise even if gross output is falling.)

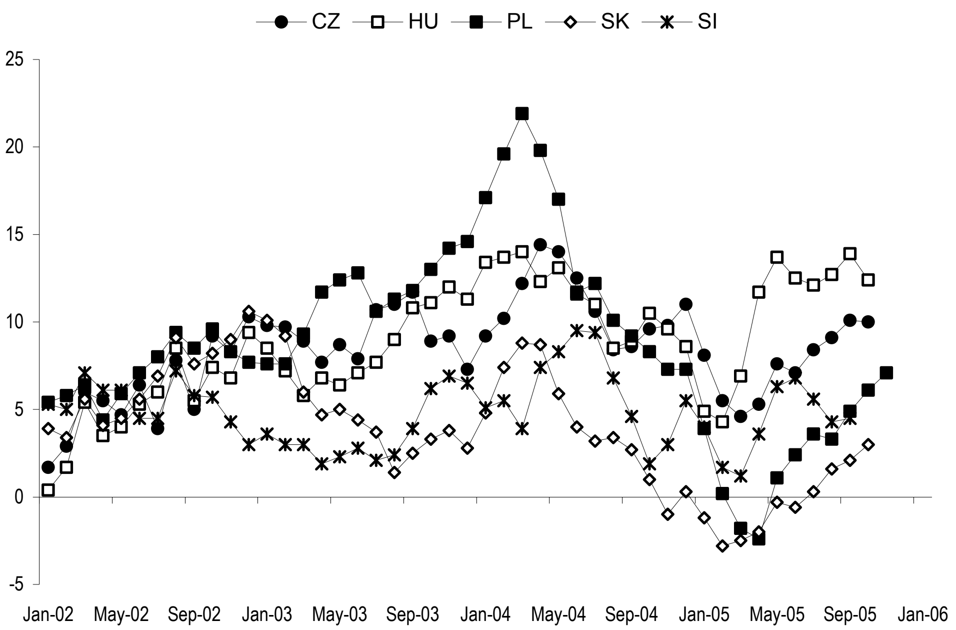
Certainly, the analysis of data on the dynamics of gross industrial output will continue to yield important insights, especially where trends in terms of labour productivity and unit labour costs are concerned. Analyses of the external competitiveness of industrial production customarily require information on gross output as well (in relation to employment, prices, wages and exchange rates).

As can be seen in Figure 3, labour productivity in industry has recently been moving roughly in line with industrial output (which follows from the fact that changes in industrial employment have become rather small as compared with earlier years). Interestingly, a slowdown in the growth of labour productivity was observed everywhere in the first half of 2005. It even generated losses in labour productivity in Hungary, Poland and Slovakia. However, later in 2005 labour productivity growth resumed everywhere and the losses suffered in the three countries proved temporary.

Figure 3

NMS-5: Labour productivity in industry, 2002-2005

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



Source: wiiw Monthly Database incorporating national statistics.

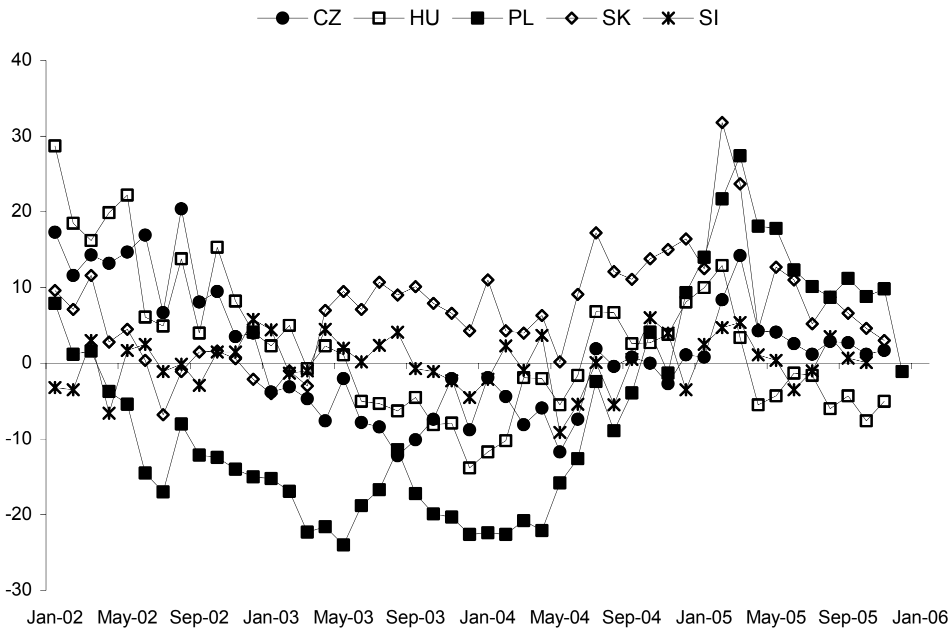
The recent positive trends in labour productivity have not been sufficiently strong to prevent a marked – and sustained – increase in unit labour costs (ULC) in industry. As can be seen in Figure 4, since about the fourth quarter of 2004 euro-adjusted ULC have generally been on the rise.

Only in Hungary, where the domestic currency has been weakening, has the rise in ULC been stopped (and then reversed) in the course of 2005. In all remaining countries rising wages and/or appreciating currencies resulted in rising ULC throughout 2005. The lowest increases were recorded in Slovenia, the highest in Poland. Two comments are in order now. First, it may be observed that the rates of growth of ULC seem to be falling. However, whether or not the earlier pattern of *negative* rates (i.e. falling ULC) will be restored is an open question. Second, it ought to be noted that worsening ULC have coincided with outstanding foreign trade (and especially export) performance. Moreover, it turns out that Hungary (where ULC fell) and Slovenia (where ULC rose minimally) performed less impressively in foreign trade than Poland (where ULC rose significantly).

Figure 4

NMS-5: Unit labour costs in industry, 2002-2005

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



Source: wiiw Monthly Database incorporating national statistics.

Qualitative improvements, reflected in rising prices for products exported by the NMS, are certainly offsetting – at least partially – the growing unit labour costs.[2] Furthermore, the fact that unit labour costs are rising is less relevant (e.g. to foreign investors locating their activities in the NMS) in so far as actual wages (and associated labour costs) are still very low by West European standards (see Appendix, Selected indicators of competitiveness, and also Havlik, 2005[3]).

While the ULC indicators may be poor predictors of the foreign trade performance, they continue to be relevant as far as the bulk of traditional labour-intensive activities of the NMS-5 are concerned. For those activities, an unchecked rise in unit labour costs may soon prove troublesome – especially

2 The rising qualitative/structural improvements in the production and exports of NMS are documented in M. Landesmann and J. Wörz (2006), 'Competitiveness – the CEECs versus the Rest of the World', study commissioned by Bank Austria Creditanstalt, wiiw, Vienna, January.

3 P. Havlik (2005), 'Unit Labour Costs in the New EU Member States', *wiiw Statistical Reports*, No. 1, January.

when they stem from undue appreciation of domestic currencies. Therefore, only to the extent that the national economic structures of some NMS depend on traditional activities, any undue appreciation of domestic currencies – and any excessive hike in wages – will continue to pose a potential threat to the foreign trade performance.

Labour market situation improving slightly

Unemployment rates fell everywhere in 2005, except in Hungary. The falling unemployment rates primarily reflect rising employment.[4] This appears to be consistent with the estimates of employment elasticity to growth, which suggest that sustained GDP growth at a rate of some 4-5% p.a. may be needed to ensure the gradual absorption of redundant labour.[5]

Table 6

Unemployment, LFS definition, annual averages

	in 1000 persons						rate in %				
	2000	2001	2002	2003	2004	2005 1)	2003	2004	2005 1)	2006 forecast	2007 forecast
Czech Republic 2)	455	421	374	399	426	410	7.8	8.3	8	7.5	7.5
Hungary	264	234	239	245	253	304	5.9	6.1	7.2	7.2	7.3
Poland	2785	3170	3431	3329	3230	3070	19.6	19.0	18	17.5	17
Slovak Republic	485	508	487	459	481	430	17.4	18.1	16	15	14
Slovenia	68	63	62	65	64	65	6.7	6.3	6.3	6	5.8
NMS-5 3)	4056	4396	4593	4496	4454	4279	15.1	14.9	14.2	13.7	13.4
Estonia	90	83	67	66	64	53	10.0	9.6	8.0	7	6.5
Latvia	159	145	135	119	119	104	10.6	10.4	9.2	9	8.5
Lithuania	274	284	224	204	184	135	12.4	11.4	8.4	7.5	7
NMS-8 3)	4579	4908	5019	4885	4820	4571	14.7	14.4	13.6	13.1	12.8

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

Source: wiiw Database incorporating national statistics, forecast: wiiw, and European Commission (2005) for the Baltic countries.

Rising employment is a new phenomenon in the NMS. In 2003 total employment in the NMS-8 rose only 0.2% (vs. 0.3% in the EU-15). In 2004 employment was up 0.7% in both the NMS-8 and the EU-15. In the first three quarters of 2005 employment in the NMS-8 rose by 1.5% (vs. 1.1% in the EU-15). Employment growth, which has been most consistent in the Czech Republic, Estonia and Latvia, has recently been strongest in Slovakia and the three Baltic countries.

Interestingly, until recently employment in industry has tended to contract even under fairly strong growth of industrial output, which resulted in high gains in industrial labour productivity. (Simultaneously, one observed rising employment in various service activities, even under overall

4 The economically active populations are roughly constant. Thus the changes in unemployment rates were virtually unaffected by either a rising number of retirements or larger migration.

5 See 'Industrial Restructuring and Implications for Labour Markets in the New EU Member States', Research Project commissioned by EU DG Employment, Social Affairs and Equal Opportunities, Contract No. VC/2003/0367, coordinated by The Vienna Institute for International Economic Studies (wiiw) in cooperation with Alphametrics and DIW Berlin, December 2004.

weak GDP growth.) In 2005 (in the Czech Republic and Slovakia already in 2004) industrial employment rose despite relatively slower growth of output. Only in Hungary did industrial employment continue to decline. Industry's rising demand for labour may follow from an evolution in the composition of industrial output. On the one hand, the traditional domestic labour-intensive activities (such as the clothing industry) seem to have been contracting in the NMS. On the other hand, there is a tendency to relocate labour-intensive medium-skill manufacturing (for instance in the car and domestic electronics industries) from the 'old' EU to the NMS. Gains in employment in the new labour-intensive FDI factories may be higher than employment lost in traditional manufacturing.

Despite some increase in unemployment in Hungary, the rate of unemployment in that country is rather moderate by EU standards. Unemployment is also less of a problem in the Czech Republic, Slovenia and the Baltic countries. Despite some improvements, unemployment remains a grave social and economic problem in Poland and in Slovakia. Nonetheless, in the coming two years unemployment rates are expected to continue their downward drift in both countries – while remaining largely unchanged in Hungary, the Czech Republic and Slovenia.

Continuing expansion of foreign trade

2004 was an exceptionally successful year in terms of NMS external trade. The accession to the EU and the related changes in the trade regime have apparently provided an additional stimulus for both exports and imports. NMS-8 exports surged by 21.6% (in current euro terms), significantly faster than imports (+18.3%): the region’s trade integration into both the European and the global economy thus forged ahead.

Generally, the positive trends have continued in 2005, despite the growth slowdown in the 'old' EU. Of course, the expansion of trade has become less buoyant. Nonetheless, export revenues of each of the NMS rose at double-digit rates, with imports rising at substantially lower speeds (Table 7). All in all, each of the five Central European NMS (excepting Slovakia) has ended the year 2005 with lower trade deficits than a year before. The Czech Republic even worked out a handsome trade surplus. No doubt, at less extravagant world market energy prices, these countries would have achieved even better results.

Table 8 documents NMS trade with the enlarged EU-25. It turns out that the rapid rise in both exports and imports in 2004 extended into 2005 – with import growth, however, losing momentum. In effect the Central European NMS (except Slovenia) increased their already large trade surpluses vis-à-vis the whole EU. Again, the performance of the Czech Republic has been the strongest, yet Poland achieved a trade surplus for the first time. Rising trade surpluses (or a lower deficit in Slovenia) may indicate that EU trade has positively contributed to NMS GDP growth.

As in 2004, growth in NMS foreign trade with the EU-25 was less dynamic than NMS foreign trade overall. In fact the shares of trade with the EU-25 were falling in each NMS. Paradoxically, accession turned out to be better for trade with the 'outer' world than for trade with the EU. Partly, this is due to the liberalized import regime of third countries. Otherwise, the expansion of exports to third countries is both understandable – and rather positive. As economic growth in the 'outside world' is much faster than in the EU, its demand for imports is also rising faster than the EU's. The fact that the NMS appear to be capable of meeting that demand is certainly a good omen.

Table 7

Foreign trade of the new EU member states, EUR million

(based on customs statistics)

		1999	2000	2001	2002	2003	2004	2005 [1]	2004 change in %	2005 change in %
Czech Republic	Exports	24640	31483	37251	40726	43051	53995	62829	25.4	16.4
	Imports	26386	34876	40675	43025	45243	54824	61423	21.2	12.0
	Balance	-1746	-3393	-3424	-2298	-2192	-829	1406	.	.
Hungary [2]	Exports	23491	30545	34082	36523	38041	44630	49550	17.3	11.0 [I-XI]
	Imports	26288	34856	37654	39939	42189	48550	52240	15.1	7.6 [I-XI]
	Balance	-2797	-4312	-3572	-3417	-4149	-3920	-2690	.	
Poland	Exports	25729	34383	40375	43400	47511	60014	71220	26.3	18.7 [I-XI]
	Imports	43151	53122	56223	58307	60288	71812	80460	19.1	12.0 [I-XI]
	Balance	-17422	-18739	-15848	-14907	-12777	-11798	-9240	.	.
Slovakia [3]	Exports	9602	12880	14115	15270	19359	22352	25580	15.5	15.1 [I-XI]
	Imports	10628	13860	16488	17517	19947	23525	27150	17.9	16.3 [I-XI]
	Balance	-1025	-980	-2372	-2247	-587	-1172	-1570	.	.
Slovenia	Exports	8037	9505	10349	10966	11288	12786	14270	13.3	11.6 [I-XI]
	Imports	9482	10996	11345	11578	12242	14146	15530	15.6	9.8 [I-XI]
	Balance	-1445	-1491	-997	-612	-954	-1360	-1260	.	.
NMS-5	*Exports*	*91499*	*118795*	*136172*	*146885*	*159250*	*193777*	*223449*	*21.7*	*15.4*
	Imports	*115935*	*147709*	*162385*	*170367*	*179908*	*212856*	*236803*	*18.3*	*11.3*
	Balance	*-24436*	*-28915*	*-26213*	*-23481*	*-20658*	*-19080*	*-13354*	.	.
Estonia	Exports	2238	3445	3698	3642	4003	4747	6160	18.6	29.8 [I-XI]
	Imports	3224	4615	4798	5079	5715	6738	8220	17.9	22.0 [I-XI]
	Balance	-985	-1171	-1101	-1437	-1713	-1991	-2060	.	.
Latvia	Exports	1617	2020	2233	2418	2560	3175	4050	24.0	27.5 [I-XI]
	Imports	2764	3453	3913	4287	4635	5615	6760	21.1	20.4 [I-XI]
	Balance	-1147	-1433	-1680	-1868	-2076	-2440	-2710	.	.
Lithuania	Exports	2579	3837	4775	5524	6158	7451	9500	21.0	27.4 [I-XI]
	Imports	4333	5644	6762	7941	8526	9875	12380	15.8	25.4 [I-XI]
	Balance	-1754	-1807	-1987	-2416	-2368	-2424	-2880	.	.
NMS-8	*Exports*	*97933*	*128096*	*146877*	*158470*	*171970*	*209150*	*243159*	*21.6*	*16.3*
	Imports	*126255*	*161422*	*177858*	*187673*	*198785*	*235084*	*264163*	*18.3*	*12.5*
	Balance	*-28322*	*-33326*	*-30980*	*-29203*	*-26814*	*-25934*	*-21004*	.	.

1) Preliminary. - 2) Including trade of firms with customs free legal status. - 3) 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-25, EUR million

(based on customs statistics)

		2001	2002	2003	2004	2005 [1]	2004	2005 [1]	2004	2005 [1]
							change in %		share of EU-25 in % of total	
Czech Republic	Exports	31804	34477	37153	46409	52922	24.9	14.0	85.9	84.2
	Imports	29858	31069	32303	39375	43482	21.9	10.4	71.8	70.8
	Balance	1946	3409	4850	7034	9440	.	.	.	.
Hungary [2]	Exports	27586	29885	30877	35472	37880	14.9	6.8	79.5	76.4
	Imports	24368	25444	26613	34814	35410	8.4	1.7	71.7	67.8
	Balance	3217	4441	4263	658	2470	.	.	.	.
Poland	Exports	32415	34822	38392	47548	54880	23.9	15.4 I-XI	79.2	77.1
	Imports	38958	40428	41699	49020	52870	17.6	7.8 I-XI	68.3	65.7
	Balance	-6543	-5606	-3307	-1472	2010	.	.	.	.
Slovakia [3]	Exports	12593	13449	16375	19039	21720	16.3	14.8 I-X	85.2	84.9
	Imports	11902	12815	14834	17317	19220	16.7	12.0 I-X	73.6	70.8
	Balance	690	634	1541	1722	2500	.	.	.	.
Slovenia [2]	Exports	7206	7402	7551	8507	9580	12.7	12.6 I-XI	66.5	67.1
	Imports	8638	8840	9258	11649	12340	14.6	6.0 I-XI	82.3	79.5
	Balance	-1432	-1438	-1706	-3143	-2760	.	.	.	.
NMS-5	*Exports*	*111603*	*120035*	*130348*	*156974*	*176982*	*20.4*	*12.8*	*81.0*	*79.2*
	Imports	*113724*	*118596*	*124707*	*152174*	*163322*	*16.1*	*7.4*	*71.5*	*69.0*
	Balance	*-2121*	*1439*	*5641*	*4800*	*13660*	.	.	.	.
Estonia [2]	Exports	3006	2974	3298	3797	5070	15.1	33.6 I-XI	80.0	82.3
	Imports	3177	3485	3699	5238	6740	19.3	28.7 I-XI	77.7	82.0
	Balance	-170	-511	-401	-1441	-1670	.	.	.	.
Latvia [2]	Exports	1754	1879	2030	2475	3110	21.9	25.8 I-XI	77.9	76.8
	Imports	2965	3310	3494	4278	5110	21.2	19.5 I-XI	76.2	75.6
	Balance	-1210	-1431	-1464	-1804	-2000	.	.	.	.
Lithuania [4]	Exports	3498	3822	3849	4951	6240	28.6	26.0 I-XI	66.4	65.7
	Imports	4306	5258	5561	6222	7230	11.9	16.3 I-XI	63.0	58.4
	Balance	-808	-1435	-1712	-1271	-990	.	.	.	.
NMS-8	*Exports*	*119861*	*128711*	*139525*	*168198*	*191402*	*20.6*	*13.9*	*80.4*	*78.7*
	Imports	*124171*	*130649*	*137460*	*167913*	*182402*	*16.1*	*8.7*	*71.4*	*69.0*
	Balance	*-4310*	*-1938*	*2065*	*285*	*9000*	.	.	.	.

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) From 2003 dispatches and arrivals according to Intrastat methodology.

Source: wiiw Database incorporating national statistics.

Accession continues to be conducive to trade among the NMS, which is expanding much faster than their overall trade, or their trade with the entire EU-25 (see Table 9). According to available data, the

Czech Republic has even managed to massively increase its (otherwise high) surpluses also in trade with other NMS.

Table 9

Intra-NMS-8 foreign trade (trade among the new EU member states), EUR million

(based on customs statistics)

		2000	2001	2002	2003	2004	2005 [1]	2004	2005 [1]	2004	2005 [1]
								change in %		share of NMS-8 in % of EU-25	
Czech Republic	Exports	5177	6121	6620	7086	9535	11222	34.6	17.7	20.5	21.2
	Imports	4188	4719	5166	5498	7144	7932	29.9	11.0	18.1	18.2
	Balance	989	1403	1454	1588	2391	3290	.	.	.	.
Hungary [2]	Exports	1892	2270	2444	2869	3874	5520	35.1	42.5	10.9	14.6
	Imports	2283	2607	2977	3407	4476	5500	22.8	22.9	12.9	15.5
	Balance	-391	-337	-533	-538	-602	20	.	.	.	.
Poland	Exports	3630	4473	5002	5721	7081	.	23.8	.	14.9	.
	Imports	3968	4446	4457	4837	6167	.	27.5	.	12.6	.
	Balance	-337	27	545	884	915	.	.	.	.	.
Slovakia	Exports	3799	4143	4202	4635	5691	.	22.8	.	29.9	.
	Imports	2955	3695	4001	4599	5533	.	20.3	.	32.0	.
	Balance	844	448	201	36	158	.	.	.	.	.
Slovenia [2]	Exports	707	776	893	956	1068	1100	11.7	3.0	12.6	11.5
	Imports	896	964	969	1023	1275	1190	19.2	-6.6	10.9	9.6
	Balance	-189	-187	-76	-67	-207	-90	.	.	.	.
NMS-5	*Exports*	*15205*	*17783*	*19161*	*21267*	*27250*	.	*28.1*	.	*17.4*	.
	Imports	*14289*	*16431*	*17570*	*19363*	*24594*	.	*25.2*	.	*16.2*	.
	Balance	*916*	*1353*	*1591*	*1903*	*2655*	.	.	.	.	.
Estonia [2]	Exports	398	438	498	562	843	1040	50.0	23.4	22.2	20.5
	Imports	361	465	545	646	1085	1360	35.3	25.4	20.7	20.2
	Balance	37	-27	-46	-84	-242	-320	.	.	.	.
Latvia [2]	Exports	325	387	419	447	730	1200	63.5	64.3	29.5	38.6
	Imports	744	908	1040	1132	1629	2160	30.3	32.6	38.1	42.3
	Balance	-419	-521	-622	-685	-899	-960	.	.	.	.
Lithuania [3]	Exports	934	1106	1082	1197	1579	2180	32.0	38.0	31.9	34.9
	Imports	880	1065	1325	1453	1799	2220	23.9	23.4	28.9	30.7
	Balance	55	41	-243	-256	-220	-40	.	.	.	.
NMS-8	*Exports*	*16862*	*19715*	*21160*	*23472*	*30402*	.	*29.5*	.	*18.1*	.
	Imports	*16273*	*18869*	*20480*	*22594*	*29108*	.	*25.7*	.	*17.3*	.
	Balance	*589*	*846*	*680*	*878*	*1294*	.	.	.	.	.

1) Preliminary. - 2) From 2004 dispatches and arrivals according to Intrastat methodology. - 3) From 2003 dispatches and arrivals according to Intrastat methodology.

Source: wiiw Database incorporating national statistics.

Improving trade balances have lowered current account deficits. Despite this, the Baltic countries, Slovakia and Hungary[6] still register quite large current account deficits (see Table 10).

Table 10

Foreign financial position

EUR billion, end of period

	Gross external debt			Reserves of National Bank (excluding gold) 1)			Current account				Current account in % of GDP			
	2003	2004	2005	2003	2004	2005	2004	2005	2006 forecast	2007 forecast	2004	2005	2006 forecast	2007 forecast
Czech Republic	27.6	33.3	37.8 IX	21.3	20.9	25.0	-4.5	-2.5	-3.0	-2.6	-5.2	-2.5	-2.8	-2.2
Hungary	46.0	55.1	64.4 IX	10.1	11.7	15.6	-7.1	-7.0	-7.4	-7.8	-8.8	-7.9	-8.0	-7.7
Poland	84.8	94.0	105.6 IX	26.0	25.9	34.5	-8.4	-3.7	-3.8	-3.8	-4.1	-1.5	-1.5	-1.4
Slovak Republic	14.7	17.4	22.0 IX	9.7	11.0	13.1	-1.1	-2.2	-2.0	-2.0	-3.5	-5.9	-4.7	-4.2
Slovenia	13.3	15.3	18.9 XI	6.8	6.5	6.8	-0.5	-0.2	-0.2	-0.1	-2.1	-0.7	-0.7	-0.3
Estonia	5.6	7.3	9.6	1.1	1.3	1.6	-1.1	-1.1	-0.9	-0.9	-12.7	-10.7	-7.9	-7.2
Latvia	7.5	9.8	12.3	1.1	1.4	1.5	-1.4	-1.6	-1.5	-1.6	-13.1	-13.1	-10.8	-10.1
Lithuania	6.7	7.7	9.5	2.7	2.6	3.1	-1.4	-1.5	-1.6	-1.7	-7.7	-7.4	-7.2	-7.0

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 (2005) for Baltic States.

In Hungary, the persistently high current account deficits are combined with large foreign debt and modest FDI inflows. The potential risk of a sudden devaluation, or sudden outflow of foreign exchange, may seem larger than elsewhere in the region. Nonetheless, even in Hungary do those risks not seem very large. If anything, one may perhaps be more concerned with the prospects of rising transfers from the EU budget and the resulting appreciation pressures.[7]

No rush on the fiscal front

Despite growth acceleration the fiscal (general government) deficit/GDP ratios worsened in Hungary and in Slovakia. In Poland the ratio improved in spite of growth deceleration. Hungary, true to its tradition, finished the year 2005 with a huge deficit. Public finances in Slovenia (and the Baltic countries) continue to be close to balance.

The excessive deficits in Hungary have been attracting the EU Commission's attention. No doubt the public finances in Hungary are ripe for a deep reform. The situation is far less dramatic than in 1994/95; the fiscal consolidation will certainly not be as painful as the Bokros stabilization programme. But it will make any growth acceleration in Hungary rather unlikely. The fiscal reform will not, perhaps, be instituted in the current (2006) election year, but may become a necessity in 2007. Slovakia, which

6 This is partly due to large and rising deficits on income accounts which represent rising profits of foreign-owned companies.

7 The net transfers to the NMS will be quite significant, ranging between 2.5% and 4% of the receiving countries' Gross National Income (see the analysis by S. Richter, pp. 22ff. in this report).

has volunteered to enter the ERM II in November 2005 for not entirely clear reasons, will also have to rein in its finances somewhat more energetically. As in Hungary, the elections may delay or perhaps even spoil the fiscal consolidation.

Slovakia's reform of the tax system promised many good things, among them higher tax revenues with lower tax rates. That particular promise has not been fulfilled. In actual fact the share of General Government revenues in the GDP has fallen in Slovakia in 2005 (and is the lowest among the five NMS). Too low revenues – with spending that could not contract as fast as revenues – underlies Slovakia's current fiscal problems. It is hard to see how this situation can be ameliorated without raising the tax rates. (The alternative of further cuts in spending does not seem politically acceptable, especially given the levels of poverty in some parts of the country.) It is interesting that this negative aspect of Slovakia's tax reform tends to be ignored by the proponents of radical tax reforms in other countries.

Table 11

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

	1995	2000	2001	2002	2003	2004	2005 [2)]	2006 forecast	2007
Czech Republic	-13.4	-3.7	-5.9	-6.8	-12.5	-3.0	-3.2	-3.7	-3.3
Hungary	.	-3.0	-3.5	-8.5	-6.5	-5.4	-6.1	-5.9	-4.3
Poland	-2.3	-1.6	-3.7	-3.3	-4.8	-3.9	-3.6	-3.6	-3.4
Slovak Republic	-0.9	-12.3	-6.6	-7.8	-3.8	-3.1	-3.8	-2.9	-3
Slovenia	.	-3.5	-3.9	-2.7	-2.7	-2.1	-1.7	-1.9	-1.6
Estonia	0.4	-0.6	0.3	1.5	2.6	1.7	1.1	0.6	0.4
Latvia	-2.0	-2.8	-2.1	-2.3	-1.2	-0.9	-1.2	-1.5	-1.5
Lithuania	-1.9	-3.5	-2.0	-1.4	-1.2	-1.4	-2	-1.8	-1.6

1) EU definition: net lending (+) or net borrowing (-) according to ESA'95, excessive deficit procedure. - 2) Preliminary.

Source: AMECO Database; forecast: wiiw; and European Commission for the Baltic countries.

Inflation is not a problem

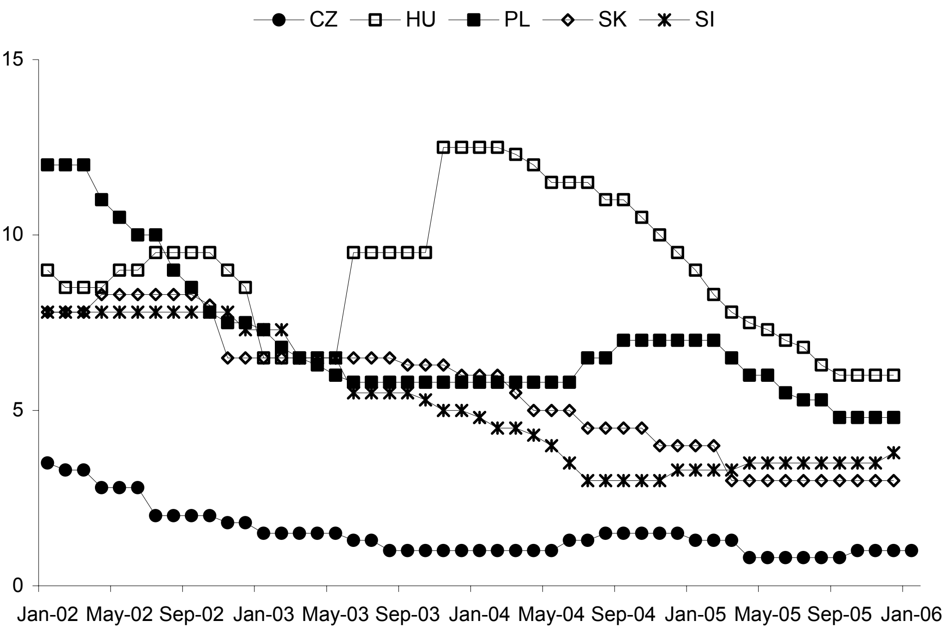
In the year 2004 inflation had temporarily accelerated in a number of countries. This had been the result of fiscally motivated hikes in regulated prices and/or changes in indirect taxes and excises prior to EU accession. In 2005 inflation calmed down in all five Central European NMS, but was higher in the Baltic countries. (This may be a problem, in view of the Baltic countries' euro aspirations.) Despite higher world market prices of energy, inflation was fairly low in the Czech Republic, Poland, Slovakia and Slovenia. In Hungary it was still slightly higher despite disinflation during 2005. The ongoing real appreciation in the Czech Republic, Poland and Slovakia may have helped to depress inflation.

Shortly after the accession to the EU in May 2004 inflation slowed down, and even some signs of deflation could be detected. This prompted an easing of the monetary policy in Hungary, Slovenia, and Slovakia. This notwithstanding, monetary policy in Hungary, and especially in Poland, has remained quite restrictive, as evidenced by fairly high interest rates (see Figure 5).

Figure 5

NMS-5: Minimum interest rates

nominal NB leading rate in % p.a.



Source: wiiw Monthly Database incorporating national statistics.

NMS exchange rates with respect to the euro have been fairly stable over the past few years. However, throughout much of 2005 all NMS-5 currencies (excepting Slovenia) firmed up in nominal terms against the euro (see Figure 6a). This is a reflection of relatively high capital inflows. In the case of Poland and Hungary, the inflows seem to have been reinforced by the relatively high interest rates administered by the respective National Banks (and thus the yields on government debt). Despite much lower official interest rates, the currencies of Slovakia and the Czech Republic have also appreciated. To some extent this may reflect expectations of further nominal appreciation.

Table 12a

Consumer price inflation

change in % against preceding year

	1995	2000	2001	2002	2003	2004	2005 [1]	2006 forecast	2007 forecast
Czech Republic	9.1	3.9	4.7	1.8	0.1	2.8	1.9	2.8	2.5
Hungary	28.2	9.8	9.2	5.3	4.7	6.8	3.6	2	3
Poland	27.8	10.1	5.5	1.9	0.8	3.5	2.1	2.5	2.5
Slovak Republic	9.9	12.0	7.1	3.3	8.5	7.5	2.7	3	3
Slovenia	13.5	8.9	8.4	7.5	5.6	3.6	2.5	2.4	2.3
Estonia	29.0	4.0	5.8	3.6	1.3	3.0	4.1	3.3	2.6
Latvia	25.0	2.6	2.5	1.9	2.9	6.2	6.7	6	4.8
Lithuania	39.6	1.0	1.3	0.3	-1.2	1.2	2.7	2.8	2.9

1) Preliminary.

Source: wiiw Database incorporating national statistics, forecast: wiiw, and European Commission (2005) for Baltic countries.

Table 12b

Producer prices in industry

change in % against preceding year

	1995	2000	2001	2002	2003	2004	2005 [1)]	2006 forecast	2007 forecast
Czech Republic	7.6	4.9	2.8	-0.5	-0.4	5.7	3.0	3	2
Hungary	28.9	11.6	5.2	-1.8	2.4	3.5	4.3	3	3
Poland	25.4	7.8	1.6	1.0	2.6	7.0	0.7	1	1.5
Slovak Republic	9.0	10.8	6.5	2.1	8.3	3.4	4.5	4	3
Slovenia	12.8	7.6	8.9	5.1	2.5	4.3	2.7	2.5	2.4
Estonia	25.6	4.9	4.4	0.4	0.2	2.9	2.1	.	.
Latvia	11.9	0.6	1.7	1.0	3.2	8.6	7.8	.	.
Lithuania	28.3	16.0	-3.0	-2.8	-0.5	6.0	11.5	.	.

1) Preliminary.

Source: wiiw Database incorporating national statistics, forecast: wiiw, and European Commission (2005) for Baltic countries.

The low inflation expected in the coming years should result in further cuts in interest rates. This may help to restrict the appreciation tendencies in Poland and Hungary. Given the low levels of interest rates in the Czech Republic and Slovakia, the pace of nominal appreciation of their currencies may slow down gradually to levels consistent with their 'fundamentals', i.e. trends in productivity and external competitiveness. Avoiding excessive appreciation (and the subsequent loss of international competitiveness) remains one of the key challenges to the exchange rate policy prior to joining the EMU.

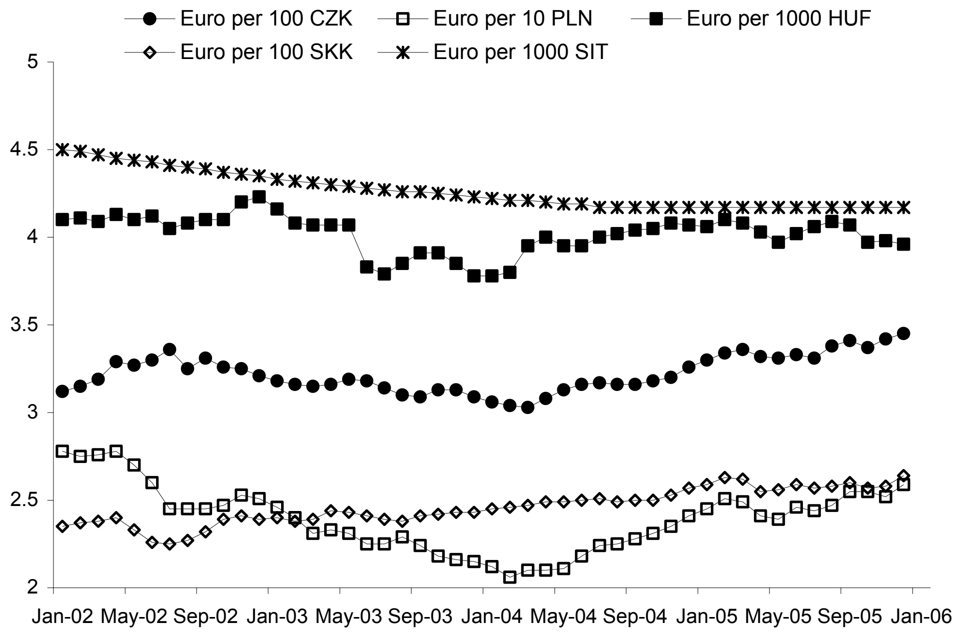
In November 2005 Slovakia joined Slovenia and the three Baltic countries currently operating under the provisions of the ERM II mechanism. At the moment Slovenia's chances for an early adoption of the euro (in 2007) are looking quite good: inflation in that country is low and falling, fiscal deficits and public debt are low. Rebounding inflation in the Baltic countries (particularly in Latvia) may be a good pretext to delay these countries' entry into the Economic and Monetary Union. (The European Central Bank seems to have some doubts about the economic wisdom of allowing a fast entry of the relatively poor Baltics into the EMU.) The economic motives behind Slovakia's decision to enter the ERM II mechanism are not quite clear. First, Slovak public finances are still far from being consolidated. In addition, it is generally believed that membership in the ERM II involves enhanced risks of speculative attacks. For that reason membership in the ERM II should be as short as possible. However, the Slovak authorities seem to be planning to spend more than the required two years under that mechanism.

Poland, the Czech Republic and Hungary will not be entering the ERM II in 2006-07. Hungary still has to cope with its overblown public sector deficit. In Poland and the Czech Republic the adoption of the euro is still unpopular among influential politicians and policy makers. All three countries are likely to adopt the euro only after 2010.

Figure 6a

NMS-5: Nominal exchange rates, 2002-2005

EUR relative to NCU, monthly average

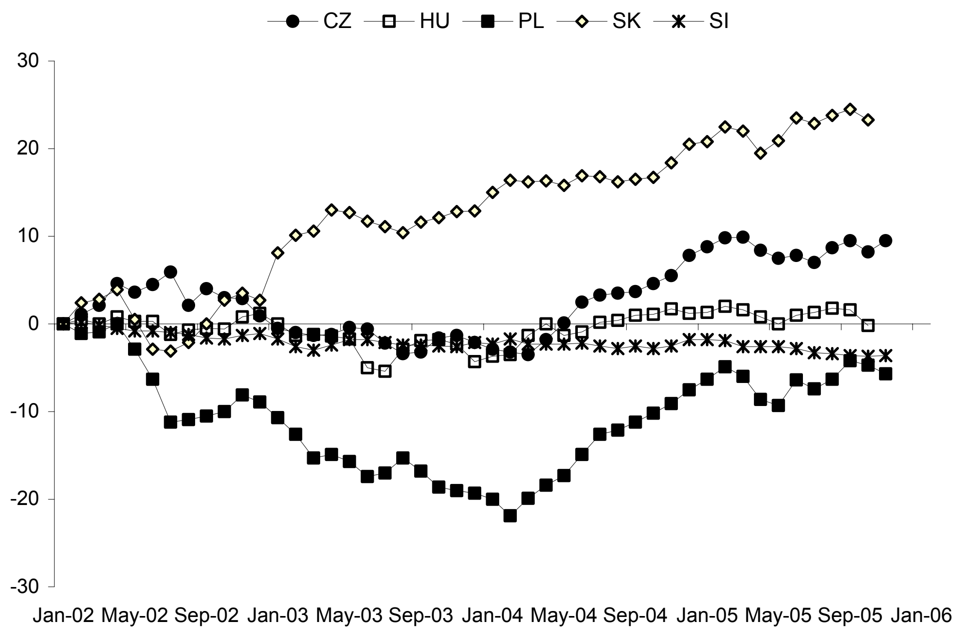


Source: wiiw Monthly Database incorporating national statistics.

Figure 6b

NMS-5: Real appreciation*, 2002-2005

EUR per NCU, PPI-deflated, in % against January 2002



* Increasing line indicates real appreciation.

Source: wiiw Monthly Database incorporating national statistics.

High FDI inflows[8]

UNCTAD estimates global FDI inflows to amount to EUR 720 billion in 2005, 29% above the previous year's level.[9] For the NMS-8, wiiw assumes FDI inflows of EUR 26 billion, an increase of 23%. This is an all-time high exceeding previous forecasts.

The main investment projects that shaped the amount of FDI inflows have been mergers and acquisitions (M&A). The value of such businesses is determined by share prices and profit expectations. Both of these indicators improved in 2005, thus investors paid more than before for shares in the acquired companies. M&A in the NMS were mostly related to privatization projects. The largest of them, the sale of Czech Telecom and the Budapest Airport, generated record FDI inflows in these countries.

Table 13

FDI inflow to NMS, EUR million

	2000	**2001**	**2002**	**2003**	**2004**	**2005** 1)	**2005** 1) in % CA	**2005** 1) stock
Czech Republic	5404	6296	9012	1863	3596	9000	360	50000
Hungary	2998	4391	3185	1888	3708	5000	71	50000
Poland	10334	6372	4371	4067	10070	6500	176	70000
Slovakia	2089	1768	4397	593	1016	1500	68	13000
Slovenia	149	412	1700	300	662	270	135	6000
NMS-5	*20974*	*19239*	*22665*	*8710*	*19051*	*22270*	*143*	*189000*
Estonia	425	603	307	822	838	2690	245	10000
Latvia	447	147	269	260	563	520	33	4000
Lithuania	412	499	772	160	623	440	30	5000
NMS-8	*22258*	*20488*	*24013*	*9952*	*21075*	*25920*	*131*	*208000*

1) Preliminary.

CA stands for current account deficit.

Remarks: Czech Republic: equity capital + reinvested earnings from 1998 + loans from 1998.
Hungary: equity capital + reinvested earnings from 1995 + loans from 1995.
Poland: equity capital + reinvested earnings + loans from 1991.
Slovak Republic: equity capital + reinvested earnings from 1995 + loans from 1995.
Slovenia: equity capital + reinvested earnings from 1994 + loans from 2001.
Estonia: equity capital + reinvested earnings + loans.
Latvia: equity capital + reinvested earnings from 1996 + loans from 1996.
Lithuania: equity capital + reinvested earnings from 1995 + loans from 1997.

Source: Respective National Banks according to balance of payments statistics.

Most probably, also green-field investments and increases in capital surged in 2005. There are indications that manufacturing industry output and exports have been increasingly generated by foreign subsidiaries. Only few of these foreign investment enterprises are the result of outright relocation with capacities having been moved from the EU-15 to the NMS. But capacity increases in

8 This chapter was written by G. Hunya (wiiw).

9 UNCTAD press release, 23 January 2006.

the European motor industry and several other manufacturing branches take place to a large extent in the new member states.

Considerable amounts of FDI in the NMS continued flowing into the banking and the real estate businesses where profits are higher than in the EU-15 and markets are still expanding. In Estonia FDI inflows surged mainly due to Swedish banks increasing capital in their regional headquarters. In most of the countries, real estate and other business services attracted more FDI than manufacturing. Services off-shoring frequented Estonian, Czech, Polish and Hungarian urban centres.

Outward FDI increase is a recent characteristics of the more developed NMS. Companies from Hungary and Slovenia have been investing abroad for several years while Polish and Czech ones have started only more recently. As a result, Slovenia became a net FDI exporting country in 2005. The main target countries of NMS investors are in South Eastern Europe.

Profits of foreign investment enterprises including both repatriated and reinvested earnings are the most important negative item in the current accounts of the NMS. In the first three quarters of 2005 the Czech income balance (FDI- and debt-related combined) recorded a deficit of EUR 3.5 billion while the trade balance was in surplus and the current account deficit amounted to only EUR 1.5 billion. In Hungary the FDI-related income balance ran a deficit of EUR 3 billion, constituting a major part of the EUR 5 billion current account deficit. In Poland the current account deficit diminished substantially in 2005, amounting to EUR 2.5 billion in the first three quarters, but the FDI-related incomes deficit amounted to EUR 5.4 billion, only marginally less than a year before. Also in Slovakia, the worsening of the current account deficit was mainly due to the incomes account.

Preliminary data do not allow to calculate how much of the FDI-related income was reinvested in 2005. Three-quarters data for Hungary suggest that only one quarter, less than in previous years, was reinvested. Also in Poland, the share of reinvestment in FDI income was below 40% while one year earlier it had reached 65%. But most of the annual transaction take place in December, thus the picture may change substantially. Due to this fact, also the FDI inflow predictions have to be interpreted with caution.

Outlook: acceleration of growth in 2006 and 2007

In 2006 the 'old' EU countries are expected to grow slightly faster than in 2005. Taking this expectation at face value, one should count on a continuation of the rather fast growth in the NMS. Net exports will continue to be important sources of GDP growth in the Czech Republic, Hungary, Poland and Slovenia. The experience of 2005 indicates that the export sectors of the NMS are capable of strong performance even in the face of substantial real appreciation, rising unit labour costs in industry, and weak growth in the 'old' EU. There are good grounds to believe that with the ongoing structural changes, qualitative improvements etc. the NMS will continue to fare well in foreign trade. A stronger increase in household incomes in the Czech Republic and Poland will be supporting a stronger rise in consumption, while at the same time diminishing the role of net exports (via increased imports). Rising gross fixed investment will play an important role primarily in Slovakia. Whether investment accelerates in other NMS is not certain yet. Generally, no positive impulses are to be expected from the fiscal policy. But the upcoming parliamentary elections in Hungary, Slovakia and the Czech Republic make any substantial tightening of the fiscal policies unlikely as well. The positive impacts of more relaxed monetary policies (which are likely as inflation is low and on the retreat everywhere) will be of secondary importance.

Presently it is assumed that growth in the 'old' EU will further accelerate in 2007. That would of course help to maintain high growth in the NMS. Even if the current forecast for the 'old' EU is too optimistic, the NMS are likely to grow quite fast in 2007. By that year the EU transfers to the NMS will be quite sizeable. No doubt they will be supporting rising investment and overall growth.

The highlights of the country-specific forecasts are presented below. More detailed analyses of the individual NMS in Central Europe follow this overview.

The Czech Republic

Booming foreign trade has been the main force behind quite phenomenal growth in 2005. In 2006 and 2007 high GDP growth will continue. However, under rising household income and domestic demand, imports are likely to grow faster so that the contribution of foreign trade to overall growth will be more moderate.

Hungary

Hungary's economic performance was quite good in 2005. But public finances are in rather poor shape. In view of the upcoming elections, the necessary and long overdue consolidation of public finances will come only in 2007.

Poland

Despite the quite satisfactory performance of foreign trade, overall GDP growth was rather unimpressive. This was due to continuing weakness of household income (stagnant wages) and private consumption. Relatively low interest rates and the very strong financial standing of the corporate sector have yet to produce higher investment growth. Continuing political turmoil will be enhancing uncertainties, also as far as economic policy is concerned. This need not be conducive to the long overdue investment expansion.

Slovakia

Backed by rising private consumption, investment and foreign trade, GDP growth accelerated in 2005. The labour market situation has improved. Further growth acceleration is very likely in 2006-07, despite actual FDI inflows falling short of earlier proud announcements and the current political turmoil. The unexpected entry into the ERM II in November 2005 seems to have been politically motivated.

Slovenia

Slovenia currently meets the Maastricht criteria and the prospects for the euro introduction at the beginning of 2007 are favourable. Supported by buoyant domestic demand and continued export expansion, GDP will grow by slightly less than 4% both in 2006 and 2007. The introduction of the flat tax, reforms of the social benefit system and speeding up privatization are the government’s main priorities over the next two years.

Sándor Richter

Higher demand through transfers from the EU

The European Council of 15/16 December 2005 arrived at a compromise on the Financial Perspective (the long-term 'EU-budget') for the period 2007 to 2013, opening the door for substantial financial assistance to post-communist reconstruction and modernization, a so far unfulfilled dream of the new EU member states from Central and Eastern Europe (NMS).[10] The financial framework for the period 2007-2013 is EUR 862.4 billion (1.045% of the EU's GNI). Even though the European Parliament will have a word in finally adopting the Financial Perspective, any changes will be minimal and relate to upward corrections only. The agreed sum is less than the Commission's first proposal from 2004 (EUR 1022 billion or 1.24% of the EU's GNI) and only slightly higher than the figures proposed by the six major net-payer member states in December 2003 (1% of the EU's GNI). Nevertheless, the NMS are among those whose loss is relatively small. The main budgetary cuts were made with respect to the support of competitiveness (R&D, trans-European infrastructure networks, etc.) – areas in which the major beneficiaries would have been the highly developed old member states. Nearly half of the originally planned resources were cut. About half of the originally planned expenditures for citizenship, freedom, security & justice, for external policies, and the EU as global partner, were also eliminated; again, these are expenditures with only moderate significance for the NMS. The reduction in direct payments and market intervention in agriculture, a segment with high relevance for several NMS, was less than 3%. This is a minimal reduction, even if related expenditures for Bulgaria and Romania will have to be paid from the sum originally earmarked for just 25 and not for 27 member states.[11]

What is in fact painful for the NMS is the 20% cut for rural development and also the smaller transfers for cohesion (structural policy interventions) which were reduced by about one tenth. All in all, spending for cohesion came out as a relatively spared segment of the expenditure chapters in the future budget. Moreover, the NMS achieved remarkable concessions. First, for member states below 85% of the EU average level of development, the so-called n+2 rule was changed to n+3, remaining in force until 2010. That means that payment commitments made in year 'n' may now be spent in that year or in the following three years (the current regulation allows only two years added); any de-commitment (the loss of unused resources which are then transferred back to the common budget) follows only thereafter. For NMS coping with absorption problems this is an important improvement. Second, the ceiling for the EU co-financing rate was raised to 85% (or, put differently, the minimum national co-financing rate was lowered to 15%) in all structural policy interventions..[12] Less national co-financing is an important relief for those NMS where fiscal balances are in disarray and local governments also have to cope with shortage of resources. Finally, for all member states below 85% of the EU-25 average level of development, non-reimbursable VAT shall count as eligible expenditure for the purpose of calculating the contributions in structural policy interventions. This is in contrast to the general rule, applied to all other member states, that VAT is not eligible for

10 This text partly relies on a comment by the author on the December European Council (see S. Richter, 'The miracle of Brussels: a compromise on the long-term budget of the European Union', *The Vienna Institute Monthly Report*, No. 1, 2006, pp. 1-3).

