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Wiener Institut für Internationale Wirtschaftsvergleiche

The Vienna Institute for International Economic Studies

Current Analyses and Forecasts | 4 | July 2009

Economic Prospects for Central, East and Southeast Europe

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Where Have All the Shooting Stars Gone?

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The authors of this report wish to thank Boriana Assenova, Nadja Heger, Beate Muck, Renate Prasch, Hana Rusková, Monika Schwarzhappel and Barbara Swierczek (all wiiw) for statistical assistance.

Executive Summary

The 21 countries covered in our report have been hit hard by the global crisis, particularly via the trade channel and international capital markets. The current forecast is based on the assumption that no further waves of the global crisis are in sight and the Western financial institutions, including the parent banks of affiliates in Central, East and South East Europe and the CIS have consolidated their positions. We expect that in most countries covered in our report GDP decline will have bottomed out over the second half of 2009. A pronounced recovery, however, is not thought to set in before 2011. There are numerous downward risks which may render this scenario too optimistic.

The earlier good performing new EU members states (NMS) in terms of GDP growth, namely the Baltic States, Slovakia, Slovenia, and Romania, suffered a severe shock after September 2008. The growth reversal was somewhat milder in Bulgaria, the Czech Republic, Hungary and Poland. Generally, NMS with fixed exchange rates or the euro came off worse than NMS with flexible exchange rates. The NMS with fixed exchange rates or the euro are, in contrast to the other NMS, unable to adjust to the changed external environment through depreciation of the exchange rate. Depreciation can provide some competitiveness gain for small open economies.

For the small, export-oriented NMS, diminishing foreign demand is the main concern. Exports have started to shrink already in the last quarter of 2008. A very strong contraction of investments, a depletion of inventories and shrinking consumption led, together with lower energy prices, to an even more severe contraction in imports, in April 2009 ranging between 31% and 50%, compared to the same month in the previous year. The result was a rapidly improving trade balance across the board.

Current account positions of NMS will substantially improve. This is the consequence of improving trade balances and evaporating profits of foreign-owned enterprises, accounted for as an outflow in the current account. This change coincides with the radically diminished capital inflows.

Among the NMS, only the Czech Republic, Slovenia and Bulgaria are pursuing active demand management through anti-cyclical fiscal policy in order to ease the consequences of the crisis. In the Czech Republic, both the relatively sound fiscal stance and a crisis-resistant banking sector are permitting cautious and modest fiscal expansion. In Bulgaria, sufficient fiscal reserves have been accumulated in the last years to allow for substantial counter-cyclical spending. In Slovenia, the government has found it indispensable to boost domestic demand in view of the lack of ways to improve external competitiveness. Hungary, Romania and the Baltic States, however, are compelled to pursue a pro-cyclical fiscal policy. These countries, which had either a poor record of fiscal discipline (Hungary) or unsustainably high current account deficits (Romania, Baltic States), must regain the confidence of international financial investors, primarily through prudential fiscal policy, in some cases involving drastic austerity measures. This, moreover, is a cornerstone of the IMF stand-by agreements in force with Hungary, Romania and Latvia.

Foreign-owned banks in the NMS have benefited from government backing of parent companies in the EU-15. NMS central banks and governments have introduced various instruments to increase liquidity in the domestic banking system and mitigate the increased costs of borrowing. Nevertheless, the stability of the NMS banking system has remained fragile; the volume and depth of financial intermediation is far from those in the pre-crisis era and further financial assistance for parent banks or their affiliates in the NMS may be needed in the face of rising bad debt and defaults.

The NMS have been highly dependent on external financing. Foreign capital inflows reach the NMS through various channels: placements of government securities in foreign or national currencies, FDI, loans for financial and non-financial businesses and transfers from the EU budget. Of these channels, all but the EU transfers have narrowed or gotten clogged for shorter or longer periods since October 2008. The drying out of external finances compelled Hungary, Latvia and Romania to turn to the IMF for help.

The current wiiw baseline scenario for the NMS is based on the assumptions that no further deterioration in international financial intermediation will take place and that in the second half of the year a slow improvement of growth indicators in Western Europe will begin. However, throughout 2009 the NMS economies will be affected by persisting limitations on external financing and higher costs of borrowing. For businesses this will add up to problems caused by the fact that foreign and domestic demand will be lower than the pre-crisis level.

In 2009, only the three best-performing NMS – the Czech Republic, Poland and Bulgaria – are expected to have a smaller GDP decline than the 3.9% forecast for the EU on average, and thus continue to catch up. Poland, alone among the NMS, will achieve positive GDP growth in 2009, while the decline will be relatively modest in the Czech Republic and steeper in Bulgaria, with a predicted 3%. The second NMS group (Hungary, Slovakia, Slovenia and Romania) will face a

deeper recession than the EU average, in the range of 4% (Slovenia) to 6.5% (Hungary). In the Baltic States the GDP decline is forecast to assume catastrophic proportions, from 16% (Estonia and Lithuania) to 20% (Latvia). The wiiw expects a practically unchanged level of economic performance in the NMS as a whole in 2010 and a rather weak (less than 3%) growth in 2011.

Future member states of the EU (FMS) in Southeast Europe (Croatia, Macedonia and Turkey; further Albania, Bosnia and Herzegovina (BiH), Montenegro and Serbia) all have to face a GDP decline in 2009, which the wiiw expects to range between 1% and 7%. Compared to the growth rates achieved in 2007-2008, this means a dramatic drop: by close to 8 percentage points in Macedonia, by around 10 percentage points in Croatia, Albania, BiH and Serbia and between 12 and 14 percentage points in Turkey and Montenegro. The shift from growth to contraction in the FMS is more pronounced than the EU average, and we expect consequences in terms of increased unemployment, which will be especially severe for Turkey but milder in countries where a smaller segment of the economy is exposed to external developments. Two countries are pursuing active business stimulation policies: Macedonia and especially Turkey, where the government has prepared a comprehensive set of measures and the central bank has lowered its interest rates.

In the past couple of years, the FMS strongly relied on borrowing from abroad, which is mirrored by high deficits in trade with goods. Depending on net results in trade with services, net income and net transfer flows, these gaps in the balance of trade led to extremely high current account deficits. For Croatia and Montenegro, tourism helps finance a high proportion of trade deficits, whereas for Albania, Macedonia and BiH high inflow of current transfers fulfils this role. In the course of the current crisis, imports of goods declined more than exports, whereas revenues from tourism and transfer inflows decreased. Sources funding current account deficits (direct foreign investment, portfolio investment and loans) also became scarce, and the countries lost part of their currency reserves. Transition towards lower current account deficits is on the way. This adjustment may be less painful for Serbia and Turkey, the two countries with flexible exchange rates. Their business sector has profited from significant real depreciation in the course of the crisis. In both countries, inflation has remained higher than in Montenegro, which has the euro as legal tender, or in the currency board country BiH and the de-facto peg countries Albania, Croatia and Macedonia.

There are signs that the decline in industrial output and GDP will have bottomed out by mid-2009 in the FMS. We expect a relatively pronounced recovery and a return to GDP growth in 2010-2011 of between four and ten percentage points (BiH and Turkey, respectively). Whether this projection will prove true depends mainly on external developments.

Russia, Ukraine and to some extent Kazakhstan have also been seriously hit by the current global crisis. The main transmission channels have been falling commodity prices, the credit squeeze, currency devaluations and falling investments. In Russia, most current forecasts reckon with a sharp GDP drop in 2009, with stabilization or even some modest increase possible in 2010. Unlike Russia, Ukraine is not in a position to implement a stimulus programme to mitigate the impact of the crisis and its GDP decline will be in double digits. In Kazakhstan, GDP will decline in 2009 by a relatively modest 2%. In all three countries, a weak – partly export-led – recovery is forecast for 2010. Rather

slow growth is expected also in the medium term. Both Russia and Kazakhstan officially halted negotiations with the WTO in June 2009 due to the decision to create a Customs Union (together with Belarus) in 2010. All three countries plan to enter the WTO as a single block, effectively (in the case of Russia) delaying WTO accession by several years.

Summarizing our forecast, for 19 of the 21 countries we have covered in this report, we expect a GDP decline in 2009. In 7 countries the contraction of the economy will be smaller than the 3.9% EU average decline, in 8 countries more severe (4% to 10 %), and in 4 countries extremely severe (over 10%). The era of large current account deficits is over. In the current global situation, no external financing is available for maintaining the earlier extent of current account deficits. The forthcoming recovery phase will be decisively influenced by the limits of external funding.

The wiiw finds that in order to gain strength, the forthcoming recovery in the NMS, FMS and the former Soviet Union will need to be backed by an improving global or at least European business climate. There is no guarantee yet that this situation will materialize, in spite of most forecasts predicting it. In countries where the degree of capacity utilization is extremely low, as is the case in large parts of Europe, a merely slight increase in demand will not provide much in the way of relief for companies, especially debt-burdened ones. The creation of new, upgraded production capacities can be expected to follow later on. Finally, there is still the possibility of exchange rate crises (including the breakdown of fixed/pegged exchange rate regimes) with accompanying contagion effects.

Albania will face recession this year. First quarter data on remittances sent home by Albanian workers abroad register an 8% drop compared to the same period in the previous year. This is much worse than predicted in earlier forecasts. Remittances are an important source of growth in the construction sector as well as in the private consumption of Albanians. Pre-election government overspending in the first half of 2009 will somewhat outweigh the loss of income. However, for the whole year wiiw expects a 1% decline in GDP.

In **Bosnia and Herzegovina** a recently negotiated deal with the IMF will strengthen the currency board's trustworthiness. The country's various governments committed themselves to cutting their expenditures, and now the question is when this is going to happen. The real sector would profit from economic agents' spending more rather than less. Given that the producers of tradables, who are suffering most from the current crisis, generate a relatively small share of overall GDP, GDP decline in 2009 may remain confined to 3%. As far as business stimulation is concerned, policymakers tend to regard protectionist measures as the less costly and more supportive strategy.

GDP growth in **Bulgaria** was negative in the first quarter but the depth of the recession was not as great as previously expected, having been partly mitigated by the government's countercyclical measures. The downturn was accompanied by a structural adjustment, reflected in a shrinking domestic demand and a concomitant reduction of the trade and current account deficits. The labour market adjustment is lagging behind but is expected to follow in the coming months, and will

probably be of a more lasting nature. The outlook is dominated by downside risks, but will largely depend on the overall outlook for the European economy.

Economic activities in **Croatia** will continue to deteriorate in 2009. This is primarily an effect of falling exports of goods and services – tourism in particular – coupled with a contraction of domestic demand. Unavoidably, the current account will have to undergo substantial adjustment and it can be expected that the current account deficits in 2009 and 2010 will be considerably lower than in the past couple of years. Servicing the high foreign debt and maintaining the exchange rate of the kuna will remain the most challenging tasks in the coming months.

In the **Czech Republic,** if the national currency remains relatively weak, domestic production should become sufficiently competitive to replace at least some imports. In 2008 the contribution of foreign trade to GDP growth was negative, but it is likely that this will not be the case in 2009, or at least not to the same extent. Consumption, aided by continuing growth of lending to households and also supported by the relaxed fiscal policy, will reduce the scale of GDP decline, partially offsetting the strong contraction in gross capital formation.

Despite a significant slowing down of the economy in **China**, growth rates are still high by international standards, having reached 6.1% in the first quarter of this year. Moreover, there are certain signs that the slowdown of the Chinese economy has already bottomed out, helped also by massive stimulus measures instituted by the government. In consequence, GDP growth is expected to reach about 7% in 2009 and probably 8% in 2010.

In **Estonia,** the credit crunch has put an end to the externally financed economic boom, resulting in a 16% economic slump this year. Nevertheless, in order to meet the Maastricht criteria and enter the euro zone as soon as possible, preferably in 2011, the government has approved budget cuts which will further reduce domestic demand.

In **Hungary,** fiscal prudence, indispensable to the restoration of international investors' confidence, will diminish domestic demand in both 2009 and 2010. It is assumed that foreign demand will bottom out in the second half of 2009 and increase modestly in 2010, thus determining the depth of the recession this year and in the next two years. After a GDP decline of 6.5% this year and 1.5% in 2010, growth can be expected only in 2011, when fiscal consolidation has already been completed.

The wiiw forecast for **Kazakhstan** has been revised downwards because exports have been hit more severely than expected by a drop in external demand, and problems in the banking system have turned out to be even more profound than previously predicted. The government has been pumping resources into the country's banking sector; however, so far, the success of this policy has been limited. GDP will decline in 2009, albeit only by 2%. Recovery will start in 2010, when real GDP will grow by 2%, in particular owing to the expected increase in world oil prices.

Latvia is sliding into the abyss of a tremendous economic depression (-20% in 2009) due to the slump of both internal and external demand. The rescue package of the EU and the IMF has helped

prevent sovereign default, but has provoked the government to implement harsh pro-cyclical austerity measures, while trying to defend the euro peg of the lats against escalating pressure. This will lead to a period of substantial deflation and a reduction of GDP by about 30% in 2009-2011.

Lithuania, like its Baltic neighbours, is attempting to stick to deflationary fiscal policies in order to keep the litas pegged to the euro. The immediate effect of the simultaneous collapse of private and public consumption, investments and exports is that the unemployment rate tripled year on year and will exceed 20% by the end of this year, while GDP will decline by 16% in 2009.

Early effects of the crisis were rather subdued in **Macedonia**, but more bad news is expected in the short term. Stagnation is the most probable outcome in the medium term. An IMF programme is to be expected some time down the road. On the positive side, the start of membership negotiations with the EU can be expected next year.

In **Montenegro** the declines in industrial production and in exports of commodities are not that damaging, as this is an economy based on services. If the tourist season turns out to be poor, it will present problems for the balance of payments and for fiscal balances. The key to medium-term developments is investment in energy and tourism. Montenegro expects to start negotiating for membership in the EU sometime next year or in 2011.

Poland's relatively good performance is explained by the country's size, low levels of exports and imports, and a quite diversified production structure. With the domestic currency undergoing deep depreciation, these features are advantageous, with imports being at least partly substituted by domestic production. Apart from that, Poland's domestic financial system appears to be in good shape, with the debt levels (of households, the government and the corporate sectors) significantly lower than elsewhere.

The contraction of the **Romanian** economy is expected to reach 6% in 2009 due to a collapse of private consumption and poor agricultural performance. Fiscal and current account stability have improved and are safeguarded by an IMF loan package. Abundant multilateral financing will save the country in the case of external shocks, but also restricts the government in giving fiscal stimulus to the economy. The inflow of private financing may remain meagre for some years. Hence we can expect a stagnation of economic performance in 2010 and only a modest recovery in the following years.

Russia has been seriously hit by the current global crisis. Despite considerable fiscal stimulus, most current forecasts reckon with negative GDP growth in 2009, and stabilization or even a possible modest increase in 2010. A GDP growth slowdown appears inevitable in the medium term as well. Major challenges – institutional developments, economic diversification and demography – remain unchanged. Neither the economic nor the political prospects for Russia are encouraging.

Negative developments will continue in **Serbia** throughout the year and stagnation or slow recovery can be expected in the medium term. A lot will depend on continuous financial support by the IMF,

which will, in turn, depend on the ability of the Serbian government to implement a consistent economic policy. This will be difficult, given the growing risks of political and social instability.

GDP will contract by about 5% this year in **Slovakia**, mostly due to the overambitious SKK/EUR conversion rate and the falling foreign demand. Given the anti-crisis package, as well as lower budgetary revenues, the fiscal deficit and public debt will expand. Reduced economic activities will result in rising unemployment and in a lessening of the current account deficit.

Slovenia has become one of the new EU member states hardest hit by the global economic crisis. Shrinking export orders coupled with a strong contraction of investments are expected to lead to a noticeable decline in GDP in 2009. So far, two recovery packages mitigating the impact of the crisis have been adopted, and a third is in preparation. Along with the drop in GDP and the full operation of automatic stabilizers, the implementation of these measures may lead to a widening of the general government deficit to 5-6% of GDP. Trade and current account deficits will diminish.

Turkey's manufacturing sector was hit hard by the global economic crisis, and GDP may decline by about 7% in 2009. The business confidence index was extremely low last December, but has recovered since then, and cautious optimism is also on the rise among international investors, who would, however, like to see an agreement with the IMF first before stepping up their engagement. After such a deal, appreciation pressure could increase. The government has prepared a large stimulus package, the major impact of which should become visible in 2010. The central bank is using decelerating inflation as an opportunity to decrease interest rates.

Ukraine's economy has been hit hard by the falling steel prices and the international credit crunch since September 2008, with exports and investments suffering the most. At the same time, plummeting imports have nearly restored the external equilibrium, the currency has been strengthening recently (after having fallen by some 60%), and the withdrawal of private deposits from the banking system has stopped. Still, the wiiw expects a double-digit fall in GDP in 2009 and only a moderate export-led recovery next year – provided that the external environment is not too unfavourable.