11 It is important to mention in this context that the Financial Perspective for 2007-2013 does not include resources for Croatia as a member state, should this country join the EU before 2014.

12 Currently this favourable EU co-financing rate applies only to Cohesion Fund transfers; interventions from the Structural Funds have had maximum 75% EU co-financing rates. It is important to point out that these are maximum co-financing rates: profit-oriented EU transfer recipients typically get lower EU co-financing than other, non-profit recipients.

EU co-financing. This exemption shifts the proportions between the EU co-financed part versus nationally co-financed part in projects in such a way that again the burden of national co-financing will be smaller.

All in all, from 2007 on cohesion transfers may amount to 3.2% to 3.8% of the new member states' GNI[13], and an additional 0.2% to 1% may come from agricultural subsidies[14]. Further minor transfers will be disbursed from other spending chapters. That means that altogether transfers in the magnitude of 3.5% to 5% of the new member states' GNI will flow for a period of at least seven years (2007-2013). At the same time, the NMS annual contribution to the EU budget will make up about 1% of their GNI. The resulting *net financial position* of the NMS may thus amount to 2.5% to 4% of their GNI per year in the period concerned.

A historical comparison may give some insight into the significance of EU transfers for the NMS. After World War II, the USA provided financial assistance to Western Europe in the framework of the European Recovery Programme (the Marshall plan). The financial inflow of that programme corresponded on average to 2.1% of the recipient countries' GDP annually between 1948 and 1952.[15] A comparison with a more contemporary phenomenon regards FDI inflows to NMS: From 2007 on, transfers from the EU budget will reach the magnitude of inward FDI over the past five years.

The macroeconomic impact of the EU transfers has yet been hardly felt since the NMS' EU accession in May 2004. This is understandable because the 'phasing-in' process of both structural policy interventions and direct payments for farmers, i.e. a gradual increase in transfers gearing up to their 'normal' level in 2007 in the case of structural policy transfers and (probably) in 2013 in direct payments for farmers. Furthermore, in most cases of structural policy transfers, the time period from project design and application for support until the completion of the project concerned spreads over more than one year. Thus even the moderate commitments made in 2004 will have their impact mostly in 2006. In 2007, structural policy transfers will increase. The latest wiiw macroeconomic forecasts for 2007 take into account the demand effects coming from EU transfers. Transfers in that year (and in each year up to at least 2013) will be three times larger than the average annual transfers in the period 2004-2006.

Due to initial difficulties in the institutional system managing EU transfers and the time lag between commitments and actual payments, the aggregate demand effect of EU transfers may amount to 1% to 2% of the new member states' GNI in 2006 and to 2% to 3% in 2007. The composition of the additional demand is difficult to assess. In structural policy interventions, applicants for EU support must provide a detailed allocation of planned expenditures: these may be purchases of real estate, investments in machinery or construction, purchases of materials and immaterial goods, personal costs and non-reimbursable VAT. At the national level expenditures are allocated among operational programmes (in Slovenia among priorities) which may have a widely diverging mix of spending

---

13 Council of the European Union, Note to the Presidency 15915/05, CADREFIN 268, Brussels, 19 December 2005, p. 16.

14 Z. Lukas and J. Pöschl, 'Bedrohung für Österreichs Landwirtschaft? Szenarien zur Entwicklung der MOE-Landwirtschaft im europäischen und internationalen Verbund', study commissioned by the Austrian Ministry of Agriculture and Forestry, The Vienna Institute for International Economic Studies (wiiw), 2003, p. 99.

15 J. Beutel, 'The economic impact of objective 1 interventions for the period 2002-2006', Final Report to the Directorate General for Regional Policies of the European Commission, Konstanz, May 2002, p. 8.

modalities: e.g., projects in the operational programme for human resources development will have a substantially higher share of personal costs than investment in machinery, while in the operational programme for the development of transport infrastructure the contrary will apply. All NMS are now in the phase of programming for the years after 2006. A more detailed assessment of the composition of additional demand will be possible once the national development strategies (including the allocation of available support among operational programmes and sub-programmes) have been approved later this year. It is important to point out that the additional demand via EU transfers will not necessarily appear as domestic demand. As illustrated by the example of the 'old' EU cohesion countries, a substantial part, 25% to 35% of the value of structural policy interventions, may be spent on imports.[16] A possible crowding out of non-EU co-financed investment projects by EU co-financed projects will neutralize part of the additional demand created by EU transfers.

Concerning direct payments for farmers, the assessment of the allocation of transfers by spending modalities is extremely difficult, as the beneficiaries are not bound by any restrictions in terms of utilization: the whole sum may be spent either on investment, or covering all sorts of operational costs or consumption, and it may even be saved by the recipient. Beneficiaries' spending behaviour may vary by regions, extent and the main specialization direction of the farm concerned, and even by individual years. Only carefully designed surveys may deliver insight into the detailed demand effect of direct payments.

[16] European Commission, 'A new partnership for cohesion', Third report on economic and social cohesion, February 2004, p. XVII.

Country reports

Leon Podkaminer

The Czech Republic: an export-led expansion

The high GDP growth which started already in the second quarter of 2004 has been continuing. In the third and probably fourth quarters of 2005 GDP rose by 4.9%, thus somewhat less than earlier in the year. Nonetheless, at an about 5% yearly growth rate, the current performance of the Czech economy is the best so far. What is quite noteworthy about the current situation is that growth, sustained over quite a long period now, has not produced any visible symptoms of 'overheating'.

First, one does not observe the usual signs of impending inflationary acceleration. In actual fact both the consumer and producer price inflation indices are much lower than in 2004, and that despite high energy prices, large increases in administered prices and indirect taxes. Moreover, the industrial producer price index has actually been falling throughout 2005.

Second, faster growth has not produced any tensions in foreign trade. To the contrary, the trade and current account balances have been improving. A sizeable trade (goods and services) surplus, equivalent to about 1.7% of the GDP, is expected for the whole year 2005 – the first such development in a decade. The current account deficit has roughly halved compared with 2004 (with investment income earned on inward foreign investment continuing to increase quite strongly).

Foreign trade contributed decisively to the overall GDP growth, with exports performing very strongly. The (negative) contribution of imports was much smaller. The relatively weak growth of imports[17] reflects the weakness of domestic demand, which rose only about 0.7%. Households' real disposable incomes rose somewhat faster than in 2004, but at a low pace all the same (by about 2%). This is consistent with a rather modest rise in private consumption (by about 2.6%) which was supported by expanding bank lending.

The low (and falling) share of labour income in GDP (about 42.6% in 2005), and hence a relatively high (and rising) share of corporate profits/mixed income, prove conducive to moderate growth of fixed capital formation (about 3%). However, part of the rise in fixed capital formation can be attributed to a fast rise in residential housing investment financed by expanding credits, and to rising government investment. There are good grounds to believe that fixed investment in the corporate sector may have stagnated in 2005.

The fact that the relatively low (and generally not expanding) unemployment rate coexists with very moderate wage hikes indicates the presence of commendable moderation on the part of the Czech labour. On the other hand, also the Czech economic authorities seem to be doing a fairly good job. The consolidation of public finances has proceeded without undue haste. Fashionable – and controversial – reforms of the tax system (e.g. flat tax) have not yet been experimented with in the Czech Republic (though they figure on the programme of the opposition Civic Democratic Party) and cuts in social spending have been much more moderate and gradual than elsewhere in the region.

[17] During the first three quarters of 2005 exports rose by 11.5% in real terms while imports by only 5.3%.

Nonetheless the fiscal deficit in 2005 is provisionally estimated at about 3% of the GDP.[18] Still, in view of the parliamentary elections (scheduled for June) the deficit may rise temporarily in 2006 – only to be reined in later on.

The Czech National Bank has been maintaining very low interest rates (actually lower than the ECB's). This is consistent with very low 'core inflation'. Additionally, the CNB's policy is certainly motivated by a concern over an undesirable excessive strengthening of the domestic currency. The inflation target for 2006 (and beyond) is 3% (actually a 2-4% range). There is little doubt that inflation will fall into that range. However, as a consequence of the liberalization of housing rents and other administrative interventions, inflation in 2006 is likely to be temporarily somewhat higher than in 2005. But the risk of the CNB engaging in any exaggerated actions over increased inflation is minimal. Nonetheless, the steady nominal appreciation of the Czech koruna vs. the euro is quite certain to continue. Falling current account deficits coupled with steady capital inflows (dominated by foreign direct investments[19]) and rising transfers from the EU will continue to exert some appreciation pressure.

The general character of growth in 2006 and 2007 will not be radically different from that observed recently. Low inflation – which is relatively easy to control given the nominal appreciation of the domestic currency, maintained wage moderation and rather disciplined social spending – will allow for maintaining low interest rates. This in itself will not be provoking an excessive appreciation of the Czech koruna. Then, further gains in labour productivity and relative unit costs (low pace of wage increases) will be consolidating the country's external competitive position, despite some nominal (and thus quite remarkable real) appreciation.

Of course, some changes in the composition of growth are quite likely. First, domestic demand will probably accelerate gradually. Improved profitability and the overall financial position of the corporate sector achieved in 2005 may be expected to induce a revival in its fixed investment. Growth in private consumption is also likely to be higher than in 2005, primarily on account of gradually improving real disposable incomes (rising – though moderately – employment, wages and social benefits). Continuing availability of cheap credit will continue to be conducive to higher household consumption and residential investment.

The expansion of Czech exports is likely to carry on, not only because of their maintained external price (and cost) competitiveness, but – first of all – because of their fast improving qualitative characteristics (high levels of FDI in the export-oriented activities). However, under sustained growth of exports and accelerating domestic demand, imports are unlikely to remain as anaemic as in 2005. Assuming that exports of goods and services will continue to rise at some 10% per annum in real terms, and domestic demand will rise at a moderate 3.5%, one would have to count with at least 8-9% real growth in imports. Net exports would then continue to add to overall growth, but their role would cease to be as dominant as in 2005.[20]

---

[18] The fiscal balance was positively affected by privatization revenues earned on two large privatization deals (sale of Czech Telecom and the petrochemicals firm Unipetrol) – and negatively by large one-off expenses on military hardware.

[19] The FDI inflow in 2005 was over EUR 9 billion, almost twice the 2004 level. The two large privatization deals are certainly responsible for the results achieved in 2005. Nonetheless most of the FDI inflows are not related to privatization, and about one third of them consist of reinvested profits.

[20] In the first three quarters of 2005 the Czech GDP rose by 5%, out of which 4.4% were due to net exports.

Table CZ

Czech Republic: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 [1]		2006 forecast	2007 forecast
Population, th pers., mid-year [2]	10282.8	10272.5	10224.2	10200.8	10201.7	10206.9	10231.7		.	.
Gross domestic product, CZK bn, nom. [3]	2041.4	2150.1	2315.3	2414.7	2555.8	2767.7	2960		3180	3410
annual change in % (real) [3]	1.2	3.9	2.6	1.5	3.2	4.7	5.0		4.5	4.7
GDP/capita (EUR at exchange rate)	5383	5878	6644	7683	7867	8499	9710		.	.
GDP/capita (EUR at PPP - wiiw)	12190	12810	13510	14280	14740	15920	16840		.	.
Gross industrial production										
annual change in % (real)	-3.1	1.5	10.6	4.8	5.8	9.9	5.7		6	6
Gross agricultural production										
annual change in % (real)	0.6	-4.5	2.5	-4.4	-7.6	14.9	.		.	.
Construction industry										
annual change in % (real)	-6.5	5.3	9.6	2.5	8.9	9.7	3.8	I-XI	.	.
Consumption of households, CZK bn, nom. [3]	1046.3	1108.8	1179.4	1220.6	1300.5	1372.4	.		.	.
annual change in % (real) [3]	2.2	2.9	2.8	2.7	4.6	3.3	3		3.3	4
Gross fixed capital form., CZK bn, nom. [3]	550.6	594.9	638.6	643.3	685.6	743.8	.		.	.
annual change in % (real) [3]	-3.6	4.9	5.4	3.4	4.7	5.3	3		5	5
LFS - employed persons, th, avg. [4]	4764.1	4731.6	4750.2	4764.9	4733.2	4706.6	4764.0		.	.
annual change in %	-2.1	-0.7	0.4	0.8	-0.7	-0.6	1.2		.	.
LFS - employed pers. in industry, th, avg. [4]	1468.7	1429.4	1470.6	1463.1	1424.7	1409.0	1414.3	I-IX	.	.
annual change in %	-3.4	-2.7	2.9	-0.1	-2.6	-1.1	0.4	I-IX	.	.
LFS - unemployed, th pers., average	454.1	454.5	421.0	374.1	399.1	425.9	410.2		.	.
LFS - unemployment rate in %, average [4]	8.7	8.8	8.1	7.3	7.8	8.3	8.0		7.5	7.5
Reg. unemployment rate in %, end of period	9.4	8.8	8.9	9.8	10.3	9.5	8.9		8.5	8.5
Average gross monthly wages, CZK [5]	12797	13614	14793	15866	16917	18035	19100		.	.
annual change in % (real, gross)	6.2	2.4	3.8	5.4	6.5	3.7	4		.	.
Consumer prices, % p.a.	2.1	3.9	4.7	1.8	0.1	2.8	1.9		2.8	2.5
Producer prices in industry, % p.a.	1.0	4.9	2.8	-0.5	-0.4	5.7	3.0		3	2
General governm. budget, EU-def., % GDP [6]										
Revenues	39.2	38.5	39.1	40.2	41.0	41.6	41.8		41.5	41.4
Expenditures	42.9	42.1	45.0	46.9	53.5	44.7	45.0		45.2	44.7
Deficit (-) / surplus (+)	-3.6	-3.7	-5.9	-6.8	-12.5	-3.0	-3.2		-3.7	-3.3
Public debt, EU-def., in % of GDP [6]	13.3	18.2	26.3	29.8	36.8	36.8	36.2		36.6	36.9
Discount rate, % p.a., end of period	5.0	5.0	3.8	1.8	1.0	1.5	1.0		.	.
Current account, EUR mn	-1372	-2945	-3652	-4426	-5044	-4490	-2500		-3000	-2600
Current account in % of GDP	-2.5	-4.9	-5.4	-5.6	-6.3	-5.2	-2.5		-2.8	-2.2
Gross reserves of NB incl. gold, EUR mn	12771	14159	16400	22614	21340	20884	25003		.	.
Gross external debt, EUR mn	22765	23285	25368	25738	27624	33258	37779	IX	.	.
FDI inflow, EUR mn	5933	5404	6296	9012	1863	3596	9000		.	.
FDI outflow, EUR mn	84	47	185	219	183	440	700		.	.
Exports of goods, BOP, EUR mn	24640	31483	37251	40711	43051	53714	63400		73000	82000
annual growth rate in %	6.8	27.8	18.3	9.3	5.7	24.8	18		15	12
Imports of goods, BOP, EUR mn	26424	34876	40675	43026	45243	54414	61500		69000	77000
annual growth rate in %	4.1	32.0	16.6	5.8	5.2	20.3	13		12	12
Exports of services, BOP, EUR mn	6612	7436	7913	7501	6882	7787	8600		9500	.
annual growth rate in %	-3.1	12.5	6.4	-5.2	-8.3	13.2	10		10	.
Imports of services, BOP, EUR mn	5486	5904	6211	6792	6466	7396	8100		8900	.
annual growth rate in %	7.4	7.6	5.2	9.4	-4.8	14.4	10		10	.
Average exchange rate CZK/USD	34.60	38.59	38.04	32.74	28.23	25.70	23.95		.	.
Average exchange rate CZK/EUR (ECU)	36.88	35.61	34.08	30.81	31.84	31.90	29.78		29.4	29.0
Purchasing power parity CZK/USD	14.26	14.38	14.60	14.27	14.50	14.55	14.42		.	.
Purchasing power parity CZK/EUR	16.29	16.34	16.76	16.58	16.99	17.03	17.18		.	.

Notes: 1) Preliminary. - 2) From 2001 based on census March 2001. - 3) According to ESA 95, real change based on constant prices of previous year. - 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; AMECO Database; wiiw forecasts.

Under the scenario just outlined, eventual GDP growth would be about 4-4.5% in both 2006 and 2007. Growth rates of that order, though not quite as impressive as e.g. the performance of neighbouring Slovakia, would still be much higher than in the old EU. Moreover, they would stipulate rising trade surpluses and a stabilization of the current account deficits. On the other hand, as at the same time the level of the Czech gross national income will be lower by some 6% than its GDP, this otherwise realistic scenario is not quite perfect.

Sándor Richter

Hungary: waiting for the spring elections

Hungary's economic performance was improving over the year 2005. GDP growth accelerated from 3.2% in the first quarter to 4.5% in the second and third quarters. The annual growth rate in 2005 must have surpassed 4%. This performance, while substantially better than that of the 'old' EU members (about 1.4%), is less impressive in comparison with other new EU member states. The interpretation of macroeconomic indicators has become the battlefield of pre-election political struggles, with the government pointing at a robust performance of the economy and the opposition seeing malfunction and failure everywhere. This completely different evaluation of the country's economic performance is rooted in a really existing duality, namely the 'co-habitation' of a flourishing business sector with ailing public finances.

Contrary to the period 2000-2003, exports and investment are the engines of growth, with net exports showing the best result since 2000. Consumption increased by 2.3% in the first three quarters of the year, substantially below the pace of GDP growth.

Due to speeded-up highway construction the expansion of construction activities (17.4% in the first three quarters) exceeded growth in any other segment of the economy. Though this acceleration must certainly be seen as part of the election campaign, the remarkably strong correlation of foreign investments with easy accessibility of the chosen site via highways shows that the programme is worth being pushed, even if part of the public finance problems are caused by the related high financing requirements. Industrial output increased by 7.3% in the first eleven months of the year, with exceptionally high growth rates in northern Hungary and central Transdanubia and weak performance in the earlier growth centres western Transdanubia and Budapest. Export sales expanded more than twice as dynamically as domestic sales. Productivity increased by 10% in the first ten months of the year. In October 2005 the volume of new orders was up one quarter against a year earlier, in chemical products and electrical and optical equipment new orders even rose by more than 40%. The performance of the services sector expanded at the same pace as did GDP, with transport, storage and communication far above the sectoral average, and public administration, education, health and social work far below that average.

Economic growth was increasingly supported by export expansion. From the third quarter of 2003 exports increased more rapidly than imports; in the first eleven months of 2005 the difference in growth rates made up 3.4 percentage points in favour of exports. The trade deficit was nearly one third smaller than in the respective period in 2004. The geographical destination/source of trade flows has undergone a remarkable shift: trade with the EU-15 stagnated while that with the new EU

Table HU

Hungary: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 [1)]	2006	2007
								forecast	
Population, th pers., end of period	10221.6	10200.3	10174.9	10142.4	10116.7	10097.5	10065	10040	10020
Gross domestic product, HUF bn, nom. [2)]	11393.5	13150.8	14989.8	16915.3	18650.8	20413.5	22000	23400	25000
annual change in % (real) [2)]	4.2	5.2	4.3	3.8	3.4	4.6	4.2	4.2	4.0
GDP/capita (EUR at exchange rate) [2)]	4402	4953	5732	6853	7263	8025	8800	.	.
GDP/capita (EUR at PPP - wiiw) [2)]	9740	10550	11640	12510	12890	13620	14490	.	.
Gross industrial production									
annual change in % (real)	10.4	18.1	3.6	2.8	6.4	7.4	7.5	8	7
Gross agricultural production									
annual change in % (real)	0.4	-6.5	15.8	-4.1	-4.5	22.8	.	.	.
Construction industry									
annual change in % (real)	9.0	7.9	7.7	17.5	2.2	6.8	17	.	.
Consumption of households, HUF bn, nom. [2)]	5826.6	6689.2	7816.9	8904.2	10066.5	10844.9	.	.	.
annual change in % (real) [2)]	5.4	4.4	6.1	10.8	8.5	3.2	2.5	3.2	2.5
Gross fixed capital form., HUF bn, nom. [2)]	2724.5	3179.8	3493.0	3916.9	4141.3	4616.0	.	.	.
annual change in % (real) [2)]	5.9	7.7	5.9	9.3	2.5	8.4	8.5	7	8
LFS - employed persons, th, avg.	3809.3	3856.2	3868.3	3870.6	3921.9	3900.4	3901.5	.	.
annual change in %	0.6	1.2	0.3	0.1	1.3	-0.5	0.0	.	.
Reg. employees in industry, th pers., avg. [3)]	834.0	844.8	833.9	817.9	801.8	785.2	762	.	.
annual change in %	0.8	1.3	-1.3	-1.9	-2.0	-2.1	-3	.	.
LFS - unemployed, th pers., average	285.3	263.7	234.1	238.8	244.5	252.9	303.9	.	.
LFS - unemployment rate in %, average	7.0	6.4	5.7	5.8	5.9	6.1	7.2	7.2	7.3
Reg. unemployment rate in %, end of period	9.3	8.6	8.0	8.0	8.3	9.1	9.1	9.1	9.2
Average gross monthly wages, HUF [3)]	77187	87645	103553	122482	137193	145521	158600	.	.
annual change in % (real, net)	2.5	1.5	6.4	13.6	9.2	-0.7	6	.	.
Consumer prices, % p.a.	10.0	9.8	9.2	5.3	4.7	6.8	3.6	2	3
Producer prices in industry, % p.a.	5.1	11.6	5.2	-1.8	2.4	3.5	4.3	3	3
General governm.budget, EU-def., % GDP [4)]									
Revenues	44.4	44.6	44.9	44.1	44.0	44.5	43.4	.	.
Expenditures	49.9	47.7	48.5	52.6	50.4	49.9	49.5	.	.
Deficit (-) / surplus (+) [5)]	-5.5	-3.0	-3.5	-8.5	-6.5	-5.4	-6.1	-5.9	-4.3
Public debt, EU-def., in % of GDP [4)5)]	61.2	55.4	52.2	55.5	57.4	57.4	57.2	.	.
Refinancing rate, % p.a., end of period	14.5	11.0	9.8	8.5	12.5	9.5	6.0	5.0	4.5
Current account, EUR mn	-3531.4	-4352.4	-3576.5	-4929.2	-6381.7	-7136.1	-7000	-7400	-7800
Current account in % of GDP	-7.8	-8.6	-6.1	-7.1	-8.7	-8.8	-7.9	-8.0	-7.7
Reserves total, excl. gold, EUR mn	10845.3	12038.4	12163.7	9887.4	10108.3	11670.9	15640.3	.	.
Gross external debt, EUR mn	29230.9	32571.5	37387.0	38559.3	46041.1	55061.7	64446.2 [IX]	.	.
FDI inflow, EUR mn	3106.4	2998.4	4390.7	3185.1	1887.5	3707.6	5000	4000	4000
FDI outflow, EUR mn	234.7	664.4	398.5	295.7	1463.4	856.0	1300	1000	1000
Exports of goods, BOP, EUR mn	24058.8	31277.5	34697.1	36820.7	38376.9	45074.0	49600	54560	60000
annual growth rate in %	14.3	30.0	10.9	6.1	4.2	17.5	10	10	10
Imports of goods, BOP, EUR mn	26102.4	34457.1	37192.8	39024.1	41274.5	47520.0	50850	55430	60400
annual growth rate in %	14.8	32.0	7.9	4.9	5.8	15.1	7	9	9
Exports of services, BOP, EUR mn	4910.2	6429.2	7864.7	7820.0	7673.8	8294.5	9400	10340	11370
annual growth rate in %	2.1	30.9	22.3	-0.6	-1.9	8.1	13	10	10
Imports of services, BOP, EUR mn	4093.9	5194.8	6203.3	7233.1	8074.7	8343.2	9500	10450	11500
annual growth rate in %	9.6	26.9	19.4	16.6	11.6	3.3	14	10	10
Average exchange rate HUF/USD	237.31	282.27	286.54	258.00	224.44	202.63	199.66	.	.
Average exchange rate HUF/EUR (ECU)	252.80	260.04	256.68	242.97	253.51	251.68	248.05	252	246
Purchasing power parity HUF/USD	99.96	107.43	110.13	114.72	121.84	126.65	127.55	.	.
Purchasing power parity HUF/EUR	114.24	122.11	126.46	133.14	142.85	148.28	150.59	.	.

Notes: 1) Preliminary. - 2) From 2001 revised data (FISIM adjustment). - 3) Enterprises with more than 5 employees. - 4) According to ESA'95, excessive deficit procedure. - 5) After corrections related to the pension reform.

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

members and the rest of the world expanded dynamically. Machinery and transport vehicles accounted for 61% of total exports. In this commodity group, exports to the ‘old’ EU members exceeded imports from that country group by 36%, while the balance with non-EU members in machinery and transport vehicles trade was negative. The improving trade performance is reflected in the balance of payments. Though the current account deficit in the first three quarters of 2005 amounted to EUR 5053 million, only about 6% less than in the respective period of 2004, the (BOP) trade of goods balance improved dramatically, showing only half the deficit registered a year earlier. The positive impact of goods trade was counterbalanced by the deterioration of the income balance (mainly due to significant profit repatriation of foreign-owned companies). In the first three quarters of 2005 non-debt generating financing was substantially less than in 2004; however, with the sale to British Airport Authority of the exclusive rights to operate the Budapest airport in December 2005 (the value of the deal amounts to about EUR 1.8 billion) the picture will change completely in the statistics embracing the whole year 2005.

Public finance has remained the problem number one in 2005. Although in 2005 the general government deficit remained below the planned figure for the first time in the past four years, this was possible only with the help of one-off revenues and some ‘creative’ book-keeping. Even so the public deficit amounted to 6.1% of the GDP, more than double the entrance requirement to Euroland. There is a broad consensus in the research community that the general government deficit target for 2006 (4.7% of the GDP) cannot be attained.

It is obvious that the targets of the revised convergence programme (3.4% deficit/GDP ratio in 2007, 1.9% in 2008) cannot be achieved with expenditure cuts here and there and streamlining of the state administration. Hungary badly needs a series of fiscal reforms, in particular in health care, education and local governments. The current system is swallowing enormous resources while producing outputs which leave the consumers of these outputs deeply unsatisfied. Reforms have continuously been postponed since 1997, the last major reform (transformation of the pension system) and are to be introduced apart from the requirements for the introduction of the euro in 2010, the date envisaged by the government. Regretfully reforms are not among the central issues in the emerging election campaign. Stabilization, despite the obviously positive outcome of the so-called Bokros package in 1995 has remained taboo not only for the biggest opposition party FIDESZ but for the Socialist Party as well, the senior partner in the present government and the erstwhile initiator (together with the Free Democrats) of the successful 1995 stabilisation. With regard to the irresponsible promises to various groups of the population one has the impression that both big political parties are apparently convinced that the 2006 elections can be won only by populist programmes.

While no reforms or measures to consolidate the fiscal stance may be expected before the elections, thereafter the likelihood of a resolute turn in the management of fiscal problems is high. Repeated warnings from the EU, the downgrading of Hungary’s foreign currency debt rating by Fitch last December and the weakening of the forint over 2005 are warning signs, and all hint at the lurking risk of a major currency crisis. That risk may turn into acute danger unless immediate steps are taken by the incoming government towards consolidation of the budget, with or without maintaining 2010 as target date for the euro introduction. The critical issues to be addressed in the first hundred days will be launching reforms in health care, education and local government, reconsidering initiated or promised tax reforms which reduce the government’s revenues, a new design for the financing of highway construction, and painful decisions about the future of the state-financed institutions. Whether a comprehensive reform package has already been elaborated either by the government parties or the parties in opposition, will most probably remain a well-guarded secret until after the elections.

The likely turn in fiscal policy will have an impact on the exchange rate resulting, by the end of 2006, in an exchange rate below 250 HUF/EUR and a central bank base rate of 5% or less. Inflation will be around 2% due to lowering of the top VAT rate from 25% to 20%, but an element of uncertainty with respect to energy prices. Fiscal policy changes will have no major impact on economic growth in 2006. The GDP will increase by more than 4%, exports and investment remain the driving force behind the output expansion. The current account deficit will grow, but will remains unchanged in relation to the GDP. The fiscal corrections will mainly affect the year 2007; the impact for 2006 may merely be an overshooting of the official deficit target – yet to a smaller extent than would be the case without the corrective measures (up to 6% of GDP versus 4.7%).

Leon Podkaminer

Poland: heightened uncertainty

After very weak performance in the first quarter of 2005, growth in both private consumption and gross fixed capital formation was gradually accelerating (from 1.7% and 1.2% respectively in the first quarter to an estimated 3.3% and 7% in the fourth). GDP growth accelerated – from 2.1% in the first quarter to an estimated 4.4% in the fourth. Rising consumption (private and public combined) contributed 2.8 percentage points (p.p.) to the 3.2% GDP growth in 2005, gross fixed investment a further 1.1 p.p. and net trade in goods and services as much as 1.4 p.p.[21] Exports of goods and services expanded by about 7.1% in real terms while imports by about 3.4%.

The fragility of private consumption growth reflected the protracted weakness of the principal components of household income. The real purchasing power of pensions and disability pays was stagnant while the real purchasing power of other social benefits was eroding constantly. The average wage rose by 1.3% in real terms in the first three quarters of 2005 (but merely 0.3% in the corporate sector). The entire wage bill rose by a more respectable 2.6% in real terms – on account of total employment increasing by some 1.4%, with average employment in the corporate sector up some 1.9%. In the fourth quarter wages in the corporate sector sped up so that in the entire year 2005 the wage bill of the corporate sector rose by close to 3% in real terms. In all probability growth in private consumption must have also sped up, especially as there was a strong rise in credit extended to households.

Profits of the non-financial corporate sector were lower than a year earlier. In the first three quarters of 2005 net profits amounted to PLN 40 billion, down from 46.4 billion earned in the same period of 2004. Net profitability (net profit as a share of all revenue) declined from 5.1% to 4.2% – remaining very high all the same. The financial situation of the corporate sector, its liquidity position, continued to improve, with firms' bank deposits expanding further.

---

[21] Change in inventories and statistical discrepancy contributed minus 1.3 percentage points.

Table PL

Poland: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 [1]	2006	2007
								forecast	
Population, th pers., end of period [2]	38654	38254	38248	38219	38191	38174	38157	.	.
Gross domestic product, PLN mn, nom. [3]	666308	744622	779205	807860	842120	922157	967700	1029600	1099700
annual change in % (real) [3]	4.5	4.2	1.1	1.4	3.8	5.3	3.2	3.8	4.2
GDP/capita (EUR at exchange rate) [3]	4078	4853	5553	5480	5013	5327	6299	.	.
GDP/capita (EUR at PPP - wiiw) [3]	8640	9400	9600	9980	10210	11060	11550	.	.
Gross industrial production (sales)									
annual change in % (real)	3.6	6.7	0.6	1.1	8.3	12.6	3.8	7	7
Gross agricultural production									
annual change in % (real)	-5.2	-5.6	5.8	-1.9	-0.8	7.5	-2.1	.	.
Construction output total									
annual change in % (real)	6.2	1.0	-6.4	-0.3	0.9	-7.0	5.0	.	.
Consumption of households, PLN mn, nom. [3]	414581	469306	497809	531100	543203	582449	.	.	.
annual change in % (real) [3]	5.4	3.0	2.2	3.3	1.9	4.0	2.3	2.5	3
Gross fixed capital form., PLN mn, nom. [3]	162458	176739	161277	151472	153758	165848	.	.	
annual change in % (real) [3]	6.6	2.7	-9.7	-6.3	-0.1	6.3	6.2	6	6
LFS - employed persons, th, avg. [4]	14757.0	14526.0	14207.0	13782.0	13616.8	13794.8	14200	.	.
annual change in %	-3.9	-1.6	-2.2	-3.0	0.6	1.3	2.9	.	.
Reg. employees in industry, th pers., avg.	3138.4	2955.0	2820.6	2670.5	2639.1	2655.1	2426.0 [5]	.	.
annual change in %	-7.1	-5.8	-4.5	-5.3	-1.2	0.6	1.1 [5]	.	.
LFS - unemployed, th pers., average [4]	2391.0	2785.0	3170.0	3431.0	3328.5	3230.3	3070		
LFS - unemployment rate in %, average [4]	13.9	16.1	18.2	19.9	19.6	19.0	18.0	17.5	17
Reg. unemployment rate in %, end of period [4]	13.1	15.1	17.5	18.0	20.0	19.1	17.6	.	.
Average gross monthly wages, PLN	1697.1	1893.7	2045.1	2097.8	2185.0	2273.4	2515.9 [5]	.	.
annual change in % (real, gross)	4.7	1.0	2.5	0.7	3.4	0.7	1.2 [5]	.	.
Consumer prices, % p.a.	7.3	10.1	5.5	1.9	0.8	3.5	2.1	2.5	2.5
Producer prices in industry, % p.a.	5.7	7.8	1.6	1.0	2.6	7.0	0.7	1	1.5
General governm.budget, EU-def., % GDP [6]									
Revenues	44.9	42.5	40.9	42.3	40.9	40.8	41.8	41.4	41.3
Expenditures	47.0	45.2	44.7	45.6	45.8	44.7	45.0	45.0	44.6
Deficit (-) / surplus (+)	-1.4	-1.6	-3.7	-3.3	-4.8	-3.9	-3.6	-3.6	-3.4
Public debt, EU-def., % of GDP [6]	40.3	36.8	36.7	41.2	45.3	43.6	46.3	47.0	47.3
Discount rate of NB % p.a., end of period	19.0	21.5	14.0	7.5	5.8	7.0	4.8	.	.
Current account, EUR mn	-11716	-10788	-6006	-5399	-4108	-8401	-3700	-3800	-3800
Current account in % of GDP	-7.4	-5.8	-2.8	-2.6	-2.1	-4.1	-1.5	-1.5	-1.4
Gross reserves of NB excl. gold, EUR mn	26224	28555	29031	27367	26000	25904	34536	.	.
Gross external debt, EUR mn	65121	74670	81461	81045	84818	94035	105559 IX	.	.
FDI inflow, EUR mn	6824	10334	6372	4371	4067	10070	6500	.	.
FDI outflow, EUR mn	29	18	-97	228	269	631	867	.	.
Exports of goods, BOP, EUR mn	28215	39022	46537	49338	53836	65847	76400	82500	89100
annual growth rate in %	-2.5	38.3	19.3	6.0	9.1	22.3	16	8	8
Imports of goods, BOP, EUR mn	42361	52349	55094	57039	58913	70399	76400	84100	92500
annual growth rate in %	4.9	23.6	5.2	3.5	3.3	19.5	9	10	10
Exports of services, BOP, EUR mn	7850	11320	10914	10545	9850	10821	12900	13300	13700
annual growth rate in %	-18.8	44.2	-3.6	-3.4	-6.6	9.9	19	3	3
Imports of services, BOP, EUR mn	6553	9773	10021	9690	9408	10026	11200	11300	11650
annual growth rate in %	10.9	49.1	2.5	-3.3	-2.9	6.6	12	1	3
Average exchange rate PLN/USD	3.97	4.35	4.09	4.08	3.89	3.65	3.23	.	.
Average exchange rate PLN/EUR (ECU)	4.23	4.01	3.67	3.86	4.40	4.53	4.03	4	4
Purchasing power parity PLN/USD	1.75	1.82	1.85	1.83	1.84	1.87	1.85	.	.
Purchasing power parity PLN/EUR	1.99	2.07	2.12	2.12	2.16	2.18	2.20	.	.

Notes: 1) Preliminary. - 2) From 2000 according to census May 2002. - 3) Revised data (FISIM adjustment, new methodology in government sector, new estimate of shadow economy etc.). - 4) From 2003 according to census May 2002. - 5) Enterprises with more than 9 employees.- 6) According to ESA'95, excessive deficit procedure.

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

The weakening of profits was most pronounced in export-oriented firms. No doubt this must be attributed to the continuing strong appreciation of the zloty which started already in the first half of 2004. Nonetheless, profitability of the export-oriented firms and branches is, on average, still higher than that of non-exporters.[22]

Despite falling profits and the stagnant volume of credits extended to the corporate sector, investments picked up, albeit only gradually. However, this positive message must be qualified. It turns out that growth of investment in the private corporate sector has been quite anaemic. Overall investment growth was due primarily to a vigorous acceleration of investment in the public sector, in particular in its coal mining branch and in large publicly-owned industrial and infrastructure firms. (Under the impact of rising energy prices, coal mining – until 2004 a permanent loss-maker – has been generating huge profits.) As long as there is no sustained recovery of investment in the private sector, its current overall acceleration need not prove sustainable.

Net exports are likely to contribute positively to GDP growth also in the coming years[23], provided the appreciation of the zloty comes to a halt, or at least slows down. Continuing gains in labour productivity and unit labour costs (low pace of wage increases) are to be expected. This will be offsetting the negative effects of moderate appreciation. But it would be incorrect to assume that any level of nominal appreciation can be neutralized through cost/wage adjustments. Although firms have demonstrated a good deal of adaptability to adverse exchange rate conditions, they may be unable to perform once the losses on exports rise too much and too fast.

The authorities have not done much to prevent the recent (second half of 2005 and January 2006) nominal appreciation. Despite generally deflationary conditions the National Bank of Poland keeps referring to higher energy prices and alluding to the lack of 'fiscal consolidation' – and traditionally drags its feet on cutting interest rates. In effect at similar inflation rates, the official Polish interest rates are about four times the Czech ones. This has certainly not been moderating the appreciation. Besides, some actions of the Finance Ministry of the new Polish government appear to be supporting the strengthening of the zloty as well. Large chunks of the Ministry's newly drawn foreign-exchange debt have been exchanged into zloty on the foreign exchange market, rather than with the National Bank. (There is additional irony in the fact that due to the NBP's ‘policy stance’ the government prefers to borrow abroad rather than domestically.)

The conflict between the National Bank and the new government formed by the party of the Kaczyński brothers, which had been widely expected prior to the elections, has actually been quite muted so far. That (minor) conflict will be played out later. At the moment the brothers have more urgent, fundamental, tasks to accomplish. They are busy provoking major conflicts which are to discredit and demolish the entire constitutional framework of the Republic that had been developed (by 'wrong parties' and 'wrong personalities') during the past 16 years. Their actions aim not only at elimination – by means foul rather than fair – political competitors (and erstwhile allies alike); they have also been trying, with a remarkable degree of success, to hollow out the basic institutions (the

[22] There are some exceptions though: in telecommunications and the real estate, renting and business activities' branch, profitability is high and rising. Also net profits of the financial sector have risen very strongly: those of banks by 23%, totalling some PLN 7 billion in the first three quarters of 2005, and those of insurance companies by close to 55%, totalling PLN 1.7 billion.

[23] Foreign trade contributed positively to GDP growth in 2000, 2001, 2002 and 2003. Only in 2004, under the conditions of the 'accession boom', its contribution was negative (but otherwise small).

parliament itself) and principles (division of branches of government, system of checks and balances, separation of the state and religion, independence of the media, protection of minorities etc.) of a modern state. All that may serve the purpose of creating a rather anachronistic – at least as far as contemporary European standards are concerned – political system.

At present the new authorities do not waste too much effort on the formulation, let alone actual execution, of any coherent economic or social policy. The low priority given to economics was exposed first when two rather anonymous outsiders were nominated key economics Ministers (for finances, state property). This was then followed by their unceremonious sacking. But the replacements, chosen for purely political reasons, seem equally incompetent. Fortunately, the budget for 2006 is there, worked out under the previous government (of Mr. Belka). Thus at least in the short run the fiscal policy should not perhaps be unpredictable. The predictability of other elements of economic policy, however, is currently rather low. What seems quite obvious is that the brothers' generally combative mood will occasionally (or perhaps even quite frequently) lead to conflicts with e.g. domestic business, or trade unions, foreign investors, or the managers of the publicly-owned concerns. Also, their relationships with the unloved Brussels bureaucracy are likely to be strained.

Summing up, GDP growth acceleration requires a more definite revival of the private sector's propensity to invest and a return to more exporter-friendly levels of the exchange rates. But, at present, one does not see good reasons why the investment attitudes of the private sector should be improving anytime soon. Apparently, on average firms are satisfied with the stocks of fixed capital at their disposal. They seem to be capable of raising output by increasing employment. One could perhaps be more optimistic about the exchange rate trends: the current strengthening should stop sooner rather than later, especially if the National Bank and the Finance Ministry decide to cooperate (or, if the former decides to subordinate). But, of course, one cannot be quite sure about the medium-term strength of the Polish currency – especially given what is going on in the political arena.

Zdenek Lukas

Slovakia: accelerating GDP growth and rising self-confidence towards elections

On 26 November 2005, Slovakia was – quite unexpectedly – admitted into the ERM-II. The central exchange rate parity was set at SKK 38.455 to the euro, with a +/-15% fluctuation band. If Slovakia meets the Maastricht criteria, it could adopt the euro in 2008, or – more realistically – at the beginning of 2009. Although Slovakia is relatively successful on its way to meeting the criteria, the rapid entry into the EMR-II was probably driven by political rather than economical considerations. While the EMR-II restricts a country’s sovereignty in national monetary, fiscal and exchange rate policies, the Slovak economy does not yet seem stabilized enough to give up some instruments of national economic policy. On the other hand, the political reasons for entering the ERM-II are well understandable given the approaching parliamentary elections (September). The opposition parties are leading in the opinion polls, therefore impressive news of any kind are highly valued by the government. Supported by the EMR-II entry and positive expectations for the future, the Slovak koruna has appreciated, reaching SKK 37.40 to the euro on 10 January 2006. Since then it has remained on the stronger side of the parity.

Table SK

Slovak Republic: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 [1)]	2006	2007
								forecast	
Population, th pers., mid-year	5395.3	5400.7	5379.8	5378.8	5379.0	5382.2	5386.7	.	.
Gross domestic product, SKK bn, nom.	844.1	934.1	1009.8	1098.7	1201.2	1325.5	1440	1570	1720
annual change in % (real)	1.5	2.0	3.8	4.6	4.5	5.5	5.6	6.0	6.5
GDP/capita (EUR at exchange rate)	3546	4061	4334	4784	5382	6149	6930	.	.
GDP/capita (EUR at PPP - wiiw)	8750	9470	10040	10860	11190	11750	12630	.	.
Gross industrial production									
annual change in % (real)	-2.6	8.4	7.6	6.7	5.3	4.2	3.1	7	8
Gross agricultural production									
annual change in % (real)	-2.5	-12.3	9.9	1.5	-2.4	1.1	.	.	.
Construction industry									
annual change in % (real)	-25.8	-0.4	0.8	4.1	6.0	5.7	16.4 I-X	.	.
Consumption of households, SKK bn, nom.	473.0	519.6	577.5	624.5	667.5	738.7	.	.	.
annual change in % (real)	2.7	-0.9	4.9	5.5	-0.8	3.5	6	7	4
Gross fixed capital form., SKK bn, nom.	249.8	242.3	291.0	303.5	308.4	327.2	.	.	.
annual change in % (real)	-19.6	-7.2	13.9	-0.6	-1.5	2.5	12	15	15
LFS - employed persons, th, avg.	2132.1	2101.7	2123.7	2127.0	2164.6	2170.4	2210	.	.
annual change in %	-3.0	-1.4	1.0	0.2	1.8	0.3	2	.	.
LFS - employed pers. in industry, th, avg.	630.3	615.3	628.8	640.9	634.1	641.3	647.9 I-IX	.	.
annual change in %	-4.9	-2.4	2.2	1.9	-1.1	1.1	1.4 I-IX	.	.
LFS - unemployed, th pers., average	416.8	485.2	508.0	486.9	459.2	480.7	430	.	.
LFS - unemployment rate in %, average	16.2	18.6	19.2	18.5	17.4	18.1	16	15	14
Reg. unemployment rate in %, end of period	19.2	17.9	18.6	17.5	15.6	13.1	11.4	10	9
Average gross monthly wages, SKK	10728	11430	12365	13511	14365	15825	17300	.	.
annual change in % (real, gross)	-2.8	-4.5	1.0	5.8	-2.0	2.5	6	.	.
Consumer prices, % p.a.	10.6	12.0	7.1	3.3	8.5	7.5	2.7	3	3
Producer prices in industry, % p.a.	4.3	10.8	6.5	2.1	8.3	3.4	4.5	4	3
General governm.budget, EU-def., % GDP [2)]									
Revenues	49.8	47.6	37.1	36.0	35.9	37.3	37.0	.	.
Expenditures	56.9	59.9	43.6	43.7	39.7	40.5	40.8	.	.
Deficit (-) / surplus (+)	-7.1	-12.3	-6.6	-7.8	-3.8	-3.1	-3.8	-2.9	-3
Public debt in % of GDP [2)]	47.2	49.9	49.2	43.7	43.1	42.5	36.7	38.2	38.5
Discount rate, % p.a., end of period	8.8	8.8	8.8	6.5	6.0	4.0	3.0	.	.
Current account, EUR mn [3)]	-920	-761	-1950	-2043	-244	-1149	-2200	-2000	-2000
Current account in % of GDP	-4.8	-3.5	-8.4	-7.9	-0.8	-3.5	-5.9	-4.7	-4.2
Gross reserves of NB incl. gold, EUR mn [4)]	3410	4391	4748	8824	9717	10954	13083	.	.
Gross external debt, EUR mn	10470	11637	12516	12655	14654	17421	21996 IX	.	.
FDI inflow, EUR mn	402	2089	1768	4397	593	1016	1500	.	.
FDI outflow, EUR mn	-348	23	39	5	20	-114	100	.	.
Exports of goods, BOP, EUR mn [3)]	9603	12879	14115	15270	19359	22354	25000	28800	34600
annual growth rate in %	0.7	34.1	9.6	8.2	26.8	15.5	12	15	20
Imports of goods, BOP, EUR mn [3)]	10628	13860	16488	17517	19924	23526	26500	30500	35400
annual growth rate in %	-8.6	30.4	19.0	6.2	13.7	18.1	13	15	16
Exports of services, BOP, EUR mn [3)]	1937	2436	2779	2958	2912	3000	3500	.	.
annual growth rate in %	-10.7	25.8	14.1	6.4	-1.5	3.0	17	.	.
Imports of services, BOP, EUR mn [3)]	1732	1961	2244	2474	2703	2785	3100	.	.
annual growth rate in %	-14.5	13.2	14.5	10.3	9.2	3.0	11	.	.
Average exchange rate SKK/USD	41.42	46.20	48.35	45.34	36.77	32.26	31.02	.	.
Average exchange rate SKK/EUR (ECU)	44.12	42.59	43.31	42.70	41.49	40.05	38.59	37.0	36.0
Purchasing power parity SKK/USD	15.65	16.08	16.30	16.21	17.03	17.91	17.93	.	.
Purchasing power parity SKK/EUR	17.87	18.26	18.70	18.80	19.96	20.97	21.17	.	.

Notes: 1) Preliminary. - 2) According to ESA'95, excessive deficit procedure. - 3) wiiw calculated from USD. - 4) From January 2002 new valuation of gold.

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

The economy continues to grow at a high rate in spite of just moderate growth in the old EU countries. Growth even accelerated in the third quarter of 2005 when GDP was up by 6.2% compared to 5.1% in the second quarter. Backed by rising wages, private consumption rose by 5.8%. Following three years of near-stagnation, gross fixed capital formation expanded by 11.4% mostly due to rising industrial investment. Exports are again gaining momentum and the contribution of foreign trade to GDP growth turned positive: the strong expansion of exports (goods and services) exceeded the rise in imports of consumer and investment goods. That occurred despite the real appreciation of the Slovak currency (by some 6% on annual average), which made imports cheaper. The real appreciation was compensated by shifting to high-value export products.

Following stagnation in the first quarter of 2005, industry has recovered. As a result, gross industrial output rose by 3.2% in the first eleven months of 2005. Up until 2003 industrial growth had been chiefly fuelled by car production by VW Bratislava, but in the past two years foreign investment companies, mostly operating in metallurgy, machinery & equipment, electrical & optical equipment and wood manufacturing, registered above-average growth rates. Wages expanded faster than labour productivity in all important sectors, resulting in rising unit labour costs.