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

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

Table I

Overview developments 2007-2008 and outlook 2009-2011

	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				
	2007	**2008**	**2009**	**2010**	**2011**	**2007**	**2008**	**2009**	**2010**	**2011**	**2007**	**2008**	**2009**	**2010**	**2011**	**2007**	**2008**	**2009**	**2010**	**2011**
			Forecast					**Forecast**					**Forecast**					**Forecast**		
Czech Republic	6.0	3.2	-1.5	1	3	2.9	6.3	1.0	2.0	2.5	5.3	4.4	7	7.0	6.5	-3.2	-3.1	-1.8	-1.4	-1.9
Hungary	1.2	0.5	-6.5	-1.5	3	7.9	6.0	4.7	4.3	3	7.4	7.8	10.5	11	10	-6.4	-8.4	-4.4	-4.0	-3.9
Poland	6.6	5.0	0.8	1.5	3.0	2.6	4.2	3.3	2.6	2.5	9.6	7.1	9	10	9.0	-4.7	-5.5	-1.7	-2.2	-2.9
Slovakia	10.4	6.4	-5	0	1	1.9	3.9	2	2	3	11.1	9.5	13	14	14	-5.7	-6.6	-4.7	-5.1	-5.3
Slovenia	6.8	3.5	-4	1	3	3.8	5.5	1.5	2	2	4.8	4.4	7	7.5	7	-4.2	-5.5	-2.8	-3.2	-4.1
NMS-5 [2)3)]	*6.0*	*4.0*	*-1.5*	*0.8*	*2.8*	*3.5*	*5.0*	*2.8*	*2.6*	*2.6*	*8.5*	*6.9*	*9.2*	*9.9*	*9.1*	*-4.7*	*-5.5*	*-2.5*	*-2.6*	*-3.1*
Bulgaria	6.2	6.0	-3	0	3	7.6	12.0	2	2	3	6.9	5.6	9	9	8	-25.2	-25.3	-13.9	-12.2	-10.7
Romania	6.2	7.1	-6	0	3	4.9	7.9	6	4	3	6.4	5.8	9	9	8	-13.5	-12.2	-5.0	-5.3	-5.9
Estonia	6.3	-3.6	-16	-10	-2	6.7	10.6	0	-4	-2	4.7	5.5	15	18	18	-18.1	-9.2	1.1	1.8	-0.9
Latvia	10.0	-4.6	-20	-12	-2	10.1	15.2	3	-5	-4	6.0	7.5	18	22	20	-22.5	-12.7	0.5	1.9	2.8
Lithuania	8.9	3.0	-16	-13	-3	5.8	11.1	4.5	-2	0	4.3	5.8	15	19	18	-14.6	-11.6	0.7	-2.1	-2.6
NMS-10 [2)3)]	*6.2*	*4.3*	*-3.3*	*-0.1*	*2.5*	*4.2*	*6.3*	*3.3*	*2.5*	*2.4*	*7.7*	*6.5*	*9.4*	*10.0*	*9.1*	*-7.7*	*-7.6*	*-3.1*	*-3.2*	*-3.7*
EU-15 [3)]	*2.7*	*0.6*	*-4.0*	*-0.1*	.	.	.	.	.	.	*7.0*	*7.1*	*9.5*	*11.1*	.	*0.1*	*-0.3*	.	.	.
EU-27 [3)]	*3.1*	*1.0*	*-3.9*	*-0.1*	.	*2.3*	*3.7*	*0.7*	*1.3*	.	*7.1*	*7.0*	*9.5*	*10.9*	.	*-0.5*	*-0.9*	*-1.9*	*-2.0*	.
Croatia	5.5	2.4	-4	0.5	2	2.9	6.1	3	2.5	2.5	9.6	8.4	10.5	11	10	-7.6	-9.4	-6	-6	-6.5
Macedonia	5.9	5.0	-2	0	2	2.3	8.3	3	3	3	34.9	33.8	34	33	33	-7.2	-13.1	-7	-8	-8
Turkey	4.7	1.1	-7.0	1	3	8.8	10.4	6	5	4	9.9	10.6	16	17	17	-5.9	-5.6	-2.1	-2.5	-2.7
Candidate countries [2)3)]	*4.8*	*1.3*	*-6.7*	*0.9*	*2.9*	*8.2*	*10.0*	*5.7*	*4.8*	*3.9*	*10.7*	*11.2*	*16.5*	*17.4*	*17.3*	*-6.1*	*-6.0*	*-2.5*	*-2.9*	*-3.1*
Albania	6.2	8	-1	1	5	2.9	3.4	2	2	3	13.5	12.8	15	16	14	-10.5	-14.4	-14.5	-13.7	-13.2
Bosnia & Herzegovina	6.8	5.0	-3	-1	1	1.5	7.5	-0.5	0	1	29.0	23.4	27	28	27	-10.4	-15.1	-9	-8	-8
Montenegro	10.7	8.1	-3	-1	2	4.2	7.4	3	3	3	19.3	17.2	19	20	20	-29.4	-29.2	-10	-10	-10
Serbia	6.9	5.4	-4	0	2	7.0	11.7	8	6	3	18.1	14.0	18	20	20	-15.7	-17.6	-10	-10	-11
Potential candidate countries [2)3)]	*7.0*	*5.9*	*-3.2*	*-0.1*	*2.3*	*5.0*	*9.1*	*4.9*	*3.9*	*2.6*	*19.2*	*15.7*	*19.1*	*20.7*	*19.9*	*-14.5*	*-17.3*	*-10.1*	*-9.8*	*-10.9*
Kazakhstan	8.7	3.3	-2	2	4.5	10.8	17.1	9.5	8	7	7.3	6.6	7.5	7	6.5	-7.0	5.2	-4.6	-2.3	-1.7
Russia	8.1	5.6	-4.7	4.0	4.1	9.1	14.1	12	10	8	6.1	6.3	10.5	10	9	5.9	6.1	3.1	2.4	2.2
Ukraine	7.9	2.1	-11.0	1.5	4.5	12.8	25.2	16	12	10	6.4	6.4	8.5	8	7.5	-4.1	-7.2	-0.8	0.4	0.7
China [4)]	13.0	9.0	7	8	8.2	4.8	5.9	0.5	1	2	4.0	4.2	4.6	4.3	4.2	11.0	9.9	6.3	6.8	6.3

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) Registered urban unemployment rate, end of period.

Source: wiiw (June 2009), Eurostat. Forecasts by wiiw and European Commission (Economic Forecast, Spring 2009) for EU-15 and EU-27.

Table II **Central and East European new EU member states (NMS-10): an overview of economic fundamentals, 2008**

	Bulgaria	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	*NMS-10* [1]	*EU-15*	*EU-27* [2]
GDP in EUR at exchange rates, EUR bn	34.12	148.56	15.86	105.24	23.12	32.29	362.10	137.03	64.88	37.13	*960.3*	*11521.3*	*12504.4*
GDP in EUR at PPP, EUR bn	75.81	212.97	21.90	157.63	31.33	51.12	536.68	242.14	95.90	46.51	*1472.0*	*10932.8*	*12504.4*
GDP in EUR at PPP, EU-27=100	0.6	1.7	0.2	1.3	0.3	0.4	4.3	1.9	0.8	0.4	*11.8*	*87.4*	*100.0*
GDP in EUR at PPP, per capita	9800	20400	16300	15700	13800	15200	14100	11300	17700	22800	*15900*	*27700*	*25100*
GDP in EUR at PPP per capita, EU-27=100	39	81	65	63	55	61	56	45	71	91	*63*	*110*	*100*
GDP at constant prices, 1990=100	125.4	143.9	153.9	140.7	121.0	128.3	177.7 [3]	136.3	165.5	168.0	*163.9*	*144.0*	*146.5*
GDP at constant prices, 2000=100	154.8	140.3	165.1	130.4	174.6	176.1	138.4	162.1	162.0	140.1	*145.6*	*115.5*	*118.5*
Industrial production real, 1990=100	94.1	132.9	114.7	231.4	63.8	72.8	214.1 [3]	82.8	151.9	115.9	*170.7*	*124.3*	*130.3*
Industrial production real, 2000=100	177.6	163.0	175.6	152.9	135.9	188.9	165.2	142.5	162.6	129.3	*161.6*	*106.3*	*112.4*
Population - thousands, average	7621	10428	1341	10038	2266	3358	38123	21513	5406	2040	*102133*	*394776*	*498116*
Employed persons - LFS, thousands, average	3361	5003	657	3879	1125	1520	15800	9369	2434	996	*44142*	*177080*	*221765*
Unemployment rate - LFS, in %	5.6	4.4	5.5	7.8	7.5	5.8	7.1	5.8	9.5	4.4	*6.5*	*7.1*	*7.0*
General gov. expenditures, EU-def., in % of GDP	37.4	42.4	40.9	49.8	39.5	37.2	43.1	38.5	34.9	43.6	*38.8*	*47.2*	*46.8*
General gov. revenues, EU-def., in % of GDP	39.0	40.9	37.9	46.5	35.5	34.0	39.2	33.1	32.7	42.7	*42.0*	*44.9*	*44.5*
Price level, EU-27=100 (PPP/exch. rate)	44	71	73	68	73	63	68	57	68	80	*65*	*105*	*100*
Compensation per employee [4], monthly, in EUR	364	1275	1252	1242	967	915	905	697	1035	1950	*1083*	*3311*	*2842*
Compensation per employee, monthly, EU-27=100	12.8	44.9	44.1	43.7	34.0	32.2	31.8	24.5	36.4	68.6	*38.1*	*116.5*	*100.0*
Exports of goods in % of GDP	44.8	66.5	53.9	68.7	28.0	49.8	33.2	24.5	73.5	54.0	*45.7* [5]	*30.1* [5]	*31.3* [5]
Imports of goods in % of GDP	70.4	63.7	65.4	68.6	45.0	61.4	37.8	37.9	74.6	61.0	*51.2* [5]	*30.9* [5]	*32.5* [5]
Exports of services in % of GDP	15.7	10.2	21.9	13.0	13.4	10.2	6.7	6.4	8.9	14.0	*9.2* [5]	*9.6* [5]	*9.6* [5]
Imports of services in % of GDP	13.3	8.0	14.7	12.1	9.4	9.2	5.7	5.8	9.7	9.2	*7.8* [5]	*8.4* [5]	*8.3* [5]
Current account in % of GDP	-25.3	-3.1	-9.2	-8.4	-12.7	-11.6	-5.5	-12.2	-6.6	-5.5	*-7.6* [5]	*-0.3* [5]	*-0.9* [5]
FDI stock per capita in EUR	4293	7844	8690	6254	3566	2722	3147	2402	5700	5100	4100	.	.

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

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

Source: wiiw, AMECO, Eurostat.

Table III

Future EU member states: an overview of economic fundamentals, 2008

	Croatia	Macedonia	Turkey	Albania	Bosnia and Herzegovina	Montenegro	Serbia	*NMS-10* [1]	*EU-15*	*EU-27* [2]
GDP in EUR at exchange rates, EUR bn	47.37	6.51	498.4	8.96	12.48	3.34	33.71	*960.3*	*11521.3*	*12504.4*
GDP in EUR at PPP, EUR bn	69.16	16.72	794.9	20.23	25.63	6.98	66.84	*1472.0*	*10932.8*	*12504.4*
GDP in EUR at PPP, EU-27=100	0.6	0.1	6.4	0.2	0.2	0.06	0.5	*11.8*	*87.4*	*100.0*
GDP in EUR at PPP, per capita	15600	8200	7000	6400	6700	11100	9100	*15900*	*27700*	*25100*
GDP in EUR at PPP per capita, EU-27=100	62	33	28	25	27	44	36	*63*	*110*	*100*
GDP at constant prices, 1990=100	119.7	113.1	202.6	185.6	514.2 [3]	.	.	*163.9*	*144.0*	*146.5*
GDP at constant prices, 2000=100	141.1	124.1	141.5	160.9	150.4	149.2	152.4	*145.6*	*115.5*	*118.5*
Industrial production real, 1990=100	91.2	60.4	220.2	.	.	.	.	*170.7*	*124.3*	*130.3*
Industrial production real, 2000=100	142.0	114.3	143.6	167.8	190.6	113.2	117.1	*161.6*	*106.3*	*112.4*
Population - thousands, average	4435	2048	74414	3170	3843	628	7350	*102133*	*394776*	*498116*
Employed persons - LFS, thousands, average	1636	609	21571	1230	890	219	2805	*44142*	*177080*	*221765*
Unemployment rate - LFS, in %	8.4	33.8	10.6	12.8	23.4	17.2	14.0	*6.5*	*7.1*	*7.0*
General gov. expenditures, nat. def., in % of GDP	42.3 [4]	34.2	20.4 [5]	31.6	43.0	37.2	45.0	*38.8* [5]	*47.2* [5]	*46.8* [5]
General gov. revenues, nat. def., in % of GDP	40.3 [4]	33.3	18.2 [5]	26.4	45.0	38.4	42.5	*42.0* [5]	*44.9* [5]	*44.5* [5]
Price level, EU-27=100 (PPP/exch. rate)	69	38	63	44	47	48	49	*65*	*105*	*100*
Average gross monthly wages, EUR at exchange rate	1044	428	731 [6]	206	547	609	558 [7]	*1,083* [6]	*3311* [6]	*2842* [6]
Average gross monthly wages, EUR at PPP	1525	1100	1166 [6]	465	1124	1273	1106 [7]	*38.1* [6]	*116.5* [6]	*100.0* [6]
Exports of goods in % of GDP	20.6	41.3	19.2	10.2	28.2	15.9	22.2	*45.7* [8]	*30.1* [8]	*31.3* [8]
Imports of goods in % of GDP	43.5	67.9	26.3	37.2	66.9	59.0	45.0	*51.2* [8]	*30.9* [8]	*32.5* [8]
Exports of services in % of GDP	21.3	10.6	4.8	17.0	9.0	22.6	8.2	*9.2* [8]	*9.6* [8]	*9.6* [8]
Imports of services in % of GDP	6.6	10.6	2.4	17.2	3.5	10.5	12.8	*7.8* [8]	*8.4* [8]	*8.3* [8]
Current account in % of GDP	-9.4	-13.1	-5.6	-14.4	-15.1	-29.2	-17.6	*-7.6* [8]	*-0.33* [8]	*-0.9* [8]
FDI stock per capita in EUR	4930	1600	730	935	1400	4864	1586	4100	.	.

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

1) wiiw estimates. - 2) wiiw estimates, except: budget and compensation per employee. - 3) 1995=100. - 4) 2007. - 5) EU definition: expenditures and revenues according to ESA'95, excessive deficit procedure. - 6) Gross wages plus indirect labour costs, whole economy, national account concept. - 7) Including various allowances. - 8) Data for NMS-10, EU-15 and EU-27 include flows within the region.

Source: wiiw, AMECO, Eurostat.

*Sándor Richter et al.**

New EU member states facing recession

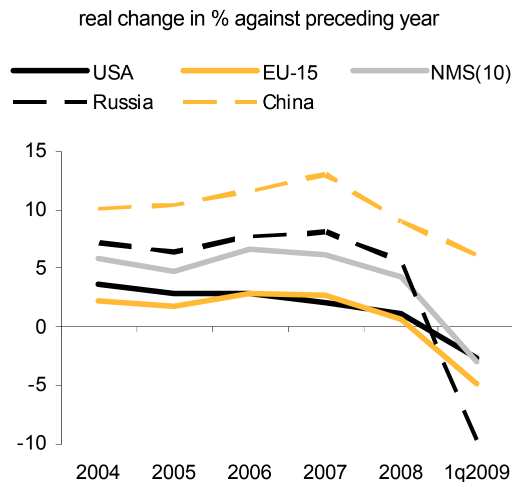
Slump in the main export markets, easing tensions in global financial markets

The financial and economic crisis spread to major regions of the world economy at the beginning of 2009. The US economy shrank by 2.5%, that of Japan by 9.1% and that of the EU by 4.7% in the first quarter of 2009.[1] The percentage of total exports of the new EU member states (NMS)[2] destined for the European Union ranges from 60.5% (Bulgaria) to 85.3% (Slovakia). Thus, developments in the European markets are of vital importance for the small and open NMS, which were hit hard by contracting output and correspondingly shrinking demand for imports in Western European members of the EU.

Figure 1

Quarterly GDP in selected regions and countries, 2004-2009

real change in % against preceding year



Source: wiiw Database incorporating national statistics; Eurostat

At present, in the early summer of 2009, the peak of the global financial crisis seems to be already behind us. Following government intervention in Western Europe, the financial institutions, including

* The research on this overview was completed on 30 June 2009. Peter Havlik, Kazimierz Laski, Michael Landesmann and the authors of the individual country reports provided useful comments on the earlier draft.

1 Eurostat newsrelease, 3 June 2009.

2 New member states: this refers to all countries which joined the EU in 2004 and 2007 respectively, excluding Cyprus and Malta.

the parent banks of affiliates in the NMS, have strengthened their positions. The danger of a 'sudden stop' of cross-border lending has significantly diminished. Stock exchanges all over the world have begun to recover, and credit default swap (CDS) spreads have come down from earlier highs, although borrowing costs still remained high. Earnings of key US banks are better than expected; they have even started to repay government loans, thus releasing themselves from some of the state-imposed restrictions.