The Russian-Ukrainian gas dispute temporarily affected supplies to Slovakia. By relying on own gas reserves, however, the gas supplies for domestic consumers did not suffer. Slovakia is a highly energy-intensive economy with an output structure dominated by the most energy-intensive industries such as steel and aluminium metallurgy.

The strong economic growth has been reflected in rising employment. Total employment (LFS) increased by 2% in the first three quarters of 2005. At the same time, the unemployment rate (LFS) dropped by 2.1 percentage points to 16%. Nevertheless Slovakia has the second highest unemployment rate in the EU, after Poland.

In recent years, Slovakia has gained a reputation as a reform pioneer. Because of comprehensive reforms and favourable macroeconomic developments, in December 2005 Standard & Poor's Ratings services upgraded Slovakia's long-term and short-term sovereign credit ratings.

The projected budget deficit of 3.8% of GDP in 2005 has most probably been met. Despite its minority position in parliament, the government managed to push through the draft budget for 2006. The projected general government budget deficit is to amount to 2.9% of the GDP, excluding pension reform costs.

Volkswagen (VW), still the largest carmaker in Slovakia, produced above 200 thousand cars in 2005. The projected output in 2006 is 220 thousand units (mostly Audi Q7). VW is generating about one fifth of Slovakia's total exports, which is to expand to one quarter in 2006. Another carmaker, PSA Peugeot Citroen, confirmed its plan to invest about EUR 1 billion into a new plant in Trnava, instead of the originally stated EUR 0.7 billion. If fully realized, PSA will manufacture some 450 thousand cars per year by the end of the decade. In addition, KIA, the Hyundai associate, envisaged production of at least 200 thousand cars a year after 2006. Three big FDI projects[24] in a

---

[24] The projects relate to KIA car manufacturing, the privatization of a 66% stake in the power utility Slovenské elektrárne by the Italian company Enel and tyre production by the Korean company Hankook Tyre. For details see *The Vienna Institute Monthly Report*, No. 10, 2005, p. 11.

total value of some EUR 2 billion, announced in the past two years, are however still in delay. After FDI inflows of EUR 1 billion in 2004, the total inflow probably reached close to EUR 1.5 billion in 2005.

Significant confusion surrounded the privatization of a 66% stake in Slovakia's two largest airports just a few weeks ago. Some observers claimed that the TwoOne consortium (Vienna International Airport, Raiffeisen Zentralbank and Penta) favoured by the tender commission had presented the weakest business plan for the Bratislava and Košice airports among four bidders.[25] Following several weeks of heavy criticism led by the opposition parties, on 19 January the government ordered a second round in the airport tender. With EUR 300 million, TwoOne offered more than the closest bidder, a consortium led by Abertis. As a result, on 1 February the cabinet approved TwoOne as purchaser. In addition, the winner is obliged to invest some EUR 250 million in both airports (of which EUR 240 million in Bratislava) in the period 2006 to 2010. The contract is to be signed by 28 February.

Vigorous private demand, fuelled by rising real wages and pre-election populism, as well as strong investment growth coupled with growing export expansion will keep GDP growth at a high level, reaching close to 6% this year. Later on gradually rising industrial output, mainly in FDI-led car manufacturing, will contribute most to the GDP expansion. In the wake of increasing labour demand the unemployment rate may go down further. An increase in energy prices and in the excise tax on spirits will induce somewhat higher inflation. The budget deficit may fall below 3% already in 2006. Increasing repatriation of profits by FDI companies and expanding domestic demand as well as high prices for imported fuels will keep the current account deficit at a high level in the years to come. In addition, the strong domestic currency will encourage imports.

The government is satisfied with the approved EU budget for 2007 to 2013. For instance, according to the agreement, in this period Slovakia is to receive some EUR 1.35 billion annually from the EU budget for cohesion.[26] In addition, it is to obtain around EUR 370 million in support for decommissioning the V1 nuclear power plant in Jaslovske Bohunice. The total costs thereby incurred are estimated at about EUR 1.8 billion. The EU will also support the development of infrastructure and under-developed regions in Slovakia with a total amount of some EUR 390 million.

Hermine Vidovic

Slovenia: fundamental changes ahead

Driven by both domestic demand and an upswing in foreign demand, GDP grew by 3.8% in 2005, at a slightly lower rate than a year earlier. Domestic demand was mainly supported by rising private consumption backed by increased household lending. Investment growth decelerated to about 2%, from 6% in 2004, caused by a decline in machinery and equipment investments. Construction activities recovered from month to month, particularly those pertaining to buildings. The disinflation process continued, with consumer price inflation averaging 2.5% in 2005.

[25] Apart from TwoOne, a consortium including the Spanish Abertis, the British TBI and the Slovak J&T financial group, Tepe Akfen Ventures and Independent Slovak Airport Partners (Köln-Bonn Airport, SNC-Lavalin International, and Airport Consulting Vienna) had bidden for the airports.

[26] If fully utilized, that would account for roughly 2.5% of real GNI annually in the period 2007 to 2013.

Table SI

Slovenia: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 [1]	2006	2007
								forecast	
Population, th pers., mid-year	1985.6	1990.3	1992.0	1995.7	1996.8	1997.0	2001.1	.	.
Gross domestic product, SIT bn, nom. [2]	3919.0	4300.4	4799.6	5355.4	5813.5	6251.2	6650	7080	7530
annual change in % (real) [2]	5.4	4.1	2.7	3.5	2.7	4.2	3.8	3.9	3.9
GDP/capita (EUR at exchange rate) [2]	10194	10538	11094	11862	12458	13105	13870	.	.
GDP/capita (EUR at PPP - wiiw) [2]	13870	14640	15400	16040	16510	17930	18900	.	.
Gross industrial production									
annual change in % (real) [3]	-0.5	6.2	2.9	2.4	1.4	4.8	2.8	2.5	2
Gross agricultural production									
annual change in % (real)	-1.7	1.0	-4.3	13.4	-12.7	19.3	.	.	.
Construction output, in effect. working time									
annual change in % (real) [4]	10.2	-1.2	-2.1	-3.4	-1.7	2.5	2.1 I-XI	.	.
Consumption of households, SIT bn,nom. [2]	2225.6	2415.1	2657.8	2903.4	3167.4	3386.2	.	.	.
annual change in % (real) [2]	6.0	0.7	2.3	1.3	3.5	3.3	3.5	3	3
Gross fixed capital form., SIT bn, nom. [2]	1033.2	1098.9	1158.7	1211.5	1353.1	1506.0	.	.	.
annual change in % (real) [2]	18.2	1.8	0.4	0.9	7.1	5.9	2.0	3	3.5
LFS - employed persons, th, avg.	886	901	916	910	897	943	950	.	.
annual change in %	-1.7	1.7	1.7	-0.7	-1.4	5.1	0.7	.	.
Reg. employees in industry, th pers., avg. [5]	242.8	241.6	243.5	246.1	242.2	239.7	240.0 I-IX	.	.
annual change in %	-1.4	-0.5	0.8	1.1	-1.6	-1.0	.	.	.
LFS - unemployed, th pers., average	73.0	68.0	63.0	62.0	64.8	64.0	65	.	.
LFS - unemployment rate in %, average	7.6	7.0	6.4	6.4	6.7	6.3	6.3	6	5.8
Reg. unemployment rate in %, end of period	13.0	12.0	11.8	11.3	11.0	10.4	10.4	10	9.5
Average gross monthly wages, SIT [6]	173245	191669	214561	235436	253200	284281	276073 I-XI	.	.
annual change in % (real, net) [6]	3.0	1.4	3.1	2.1	1.8	2.1	4.1 I-XI	.	.
Consumer prices, % p.a.	6.1	8.9	8.4	7.5	5.6	3.6	2.5	2.4	2.3
Producer prices in industry, % p.a.	2.1	7.6	8.9	5.1	2.5	4.3	2.7	2.5	2.4
General governm.budget, EU-def., % GDP [7]									
Revenues	.	44.7	45.1	45.7	45.8	45.8	45.4	.	.
Expenditures	.	48.2	49.0	48.4	48.5	47.9	47.2	.	.
Deficit (-) / surplus (+), % GDP	.	-3.5	-3.9	-2.7	-2.7	-2.1	-1.7	-1.9	-1.6
Public debt in % of GDP [7]	24.9	27.4	28.4	29.8	29.4	29.8	29.3	29.5	29.2
Discount rate % p.a., end of period [8]	8.0	10.0	7.8	7.3	5.0	3.3	3.8	.	.
Current account, EUR mn	-664.2	-583.0	38.0	343.8	-81.2	-543.7	-200	-200	-100
Current account in % of GDP	-3.3	-2.8	0.2	1.5	-0.3	-2.1	-0.7	-0.7	-0.3
Gross reserves of NB excl. gold, EUR mn	3159.2	3435.8	4907.5	6701.5	6798.2	6464.0	6824.1	.	.
Gross external debt, EUR mn	8012	9490	10403	11484	13259	15278	18926 XI	.	.
FDI inflow, EUR mn	99.2	149.1	412.4	1700.2	300.3	662.1	270	.	.
FDI outflow, EUR mn	44.7	71.7	161.2	162.1	418.0	441.5	460	.	.
Exports of goods, BOP, EUR mn	8103.2	9574.2	10454.3	11081.6	11417.1	12932.8	14470	15700	16900
annual growth rate in %	0.2	18.2	9.2	6.0	3.0	13.3	12	9	8
Imports of goods, BOP, EUR mn	9267.3	10801.2	11138.7	11346.6	11959.9	13941.6	15390	16800	18300
annual growth rate in %	5.4	16.6	3.1	1.9	5.4	16.6	10	9	9
Exports of services, BOP, EUR mn	1763.5	2051.5	2177.6	2440.0	2464.8	2782.2	3200	.	.
annual growth rate in %	-2.3	16.3	6.1	12.0	1.0	12.9	15	.	.
Imports of services, BOP, EUR mn	1434.0	1562.3	1642.1	1819.9	1924.0	2096.2	2320	.	.
annual growth rate in %	5.7	8.9	5.1	10.8	5.7	9.0	11	.	.
Average exchange rate SIT/USD	181.77	222.68	242.75	240.24	207.11	192.38	192.70	.	.
Average exchange rate SIT/EUR (ECU)	193.63	205.03	217.19	226.22	233.70	238.86	239.64	239.9	240
Purchasing power parity SIT/USD	124.63	129.94	136.39	144.24	150.37	149.15	.	.	.
Purchasing power parity SIT/EUR	142.35	147.57	156.42	167.32	176.31	174.64	.	.	.

Notes: 1) Preliminary. - 2) Revised data (FISIM adjustment and previous year price introduction). - 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 legal persons with 1 or 2 employees in private sector are included. - 7) According to ESA'95, excessive deficit procedure. - 8) From 2001 main refinancing rate.

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

Industrial output growth gained momentum from the second quarter of the year and was up by about 3% in 2005. However, this increase was the result of methodological changes in data compilation starting from July rather than an ‘actual’ improvement. Capital goods production increased most (8%), while the production of intermediate and consumer goods performed below average. Output growth of manufacturing exceeded the average industrial growth, with the most outstanding result reported for the manufacture of transport equipment – car production (19%). On the negative side, the country’s textile industry continued its downward trend with production contracting by another 10% in 2005.

Foreign trade developed dynamically in 2005, with exports and imports expanding by 12% and 10% respectively, resulting in a cut of the trade deficit compared to 2004. Detailed data obtained from the customs statistics for the period January to October point to an above-average export increase to the EU, particularly to France, where Slovenia exported 50% more than in the same period a year earlier. Slovenia’s main export item to France are cars produced by the Revoz factory in Novo mesto. In contrast to the past few years when Slovenia recorded a remarkable expansion of exports to the successor states of the former Yugoslavia, deliveries to this area grew below average in 2005, with even declining exports to Bosnia and Herzegovina and Macedonia. The current account improved as against 2004 when the deficit to GDP ratio had posted an all time high (-2.1%) since the country’s independence. In 2005 the deficit fell to some EUR 200 million or 0.7% of the GDP, which was mainly made possible through the reduction of the trade deficit and increasing net revenues from services, particularly from travel and transport. As in 2003, Slovenia was again a net exporter of FDI in 2005: the outflow of FDI was mainly targeting the successor states of the former Yugoslavia, but also Bulgaria and Romania, e.g. in banking (Nova Ljubljanska Banka) or retail trade. According to the Bank of Slovenia, in 2004 the highest Slovenian outward FDI stock was registered in Croatia, followed by Serbia and Montenegro, the Netherlands and Bosnia and Herzegovina.

Despite sizable GDP growth, the impact on employment remained weak. Overall, the number of employed rose by less than 1%, with a further decline in agriculture and manufacturing but an increase in the construction and services sector employment. Unemployment, at 6.3% according to the labour force survey and 10.3% based on registration data, remained unchanged as compared to a year earlier.

By mid-December the Slovenian parliament passed the (state) budgets for 2006 and 2007, envisaging budget deficits of 1.4% and 1.2% respectively of the estimated GDP (the respective values for the general government deficits are 1.7% and 1.4%, slightly lower than the EU forecasts). Altogether, Slovenia meets the Maastricht criteria for long-term interest rates, the fiscal deficit and the public debt to GDP ratio. Since the entry of the Slovenian tolar into the ERM II as of the end of June 2004, the exchange rate of the tolar against the euro has remained close to the central band.

In contrast to former governments that pursued a gradualist approach in implementing economic reforms, Slovenia’s new centre-right government – in office since December 2004 – has come up with a package of radical reform measures. The centrepiece is a 20% flat tax to be introduced after Slovenia’s admission to the euro zone in 2007; in addition, significant cuts in the social benefit system are envisaged. The privatization of state-owned enterprises and banks should be speeded up: proposals for the privatization of Nova Ljubljanska Banka (the country’s biggest bank) and Nova Kreditna Banka Maribor, the privatization of telco, the Slovenian Telecom company, and the energy sector have already been submitted to the government. The privatization programme for the

Slovenian Steel Group was adopted in late December, envisaging a reduction of the state's stake in the group to 25% plus one share over the next two years. The group, consisting of six steel producers, is intended to be sold as a whole and not piece by piece as foreseen in the original privatization programme. In addition, the government plans to sell all its minority stakes that it holds in Slovenian companies by the end of 2007.

Some of the intended measures, particularly the introduction of the flat tax and the cuts in social welfare, come with some surprise as similar measures have so far been implemented only in less developed CEE countries facing severe economic problems at the outset of reforms. Within the country the announced reforms meet with strong opposition from trade unions, pensioners and students as well as some opposition parties.

In order to coordinate the implementation of the announced reforms (formulated in Slovenia's Development Strategy) a Reform Coordination Office was established at the beginning of January 2006, headed by Jože Damijan, an economist and minister without portfolio. The main objectives of the office's activities are to enhance economic competitiveness, raise economic growth and curb unemployment, while maintaining social security. The office is divided into two divisions: on economic and on social reforms.

The general outlook for the next two years is favourable. GDP growth rates at close to 4% will be backed by both domestic and foreign demand. Taking into account the Slovenian authorities' declared intention to fulfil and maintain the Maastricht criteria, the introduction of the euro at the beginning of 2007 is realistic and feasible. A further lowering of inflation may be jeopardized by increasing oil prices. The situation in mid-2006 will be crucial for assessing Slovenia's readiness for the adoption of the euro.

Part B: Southeast European countries

*Vladimir Gligorov**

Southeast Europe: managing growth

Introduction

Growth has remained strong throughout the region, though on average below the record rates in 2004, while economic policy dilemmas have sharpened. External imbalances have widened in a number of cases, while worries are being voiced about the fast growth of consumption fuelled by the expansion of credit. With growth prospects being generally good and the financial sector continuing to expand, the main issue is how to manage growth. That poses the question of the appropriate policy mix in Southeast Europe and its possible impact on growth and stability.

The key problem with the design of the proper policy mix is perhaps that bubbles of growth are popping up in financial services, construction and private consumption, while industrial production is recovering only slowly and employment is still hard to come by. Thus, monetary policy is used to prevent bubbles from bursting while fiscal policy cannot be reformed more aggressively for the fear that it might have negative consequences for employment.

The problems with the choice of the proper policy mix will persist because inflows of foreign investments will also continue while public sector restructuring and further fiscal consolidation may be hard to pursue given the need to finance development projects. That may lead to unnecessary volatility in growth rates in the medium run.

Growth and trade

Throughout the region, growth was driven by consumption, more private than public, and to a lesser extent by investment, again more private than public, in 2005. This is clear in the case of Bulgaria, Romania and Croatia, the countries for which quarterly data on GDP contributions to growth are available. In other countries, the available data suggest a similar development at least as far as consumption is concerned.

Net exports contributed negatively in a number of countries, though not in Serbia, Montenegro, Macedonia and Croatia. Exports of goods and services are growing practically everywhere and even faster than imports in most of the Western Balkans (Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Serbia and Kosovo) while the opposite is the case in the Eastern Balkans (Romania and Bulgaria). Trade within the region is also growing, though not necessarily faster than with the EU or the rest of the world.

Unlike the growth of GDP, industrial production is growing rather sluggishly in most countries. Fast growth is recorded in Bulgaria and Bosnia and Herzegovina and decent growth rates can be found

---

* K. Laski, P. Havlik, M. Landesmann (all wiiw) as well as the authors of the country reports provided valuable comments on the draft of this overview.

in Croatia, Turkey and Macedonia (in the latter, production is recovering from the recession in the previous year), while in the other countries growth rates are unimpressive. It is mostly the growth of services that is pulling the growth of GDP. In a number of countries (Turkey, Serbia, Montenegro, Albania), construction is continuing to grow or grow quite fast.

Table 1

Contributions (percentage points) to the GDP growth rates

	2000	2001	2002	2003	2004	1-3 Q 2004	1-3 Q 2005
Bulgaria							
GDP growth rate (%)	**5.4**	**4.1**	**4.9**	**4.5**	**5.6**	**5.3**	**5.6**
Consumption	5.0	3.8	3.2	5.7	4.4	3.7	6.4
Gross fixed investm.	2.3	3.7	1.5	2.5	2.3	2.4	3.4
Trade balance	-2.0	-3.5	0.8	-4.9	-1.9	-2.0	-6.4
Other items*	0.1	0.1	-0.6	1.2	0.8	1.2	2.2
Romania							
GDP growth rate (%)	**2.1**	**5.7**	**5.1**	**5.2**	**8.3**	**7.8**	**3.6**
Consumption	1.3	5.4	4.2	5.9	8.8	8.3	8.3
Gross fixed investm.	1.0	1.9	1.6	1.9	2.2	2.9	2.3
Trade balance	-2.3	-3.1	0.9	-2.9	-2.8	-3.7	-6.7
Other items*	2.1	1.5	-1.6	0.3	0.1	0.3	-0.3
Croatia							
GDP growth rate (%)	**2.8**	**4.4**	**5.2**	**4.3**	**3.8**	**3.9**	**4.1**
Consumption	2.1	1.1	4.1	2.5	2.3	2.2	2.2
Gross fixed investm.	-0.9	1.5	2.7	4	1.2	1.5	0.9
Trade balance	3.2	-1.4	-4.2	-1.5	0.5	-0.1	0.3
Other items*	-1.6	3.2	2.6	-0.7	-0.2	0.2	0.7

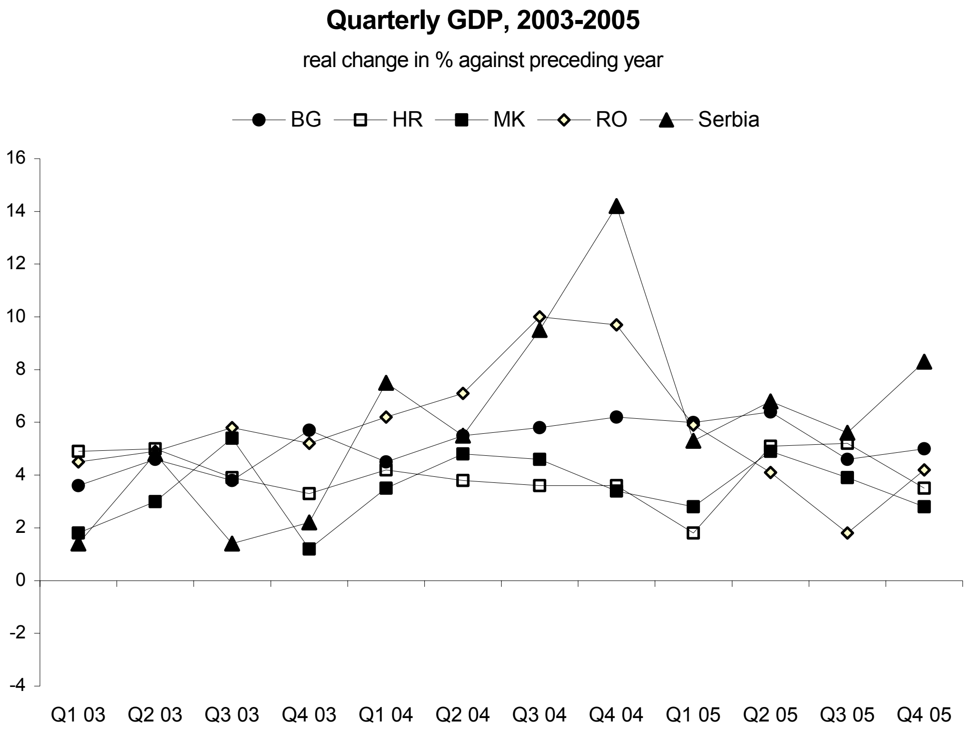
* Other items include change in stocks and statistical discrepancies.

Source: Eurostat, wiiw estimates incorporating national sources.

Growth of exports is not everywhere broadly based. High prices of metals and growth of agricultural production are lifting exports in some countries. In others, the effects of foreign direct investment are spilling over into growing exports. In a number of countries – Croatia, Montenegro, Bulgaria – tourism is growing and in those countries export of services is strongly positive. Also, private transfers, essentially remittances, are increasing, though in some cases, e.g., in Macedonia, this is probably the consequence of an improvement in the statistics. Finally, it is to be expected (data for the whole year are not yet available) that income balances remained negative in 2005, as they had been in 2004. Clearly, with current accounts negative throughout the region, foreign liabilities are growing and thus in turn income outflows too.

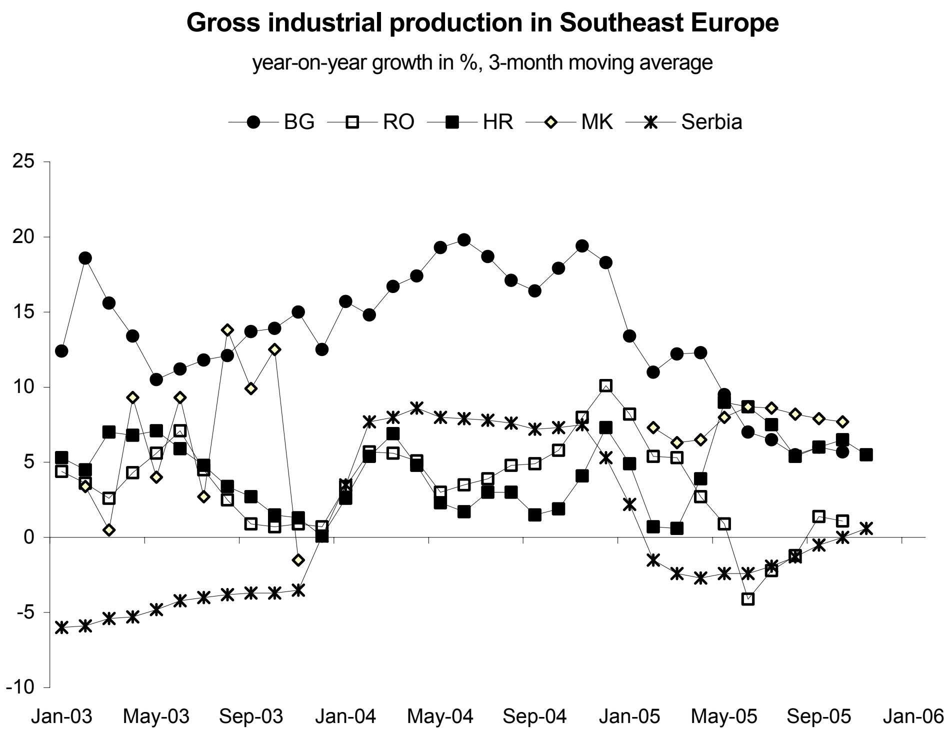
In the case of imports, the developments are influenced by two factors. On the one hand, in countries such as Romania and Bulgaria, continuing large FDI inflows, though lower than in 2004, translate into growing imports. In other cases, the deceleration of import growth is apparently the consequence of the monetary authorities' attempts to put under control the growth of credits, especially those to households. The effects of these attempts are hard to assess, but the deceleration of imports in a number of countries can plausibly be attributed to the more restrictive stance of the monetary policy.

Figure 1



Source: wiiw Monthly Database incorporating national statistics.

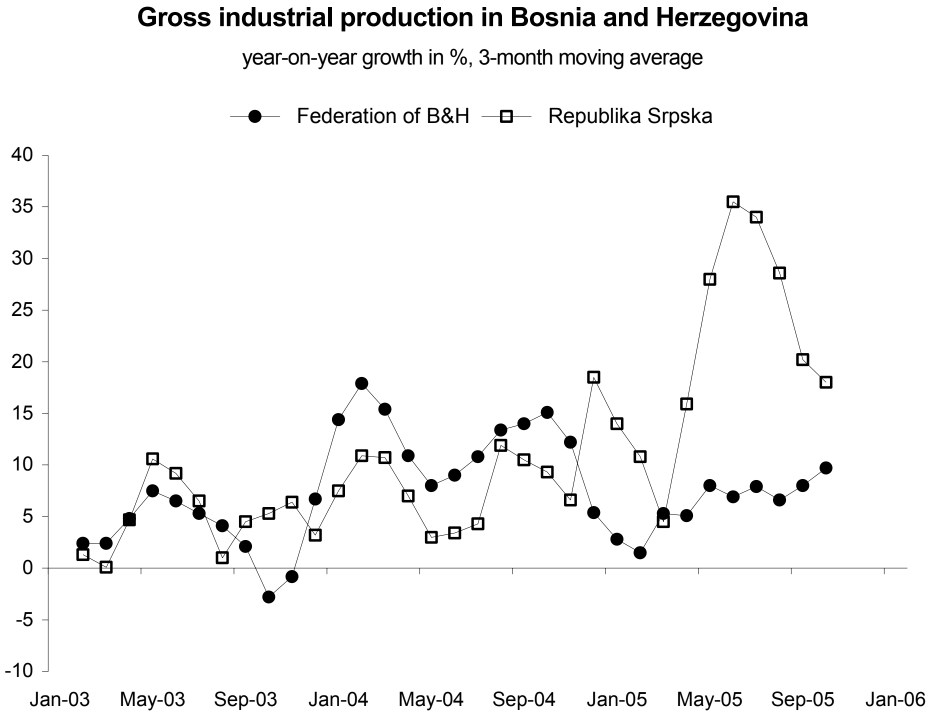
Figure 2



From 2005 new weighting system for Macedonia.

Source: wiiw Monthly Database incorporating national statistics.

Figure 3



Source: wiiw Monthly Database incorporating national statistics.

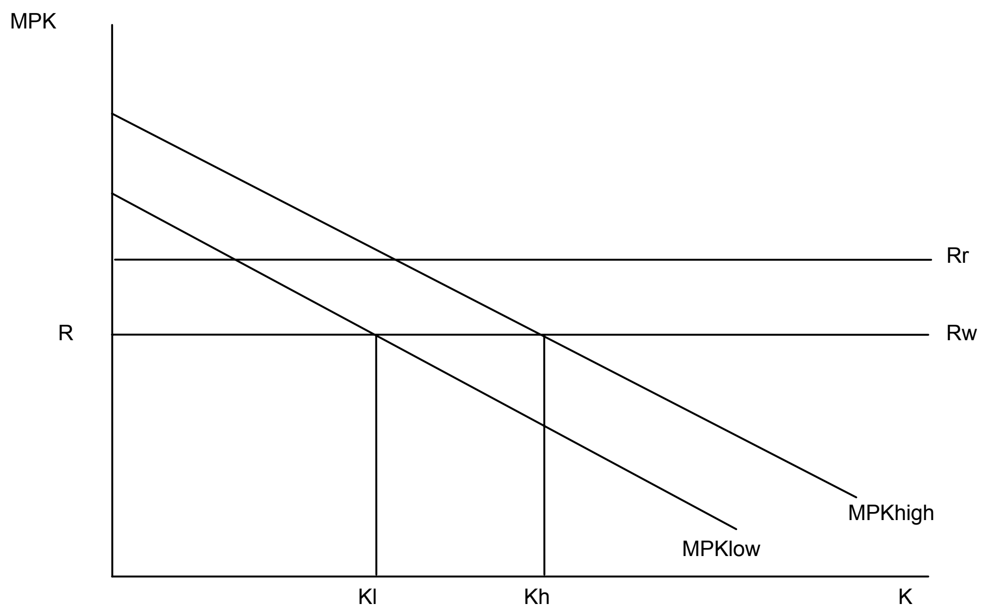
Growth has brought some deterioration of current accounts in a number of countries (Eastern Balkans and Croatia), though not in all of them (most of the countries of the Western Balkans have improved their current accounts). This has again raised the issue of the causes of these imbalances and of possible policy responses. In some cases, the most important cause of widening current account deficits is the inflow of foreign investments. Those are either already high or increasing in most of the region, as was the case in the Central European transition economies some years ago.

One way to understand what is happening with foreign investments is depicted in Figure 4.[27] A less developed country should have a higher marginal product of capital (MPK), so investment (K) will flow into that country assuming that the risk to investment, as indicated by the interest rate R, is the same as in the developed country, i.e., there is a world interest rate, Rw. If, however, the risk is higher (Rr) in the less developed country, investments will not be as high or may in fact flow to the more developed country rather than to the capital-poor country. Therefore, assuming that productivity gains can be achieved and that they can be captured rather than driven away by high risks, it is to be expected that capital will flow from a developed to the developing country and that the current account of the latter will be in deficit.

[27] Adapted from J. Ventura (2003), 'Toward a Theory of Current Accounts', *World Economy*, Vol. 26 (4), pp. 483-512.

Figure 4

Investment flow



This seems to be what is happening in the transition economies. Once risks to investment start falling, the productivity gains offered by the restructuring of the privatized firms or by the green-field investments benefiting from lower wages, attract foreign investments and translate into growing imports. One of the key factors that works on the risk development, though not the only one, is the process of EU integration. The closer the date of accession to the EU, the lower the investment risks (due perhaps also to increased financial integration), the higher the foreign investments.

In addition to that, the privatization of the banking system, which is either mostly under foreign ownership or characterized by a substantive presence of foreign banks, is contributing to the emergence of a competitive banking sector, which supports a more active lending policy. Finally, the difference between the interest rates in the EU and in the transition countries should be attracting foreign capital inflows and should eventually close down that gap, except for the genuine difference in the levels of risks. Then, it should be the higher productivity that should be driving foreign investments into a developing country in transition.

If that is correct, it is to be expected that inflows of foreign investments will continue and should grow in countries that have been laggards so far. This can be already observed in the case of most countries in the Western Balkans, though the progress is still relatively slow due to institutional weaknesses and slow progress in public sector restructuring and in some structural reforms. Significant improvements are expected this year and the next when a number of constitutional and integration issues should be resolved. In the region as a whole, however, besides foreign direct investments, significant inflows of foreign credit can be observed. In Table 5 it can be seen that other capital inflows, mostly loans, are increasing in all countries for which data are available, except Macedonia.

Table 2

Foreign trade

cumulated data within respective period, based of customs statistics

Exports total (fob)

		2003				2004				2005			
		I Q	I-II Q	I-III Q	I-IV Q	I Q	I-II Q	I-III Q	I-IV Q	I Q	I-II Q	I-III Q	I-IV Q
Albania	EUR mn	101	204	303	**401**	109	239	361	**486**	121	265	399	**540**
	change in %	16.5	23.8	19.7	**14.7**	7.8	16.8	18.9	**21.3**	11.3	10.8	10.5	**11.2**
B&H	EUR mn	260	602	955	**1303**	357	760	1197	**1677**	427	967	1503	**2090**
	change in %	9.0	15.5	14.7	**11.5**	37.3	26.2	25.4	**28.7**	19.4	27.4	25.5	**24.6**
Bulgaria	EUR mn	1635	3252	5004	**6668**	1718	3615	5798	**7985**	2081	4386	6800	**9440**
	change in %	20.5	15.0	10.9	**10.0**	5.0	11.2	15.9	**19.7**	21.1	21.3	17.3	**18.2**
Croatia	EUR mn	1364	2696	4002	**5468**	1452	3042	4726	**6452**	1492	3334	5165	**7030**
	change in %	15.5	6.8	4.2	**5.4**	6.5	12.8	18.1	**18.0**	2.7	9.6	9.3	**9.0**
Macedonia	EUR mn	274	590	891	**1209**	293	598	960	**1346**	368	773	1188	**1660**
	change in %	-1.4	4.1	1.5	**2.4**	6.6	1.4	7.7	**11.4**	25.6	29.2	23.8	**23.3**
Romania	EUR mn	3778	7501	11574	**15614**	4337	9033	13995	**18935**	5098	10532	16464	**22255**
	change in %	14.4	8.2	7.6	**6.4**	14.8	20.4	20.9	**21.3**	17.5	16.6	17.6	**17.5**
Serbia	EUR mn	576	1173	1812	**2441**	522	1137	1916	**2836**	758	1668	2595	**3664**
	change in %	22.3	18.4	14.1	**11.3**	-9.3	-3.1	5.7	**16.2**	45.2	46.7	35.5	**29.2**

Imports total (cif)

		2003				2004				2005			
		I Q	I-II Q	I-III Q	I-IV Q	I Q	I-II Q	I-III Q	I-IV Q	I Q	I-II Q	I-III Q	I-IV Q
Albania	EUR mn	384	802	1218	**1648**	364	791	1244	**1762**	398	905	1421	**2000**
	change in %	4.6	5.1	5.2	**3.6**	-1.0	3.0	6.9	**12.3**	9.5	14.5	14.2	**13.5**
B&H	EUR mn	1045	2332	3654	**4974**	1051	2421	3855	**5354**	1143	2697	4289	**5960**
	change in %	3.5	8.2	8.7	**6.0**	0.6	3.8	5.5	**7.6**	8.8	11.4	11.2	**11.3**
Bulgaria	EUR mn	2084	4541	6933	**9611**	2412	5331	8209	**11620**	2962	6592	10404	**14770**
	change in %	17.1	17.1	16.5	**14.3**	15.8	17.4	18.4	**20.9**	22.8	23.6	26.7	**27.1**
Croatia	EUR mn	2752	5982	9176	**12546**	2919	6483	9855	**13342**	3093	7100	10878	**14920**
	change in %	12.5	9.9	10.2	**10.8**	6.1	8.4	7.4	**6.3**	6.0	9.5	10.4	**11.8**
Macedonia	EUR mn	496	1009	1499	**2039**	493	1084	1663	**2335**	535	1239	1869	**2610**
	change in %	-2.1	0.0	-0.6	**-3.4**	-0.8	7.5	10.9	**14.5**	8.6	14.2	12.4	**11.8**
Romania	EUR mn	4541	9814	15129	**21201**	5482	11992	18644	**26281**	6668	14740	23060	**32569**
	change in %	9.3	10.5	10.6	**12.3**	20.7	22.2	23.2	**24.0**	21.6	22.9	23.7	**23.9**
Serbia	EUR mn	1531	3117	4692	**6603**	1796	3818	5813	**8628**	1525	3609	5880	**8537**
	change in %	14.0	14.1	10.9	**11.6**	17.3	22.5	23.9	**30.7**	-15.1	-5.5	1.2	**-1.1**

Trade balance

		2003				2004				2005			
		I Q	I-II Q	I-III Q	I-IV Q	I Q	I-II Q	I-III Q	I-IV Q	I Q	I-II Q	I-III Q	I-IV Q
Albania	EUR mn	-283	-598	-915	**-1247**	-254	-552	-884	**-1277**	-277	-640	-1022	**-1460**
B&H	EUR mn	-784	-1731	-2699	**-3671**	-694	-1661	-2658	**-3677**	-716	-1729	-2786	**-3870**
Bulgaria	EUR mn	-448	-1289	-1929	**-2942**	-694	-1717	-2411	**-3635**	-881	-2206	-3604	**-5330**
Croatia	EUR mn	-1388	-3286	-5174	**-7079**	-1466	-3441	-5128	**-6890**	-1601	-3766	-5713	**-7890**
Macedonia	EUR mn	-222	-420	-608	**-831**	-200	-487	-703	**-989**	-167	-466	-681	**-950**
Romania	EUR mn	-763	-2313	-3555	**-5588**	-1146	-2959	-4649	**-7346**	-1571	-4208	-6596	**-10314**
Serbia	EUR mn	-956	-1944	-2880	**-4162**	-1274	-2682	-3897	**-5792**	-768	-1942	-3285	**-4873**

Albania, Bosnia and Herzegovina: data refer to balance of payments statistics; I-IV Q 2005 partly estimated by wiiw.

Source: wiiw Monthly Database incorporating national statistics; IMF for Albania.

Table 3

Current account

in % of GDP

	Balance on goods				Balance on services				Balance on incomes			Balance on transfers		
	2002	**2003**	**2004**	**2005**	**2002**	**2003**	**2004**	**2005**	**2002**	**2003**	**2004**	**2002**	**2003**	**2004**
Albania	-25.9	-23.8	-21.0	-19.1	-0.1	-1.5	-0.7	-2.1	2.9	3.0	2.3	13.1	15.0	14.6
Bosnia & Herzegovina	-59.1	-58.4	-53.5	-53.3	3.7	3.7	4.3	5.5	9.1	7.5	5.2	25.2	22.7	21.5
Bulgaria	-10.2	-12.5	-14.0	-19.2	2.9	3.0	3.7	3.4	-1.7	-3.2	-2.7	3.4	3.5	4.6
Croatia	-24.6	-27.3	-24.4	-25.6	13.6	19.3	17.1	17.6	-2.4	-4.2	-2.3	4.8	4.9	4.3
Macedonia	-21.3	-18.3	-20.7	-19.4	-0.6	-0.2	-1.0	-0.4	-0.8	-0.7	-0.7	13.2	16.0	14.7
Romania	-5.7	-7.8	-9.0	-9.8	0.0	0.1	-0.4	-0.8	-1.0	-2.4	-4.3	3.3	4.0	5.0
Serbia	-22.6	-22.6	-29.2	-24.6	0.9	1.1	0.8	0.0	-0.7	-1.1	-1.0	10.0	12.0	14.9
Montenegro	-32.7	-25.1	-28.1	-34.8	7.6	7.8	9.1	11.0	5.8	6.9	6.8	6.7	3.2	2.9
Turkey	-4.0	-5.8	-7.9	-8.9	4.3	4.4	4.2	4.1	-2.5	-2.3	-1.8	1.3	0.4	0.4

Source: wiiw Database incorporating national bank statistics.

Table 4

FDI inflow to SEE, EUR million

	2000	**2001**	**2002**	**2003**	**2004**	**2005** 1)	**2005** 1) in % CA	**2005** 1) stock
Albania	156	231	151	158	278	200	50	1500
Bosnia and Herzegovina	159	133	282	338	488	240	12	1700
Bulgaria	1103	903	980	1851	2278	1600	53	8600
Croatia	1142	1503	1195	1788	980	1500	68	11000
Macedonia	189	493	83	85	126	100	200	1300
Romania	1147	1294	1212	1946	5183	4800	69	18000
Serbia	55	184	504	1204	779	1000	56	4500
Montenegro	.	11	89	39	50	250	167	400
Turkey	1854	3685	1205	1816	2604	7200	44	42000

1) Preliminary.

CA stands for current account deficit.

Remarks: Albania: equity capital.
Bosnia and Herzegovina: equity capital.
Bulgaria: equity capital + reinvested earnings + loans.
Croatia: equity capital + reinvested earnings + loans.
Macedonia: equity capital.
Romania: equity capital + reinvested earnings from 2003 + loans.
Serbia: FDI net (inflow minus outflow).
Montenegro: FDI net (inflow minus outflow).
Turkey: equity capital + reinvested earnings + loans.

Source: Respective National Banks according to balance of payments statistics.

Table 5

Capital flows, EUR million

Bulgaria	2003	2004	2004 Jan-Nov	2005 Jan-Nov
Capital inflow transfer	**2511.3**	**2738.7**	**2170.6**	**2814.5**
Capital transfer	-0.2	-0.1	0	-1.0
FDI	1827.2	1797.1	1045.8	1480
Portfolio	-191.0	-556.9	-327.7	-682.2
Financial derivatives				
Other capital (loans)	875.3	1498.6	1452.5	2017.7
Destination of capital inflow	**2446.9**	**3141.6**	**2639.6**	**3219.4**
Current account deficit	1630.2	1648.2	1292.3	2681.1
Increase reserves	816.7	1493.4	1347.3	538.3
Errors and omissions	**-64.4**	**402.9**	**469.4**	**405.3**

Romania	2003	2004	2004 Jan-Oct	2005 Jan-Oct
Capital inflow transfer	**4491**	**9053**	**8620**	**10150**
Capital transfer	188	512	440	490
FDI	1910	5127	4700	4410
Portfolio	529	-416	-30	100
Financial derivatives				-30
Other capital (loans)	1864	3830	3510	5180
Destination of capital inflow	**4080**	**9938**	**7920**	**11280**
Current account deficit	3060	5099	4230	6020
Increase reserves	1020	4839	3690	5260
Errors and omissions	**-411**	**884**	**-700**	**1130**

Croatia	2003	2004	2004 Jan-Sept	2005 Jan-Sept
Capital inflow transfer	**4159.5**	**2289.0**	**1405.2**	**2427.9**
Capital transfer				
FDI	1695.4	698.0	593.8	1150.2
Portfolio	868.8	244.2	556.3	-1015.2
Financial derivatives				
Other capital (loans)	1595.3	1346.8	255.0	2292.9
Destination of capital inflow	**3101.7**	**1489.7**	**249.9**	**15.2**
Current account deficit	1866.2	1446.7	119.5	418.0
Increase reserves	1235.5	43.0	130.3	-402.9
Errors and omissions	**-1130.3**	**-822.4**	**-1436.7**	**-1526.9**

Macedonia	2003	2004	2004 Jan-Sept	2005 Jan-Sept
Capital inflow transfer	**200.1**	**343.6**	**234.8**	**175.2**
Capital transfer	-5.9	-3.7	-4.1	0.1
FDI	85.1	125.6	89.2	71.1
Portfolio	3.0	11.9	0.6	31.7
Financial derivatives				
Other capital (loans)	117.8	209.8	149.1	72.3
Destination of capital inflow	**177.3**	**349.8**	**245.6**	**194.1**
Current account deficit	132.1	334.2	233.6	68.0
Increase reserves	45.2	15.7	12.0	126.1
Errors and omissions	**-22.7**	**6.3**	**10.8**	**-4.0**

Serbia	2003	2004	2004 Jan-Nov	2005 Jan-Nov
Capital inflow transfer	**2219.1**	**2412.7**	**1846.3**	**2814.5**
Capital transfer	.	.	.	.
FDI	1203.8	779.1	629.2	1079.5
Portfolio	.	.	.	.
Financial derivatives	.	.	.	.
Other capital (loans)	1015.3	1633.7	1217.1	1735.0
Destination of capital inflow	**2177.5**	**2593.6**	**1933.9**	**2713.1**
Current account deficit	1362.3	2233.5	1703.6	1472.8
Increase reserves	815.2	360.2	230.3	1240.3
Errors and omissions	**-41.6**	**180.9**	**87.6**	**-101.4**

Source: National statistics.

Stability

SEE continues to be a zone of price stability, except in the case of Serbia and partly Romania. Though inflation has speeded up in some other countries too, it is in single digits and as a rule below 5%. Some of the acceleration in a number of countries should be attributed to rising energy costs as well as to the adjustments in administered prices. Disregarding that, the bulk of the region is enjoying relative price stability, strong GDP growth and growth in productivity notwithstanding.

Table 6

Consumer price inflation

change in % against preceding year

	1995	2000	2001	2002	2003	2004	2005 [1]	2006 forecast	2007 forecast
Albania	7.8	0.1	3.1	5.3	2.4	2.9	2.4	2.5	2
Bosnia and Herzegovina [2]	.	4.9	3.2	1.3	1.1	0.7	2.9	2	1
Bulgaria	62.1	10.3	7.4	5.8	2.3	6.1	5.0	6	4
Croatia [3]	2.0	6.2	4.9	1.7	1.8	2.1	3.3	3	2.5
Macedonia	15.7	5.8	5.5	1.8	1.2	-0.4	0.6	2	2
Romania	32.3	45.7	34.5	22.5	15.3	11.9	9.0	8	7
Serbia	.	79.6	93.3	16.6	9.9	11.4	16.2	15	15
Montenegro	.	20.2	21.8	16.0	6.7	2.4	2.5	3	3
Turkey	89.0	54.9	54.4	45.0	25.3	10.6	7.7	5.5	4.5

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

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

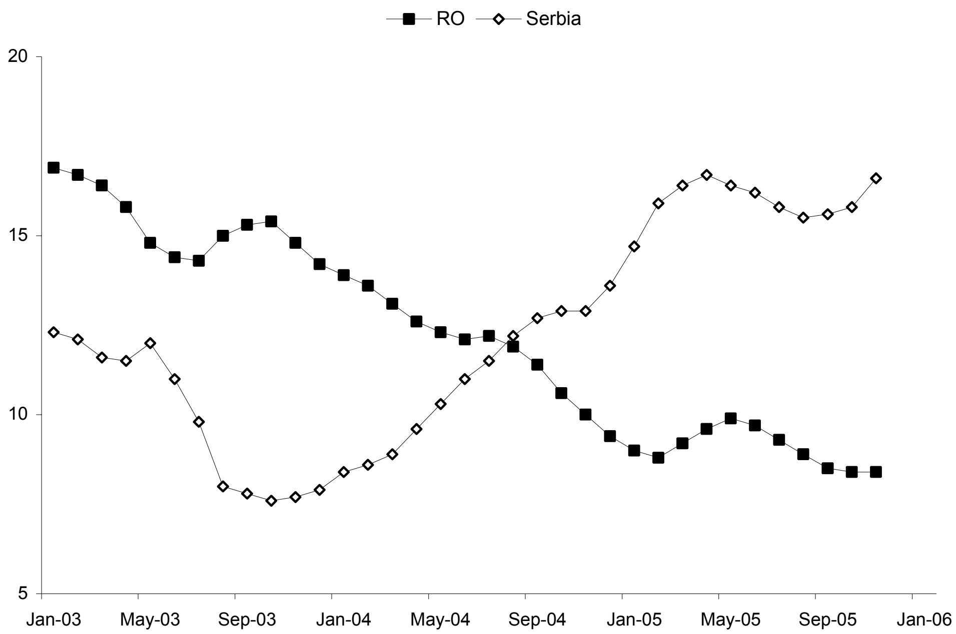
It is perhaps most interesting to compare the inflation record of the two outliers, Serbia and Romania, in the past three years. While Romanian inflation is slowing down, i.e., it is stabilizing, though not as fast as expected or targeted, that in Serbia is accelerating since the end of 2003. In the latter case, the acceleration of inflation has gone against the expressed targets of the monetary and fiscal authorities and against the targets agreed on with the International Monetary Fund. Strangely enough, until quite recently, practically nobody, IMF included, has shown any serious concern with inflation and indeed almost everybody seems to have been happy with paying lip-service to price stability and doing everything contrary to the achievement of this target. The clear beneficiary of the benign view of accelerating inflation has been the fiscal policy because the general government was able to show a surplus at the end of the year. Thus, for all that can be known, the acceleration of inflation in Serbia has been the consequence of the monetization of the budget. The break in the process of disinflation in Romania, however, can be attributed to rising costs, especially of labour, in the context of the changing monetary and exchange rate policies.

One reason for price stability is the exchange rate policy. Apart from Romania and Serbia, most other countries are on fixed or very fixed exchange rates. They fall into different classes when it comes to the behaviour of real exchange rates, however. In the case of countries in the Western Balkans, most are targeting real exchange rate stability with nominal exchange rate stability and that requires price stability too. Croatia, Macedonia, Montenegro and Bosnia and Herzegovina, which rely on fixed exchange rates, try to keep their inflation rates in line with those in the euro zone. This is because they cannot afford real appreciation of their currencies and the consequent loss of competitiveness because they have either inherited, from former Yugoslavia, or moved to relatively high price levels, as a consequence of significant inflows of aid and other transfers, and attendant high levels of wage costs. In the case of the Eastern Balkan countries, real appreciation may not be as serious a problem because their inherited price levels were very low and may not have recovered so much as to present a threat to their competitiveness.[28]

Figure 5

Consumer price inflation in Serbia and Romania, 2003-2005

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



Source: wiiw Monthly Database incorporating national statistics.

Serbia is an outlier, however, because it falls in a category of a country that has allowed real appreciation until some time in 2003 though its inherited price level has been rather high and wages have grown quite rapidly since the year 2000. This has led to a rather ambiguous exchange rate policy. In 2005, initially the dinar was rather stable only to appreciate in real terms by the end of the year. This has spurred inflationary expectations rather than calming them down. By the end of the year, it became unclear what exchange rate policy the central bank was actually following. This confusion has been continuing at the beginning of 2006. Indeed, the beginning of the year has been characterized by a continuation of the policy of nominal exchange rate depreciation, which may signal that persistent inflation is not perceived as a serious problem.

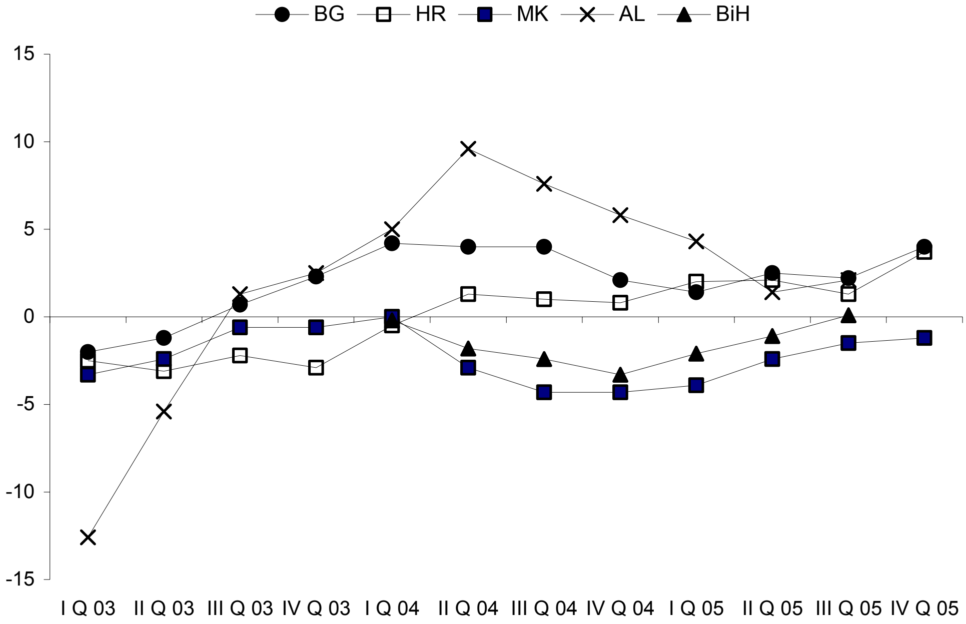
---

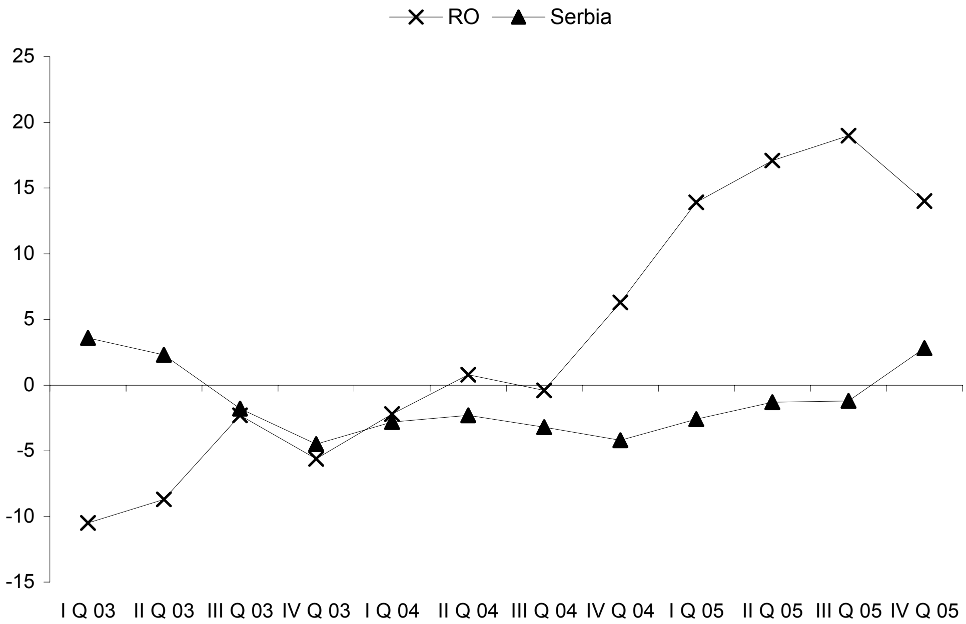
[28] On that see M. Holzner, 'Real exchange rate distortion in Southeast Europe', *European Balkan Observer*, No. 8, 2005, pp. 2-9. It shows that most former Yugoslavia states have overvalued currencies, i.e., have relatively high price levels while Bulgaria and Romania have undervalued currencies. In the last couple of years, the nominal and real appreciation of the Romanian currency may have erased much of that inherited undervaluation. Also, comparisons of wages in Romania and Bulgaria show that those in the former economy have become significantly higher than those in the latter. Nevertheless, wages in the rest of the Balkans, with the exception of Albania, are still higher.

Figure 6

Real appreciation*, 2003-2005

EUR per NCU, CPI-deflated, growth rate year-on-year





* Increasing line indicates real appreciation. Serbia: based on end-of-month exchange rates.

Source: wiiw Monthly Database incorporating national statistics.

In Romania, real appreciation has been massive in the last year. This has been the consequence of the introduction of the policy of inflation targeting, which has left the exchange rate to float more or less freely. Nominal and real appreciations have supported price stabilization, though inflation is still running at around 9% per year. Real appreciation has also characterized the developments in Bulgaria and Croatia, though this trend was reversed in the latter country by the end of the year. In

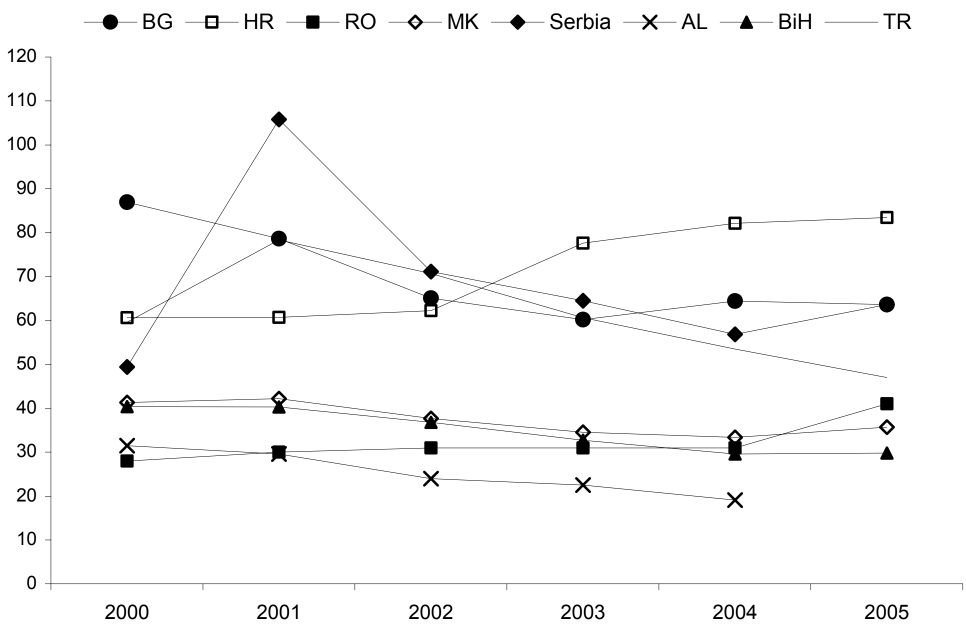
Bosnia and Herzegovina as well as in Montenegro, the real exchange rate has been mostly stable, while the Macedonian currency has depreciated in real terms due to a close to zero inflation rate in that country.

Given that exchange rate movements have not yet had negative influences on exports, though imports have continued to grow, the issue of competitiveness is an open one, while there may be an issue of sustainability of the external imbalances. In previous years, debt to GDP ratios tended to grow in Croatia and practically nowhere else. Bulgaria, for instance, exhibited a clear trend of a falling debt to GDP ratio from the 1996-1997 crisis onwards. In the last year or two, things have changed somewhat. The debt to GDP ratios have started to grow in Bulgaria and Romania, though the level is still relatively low in Romania. In Croatia, the trend of increase has continued, though it is not altogether clear whether the growth of the debt to GDP ratio has decisively slowed down. In Serbia, the debt to GDP ratio is worsening rather quickly, but there are still some debt-write offs to materialize, so the issue of debt-sustainability is an open one. In other countries, the levels of debt are not high or are moderate and the indicators of indebtedness do not show a significant worsening. It is interesting to note also the sharp improvement in Turkey. In any case, except for Croatia and perhaps Bulgaria, foreign debt exposure seems sustainable, assuming growth persists.

Figure 7

Share of total foreign debt in GDP, 2000-2005*

in %



* Data for 2005 are estimates.

Source: National Banks of the respective countries.

Credit expansion

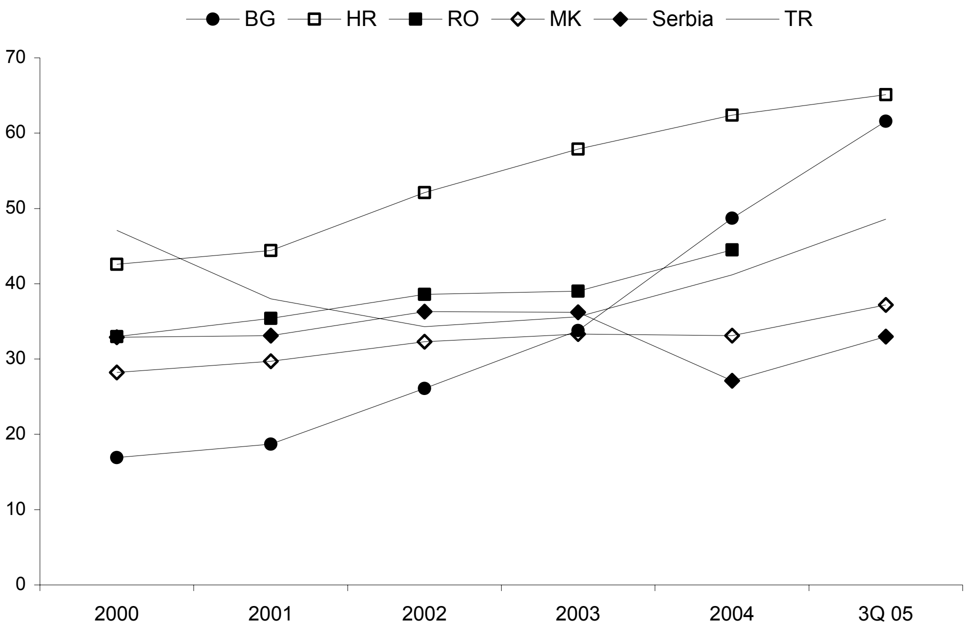
The region has been starved for money for quite some time. As Figure 9 shows, the share of broad money in GDP has not increased significantly, except in Bulgaria. In the past two years and especially in the last year, however, credit expansion has accelerated. This has started to worry the monetary authorities because it has been seen as the cause of widening trade deficits and as a possible cause of the speed-up of inflation.[29] In a number of cases, the monetary authorities have countered with the tightening of monetary policy. The results of their efforts are mixed, to say the least.

Country by country data show a significant increase in banks' credit activities. As most countries, with the exception of Croatia and Albania, do not run significant budget deficits, most of the credits go to enterprises and households. In a number of countries, the growth of household incomes and improvements in the mortgage and other laws have led to higher demand for household loans. Given the falling risk and the stable exchange rate, banks have an interest to borrow abroad and lend domestically. Given that the stock of credit is relatively low, except perhaps in Croatia, and given the still significant difference between foreign and domestic interest rates, there is a lot of room for credit expansion. That, however, poses a dilemma for monetary policy: should the monetary authorities stand by or should they try to somehow ration this convergence over time?

Figure 8

Share of private foreign debt in total foreign debt, 2000-2005

in %



For Bulgaria, 2005 data refer to November.

Source: National Banks of the respective countries.

In a number of countries, the monetary authorities have decided that they need to slow down financial inflows. In Croatia and Bulgaria, outright quantitative limits to credit expansion have been introduced; in Bulgaria credit growth is limited to 23% per year. In Romania, restrictions on capital inflows are being relied on. In Serbia and Bosnia and Herzegovina, reserve requirements have been

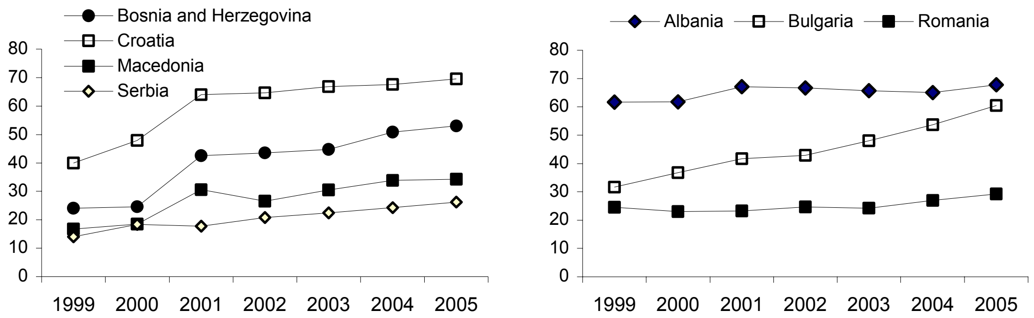
[29] On that see Ch. Duenwald, N. Gueorguiev and A. Schaechter (2005), 'Too Much of a Good Thing? Credit Booms in Transition Economies: The Cases of Bulgaria, Romania, and Ukraine', *IMF Working Paper* WP/05/128. The others consider the effects of credit expansion on inflation and on the growth of imports and find evidence for the latter only.

hiked. In Macedonia and Montenegro those have been high for a while now. As of the beginning of 2006, banks were required to hold reserves with the central bank at a level of 35% of their foreign currency assets in Romania (to grow to 40% in spring of 2006), up to 55% on new inflows in Croatia, of 15% in Bosnia and Herzegovina, and up to 38% on new inflows in Serbia.

Figure 9

Broad money

in % of GDP



Source: wiiw Annual Database incorporating national statistics.

Thus, as a rule, restrictive monetary measures have been applied in order to sap the growth of credit especially to households. The reason that banks are extending loans to households rather than to enterprises is that the term and interest rate structure of loans to households is better and because apparently the risks are lower. In countries where loans to firms are also growing, e.g., in Croatia, that is perhaps a sign that the risk to lending to the enterprise sector has gone down.

Restrictive measures of monetary policy are risky for various reasons. Given that risk is in fact falling, interest rate hikes or alternative measures with the same effect will invite more inflows rather than less. It will also divert loans to households, because there the risks are anyway lower. Finally, the effects are transitory, because banks and other financial institutions find alternative ways to get around quantitative restrictions.[30]

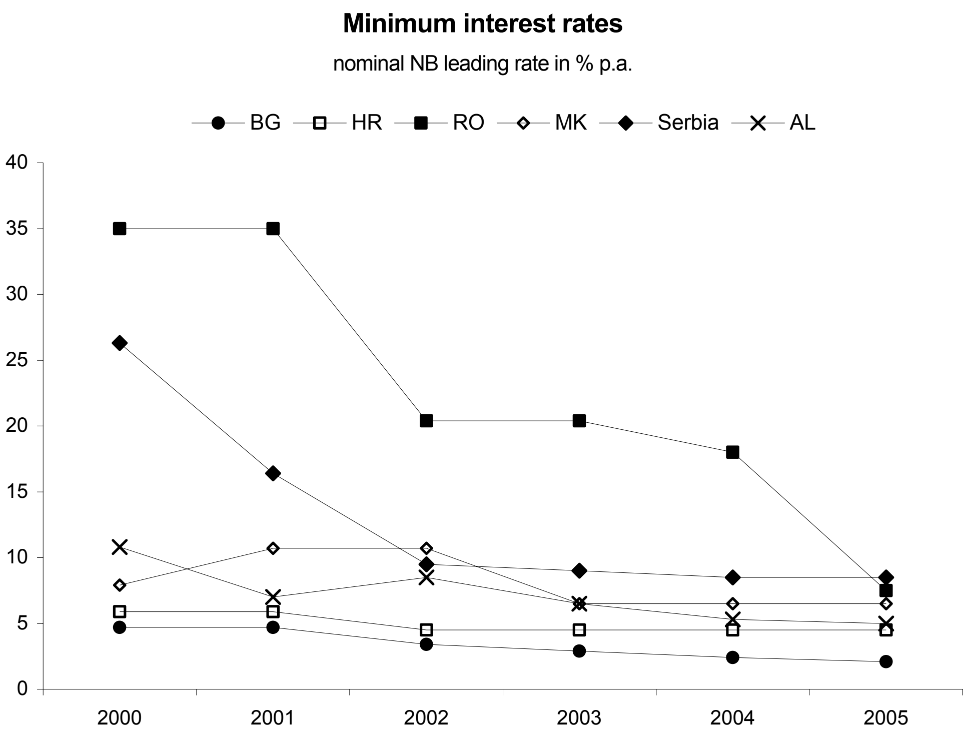
The main positive effect should be slower growth of private consumption and thus lower growth rates of imports. In a number of countries, this aim has apparently been achieved, at least temporarily. In Serbia, monetary tightening has been additionally justified with the need to slow down inflation. There is scant evidence, however, that credit restriction in open economies has a significant influence on inflation. It is quite possible that these measures are even counterproductive because restrictive monetary policy may slow down growth, which may have inflationary consequences if higher incomes are chasing less products; also higher interest rates or the need to look for alternative sources of finance, due to credit rationing, may in fact increase costs and thus put additional pressure on inflation.

[30] For a recent assessment of the efficiency of capital controls, see N. Magud and C. M. Reinhart (2006), 'Capital Controls: An Evaluation', *NBER Working Paper* 11973. For an assessment of the financial sector in transition economies, see A. Maechler, S. Mitra and D. Worrell (2005), 'Exploring Financial Risks and Vulnerabilities in New and Potential EU Member States', paper presented at the Second Annual DG ECFIN Research Conference on 'Financial Stability and the Convergence Process in Europe'.

Perhaps one way to see the monetary policy dilemma clearly is to notice the relationship between interest rates and the exchange rate. Nominal appreciation is the same as an interest rate hike and *vice versa*. This is especially so if the interest rates do not reflect risks properly but are artefacts of restrictive monetary policy. In the case of Southeast Europe, exchange rates have been fixed, except in Romania and now perhaps intermittently in Serbia. As a consequence, improved economic performance tends to invite higher inflows of investment and put a downward pressure on interest rates. That would normally lead to nominal depreciation especially if the current account deficit is widening. With fixed exchange rates, that is difficult to achieve. Thus, interest rates or other restrictive measures of monetary policy stay longer than necessary and tend to aggravate the external imbalances, except perhaps temporarily.

In the Balkans, restrictive measures on credit expansion have not yet led to significant growth of interest rates. Indeed, interest rates have either continued to decline or that decline has been slowed down or stopped for the time being. This is true not only of the countries that exhibit real appreciation of their currencies, but of the country that has been trying to depreciate its currency nominally and in real terms, that is of Serbia. Declining interest rates should ease the pressure on the nominal and real appreciation of currencies. Hiking the interest rates makes sense only if it reflects higher risks either of inflation accelerating or of the financial system experiencing problems with liquidity.

Figure 10



For Albania, 2005 data refer to September.

Source: wiiw Monthly Database incorporating national statistics.

In the case of Romania, however, a more flexible exchange rate has indeed led to significant nominal appreciation allowing at the same time for a significant easing of the monetary policy as can be seen from the decline of the leading interest rate. Unless the monetary authorities get nervous, the convergence of interest rates and of inflation with those in the euro area should lead to both growth and trade stabilization.

In the case of Romania and Bulgaria, though for different reasons, monetary policy measures and exchange rate management may be difficult to pursue given that these two countries are joining the EU and will have to have an open capital account. In the case of Bulgaria, assuming that it will not give up its currency board, that essentially rules out monetary policy as an instrument altogether. In the case of Romania, inflation targeting, followed since the second half of last year, is an appropriate policy, but that would require relatively quick convergence of inflation rates, which perhaps is to be expected anyway if growth continues and no major policy mistakes are made.

In the rest of the Balkans, there is a choice to either open the capital account or to continue to ration capital inflows. Monetary policy proper is difficult to pursue against the background of fixed exchange rates and significant and, in some case, increasing euroization. It seems that most countries have chosen to attempt to manage capital inflows and most of them capital outflows too, except for Albania where it is really the private transfers that are the main sources of financial inflows anyway.

Public sector and employment

Significant fiscal consolidation has been achieved in the whole region already in the previous years and has been maintained by and large last year too. The remaining outlier is Croatia, which is still struggling to bring its general budget deficit to around 3% of GDP. Currently, the plan is that this goal will be achieved in the year 2007. Another problematic case is Serbia, which recorded a surplus in 2005, but that was on the back of accelerating inflation. If inflation is curbed this year or in the medium run, the general government budget will turn negative again in all probability. Finally, Albania is still relying on deficit financing as is to a lesser extent the case with Montenegro. In other countries, balanced or near balanced budgets or surpluses are recorded.

The structure of public financing, both on the expenditure and on the revenue sides, shows significant structural weaknesses and inefficiencies though. In the case of Serbia and Croatia, which have bigger states than the other countries in this region, some of the reasons for high public expenditures have to do with the process of transition but others are connected with the delays in public sector reforms.

In principle, transition is characterized by growing productivity as a consequence of privatization, private firms saving more on labour than public ones. The excess labour falls either on the budget directly or moves into the informal economy, relying on the budget indirectly. The idea is captured in Figure 11. The level of taxation, T, is connected with the distribution of employment between the private, public and informal sectors. In the policy setting, by varying the tax burden and perhaps its incidence, the distribution of employment across different sectors is determined.[31]

Thus, low levels of employment or high levels of unemployment may be connected both with speedy transitions and with delayed transitions. If significant employment is found in the public sector and there are significant unemployment or other social benefits and if the level of public expenditures is high, it is probably the case that the process of transition is slow. This picture fits Croatia and Serbia

[31] For an analytical survey of the literature and the evidence see T. Boeri (2000), 'Optimal Speed of Transition 10 Years After', *CEPR Discussion Paper* DP2384.

well, though the former is much more advanced than the latter. If, on the other hand, public expenditures are relatively small and social benefits are not very generous, but public employment is not insignificant, while employment levels are low and unemployment levels are high, that is probably also the consequence of a rather unsuccessful transition, which can be the result of a number of causes. This is somewhat characteristic of Macedonia and Bosnia and Herzegovina. These two countries have low employment, with a significant share of it in the public sector, and high unemployment.

Figure 11

Taxes and employment

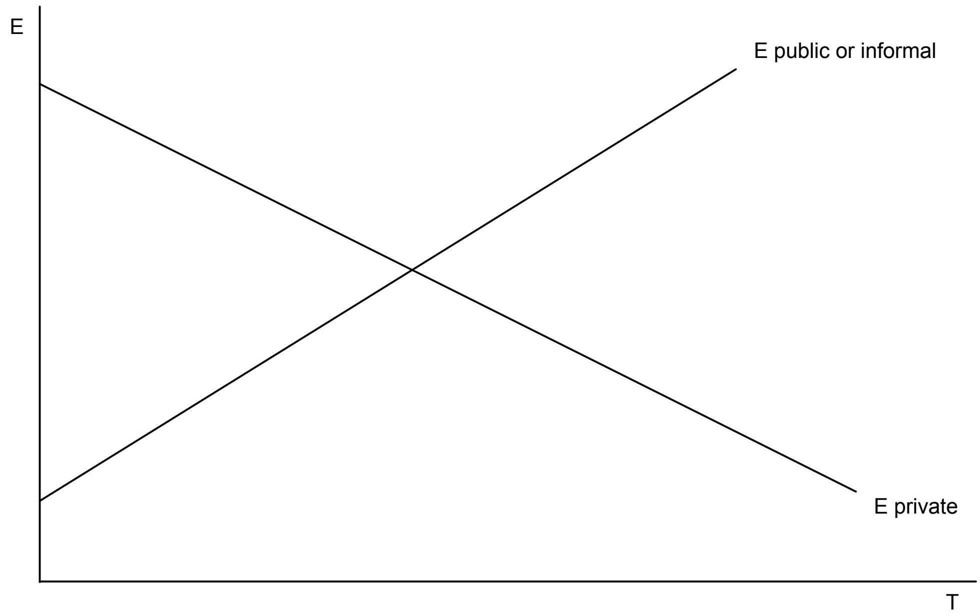


Table 7

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

	2000	2001	2002	2003	2004	2005 [2)]	2006 forecast	2007 forecast
Albania	-7.5	-6.9	-6.1	-5.0	-4.9	-4	-3	-3
Bosnia and Herzegovina	-7.0	-3.3	-0.2	0.8	1.8	.	.	.
Bulgaria	-0.6	-0.6	-0.7	0.0	1.7	2.4	1	0.5
Croatia	-6.5	-6.8	-4.8	-6.3	-4.9	-4.5	-4	-3.8
Macedonia [3)]	2.3	-6.3	-5.0	-1.1	0.0	1.0	.	.
Romania	-4.0	-3.2	-2.5	-2.3	-1.1	-0.8	-1	-2
Serbia	-0.9	-1.6	-3.7	-4.2	-1.5	.	.	.
Montenegro [4)]	-6.0	-3.1	-2.8	-3.0	-2.1	.	.	.
Turkey [5)]	-11.9	-16.2	-12.6	-8.6	-7.0	-3.0	-2.4	.

1) National definition, for Croatia IMF definition. - 2) Preliminary. - 3) From 2001 excluding privatization revenues. - 4) Central government deficit. - 5) Based on PSBR methodology.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Romania and Bulgaria fall in a different category. Though employment levels are not all that high, unemployment rates are either low, as in the case of Romania, or are coming down, as in the case of Bulgaria. How much of that is due to the increase in private sector employment is not altogether clear, as it is not clear what is the effect of outward migration. Still, these are countries with moderate public sectors and with modest social safety nets. The strength of the informal economy is subject to different assessments, but it should not be larger than in other Balkan countries. Thus, these are examples of relatively successful transition, though there is still a lot to be done in terms of public sector restructuring especially in the case of Romania.

Given the balanced fiscal positions in most countries, fiscal policy cannot contribute all that much to short-term developments – except in the sense that public expenditures should be further decreased and budget surpluses should be targeted. The IMF has suggested such fiscal policies, but has met resistance in a number of countries, e.g., in Romania, Serbia, Croatia, and Bulgaria. Thus, most countries have opted for a restrictive monetary policy rather than for further fiscal consolidation. This is a policy mix that is not generally considered effective to check the widening of the external imbalances. Indeed, Turkey provides an example of a successful adjustment based on quite tight fiscal policy of the kind usually prescribed by the international financial institutions.

Partial exceptions to fiscally prudent policies are Croatia and Serbia, in the former case in terms of the influence on the growth rate via public investments, while in the latter in terms of the influence on inflation via more restrictive public spending. In the medium run, however, public sector restructuring can significantly influence growth prospects. The reforms include changes in the level and the structure of public expenditures and the sources of public revenues. Given that these countries are rather diverse, the reforms will look different in the individual countries. In cases like Macedonia and Albania, more expenditures for development will come in place of social benefits. In the case of Serbia and Croatia, further reduction of public employment will be necessary together with cuts in social benefits. In most other cases, various reforms to shore up public services and social transfers will be needed.

Table 8

Unemployment, LFS definition, annual averages

	in 1000 persons						rate in %				
	2000	**2001**	**2002**	**2003**	**2004**	**2005** [1]	**2003**	**2004**	**2005** [1]	**2006** forecast	**2007** forecast
Albania [2]	215	181	172	163	157	155	15.0	14.4	14	14	14
Bosnia & Herzegovina [2]	421	422	442	460	491	523	42.0	43.9	46	46	46
Bulgaria	567	664	592	449	400	330	13.7	12.0	10	9	8
Croatia	298	277	266	256	250	236 I-VI	14.3	13.8	13.1 I-VI	13	12.8
Macedonia	262	263	263	316	309	330	36.7	37.2	37.5	37	37
Romania [3]	821	750	845	692	800	695	7.0	8.0	7.0	7	7
Serbia [4]	426	433	460	500	665	.	14.6	18.5	20	22	23
Montenegro [5]	55	58	58	.	72	.	.	27.7	28	28	28
Turkey [6]	1497	1967	2464	2493	2498	2467 I-IX	10.5	10.3	10	9.7	9.3

Notes: 1) Preliminary. - 2) Unemployment by registration, end of period. - 3) From 2002 new methodology in accordance to EU definitions. - 4) 2004 according to ILO and EUROSTAT, census 2002. - 5) From 2004 according to ILO and EUROSTAT, census 2003. - 6) Civilian Labour Force.

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

Reforms on the revenue side are all in the direction of flattening the tax rates. The aim is to broaden the tax base, give incentives to investments and lower the costs of labour. In addition, the aim is to speed up the restructuring of the public sector and increase private sector employment, at the same time stimulating the legalization of the informal employment. Though these ideas have been around for some time now, they have been resisted in most countries. With the tax reform in Romania, that may change. Serbia has already lowered the tax on corporate income and in other countries various taxes and contributions that fall on labour are under review. Social benefits are under review in several countries with the aim to scale down the pension and health bill. Still, in a number of countries, the system of taxation is rather unreformed and also inefficient. VAT was introduced in Serbia and Montenegro only in 2005 and in Bosnia and Herzegovina only at the beginning of this year.

These reforms are easier in countries with lower unemployment rates, while they are difficult to implement in the majority of the countries of the region because the economy is still shedding labour and unemployment rates are going up rather than down. Labour market reforms are also being contemplated, but greater flexibility in the sense of laxer rules for firing and hiring do not necessarily lead to greater flexibility in the wage rate and the net effect is that employment is lost but new employment is still hard to come by.

Regional integration

Growth of GDP and trade has reopened the issue of regional liberalization and integration. Trade in the region is growing as is intra-regional investment. Clearly the more developed countries in the region, such as Croatia, are benefiting from the improved growth prospects of the region. Still, intra-regional trade and investment flows remain relatively limited. In fact, most of the regional trade boils down to exports to Bosnia and Herzegovina and, to a lesser extent, Kosovo (though the latter is not directly observable in the data). The only other significant regional trade is that between Serbia and Macedonia and Serbia and Montenegro. It is not clear, however, whether these regional trade integrations will persist in the future.

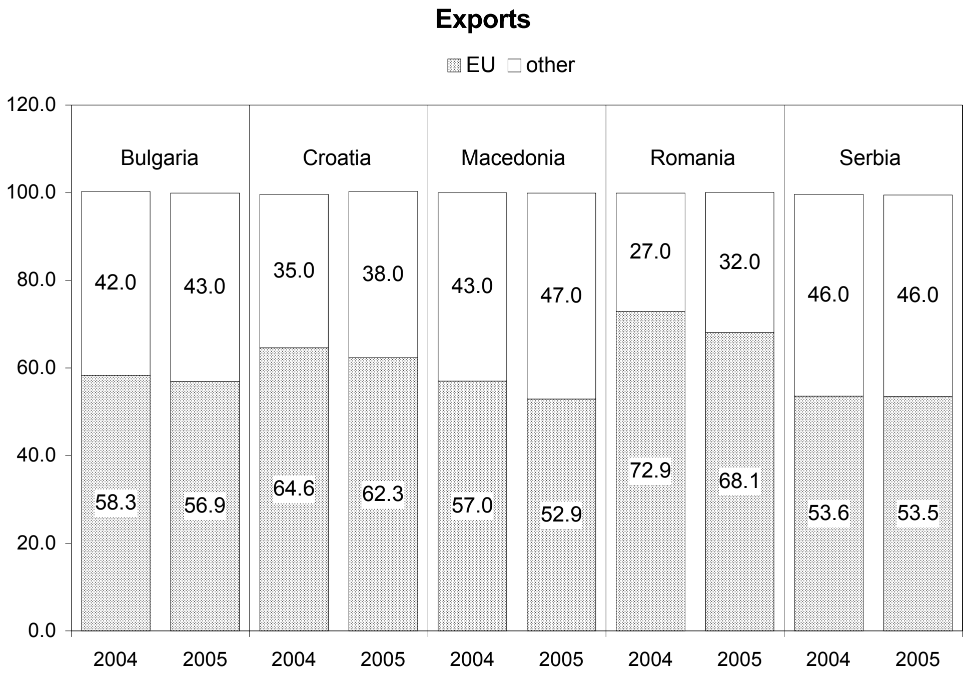
In any case, the EU has supported the signing of bilateral trade agreements between all the countries in the region and now supports the creation of a Western Balkan free trade area. That should remove remaining barriers to trade, e.g., bilateral rules of origin, and should enable entrepreneurs to optimize the allocation of their investments regionally. Still, given the pattern of trade flows that has existed, it is not likely that this free trade area will increase the level of regional trade all that much. Similarly, given that major investors are from the outside of the region, it is not altogether clear that a significant increase in intra-regional investment should be expected.

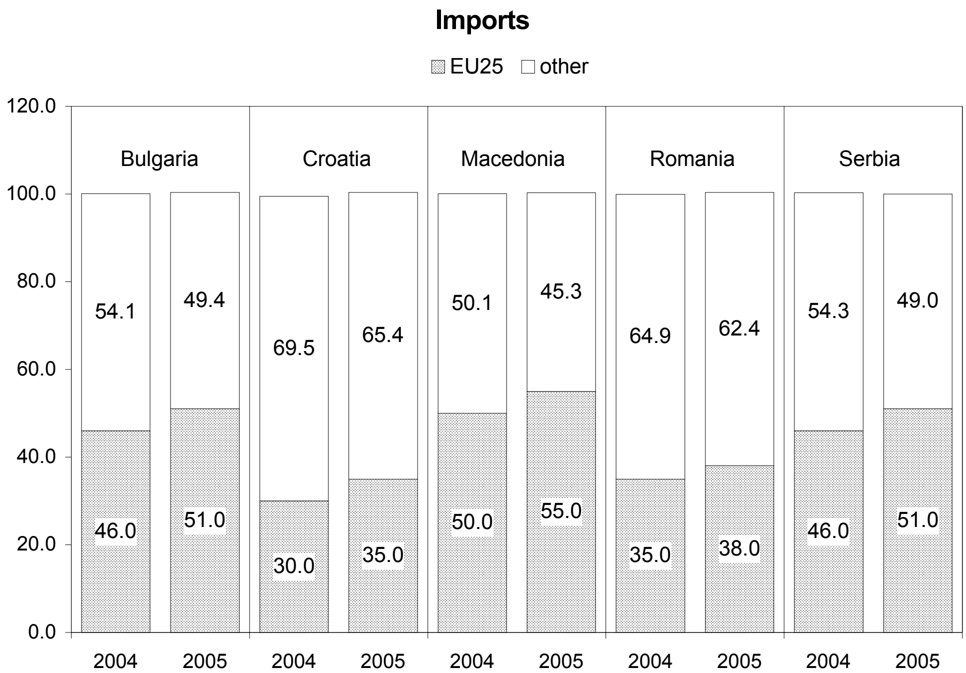
Other problems with this initiative include (i) the fact that barriers to trade and investment are more of a political nature than connected to trade regime and policy, and (ii) the disharmony between the process of regional and EU integration. Given that Croatia and Macedonia are candidates for EU membership, they will show the same lack of interest in regional integration that characterized Bulgaria and Romania in about the past five years. Still, every advance in liberalization in this region cannot but have positive effects. Also, the process of EU integration may be speeded up if the region leaves the impression that it does not present security and other political problems.

Figure 12

Foreign trade of Southeast European countries, 2004-2005

% of total





Source: wiiw Monthly Database incorporating national statistics.

Table 9

SEE trade: exports as % of total (2004)

percentage point change in shares 2001-2004

of:	ALB	B&H	BUL	CRO	MAC	ROM	S&M
to:							
Albania		0.1	-0.1	0.1	0.1	0.0	0.4
Bosnia & Herzegovina	0.0		-0.1	**1.7**	-0.1	0.0	**4.6**
Bulgaria	0.0	0.0		0.2	0.4	0.4	0.3
Croatia	-0.2	**8.2**	0.4		**2.2**	0.6	**2.1**
Macedonia	-0.3	-0.1	0.0	-0.2		-0.1	**-2.1**
Romania	0.0	**-1.0**	0.7	0.6	0.1		**-2.4**
Serbia & Montenegro	**1.2**	**-3.1**	-0.6	0.3	**2.5**	-0.4	
EU-4*	**-6.5**	**3.4**	**-1.9**	**-2.5**	**-1.9**	**-1.4**	0.4
SEE-7	0.8	**4.1**	0.3	**2.7**	**5.3**	0.5	**2.9**
Total change, USD bn	**0.2**	**0.7**	**4.0**	**3.6**	**0.3**	**10.4**	**1.5**

* EU-4 = Austria, Germany, Greece, Italy.

Source: IMF Direction of Trade Statistics, Croatian Bureau of Statistics, Statistical Office of Macedonia, National Bank of Serbia, Central Bank of Bosnia & Herzegovina, Ukrainian Statistical Office, Czech Statistical Office, Hungarian Central Bank.

Table 10

SEE trade: imports as % of total (2004)

percentage point change in shares 2001-2004

of:	ALB	B&H	BUL	CRO	MAC	ROM	S&M
from:							
Albania		0.0	0.0	0.0	0.0	0.0	0.1
Bosnia & Herzegovina	0.1		0.0	0.8	0.0	-0.1	0.1
Bulgaria	-0.1	-0.1		0.2	**3.3**	0.0	**-1.2**
Croatia	0.3	**3.9**	0.2		0.8	0.2	0.0
Macedonia	-0.3	-0.3	0.0	0.0		0.0	**-4.1**
Romania	-0.1	0.0	0.0	0.9	0.0		**-1.2**
Serbia & Montenegro	0.6	**3.5**	0.0	0.4	**2.1**	-0.3	
EU-4*	**-5.8**	**-1.1**	**4.0**	**-1.7**	**-1.9**	**-3.4**	**-1.0**
SEE-7	0.4	**7.0**	0.2	**2.2**	**6.2**	-0.2	**-6.4**
Total change, USD bn	**1.0**	**2.3**	**6.8**	**7.7**	**0.2**	**17.1**	**5.0**

* EU-4 = Austria, Germany, Greece, Italy.

Source: IMF Direction of Trade Statistics, Croatian Bureau of Statistics, Statistical Office of Macedonia, National Bank of Serbia, Central Bank of Bosnia & Herzegovina, Ukrainian Statistical Office, Czech Statistical Office, Hungarian Central Bank.

EU integration

In the wake of the crisis in the process of EU deepening, the process of widening has proceeded surprisingly well and on schedule. There is still some risk that Bulgaria and Romania will not join the

EU on 1 January 2007, but the odds are still in favour of Balkan enlargement starting on that date and coming to an end by 2015. There are major stumbling blocks because of a host of constitutional issues that need to be sorted out, primarily this year. By contrast, economic recovery, with some pockets still lagging, is well under way and this supports both political solutions as well as increased interest in EU integration.

Assuming that all the remaining Balkan problems are solved, at least in principle, and all the Association and Stabilization Agreements are negotiated and signed, and that negotiations with Macedonia are initiated by the end of this year, the accession of Romania and Bulgaria may signal the start of the Balkan enlargement of the EU at the beginning of 2007. The solution of the problems and the clear prospects of EU integration should prove to be stabilizing for the region and should put it on a path of sustainable growth and convergence.

Conclusion on prospects

The growth prospects of the acceding countries, Bulgaria and Romania, look good, though monetary policy remains the main risk to steady growth. The candidate countries, Croatia and Macedonia, face different problems and can be expected to continue to expand at a measured pace. The rest of the Western Balkans faces the prospect of steady growth at relatively high rates, if the major political issues are resolved without undue internal political wrangling or even conflicts.

Country reports

Mario Holzner

Albania: power issues

Albania is currently struck by power issues – those related to the political sphere as well as concerning the domestic electricity supply. Both have important implications for the development of the country.

In fulfilling its number one election campaign promise of fighting corruption, the new conservative government also 'takes revenge' on the socialist party after the years spent in opposition. In this respect a number of international contracts that the previous socialist government had signed were cancelled.

For instance, the government suspended a deal to sell the state-owned fixed-line telephone company Albtelecom to a Turkish consortium. In May 2005 the consortium of Turk Telekom and Calik Enerji had offered EUR 120 million to buy 76% of Albtelecom. The former socialist government considered this deal as one of their most successful privatizations. However, the new economy minister Genc Ruli declared the deal to have violated Albanian law and announced a corruption investigation. It is intended to open an international tender to select a consultant for the privatization of Albtelecom.

Also, a high speed rail line project linking the capital Tirana and the second biggest city and main port of Durres was cancelled. The USD 83 million deal had been agreed between the US-based General Electric and the former government. Minister Ruli declared that this state-funded project was too high a burden to place on the debt of the Albanian state. Similarly, a big road construction project was put on hold. These moves are likely to raise concerns on the part of international investors with regard to the contract constancy of Albanian governments.

A more direct clash started over the decision of the National Council of Territory Adjustment on the demolition of an overpass in the socialist-run municipality of Tirana. Tirana Mayor and head of the socialist party Edi Rama communicates with the central government via the courts. A rally organized by the socialists has further fuelled the dispute. The political climate in the country has once again hit rock bottom. This has even made the Council of Europe to arbitrate between the parties in order to help resolve the deadlock.

Given that the Albanian government wishes to sign the Stabilization and Association Agreement (SAA) with the EU in the first half of 2006 (during Austria's EU presidency) it will be of utmost importance to settle the differences soon and thereby prove democratic maturity and the functioning of the constitutional state.

Meanwhile the electricity crisis continues. Heavy flooding has led to further electricity shortages in the centre and south of the country, in addition to those caused by the previous drought. Albania mainly relies on national hydro power generation. However, the worst part of the crisis with its peak in late 2005 seems to be over. The capital Tirana reports almost no power cuts although other major cities such as Vlora and Shkodra still face up to eight hours of regular power cuts.

Table AL

Albania: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 [1)]	2006 forecast	2007 forecast
Population, th pers., end of period [2)]	3058.5	3063.3	3084.1	3102.8	3119.5	3135.0	3150	.	.
Gross domestic product, ALL mn, nom.	474291	530907	587717	624718	682669	780100	836900	910000	980000
annual change in % (real)	10.1	7.3	7.0	2.9	5.7	6.0	5.5	5.5	6.0
GDP/capita (EUR at exchange rate)	1057	1308	1488	1526	1596	1955	2140	.	.
GDP/capita (EUR at PPP - wiiw)	3100	3540	3820	3930	4160	4490	4710	.	.
Gross industrial production									
annual change in % (real) [3)]	34.2	0.5	7.1	1.8	2.7	3.1	2	2	3
Gross agricultural production									
annual change in % (real) [3)]	0.4	4.5	2.2	2.1	3.0	3.1	3	3.5	3.5
Construction output total									
annual change in % (real) [3)]	17.8	37.2	49.3	8.7	11.3	10.6	10	10	11
Consumption of households, ALL mn, nom.	334801	371522	422651	455952	508108	.	.	.	.
in % of GDP	70.6	70.0	71.9	73.0	74.4	.	.	.	.
Gross fixed capital form., ALL mn, nom.	81633	112958	151156	143914	160210	.	.	.	.
in % of GDP	17.2	21.3	25.7	23.0	23.5	.	.	.	.
Reg. employment total, th pers., end of period [4)]	1065.1	1068.2	920.6	920.1	926.2	931.0	931	.	.
annual change in %	-1.8	0.3	-13.8	0.0	0.7	0.5	0	.	.
Reg. unemployed, th pers., end of period [4)]	239.8	215.1	180.5	172.4	163.0	157.0	155	.	.
Reg. unemployment rate in %, end of period	18.2	16.8	16.4	15.8	15.0	14.4	14	14	14
Average gross monthly wages, ALL [5)]	12708	14963	17218	19659	21325	24393	27000	.	.
annual change in % (real, gross) [5)]	9.9	17.7	11.6	8.1	6.1	11.2	11	.	.
Consumer prices, % p.a.	0.4	0.1	3.1	5.3	2.4	2.9	2.4	2.5	2
Producer prices in manufacturing ind., % p.a.	2.8	6.5	-7.2	5.1	1.8	12.2	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	26.0	24.6	24.8	24.7	24.5	23.6	.	.	.
Expenditures	34.9	32.1	31.7	30.8	29.5	28.5	.	.	.
Deficit (-) / surplus (+), % GDP	-9.0	-7.5	-6.9	-6.1	-5.0	-4.9	-4	-3	-3
Public debt in % of GDP	37.0	43.0	41.0	41.4	40.3	37.8	.	.	.
Refinancing base rate, % p.a., end of period	18.0	10.8	7.0	8.5	6.5	5.3	5.0 IX	.	.
Current account, EUR mn [6)]	-125.5	-175.6	-243.5	-433.1	-360.7	-286.2	-400	-370	-360
Current account in % of GDP	-3.9	-4.4	-5.3	-9.2	-7.3	-4.7	-5.9	-5.0	-4.5
Gross reserves of BoA incl. gold, EUR mn [7)]	518.2	691.5	863.5	813.0	812.7	1005.2	1142.8 X	.	.
Gross external debt, EUR mn	1103.0	1262.0	1355.0	1135.0	1118.0	1165.0	.	.	.
FDI inflow, EUR mn [6)]	36.5	156.1	231.2	151.4	157.8	278.4	200	.	.
Exports of goods, BOP, EUR mn [6)]	258.6	277.5	340.2	350.5	397.9	485.6	540	560	650
annual growth rate in %	39.3	7.3	22.6	3.0	13.5	22.0	11	4	16
Imports of goods, BOP, EUR mn [6)]	879.8	1166.8	1486.5	1574.5	1578.3	1762.3	2000	2020	2100
annual growth rate in %	21.2	32.6	27.4	5.9	0.2	11.7	13	1	4
Exports of services, BOP, EUR mn [6)]	250.2	485.6	595.3	618.4	638.1	807.5	920	950	1050
annual growth rate in %	225.8	94.1	22.6	3.9	3.2	26.6	14	3	11
Imports of services, BOP, EUR mn [6)]	154.6	467.2	494.8	623.7	709.8	848.0	1060	1100	1150
annual growth rate in %	32.1	202.2	5.9	26.1	13.8	19.5	25	4	5
Average exchange rate ALL/USD	137.7	143.7	143.5	140.2	121.9	102.8	99.9	.	.
Average exchange rate ALL/EUR (ECU)	147.0	132.6	128.5	132.4	137.5	127.6	124.2	123	122
Purchasing power parity ALL/USD, wiiw [8)]	43.8	43.2	43.6	44.3	45.0	47.5	47.1	.	.
Purchasing power parity ALL/EUR, wiiw [8)]	50.2	49.1	50.0	51.3	52.7	55.6	56.6	.	.

Note: ALL: ISO-Code for the Albanian lek.

1) Preliminary. - 2) Based on combined censuses 1989 and April 2001. - 3) According to gross value added. - 4) From 2001 according to census April 2001. - 5) Public sector only. - 6) Until 2003 calculated from USD. - 7) Refer to total foreign assets of Bank of Albania. - 8) wiiw estimates incorporating data of World Penn Tables.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

The lack of electric power made the Albanian economy suffer. It is reported that some of Albania's main export branches such as manufacturing of textiles, shoes and processed foods experienced up to double-digit export drops in October. Although the exact impact of the electricity shortage on overall growth cannot yet be assessed, it may be expected that the economy will expand by 'only' 5.5% in both 2005 and 2006. This is about half a percentage point below the medium-term growth path of 6% which might be achieved again in 2007. While this does not appear to be too dramatic an effect, it has to be borne in mind that the original expectations for the 2005 real GDP growth rate were above 6%.

In reaction to the electricity crisis the government held an international tender to purchase electricity in order to secure enough imported energy for 2006. However, the tender has been cancelled as well. It was officially argued that the companies participating in the tender were not able to meet the minimum legal terms and conditions. In turn the government decided to authorize the state-owned electricity monopolist KESH to buy electricity for the first quarter of 2006 directly from foreign providers. According to the Albanian government, in the long run the only way to overcome the pathological energy crisis is to invest about EUR 1.5 billion in constructing a set of new thermo-electric power plants.

However, it might be argued that also a more market-based approach including the establishment of property rights (i.e. the fight against the wide-spread electricity theft) could improve the secure supply of electricity to the customers. In any case, it is one of the main tasks of the government to assure proper energy supply, which is vital for the Albanian economy as well as the living standard of the population.