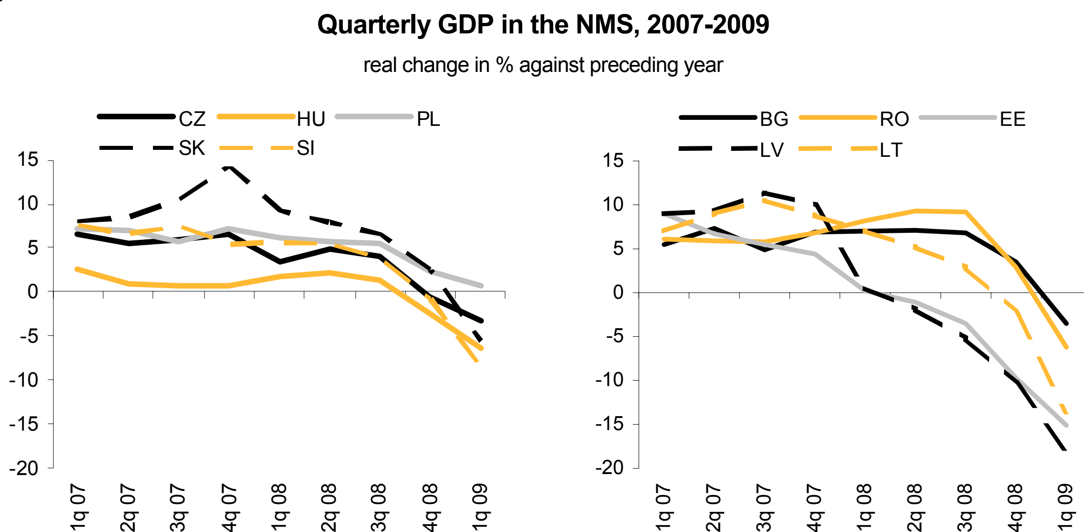
Sudden growth reversal of unprecedented magnitude

The impact of the global financial crisis reached the NMS in October 2008, soon after the collapse of Lehman Brothers. Disruptions in financial intermediation in the domestic markets, an ebbing of all forms of cross-border financing, rising credit default swaps, depreciation and huge volatilities of the exchange rate (in countries with flexible regimes) suddenly and radically changed the external and internal environment for economic activities. Initial hopes that emerging markets, including the NMS, could resist contagion proved wrong. Previously existing vulnerabilities such as excessive current account deficits, considerable foreign and/or public debt, and a high percentage of household and business loans denominated in foreign currencies gained in importance as credit became scarce. The dominance of foreign-owned banks in most NMS, formerly seen as a guarantee for an abundance of credit, lost appeal in view of the serious difficulties their parent companies were having to face.

Figure 2

Quarterly GDP in the NMS, 2007-2009

real change in % against preceding year



Source: Eurostat

The deceleration of economic growth that started in most NMS countries in the third or fourth quarter of 2008 (much earlier in the Baltics) became a decline in the first quarter of 2009, except in Poland, where marginal growth was recorded. The growth reversal was rapid and huge (Table 1, Figure 2). The Baltic States, Slovakia, Slovenia and Romania, still 'shooting stars' until the first half of 2008, suffered a severe shock, with growth reversals of -13 to -19 percentage points. In the case of

Slovakia and Slovenia this may, to a smaller (Slovenia) or greater (Slovakia) extent, be related to the adoption of the euro at the beginning of this year and in 2007, respectively. Neither of the two small, export-dependent economies was able to adjust to the new situation through devaluation, and that led to a deterioration of their competitiveness. Generally, other NMS with fixed exchange rates came off poorly as well in terms of GDP growth. All three Baltic countries suffered a horrific decline in economic performance, although Estonia's and Latvia's growth had already been minimal in the first half of last year. Bulgaria is the exception: despite its fixed exchange rate, its growth reversal was relatively less severe. Altogether, NMS with flexible exchange rates have performed better than NMS with fixed exchange rates.

Table 1

Extent of the growth reversal

	Change in quarterly GDP growth rates, 1Q2009 compared to 2Q2008, percentage points	GDP growth rates real change in % against preceding year		
		2008 2Q	**2009 1Q**	**2009 Forecast**
Lithuania	-18.8	5.2	-13.6	-16
Latvia	-16.1	-1.9	-18.0	-20
Romania	-15.5	9.3	-6.2	-6
Estonia	-14.0	-1.1	-15.1	-16
Slovenia	-14.0	5.5	-8.5	-4
Slovakia	-13.5	7.9	-5.6	-5
Bulgaria	-10.6	7.1	-3.5	-3
Hungary	-8.8	2.1	-6.7	-6.5
Czech Republic	-8.2	4.9	-3.3	-1.5
Poland	-5.1	5.9	0.8	0.8

Source: Eurostat and national statistics. Forecasts by wiiw.

The development of the two main components in the final use of GDP in Table 2 reveals that up to the first quarter of this year, the contraction was typically much larger in investment than in household consumption (investors reacted faster than consumers to the crisis elsewhere, too). The Czech Republic, Poland and Slovenia achieved positive growth rates in household consumption, hinting at the role of this component in maintaining economic growth (Poland) or facilitating only a moderate decline (Czech Republic). Romania is an outlier; in this country, household consumption fell well over 10% in the first quarter but investments hardly dropped. The Baltic States are a separate chapter; here the unavoidable radical narrowing of imports due to lack of financing had already caused a catastrophic decline in investment and, at least in the first quarter of 2009, a huge but yet somewhat smaller reduction in household consumption.

It is remarkable that only Poland managed to maintain positive GDP growth, and actually, in the EU, apart from Poland, only Greece, Cyprus and Malta were able to attain an expansion of the economy

in the first quarter of 2009. What makes Poland different from the other NMS? It is, to some extent, a matter of the country's size, its relatively low levels of exports and imports, and a production structure more diversified than in other NMS. Together with a depreciation of the domestic currency, these features turn out to be advantageous: the drop in exports is overcompensated by the drop in imports – the latter being at least partly substituted by domestic production. In smaller, more export-specialized countries, the adjustments in imports are less pronounced, even under quite strong currency depreciation. Apart from that, Poland's domestic financial system turns out to be in good shape, with the debt levels (of households, the government and the corporate sectors) significantly lower than elsewhere. This fact is not a sign of an exceptionally forward-looking policy. Rather, it follows from the brevity of the preceding GDP growth speedup which started only in 2006 and did not have time to reach the unsound proportions which characterized many other NMS.

Table 2

Gross fixed capital formation and consumption of households

real change in % against preceding year

	Gross fixed capital formation						Consumption of households					
	2008				2009		2008				2009	
	1Q	2Q	3Q	4Q	1Q	Forecast	1Q	2Q	3Q	4Q	1Q	Forecast
Czech Republic	0.5	0.0	1.4	-2.1	-3.4	-8	2.8	3.1	2.8	2.2	3.0	2
Hungary	-5.1	-1.9	-1.5	-2.7	-6.9	-9.5	0.6	1.6	0.2	-4.1	-7.3	-7
Poland	15.7	14.6	3.5	4.6	1.2	-4	5.6	5.6	5.1	5.3	3.3	3
Slovak Republic	7.5	11.8	7.3	1.4	-4.1	-2	8.4	5.7	6.0	4.7	-1.2	0
Slovenia	16.9	10.3	4.5	-5.3	-23.6	-15	3.7	3.5	0.6	1.1	0.1	-2
Bulgaria	15.5	28.6	22.3	15.8	-14.1	-8	6.5	5.4	6.5	1.5	-6.4	0
Romania	33.2	30.0	24.3	2.8	-0.3	-5	15.6	13.5	16.1	-4.7	-12.3	-8
Estonia	0.6	-2.5	-6.0	-24.0	-26.6	-28	0.1	-2.0	-3.5	-10.4	-17.6	-18
Latvia	-7.2	-11.8	-16.9	-15.0	-34.1	-30	-0.5	-8.4	-13.3	-20.1	-17.4	-21
Lithuania	1.6	-2.3	-3.3	-17.9	-37.1	-30	11.1	7.3	4.7	-2.9	-15.1	-18

Source: Eurostat and national statistics. Forecasts by wiiw.

Industrial production rapidly shrinking, due to evaporating export opportunities

The data of Table 3 display the accelerating decline of industrial output in the NMS from month to month in the second half of last year and the first four months of 2009. The really strong, mostly two-digit contraction began in November 2008 and seems to have reached its climax in January and February 2009. The rate of decline was still very strong in March; nevertheless, in nine of the ten NMS it was substantially smaller than in the two previous months. April data, however, show a considerable deterioration again. It is notable that in Poland, Bulgaria and Romania the contraction of industrial output has been somewhat less severe than the NMS average. The explanation is that in these three countries the share of exports and imports compared to GDP is substantially smaller than in other NMS (excluding the Baltic States) and these countries are less exposed to shrinking foreign demand.

Table 3

Gross industrial production

real change in % against preceding year (based on NACE Rev. 2)

	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09
Czech Republic	5.0	-7.4	4.3	-9.8	-18.0	-12.8	-22.8	-23.0	-12.2	-22.1
Hungary	1.2	-5.0	1.3	-5.5	-10.6	-19.2	-22.6	-28.9	-15.6	-27.1
Poland	4.9	-4.4	5.5	-2.0	-10.7	-5.6	-15.3	-14.6	-2.0	-12.4
Slovakia	14.6	0.0	2.7	-2.1	-13.9	-18.8	-26.9	-26.4	-15.9	-25.8
Slovenia	-2.2	-5.8	5.5	-3.0	-14.9	-15.9	-19.8	-21.2	-15.9	-28.3
Bulgaria	4.3	-4.0	3.4	-3.4	-9.1	-8.5	-18.4	-17.7	-16.9	-20.0
Romania	6.2	-1.7	9.2	1.3	-9.5	-12.5	-16.4	-14.5	-8.4	-9.4
Estonia	-0.3	-8.8	0.2	-13.7	-21.3	-17.7	-28.1	-32.3	-25.5	-35.6
Latvia	-0.3	-11.7	0.6	-5.0	-16.0	-10.4	-22.6	-27.5	-18.6	-20.2
Lithuania	3.5	-1.6	9.3	0.9	-2.6	-0.7	-7.0	-15.5	-18.5	-25.5

Source: wiiw Monthly Database incorporating national statistics.

In the epicentre of the NMS crisis: developments in foreign trade

Monthly export growth rates (year on year) show that the last month of the 'good old times' was September 2008, still with double-digit expansion rates in all but one NMS, in five countries with growth rates exceeding 20% – in Lithuania an amazing 40% (see Table 4). Only two months later, declines were reported from all NMS; eight countries even had double-digit contraction rates. The most severe shrinkage of exports year on year took place in January and February, with rates of decline between 25% and 30%. March saw a somewhat less steep decline, in tandem with the development of industrial output, but it was still typically double-digit. April was again characterized by steep declines, in the Baltic States the worst monthly rates by far since November 2008. The speed of contraction and its simultaneity with that in industry are remarkable. Between January and December 2008, exports dropped to 70-80% of their initial level, then recovered to some extent in the spring months (see Figure 1 in Special Section *Foreign trade as a transmission channel of the global crisis,* p. 142)

Monthly changes in imports roughly follow the pattern observed in exports with about a one-month lag. However, from January 2009, some NMS, and in February through April all but one, reported a much steeper decline in imports than in exports. The imports' contraction rate in April exceeded 30% in all 10 NMS; in the Baltic States, the contraction rate was over 40%, with an unbelievable 50% in Lithuania. The widening export-import gap is reflected in the development of the trade balances. By April 2009, a considerable improvement had taken place in the trade balances of Poland, Hungary and Bulgaria. An improvement, though less spectacular, was also reported from the other NMS. This improvement may be the result of circumstances related to the crisis: sinking demand for imported items due to diminished consumption and falling investments, more expensive and not so easily available credit for trade financing and in general for project financing, cheaper energy and, finally, more competitive domestic production, i.e. import substitution, due to devaluated exchange rates (not in countries with fixed exchange rates).

Table 4

Foreign trade, July 2008 – April 2009

Exports total (fob)
change in % against preceding year (Euro-based)

	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09
Czech Republic	25.5	2.7	17.8	-1.4	-13.0	-11.7	-27.8	-31.3	-15.3	-27.6
Hungary	9.2	-1.2	9.0	-5.0	-10.3	-17.1	-31.5	-29.6	-18.4	-29.3
Poland	23.3	9.1	21.1	0.3	-12.7	-19.9	-26.7	-30.3	-12.8	-29.7
Slovakia	18.7	13.9	20.6	9.8	-7.6	-10.6	-26.3	-25.3	-12.6	-18.6
Slovenia	4.8	-8.5	11.6	-0.1	-13.7	-14.5	-25.3	-24.1	-18.1	-29.7
Bulgaria	22.1	14.2	16.9	-1.4	-15.0	-14.3	-27.3	-26.1	-27.2	-39.8
Romania	22.4	17.8	18.5	14.2	-8.4	-15.6	-24.1	-27.4	-6.6	-22.9
Estonia	11.0	8.3	25.1	12.6	-16.2	-6.5	-28.1	-26.3	-22.1	-37.6
Latvia	13.2	7.5	24.7	6.5	-15.2	-11.1	-25.0	-29.3	-23.3	-30.9
Lithuania	35.7	26.9	40.8	24.2	17.7	-3.2	-15.4	-27.0	-31.1	-39.8

Imports total (cif) [1)]
change in % against preceding year (Euro-based)

	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09
Czech Republic	20.8	1.6	19.7	4.4	-7.8	-7.3	-25.5	-31.0	-21.4	-30.7
Hungary	13.8	-2.3	11.2	-2.4	-10.0	-17.4	-29.7	-32.7	-23.6	-35.3
Poland	23.3	19.7	22.8	5.1	-8.0	-16.9	-27.8	-35.3	-26.1	-36.7
Slovakia	20.8	6.0	24.1	8.7	-6.1	-9.8	-19.6	-26.8	-16.4	-31.1
Slovenia	15.0	3.9	10.6	4.7	-12.4	-11.6	-30.7	-27.7	-22.3	-34.9
Bulgaria	26.0	12.5	16.2	12.8	-11.2	-16.5	-33.1	-31.1	-25.9	-39.6
Romania	17.0	8.6	28.5	5.9	-16.1	-23.8	-35.8	-34.9	-34.7	-40.0
Estonia	7.3	-7.8	4.9	-2.8	-18.6	-15.1	-36.6	-34.9	-30.2	-40.6
Latvia	-10.3	-7.6	10.1	-5.8	-20.8	-15.6	-36.3	-39.6	-33.6	-45.6
Lithuania	25.7	13.8	27.0	10.2	-6.7	-8.8	-39.8	-40.7	-43.5	-50.2

1) Imports on 'fob' basis for Czech Republic and Slovakia.

Trade balance, EUR mn

	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09
Czech Republic	289	70	451	-210	-30	-392	151	307	826	447
Hungary	-397	-97	120	-80	93	-93	-167	311	489	424
Poland	-2349	-2129	-2070	-2184	-2164	-2132	-986	-564	-311	-446
Slovakia	-128	70	6	69	-190	-341	-219	67	105	372
Slovenia	-318	-337	-242	-323	-227	-328	-73	-68	-89	-43
Bulgaria	-926	-739	-803	-1097	-847	-725	-407	-415	-518	-535
Romania	-1964	-1770	-2458	-2103	-1712	-1503	-635	-806	-585	-835
Estonia	-263	-150	-190	-158	-195	-196	-94	-67	-103	-112
Latvia	-387	-339	-409	-378	-298	-319	-206	-178	-177	-138
Lithuania	-431	-312	-408	-326	-280	-323	-44	-99	-172	-88

Source: wiiw Monthly Database incorporating national statistics.

Table 5

Foreign trade by commodity groups, January to March 2009

Development of NMS exports to EU-27, January to March 2009

(a) = change in % against preceding year, (b) = share in % of total exports to EU-27

	Czech Republic		Hungary		Poland		Slovakia		Slovenia		Bulgaria		Romania	
Selected SITC 1-digit commodity groups	**(a)**	**(b)**	**(a)**	**(b)**	**(a)**	**(b)**	**(a)**	**(b)**	**(a)**	**(b)**	**(a)**	**(b)**	**(a)**	**(b)**
0 Food and live animals	-7.9	4.1	-4.3	7.4	-6.2	9.8	-21.5	3.4	1.5	5.2	45.4	11.2	52.1	3.5
2 Crude materials, inedible, except fuels	-34.6	2.3	-11.7	2.4	-40.6	1.8	-42.8	1.8	-38.6	2.2	-24.0	4.6	2.1	3.4
3 Mineral fuels, lubricants and related materials	-8.7	4.4	-46.8	1.9	-42.6	3.2	-32.6	4.4	14.2	2.5	-40.3	5.0	-40.2	3.1
5 Chemicals and related products, n.e.s.	-26.4	5.4	-23.5	7.4	-21.3	6.7	-35.0	4.1	-9.7	10.7	-33.9	4.7	-37.0	3.4
6 Manufactured goods classified chiefly by material	-29.3	18.4	-32.1	9.1	-33.5	18.2	-30.7	18.1	-31.0	20.5	-37.7	27.2	-29.3	16.8
7 Machinery and transport equipment	-28.1	52.5	-28.1	56.7	-18.3	43.5	-15.9	53.3	-22.4	46.0	-14.2	18.5	-4.0	42.5
8 Miscellaneous manufactured articles	-12.9	12.0	-22.9	8.7	-14.6	15.1	-2.3	11.7	-17.6	12.6	-20.1	25.7	-19.6	25.3