Overall stability in both power issues – the political as well as the electric – are decisive for Albania's development. A stable political environment is the precondition for the aspired European integration. This, together with a functioning energy infrastructure, is essential for attracting foreign direct investment and achieving, eventually, economic prosperity as well. However, at present the outlook for attaining stability in both power issues is rather dim.

Josef Pöschl

Bosnia and Herzegovina in value-added tax fever

By 1 January 2006 the new value-added-tax system came in operation. Apart from those on capital markets, it taxes all transactions with one single rate of 17%. The latter fact triggered fierce discussions already prior to its implementation, and they continued afterwards, when people saw themselves confronted with increased prices for food, housing and public utilities. The consumers' perception differs considerably from that of statistical offices who maintain that all in all the VAT-induced rise of the price index, being the net outcome of increases and reductions, is moderate. Towards the end of the year, the forthcoming change of the tax system also gave reason to enhance business activities such as domestic trade and imports.

In 2005, most probably the real GDP grew somewhat faster than in previous years. However, a safe confirmation of this observation may never be possible. Bosnia and Herzegovina (BiH) is still living

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 [1]	2006	2007
								forecast	
Population, th pers., mid-year	3725	3781	3798	3828	3832	3842	3845	.	.
Gross domestic product, BAM mn, nom.	8990.0	10050.0	10960.0	11651.1	12303.0	13439.8	14690	15880	17000
annual change in % (real)	10.0	5.5	4.5	5.5	3.0	6.0	6.5	6	6
GDP/capita (EUR at exchange rate)	1234	1359	1475	1556	1642	1789	1950	.	.
GDP including NOE, BAM mn, nom. [2]	12802	14160	15410	16170	16954	17980	19650	.	.
GDP/capita, incl. NOE (EUR at PPP - wiiw)	4620	4880	5150	5350	5500	5770	6140	.	.
Gross industrial production									
annual change in % (real) [3]	8.0	7.9	4.9	5.7	5.1	12.1	11.0	10	10
Net agricultural production, total									
annual change in % (real)	4.1	-23.5	11.3	1.2	-7.3	7.1	.	.	.
Reg employees total, th pers., end of period	630.9	640.6	625.6	637.7	634.0	626.4	626	.	.
annual change in %	-3.1	1.5	-2.3	1.9	-0.6	-1.2	-0.1	.	.
Reg. unemployed, th pers., end of period	409.3	421.2	422.2	441.9	459.6	491.3	523	.	.
Reg. unemployment rate in %, end of period	39.3	39.7	40.3	40.9	42.0	43.9	46	46	46
Average gross monthly wages, BAM	503	541	652	661	716	747	790	.	.
annual change in % (real, net) [4]	9.7	4.0	14.8	-0.6	7.3	3.4	3.2 I-VIII	.	.
Consumer prices, % p.a. [5]	5.6	4.9	3.2	1.3	1.1	0.7	2.9	2	1
General government budget, in % of GDP									
Revenues	57.7	53.8	49.7	44.0	43.2	41.5	.	.	.
Expenditures	65.5	60.7	53.1	44.2	42.4	39.7	.	.	.
Deficit (-) / surplus (+), % GDP	-7.8	-7.0	-3.3	-0.2	0.8	1.8	.	.	.
Public debt in % of GDP	.	58.8	48.2	42.2	34.0	.	.	.	.
Current account, EUR mn [6]	-470.6	-446.3	-841.6	-1263.8	-1539.5	-1544.2	-1650	-1620	-1600
Current account in % of GDP	-10.2	-8.7	-15.0	-21.2	-24.5	-22.5	-22.0	-20.0	-18.4
Gross reserves of CB excl. gold, EUR mn	442.6	522.2	1378.7	1260.0	1421.7	1767.8	2015.7 IX	.	.
Gross external debt, EUR mn [7]	1914.7	2073.6	2260.6	2193.8	2054.2	2036.4	2185.1 IX	.	.
FDI inflow, EUR mn	165.9	158.6	132.8	281.8	337.6	400.4	240	.	.
Exports of goods, BOP, EUR mn [6]	780.7	1226.3	1268.1	1168.5	1303.0	1677.0	2100	2600	3200
annual growth rate in %	31.8	57.1	3.4	-7.9	11.5	28.7	25	24	23
Imports of goods, BOP, EUR mn [6]	3875.3	4226.7	4576.4	4692.2	4974.1	5354.4	6100	6600	7100
annual growth rate in %	14.9	9.1	8.3	2.5	6.0	7.6	14	8	8
Exports of services, BOP, EUR mn [6]	435.3	488.4	555.9	552.0	601.4	666.5	780	900	1050
annual growth rate in %	6.0	12.2	13.8	-0.7	8.9	10.8	17	15	17
Imports of services, BOP, EUR mn [6]	267.2	302.0	311.6	332.3	366.5	367.7	370	380	400
annual growth rate in %	10.9	13.0	3.2	6.6	10.3	0.3	1	3	5
Average exchange rate BAM/USD	1.834	2.119	2.186	2.077	1.734	1.576	1.556 I-X	.	.
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]	0.651	0.675	0.688	0.682	0.686	0.693	0.692	.	.
Purchasing power parity BAM/EUR, wiiw [8]	0.745	0.767	0.788	0.789	0.804	0.810	0.832	.	.

Note: BAM: ISO-Code for the Bosnian convertible mark.

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 BiH and Republika Srpska). - 4) wiiw calculation. - 5) Costs of living. - 6) Converted from the national currency . - 7) General government foreign debt. - 8) Rough estimates based on World Bank and wiiw; price level presumably higher.

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

without fully developed national accounting. The relatively large statistical offices from the two entities (Federation of BiH and Republika Srpska) derive their GDP estimates from supply-side figures, whereas the poorly staffed office for the country as a whole confines itself to aggregating the entities' figures. No double- or triple check (from the expenditure and income side) is being done so far. As a result, even the estimates of official sources diverge by a wide range: for example, for 2004 the BiH Statistical Office records a nominal GDP growth of 9.2%, which implies very high real growth given that according to indicators available inflation was very low. According to estimates of the Central Bank, which closely cooperates with the IMF, real GDP growth was about 6% in 2004. In both cases the estimates exclude the informal sector. Identifying incapability of statistical offices as the culprit for the persistent lack of national accounting would be too simplistic. This phenomenon is only one example for the continuous lack of coordination and cooperation in public administration, or, in other words, feeble public governance.

Although accurate aggregate GDP data are lacking, there is no doubt that during the last few years real sector activities kept expanding significantly. The set of latest available data suggests that this trend has not experienced interruption and will remain valid also in the nearer future. Industrial output growth, albeit still from a weak base, is robust. The main engine of this is a limited number of successful larger companies, most of them foreign-owned, whereas the performance of many others has remained poor. From a demand side point of view, real growth of wages and a slight increase in employment are supporting the growth of private consumption. Estimates for the growth of gross fixed investment are not available, but it should be substantial, a conclusion which is supported by the expansion of construction activities and by machinery and mechanical appliances being the largest component of imports. Of course, the big unknown is changes in inventories, which have the potential of impacting GDP growth significantly. The public sector figures are signalizing priority given to fiscal discipline rather than to growth acceleration. Exports of goods, with base metals and articles thereof as their largest component, still cover only about one third of import expenditures, but the former are now growing much more than the latter. The expansion of the trade deficit would have come to a standstill, had there not been a strong increase in the bill for imported fuels. The balance of services is positive and has climbed to over 5% of GDP, and a strong inflow of remittances continues to be the main responsible for keeping the current account deficit much below the trade deficit (below 25% of GDP compared to over 50%).

The country's corporate sector has never fully recovered from the setback it suffered more than a decade ago and remains unable to employ a satisfactory number of citizens in an efficient way. About 630,000 persons are registered as employed, whereas a not much lower figure, over 520,000, is registered as unemployed. Even more disturbing is the fact that during the last years registered employment more or less stagnated, whereas the number of persons registered as unemployed is on the rise over time. Large parts of the corporate sector need an overhaul, which in the short term however usually increases unemployment. This will further go on in a situation which is tense and politically delicate already. There is the argument that these registration figures do not tell you the truth. On the one hand, some of those registered as employed actually do not work, whereas many others are registered as unemployed, but are active in the informal sector. Labour force surveys came to the result that the rate of unemployment in recent years may have been below 20%. Even with this being the case, the situation would not be comfortable. The business sector is split between those who do fully meet their obligations towards tax authorities and social security institutions and those who do not at all or do it only partially. This situation also creates a sharp contrast between those who enjoy the privilege of being protected by social security institutions and those who do not.

Aggregate income is on the rise, but not many citizens see themselves profiting from this development.

The rate of inflation for the year 2004 is likely to slightly surpass 2.5% which is a unusually high rate compared to past years. In the first nine months of 2005, the year-on-year rate of inflation averaged 2.3%, and in the last quarter it was probably higher. The increase is attributable mainly to increases in regulated prices for a few goods and services. Even under the currency board regime the central bank is not completely left without monetary policy instruments, as we could see in 2005. A strong credit expansion by commercial banks prompted a reaction by the central bank; it lowered its remuneration rate from 2% to 1% and increased the mandatory deposit rate from 10% to 15%. Most of the lending goes to the household sector. Lending rates are, although being slowly declining, still as high as 8.3% for long-term loans. Aggregate deposits (6.5 billion Bosnian convertible mark, BAM) were not much below the volume of loans (BAM 7 billion) at the end of September 2005.

Starting operation of the new tax system at the beginning of an election year was a heroic act indeed. It was a big step towards a better integrated country. The outcome in political terms is not yet predictable. No matter who will win the next elections, much will have to be done to build up structures as required for EU accession. BiH has joined the club of high-growth countries, but to join the European Union also, it will have to put immense effort into improving public governance.

Anton Mihailov

Bulgaria: economy in good shape despite recent slowdown

As expected, the growth of aggregate output slowed down noticeably in the third quarter of 2005: the year-on-year rate of GDP growth fell to 4.6%, after the record high 6.4% seen in the second quarter. Several factors contributed to this outcome. The heavy summer floods caused serious economic damage to agriculture. Compared to the same period of 2004, value-added produced in agriculture in January-September was down by 5.5% and this was a major drag on aggregate output as a whole. There were disruptions in other sectors of economic activity as well (in particular, transport) with adverse effects for services as a whole. Exports also lost some steam in the third quarter resulting in a deceleration of the growth of manufacturing output. Still, thanks to the fast pace of economic expansion in the first half of the year, the rate of GDP growth for the period January-September still amounted to 5.6%.

Notwithstanding the difficulties, the main causes of the slowdown (those related to the floods) were of a one-off nature and are not expected to deepen further. Export activity has been picking up speed in the fourth quarter, raising hope of a new upturn in manufacturing. Damage repair construction works undertaken in the second half of the year and financed by extra public funding were also adding to the invigoration of aggregate output growth. Domestic demand (both private consumption and investment) remained buoyant throughout the year, thus providing a lasting impetus to economic activity.

The situation in the labour market continued to improve steadily. In the third quarter of 2005, the LFS rate of unemployment fell to single-digit levels (to 9.2%) for the first time since internationally

Table BG

Bulgaria: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 [1)]	2006 forecast	2007 forecast
Population, th pers., end of period [2)]	8190.9	8149.5	7891.1	7845.8	7801.3	7761.0	7730	.	.
Gross domestic product, BGN mn, nom.	23790.4	26752.8	29709.2	32335.1	34546.6	38008.4	41800	46500	50800
annual change in % (real)	2.3	5.4	4.1	4.9	4.5	5.6	5.5	5.3	5
GDP/capita (EUR at exchange rate)	1481	1674	1920	2101	2258	2497	2760	.	.
GDP/capita (EUR at PPP - wiiw)	4900	5330	5840	6090	6470	6880	7490	.	.
Gross industrial production									
annual change in % (real)	-8.0	8.3	1.5	6.5	14.1	18.3	8	12	10
Gross agricultural production									
annual change in % (real)	2.7	-9.1	-0.1	4.2	-1.0	2.7	.	.	.
Construction output total									
annual change in % (real)	8.8	8.0	15.0	2.7	5.6	12.9	.	.	.
Actual final consump.of househ., BGN mn, nom.	18791.2	20687.8	23009.1	24822.9	26846.0	29136.4	.	.	.
annual change in % (real)	9.3	4.9	4.6	3.4	7.1	4.9	7.5	.	.
Gross fixed capital form., BGN mn, nom.	3600.5	4206.0	5415.2	5908.5	6694.4	7957.3	.	.	.
annual change in % (real)	20.8	15.4	23.3	8.5	13.9	12.0	16	14	12
LFS - employed persons, th, avg.	2875.3	2794.7	2698.8	2739.6	2834.8	2922.5	3000	3100	3200
annual change in %	-5.3	-2.8	-3.4	1.5	3.5	3.1	2.7	3	3
Reg. employees in industry, th pers., avg.	722.5	662.0	658.4	666.8	689.5	695.8	678.0 I-IX	.	.
annual change in %	-10.0	-8.4	-0.5	1.3	3.4	0.9	-1.4 I-IX	.	.
LFS - unemployed, th pers., average	534.0	566.8	663.9	592.4	448.7	399.7	330	300	270
LFS - unemployment rate in %, average	15.7	16.9	19.7	17.8	13.7	12.0	10	9	8
Reg. unemployment rate in %, end of period	16.0	17.9	17.3	16.3	13.5	12.2	10.7	9.5	8.5
Average gross monthly wages, BGN	201.0	224.5	240.0	257.6	273.3	292.4	320	.	.
annual change in % (real, gross)	6.9	1.3	-0.5	1.5	3.7	0.8	4.2	.	.
Consumer prices, % p.a.	2.6	10.3	7.4	5.8	2.3	6.1	5.0	6	4
Producer prices in industry, % p.a.	2.8	17.5	3.8	1.2	4.9	6.0	6.9	5	4
General governm.budget, nat.def., % GDP									
Revenues	40.7	41.4	39.8	38.7	40.7	41.7	43.0	.	.
Expenditures	40.5	42.0	40.4	39.4	40.7	40.0	40.7	.	.
Deficit (-) / surplus (+), % GDP	0.2	-0.6	-0.6	-0.7	0.0	1.7	2.4	1	0.5
Public debt in % of GDP [3)]	79.3	73.6	66.2	53.2	46.2	38.8	30.5	26	23
Base rate of NB % p.a., end of period	4.5	4.7	4.7	3.4	2.9	2.4	2.1	.	.
Current account, EUR mn	-586.9	-761.4	-1101.6	-925.5	-1630.2	-1648.2	-3000	-2800	-2500
Current account in % of GDP	-4.8	-5.6	-7.3	-5.6	-9.2	-8.5	-14.0	-11.8	-9.6
Gross reserves of NB excl. gold, EUR mn	2878.7	3390.6	3734.0	4247.1	4981.0	6443.0	6815.7	.	.
Gross external debt, EUR mn	10846.6	11882.7	11934.9	10768.9	10640.6	12522.1	13410.2 X	.	.
FDI inflow, EUR mn	866.0	1103.3	903.4	980.0	1850.5	2278.2	1600	2200	2000
FDI outflow, EUR mn	16.3	3.5	8.7	29.0	23.3	-168.3	250	.	.
Exports of goods, BOP, EUR mn	3733.7	5253.1	5714.2	6062.9	6668.2	7984.9	9500	10800	12300
annual growth rate in %	-0.4	40.7	8.8	6.1	10.0	19.7	19	14	14
Imports of goods, BOP, EUR mn	4741.4	6533.0	7492.6	7754.7	8867.8	10713.8	13600	15200	16700
annual growth rate in %	16.3	37.8	14.7	3.5	14.4	20.8	27	12	10
Exports of services, BOP, EUR mn	1686.2	2366.2	2384.8	2478.9	2790.9	3361.6	3600	4000	4400
annual growth rate in %	5.2	40.3	0.8	3.9	12.6	20.4	7	11	10
Imports of services, BOP, EUR mn	1380.6	1818.6	1930.3	1992.9	2267.7	2638.3	3000	3300	3600
annual growth rate in %	10.5	31.7	6.1	3.2	13.8	16.3	14	10	9
Average exchange rate BGN/USD	1.838	2.124	2.185	2.077	1.733	1.575	1.574	.	.
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	0.517	0.541	0.561	0.582	0.583	0.607	0.610	.	.
Purchasing power parity BGN/EUR	0.591	0.614	0.643	0.675	0.683	0.710	0.721	.	.

Notes: 1) Preliminary. - 2) From 2001 according to census March 2001. - 3) According to ESA'95, excessive deficit procedure.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

comparable labour force surveys were initiated in 1997. Mirroring this, total employment kept on growing for the fourth consecutive year. At the same time, secondary effects of the rising energy prices caused an acceleration of both CPI and PPI in the second half of the year. Also the persistently high domestic demand probably contributed to the upturn in inflation.

The combination of robust domestic demand and slowing down (in the second and third quarters) exports contributed to an escalation of the current account deficit, despite all policy efforts to arrest its further widening. Although the series of credit restrictions introduced in 2004 and 2005 finally helped to put a certain brake on credit expansion (one of the factors underpinning the buoyant consumer and investment spending), this seems to have been partly offset by purchases financed by leasing and other forms of innovative financing. The high energy prices also added to the widening of the merchandise trade deficit. Anyway, despite its magnitude, the current account deficit does not seem to pose immediate threats to macroeconomic and financial stability.

While the fiscal policy stance remained restrictive in terms of the overall general government fiscal balance in 2005, total public spending overshot the budgetary provisions for the year thanks to better than projected fiscal revenue. The latter reflects an ongoing improvement in tax collection as a result of the strengthening of the tax administration and other institutional reforms. Part of the supplementary spending was allocated to finance damage repair, and another part for an early repayment of public debt. At the end of December 2005 and in early January 2006, the government retired some EUR 339 million of outstanding debt to the IMF and the World Bank, all of which was formally reported as 2005 spending.

The 2006 budget was formally adopted with a zero budget deficit. The IMF had been pressing for a much more restrictive budget (a fiscal surplus of 3%); however, the government strongly resisted this due to internal political pressures. Anyway, it appears that, in order to avoid a formal IMF reprimand, the authorities have informally committed themselves to end 2006 with a fiscal surplus similar to that in 2005. The legislative package of the 2006 budget included some important changes in taxation. Thus payroll taxes were reduced by a total of some 6 percentage points, a move aimed at lowering labour costs and thus stimulating investment. At the same time, the workers' own social security contributions were raised, though by a smaller margin. The most important excises (on gasoline, alcohol and tobacco) were also raised steeply, de facto absorbing most of the envisaged increases through 2008. This move seeks to reduce the inflationary pressures after 2007, when Bulgaria hopes to accede to both the EU and ERM II, and when it will strive to meet the Maastricht criteria of nominal convergence in preparation for entry to the euro zone (the current target date of EMU accession is 2009).

The 2005 monitoring report of the European Commission (published in October) was moderately critical of Bulgaria's progress towards accession. While noting that Bulgaria meets the main political criteria for membership and has a functioning market economy, the report pointed out that a number of shortcomings still exist. Among those explicitly mentioned are the problems in the justice system which reduce its efficiency in combating organized crime and corruption. The report also noted the need for further effort in integrating the Roma minority and in improving the environment for doing business. Nevertheless, the report also stated that despite the remaining hurdles, Bulgaria still has chances to accede to the EU in January 2007, provided that it accelerates its efforts in resolving the existing problems. The European Commission's final recommendation on the date of Bulgaria's accession is expected in March.

The outlook for the Bulgarian economy remains positive. Given the seasonal nature of the recent slowdown, it is expected that economic growth in 2006 will remain robust, with GDP increasing by more than 5%. The ongoing economic expansion will be beneficial for the labour market and the rate of unemployment should continue to fall. Average annual inflation in 2006 will remain relatively high due to the repercussions of elevated energy prices and the recent excise hikes, which will push up administrative prices. The fiscal stance will remain moderately tight, with a likely small fiscal surplus in 2006. The adopted credit restrictions (the monetary authorities are now contemplating some further restrictive measures and controls on leasing activities) are expected to be fully in place which should help contain both the credit boom and the further widening of the current account deficit.

Hermine Vidovic

Croatia: credit growth out of control?

During 2005 Croatia's economic growth gained momentum from quarter to quarter and the GDP was finally up close to 4% year on year. Growth was driven by private consumption supported by increased household lending and a modest revival of government consumption and investment growth. In addition, foreign trade again contributed positively to GDP growth (as in 2003). Construction output finally declined, after the favourable trend in the past several years, mainly due to the completion of big infrastructural projects. The relatively strong rise in consumer prices came as no surprise since inflation was pushed up by energy prices. Consumer price inflation averaged 3.3% in 2005 or 3.6% in December year on year. The labour market did not benefit from GDP growth: registered employment was stagnant (LFS data even suggest a decline) and unemployment, though somewhat declining, remained at high levels – 18% by registration and 13% by LFS data.

Industrial production growth, up 5.1% in 2005, was much more favourable than was to be expected after the weak performance at the beginning of the year. Output of capital goods developed quite well, expanding by nearly 15%. Manufacturing reported above-average growth; the most favourable results were achieved in machinery and equipment, publishing and printing, electrical machinery and apparatus, and the manufacture of rubber and plastics. Labour-intensive industries such as textiles and the manufacture of wearing apparel, leather, and the manufacture of furniture all suffered severe output declines. Due to continued layoffs labour productivity in industry has further increased, with a very uneven development however across individual branches.

In foreign trade overall imports again rose significantly faster than exports, resulting in a record trade deficit of about EUR 7.7 billion. A regional breakdown of trade derived from customs statistics shows that overall growth was driven by the strong export performance to the successor states of the former Yugoslavia (excluding Slovenia), while exports to the EU-25 developed far below average. The strong import growth was mainly due to a sharp rise in imports of oil, refined petroleum products and electricity. The poor trade performance again resulted in a deterioration of the current account, one of Croatia's most burning and persistent problems. After an improvement in 2004, owing partly to a one-off receipt of reinvested earnings, the current account closed with an estimated EUR 2.2 billion deficit or again more than 7% of the GDP in 2005. The widening trade deficit could only partly be offset by higher earnings from services, particularly from tourism, with overnight stays increasing by 8%. FDI data available for the first three quarters of the year indicate a significant upswing of inward FDI, primarily targeting sectors such as financing, oil and gas, retail trade and tourism.

Table HR

Croatia: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 [1)]	2006 forecast	2007 forecast
Population, th pers., mid-year [2)]	4554	4437	4437	4443	4442	4439	4439	.	.
Gross domestic product, HRK mn, nom.	141579	152519	165640	179390	193067	207082	222260	237400	252580
annual change in % (real)	-0.9	2.9	4.4	5.2	4.3	3.8	3.9	3.7	3.8
GDP/capita (EUR at exchange rate)	4102	4502	4998	5451	5747	6224	6770	.	.
GDP/capita (EUR at PPP - wiiw)	7460	8120	8630	9280	9710	10320	11000	.	.
Gross industrial production [3)]									
annual change in % (real)	-1.4	1.7	6.0	5.4	4.1	3.7	5.1	4	4
Gross agricultural production									
annual change in % (real)	-3.5	-10.0	8.5	7.7	-15.9	11.9	.	.	.
Construction industry, hours worked [3)]									
annual change in % (real)	-7.7	-9.1	3.6	12.8	22.8	2.0	-1.2 I-XI	.	.
Consumption of households, HRK mn, nom.	81546	89637	98054	107427	113396	120312	128630	.	.
annual change in % (real)	-2.9	4.2	4.5	7.6	4.1	3.9	3.5	4	4
Gross fixed capital form., HRK mn, nom.	33025	33281	36984	44114	53168	57141	61090	.	.
annual change in % (real)	-3.9	-3.8	7.1	12.0	16.8	4.4	3.5	4	4.5
LFS - employed persons, th, avg.	1492	1553	1469	1528	1537	1563	1566 I-VI	.	.
annual change in %	-3.4	4.1	-5.4	4.0	0.6	1.7	-1.1 I-VI	.	.
Reg. employees in industry, th pers., avg.	299.5	291.9	287.2	281.0	282.6	281.7	276.3 I-XI	.	.
annual change in %	-3.0	-2.5	-1.6	-2.2	0.6	-0.3	-2.0 I-XI	.	.
LFS - unemployed, th pers., average	234.0	298.0	277.0	266.0	256.0	249.5	236 I-VI	.	.
LFS - unemployment rate in %, average	13.6	16.1	15.9	14.8	14.3	13.8	13.1 I-VI	13	12.8
Reg. unemployment rate in %, end of period	20.4	22.3	23.1	21.3	19.1	18.7	18.0	17.5	17
Average gross monthly wages, HRK	4551	4869	5061	5366	5623	5985	6250	.	.
annual change in % (real, net)	10.1	3.4	1.6	3.1	3.8	3.7	1.6	.	.
Consumer prices, % p.a. [4)]	4.2	6.2	4.9	1.7	1.8	2.1	3.3	3	2.5
Producer prices in industry, % p.a.	2.6	9.7	3.6	-0.4	1.9	3.5	3.0	2.7	2.4
General governm.budget, IMF-def., % GDP									
Revenues	48.4	46.2	44.7	45.2	44.9	.	.	.	.
Expenditures	56.6	52.7	51.5	50.0	49.5	.	.	.	.
Deficit (-) / surplus (+), % GDP	-8.2	-6.5	-6.8	-4.8	-6.3	-4.9	-4.5	-4	-3.8
Public debt in % of GDP	42.3	48.9	50.3	50.4	51.7	53.2	54.5	55	56
Discount rate % p.a., end of period	7.9	5.9	5.9	4.5	4.5	4.5	4.5	.	.
Current account, EUR mn	-1312.9	-489.9	-817.7	-2097.2	-1866.2	-1446.7	-2200	-1900	-1800
Current account in % of GDP	-7.0	-2.5	-3.7	-8.7	-7.3	-5.2	-7.3	-6.0	-5.3
Gross reserves of NB excl. gold, EUR mn	3012.6	3783.2	5333.6	5651.3	6554.1	6436.2	7220.4 XI	.	.
Gross external debt, EUR mn	10101.3	12109.3	13458.3	15054.8	19810.6	22675.4	24837.2 XI	.	.
FDI inflow, EUR mn	1369.1	1142.1	1502.5	1195.1	1788.4	980.0	1500	.	.
FDI outflow, EUR mn	54.4	1.5	175.7	598.3	93.0	285.8	100	.	.
Exports of goods, BOP, EUR mn	4134.1	4969.3	5318.8	5293.1	5571.7	6603.1	7200	7600	8100
annual growth rate in %	1.2	20.2	7.0	-0.5	5.3	18.5	9	6	7
Imports of goods, BOP, EUR mn	7240.0	8468.6	9922.6	11253.5	12545.9	13330.9	14900	15900	16900
annual growth rate in %	-6.1	17.0	17.2	13.4	11.5	6.3	12	7	6
Exports of services, BOP, EUR mn	3509.6	4442.0	5481.3	5832.3	7565.9	7636.7	8000	.	.
annual growth rate in %	-0.7	26.6	23.4	6.4	29.7	0.9	5	.	.
Imports of services, BOP, EUR mn	1965.1	1971.5	2178.5	2547.5	2632.8	2921.7	2700	.	.
annual growth rate in %	16.8	0.3	10.5	16.9	3.3	11.0	-8	.	.
Average exchange rate HRK/USD	7.11	8.28	8.34	7.86	6.70	6.04	5.95	.	.
Average exchange rate HRK/EUR (ECU)	7.58	7.63	7.47	7.41	7.56	7.50	7.40	7.45	7.5
Purchasing power parity HRK/USD	3.65	3.73	3.77	3.75	3.82	3.86	3.85	.	.
Purchasing power parity HRK/EUR	4.17	4.23	4.33	4.35	4.47	4.52	4.55	.	.

Notes: 1) Preliminary. - 2) From 2000 according to census March 2001. - 3) Enterprises with more than 20 employees. - 4) Up to 2001 retail prices.

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

Foreign debt grew at a slower pace than in the past couple of years. By the end of November 2005 it stood at EUR 24.8 billion or 82.7% of the GDP, and was EUR 2.2 billion higher than in December 2004. The bulk of this increase was due to enterprise borrowing and, to a lesser extent, to borrowing by banks, while the government could reduce its foreign liabilities. Consequently, the structure of the debt stock by debtors has changed remarkably, pointing to a high and growing portion of enterprises and banks while the government's share fell from 40% in 2002 to about 28% in November 2005. Borrowing abroad enabled banks to increase their domestic placements: loans to the government were up by almost 40% in October year on year, to households by 23% and to enterprises by 18%. In order to prevent a further credit expansion, which would entail increasing imports and a widening of the current account deficit, the National Bank decided to further raise marginal reserve requirements. Accordingly, as of 11 January 2006, banks are required to allocate 55% (instead of 40% earlier) of their foreign liabilities' increase to a foreign exchange account held with the National Bank. The effectiveness of this step is, however, questionable: even if there is some slowdown in banks' external borrowing this measure will have no noticeable impact on enterprise borrowing, which reports the fastest growth.

The structure of Croatia's public debt has changed remarkably over recent years. While up to 2003 the foreign debt portion was close to 60%, it diminished steadily thereafter and amounted to only 48.5% in October 2005. This turnaround came in the wake of an agreement with the IMF from August 2004 when the country's authorities committed themselves to 'reducing sharply the reliance on foreign borrowing'. Thus, Croatia's government has borrowed almost exclusively on the domestic market recently.[32] In October 2005 public debt (including guarantees) grew to 54% of the expected GDP in 2005. This figure does not include pension arrears, an inclusion of which into public debt would significantly increase the debt to GDP indicator.

The 2006 budget bill passed at the end of November is aimed at a reduction of the general government deficit to 3.3% of GDP in 2006 (the revised target rate for 2005 was 4.2%). Considering the past experience the budget target appears overoptimistic, particularly as concerns the cut of budgetary expenditures on subsidies, wages and social spending. Part of the deficit should be covered by privatization receipts. According to the second Pre-accession Programme for the period 2006-2008, adopted in December, the government expects some EUR 900 million from privatizations over that period. The bulk of privatization receipts is envisaged to accrue in 2006, first of all through the second stage of the privatization of the oil and gas company INA. In addition, further shares of Croatian Telecom and the country's biggest insurance company, Croatia Osiguranje, are to be sold.

After several months of delay, the EU launched membership talks with Croatia on 3 October 2005 following a positive report by Carla del Ponte concerning Croatia's cooperation with the war crimes tribunal in The Hague. The capture of the fugitive war crimes suspect Ante Gotovina in Spain in December 2005 – the Croatian authorities' earlier failure to arrest him had been the main obstacle to starting negotiations as scheduled – has helped to smooth the country's integration process into the EU and NATO.

---

[32] However, even domestic banks' loans granted to the government – a substantial part of the government debt increase – may in fact be considered as a form of foreign debt as the domestic banks in turn are borrowing abroad.

In 2006 GDP growth will slightly decelerate, considering the restrictive measures imposed by the National Bank at the beginning of the year and the further tightening of the fiscal policy. Thus, a decisive improvement on the labour market is not in sight. Despite some rise in inflation in 2005, the National Bank will adhere to its policy of stable prices and exchange rates. External imbalances will remain in the focus of economic policy makers. The beginning of negotiations with the EU may help to accelerate outstanding reforms and boost foreign investments.

Vladimir Gligorov

Macedonia: EU prospects boost confidence

At the end of 2005, the European Union decided to issue a positive *avis* to Macedonia's application for membership and granted it a candidate status. This was somewhat surprising given the growing pessimism about the future enlargement of the EU after the negative results of the French and Dutch referenda on the EU constitutional treaty. Since then, the EU has taken a number of steps that suggest that it intends to honour the commitments to the Balkan countries. Certainly, for Macedonia this is very reassuring because 'Europeization' is its main strategy of economic development and institution building. It stabilizes the country at a moment when significant decisions have to be taken about the constitutional issues in the region that might have an impact on Macedonia.

In addition to its political position, Macedonia's economic situation is improving as well. GDP has continued to expand, though perhaps not as strongly as would be desirable for a transition economy. Also, industrial production is recording growth, though against the background of poor performance in the previous year. This growth is still not fast enough to make a dent in the very high level of unemployment, which certainly remains the key economic and social problem in Macedonia.

In 2005, exports expanded faster than imports and the current account recorded a remarkable adjustment. Rather than having a current account deficit of 6% to 7% of GDP, as usual, the deficit has shrunk to around 1% of GDP. The narrowing of the trade deficit is not enough to explain that improvement. Also, services have not reported a growing surplus, so the only possible explanation is that private transfers have increased remarkably. This may be an artefact of statistics, i.e., it may be that the inflow of remittances is better recorded now than was the case in previous years.

Foreign investments continue to under-perform. They tend to be larger than usual when there are some significant sales, otherwise green-field investments as well as portfolio investments are not very pronounced. But, this year and the next, the electricity sector is to be privatized and that should bring in significant resources. Given that Macedonia is a moderately indebted country, the proceeds could be used to finance investments, perhaps with a view to achieving certain development aims.

As in other countries in the region, credit expansion has been significant. Political stabilization and improved prospects for EU integration are boosting the confidence in the country and in the economy, so banks are more ready to offer credits to households and businesses. Also, Macedonia has continued to enjoy price stability, indeed to an extent that the very firmly fixed denar is depreciating against the euro in real terms. The prospects for stability and modest growth in the medium run are quite good.

Table MK

Macedonia: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 [1]		2006	2007
									forecast	
Population, th pers., mid-year [2]	2017.1	2026.4	2034.9	2020.2	2026.8	2030	2035		.	.
Gross domestic product, MKD mn, nom.	209010	236389	233841	243970	251486	265257	284027		301300	319600
annual change in % (real)	4.3	4.5	-4.5	0.9	2.8	4.1	3.6		4	4
GDP/capita (EUR at exchange rate)	1709	1921	1887	1981	2025	2130	2280		.	.
GDP/capita (EUR at PPP - wiiw)	4820	5160	5000	5210	5350	5680	5980		.	.
Gross industrial production										
annual change in % (real) [3]	-2.6	3.0	-2.9	-5.3	4.7	-2.2	6.7		5	5
Gross agricultural production										
annual change in % (real)	1.0	1.0	-10.2	-2.3	4.5	6.8	2.2		.	.
Construction output, value added										
annual change in % (real)	10.4	-1.1	-14.4	0.6	13.3	7.2	.		.	.
Consumption of households, MKD mn, nom.	145693	175965	163788	188179	191873	206610	.		.	.
annual change in % (real)	3.6	11.2	-11.6	12.4	-1.5	.	.		.	.
Gross fixed capital form., MKD mn, nom.	34710	38332	34716	40448	42110	47286	.		.	.
annual change in % (real)	-1.4	-1.5	-8.6	17.6	1.1	.	.		.	.
LFS - employed persons, th. avg.	545.2	549.8	599.3	561.3	545.1	523.0	540		.	.
annual change in %	1.0	0.8	9.0	-6.3	-2.9	-4.1	3.3		.	.
Reg. employees in industry, th pers., avg. [4]	119.8	114.4	122.5	110.9	106.7	101.5	98.5	I-IX	.	.
annual change in % [3]	5.5	-4.5	-4.8	-9.5	-3.8	-4.9	-3.4	I-IX	.	.
LFS - unemployed, th pers., average	261.5	261.7	263.2	263.5	315.9	309.3	330		.	.
LFS - unemployment rate in %, average	32.4	32.3	30.5	31.9	36.7	37.2	37.5		37	37
Reg. unemployment rate in %, end of period	.	.	.	.	.	.	.		.	.
Average gross monthly wages, MKD	9664.0	17957.8	17886.0	19025.0	19950.0	20771.0	21250		.	.
real growth rate, % (net wages)	3.6	-0.3	-1.9	5.0	3.6	4.4	2.1		.	.
Consumer prices, % p.a.	-0.7	5.8	5.5	1.8	1.2	-0.4	0.6		2	2
Producer prices in industry, % p.a.	-0.1	10.7	2.0	-0.9	-0.3	0.9	3.4		3	3
General governm. budget, nat.def., % GDP [5]										
Revenues	42.1	43.9	34.4	34.9	33.4	33.2	32.7		.	.
Expenditures	41.1	41.5	40.8	40.0	34.5	33.2	31.7		.	.
Deficit (-) / surplus (+), % GDP	0.9	2.3	-6.3	-5.0	-1.1	0.0	1.0		.	.
Public debt in % of GDP	.	.	.	.	.	.	.		.	.
Discount rate, % p.a., end of period	8.9	7.9	10.7	10.7	6.5	6.5	6.5	XI	.	.
Current account, EUR mn [6] [7]	-30.4	-78.5	-272.1	-379.9	-132.1	-334.2	-50		-200	-200
Current account in % of GDP	-0.9	-2.0	-7.1	-9.5	-3.2	-7.7	-1.1		-4.1	-3.9
Gross reserves of NB, excl. gold, EUR mn	428.0	461.5	845.5	692.8	718.4	665.2	765.5	VIII	.	.
Gross external debt, EUR mn [8]	1440.0	1606.8	1621.4	1507.9	1417.3	1442.7	1636.6	XI	.	.
FDI inflow, EUR mn [7]	30.7	189.4	493.2	82.6	85.4	126.5	100		.	.
FDI outflow, EUR mn [7]	0.3	-0.7	1.0	0.1	0.3	0.9	1.2		.	.
Exports of goods, BOP, EUR mn [7]	1117	1433	1291	1181	1208	1347	1500		1600	1700
annual growth rate in %	-3.0	28.3	-9.9	-8.5	2.3	11.5	11.3		6.7	6.3
Imports of goods, BOP, EUR mn [7]	1582	2182	1879	2035	1959	2243	2400		2450	2600
annual growth rate in %	-1.8	37.9	-13.9	8.3	-3.7	14.5	7.0		2.1	6.1
Exports of services, BOP, EUR mn [7]	256	344	273	269	290	329	400		.	.
annual growth rate in %	92.4	34.2	-20.5	-1.6	7.8	13.4	21.7		.	.
Imports of services, BOP, EUR mn [7]	217	291	295	292	299	372	420		.	.
annual growth rate in %	16.2	34.2	1.3	-0.8	2.2	24.7	12.8		.	.
Average exchange rate MKD/USD	56.90	65.89	68.04	64.74	54.30	49.41	49.28		.	.
Average exchange rate MKD/EUR (ECU)	60.62	60.73	60.91	60.98	61.26	61.34	61.30		62	62
Purchasing power parity MKD/USD, wiiw	18.36	19.44	19.67	20.00	19.71	19.56	19.70		.	.
Purchasing power parity MKD/EUR, wiiw	21.48	22.61	22.97	23.18	23.20	23.00	23.34		.	.

Notes: 1) Preliminary. - 2) From 2002 according to census November 2002; 2004-2005 wiiw estimate. - 3) Excluding small enterprises, from 2004 new methodology. - 4) From 2001 according to NACE. - 5) From 2001 revenues excluding privatization incomes, expenditures excluding financing items. 2005 data projected. - 6) Including grants. - 7) Converted from USD. - 8) Medium- and long-term debt.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Apart from the problem with unemployment, there are still remaining structural weaknesses not only in the labour but also in the products market. On the one hand, there is little dynamism and perhaps significant rigidity, not to say monopolization, in the supply of products. On the other hand, Macedonia continues to be a less than attractive location for foreign firms because of the small size of its economy and somewhat under-developed infrastructure.

Macedonia is a landlocked country and depends more than other countries on the regional markets. This is especially true when it comes to trade, because Macedonia trades a lot with Serbia and Kosovo and it will continue to do so. A possible liberalization of trade and other economic relations in the region and especially closer integration of Kosovo in the regional economy would be helpful to Macedonia. Also, accession of Bulgaria to the EU, which should happen at the beginning of 2007, would further stabilize the political and economic relations in the region and would support economic recovery in Macedonia.

In the second half of this year, parliamentary election are to be held. If they prove to be free and fair and thus signal that democratization has stabilized, it can be expected that negotiations with the EU will start. That should be a further boost to Macedonia's economy.

Vladimir Gligorov

Montenegro: tourism to the rescue

Last year saw an improvement in the export of services, i.e., growth of tourism. Other services also posted healthy growth rates. Some investments in infrastructure have been finished, e.g. the tunnel leading from the capital Podgorica to the coast, so that a further expansion of tourism is to be expected. Contrary to that, industrial production continued to struggle, ending the year with a negative growth rate. There is scant evidence that recovery is to be expected in the short run.

Foreign investments grew beyond every expectation. Most of the investments are in tourism, but additional investments went to other services and to the aluminium plant. Though similar levels of foreign investment cannot be expected in the next few years, a steady stream of foreign money going to the development of tourism is likely. Also, the government can be expected to continue to invest in the upgrading of infrastructure to connect the hinterland with the coast, but also to upgrade the ailing railway that is vital to the development of the main port city of Bar.

In previous years it was the general budget that presented the main source of possible instability in the macroeconomic balances. Because of stricter control on spending through the well-functioning treasury system and because of improved revenues due to the growing economy, the fiscal deficit has shrunk to a rather low level. Further improvements are likely if the GDP continues to expand as is realistic to forecast.

Montenegro uses the euro as its official currency and has been able to maintain stability of prices. In addition, the banking system has been mostly privatized and is much sounder than it has traditionally been. As in other countries in the region, the restructured banking system has started to expand credit, thus contributing to the growth of consumption. This can be expected to continue

Table Montenegro

Montenegro: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005 [1)]	2006	2007
							forecast	
Population th pers., mid-year [2)]	608.9	612.9	615.9	620.1	625	630	.	.
Gross domestic product, EUR mn, nom. [3)]	1022.2	1244.8	1301.5	1433.0	1535.0	1640	1770	1900
annual change in % (real)	.	-0.2	1.7	2.3	3.7	4	5	5
GDP/capita (EUR at exchange rate)	1679	2031	2113	2311	2456	2600	.	.
GDP/capita (EUR at PPP - wiiw)	4800	4840	5030	5140	5460	5790	.	.
Gross industrial production [4)]								
annual change in % (real)	4.2	-1.0	1.0	2.0	13.8	1.0	3	3
Net agricultural production								
annual change in % (real)	-5.0	6.9	5.9	1.0	.	.	.	.
Construction output total								
annual change in %	.	.	.	.	.	.	.	.
Gross fixed investment, EUR mn, nom. [5)]	.	226	183	166	.	.	.	.
annual change in % (real)	.	.	.	.	.	.	.	.
LFS - employed persons, th, Oct [6)]	230.3	214.4	220.6	.	187.3	185	.	.
annual change in %	.	-6.9	2.9	.	.	-1.2	.	.
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 [6)]	54.9	57.5	57.7	.	71.8	.	.	.
LFS - unemployment rate in %, average [6)]	19.3	23.7	20.7	.	27.7	28	28	28
Reg. unemployment rate in %,end of period [7)]	.	.	.	32.9	29.3	26.3 VIII	.	.
Average gross monthly wages, EUR [8)]	151	176	251	271	303	326	.	.
annual change in % (real, net)	1.0	8.0	.	9.3	9.1	6.7	.	.
Consumer prices, % p.a.	20.2	21.8	16.0	6.7	2.4	2.5	3	3
Producer prices in industry, % p.a.	.	.	14.5	4.5	5.8	2.0	3	3
Central governm. budget, nat.def., % GDP [9)]								
Revenues	.	17.8	17.7	23.6	.	.	.	.
Expenditures	.	20.8	20.5	26.6	.	.	.	.
Deficit (-) / surplus (+), % GDP	-6.0	-3.1	-2.8	-3.0	-2.1	.	.	.
Public debt in % of GDP	.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	.	.	.	.	.	.	.	.
Current account, EUR mn	.	-195.4	-163.4	-102.0	-143.0	-150	-160	-150
Current account in % of GDP	.	-15.7	-12.6	-7.1	-9.3	-9.1	-9.0	-7.9
Gross reserves of NB, excl. gold, EUR mn	.	.	.	.	.	.	.	.
Gross external public debt, EUR mn	.	.	.	438.8	502.4	.	.	.
FDI net, EUR mn	.	10.6	89.2	38.7	50.0	250	.	.
Exports of goods, BOP, EUR mn	.	235.4	322.6	270.6	381.6	330	350	400
annual growth rate in %	.	.	37.1	-16.1	41.0	-14	6	14
Imports of goods, BOP, EUR mn	.	722.9	747.3	629.9	812.5	900	950	1000
annual growth rate in %	.	.	3.4	-15.7	29.0	11	6	5
Exports of services, BOP, EUR mn	.	150.2	171.7	191.4	241.1	300	.	.
annual growth rate in %	.	.	14.3	11.5	26.0	24	.	.
Imports of services, BOP, EUR mn	.	53.4	71.7	79.7	101.2	120	.	.
annual growth rate in %	.	.	34.3	11.1	27.1	19	.	.
Average exchange rate EUR/USD	0.92	0.90	0.94	1.13	1.24	1.24	.	.
Purchasing power parity EUR/USD, wiiw [10)]	0.31	0.37	0.36	0.38	0.38	0.37	.	.
Purchasing power parity EUR/EUR, wiiw [10)]	0.35	0.42	0.42	0.45	0.45	0.45	.	.

Notes: 1) Preliminary. - 2) From 2003 according to census November 2003. 2004, 2005: wiiw estimate. - 3) Including non-observed economy. - 4) Excluding small private enterprises and arms industry. - 5) 2003 excluding private sector. - 6) From 2004 according to census 2003 and revisions based on ILO and Eurostat methodology. - 7) In % of unemployed plus employment (excluding individual farmers), wiiw. - 8) From 2002 including various allowances and new personal income tax system. - 9) Revenues excluding grants, expenditures excluding net lendig. - 10) 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.

because the debt levels of the enterprise and the household sectors a rather low. The government may choose to pay back some of its debts, which are also accumulated in the banking system, and thus contribute to a further recovery of the banks as well as the economy as a whole.

High unemployment remains the main problem and the failure of industry to recover is not contributing to easing this problem. The government has so far been able to contain the social problems and will continue to do so especially in view of the political events which are scheduled for this year. In April, the referendum on independence should be held. The decision will have a major political significance. Current predictions are that there will be a small majority for independence. After that, local elections should be held and even early general elections are possible. There is no doubt that, by the end of this year, Montenegro will look rather different politically from what it looks now.

Gábor Hunya

Romania: end of the upswing

Economic growth decelerated in the second half of 2005 and GDP grew by only 3.6% in the first nine months of the year. Assuming some recovery in the last quarter, the result for the year as a whole will be around 4%. Explanations and expectations differ according to the interpretation of the 2005 decline. The government stresses the one-time impact of natural calamities and the statistical effect of the extraordinarily high rate of growth in the base year. These arguments are certainly correct, they suggest that the deceleration of growth is only temporary. But there are additional factors as well: first of all the low competitiveness of Romanian products, as shown by the near stagnation of the manufacturing sector and by the widening foreign trade deficit. Based on the presence of severe structural problems, our economic growth forecast for the coming two years cannot be more than 4.5%, about one percentage point lower than what the Romanian government expects.

Consumption and investment both grew by about 9% in 2005, suggesting overheating rather than a slowdown of the economy. As for investment, there was a shift from equipment to construction. Private housing and public infrastructure investment expanded rapidly while the modernization of production capacities slowed down. Government consumption grew less than in the previous year and the deficit of the general budget is expected to be only 0.8% of GDP. Thus consumption expanded mainly in the household sector.