Development of machinery and transport equipment exports of the NMS to EU-27, January to March 2009

(a) = change in % against preceding year, (b) = share in % of total exports to EU-27

	Czech Republic		Hungary		Poland		Slovakia		Slovenia		Bulgaria		Romania	
Selected SITC 2-digit commodity groups	**(a)**	**(b)**	**(a)**	**(b)**	**(a)**	**(b)**	**(a)**	**(b)**	**(a)**	**(b)**	**(a)**	**(b)**	**(a)**	**(b)**
7 Machinery and transport equipment	-28.1	52.5	-28.1	56.7	-18.3	43.5	-15.9	53.3	-22.4	46.0	-14.2	18.5	-4.0	42.5
71 Power-generating machinery and equipment	-27.1	2.8	-37.2	8.5	-41.6	3.8	-28.4	1.2	-31.4	2.1	-38.8	1.5	-9.4	1.5
72 Machinery specialized for particular industries	-40.7	2.3	-39.9	1.5	-34.9	1.3	-24.2	1.7	-38.2	2.7	-5.0	2.0	-23.1	1.1
73 Metalworking machinery	-2.3	1.0	-46.0	0.1	-18.7	0.3	-22.3	0.5	9.4	0.9	-41.7	0.5	-28.1	0.5
74 General industrial machinery and equipment, n.e.s., and machinery parts, n.e.s.	-32.0	6.0	-45.0	3.4	-31.2	3.0	-25.1	4.1	-26.2	5.3	-34.8	2.8	-35.4	4.4
75 Office machines and automatic data-processing machines	-21.4	7.4	-35.7	3.1	72.7	2.5	-6.3	1.3	7.0	1.4	-37.6	0.2	-51.3	0.9
76 Telecommunications and sound-recording and reproducing apparatus and equipment	-29.5	6.3	4.9	15.8	-3.6	7.8	32.5	21.1	399.0	2.1	47.3	2.2	329.9	5.8
77 Electrical machinery, apparatus and appliances, n.e.s., and electrical parts thereof (including non-electrical counterparts, n.e.s., of electrical household-type equipment)	28.9	8.8	-34.6	8.9	-30.4	7.0	-10.3	7.5	-12.0	9.6	-12.3	7.3	-27.6	12.8
78 Road vehicles (including air-cushion vehicles)	-29.3	16.8	-42.3	8.9	-11.7	16.7	-43.8	15.1	-30.8	21.0	16.7	1.5	11.6	11.0
79 Other transport equipment	12.0	1.2	-13.5	6.4	-29.3	1.1	-1.5	0.7	1.4	0.9	7.6	0.6	55.2	4.3

Source: Eurostat (Comext database).

Data on the development of exports by commodity groups in the first three months of this year reveal the vulnerability of the NMS coming from strong specialization. The share of machinery and transport equipment (SITC 7) is over 50% of total exports in the Czech Republic, Hungary and Slovakia, and 40% to 50% in Poland, Slovenia and Romania (see Table 5). Within this group, SITC 78, road vehicles, are especially important for the Czech Republic, Hungary, Slovakia and Slovenia, where in the last decade major outlets of the world's automotive industry were established.[3] The world-wide crisis of the automotive industry, including the slump in foreign demand for cars produced in the NMS, can be followed in the strongly contracting exports of this commodity group in each of the countries concerned. Commodity group SITC 6 (semi-finished manufactured products), the second most important commodity group in exports of the countries concerned, suffered even larger losses in the first quarter of the year, reflecting the reservation of European manufacturers concerning the purchase of inputs for production under the current bleak economic growth prospects. Exports of the third most important export commodity group, SITC 8 (mainly consumer durables), decreased to a somewhat smaller extent than that of motor vehicles, transport vehicles and semi-finished products due to smaller drops in consumer durables consumption than in inputs for production and investment. Interestingly, amidst the overall collapse of exports, Bulgaria, Romania and Slovenia saw an increase in deliveries of food and live animals abroad.[4]

Absorbing the shock: exchange rates matter

In our Forecast 2 from July 2008, only a year ago, the wiiw still devoted a 'special topic' to addressing the danger of accelerating inflation, since at that time the issue of exploding energy and food prices was a hot topic worldwide.[5] Now, in mid-2009, the NMS (and not only they) report substantially lower inflation than a year ago (see Table I and Figure 3). Consumer price indices in the NMS have been diminishing since the third quarter of 2008, which corresponds well with the deflationary environment evolving in the euro area and in the global economy.

With the period of relatively high inflation and booming economy over, the era of continuous real appreciation also came to an end – in four NMS (Czech R., Hungary, Poland, Romania) where the flexible exchange rate regime allowed the nominal depreciation of the national currencies (Figure 4). As seen in Figure 5, a considerable real depreciation took place after September 2008 in the Czech Republic, Poland and Romania, a milder one in Hungary. A small turnaround took place in April. In Slovenia and Slovakia, members of the euro area since 2007 and January 2009, respectively, and in Bulgaria and the Baltic States, with their exchange rates pegged to the euro, there is no way for nominal depreciation of the exchange rate to adjust to the changed international environment. As Figure 5 indicates, however, strong producer price deflation in Bulgaria and even more in Lithuania

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3 In per capita terms, Slovakia is the world's first in car production, Slovenia is placed second, the Czech Republic third, all three outrunning the US, Japan, South Korea, Germany, France and Italy. Hungary is 12th in this ranking (2007 data). Fitch Ratings Special Report Emerging Europe Growth Outlook April 1, 2009, p. 5.

4 For additional analysis of developments in foreign trade see Special *Section Foreign trade as a transmission channel of the global crisis* pp. 136 to 148 in this report.

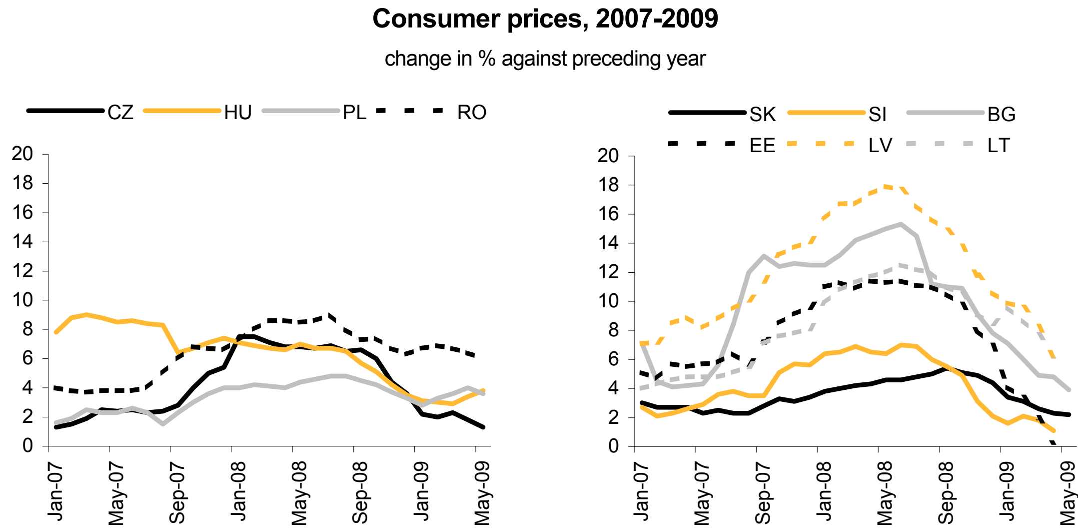
5 Podkaminer, Pöschl et al.: *The Big Boom is Over, but Growth Remains Strong and Inflation Calms Down* wiiw Current Analyses and Forecasts 2, July 2008, pp. 1-23.

led to a real depreciation of the exchange rate from September 2008. In Lithuania, a country where oil refining is an important part of the industrial activities, a steep drop in prices of imported oil explains the producer price deflation, while in Bulgaria a sharp decline in producer prices for steel products is the explanation. This, however, also means that we cannot speak of a general improvement of export competitiveness in either country.

Figure 3

Consumer prices, 2007-2009

change in % against preceding year

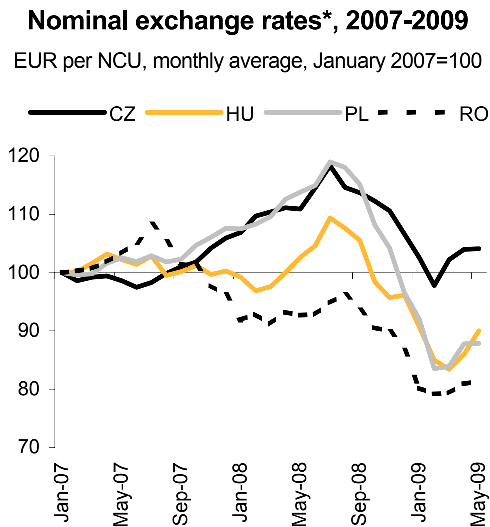


Source: wiiw Monthly Database incorporating national statistics.