What are the reasons behind private consumption growing two to three times more rapidly than GDP? Wage policy was lax and the 16% flat tax represented a massive relief for the higher-income segments of the population. Real net wages were about 13.5% higher than in the previous year and retail sales expanded by some 18%. Wage expansion, tax reduction and appreciation had a cumulative effect on euro wages. In gross terms these were EUR 268 on a monthly average, in net terms EUR 204. This means that the average tax burden was EUR 64, i.e. 24% of the gross salary. One year earlier gross wages were only EUR 204 and EUR 147 in net terms, meaning that the tax burden was only EUR 57 but 28% of the gross salary. The 31% increase in gross wages curtailed the competitiveness of labour-intensive industries, the net wage increase by 39% stimulated private

Table RO

Romania: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 1)	2006 forecast	2007 forecast
Population, th pers., mid-year 2)	22458.0	22435.2	22408.4	21794.8	21733.6	21673.3	21623.8	.	.
Gross domestic product, RON mn, nom.	54573.0	80377.3	116768.7	151475.1	190335.4	238791.4	277500	313100	350000
annual change in % (real)	-1.2	2.1	5.7	5.1	5.2	8.3	4	4.5	4.5
GDP/capita (EUR at exchange rate)	1491	1795	2002	2224	2332	2718	3500	.	.
GDP/capita (EUR at PPP - wiiw)	4770	5010	5460	6060	6280	7070	7440	.	.
Gross industrial production									
annual change in % (real)	-2.4	7.1	8.3	4.3	3.1	5.3	1.5	3	3
Gross agricultural production									
annual change in % (real)	4.0	-14.8	22.7	-3.5	7.5	24.1	.	.	.
Construction output total									
annual change in % (real)	-0.2	2.8	9.0	10.0	9.8	8.9	7.5	.	.
Actual final consump.of househ., RON mn, nom.	45330.8	63459.0	91718.6	116940.4	148348.1	189693.7	.	.	.
annual change in % (real)	-1.1	0.2	6.8	4.8	7.2	10.8	9	.	.
Gross fixed capital formation, RON mn, nom.	9663.0	15194.7	24115.4	32283.6	42253.5	53254.9	.	.	.
annual change in % (real)	-4.8	5.5	10.2	8.2	9.1	10.1	9	8	10
LFS - employed persons, th, avg. 2)3)	10775.6	10763.8	10696.9	9234.3	9222.5	9157.6	9160	.	.
annual change in %	-0.6	-0.1	-0.6	.	-0.1	-0.7	0.0	.	.
Reg. employees in industry, th pers., avg.	1991.0	1873.0	1901.0	1891.0	1848.0	1818.0	1790	.	.
annual change in %	-12.4	-5.9	1.5	-0.5	-2.3	-1.6	-1.6	.	.
LFS - unemployed, th pers., average 2)3)	789.9	821.2	750.0	845.3	691.8	799.5	695	.	.
LFS - unemployment rate in %, average 2)3)	6.8	7.1	6.6	8.4	7.0	8.0	7.0	7	7
Reg. unemployment rate in %, end of period	11.8	10.5	8.8	8.4	7.4	6.2	5.8	5.8	5.7
Average gross monthly wages, RON	192.2	284.0	422.0	532.1	663.8	826.1	970	.	.
annual change in % (real, net)	-3.8	4.6	4.9	2.1	10.7	9.5	13.5	.	.
Consumer prices, % p.a.	45.8	45.7	34.5	22.5	15.3	11.9	9.0	8	7
Producer prices in industry, % p.a.	44.5	53.4	38.1	23.0	19.5	19.1	11	.	.
General governm.budget, nat.def., % GDP									
Revenues	32.8	31.2	30.1	29.5	29.8	29.6	.	.	.
Expenditures	34.7	35.2	33.3	32.1	32.1	30.7	.	.	.
Deficit (-) / surplus (+)	-1.9	-4.0	-3.2	-2.5	-2.3	-1.1	-0.8	-1	-2
Public debt, EU-def., % of GDP 4)	24.0	23.9	23.2	23.3	21.3	18.5	16.2	.	.
Discount rate, % p.a., end of period 5)	35.0	35.0	35.0	20.4	20.4	18.0	7.5	.	.
Current account, EUR mn	-1355	-1494	-2488	-1623	-3060	-5099	-7000	-7600	-8300
Current account in % of GDP	-4.0	-3.7	-5.5	-3.3	-6.0	-8.7	-9.1	-8.5	-8.5
Gross reserves of NB excl. gold, EUR mn	1520.0	2654.8	4445.3	5876.8	6373.6	10848.2	16794.7	.	.
Gross external debt, EUR mn 6)	9140.4	11969.6	14685.5	16199.8	17835.3	23943.9	28218.5 IX	.	.
FDI inflow, EUR mn	964	1147	1294	1212	1946	5183	4800	5000	4000
FDI outflow, EUR mn	15	-14	-18	18	36	56	30	.	.
Exports of goods, BOP, EUR mn	7977	11273	12722	14675	15614	18935	22500	25000	27500
annual growth rate in %	7.8	41.3	12.9	15.4	6.4	21.3	19	11	10
Imports of goods, BOP, EUR mn	9164	13140	16045	17427	19569	24258	30000	33000	36300
annual growth rate in %	-5.7	43.4	22.1	8.6	12.3	24.0	24	10	10
Exports of services, BOP, EUR mn	1287	1910	2273	2468	2671	2903	3800	4200	4500
annual growth rate in %	18.2	48.4	19.0	8.6	8.2	8.7	31	11	7
Imports of services, BOP, EUR mn	1657	2170	2402	2463	2609	3116	4400	5000	5600
annual growth rate in %	2.3	31.0	10.7	2.5	5.9	19.4	41	14	12
Average exchange rate RON/USD	1.5333	2.1693	2.9061	3.3055	3.3200	3.2637	2.9137	.	.
Average exchange rate RON/EUR (ECU)	1.6296	1.9956	2.6027	3.1255	3.7556	4.0532	3.6234	3.5	3.6
Purchasing power parity RON/USD	0.4459	0.6293	0.8324	0.9893	1.1894	1.3312	1.4580	.	.
Purchasing power parity RON/EUR	0.5097	0.7147	0.9547	1.1475	1.3946	1.5586	1.7239	.	.

*) On 1st July 2005 the new Romanian leu was introduced (1 RON = 10000 ROL). Data in this table are presented in new leu (RON).

Notes: 1) Preliminary. - 2) From 2002 according to census March 2002. - 3) From 2002 break in methodology. - 4) According to ESA 95, excessive deficit procedure. - 5) From February 2002 reference rate of NB. - 6) From 2004 including short-term deposits and foreign direct investment intercompany lending.

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

consumption and imports. Higher wages also increased the creditworthiness of the population, which became increasingly indebted in order to purchase durable consumer goods and construct new dwellings. Foreign currency loans were based on the assumption of both banks and customers that salaries and the exchange rate will develop with the same trend in the future. This however may not be the case, as towards the end of the year appreciation came to a halt and the National Bank introduced credit ceilings for each commercial bank to limit the credit expansion in foreign currency.

The buoyant domestic demand did not stimulate industrial output but mainly imports, which may be interpreted as a sign of structural weakness of the economy. The Romanian industry is mainly specialized on consumer goods of lower quality and prestige, not very much in demand by the better-off segment of the population which benefited most from the income surge. In the first three quarters of the year the exports of goods and services rose only by 6.8% while imports by 17.2%, resulting in a deficit one third higher than in the previous year. The decline in agricultural production generated imports and reduced exports, yet on the whole not very significantly. There has been a more significant change regarding the decline in textile, clothing and shoe production and exports. Romania was the 'tailor of Europe' in the past several years and suffers heavily under increased Chinese competition. This competition appeared both on the Romanian and on the export markets. The production of clothing articles declined by 16%, their exports by 2% in 2005. In numerous cases Italian companies, the owners or main customers of clothing and shoe producers in Romania, have shifted production to China. Along with the effect of appreciation and wage-drift, profits must have eroded, and a further shrinking of these industries seems unavoidable. Fortunately there are also booming parts of Romanian manufacturing, first of all the production of cars and household appliances where large foreign multinationals have invested. These sectors will support export growth but with a high import content in 2006 and 2007.

The current account deficit reached about EUR 7 billion or 9.1% of GDP in 2005. Capital inflow is abundant due to capital account liberalization and the improved risk ratings. While public debt declined, private medium- and long-term foreign debt soared; public and private debt combined reached EUR 23.6 billion by November – a 33% increase within one year. But the reserves of the National Bank expanded even faster, to EUR 16.8 billion. Even if the current account deficit were to expand further in 2006, financing problems would not appear. The sale of the Romanian Commercial Bank (BCR), acquired late last year by Erste Bank, will generate about EUR 2.3 billion net FDI inflow in 2006. Further large privatization deals are in the pipeline in 2006 and may bring an additional EUR 1.7 billion. Thus the high current account deficit represents no problem in the short run; in one or two years however, privatization revenues will dry up, the exposure to speculative capital movements will increase and the exchange rate may become more volatile.

Monetary policy has to cope with increasing challenges while having limited means available in the framework of the inflation targeting policy. The 2005 year-end inflation, initially targeted at 7%, was 1.6% percentage points above that mark. During the year the target had been raised to 7.5% plus-minus 1 percentage point, thus the inflation targeting policy introduced in July missed its goal only by a small margin. But in fact this policy can neither tackle the impact of administrative price changes nor the excessive appreciation of the domestic currency. The National Bank and the government have set the 2006 year-end inflation target at 5% plus/minus one percentage point. This may prove over-optimistic since tariff rises for utilities continue and the demand-pull factor remains strong. Annual average inflation may thus decline only marginally, to 8% in 2006 and 7% in 2007.

EU accession is on the agenda for 2007 or 2008. The Comprehensive Monitoring Report on Romania's progress towards accession, published on 25 October 2005, has raised hopes that the earlier date may be realized, but the final decision is due only in April 2006. Improvement was praised in the field of competition. As a result of privatization and more prudent government policies, subsidization has been curtailed; the Romanian authorities argue that the same processes have also made the economy more transparent and less prone to corruption. World Bank and EBRD surveys agree that the business environment has improved. EU experts still find a lot to do in the field of the judiciary and fighting large-scale corruption. In early 2006 the authorities started investigations against some leading politicians indicating their readiness to sacrifice some big fish, thus giving a demonstrative signal. The EU Commission also lists as problematic those areas which would allow Romania to get access to EU funds. The country's capacity of funds absorption will be limited initially and transfers will not boost economic growth in the first few years of membership.

Vladimir Gligorov

Serbia: in search of stability

The key developments of last year were growing exports with stagnating imports and accelerating inflation. GDP growth has been officially estimated at 6.5%, but that looks excessive. Industrial production has barely managed to post a positive growth rate, though it was declining during most of the year. Agricultural production declined because the previous, 2004, year saw a very strong recovery. Thus, all of the apparent high growth needs to be attributed to services, with especially high growth of construction.

Still, it is the growth of exports that is the most important. The recovery of exports started in the last quarter of 2004 and continued throughout 2005. This increase looks more like a jump in the level than a continuous improvement. Thus, it remains to be seen what the growth rates will look like this year given that the base is now much higher. With no improvement in industrial and agricultural production, exports may not continue to grow all that much in the short run. Unlike exports of goods, exports of services are not growing very strongly. Indeed, last year's services balance was around zero, which is a deterioration because Serbia usually records surpluses on the services account. Imports increased by about 6% for the first 11 months, and it is only when the December figure is added that they show a small decline for the year as a whole. Imports in December 2004 were exceptionally high ahead of the introduction of VAT at the beginning of 2005. If December 2004 imports were to be partly attributed to the early months of 2005, imports for the whole year would show significant growth. Similar problems exist with the figures for exports, because those may have been underreported prior to 2005. In any case, monthly data on exports show stability over the whole year, while imports are growing. Thus, there is some uncertainty about the development of the trade balance in 2006.

Because of the improvement in the trade balance, the current account has also improved in 2005. Given the uncertainty about the future development of the trade balance, and given that the balance of services is turning negative, the deficit of the current account may increase in 2006. This may prove to be unavoidable if foreign investments increase also. In the past two years, FDI inflows have not been all that impressive. Indeed, as has been the case in previous years, private transfers have continued to be higher than foreign direct investments.

Table Serbia

Serbia: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005 [1]	2006	2007
							forecast	
Population total [2]	7661.4	7736.4	7515.1	7532.6	7550	7570	.	.
Gross domestic product, CSD mn, nom.	355168	708423	919231	1095402	1330000	1650000	1890000	2260000
annual change in % (real)	5.2	5.1	4.5	2.4	9.3	6.5	4	4
GDP/capita (EUR at exchange rate) [3]	882	1540	2016	2236	2400	2600	.	.
GDP/capita (EUR at PPP - wiiw)	4290	4560	5010	5140	5740	6210	.	.
Gross industrial production [4]								
annual change in % (real)	11.4	0.1	1.8	-3.0	7.1	1.3	4	4
Gross agricultural production								
annual change in % (real)	-12.8	18.6	-3.4	-7.2	19.5	-5.3	.	.
Construction output total								
annual change in % (real) [5]	16.8	-14.3	-7.4	10.8	3.5	.	.	.
Gross fixed investment, CSD mn, nom.	50047	66765	122922	.	.	.	.	.
annual change in % (real)	13.2	-4.1	-0.8	.	.	.	.	.
LFS - employed persons, th. Oct [6]	3093.7	3105.6	3000.2	2918.6	2930.8	2900	.	.
annual change in %	-0.3	0.4	-3.4	-2.7	0.4	-1.0	.	.
Reg. employees in industry, th pers., avg.	.	704.5	648.1	605.3	562.0	532.6 I-X	.	.
annual change in %	.	.	-8.0	-6.6	-7.1	-5.4 I-X	.	.
LFS - unemployed, th pers., average [6]	425.6	432.7	459.6	500.3	665.4	.	.	.
LFS - unemployment rate in %, average [6]	12.1	12.2	13.3	14.6	18.5	20	22	23
Reg. unemployment rate in %,end of period [7]	.	.	30.5	31.9	32.4	33	34	34
Average gross monthly wages, CSD [8]	3799	8691	13260	16612	20555	25565	.	.
annual change in % (real, net)	5.5	16.5	29.9	13.6	10.1	5.7	.	.
Consumer prices, % p.a.	79.6	93.3	16.6	9.9	11.4	16.2	15	15
Producer prices in industry, % p.a.	102.6	87.7	8.8	4.6	9.1	14.2	15	15
General governm. budget, nat.def., % GDP								
Revenues	.	39.1	44.3	43.1	44.3	.	.	.
Expenditures	.	40.7	48.0	47.3	45.8	.	.	.
Deficit (-) / surplus (+), % GDP	.	-1.6	-3.7	-4.2	-1.5	.	.	.
Public debt in % of GDP	.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	26.3	16.4	9.5	9.0	8.5	8.5	.	.
Current account [9]	-167	-354	-1348	-1362	-2233	-1800	-2000	-2000
Current account in % of GDP	-0.7	-3.0	-8.9	-8.1	-12.3	-9.1	-10.0	-10.0
Gross reserves of NB, excl. gold, EUR mn	429.9	1138.6	2076.8	2728.2	3008.0	4145.2 X	.	.
Gross external debt, EUR mn	11659	12609	10768	10858	10355	12046 IX	.	.
FDI net, EUR mn [9]	55	184	504	1204	779	1000	.	.
Exports of goods, BOP, EUR mn [9]	1794	2032	2348	2598	2993	3660	4030	4430
annual growth rate in %	.	13.3	15.5	10.7	15.2	22	10	10
Imports of goods, BOP, EUR mn [9]	3519	4608	5774	6409	8320	8540	9400	10340
annual growth rate in %	.	31.0	25.3	11.0	29.8	3	10	10
Exports of services, BOP, EUR mn [9]	459	685	795	906	1170	1300	.	.
annual growth rate in %	.	49.3	16.0	13.9	29.2	11	.	.
Imports of services, BOP, EUR mn [9]	305	413	657	720	1018	1300	.	.
annual growth rate in %	.	35.2	59.1	9.5	41.4	28	.	.
Average exchange rate CSD/USD	16.40	66.36	64.40	57.58	58.69	67.21	.	.
Average exchange rate CSD/EUR (ECU)	15.04	59.46	60.68	65.05	73.00	83.19	90	100
Purchasing power parity CSD/USD, wiiw	9.50	17.50	21.10	24.20	26.20	29.20	.	.
Purchasing power parity CSD/EUR, wiiw	10.80	20.10	24.40	28.30	30.70	35.10	.	.

Notes: 1) Preliminary. - 2) From 2002 according to census 2002. 2004-2005: wiiw estimate. - 3) In 2000 wiiw estimate using black market rate. - 4) From 2004 according to NACE and new weighting system. - 5) Gross value added. - 6) From 2004 according to census 2002 and revisions based on ILO and Eurostat methodology. - 7) In % of unemployed plus employment (excluding individual farmers), wiiw. - 8) From 2002 including various allowances. - 9) Converted from USD.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Borrowing abroad has grown rather fast. This has started to worry the central bank and also the International Monetary Fund. As a consequence, the monetary squeeze has increased over the year and additional restrictive measures can be expected. These have been introduced apparently for two reasons. On the one hand, there is concern that the banks' balance sheets deteriorate with the accumulation of bad loans. There is no reliable study that actually documents that. The banking sector is rejecting the suggestion, however. On the other hand, it is believed that credit expansion is pushing prices and thus is accelerating inflation. That is not supported by the data, however, because the fastest growing prices were those of food in 2005.

This being an interesting issue and one that will be very much on the mind of economic policy makers in Serbia, a closer look at some of the claims and the data may be in place here. The monetary authorities, the IMF included, are especially worried by the fast growth of loans to households. The growth rate has indeed been high, over 60%, in 2005. Therefore, the central bank has started to restrict that expansion rather aggressively, at the same time favouring the extension of credit to enterprises. A check of the data on the growth of deposits, however, reveals that deposits of households are in fact growing faster than credits to that sector. This implies that the excess of credits over deposits is mostly due to growing borrowing by the enterprise sector. Thus, loans of the enterprise sector are being financed from the deposits of households. Given that these deposits are mostly short-term and in foreign currency while loans to the enterprise sector are mostly longer-term and in dinars, though indexed to the euro, there is a possibility that the policy of the central bank, to the extent that it is biased towards loans to enterprises and against loans to households, is contributing to the mismatch of the currency and term structure of loans.

It is also not clear what impact the restrictive monetary policy has on inflation. Credits taken by households mostly translate into imports, because those are used for consumer durables and for investments in housing. As long as the exchange rate is not depreciating due to growing demand for foreign currency, inflation should not be accelerated due to higher imports. In Serbia, the dinar depreciated less than the inflation, so it is more appropriate to speak about the failure of the exchange rate to provide an anchor to prices rather that seeing it as a cause of inflation.

Growing costs of lending, due to e.g. rising reserve requirements, could push the prices up especially if demand for loans by the enterprise sector is strong. Also, investments may be negatively affected and that may bring growth down, which could then have inflationary consequences as long as demand decreases as well. All this reliance on monetary policy both to put the external balance under control and to sap inflation does not inspire confidence anyway. In these circumstances, it is the fiscal policy that is probably the proper instrument to put demand under control and stabilize the trade balance as well as the rise of prices.

In the course of last year, fiscal policy was under constant pressure. The successful conclusion of the three-year IMF programme was postponed again and again because of the difficulties with coming to an agreement about the amount of the fiscal deficit that the general budget should be allowed to run. At the end of the year, the fiscal balance showed a surplus. This was mainly an artefact of the accelerating inflation. That allowed the government to spend more but still below the growth of GDP, thus reporting a falling public expenditure to GDP ratio. If inflation is brought down aggressively in the short run, the fiscal balance will again report a deficit especially because of the potential increase in political instability and in social pressures.

This year will indeed be a trying one in political terms. Montenegro is planning to hold a referendum on independence in mid-spring. In the second half of the year the Kosovo status will be determined, with independence of this province as the most likely outcome. Finally, there is increasing pressure on the Serbian government to intensify its cooperation with the Hague Tribunal by arresting the remaining people indicted of war crimes. The EU is threatening the break-up of the ongoing negotiations on the Stabilization and Association Agreement.

Each one of these issues separately and especially all of them together present a challenge to political stability in Serbia. In any case, it is quite likely that the government will decide to hold early parliamentary elections or may choose to consult the electorate about the proper policy towards the resolution of some of the issues mentioned above, in particular the one on the future status of Kosovo. These potential political shocks may have significant economic consequences, which may further destabilize the relatively fragile macroeconomic equilibrium.

If these shocks prove to be relatively mild and if political stability is preserved, the economy should continue to grow mainly on the basis of rising investments and private consumption. Public consumption may also expand if the political situation proves to require it. Serbia will not hurry to negotiate a new agreement with the IMF so it will not have to justify its expansionary fiscal policy if it decides to pursue one. Thus, GDP should expand by about 5% in the medium run and inflation should stay at a relatively high but stable level. Growth of exports may slow down, especially if restructuring of the public sector stalls as is likely. Once the key political uncertainties are resolved and new elections are held, it will be easier to make longer-term forecasts for the development of the Serbian economy.

Michael Landesmann and Julia Wörz

Turkey: investment and construction boom

With third quarter figures on GDP growth amounting to 7%, growth for 2005 is now estimated to be just below the 6% mark. Private investment activity has continuously been speeding up through 2005 reaching an increase in the third quarter of 26.7% above the corresponding level in 2004. Taking the first nine months together, it emerges clearly that investment components of aggregate expenditure have been growing much more strongly than the consumption components (private consumption +6.9%[33], private investment +15.9%, public consumption +3.9%, public investment +32.7%) and furthermore that growth in imports (+10.1%) outstripped growth in exports (+5.8%). As regards sectoral developments, there was a relatively balanced pattern with agriculture growing at 4.5%, industry at 5.5%, services at 4.4% (with strong growth in trade of 5.8%); the exception was construction activity, which increased by as much as 19.7%. Hence we can speak of the Turkish growth performance being carried in 2005 by an investment and a construction boom.

As to the causes of this boom, to some extent one may still speak of a sustained recovery following the deep slump in the wake of the crisis in 2001 (the pre-crisis level of GDP was regained only in mid-2003). However, most commentators would agree that the recent developments – strong disinflation (bringing CPI inflation rate down to 7.7% by end-year 2005 from an average inflation rate

[33] All growth figures refer to growth in the first nine months of 2005 over the same period in 2004.

of over 70% in the 1990s), a sustained and successful effort to reduce public debt levels (the gross public debt ratio to GDP declined from a peak of 107.5% in 2001 to 61.2% in 2005[34]) and general political stabilization through a strong government and the expected and then actual decision to start negotiations concerning EU membership – have sharply improved the underlying mood of domestic and international actors with respect to the sustained character of the Turkish growth performance.

The one worrying item in the overall performance is the apparent inability to increase (so far) the overall export-import ratio in goods trade, which amounted to 74.3% in 2004 (January-November) and fell to 70.5% (same period) in 2005.[35] This gap between the levels of exports and imports (and the continued discrepancy in their growth rates) is central to the discussion of whether the Turkish growth performance on its current path is sustainable. We take a relatively optimistic position on the pure trade side of the current account which could be seen as a typical feature of a catching-up economy which is in the process of upgrading its production capacities (industry experiences fast productivity growth and there is evidence of upgrading in export structures; see below). However, the greater concern exists with regard to developments in the international financial accounts: over the period January-November 2005, a record high capital inflow of USD 36.7 billion was observed. Of this total, USD 6.3 billion was in the form of foreign direct investment (i.e. only 17% of the inflows), USD 11.2 billion was through portfolio investment and USD 19.2 billion in the form of other investments. Half of the inflow through the portfolio investment account stems from the net purchases of foreigners in the domestic equity market, the rest went into net purchases of domestic bonds and treasury bills and euro-bond issues by the Treasury. Of the total inflows through the other investments account, USD 9.8 billion was through the banking sector mainly due to the loans received from abroad; the other sectors (mainly corporate sector) account for a further USD 12.1 billion, mainly through trade and other credits they acquired from abroad.

As a result of these developments, the current account deficit (which amounted to USD 18.7 billion during the period January-November 2005) was financed by a capital inflow of USD 36.7 billion and a positive balance of USD 3.8 billion in the net errors and omissions account. There were USD 4.9 billion net repayments to the IMF and hence the official reserves increased by USD 14.5 billion over the period. The picture which presents itself is thus a massive capital inflow in the context of government policy which is committed to reducing inflation, with nominal interest rates coming down (e.g. interest rates on government debt instruments, GDI, have come down from 20.3%[36] at the beginning of 2005 to 13.8% at the end of the year) and – resulting from the capital inflow – a nominal appreciation of the currency (by 12.9% vis-à-vis the euro in 2005). The remaining considerable nominal interest rate differential between domestic and international loans encourages borrowing from abroad by the private sector which in turn accounts for a substantial share of foreign capital inflows. Monetary policy finds itself in a difficult position, trying to stem some of the exuberant items of private expenditure (on consumer durables, on construction activity and in the housing market) through a relatively cautious interest rate policy, but this maintains the attractiveness to

Table TR

---

34 The central government budget deficit declined from 15.2% in 2001 to 7.1% in 2004 and to 2.8% in 2005 (the last figure is an estimate given data until November 2005). Interest payments on public debt declined from 23.3% of GDP in 2001 to 7.1% in 2004 and 2.8% in 2005 (again an estimate).

35 Given the substantial surplus in services trade (mostly in tourism) this ratio increases for overall goods and services trade to 90.5% in 2004 and 86.4% in 2005.

36 Refers to the interest rate of the most actively traded bond on the secondary market.

Republic of Turkey: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 1)	2006	2007
								forecast	
Population, th pers., mid-year 2)	66350	67420	68365	69302	70231	71152	72065	.	.
Gross domestic product, YTL mn, nom.	77415	124583	178412	277574	359763	430511	491000	544000	603000
annual change in % (real)	-4.7	7.4	-7.5	7.9	5.8	8.9	5.8	6.0	6.0
GDP/capita (EUR at exchange rate)	2626	3211	2386	2799	3028	3416	4070	.	.
GDP/capita (EUR at PPP - wiiw)	5320	6000	5370	5650	5810	6520	6830	.	.
Gross industrial production									
annual change in % (real)	-5.0	6.1	-8.7	9.4	7.8	9.3	5	.	.
Gross agricultural production									
annual change in % (real)	-5.0	3.9	-6.5	6.9	-2.5	2.0	5	.	.
Construction industry									
annual change in % (real)	-9.4	0.2	-10.6	-5.6	-9.0	4.6	20	.	.
Consumption of households,YTL mn, nom.	55928	89098	128513	184420	239586	284631	.	.	.
annual change in % (real)	-2.6	6.2	-9	2.1	6.6	10.1	7	.	.
Gross fixed capital form., YTL mn, nom.	16931	27848	32409	46043	55618	76722	.	.	.
annual change in % (real)	-15.7	16.9	-31.5	-1.1	10.0	32.4	18	15	15
LFS - employed persons, th, avg.	22048	21580	21524	21354	21147	21791	22138 I-IX	.	.
LFS - employed pers. in agricult. th, avg.	8856	7769	8089	7458	7165	7400	6872 I-IX	.	.
LFS - employed pers. in industry th, avg. 3)	3784	3810	3774	3954	3846	3988	4203 I-IX	.	.
LFS - employed pers. in services th, avg.	9410	10001	9661	9942	10136	10403	11063 I-IX	.	.
LFS - unemployed, th pers. average 4)	1830	1497	1967	2464	2493	2498	2467 I-IX	.	.
LFS - unemployment rate in %, average	7.7	6.5	8.4	10.3	10.5	10.3	10	9.7	9.3
Reg. unemployment rate in %, average	2.1	3.3	3.2	1.9	2.5	.	.		
Average gross wages (YTL/Hour)	0.95	1.48	1.95	2.68	3.30	.	.	.	.
annual change in % (real)	11.0	0.8	-14.6	-5.4	-1.9	2.5	.	.	.
Consumer prices, % p.a.	64.9	54.9	54.4	45.0	25.3	10.6	7.7	5.5	4.5
Wholesale prices in manufacturing, % p.a.	57.2	56.1	66.7	48.3	23.8	11.1	5.9	.	.
Government budget, % GDP									
Central government revenues	24.3	25.6	26.7	24.9	27.5	24.6	.	.	.
Central government expenditures	36.2	37.4	44.6	40.9	38.9	32.6	.	.	.
General governm. deficit (-) / surplus (+) 5)	-15.7	-11.9	-16.2	-12.6	-8.6	-7.0	-3.0	-2.4	.
Public debt in % of GDP	52.7	68.8	106.4	92.7	82.7	77.1	61.2	54.8	.
Discount rate % p.a., end of period	60.0	60.0	60.0	55.0	38.5	25.0	13.8	11.0	.
Current account, EUR mn 6)	-1264	-10663	3797	-1606	-7126	-12555	-18200	-21500	-23800
Current account in % of GDP	-0.7	-4.9	2.3	-0.8	-3.4	-5.2	-6.2	-6.5	-6.5
Gross reserves of CB, excl. gold, EUR mn	21798	24078	21042	28250	29812	28973	38275 XI	.	.
Gross external debt, EUR mn	97121	129107	127620	137229	128901	130143	137750	.	.
FDI inflow, EUR mn 6)	765	1854	3685	1205	1816	2604	7200	.	.
FDI outflow, EUR mn 6)	28	787	25	145	303	370	800	.	.
Exports of goods, BOP, EUR mn 6)	27125	33362	38469	42229	45344	53873	61000	72000	86000
annual change in %	0.2	23.0	15.3	9.8	7.4	18.8	14	18	20
Imports of goods, BOP, EUR mn 6)	35689	55145	41572	48476	55532	70344	84000	101000	121000
annual change in %	-6.3	54.5	-24.6	16.6	14.6	26.7	20	20	20
Exports of services, BOP, EUR mn 6)	15800	22115	17954	15579	16872	18448	21000	.	.
annual growth rate in %	-24.4	40.0	-18.8	-13.2	8.3	9.3	15	.	.
Imports of services, BOP, EUR mn 6)	8759	9769	7728	7276	7556	8162	9000	.	.
annual growth rate in %	-2.5	11.5	-20.9	-5.9	3.8	8.0	16	.	.
Average exchange rate YTL/USD	0.4178	0.6250	1.2253	1.5077	1.5003	1.4253	1.3443	.	.
Average exchange rate YTL/EUR (ECU)	0.4443	0.5755	1.0940	1.4307	1.6918	1.7714	1.6745	1.65	1.65
Purchasing power parity YTL/USD	0.1917	0.2711	0.4240	0.6115	0.7524	0.7930	0.8301	.	.
Purchasing power parity YTL/EUR	0.2193	0.3081	0.4859	0.7084	0.8817	0.9277	0.9977	.	.

Notes: 1) Preliminary. - 2) 2004 and 2005 SIS projections.- 3) Mining and Quarrying,, Manufacturing, Electricity, Gas and Water.- 4) Civilian Labour Force: unemployed. - 5) Based on the Public Sector Borrowing Requirement (PSBR) methodology including local public administraion, social security and enterprises under public administration. - 6) 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.

borrow abroad, hence enhances capital inflows and exchange rate appreciation with detrimental effects on the possibility to reduce the import-export gap. A shock in the form of a further rise in the oil price or falling tourism income in the wake of the birds flu epidemic could severely test the inherent vulnerability of this situation.

Apart from the above-discussed developments on international financial accounts, tendencies in the real economy are very promising. There were strong increases in manufacturing labour productivity, which resulted in a constantly high growth rate of exports despite a pronounced appreciation of the new Turkish lira. The widening trade deficit is mostly due to imported intermediates and capital goods and to a lesser extent due to increased consumption expenditures on imports. Hence the current account deficit is now tied to strong increases in investment rates, which leads some analysts to interpret the current account deficit (6.2% of GDP in 2005) as an expression of economic strength since it reflects faster productivity-driven output growth relative to Turkey's main trading partners.

The trade to GDP ratio (which stands now at 50%) has been marked by the increased openness of the Turkish economy over the past five years (trade to GDP ratios had earlier moved from 23% in 1990 to 40% in 2000). The EU remains by far the most important trading partner, however, increasingly also other markets are targeted. In 2000, the Turkish government initiated a trade development strategy with neighbouring countries with the aim to take advantage of Turkey's location as a local hub in the region. Trade among Turkey and these countries has more than doubled over the past four years. Asian markets were targeted in a similar strategy starting in 2005, and the strategy plans for the year 2006 to increase Turkish presence in the US market, which currently accounts for about 6% of Turkish exports. There is a clear trend (supported by a number of policies) towards higher-quality export products which is seen as a major challenge for Turkish exporters. There is also a shift away from traditional export goods, such as textiles and clothing. While still being the primary export category, the industry's share in total exports is decreasing. In 2005 the textile industry had to stand up against fierce competition from China and other previously quota-constrained exporters. This was primarily felt through rapid import increases on the domestic market, leading to output falls despite special safeguard measures taken up against China. Due to increased market opportunities in the US market, textile exports expanded in absolute terms in 2005. The diversification of Turkish exports is reflected in the rise in exports of transport equipment, which has become the second most important export category. Favourable developments were further observed in chemical and electronic goods (above all household appliances).

2005 has been characterized by high privatization revenues from selling to both Turkish and foreign investors. The last months of the year brought two major deals. One of the largest deals of the entire year 2005 was the takeover of Turkey's second largest mobile phone operator Telsim by the British Vodafone Group. Vodafone paid more than EUR 3.5 billion and will invest an additional EUR 1.2 billion. A further big deal was struck in the steel industry where Erdemir, Turkey's largest steel producer, which was acquired in September by the Turkish OYAK group (operating in diverse fields such banking to automobiles), was partially sold to Arcelor.

Total privatization revenues for the year 2005 are estimated to be around EUR 14 billion, to which also smaller, domestic investments contributed a notable share.[37] Outward investment has also

[37] For example, the tourism sector experienced a bout of privatization. The Istanbul Hilton hotel was sold to Aydin Doğan, owner of the English newspaper *Turkish Daily News* and Turkey's biggest media owner for EUR 205 million. Further, a

increased compared to the previous year through a range of smaller deals, such as the opening up of the first Koç's Edward's (high fashion) store in Moscow and the takeover of a German ceramic tile manufacturer by Eczacıbaşı Building Materials Division.

As far as the outlook is concerned, we take as central forecast for 2006 and 2007 a continuing growth rate in GDP of about 6%, but point to the important vulnerability of such a projection in the short to medium term based on the evidence presented above regarding the high international borrowing activity by the private sector which puts pressure on the nominal exchange rate and the current account. An external shock in the form of a further sharp increase in the oil price, perceptions of a conflict potential in the Middle East or a scare in relation to the birds flue epidemic, which might affect Turkey's substantial reliance on tourism income, could lead to a reversal of short-run international capital movements, thus affecting credit conditions and further investment activity.

Turkish joint-venture group (Tahinicioğlu-Nida-M.V.) acquired the Büyük Efes hotels in Izmir from the state retirement pension fund for EUR 97.6 million while the Büyük Efes hotels in Ankara went to Çelikler İnşaat A.Ş. for roughly EUR 30 million.

Part C: Russia and Ukraine; China

Country reports

Peter Havlik

Russian Federation: gaining strength, some muscle and more fat

Russia's GDP increased by slightly more than 6% last year, roughly maintaining the average growth rate of the past five years. In 2005, the main driver of growth was rising domestic demand (both private consumption and investments grew by more than 10%) while the contribution of real net exports to GDP growth was again negative. However, export revenues boomed for the second consecutive year in nominal terms, largely thanks to the surging energy prices. The sizeable expansion of imports notwithstanding, the trade surplus reached EUR 100 billion (more than 16% of GDP) and the current account surplus nearly EUR 70 billion (11% of GDP) in 2005. Due to significant improvements in the terms of trade, Russian domestic absorption could thus grow much faster than GDP – even with rising trade and current account surpluses.[38] The government budget also recorded a record surplus in 2005 (more than 8% of GDP) and foreign exchange reserves reached EUR 150 billion at the end of 2005 (an increase by EUR 60 billion within one year). After repaying all outstanding IMF credits (USD 3.3 billion) at the beginning of 2005, the government agreed with the Paris Club creditors in summer to pay back some USD 15 billion of debt ahead of schedule. The Stabilization Fund, established in 2004 and fed from a portion of windfall oil export revenues, reached nearly EUR 40 billion by the end of 2005. The Ministry of Finance announced in September its intention to repay all remaining debt to the Paris Club – USD 28 billion – in the course of 2006.

Nevertheless, growth of GDP and particularly of industry has decelerated since 2003. The slowdown was recorded in both extraction and manufacturing industries as well as in transport, whereas the output growth of some services (in particular retail trade and telecommunications) accelerated. Agricultural production has been nearly flat since 2002. Industrial production grew by 4% only (of which manufacturing, especially transport equipment and electrotechnical industry for domestic use, by 6%). The pace of structural reforms has slowed down substantially. State interventions in the economy are increasing, the resulting bureaucratic obstacles and corruption being blamed as the main culprits for the poor investment climate. Gazprom, Rosneft and other large state-owned (or controlled) corporations are acquiring new assets (such as the oil companies Yukos and Sibneft, the power engineering conglomerate Silovye Machiny, the car manufacturers Avtovaz and Kamaz, etc.). While launching new state investment programmes (in health, education, housing and transport) and establishing special economic zones with tax privileges and legal guarantees, the government restricts access of foreign investors to 'strategic' sectors. Nonetheless, inflows of FDI are rising, the country's credit rating is improving and the Russian Stock Exchange boomed during 2005 as well. Symptoms of a Russian Dutch disease variety are becoming apparent as a growing part of export revenues stems from resource-based industries – revenues from oil and natural gas exports account for more than 60% of the total – and huge foreign exchange inflows exert appreciation pressures on

[38] Real exports grew by less than 4% in 2005 while imports expanded by nearly 18%. The real contribution of net exports to GDP growth was thus negative for the second year in a row. The estimated terms of trade gains amounted to 6.6% of GDP.

Table RU

Russia: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 [1]	2006	2007
								forecast	
Population, th pers., end of period [2]	145559	144819	143954	144964	144168	143500	143250	142500	142000
Gross domestic product, RUB bn, nom.	4823.2	7305.6	8943.6	10830.5	13243.2	17008.4	21665.0	25300	29000
annual change in % (real)	6.4	10.0	5.1	4.7	7.3	7.2	6.4	6.2	6
GDP/capita (EUR at exchange rate)	1256	1928	2365	2539	2641	3302	4294	.	.
GDP/capita (EUR at PPP - wiiw)	5460	6020	6490	7010	7500	8260	9000	.	.
Gross industrial production									
annual change in % (real)	11.0	11.9	4.9	3.7	7.0	6.1	4.0	4.5	5.0
Gross agricultural production									
annual change in % (real)	4.1	7.7	7.5	1.5	1.3	1.6	2.0	.	.
Construction output total									
annual change in % (real)	6.0	17.0	9.9	2.7	14.4	10.1	10.5	.	.
Consumption of households, RUB bn, nom.	2526.2	3295.2	4318.1	5408.4	6540.2	8132.2	10161.1	.	.
annual change in % (real)	-2.9	7.3	9.5	8.5	7.5	11.6	11.1	10	10
Gross fixed capital form., RUB bn, nom.	694.0	1232.0	1689.3	1938.8	2432.2	3106.5	3926.1	.	.
annual change in % (real)	6.4	18.1	10.2	2.8	12.8	11.3	10.5	11	11
LFS - employed persons, th, avg. [3]	62475	64255	64400	66071	65800	67417	68200	.	.
annual change in %	6.9	2.8	0.2	2.6	-0.4	1.6	1.2	.	.
Reg. employment in industry, th pers., avg.	14297	14543	14692	14534	14345	14130	.	.	.
annual change in %	1.0	1.7	1.0	-1.1	-1.3	-1.5	.	.	.
LFS - unemployed, th pers., average [3]	9323.0	7515.0	6416.0	5712.0	6231.0	5988.0	5628.9	.	.
LFS - unemployment rate in %, average [3]	13.0	10.5	9.1	8.0	8.6	8.2	7.6	7.5	7
Reg. unemployment rate in %, end of period	1.7	1.4	1.6	2.1	2.3	2.6	2.5	.	.
Average gross monthly wages, RUB	1522.6	2223.4	3240.4	4360.3	5498.5	6831.8	8530.0	.	.
annual change in % (real, gross)	-22.0	20.9	19.9	16.2	11.0	10.8	9.7	.	.
Consumer prices, % p.a.	85.7	20.8	21.6	16.0	13.6	11.0	12.5	10	8
Producer prices in industry, % p.a.	58.9	46.6	19.1	11.8	15.6	24.0	20.7	15	13
General governm.budget, nat.def., % GDP									
Revenues	25.2	28.7	30.0	32.5	31.3	32.4	35.3 I-IX	.	.
Expenditures	26.1	26.8	27.1	31.6	29.9	27.9	26.6 I-IX	.	.
Deficit (-) / surplus (+), % GDP	-0.9	1.9	3.0	0.9	1.3	4.5	8.6 I-IX	.	.
Public debt, nat.def., in % of GDP [4]	94.2	57.1	44.1	37.0	28.6	21.9	20.5 IX	.	.
Refinancing rate of NB % p.a., end of per.	55	25	25	21	16	13	12	.	.
Current account, EUR mn [5]	23100	50619	37885	30789	31330	47104	69584	60000	50000
Current account in % of GDP	12.6	18.0	11.1	8.4	8.2	9.9	11.3	8.3	5.9
Gross reserves of NB, excl. gold, EUR mn	8387	26139	37026	42290	58531	88663	148094	.	.
Gross external debt, EUR mn	176298	172903	169530	147067	148776	157423	189241 IX	.	.
FDI inflow, EUR mn [5]	3105	2933	3069	3660	7041	10315	20000	.	.
FDI outflow, EUR mn [5]	2071	3433	2828	3736	8606	8322	10000	.	.
Exports of goods, BOP, EUR mn [5]	70898	113510	113744	113468	120265	147358	197100	210000	220000
annual growth rate in %	8.5	60.1	0.2	-0.2	6.0	22.5	33.8	7	5
Imports of goods, BOP, EUR mn [5]	37102	48483	60022	64470	67304	78327	100519	115000	130000
annual growth rate in %	-27.1	30.7	23.8	7.4	4.4	16.4	28.3	14	13
Exports of services, BOP, EUR mn [5]	8509	10337	12773	14393	14359	16320	19525	20000	22000
annual growth rate in %	-21.6	21.5	23.6	12.7	-0.2	13.7	19.6	2	10
Imports of services, BOP, EUR mn [5]	12529	17540	22967	24848	23997	27132	31256	35000	40000
annual growth rate in %	-13.2	40.0	30.9	8.2	-3.4	13.1	15.2	12	14
Average exchange rate RUB/USD	24.62	28.13	29.17	31.35	30.69	28.81	28.30	28	27
Average exchange rate RUB/EUR (ECU)	26.24	26.03	26.13	29.65	34.69	35.81	35.22	35	34
Purchasing power parity RUB/USD, wiiw	5.54	7.17	8.15	9.27	10.38	12.18	14.20	14.8	16
Purchasing power parity RUB/EUR, wiiw	6.04	8.34	9.52	10.74	12.21	14.31	16.81	18.5	20

Notes: 1) Preliminary. - 2) Resident population; from 2002 according to census October 2002. - 3) From 2004 according to census October 2002. - 4) wiiw estimate. - 5) Converted from USD.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

the rouble. With a roughly constant nominal exchange rate over an extended period (around 28 RUR per USD) and persisting double-digit annual inflation (more than 12% in 2005), the rouble has strengthened by some 50% in real terms against the US dollar since 2000 (real appreciation against euro was much less pronounced). The share of the euro in the CBR's currency basket was increased to 40%.

Due to the combined effects of high foreign exchange inflows, expanding money supply, robust consumer demand and price hikes in energy and services, disinflation came to a halt. Consumer price inflation even accelerated on an annual average in 2005. Even more disturbing is the fact that producer price inflation was even higher, more than 20%, mainly as a result of surging domestic prices of energy and metals. Given the further envisaged adjustments of administered prices, e.g. of electricity and gas, it is obvious that permanently rising producer prices will eventually translate into higher consumer price inflation as well. As rapid disinflation is unlikely, wiiw expects consumer prices to hover around 10% in 2006.

Instead of net exports, the main growth pillar during the past few years has been private consumption and, increasingly, also investment. The share of investment in GDP is still quite low (about 20% in 2005), yet investment growth may again exceed 10% in the coming years. The situation of most Russian companies, in particular those which are engaged in export activities, is quite comfortable and they can easily finance investments from own resources (or from bond issue and credits – as was the case in Gazprom's recent acquisition of Yukos and Sibneft assets). Russian outward FDI is also rising, partly at the expense of capital flight. Given the surging government revenues, the recently adopted federal budget reckons with expenditures rising by 25% in 2006 (to 17.5% of GDP). Even with these planned spending increases (targeting investments, salaries of health and education personnel, housing construction and agriculture), the next year's budget envisages a surplus of 3.2% of GDP. (The actual outcome may well be twice as high owing to the rather conservative oil price assumption – USD 40 per barrel – in the budget.) wiiw reckons with GDP growth around 6% in the coming years. With more cash and power consolidation, Russian assertiveness is on the rise (as illustrated by the recent gas pricing disputes). However, sustainable and broader-based long-term growth would require more investments and economic restructuring, both not to be expected in the absence of stepped-up reforms and improved transparency of legal regulations (a separate issue is the looming threat of labour shortages and the danger of an oil price collapse).

Vasily Astrov

Ukraine: 'market economy' at last

On 1 December 2005, the European Commission finally announced its decision to grant Ukraine the 'market economy' status. This long overdue move will ease the burden of anti-dumping investigations launched against the imports from Ukraine (notably metals and chemicals) to the EU markets. Also, it may be regarded as the first tangible result of political rapprochement between the EU and Ukraine since the 'orange revolution' at the end of 2004. However, the decision itself (though politically motivated) is rather 'technical' and should not be interpreted as a step on the path of Ukraine's integration into the EU,[39] while a similar decision from the United States is still pending. Otherwise, integration with the EU has not progressed very much either: while EU citizens have been entitled since mid-2005 to visa-free entry into Ukraine, the EU's visa regime for Ukrainians remains highly restrictive, and a re-admission agreement has not been concluded yet (although, as exemplified by Russia's recent experience, even the conclusion of such an agreement may not necessarily ease the EU visa regime for the country in question). Ukraine's WTO accession, initially planned for December 2005, has been postponed, but it may be realistically expected to take place in the course of this year.

Ukraine's EU integration prospects are hardly helped by the country's political instability and the mounting economic problems. The record-high 12.1% GDP growth observed in 2004 was persistently declining in the course of 2005 and stood at a mere 2.4% for the year as a whole, reflecting first of all a slowdown in the dynamics of gross industrial output of a similar magnitude: from 12.5% in 2004 to 3.1% in 2005. The 2005 grain harvest reached about the same (high) level as in the year before, thus gross agricultural output was flat, which had a dampening effect on GDP growth as well. Viewed from the demand side of GDP, the growth slowdown has been primarily due to the weak investment activity and the disappointing foreign trade performance. As a result of the political instability, fixed investments were up by just 3.4% in the first three quarters of 2005 (compared to 34.5% over the same period of 2004). In turn, the trade balance in goods turned negative (USD -1.3 billion in January-November, according to the customs statistics) – largely due to the collapse in the world steel prices and partly also to the revaluation of the hryvnia in April. However, thanks to the high services exports (representing largely transit fees for the Russian energy carriers shipped to Europe) and the inflows of remittances, the current account in 2005 was once again in surplus, probably reaching some 3% of GDP.

A pleasant side effect of the economic slowdown has been disinflation. The *end-year* consumer price inflation last year stood at 10.3% – somewhat lower than in 2004 (12.3%), even though the *average* inflation figure turned out to be higher (13.5% vs. 9%), largely resulting from the 'overheating' which accompanied the country's economic boom throughout most of 2004. The slowdown of producer price inflation has been much more pronounced (from 24.1% in 2004 to 9.5% in 2005 on an end-year basis) and will have a mitigating effect on consumer inflation as well.

After several failed attempts, on 20 December 2005 the Verkhovna Rada (the Ukrainian parliament) finally adopted the central budget for 2006. The budget envisages a deficit of UAH 12.9 billion (or 2.5% of GDP), of which UAH 1.5 billion is to be covered by borrowing and another UAH 2.1 billion by privatization receipts. The latter target is far below both the 2005 privatization target (UAH 7 billion) and the actual privatization proceeds of the government last year, well in excess of UAH 20 billion – primarily due to the highly successful re-privatization of Ukraine's biggest steel mill Kryvorizhstal' to Mittal Steel in October. Also, the opposition-minded Rada has put a ban on the forthcoming privatization of some big industrial enterprises, probably in an attempt to prevent the transfer

[39] For instance, Russia – which does not have ambitions of EU membership – has had a 'market economy' status from the EU since 2002.

Table UA

Ukraine: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 [1)]	2006	2007
								forecast	
Population, th pers., end of period	49429.8	48923.2	48457.1	48003.5	47622.4	47280.8	46930.6	46600	46400
Gross domestic product, UAH mn, nom.	130442	170070	204190	225810	267344	344822	400800	463000	535000
annual change in % (real)	-0.2	5.9	9.2	5.2	9.6	12.1	2.4	5	6
GDP/capita (EUR at exchange rate)	595	688	872	931	928	1099	1330	.	.
GDP/capita (EUR at PPP - wiiw)	3420	3770	4240	4620	5120	5910	6210	.	.
Gross industrial production									
annual change in % (real)	4.0	13.2	14.3	7.0	15.8	12.5	3.1	6	7
Gross agricultural production									
annual change in % (real)	-6.9	9.8	10.2	1.2	-11.0	19.9	0.0	.	.
Construction output total									
annual change in % (real)	-11.0	0.4	3.5	-5.8	26.5	17.2	-6.6	.	.
Consumption of households, UAH mn, nom.	71310	92406	112260	124560	146301	185533	.	.	.
annual change in % (real)	-1.9	2.5	9.6	9.5	12.4	15.1	.	.	.
Gross fixed investment, UAH mn, nom.	17552	23629	32573	37178	51011	75714	51552 I-IX	.	.
annual change in % (real)	0.4	14.4	20.8	8.9	31.3	28.0	3.4 I-IX	7	10
LFS - employed persons, th, avg. [2)]	20048.2	20175.0	19971.5	20091.2	20163.3	20295.7	20748.2 I-IX	.	.
annual change in % [3)]	-12.8	0.6	-1.0	0.6	0.8	0.7	1.9 I-IX	.	.
Reg. employees in industry, th pers., avg. [4)]	3932.0	3445.0	3811.0	3578.1	3416.0	3408.3	3411.7	.	.
annual change in %	-5.1	-12.4	-6.2	-6.1	-4.5	-0.2	0.1	.	.
LFS - unemployed, th pers., average [2)]	2698.8	2655.8	2455.0	2140.7	2008.0	1906.7	1780	.	.
LFS - unemployment rate in %, average [2)]	11.9	11.6	10.9	9.6	9.1	8.6	8	8	8
Reg. unemployment rate in %, end of period	4.3	4.2	3.7	3.8	3.6	3.5	3.1	3	3
Average gross monthly wages, UAH [4)]	177.5	230.1	311.1	376.4	462.3	589.6	806.2	.	.
annual change in % (real, gross)	-5.4	1.1	20.7	20.0	16.7	17.0	20.4	.	.
Consumer prices, % p.a.	22.7	28.2	12.0	0.8	5.2	9.0	13.5	10	9
Producer prices in industry, % p.a.	31.1	20.9	8.6	3.1	7.8	20.4	16.8	8	7
General governm.budget, nat.def., % GDP									
Revenues	25.2	28.9	26.9	27.4	28.2	26.5	33.4	.	.
Expenditures [5)]	26.7	28.3	27.2	26.7	28.4	29.7	35.4	.	.
Deficit (-) / surplus (+), % GDP	-1.5	0.6	-0.3	0.7	-0.2	-3.2	-1.9	-2.5 [6)]	.
Public debt in % of GDP	61.0	45.3	36.5	33.5	29.0	24.7	19.5	.	.
Refinancing rate of NB % p.a., end of period	45.0	27.0	12.5	7.0	7.0	9.0	9.5	.	.
Current account, EUR mn [7)]	1559	1602	1565	3360	2559	5476	2000	500	-500
Current account in % of GDP	5.2	4.7	3.7	7.5	5.8	10.5	3.2	0.6	-0.6
Gross reserves of NB excl. gold, EUR mn [8)]	1042	1453	3353	4088	5386	6838	16168	.	.
Gross external debt, EUR mn [9)]	13456	12759	13785	12247	19055	22529	30557 IX	.	.
FDI inflow, EUR mn [7)]	466	644	884	734	1261	1380	6000	.	.
FDI outflow, EUR mn [7)]	7	1	26	-5	12	3	195 I-IX	.	.
Exports of goods, BOP, EUR mn [7)]	12400	17008	19074	19770	21013	26906	28500	29900	31400
annual growth rate in %	2.3	37.2	12.1	3.6	6.3	28.0	6	5	5
Imports of goods, BOP, EUR mn [7)]	12170	16165	18853	19018	20555	23895	29500	34000	37400
annual growth rate in %	-15.6	32.8	16.6	0.9	8.1	16.3	23	15	10
Exports of services, BOP, EUR mn [7)]	3637	4111	4459	4958	4615	5060	5300	6500	7000
annual growth rate in %	4.8	13.0	8.5	11.2	-6.9	9.6	5	23	8
Imports of services, BOP, EUR mn [7)]	2155	3433	3995	3743	3934	4149	4400	4500	4700
annual growth rate in %	-4.3	59.3	16.4	-6.3	5.1	5.5	6	2	4
Average exchange rate UAH/USD	4.130	5.440	5.372	5.327	5.333	5.319	5.125	5	5
Average exchange rate UAH/EUR (ECU)	4.393	5.029	4.814	5.030	6.024	6.609	6.389	6	6
Purchasing power parity UAH/USD, wiiw	0.705	0.849	0.912	0.943	1.000	1.127	1.246	.	.
Purchasing power parity UAH/EUR, wiiw	0.768	0.917	0.988	1.014	1.093	1.230	1.371	.	.

Notes: 1) Preliminary. - 2) From 2000 revised data according to census 2001. - 3) In 2000 unrevised data. - 4) Excluding small enterprises. - 5) From 2004 including lending minus repayments. - 6) Central budget deficit passed by Parliament end December 2005. - 7) Converted from USD . - 8) Useable. - 9) Up to 2002 long-term debt only.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

of big assets to commercial structures close to President Yushchenko. However, the government's earlier UAH 24.2 billion receipts from the Kryvorizhstal' deal should be sufficient to cover the bulk of the 2006 budget deficit – even after subtracting the UAH 4.2 billion compensation to the former Kryvorizhstal' owners, the sum allocated to bridge the gap of the Pension Fund, and money used to finance the 2005 budget deficit. Besides, the Kryvorizhstal' deal alone was responsible for a 30% surge in the foreign exchange reserves of the National Bank, which reached some EUR 16.2 billion by the end of the year.

On 10 January 2006, the government of Yuri Yekhanurov, in office only since September 2005, was sacked by the Verkhovna Rada in the aftermath of the widely criticized gas agreement with Russia. In particular, the opposition claimed that the terms of the agreement signed on 4 January ran against the country's national interests by envisaging a rise in the price of imported natural gas. Meanwhile, the agreement as it stands will hardly pose a big shock to the country's economy: the price of USD 95 per thousand cubic metres of gas agreed for the first half of 2006 is only 30% higher than the effective price paid by Ukraine to Russia before (taking into account the simultaneous upward revision of the transit fees for Russian gas destined for Europe), and stands at less than half of the 'world market' price. At the same time, many of the contract provisions are confusing: the above price seems to apply to only a limited import volume, the price for the second half of 2006 (and thereafter) has not been set, and the envisaged role of RosUkrEnergo – a Swiss-based offshore company – as the sole importer of natural gas into Ukraine is controversial.[40]

The gas agreement with Russia has been a pretext rather than the real reason behind the Rada's decision to sack the government. More generally, the move reflects the rising self-confidence of Viktor Yanukovych – whose 'Party of Regions' had supported the nomination of Mr Yekhanurov as prime-minister in September 2005, but whose popular rating has grown markedly in the meantime – but also the broad disillusionment of Ukrainian society with the new power elite, not least as a result of the earlier split between Mr Yushchenko and Ms Tymoshenko. It is also to be viewed against the background of the upcoming parliamentary elections scheduled for 26 March 2006, and the constitutional amendments taking effect this year. According to these amendments, Ukraine is converted from a presidential-parliamentary into a parliamentary-presidential republic, whereby the government is essentially formed by a parliamentary coalition – however, not until the March elections. Therefore, the current (Yekhanurov) government will most likely remain in office until the elections. However, in political terms, the Rada's decision has been a setback for Mr Yushchenko and his 'Our Ukraine' party, and will make it more difficult for them to find political allies in the newly elected parliament. Therefore, both the future parliament and the future government will be more powerful and will probably find themselves in opposition to the current president – prompting the latter to try to revert the constitutional reform, e.g. by holding a nation-wide referendum. However, in the present circumstances, such a referendum appears hardly realistic.

[40] For details of the gas agreement, see V. Astrov, 'The Ukrainian-Russian 'gas deal': a question mark', *The Vienna Institute Monthly Report*, No. 2, February 2006, pp. 2-3.

Waltraut Urban

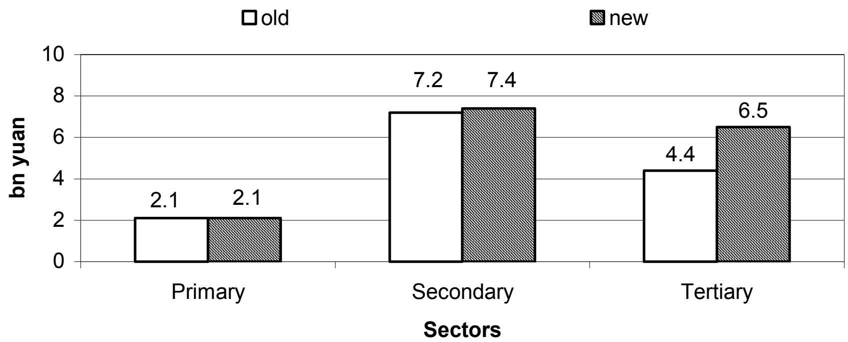
China: economy on a fast track

In 2005, the Chinese GDP rose at a rate of 9.9% – only marginally lower than in 2004, yet faster than generally expected. Investment increased by 26%, slightly less than the year before, and growth of private consumption accelerated moderately. The foreign trade surplus tripled as compared to 2004, reaching USD 103 billion. For 2006 we expect slightly slower growth (9.7%), and probably some further deceleration in 2007.

In December last year, China was in the headlines because of a substantial revision of its GDP data for 2004. According to the first nationwide economic census, the 2004 GDP was yuan (CNY) 2300 billion (or 16.8%) higher than earlier estimated. However, 93% of this amount was due to a significant revision of output of the service sector, which was revised upwards by CNY 2096 billion. Services account for 40.7% of GDP (as against the earlier estimate of 31.9%). Accordingly, the shares of the industrial sector and the primary sector were revised downwards (see Figure 1), which gives a sectoral structure more in line with other economies at a similar stage of economic development.

Figure CN

Sector shares in Chinese GDP 2004, old and new



Sources: China Statistical Yearbook 2005, Table 3-1 and press release of the Chinese National Bureau of Statistics, 20 December 2005.

Another important result of the census is the lower than estimated share of fixed asset investment in GDP (44% instead of 51%) and thus probably a relatively larger contribution of consumer demand to the overall growth of the economy. As consumption is typically fluctuating less than investment, the development of the Chinese economy is now considered more stable than before. Given the higher level of GDP in 2004 and the fast growth rate in 2005, the size of the Chinese economy (at current exchange rates) has surpassed that of France and most probably that of the United Kingdom as well, ranking fourth in the world now, after the USA, Japan and Germany.

The statistical deficiencies brought to light by the recent census have obviously cumulated over many years because of inadequate coverage of the service sector. A provisional revision of GDP data back to 1992, when the last census of services took place, has been released recently showing annual growth rates about 0.5 percentage points higher than originally assumed. These growth rates are indicated in *italics* in the table on 'Selected Economic Indicators' below, but absolute values, single components as far as available and shares in GDP were adjusted for 2004 only. The National

Bureau of Statistics has also made an upward revision of the quarterly growth rates for GDP in 2005, arriving at 9.8% for the first three quarters and 10.1% for the fourth quarter. We thus can observe a certain acceleration of economic activity in the last quarter of the year related to higher investment in fixed assets and a surge in the foreign trade surplus.

On average, the growth of fixed assets investment reached 25.7% (in nominal terms) in 2005, showing the limited impact of various government measures to curb investment. However, investment grows faster in sectors whose output is in short supply (e.g. coal mining, supply of electricity, gas and water, railways, accommodation and catering trade, trade) and more slowly in sectors with excess capacities. Within manufacturing, the metal industry topped the list (except smelting and processing of ferrous metals, suffering from over-capacities already), followed by the leather and furniture industry. But investment growth in the transport equipment industry remained significantly above average as well, despite government measures to restrict investment. Real estate investment, also targeted by various restrictive measures such as credit restrictions and the implementation of a special 'business tax', rose below average in the first 11 months of 2005 (22.2%) but showed signs of acceleration at the end of the year. For 2006 we expect investment to remain strong but to expand at a somewhat lower rate than in 2005, probably at 22%, because of foreseeable over-capacities in several sectors of the economy, for instance in clothing & textiles, leather, and certain chemicals, as indicated by falling domestic prices.

Foreign direct investment inflows remained high, reaching USD 60.3 billion, nearly the same amount as the year before. FDI in service industries, particularly in financial services (banking), is gaining importance. This has to be seen in the context of the envisaged opening-up of the financial sector as of the beginning of 2007, according to China's commitments to the World Trade Organization (WTO). To mention a few examples: The Australia & New Zealand Banking Group (ANZ) has recently bought a 19.9% stake in Tianjin City Commercial Bank; the Royal Bank of Scotland (RBS), leading a consortium that included investment banker Merrill Lynch and Hong Kong billionaire Li Ka-shing, acquired a 10% stake in the Bank of China, the second biggest Chinese bank; Standard Chartered Bank acquired a share of 19.99% of Bohai Bank; and HBSC took 19.99% of the Bank of Communications.

Data on aggregate private consumption are not available yet, but retail trade turnover, which may be used as a proxy for consumer demand, expanded at a rate of 12% (in real terms), faster than in 2004 (10.5%). However, household savings rose at a similar rate, bringing the savings amount up to CNY 14.1 trillion (USD 1.7 trillion), equivalent to 77% of GDP.

The gap between urban and rural incomes widened further despite various government measures to support the rural population. Urban per capita incomes reached CNY 874 and rural per capita incomes came up to 271 per month. Probably a more significant positive impact on consumption may be expected from nearly doubling the personal income threshold for taxation from CNY 800 to CNY 1500 (USD 183) a month and a significant rise in public sector salaries. We thus expect private consumption in 2006 to remain strong and growth to even accelerate slightly.

However, fiscal policy will be somewhat less expansive in 2006 than in the years before, with a planned reduction of the budget deficit by CNY 5 billion. Also, the amount of 'special' government bonds, introduced during the Asian financial and economic crisis, will be further reduced to CNY 60 billion in 2006, after issuing CNY 80 billion in 2005.

Table CN

China: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 [1)]		2006	2007
									forecast	
Population, mn pers., end of period [2)]	1257.9	1267.4	1276.3	1284.5	1292.3	1299.9	1307.7		.	.
Gross domestic product, CNY bn, nom. [3)]	8206.8	8946.8	9731.48	10517.2	11739.0	15987.8	18232.1		20400	22700
annual change in % (real) [3)]	7.1	8.0	7.5	8.3	9.5	9.5	9.9		9.7	9.5
annual change in % (real) - revised	*7.6*	*8.4*	*8.3*	*9.1*	*10.0*	*10.1*	.		.	.
GDP/capita (USD at exchange rate) [3)]	788	853	921	989	1098	1486	1699		.	.
GDP/capita (USD at PPP - wiiw) [3)]	3709	4063	4441	4860	5385	6992	7926		.	.
Industrial value added [4)]										
annual change in % (real)	8.8	9.9	8.9	9.9	12.5	11.1	11.4		11	.
Agricultural value added										
annual change in % (real)	2.8	2.4	2.5	2.9	2.5	6.0	5.2		.	.
Retail trade turnover, CNY bn	3113.4	3415.3	3759.5	4191.1	4572.5	5395.0	6717.0		.	.
annual change in % (real)	10.1	11.1	10.9	10.6	9.2	10.5	12.0		.	.
Total investment in fixed assets, CNY bn	2985.5	3291.8	3689.8	4283.9	5427.6	7007.3	8860.0		.	.
annual change in % (nominal)	5.1	10.3	12.1	16.1	26.7	26.6	25.7		.	.
Employment total, mn pers., end of period	713.9	720.9	730.3	737.4	744.3	752.0	.		.	.
annual change in %	0.9	1.0	1.3	1.0	0.9	1.0	.		.	.
Staff and workers, mn pers., end of period [5)]	117.7	112.6	107.9	105.6	104.6	105.8	105.6	I-IX	.	.
annual change in %	-4.6	-4.3	-4.2	-2.2	-0.7	0.8	1.0	I-IX	.	.
Unemployment rate (urban) in %, end of per. [6)]	3.1	3.1	3.6	4.0	4.5	4.2	4.2		4.5	4.5
Average gross annual wages, CNY [7)]	8346	9371	10870	12422	14040	16024	16398.4	I-IX	.	.
annual change in % (real) [8)]	13.1	11.1	15.2	15.5	12.0	10.5	.		.	.
Retail prices, % p.a.	-3.0	-1.5	-0.8	-1.8	-0.1	2.8	0.8		.	.
Consumer prices, % p.a.	-1.4	0.4	0.7	-0.8	1.2	3.9	1.8		2.0	1.8
General government budget, nat.def., % GDP										
Revenues	13.9	15.0	16.8	18.0	18.5	16.5	.		.	.
Expenditures	16.1	17.8	19.4	21.0	21.0	17.8	.		.	.
Deficit (-) / surplus (+), % GDP	-2.1	-2.8	-2.5	-3.0	-2.5	-1.3	-1.6		-1.4	.
Refinancing rate of NB % p.a., end of per. [9)]	3.2	3.2	3.2	2.7	2.7	2.9	2.9		.	.
Current account, USD bn	15.7	20.5	17.4	35.4	45.9	70.0	110.0		100	80
Current account in % of GDP	1.6	1.9	1.5	2.8	3.2	3.6	5.0		3.8	2.6
Gross reserves of NB excl. gold, USD bn	154.7	165.6	212.2	286.4	403.3	609.9	818.9		.	.
Gross external debt, USD bn	151.8	145.7	170.1	171.7	194.0	223.0	267.5	I-IX	.	.
FDI inflow, gross, USD bn	40.3	40.7	46.9	52.8	53.3	60.6	60.3		.	.
FDI outflow, gross, USD bn	2.4	2.2	7.1	2.8	1.8	2.1	6.9		.	.
Exports of goods total, USD bn [10)]	194.9	249.2	266.2	325.6	438.4	593.4	762.0		960	.
annual change in %	6.1	27.8	6.8	22.3	34.6	35.4	28.4		26	.
Imports of goods total, USD bn [10)]	165.8	225.1	243.6	295.3	412.8	561.3	660.1		845	.
annual change in %	18.2	35.8	8.2	21.2	39.9	36.0	17.6		28	.
Trade balance of goods, USD bn [10)]	29.1	24.1	22.6	30.3	25.5	32.1	101.9		115	.
Average exchange rate CNY/USD	8.278	8.278	8.277	8.277	8.277	8.277	8.206		7.8	7.5
Average exchange rate CNY/EUR	8.892	7.648	7.347	7.753	9.366	11.276	10.261		.	.
Purchasing power parity CNY/USD, wiiw [11)]	1.759	1.737	1.717	1.685	1.687	1.759	1.759		.	.
Purchasing power parity CNY/EUR, wiiw	2.012	1.975	1.967	1.951	1.977	2.058	2.115		.	.

Note: CNY: ISO-Code for the Chinese yuan.

1) Preliminary. - 2) From 2000 according to census November 2000. - 3) In 2004 data for GDP and GDP per capita revised according to the national census 2005. - 4) Including construction. - 5) Staff and workers (on duty) refer to persons who work in state-owned enterprises, urban collectives, share holding ownership and foreign invested enterprises. - 6) Ratio of registered urban unemployed in per cent of urban employed and unemployed. - 7) 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. - 8) Staff and workers cost of living index is used as deflator for calculating real wage. - 9) Overnight rate. - 10) According to customs statistics. - 11) 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.

Consumer price inflation came down significantly, from nearly 4% in 2004 to below 2% in 2005. Yet producer prices continued to rise by about 5%, due to rising costs for many inputs, putting a strain on profits. We thus expect consumer price inflation to go up again in 2006, also because of rising food prices and planned hikes in administered prices (e.g. water, electricity). In fact, the CPI, after remaining very low in September-November last year, displayed a certain acceleration in December.

The spectacular tripling of China's trade surplus is a consequence of low import growth rather than of fast export growth. Exports increased by 28.4%, compared to 35.4% in 2004, but imports rose by 17.6% only, after a 36% rise in 2004. This may reflect increasing import substitution, particularly in the field of intermediate inputs. The steel industry, for instance, became a net exporter in 2005, after having been the largest importer of steel in 2004. Also, imports of unwrought aluminium and aluminium products, paper & paperboard, yarn of synthetic fibres, and all kinds of woven fabrics declined in absolute terms. But also at higher stages in the production chain, such as in the production of automotive parts and electronic components, local suppliers are increasingly substituting imports and at the same time pushing exports because of improved quality. Import substitution is often due to foreign direct investments as their foreign suppliers follow the important customers to China, to save costs, but also for reasons of logistics ('just in time' delivery). A good example is the Austrian company AT&S, producing HDI-Microvia printed circuit boards for mobile phones, which has followed its major customer, Nokia, to China. There was also a significant decline in imports and a substantial increase in exports of grain and cereal products, because of very good crops over the past two years.[41]

Export growth, although lower than the year before, was still impressive and caused frictions with China's major trading partners, the EU and the USA, in certain fields such as clothing and shoes. However, in both product categories, total Chinese exports do not seem to have grown excessively. Growth was heavily concentrated on exports of a few important product groups. In the case of clothing, this was a consequence of the phasing-out of the 'Agreement on textiles and clothing' (ATC), leading to an abolishment of all quotas in textile and clothing trade among WTO members by the end of 2004. With regard to shoes, a bilateral quota agreement between the European Union and China ended in 2004 as well. Faced with a flood of Chinese clothing, the EU and the USA responded with special safeguard measures provided in China's accession treaty to WTO, to contain imports. Finally, in July, an agreement between China and the EU was reached, to restrict the import growth of ten important product categories until the end of 2007.[42] In November, after arduous negotiations, a similar agreement was reached with the USA, covering 21 product groups and extending until the end of 2008. In the case of shoes, the EU has opened an anti-dumping procedure according to WTO regulations and is considering new import quotas as well.

In 2006, with the Chinese economy already on a fast track, one may expect imports to rise somewhat faster than in 2005, probably at a rate of 28%. Export growth may be slightly slower, perhaps at 26%, under the assumptions that the world economy remains in good shape and taking into account several trade restrictions in place and a certain 'creeping' revaluation of the Chinese

[41] During the past two years, grain production increased by 50 million tons, reaching 484 million tons in 2005.

[42] This agreement was then adjusted in September to solve the problem of blocked deliveries of goods ordered before the agreement already.

currency throughout the year as well.[43] However, this would again result in a high trade surplus of USD 115 billion for 2006 and a large current account surplus as well, which is likely to further provoke negative reactions and repercussions on the part of China's trading partners.

China's exploding trade surplus and the corresponding high and rising trade deficits of the USA and the EU with China have increased the pressure on the Chinese authorities, especially from the US side, to allow a revaluation of the yuan by making its exchange rate system more flexible.[44] In a first step, in July 2005, the long-standing dollar peg was abandoned and China shifted to a managed float with reference to a basket of currencies, allowing daily fluctuations of ± 0.3% against the central parity defined in US dollars and ± 1.5% against other important currencies such as the euro, yen etc. (this band was then further extended to ± 3% in September 2005). The new exchange rate, set on 21 July 2005, was CNY 8.110 per USD, down from CNY 8.277 per USD, corresponding to a 2.1% revaluation versus the US dollar. The composition of the currency basket was not revealed in detail, but was said to comprise the currencies of China's major trading partners such as the US dollar, the euro, the yen, the Korean won etc. In order to bring the exchange rate closer to a market rate, 13 big banks were selected as 'market-makers' by the Chinese central bank at the end of the year, and were allowed to trade the yuan directly with each other, starting on 4 January 2006. The central bank will then guide its daily fixing by the rate determined in the interbank trading the day before. On 22 January 2006, the yuan stood at 8.0648 per USD, reflecting a slight revaluation compared to the new rate fixed in July 2005. We expect a further 'creeping' revaluation of the Chinese currency, giving an average exchange rate of around CNY 7.8 per USD for 2006 – which will be of little help in containing the Chinese trade surplus.

The ongoing reforms of the exchange rate system have lowered the speculations of a sudden, sharp revaluation of the yuan: the corresponding speculative inflows of foreign currency seem to have stopped in the second half of 2005. Nevertheless, the foreign currency reserves of the Chinese central bank have ballooned – due to the large trade surplus and continuous FDI inflows. They stood at USD 819 billion by the end of 2005, only second to Japan's (USD 828 billion). As a consequence, the efficient use of China's currency reserves has come up for discussion, raising fears that a sudden restructuring of the reserves from either USD to other currencies or from US treasury bonds to other investment forms may shake the global financial system. So far the Chinese government has been trying to slow down the accumulation of foreign reserves and to use them more productively – by relaxing foreign exchange controls and by promoting outward investment. The ceiling on the amount of foreign currency that can be held by Chinese companies has been raised and private individuals may now buy larger amounts of foreign currency for foreign travel purposes. Portfolio investments abroad are permitted now, e.g. for Chinese insurance companies, and increasing amounts of money may be transferred abroad for direct investments.

---

[43] In January 2006, China cut tariffs on more than 100 categories of products, including cars and automotive spare parts as well as certain food products and chemicals, in line with its WTO commitments. But as China had implemented most WTO tariff reduction commitments already before, that step will have no significant effect on the overall trade development. (The average tariff rate is 9.9% now.)

[44] The bilateral trade deficit of the USA with China is likely to top USD 200 billion in 2005, according to US sources (*International Herald Tribune*, 17 January 2006); according to Chinese statistics, the country's trade surplus with the USA was only USD 114 billion. The difference may partly be explained by Chinese exports via Hong Kong and different pricing methods applied (CIF versus FOB) by US and Chinese customs statistics – but a certain difference that cannot be explained remains.

Apart from the efficient use of foreign currency, the 'go-abroad' policy of the Chinese government, promoting outward investment, aims at securing raw materials (oil!), technology transfers and access to established brands and distribution channels as well as to international knowledge networks.[45] It is also part of a more long-term strategy of the Chinese government to build up a number of big Chinese transnational companies, supporting China's role as an emerging global economic power. In 2005, (gross) outward investment jumped to USD 6.9 billion, although mainly as a consequence of China Petroleum Corporation's purchase of PetroKazakstan (worth USD 4.18 billion) and full payment of the Lenovo-IBM deal of 2004 (worth USD 1.75 billion) in 2005.

On the supply side of the economy, provisional data show an increase of 11.4% of industrial value-added (including construction), nearly the same as the year before. The services sector value-added expanded by 9.6%, similar to 2004, taking the revisions of the census into account (10%). The primary sector grew by 5.2%, more vigorous than in past, due to advances in agro-technology mainly, but still somewhat less than in 2004 when a bumper crop inflated output.

Summarizing, the Chinese economy is expected to stay on its fast track but to decelerate slightly, reaching a GDP growth rate of 9.7% in 2006 and 9.5% in 2007.

In 2006, the growth of investment will somewhat decline due to government restrictions and over-capacities in certain sectors, but private consumption may grow slightly faster because of rising disposable incomes; fiscal policy will be less expansive than in the previous years. The trade surplus will remain high in view of the robust state of the world economy, but will decrease to a certain extent because of export growth decelerating and import growth picking up. Inflation will stay moderate but may accelerate to some degree because of planned hikes in administered prices. On the production side, primary production will expand at a similar pace as last year thanks to continuous modernization of Chinese agriculture. Industry growth may slow down in certain sectors because of less demand for investment goods and an oversupply in many consumer goods as well as restrictions put on particular exports (clothing, shoes, etc.). The services sector can be expected to expand faster due to rising consumer demand and also in light of a further opening-up of the sector, in line with China's commitment to WTO and an increasing inflow of FDI (e.g. banks, retail trade) in this field. In 2007, investment growth is expected to slightly decelerate further.

It should be mentioned, however, that for statistical reasons but also in view of the current Chinese government's policy to emphasize qualitative instead of quantitative growth, the official figures may represent the lower boundary of the actual economic development.

[45] For details see W. Urban, 'Chinese direct investment abroad: economic and political objectives', *The Vienna Institute Monthly Report*, No. 1, 2006, pp. 4-7.

Appendix

Selected Indicators of Competitiveness

Table A/1

GDP per capita at current PPPs (EUR), from 2005 at constant PPPs

	1991	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008	2010	2015
									projection assuming 4% p.a. GDP growth and zero population growth p.a.				
Czech Republic	9149	9973	12811	13512	14281	14741	15923	16837	17595	18422	19158	20722	25211
Hungary	7289	7467	10548	11636	12506	12889	13621	14493	15102	15706	16334	17667	21495
Poland	4493	6121	9404	9604	9975	10209	11060	11550	11988	12492	12992	14052	17096
Slovak Republic	6028	6774	9469	10039	10862	11186	11746	12630	13388	14258	14828	16038	19513
Slovenia	9523	9706	14642	15403	16038	16514	17925	18895	19632	20398	21214	22945	27916
Estonia	5885	5209	8262	8816	9717	10500	11662	12901	13830	14854	15448	16708	20328
Latvia	6219	4100	7022	7656	8234	8773	9591	10701	11525	12343	12837	13884	16892
Lithuania	8172	5032	7618	8366	9015	9840	10835	11854	12589	13319	13852	14982	18228
Cyprus	10908	12538	16262	17258	17662	17417	18846	19704	20492	21353	22207	24019	29223
Malta	9396	11371	15261	15088	15553	15527	15661	15979	16091	16268	16918	18299	22263
Bulgaria	4764	4746	5330	5839	6089	6465	6876	7486	7883	8277	8608	9310	11327
Croatia	5929	5640	8119	8631	9282	9714	10323	11002	11409	11843	12317	13322	16208
Romania	4097	4628	5013	5458	6057	6280	7069	7444	7779	8129	8454	9144	11125
Turkey	4206	4584	5999	5347	5620	5767	6459	6811	6947	7086	7228	7520	8303
Albania	1516	2477	3535	3824	3934	4161	4487	4708	4967	5265	5476	5922	7206
Bosnia & Herzeg.	.	.	4882	5147	5351	5502	5775	6141	6509	6900	7176	7762	9443
Macedonia	4343	4054	5160	5003	5211	5348	5681	5980	6219	6468	6727	7275	8852
Serbia	.	.	4292	4556	5013	5139	5738	6210	6458	6717	6985	7555	9192
Montenegro	.	.	4796	4836	5032	5135	5458	5785	6074	6378	6633	7174	8728
Russia	8112	5688	6022	6491	7008	7503	8263	8997	9555	10128	10533	11393	13861
Ukraine	5787	3276	3771	4244	4621	5116	5906	6208	6518	6909	7186	7772	9456
									projection assuming 2% p.a. GDP growth and zero population growth p.a.				
Germany	17589	18529	22501	22927	23390	23556	24608	25266	25771	26287	26813	27896	30799
Greece	10822	10911	14332	15115	16485	17466	18444	19359	19746	20141	20544	21374	23599
Spain	12465	13464	18562	19411	20486	21162	22098	22887	23345	23812	24288	25269	27899
Austria	18378	19536	25285	25447	25817	26266	27773	28564	29135	29718	30312	31537	34819
Portugal	10527	11649	16178	16626	17055	15769	16326	16574	16905	17243	17588	18299	20203
USA	21389	23199	30608	30946	31313	32146	34094	35578	36290	37016	37756	39281	43370
EU(15) average	15869	17020	22025	22755	23433	23599	24498	25164	25667	26180	26704	27783	30674
EU(25) average	14213	15327	20063	20760	21430	21636	22544	23226	23743	24273	24814	25933	28957

European Union (25) average = 100

	1991	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008	2010	2015
Czech Republic	64	69	64	65	67	68	71	72	74	76	77	80	87
Hungary	51	49	53	56	58	60	60	62	64	65	66	68	74
Poland	32	40	47	46	47	47	49	50	50	51	52	54	59
Slovak Republic	42	44	47	48	51	52	52	54	56	59	60	62	67
Slovenia	67	68	73	74	75	76	80	81	83	84	85	88	96
Estonia	41	34	41	42	45	49	52	56	58	61	62	64	70
Latvia	44	27	35	37	38	41	43	46	49	51	52	54	58
Lithuania	57	33	38	40	42	45	48	51	53	55	56	58	63
Cyprus	77	82	81	83	82	81	84	85	86	88	89	93	101
Malta	66	74	76	73	73	72	69	69	68	67	68	71	77
Bulgaria	34	31	27	28	28	30	30	32	33	34	35	36	39
Croatia	42	37	40	42	43	45	46	47	48	49	50	51	56
Romania	29	30	25	26	28	29	31	32	33	33	34	35	38
Turkey	30	30	30	26	26	27	29	29	29	29	29	29	29
Albania	11	16	18	18	18	19	20	20	21	22	22	23	25
Bosnia & Herzeg.	.	.	24	25	25	25	26	26	27	28	29	30	33
Macedonia	31	26	26	24	24	25	25	26	26	27	27	28	31
Serbia	.	.	21	22	23	24	25	27	27	28	28	29	32
Montenegro	.	.	24	23	23	24	24	25	26	26	27	28	30
Russia	57	37	30	31	33	35	37	39	40	42	42	44	48
Ukraine	41	21	19	20	22	24	26	27	27	28	29	30	33
Germany	124	121	112	110	109	109	109	109	109	108	108	108	106
Greece	76	71	71	73	77	81	82	83	83	83	83	82	81
Spain	88	88	93	94	96	98	98	99	98	98	98	97	96
Austria	129	127	126	123	120	121	123	123	123	122	122	122	120
Portugal	74	76	81	80	80	73	72	71	71	71	71	71	70
USA	150	151	153	149	146	149	151	153	153	152	152	151	150
EU(15) average	112	111	110	110	109	109	109	108	108	108	108	107	106
EU(25) average	100	100	100	100	100	100	100	100	100	100	100	100	100

Sources: National statistics, Eurostat, wiiw estimates.

Table A/2

Indicators of macro-competitiveness, 1998-2005

EUR-based, annual averages

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.
Czech Republic								
Producer price index, 2000=100	94.4	95.3	100.0	102.8	102.3	101.9	107.7	110.9
Consumer price index, 2000=100	94.3	96.2	100.0	104.7	106.6	106.7	109.7	111.8
GDP deflator, 2000=100	95.9	98.6	100.0	104.9	107.8	110.6	114.4	116.5
Exchange rate (ER), CZK/EUR	36.16	36.88	35.61	34.08	30.81	31.84	31.90	29.78
ER nominal, 2000=100	101.6	103.6	100.0	95.7	86.5	89.4	89.6	83.6
Real ER (CPI-based), 2000=100	104.5	105.6	100.0	93.4	84.7	89.2	88.8	83.1
Real ER (PPI-based), 2000=100	103.8	104.2	100.0	94.2	85.1	88.8	86.1	81.7
PPP, CZK/EUR	16.27	16.29	16.34	16.76	16.58	16.99	17.03	17.18
Price level, EU(25)=100	45	44	46	49	54	53	53	58
Average monthly gross wages, CZK	11801	12797	13614	14793	15866	16917	18035	19100
Average monthly gross wages, EUR (ER)	326	347	382	434	515	531	565	641
Average monthly gross wages, EUR (PPP)	725	786	833	883	957	995	1059	1112
GDP nominal, bn CZK	1962.5	2041.4	2150.1	2315.3	2414.7	2555.8	2767.7	2960
Employed persons - LFS, th., average	4865.7	4764.1	4731.6	4750.2	4764.9	4733.2	4706.6	4760
GDP per employed person, CZK	403330	428487	454404	487402	506762	539975	588050	621849
GDP per empl. person, CZK at 2000 pr.	420431	434473	454404	464622	469913	488009	513993	533924
Unit labour costs, 2000=100	93.7	98.3	100.0	106.3	112.7	115.7	117.1	119.4
Unit labour costs, ER adj., 2000=100	92.3	94.9	100.0	111.0	130.2	129.4	130.7	142.8
Unit labour costs, PPP adj., Austria=100	29.32	29.86	31.59	34.57	39.49	38.71	39.77	42.77
Hungary								
Producer price index, 2000=100	85.3	89.6	100.0	105.2	103.3	105.8	109.5	114.2
Consumer price index, 2000=100	82.8	91.1	100.0	109.2	115.0	120.4	128.6	133.2
GDP deflator, 2000=100	84.1	91.1	100.0	108.3	117.7	125.5	131.2	135.7
Exchange rate (ER), HUF/EUR	240.98	252.80	260.04	256.68	242.97	253.51	251.68	248.05
ER, nominal 2000=100	92.7	97.2	100.0	98.7	93.4	97.5	96.8	95.4
Real ER (CPI-based), 2000=100	108.5	104.8	100.0	92.4	84.8	86.2	81.8	79.5
Real ER (PPI-based), 2000=100	104.9	104.0	100.0	94.9	91.0	93.2	91.5	90.5
PPP, HUF/EUR	108.15	114.24	122.11	126.46	133.14	142.85	148.28	150.59
Price level, EU(25)=100	45	45	47	49	55	56	59	61
Average monthly gross wages, HUF	67764	77187	87645	103553	122482	137193	145521	158600
Average monthly gross wages, EUR (ER)	281	305	337	403	504	541	578	639
Average monthly gross wages, EUR (PPP)	627	676	718	819	920	960	981	1053
GDP nominal, bn HUF	10087.4	11393.5	13150.8	14989.8	16915.3	18650.8	20413.5	22000.0
Employed persons - LFS, th., average [1]	3674.7	3809.3	3856.2	3868.3	3870.6	3921.9	3900.4	3901.5
GDP per employed person, HUF	2745104	2990969	3410291	3875036	4370191	4755549	5233688	5638857
GDP per empl. person, HUF at 2000 pr.	3265774	3281843	3410291	3579547	3713967	3789821	3987819	4154049
Unit labour costs, 2000=100	80.7	91.5	100.0	112.6	128.3	140.9	142.0	148.6
Unit labour costs, ER adj., 2000=100	87.1	94.1	100.0	114.0	137.3	144.5	146.7	155.7
Unit labour costs, PPP adj., Austria=100	24.31	26.00	27.74	31.17	36.55	37.95	39.18	40.96
Poland								
Producer price index, 2000=100	87.8	92.8	100.0	101.6	102.6	105.3	112.7	113.4
Consumer price index, 2000=100	84.6	90.8	100.0	105.5	107.5	108.4	112.2	114.5
GDP deflator, 2000=100	87.9	93.2	100.0	103.5	105.8	106.3	110.5	112.4
Exchange rate (ER), PLN/EUR	3.923	4.227	4.011	3.669	3.856	4.398	4.534	4.025
ER, nominal, 2000=100	97.8	105.4	100.0	91.5	96.1	109.6	113.0	100.4
Real ER (CPI-based), 2000=100	112.0	113.9	100.0	88.6	93.3	107.7	109.5	97.3
Real ER (PPI-based), 2000=100	107.5	108.9	100.0	91.1	94.2	105.3	103.9	95.8
PPP, PLN/EUR	1.931	1.995	2.070	2.121	2.118	2.160	2.184	2.195
Price level, EU(25)=100	49	47	52	58	55	49	48	55
Average monthly gross wages, PLN [2]	1233	1697	1894	2045	2098	2185	2273	2350
Average monthly gross wages, EUR (ER)	314	401	472	557	544	497	501	584
Average monthly gross wages, EUR (PPP)	639	851	915	964	990	1012	1041	1070
GDP nominal, bn PLN	600.9	666.3	744.6	779.2	807.9	842.1	922.2	967.7
Employed persons - LFS, th., average [3]	15354	14757	14526	14207	13782	13617	13795	14200
GDP per employed person, PLN	39137	45152	51261	54847	58617	61844	66848	68148
GDP per empl. person, PLN at 2000 pr.	44540	48426	51261	52987	55385	58189	60483	60638
Unit labour costs, 2000=100	74.9	94.9	100.0	104.5	102.5	101.6	101.7	104.9
Unit labour costs, ER adj., 2000=100	76.6	90.0	100.0	114.2	106.7	92.7	90.0	104.5
Unit labour costs, PPP adj., Austria=100	33.76	39.28	43.81	49.32	44.84	38.46	37.97	43.43

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

(Table A/2 ctd.)

(Table A/2 ctd.)

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.
Slovak Republic								
Producer price index, 2000=100	86.5	90.2	100.0	106.5	108.7	117.8	121.8	127.3
Consumer price index, 2000=100	80.7	89.3	100.0	107.1	110.6	120.0	129.0	132.5
GDP deflator, 2000=100	86.5	92.2	100.0	104.2	108.4	113.5	118.6	122.0
Exchange rate (ER), SKK/EUR	39.60	44.12	42.59	43.31	42.70	41.49	40.05	38.59
ER, nominal, 2000=100	93.0	103.6	100.0	101.7	100.3	97.4	94.0	90.6
Real ER (CPI-based), 2000=100	111.7	113.9	100.0	97.0	94.6	86.4	79.2	75.9
Real ER (PPI-based), 2000=100	103.7	110.1	100.0	96.6	92.7	83.7	79.9	77.1
PPP, SKK/EUR	17.24	17.87	18.26	18.70	18.80	19.96	20.97	21.17
Price level, EU(25)=100	44	41	43	43	44	48	52	55
Average monthly gross wages, SKK	10003	10728	11430	12365	13511	14365	15825	17300
Average monthly gross wages, EUR (ER)	253	243	268	286	316	346	395	448
Average monthly gross wages, EUR (PPP)	580	600	626	661	719	720	755	817
GDP nominal, bn SKK	781.4	844.1	934.1	1009.8	1098.7	1201.2	1325.5	1440
Employed persons - LFS, th., average	2198.6	2132.1	2101.7	2123.7	2127.0	2164.6	2170.4	2210
GDP per employed person, SKK	355425	395905	444440	475509	516529	554927	610710	651584
GDP per empl. person, SKK at 2000 pr.	410675	429563	444440	456316	476645	489091	514843	534220
Unit labour costs, 2000=100	94.7	97.1	100.0	105.4	110.2	114.2	119.5	125.9
Unit labour costs, ER adj., 2000=100	101.9	93.7	100.0	103.6	109.9	117.2	127.1	139.0
Unit labour costs, PPP adj., Austria=100	25.97	23.66	25.35	25.88	26.74	28.14	31.02	33.41
Slovenia								
Producer price index, 2000=100	91.0	92.9	100.0	108.9	114.5	117.3	122.4	125.7
Consumer price index, 2000=100	86.5	91.8	100.0	108.4	116.5	123.1	127.5	130.7
GDP deflator, 2000=100	89.2	94.9	100.0	108.7	117.3	124.0	128.0	131.2
Exchange rate (ER), SIT/EUR	186.27	193.63	205.03	217.19	226.22	233.70	238.86	239.64
ER, nominal, 2000=100	90.8	94.4	100.0	105.9	110.3	114.0	116.5	116.9
Real ER (CPI-based), 2000=100	101.8	100.9	100.0	99.9	98.8	98.6	99.3	99.3
Real ER (PPI-based), 2000=100	96.3	97.4	100.0	98.4	97.0	98.3	98.6	100.7
PPP, SIT/EUR	137.39	142.35	147.57	156.42	167.32	176.31	174.64	175.87
Price level, EU(25)=100	74	74	72	72	74	75	73	73
Average monthly gross wages, SIT	158069	173245	191669	214561	235436	253200	284281	295652
Average monthly gross wages, EUR (ER)	849	895	935	988	1041	1083	1190	1234
Average monthly gross wages, EUR (PPP)	1151	1217	1299	1372	1407	1436	1628	1681
GDP nominal, bn SIT	3494.6	3919.0	4300.4	4799.6	5355.4	5813.5	6251.2	6650
Employed persons - LFS, th., average	901	886	901	916	910	897	943	950
GDP per employed person, SIT	3878579	4423221	4772863	5239686	5885099	6481093	6629103	7000000
GDP per empl. person, SIT at 2000 pr.	4349090	4662575	4772863	4819474	5018830	5226574	5178783	5336143
Unit labour costs, 2000=100	90.5	92.5	100.0	110.9	116.8	120.6	136.7	138.0
Unit labour costs, ER adj., 2000=100	99.6	98.0	100.0	104.7	105.9	105.8	117.3	118.0
Unit labour costs, PPP adj., Austria=100	66.57	64.82	66.43	68.51	67.49	66.57	75.05	74.36
Estonia								
Producer price index, 2000=100	96.5	95.3	100.0	104.4	104.8	105.0	108.1	110.3
Consumer price index, 2000=100	93.1	96.2	100.0	105.8	109.6	111.0	114.4	119.1
GDP deflator, 2000=100	90.8	94.9	100.0	105.6	110.2	112.5	115.9	121.4
Exchange rate (ER), EEK/EUR	15.783	15.647	15.647	15.647	15.647	15.647	15.647	15.647
ER, nominal, 2000=100	100.9	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2000=100	105.1	102.1	100.0	96.6	95.2	95.9	95.0	93.3
Real ER (PPI-based), 2000=100	100.9	100.6	100.0	96.9	95.9	96.3	95.8	98.2
PPP, EEK/EUR	7.981	8.122	8.214	8.686	8.856	8.958	8.992	9.255
Price level, EU(25)=100	51	52	52	56	57	57	57	59
Average monthly gross wages, EEK	4125	4440	4907	5510	6144	6723	7287	8020
Average monthly gross wages, EUR (ER)	261	284	314	352	393	430	466	513
Average monthly gross wages, EUR (PPP)	517	547	597	634	694	751	810	867
GDP nominal, bn EEK	78.0	81.8	92.9	104.5	116.9	127.3	141.5	160.6
Employed persons - LFS, th., average	606.5	579.3	572.5	577.7	585.5	594.3	595.5	610
GDP per employed person, EEK	128652	141163	162337	180819	199685	214258	237604	263279
GDP per empl. person, EEK at 2000 pr.	141642	148748	162337	171275	181232	190489	204953	216888
Unit labour costs, 2000=100	96.3	98.7	100.0	106.4	112.2	116.8	117.6	122.3
Unit labour costs, ER adj., 2000=100	95.5	98.7	100.0	106.4	112.2	116.8	117.6	122.3
Unit labour costs, PPP adj., Austria=100	35.04	35.87	36.47	38.25	39.25	40.32	41.31	42.31

(Table A/2 ctd.)

(Table A/2 ctd.)

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.
Latvia								
Producer price index, 2000=100	103.5	99.4	100.0	101.7	102.7	106.0	115.1	124.1
Consumer price index, 2000=100	95.2	97.5	100.0	102.5	104.4	107.5	114.1	121.8
GDP deflator, 2000=100	92.0	96.4	100.0	102.1	105.6	109.4	117.2	124.5
Exchange rate (ER), LVL/EUR	0.6614	0.6237	0.5600	0.5627	0.5826	0.6449	0.6711	0.7028
ER, nominal, 2000=100	118.1	111.4	100.0	100.5	104.0	115.2	119.8	125.5
Real ER (CPI-based), 2000=100	120.3	112.1	100.0	100.2	103.9	114.0	114.1	114.4
Real ER (PPI-based), 2000=100	110.0	107.4	100.0	99.9	101.9	109.9	107.7	109.5
PPP, LVL/EUR	0.2725	0.2781	0.2815	0.2866	0.2954	0.3097	0.3306	0.3451
Price level, EU(25)=100	41	45	50	51	51	48	49	49
Average monthly gross wages, LVL	133	141	150	159	173	192	211	240
Average monthly gross wages, EUR (ER)	202	226	267	283	297	298	314	341
Average monthly gross wages, EUR (PPP)	489	507	531	555	586	622	638	695
GDP nominal, bn LVL	3.903	4.224	4.686	5.168	5.689	6.318	7.333	8.498
Employed persons - LFS, th., average	986.1	968.5	941.1	962.1	989.0	1006.9	1017.7	1030
GDP per employed person, LVL	3958	4362	4979	5372	5753	6275	7205	8250
GDP per empl. person, LVL at 2000 pr.	4304	4526	4979	5260	5447	5736	6148	6627
Unit labour costs, 2000=100	103.1	103.7	100.0	100.6	105.8	111.7	114.3	120.6
Unit labour costs, ER adj., 2000=100	87.3	93.1	100.0	100.2	101.6	97.0	95.4	96.1
Unit labour costs, PPP adj., Austria=100	30.47	32.18	34.69	34.24	33.84	31.87	31.87	31.61
Lithuania								
Producer price index, 2000=100	84.8	86.2	100.0	97.0	94.3	93.8	99.4	110.9
Consumer price index, 2000=100	98.2	99.0	100.0	101.3	101.6	100.4	101.6	104.3
GDP deflator, 2000=100	99.6	99.0	100.0	99.5	99.7	98.6	101.4	104.7
Exchange rate (ER), LTL/EUR	4.4924	4.2712	3.6990	3.5849	3.4605	3.4528	3.4528	3.4528
ER, nominal, 2000=100	121.4	115.5	100.0	96.9	93.6	93.3	93.3	93.3
Real ER (CPI-based), 2000=100	119.9	114.4	100.0	97.8	96.1	99.0	99.8	99.4
Real ER (PPI-based), 2000=100	138.2	128.4	100.0	101.1	99.8	100.6	97.2	91.2
PPP, LTL/EUR	1.8177	1.7597	1.7078	1.6674	1.6611	1.6704	1.6774	1.7019
Price level, EU(25)=100	40	41	46	47	48	48	49	49
Average monthly gross wages, LTL	930	987	971	982	1014	1073	1158	1270
Average monthly gross wages, EUR (ER)	207	231	262	274	293	311	335	368
Average monthly gross wages, EUR (PPP)	512	561	568	589	610	642	690	746
GDP nominal, bn LTL	44.4	43.4	45.5	48.6	51.9	56.8	62.4	69.0
Employed persons - LFS, th., average	1489.4	1456.5	1397.8	1351.8	1405.9	1438.0	1436.3	1475
GDP per employed person, LTL	29795	29770	32570	35925	36950	39480	43473	46759
GDP per empl. person, LTL at 2000 pr.	29921	30078	32570	36102	37056	40033	42878	44676
Unit labour costs, 2000=100	104.3	110.1	100.0	91.3	91.8	89.9	90.6	95.4
Unit labour costs, ER adj., 2000=100	85.8	95.4	100.0	94.2	98.1	96.3	97.0	102.2
Unit labour costs, PPP adj., Austria=100	27.31	30.04	31.63	29.36	29.78	28.84	29.56	30.64
Bulgaria								
Producer price index, 2000=100	82.8	85.1	100.0	103.8	105.0	110.1	116.7	124.8
Consumer price index, 2000=100	88.4	90.7	100.0	107.4	113.6	116.2	123.4	129.6
GDP deflator, 2000=100	90.4	93.7	100.0	106.7	110.7	113.1	117.9	122.9
Exchange rate (ER), BGN/EUR	1.9723	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2000=100	100.8	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2000=100	110.6	108.3	100.0	95.2	91.9	91.6	88.1	85.7
Real ER (PPI-based), 2000=100	117.5	112.7	100.0	97.5	95.8	91.8	88.7	86.8
PPP, BGN/EUR	0.5850	0.5908	0.6143	0.6430	0.6749	0.6830	0.7104	0.7209
Price level, EU(25)=100	30	30	31	33	35	35	36	37
Average monthly gross wages, BGN	183	201	225	240	258	273	292	320
Average monthly gross wages, EUR (ER)	93	103	115	123	132	140	150	164
Average monthly gross wages, EUR (PPP)	313	340	365	373	382	400	412	444
GDP nominal, bn BGN	22.4	23.8	26.8	29.7	32.3	34.5	38.0	41.8
Employed persons - LFS, th.,average	3034.8	2875.3	2794.7	2698.8	2739.6	2834.8	2922.5	3000
GDP per employed person, BGN	7388	8274	9573	11008	11803	12187	13005	13933
GDP per empl. person, BGN at 2000 pr.	8175	8828	9573	10317	10661	10771	11031	11338
Unit labour costs, 2000=100	95.6	97.1	100.0	99.2	103.0	108.2	113.0	120.3
Unit labour costs, ER adj., 2000=100	94.8	97.1	100.0	99.2	103.0	108.2	113.0	120.3
Unit labour costs, PPP adj., Austria=100	16.14	16.37	16.93	16.55	16.74	17.35	18.43	19.32

(Table A/2 ctd.)

(Table A/2 ctd.)

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.
Romania 4)								
Producer price index, 2000=100	45.1	65.2	100.0	138.1	169.9	203.0	241.8	268.4
Consumer price index, 2000=100	47.1	68.6	100.0	134.5	164.8	190.0	212.6	231.7
GDP deflator, 2000=100	46.9	69.3	100.0	137.4	169.6	202.6	234.7	262.3
Exchange rate (ER), RON/EUR	0.9989	1.6296	1.9956	2.6027	3.1255	3.7556	4.0532	3.6234
ER, nominal, 2000=100	50.1	81.7	100.0	130.4	156.6	188.2	203.1	181.6
Real ER (CPI-based), 2000=100	103.1	116.7	100.0	99.1	99.2	105.4	103.8	87.0
Real ER (PPI-based), 2000=100	107.1	120.1	100.0	95.5	92.7	93.8	87.0	73.3
PPP, RON/EUR	0.3543	0.5097	0.7147	0.9547	1.1475	1.3946	1.5586	1.7239
Price level, EU(25)=100	35	31	36	37	37	37	38	48
Average monthly grross wages, RON	132	192	284	422	532	664	826	970
Average monthly gross wages, EUR (ER)	132	118	142	162	170	177	204	268
Average monthly gross wages, EUR (PPP)	372	377	397	442	464	476	530	563
GDP nominal, mn RON	37.1	54.6	80.4	116.8	151.5	190.3	238.8	277.5
Employed persons - LFS, th., average 5)	10844.9	10775.6	10763.8	10696.9	9234.3	9222.5	9157.6	9160
GDP per employed person, RON	3422.7	5064.5	7467.4	10916.1	16403.5	20638.2	26075.8	30295
GDP per empl. person, th. RON at 2000 pr.	7295.7	7305.4	7467.4	7942.4	9669.6	10185.4	11109.1	11551
Unit labour costs, 2000=100	47.5	69.2	100.0	139.7	144.7	171.3	195.5	220.8
Unit labour costs, ER adj., 2000=100	94.9	84.7	100.0	107.1	92.4	91.0	96.3	121.6
Unit labour costs, PPP adj., Austria=100	29.90	26.41	31.31	33.05	27.75	26.99	29.02	36.10
Croatia								
Producer price index, 2000=100	88.8	91.2	100.0	103.6	103.2	105.1	108.8	112.1
Consumer price index, 2000=100	90.4	94.2	100.0	104.9	106.7	108.6	110.9	114.6
GDP deflator, 2000=100	92.0	95.5	100.0	104.0	107.1	110.5	114.2	118.0
Exchange rate (ER), HRK/EUR	7.1366	7.5796	7.6350	7.4690	7.4068	7.5634	7.4956	7.4009
ER, nominal, 2000=100	93.5	99.3	100.0	97.8	97.0	99.1	98.2	96.9
Real ER (CPI-based), 2000=100	100.3	103.5	100.0	95.3	94.9	97.1	96.2	94.0
Real ER (PPI-based), 2000=100	101.5	104.4	100.0	95.5	94.6	95.3	93.4	93.7
PPP, HRK/EUR	4.1132	4.1693	4.2339	4.3250	4.3498	4.4744	4.5193	4.5509
Price level, EU(25)=100	58	55	55	58	59	59	60	61
Average monthly gross wages, HRK	4131	4551	4869	5061	5366	5623	5985	6250
Average monthly gross wages, EUR (ER)	579	600	638	678	724	743	798	844
Average monthly gross wages, EUR (PPP)	1004	1092	1150	1170	1234	1257	1324	1373
GDP nominal, bn HRK	137.6	141.6	152.5	165.6	179.4	193.1	207.1	222.3
Employed persons - LFS, th., average	1544.0	1492.0	1553.0	1469.0	1528.0	1536.5	1562.5	1566
GDP per employed person, HRK	89122	94892	98209	112757	117402	125654	132532	141928
GDP per empl. person, HRK at 2000 pr.	96865	99339	98209	108400	109627	113705	116061	120320
Unit labour costs, 2000=100	86.0	92.4	100.0	94.2	98.7	99.7	104.0	104.8
Unit labour costs, ER adj., 2000=100	92.0	93.1	100.0	96.3	101.8	100.7	105.9	108.1
Unit labour costs, PPP adj., Austria=100	58.49	58.57	63.19	59.94	61.71	60.25	64.46	64.77
Macedonia								
Producer price index, 2000=100	90.4	90.3	100.0	102.0	101.1	100.8	101.7	105.1
Consumer price index, 2000=100	95.2	94.5	100.0	105.5	107.4	108.7	108.2	108.9
GDP deflator, 2000=100	89.9	92.4	100.0	103.6	107.1	107.5	108.9	112.6
Exchange rate (ER), MKD/EUR	61.07	60.62	60.73	60.91	60.98	61.26	61.34	61.30
ER, nominal, 2000=100	100.6	99.8	100.0	100.3	100.4	100.9	101.0	100.9
Real ER (CPI-based), 2000=100	102.4	103.6	100.0	97.2	97.6	98.8	101.4	102.9
Real ER (PPI-based), 2000=100	107.3	105.9	100.0	99.5	99.9	101.3	102.8	104.0
PPP, MKD/EUR	21.34	21.48	22.61	22.97	23.18	23.20	23.00	23.34
Price level, EU(25)=100	35	35	37	38	38	38	37	38
Average monthly gross wages, MKD 6)	9394	9664	17958	17886	19025	19950	20771	21250
Average monthly gross wages, EUR (ER) 6)	154	159	296	294	312	326	339	347
Average monthly gross wages, EUR (PPP) 6)	440	450	794	779	821	860	903	910
GDP nominal, bn MKD	195.0	209.0	236.4	233.8	244.0	251.5	265.3	284.0
Employed persons - LFS, th., average	539.8	545.2	549.8	599.3	561.3	545.1	523.0	540
GDP per employed person, MKD	361231	383348	429919	390185	434620	461351	507189	525976
GDP per empl. person, MKD at 2000 pr.	401831	414910	429919	376587	405687	429253	465791	467067
Unit labour costs, 2000=100	56.0	55.8	100.0	113.7	112.3	111.3	106.8	108.9
Unit labour costs, ER adj., 2000=100	55.7	55.9	100.0	113.4	111.8	110.3	105.7	107.9
Unit labour costs, PPP adj., Austria=100	20.01	19.89	35.75	39.93	38.35	37.33	36.38	36.58

Note: 4) Data are given in the new leu (1 RON = 10000 ROL). - 5) Methodological break in 2001/2002. - 6) Until 1999 net wages.

(Table A/2 ctd.)

(Table A/2 ctd.)

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.
Russia								
Producer price index, 2000=100	42.9	68.2	100.0	119.1	133.0	153.8	190.7	230.2
Consumer price index, 2000=100	44.6	82.8	100.0	121.6	141.1	160.2	177.9	200.1
GDP deflator, 2000=100	42.1	72.6	100.0	116.5	134.7	153.5	184.0	220.2
Exchange rate (ER), RUB/EUR	11.063	26.239	26.029	26.130	29.647	34.686	35.814	35.218
ER, nominal, 2000=100	42.5	100.8	100.0	100.4	113.9	133.3	137.6	135.3
Real ER (CPI-based), 2000=100	92.5	119.5	100.0	84.4	84.3	88.5	84.1	75.1
Real ER (PPI-based), 2000=100	95.5	141.7	100.0	85.3	86.1	87.6	74.7	63.7
PPP, RUB/EUR	3.574	6.035	8.335	9.518	10.740	12.210	14.310	16.810
Price level, EU(25)=100	32	23	32	36	36	35	40	48
Average monthly gross wages, RUB	1052	1523	2223	3240	4360	5499	6832	8530
Average monthly gross wages, EUR (ER)	95	58	85	124	147	159	191	242
Average monthly gross wages, EUR (PPP)	294	252	267	340	406	450	477	507
GDP nominal, bn RUB	2629.6	4823.2	7305.6	8943.6	10830.5	13243.2	17008.4	21665
Employed persons - LFS, th., average	58437	62475	64255	64400	66071	65800	67417	68200
GDP per employed person, RUB	44999	77203	113698	138876	163923	201265	252287	317669
GDP per empl. person, RUB at 2000 pr.	106816	106307	113698	119225	121671	131088	137146	144248
Unit labour costs, 2000=100	50.3	73.2	100.0	139.0	183.3	214.5	254.7	302.4
Unit labour costs, ER adj., 2000=100	118.4	72.7	100.0	138.4	160.9	161.0	185.1	223.5
Unit labour costs, PPP adj., Austria=100	17.15	10.41	14.39	19.63	22.22	21.94	25.66	30.50
Ukraine								
Producer price index, 2000=100	63.1	82.7	100.0	108.6	112.0	120.7	145.3	169.7
Consumer price index, 2000=100	63.6	78.0	100.0	112.0	112.9	118.8	129.5	147.0
GDP deflator, 2000=100	63.8	81.2	100.0	109.9	115.6	124.9	143.7	163.1
Exchange rate (ER), UAH/EUR	2.768	4.393	5.029	4.814	5.030	6.024	6.609	6.389
ER, nominal, 2000=100	55.0	87.4	100.0	95.7	100.0	119.8	131.4	127.0
Real ER (CPI-based), 2000=100	83.9	109.9	100.0	87.3	92.4	107.4	110.3	96.0
Real ER (PPI-based), 2000=100	84.2	101.3	100.0	89.2	89.8	100.4	93.6	81.1
PPP, UAH/EUR	0.6160	0.7680	0.9170	0.9884	1.0137	1.0929	1.2304	1.3706
Price level, EU(25)=100	22	17	18	21	20	18	19	21
Average monthly gross wages, UAH	153	178	230	311	376	462	590	806
Average monthly gross wages, EUR (ER)	55	40	46	65	75	77	89	126
Average monthly gross wages, EUR (PPP)	248	231	251	315	371	423	479	588
GDP nominal, bn UAH	102.6	130.4	170.1	204.2	225.8	267.3	344.8	400.8
Employed persons - LFS, th., average	22998.4	20048.2	20175.0	19971.5	20091.2	20163.3	20295.7	20681
GDP per employed person, UAH	4461	6506	8430	10224	11239	13259	16990	19380
GDP per empl. person, UAH at 2000 pr.	6994	8010	8430	9299	9725	10620	11827	11885
Unit labour costs, 2000=100	80.1	81.2	100.0	122.5	141.8	159.4	182.6	248.5
Unit labour costs, ER adj., 2000=100	145.6	92.9	100.0	128.0	141.7	133.1	138.9	195.6
Unit labour costs, PPP adj., Austria=100	16.76	10.59	11.44	14.43	15.56	14.42	15.31	21.22
Austria								
Producer price index, 2000=100	96.9	96.2	100.0	101.5	101.1	102.7	107.7	110.0
Consumer price index, 2000=100	97.1	97.7	100.0	102.7	104.5	106.0	108.2	110.7
GDP deflator, 2000=100	97.6	98.3	100.0	101.8	103.0	104.5	106.5	108.4
Exchange rate (ER), ATS-EUR/EUR	1.0089	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000
PPP, ATS-EUR/EUR	1.0890	1.0644	1.0394	1.0540	1.0560	1.0638	1.0431	1.0603
Price level, EU(25)=100	108	106	104	105	106	106	104	106
Average monthly gross wages, EUR-ATS	2281	2334	2390	2428	2483	2530	2583	2644
Average monthly gross wages, EUR (ER)	2261	2334	2390	2428	2483	2530	2583	2644
Average monthly gross wages, EUR (PPP)	2095	2193	2299	2303	2351	2378	2477	2494
GDP nominal, bn EUR-ATS	192.4	200.0	210.4	215.9	220.7	227.0	237.0	245.8
Employed persons - LFS, th., average	3625.9	3665.9	3685.0	3712.4	3763.5	3795.4	3744.0	3785.2
GDP per employed person, EUR-ATS	53058	54563	57094	58150	58638	59801	63312	64940
GDP per empl. person, EUR-ATS at 2000 pr.	54336	55527	57094	57143	56911	57226	59427	59897
Unit labour costs, 2000=100	100.3	100.4	100.0	101.5	104.2	105.6	103.9	105.5
Unit labour costs, ER adj., 2000=100	99.4	100.4	100.0	101.5	104.2	105.6	103.9	105.5
Unit labour costs, PPP adjusted	0.52	0.52	0.52	0.53	0.54	0.55	0.54	0.55

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

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

For new EU member states and 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.

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

Table A/3

Indicators of macro-competitiveness, 1998-2005

annual changes in %

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.	2000-05 average
Czech Republic									
GDP deflator	11.2	2.8	1.4	4.9	2.8	2.6	3.4	1.8	2.8
Exchange rate (ER), CZK/EUR	1.0	2.0	-3.4	-4.3	-9.6	3.3	0.2	-6.6	-3.5
Real ER (CPI-based)	-7.6	1.1	-5.3	-6.6	-9.3	5.3	-0.5	-6.4	-3.9
Real ER (PPI-based)	-5.0	0.4	-4.0	-5.8	-9.7	4.4	-3.0	-5.2	-4.0
Average gross wages, CZK	9.2	8.4	6.4	8.7	7.3	6.6	6.6	5.9	6.9
Average gross wages, real (PPI based)	4.1	7.4	1.4	5.7	7.8	7.0	0.9	2.8	4.2
Average gross wages, real (CPI based)	-1.3	6.2	2.4	3.8	5.4	6.5	3.7	3.9	4.3
Average gross wages, EUR (ER)	8.2	6.3	10.2	13.5	18.6	3.2	6.4	13.4	10.8
Employed persons (LFS)	-1.4	-2.1	-0.7	0.4	0.3	-0.7	-0.6	1.1	0.0
GDP per empl. person, CZK at 2000 pr.	0.3	3.3	4.6	2.2	1.1	3.9	5.3	3.9	3.5
Unit labour costs, CZK at 2000 prices	8.9	4.9	1.7	6.3	6.0	2.7	1.2	2.0	3.3
Unit labour costs, ER (EUR) adjusted	7.8	2.9	5.4	11.0	17.3	-0.7	1.0	9.2	7.0
Hungary									
GDP deflator	12.6	8.4	9.7	8.3	8.7	6.6	4.6	3.4	6.9
Exchange rate (ER), HUF/EUR	14.2	4.9	2.9	-1.3	-5.3	4.3	-0.7	-1.4	-0.3
Real ER (CPI-based)	1.2	-3.5	-4.5	-7.6	-8.2	1.6	-5.1	-2.8	-4.5
Real ER (PPI-based)	1.2	-0.8	-3.9	-5.1	-4.2	2.5	-1.8	-1.1	-2.3
Average gross wages, HUF	18.3	13.9	13.5	18.2	18.3	12.0	6.1	9.0	12.8
Average gross wages, real (PPI based)	6.3	8.4	1.7	12.3	20.4	9.4	2.5	4.5	8.3
Average gross wages, real (CPI based)	3.5	3.5	3.4	8.2	12.3	7.0	-0.7	5.2	5.8
Average gross wages, EUR (ER)	3.6	8.6	10.4	19.7	25.0	7.4	6.8	10.6	13.1
Employed persons (LFS) [1)]	1.8	0.6	1.2	0.3	0.1	1.3	-0.5	0.0	0.4
GDP per empl. person, HUF at 2000 pr.	3.0	3.6	3.9	4.0	3.8	2.0	5.2	4.2	3.8
Unit labour costs, HUF at 2000 prices	14.9	10.0	9.3	13.6	14.0	9.8	0.8	4.6	8.6
Unit labour costs, ER (EUR) adjusted	0.5	4.9	6.2	15.1	20.4	5.2	1.5	6.2	8.9
Poland									
GDP deflator	11.0	6.1	7.3	3.5	2.2	0.4	4.0	1.7	3.2
Exchange rate (ER), PLN/EUR	5.9	7.7	-5.1	-8.5	5.1	14.1	3.1	-11.2	-0.8
Real ER (CPI-based)	-4.1	1.6	-12.2	-11.4	5.3	15.4	1.7	-11.1	-2.6
Real ER (PPI-based)	-2.7	1.3	-8.2	-8.9	3.5	11.8	-1.4	-7.7	-2.1
Average gross wages, PLN [2)]	15.7	10.6	11.6	8.0	2.6	4.2	4.0	3.4	5.6
Average gross wages, real (PPI based)	7.8	30.3	3.5	6.3	1.6	1.5	-2.8	2.6	2.1
Average gross wages, real (CPI based)	3.5	28.3	1.3	2.4	0.7	3.3	0.5	1.2	1.6
Average gross wages, EUR (ER)	9.2	27.8	17.6	18.1	-2.4	-8.7	0.9	16.4	6.4
Employed persons (LFS) [3)]	1.2	-3.9	-1.6	-2.2	-3.0	0.6	1.3	2.9	-0.3
GDP per empl. person, PLN at 2000 pr.	3.8	8.7	5.9	3.4	4.5	3.2	3.9	0.3	3.5
Unit labour costs, PLN at 2000 prices	11.4	1.7	5.4	4.5	-1.9	0.9	0.1	3.1	2.0
Unit labour costs, ER (EUR) adjusted	5.3	-5.6	11.1	14.2	-6.6	-11.5	-2.9	16.1	2.8
Slovak Republic									
GDP deflator	5.2	6.5	8.5	4.2	4.0	4.7	4.5	2.8	4.8
Exchange rate (ER), SKK/EUR	4.2	11.4	-3.5	1.7	-1.4	-2.8	-3.5	-3.6	-2.2
Real ER (CPI-based)	-1.1	2.0	-12.2	-3.0	-2.6	-8.7	-8.3	-4.1	-6.5
Real ER (PPI-based)	-0.5	6.2	-9.1	-3.4	-4.0	-9.8	-4.5	-3.5	-5.8
Average gross wages, SKK	8.4	7.2	6.5	8.2	9.3	6.3	10.2	9.3	8.3
Average gross wages, real (PPI based)	5.0	2.8	-3.8	1.6	7.0	-1.8	6.5	4.6	2.3
Average gross wages, real (CPI based)	1.6	-3.0	-4.9	1.0	5.8	-2.0	2.5	6.4	1.4
Average gross wages, EUR (ER)	4.1	-3.7	10.4	6.4	10.8	9.4	14.1	13.5	10.7
Employed persons (LFS)	-0.3	-3.0	-1.4	1.0	0.2	1.8	0.3	1.8	0.6
GDP per empl. person, SKK at 2000 pr.	4.6	4.6	3.5	2.7	4.5	2.6	5.3	3.8	3.7
Unit labour costs, SKK at 2000 prices	3.7	2.5	3.0	5.4	4.6	3.6	4.7	5.4	4.4
Unit labour costs, ER (EUR) adjusted	-0.5	-8.0	6.7	3.6	6.1	6.6	8.4	9.3	6.8
Slovenia									
GDP deflator	6.8	6.4	5.4	8.7	7.9	5.7	3.2	2.5	5.6
Exchange rate (ER), SIT/EUR	3.3	4.0	5.9	5.9	4.2	3.3	2.2	0.3	3.6
Real ER (CPI-based)	-3.1	-0.8	-0.9	-0.1	-1.1	-0.2	0.7	0.0	-0.3
Real ER (PPI-based)	-3.9	1.2	2.6	-1.6	-1.5	1.4	0.3	2.2	0.6
Average gross wages, SIT	9.6	9.6	10.6	11.9	9.7	7.5	12.3	4.0	9.3
Average gross wages, real (PPI based)	3.4	7.3	2.8	2.8	4.4	4.9	7.6	1.3	4.0
Average gross wages, real (CPI based)	1.6	3.3	1.6	3.3	2.1	1.8	8.4	1.5	3.1
Average gross wages, EUR (ER)	6.1	5.4	4.5	5.7	5.3	4.1	9.9	3.7	5.5
Employed persons (LFS)	-0.6	-1.7	1.7	1.7	-0.7	-1.4	5.1	0.7	1.2
GDP per empl. person, SIT at 2000 pr.	4.4	7.2	2.4	1.0	4.1	4.1	-0.9	3.0	2.3
Unit labour costs, SIT at 2000 prices	4.9	2.2	8.1	10.9	5.4	3.3	13.3	0.9	6.9
Unit labour costs, ER (EUR) adjusted	1.6	-1.7	2.1	4.7	1.2	0.0	10.9	0.6	3.2

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

(Table A/3 ctd.)

Table A/3 (ctd.)

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.	2000-05 average
Estonia									
GDP deflator	8.9	4.5	5.4	5.6	4.4	2.1	3.1	4.7	4.2
Exchange rate (ER), EEK/EUR	0.7	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	-5.7	-2.9	-2.0	-3.4	-1.4	0.7	-0.9	-1.8	-1.5
Real ER (PPI-based)	-4.7	-0.3	-0.6	-3.1	-1.0	0.4	-0.6	2.5	-0.4
Average gross wages, EEK	15.4	7.6	10.5	12.3	11.5	9.4	8.4	10.1	10.4
Average gross wages, real (PPI based)	10.8	8.9	5.4	7.6	11.1	9.2	5.3	7.8	7.7
Average gross wages, real (CPI based)	6.7	4.2	6.3	6.1	7.6	8.0	5.2	5.7	6.5
Average gross wages, EUR (ER)	14.6	8.6	10.5	12.3	11.5	9.4	8.4	10.1	10.4
Employed persons (LFS)	-1.7	-4.5	-1.2	0.9	1.4	1.5	0.2	2.4	0.9
GDP per empl. person, EEK at 2000 pr.	6.3	5.0	9.1	5.5	5.8	5.1	7.6	5.8	6.5
Unit labour costs, EEK at 2000 prices	8.6	2.5	1.3	6.4	5.4	4.1	0.7	4.0	3.6
Unit labour costs, ER (EUR) adjusted	7.8	3.4	1.3	6.4	5.4	4.1	0.7	4.0	3.6
Latvia									
GDP deflator	4.6	4.8	3.8	2.1	3.4	3.6	7.2	6.2	4.4
Exchange rate (ER), LVL/EUR	0.6	-5.7	-10.2	0.5	3.5	10.7	4.1	4.7	2.0
Real ER (CPI-based)	-2.7	-6.8	-10.8	0.2	3.7	9.7	0.0	0.3	0.3
Real ER (PPI-based)	-2.6	-2.4	-6.9	-0.1	1.9	7.9	-1.9	1.7	0.3
Average gross wages, LVL	11.1	5.8	6.1	6.3	8.8	11.3	9.6	13.7	9.3
Average gross wages, real (PPI based)	9.0	10.2	5.4	4.6	7.7	7.8	1.0	5.5	5.3
Average gross wages, real (CPI based)	6.1	3.3	3.4	3.7	6.8	8.1	3.2	6.6	5.3
Average gross wages, EUR (ER)	10.4	12.2	18.1	5.8	5.1	0.5	5.4	8.6	7.1
Employed persons (LFS)	-0.4	-1.8	-2.8	2.2	2.8	1.8	1.1	1.2	1.0
GDP per empl. person, LVL at 2000 pr.	5.2	5.2	10.0	5.7	3.6	5.3	7.2	7.8	6.6
Unit labour costs, LVL at 2000 prices	5.6	0.6	-3.6	0.6	5.1	5.7	2.3	5.5	2.5
Unit labour costs, ER (EUR) adjusted	5.0	6.7	7.4	0.2	1.5	-4.5	-1.7	0.7	0.5
Lithuania									
GDP deflator	5.1	-0.6	1.0	-0.5	0.2	-1.1	2.8	3.2	0.9
Exchange rate (ER), LTL/EUR	-0.8	-4.9	-13.4	-3.1	-3.5	-0.2	0.0	0.0	-3.5
Real ER (CPI-based)	-4.4	-4.5	-12.6	-2.2	-1.7	3.0	0.9	-0.5	-2.3
Real ER (PPI-based)	2.4	-7.1	-22.1	1.1	-1.3	0.9	-3.5	-6.2	-5.5
Average gross wages, LTL	19.5	6.2	-1.7	1.2	3.2	5.8	7.9	9.7	4.3
Average gross wages, real (PPI based)	25.0	4.4	-15.2	4.3	6.2	6.3	1.8	-1.6	0.0
Average gross wages, real (CPI based)	13.7	5.4	-2.7	-0.1	2.9	7.1	6.7	6.8	3.4
Average gross wages, EUR (ER)	20.4	11.7	13.5	4.4	6.9	6.0	7.9	9.7	8.0
Employed persons (LFS)	-5.2	-2.2	-4.0	-3.3	4.0	2.3	-0.1	2.7	0.2
GDP per empl. person, LTL at 2000 pr.	13.1	0.5	8.3	10.8	2.6	8.0	7.1	4.2	6.8
Unit labour costs, LTL at 2000 prices	5.6	5.6	-9.2	-8.7	0.6	-2.1	0.8	5.3	-2.4
Unit labour costs, ER (EUR) adjusted	6.4	11.1	4.8	-5.8	4.2	-1.9	0.8	5.3	1.2
Bulgaria									
GDP deflator	23.7	3.7	6.7	6.7	3.8	2.2	4.2	4.2	4.6
Exchange rate (ER), BGN/EUR	4.0	-0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	-11.2	-2.2	-7.6	-4.8	-3.5	-0.3	-3.8	-2.7	-3.8
Real ER (PPI-based)	-13.6	-4.1	-11.3	-2.5	-1.7	-4.1	-3.5	-2.1	-4.3
Average gross wages, BGN	43.3	9.7	11.7	6.9	7.3	6.1	7.0	9.4	8.1
Average gross wages, real (PPI based)	20.7	6.7	-5.0	3.0	6.1	1.1	0.9	2.4	1.4
Average gross wages, real (CPI based)	20.7	6.9	1.2	-0.4	1.4	3.7	0.8	4.2	1.8
Average gross wages, EUR (ER)	37.7	10.6	11.7	6.9	7.3	6.1	7.0	9.4	8.1
Employed persons (LFS)	-0.8	-5.3	-2.8	-3.4	1.5	3.5	3.1	2.7	0.7
GDP per empl. person, BGN at 2000 pr.	4.8	8.0	8.4	7.8	3.3	1.0	2.4	2.8	4.3
Unit labour costs, BGN at 2000 prices	36.6	1.6	3.0	-0.8	3.9	5.0	4.5	6.5	3.6
Unit labour costs, ER (EUR) adjusted	31.3	2.4	3.0	-0.8	3.9	5.0	4.5	6.5	3.6
Romania									
GDP deflator	54.2	47.8	44.2	37.4	23.4	19.4	15.8	11.7	24.8
Exchange rate (ER), ROL/EUR	23.5	63.1	22.5	30.4	20.1	20.2	7.9	-10.6	14.2
Real ER (CPI-based)	-21.4	13.2	-14.3	-0.9	0.1	6.3	-1.5	-16.2	-4.8
Real ER (PPI-based)	-8.6	12.2	-16.8	-4.5	-2.9	1.1	-7.3	-15.7	-7.9
Average gross wages, ROL	56.4	45.7	47.8	48.6	26.1	24.8	24.5	17.4	31.0
Average gross wages, real (PPI based)	17.4	0.9	-3.7	7.6	2.5	4.4	4.5	5.8	3.5
Average gross wages, real (CPI based)	-1.7	0.0	1.5	10.5	2.9	8.2	11.2	7.7	6.9
Average gross wages, EUR (ER)	26.6	-10.7	20.7	13.9	5.0	3.8	15.3	31.3	14.6
Employed persons (LFS) 4)	-1.9	-0.6	-0.1	-0.6	.	-0.1	-0.7	0.0	-0.3
GDP per empl. person, ROL at 2000 pr. 4)	-3.0	0.1	2.2	6.4	.	5.3	9.1	4.0	5.4
Unit labour costs, ROL at 2000 prices 4)	61.2	45.5	44.6	39.7	.	18.4	14.1	12.9	25.3
Unit labour costs, ER (EUR) adjusted 4)	30.6	-10.8	18.1	7.1	.	-1.4	5.7	26.3	10.7

Notes: 4) In 2002 no comparable growth rates available due to methodological break in employment. Average 2000-2005 is calculated without 2002.

(Table A/3 ctd.)

Table A/3 (ctd.)

	1998	1999	2000	2001	2002	2003	2004	2005 prelim.	2000-05 average
Croatia									
GDP deflator	8.4	3.8	4.7	4.0	3.0	3.2	3.3	3.3	3.6
Exchange rate (ER), HRK/EUR	2.5	6.2	0.7	-2.2	-0.8	2.1	-0.9	-1.3	-0.4
Real ER (CPI-based)	-1.7	3.1	-3.3	-4.7	-0.4	2.3	-0.9	-2.3	-1.6
Real ER (PPI-based)	2.4	2.9	-4.2	-4.5	-1.0	0.8	-2.0	0.3	-1.8
Average gross wages, HRK	12.6	10.2	7.0	3.9	6.0	4.8	6.4	4.4	5.4
Average gross wages, real (PPI based)	14.0	7.4	-2.5	0.3	6.5	2.8	2.8	1.4	1.9
Average gross wages, real (CPI based)	6.5	5.7	0.7	-0.9	4.3	2.9	4.3	1.1	2.0
Average gross wages, EUR (ER)	9.8	3.7	6.2	6.3	6.9	2.6	7.4	5.8	5.8
Employed persons (LFS)	-3.1	-3.4	4.1	-5.4	4.0	0.6	1.7	0.2	0.8
GDP per empl. person, HRK at 2000 pr.	5.8	2.6	-1.1	10.4	1.1	3.7	2.1	3.7	3.2
Unit labour costs, HRK at 2000 prices	6.5	7.4	8.2	-5.8	4.8	1.0	4.3	0.7	2.1
Unit labour costs, ER (EUR) adjusted	3.9	1.1	7.4	-3.7	5.7	-1.1	5.2	2.0	2.5
Macedonia									
GDP deflator	1.4	2.8	8.2	3.6	3.4	0.3	1.3	3.4	3.4
Exchange rate (ER), MKD/EUR	8.7	-0.7	0.2	0.3	0.1	0.5	0.1	-0.1	0.2
Real ER (CPI-based)	10.2	1.2	-3.5	-2.8	0.4	1.3	2.6	1.5	-0.1
Real ER (PPI-based)	3.0	-1.2	-5.6	-0.5	0.4	1.3	1.5	1.1	-0.3
Average gross wages, MKD [5]	3.7	2.9	5.5	-0.4	6.4	4.9	4.1	2.3	3.8
Average gross wages, real (PPI based) [5]	-0.3	3.0	-4.7	-2.4	7.3	5.2	3.2	-1.1	1.2
Average gross wages, real (CPI based) [5]	3.8	3.6	-0.3	-5.6	4.5	3.6	4.5	1.7	1.3
Average gross wages, EUR (ER) [5]	-4.6	3.6	5.3	-0.7	6.3	4.4	4.0	2.4	3.6
Employed persons (LFS)	5.4	1.0	0.8	9.0	-6.3	-2.9	-4.1	3.3	-0.2
GDP per empl. person, MKD at 2000 pr.	-1.9	3.3	3.6	-12.4	7.7	5.8	8.5	0.3	2.0
Unit labour costs, MKD at 2000 prices	5.6	-0.4	1.8	13.7	-1.3	-0.9	-4.1	2.0	1.7
Unit labour costs, ER (EUR) adjusted	-2.8	0.4	1.6	13.4	-1.4	-1.4	-4.2	2.1	1.5
Russia									
GDP deflator	18.5	72.4	37.7	16.5	15.7	14.0	19.8	19.7	20.3
Exchange rate (ER), RUB/EUR	69.1	137.2	-0.8	0.4	13.5	17.0	3.3	-1.7	5.0
Real ER (CPI-based)	34.3	29.3	-16.3	-15.6	-0.1	5.0	-5.0	-10.7	-7.5
Real ER (PPI-based)	55.8	48.3	-29.4	-14.7	0.9	1.8	-14.8	-14.8	-12.5
Average gross wages, RUB	10.7	44.8	46.0	45.7	34.6	26.1	24.2	24.9	33.3
Average gross wages, real (PPI based)	3.3	-8.9	-0.4	22.4	20.4	9.1	0.2	3.4	8.8
Average gross wages, real (CPI based)	-13.3	-22.0	20.9	19.9	16.0	11.0	11.9	11.0	15.0
Average gross wages, EUR (ER)	-34.6	-38.9	47.2	45.2	18.6	7.8	20.3	27.0	26.9
Employed persons (LFS)	-2.6	6.9	2.8	0.2	2.6	-0.4	2.5	1.2	1.5
GDP per empl. person, RUB at 2000 pr.	-2.7	-0.5	7.0	4.9	2.1	7.7	4.6	5.2	5.2
Unit labour costs, RUB at 2000 prices	13.8	45.5	36.5	39.0	31.9	17.0	18.8	18.7	26.7
Unit labour costs, ER (EUR) adjusted	-32.7	-38.7	37.6	38.4	16.2	0.0	15.0	20.7	20.6
Ukraine									
GDP deflator	12.0	27.4	23.1	9.9	5.1	8.0	15.1	13.5	12.3
Exchange rate (ER), UAH/EUR	31.0	58.7	14.5	-4.3	4.5	19.8	9.7	-3.3	6.4
Real ER (CPI-based)	20.0	30.9	-9.0	-12.7	5.8	16.1	2.7	-13.0	-2.2
Real ER (PPI-based)	14.1	20.3	-1.3	-10.8	0.8	11.7	-6.8	-13.4	-3.6
Average gross wages, UAH	7.0	16.0	29.6	35.2	21.0	22.8	27.6	36.7	28.7
Average gross wages, real (PPI based)	-5.5	-11.5	7.2	24.5	17.4	13.9	5.9	17.1	14.2
Average gross wages, real (CPI based)	-3.3	-5.4	1.1	20.7	20.0	16.7	17.0	20.5	15.8
Average gross wages, EUR (ER)	-18.3	-26.9	13.3	41.2	15.8	2.5	16.3	41.4	20.9
Employed persons (LFS)	-3.2	-12.8	0.6	-1.0	0.6	0.4	0.7	1.9	0.5
GDP per empl. person, UAH at 2000 pr.	1.4	14.5	5.2	10.3	4.6	9.2	11.4	0.5	6.8
Unit labour costs, UAH at 2000 prices	5.5	1.3	23.2	22.5	15.7	12.5	14.5	36.1	20.5
Unit labour costs, ER (EUR) adjusted	-19.4	-36.2	7.6	28.0	10.7	-6.1	4.4	40.8	13.2
Austria									
GDP deflator	0.3	0.6	1.8	1.8	1.3	1.4	1.9	1.8	1.7
Exchange rate (ER), ATS-EUR/EUR	0.7	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Average gross wages, ATS-EUR	3.1	2.3	2.4	1.6	2.3	1.9	2.1	2.4	2.1
Average gross wages, real (PPI based)	3.6	3.1	-1.5	0.1	2.7	0.3	-2.7	0.2	-0.2
Average gross wages, real (CPI based)	2.2	1.7	0.0	-1.1	0.5	0.5	0.0	0.0	0.0
Average gross wages, EUR (ER)	2.3	3.2	2.4	1.6	2.3	1.9	2.1	2.4	2.1
Employed persons (LFS) [6]	0.2	1.1	0.5	0.7	1.4	0.8	0.0	1.1	0.8
GDP per empl. person, ATS-EUR at 2000 pr.	3.4	2.2	2.8	0.1	-0.4	0.6	2.4	0.8	1.0
Unit labour costs, ATS-EUR at 2000 prices	-0.3	0.1	-0.4	1.5	2.7	1.3	-0.3	1.5	1.0
Unit labour costs, ER (EUR) adjusted	-1.0	1.0	-0.4	1.5	2.7	1.3	-0.3	1.5	1.0

5) Until 2000 net wages. - 6) From 2004 new methodology.

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

Sources: National statistics and wiiw estimates.

Short list of the most recent wiiw publications (as of February 2006)

For current updates and summaries see also wiiw's website at www.wiiw.ac.at

Strong Growth, Driven by Exports in the NMS and by Consumption in the Future EU Members
by Leon Podkaminer, Vladimir Gligorov et al.
wiiw Research Reports, No. 325, February 2006
(special issue on economic prospects for Central, East and Southeast Europe; covering Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Hungary, Macedonia, Montenegro, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Ukraine, Turkey, and China)
116 pages including 47 Tables and 21 Figures
hardcopy: EUR 70.00 (PDF: EUR 65.00)

The Vienna Institute Monthly Report 2/06
edited by Leon Podkaminer

- The Russian-Ukrainian gas deal: a question mark
- Alternative indicators of economic growth and real convergence in the transition countries
- Divergent trajectories of transition in Eastern Europe and China
- Selected monthly data on the economic situation in ten transition countries, 2004-2005
- Guide to wiiw statistical services on Central, East and Southeast Europe, Russia and Ukraine

wiiw, February 2006
28 pages including 20 Tables and 1 Figure
(exclusively for subscribers to the wiiw Service Package)

Croatia: Growth Slowdown and Policy Alternatives
by Hermine Vidovic and Vladimir Gligorov
wiiw Research Reports, No. 324, January 2006
35 pages including 11 Tables and 9 Figures
hardcopy: EUR 22.00 (PDF: EUR 20.00)

Rags in the High Rent District: The Evolution of Quota Rents in Textiles and Clothing
by Joseph Francois and Julia Wörz
wiiw Working Papers, No. 37, January 2006
29 pages including 11 Tables and 1 Figure
hardcopy: EUR 8.00 (PDF: free download from wiiw’s website)

The Vienna Institute Monthly Report 1/06
edited by Leon Podkaminer

- The miracle of Brussels: a compromise on the long-term budget of the European Union
- Chinese direct investment abroad: economic and political objectives
- Energy intensity and industry composition: a comparison between selected old and new EU member states
- Selected monthly data on the economic situation in ten transition countries, 2004-2005
- Guide to wiiw statistical services on Central, East and Southeast Europe, Russia and Ukraine

wiiw, January 2006
28 pages including 20 Tables and 1 Figure
(exclusively for subscribers to the wiiw Service Package)

Modelling GDP in CEECs Using Smooth Transitions
by Neil Foster and Robert Stehrer
wiiw Working Papers, No. 36, December 2005
33 pages including 6 Tables and 22 Figures
hardcopy: EUR 8.00 (PDF: free download from wiiw’s website)

The Vienna Institute Monthly Report 12/05
edited by Leon Podkaminer

- Updated wiiw forecasts for 2005 and 2006
- Albania: new government, old shortages
- Bosnia and Herzegovina: from Dayton Agreement to data disagreement
- Montenegro: decision time
- Kosovo: to be or not to be
- Selected monthly data on the economic situation in ten transition countries, 2004-2005
- Guide to wiiw statistical services on Central, East and Southeast Europe, Russia and Ukraine

wiiw, December 2005
25 pages including 14 Tables
(exclusively for subscribers to the wiiw Service Package)

Coming and Going: Gains and Losses from Relocations Affecting Hungary
by Gábor Hunya and Magdolna Sass
wiiw Research Reports, No. 323, November 2005
23 pages including 6 Tables
hardcopy: EUR 22.00 (PDF: EUR 20.00)

wiiw Handbook of Statistics 2005: Central, East and Southeast Europe
covers key economic data on Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Poland, Romania, Russia, Serbia and Montenegro, the Slovak Republic, Slovenia and Ukraine, 1990 to September 2005
wiiw, Vienna, November 2005 (ISBN 3-85209-010-5)
541 pages including 405 Tables and Figures
hardcopy: EUR 90.00
CD-ROM (PDF): EUR 90.00; CD-ROM (MS Excel Tables + PDF) + hardcopy: EUR 225.00
Individual chapters (MS Excel Tables, on CD-ROM or via E-mail): EUR 36.00 per chapter

The Vienna Institute Monthly Report 11/05
edited by Leon Podkaminer

- Russian Federation: awash with money – and problems, too
- Ukraine: policy-making becomes more balanced
- Croatia: accession negotiations finally started
- Serbia: inflation is a problem
- Macedonia: growth and promises of reforms return
- The Turkish economy’s soft landing: a new experience
- Selected monthly data on the economic situation in ten transition countries, 2004-2005
- Guide to wiiw statistical services on Central, East and Southeast Europe, Russia and Ukraine

wiiw, November 2005
33 pages including 16 Tables
(exclusively for subscribers to the wiiw Service Package)

The Vienna Institute Monthly Report 10/05
edited by Leon Podkaminer

- Czech economy basking in glory
- Hungary: improving trade balance, growing concern over budget deficit
- Poland: domestic demand weakening further
- Slovakia: robust economic growth despite political turmoil
- Slovenia: economy on track for euro adoption
- Bulgaria: credit restrictions fail to taper the current account deficit
- Romania: decelerating economic growth, widening deficits
- New *wiiw Handbook of Statistics* forthcoming in November
- Selected monthly data on the economic situation in ten transition countries, 2004-2005
- Guide to wiiw statistical services on Central, East and Southeast Europe, Russia and Ukraine

wiiw, October 2005
35 pages including 17 Tables
(exclusively for subscribers to the wiiw Service Package)

Why is Food Cheaper in Rich (European) Countries?
by Leon Podkaminer
wiiw Research Reports, October 2005
(reprinted from: *Banca Nazionale del Lavoro Quarterly Review*, No. 230, September 2004)
31 pages including 2 Tables and 6 Figures
hardcopy: EUR 8.00 (PDF: free download from wiiw's website)

The Effects of Factor- and Sector-biased Technical Change Revisited
by Robert Stehrer
wiiw Working Papers, No. 35, September 2005
24 pages including 2 Tables and 3 Figures
hardcopy: EUR 8.00 (PDF: free download from wiiw's website)

Industry Patterns in Output, FDI and Trade: A regional comparison of CEECs with OECD and East Asian countries
by Julia Wörz
wiiw Statistical Reports, No. 2, September 2005
62 pages including 18 Tables and 19 Figures
hardcopy: EUR 22.00 (PDF: EUR 20.00)

The Vienna Institute Monthly Report 8-9/05
edited by Leon Podkaminer

- Convergence and labour demand: employment projections for the new EU member states up to 2012
- Sectoral structures and linkages in selected new and old EU member states
- Balkan Free Trade Agreements seem to work
- Returning from the blind alley: three proposals to reform the EU budget
- Selected monthly data on the economic situation in ten transition countries, 2004-2005
- Guide to wiiw statistical services on Central, East and Southeast Europe, Russia and Ukraine

wiiw, August-September 2005
35 pages including 21 Tables and 2 Figures
(exclusively for subscribers to the wiiw Service Package)

Employment Effects of Foreign Direct Investment in Central and Eastern Europe
by Gábor Hunya and Ingo Geishecker
wiiw Research Reports, No. 321, August 2005
33 pages including 11 Tables and 2 Figures
hardcopy: EUR 8.00 (PDF: free download from wiiw's website)

Back from the Peak, Growth in Transition Countries Returns to Standard Rate of Catching-up
by Leon Podkaminer, Gábor Hunya et al.
wiiw Research Reports, No. 320, July 2005
(special issue on economic prospects for Central, East and Southeast Europe; covering Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Hungary, Macedonia, Poland, Romania, Russia, Serbia and Montenegro, Slovakia, Slovenia, Ukraine, Turkey, and China)
108 pages including 52 Tables and 11 Figures
hardcopy: EUR 70.00 (PDF: EUR 65.00)

Macedonia: Search for Stability without Growth
by Vladimir Gligorov and Silvana Mojsovska
wiiw Current Analysis and Country Profiles, No. 22, July 2005
64 pages including 41 Tables and 7 Figures
hardcopy: EUR 70.00 (PDF: EUR 65.00)

wiiw Service Package

The Vienna Institute offers to firms and institutions interested in unbiased and up-to-date information on Central, East and Southeast European markets a package of exclusive services and preferential access to its publications and research findings, on the basis of a subscription at an annual fee of EUR 2,000.

This subscription fee entitles to the following package of **Special Services**:

- A free invitation to the Vienna Institute's **Spring Seminar**, a whole-day event at the end of March, devoted to compelling topics in the economic transformation of the Central and East European region (for subscribers to the wiiw Service Package only).
- Copies of, or online access to, ***The Vienna Institute Monthly Report***, a periodical consisting of timely articles summarizing and interpreting the latest economic developments in Central and Eastern Europe and the former Soviet Union. The statistical annex to each *Monthly Report* contains tables of the latest monthly country data. This periodical is not for sale, it can only be obtained in the framework of the wiiw Service Package.
- Free copies of the Institute's ***Research Reports*** (including ***Reprints***), ***Current Analyses and Country Profiles*** and ***Statistical Reports****.*
- A free copy of the ***wiiw Handbook of Statistics*** (published in October/November each year and containing more than 400 tables and graphs on the economies of Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Poland, Romania, Russia, Serbia and Montenegro, the Slovak Republic, Slovenia and Ukraine)
- Free online access to the **wiiw Monthly Database**, containing more than 1200 leading indicators monitoring the latest key economic developments in ten Central and East European countries.
- **Consulting**. The Vienna Institute is pleased to advise subscribers on questions concerning the East European economies or East-West economic relations if the required background research has already been undertaken by the Institute. We regret we have to charge extra for *ad hoc* research.
- Free access to the Institute's specialized economics library and documentation facilities.

Subscribers who wish to purchase wiiw data sets **on CD-ROM** or special publications not included in the wiiw Service Package are granted considerable **price reductions**.

To
The Vienna Institute
for International Economic Studies
Oppolzergasse 6
A-1010 Vienna

- O Please forward more detailed information about the Vienna Institute's Service Package
- O Please forward a complete list of the Vienna Institute's publications to the following address

Please enter me for

- O 1 yearly subscription of *Research Reports* (including *Reprints*)
  at a price of EUR 225.00 (within Austria), EUR 250.00 (Europe) and EUR 265.00 (overseas) respectively

Please forward

- O the following issue of *Research Reports* ....
- O the following issue of *Current Analyses and Country Profiles* ....
- O the following issue of *Working Papers* ....
- O the following issue of *Statistical Reports* ....
- O the following issue of *Research Papers in German language* ....
- O the following issue of *Industry Studies* ....
- O the following issue of *Structural Reports* ....
- O the following issue of *wiiw Database on Foreign Direct Investment* ....
- O the following issue of *wiiw Handbook of Statistics* ....

....

Name

....

Address

....

Telephone Fax E-mail

....

Date Signature

Herausgeber, Verleger, Eigentümer und Hersteller:
Verein „Wiener Institut für Internationale Wirtschaftsvergleiche“ (wiiw),
Wien 1, Oppolzergasse 6
Postanschrift: A-1010 Wien, Oppolzergasse 6, Tel: [+431] 533 66 10, Telefax: [+431] 533 66 10 50
Internet Homepage: www.wiiw.ac.at
Nachdruck nur auszugsweise und mit genauer Quellenangabe gestattet.
P.b.b. Verlagspostamt 1010 Wien