Figure 4

Nominal exchange rates*, 2007-2009

EUR per NCU, monthly average, January 2007=100



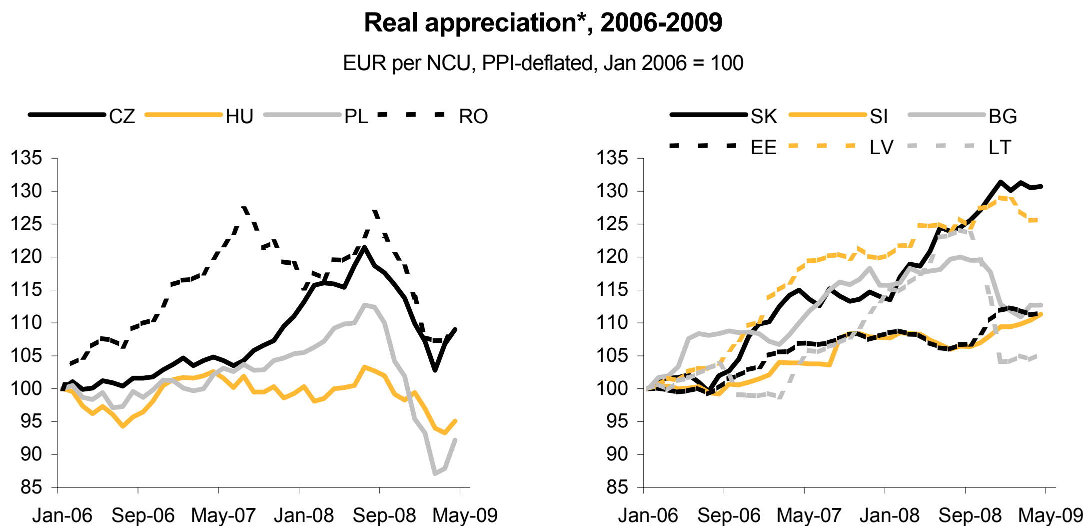
* Ascending line indicates appreciation.

Source: wiiw Monthly Database incorporating national statistics.

Figure 5

Real appreciation*, 2006-2009

EUR per NCU, PPI-deflated, Jan 2006 = 100



*Values over 100 indicate appreciation relative to January 2006.

Source: wiiw Monthly Database incorporating national statistics.

In a global environment where trade flows contract much more strongly than production, real depreciation provides some competitiveness gain for small open economies like the NMS.[6] Countries which can take advantage of the opportunities provided by their flexible exchange rate regime may gain primarily through better opportunities to obtain export orders once an upturn of economic activities and imports begins, probably in late 2009 or early 2010. An immediate, and in the short run more important, effect is, however, the elevated level of protection for domestic producers, who can now regain domestic market shares that they lost in the years of continuous real appreciation, i.e. cheap competing imports. All these advantages remain out of the reach of NMS with the euro or fixed exchange rates. Slovakia is a special case in this group. Here, real appreciation was especially strong in the last couple of years, and before entering the euro zone the government advocated the fixing of a strong central parity in July 2008, also for political reasons (wages after the conversion to the euro had to be as high as possible). This led to a conversion rate of the Slovak koruna that resulted in high Slovak labour costs in euro terms on a long-term basis (see Appendix). In this situation adjustment is possible, if not through an extremely rapid growth of productivity, then via wage cuts, a politically rather uncomfortable and hardly productive way, as the current example of Latvia clearly illustrates (see Box 1).

Depreciation, however, has its shadow side as well. Businesses (without hedging against exchange rate changes) and especially households raising loans denominated in foreign currencies were confronted with a sudden rise in their debt service obligations denominated in national currency. Higher interest and amortization payments further diminished household consumption and thus domestic demand, demonstrating a clearly pro-cyclical effect. Further, a massive default of debt

6 According to the World Bank's forecast global output is projected to fall by 2.9% and global trade by 10% in 2009. The World Bank: *Global Development Finance. Charting a Global Recovery* 2009, p. xi.

service obligations could seriously undermine the stability of the banks involved. A by no means negligible problem is inflation.

Table 6

Share of loans in foreign currency in % of total loans, end of period

	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09
Czech Republic	12.9	13.0	12.4	12.6	13.1	13.1	13.2	13.6	14.1	14.4	14.4	13.8	13.4
Hungary	58.8	56.6	56.3	55.7	56.9	58.7	63.7	63.0	64.6	67.3	67.4	68.2	66.3
Poland	24.3	24.1	24.6	24.2	25.8	27.0	30.1	30.0	33.1	34.8	35.8	35.5	33.9
Slovak Republic 1)	.	.	17.7	.	.	17.3	.	.	17.6	.	.	3.9	.
Slovenia 2)	6.8	6.6	6.5	6.4	6.6	6.7	7.0	6.8	6.7	6.6	6.4	6.1	6.0
Bulgaria	52.7	53.3	54.2	54.7	55.8	55.7	56.3	56.6	57.1	57.4	57.7	57.6	57.7
Romania	62.4	62.5	62.8	62.7	63.0	63.4	63.5	63.6	63.9	64.2	64.1	64.1	63.9
Estonia	82.5	82.9	83.6	84.3	84.6	84.7	84.9	85.1	85.3	85.7	86.0	86.4	86.7
Latvia	85.8	83.9	87.7	89.8	88.2	87.4	88.9	88.6	89.8	91.6	91.9	92.1	91.0
Lithuania	61.2	61.7	62.3	62.3	62.7	62.8	62.8	63.4	64.0	64.9	65.7	66.2	66.9

1) From 2008 non-euro currencies only. - 2) Non-euro currencies only.

Source: National bank statistics, wiiw own calculations.

Box 1

The Baltic States in a black box[7]

The Baltic States face an economic depression of a magnitude not seen since the transitional recession at the beginning of the 1990s. In 2009 GDP is expected to fall by 20% in Latvia and 16% in Estonia and Lithuania. After all three economies had boomed by 8% annually on average in the years 2000-2007, the currency board (in Estonia and Lithuania) and hard peg (in Latvia) experiments of the Baltic countries ended in disaster, with no hope of a substantial growth revival in the next three years. The magnitude of the crisis will throw the countries back almost 10 years in their catching-up process. In previous years the excessive inflow of credit via the primarily Swedish-owned banking sector triggered a boom of private consumption and investments in the real estate sector. In addition, in the first years after EU accession, substantial outflows of migrants led to a shortage of labour supply and thereupon to double-digit growth rates of real wages, consumer prices and unit labour costs (see Appendix). The subsequent loss of competitiveness, together with the soaring internal demand, resulted in escalating current account deficits (15-20% of GDP in Estonia and more than 20% in Latvia in 2006 and 2007). However, with rising inflation rates, real interest rates – particularly of euro-denominated loans – became increasingly negative, reinforcing the incentive to borrow. In Estonia and Latvia, the mainly private external debt burden built up during the boom has reached the troublesome figure of about 150% of GDP. Short-term foreign debt in percent of forex reserves actually exceeds 250% in both countries.

7 The text in Box 1 was written by Sebastian Leitner, wiiw. For more detailed information on the development of Estonia, Latvia and Lithuania please consult the country report on the Baltic States below.

The credit crunch following the burst of the housing bubble and the outbreak of the global financial crisis put not only the externally financed growth into question (which is the case in all transition countries at the moment), but caused immediate pressure on the countries' currencies. The Latvian government had to call the IMF, the EU and Nordic countries to the rescue at the end of 2008. The EUR 7.5 billion package, equalling one third of Latvia's GDP in 2008, was approved under the condition that the country's public deficit not be allowed to exceed 5% of GDP. Despite an increase in the VAT tax rate at the beginning of the year, by the end of April 2009 it was obvious that the drop in government revenues was much more dramatic than expected. Thereupon, the EU and the IMF demanded further harsh austerity measures. Taken together, the Latvian government cut public expenditures for 2009 by 40% in nominal terms compared to 2008. Similar packages of pro-cyclical fiscal measures, e.g. drastic cuts in the public wage bill, an increase in the VAT rate and a reduction of pensions or other social benefits were implemented in Estonia and Lithuania. All Baltic governments announced that they would stick to their euro pegs at any cost and implement further budget amendments in the medium term to be able to fulfil the Maastricht criteria and introduce the euro as soon as possible. In the case of Estonia, the plan is to enter the euro zone in 2011; Lithuania and Latvia want to follow suit in the subsequent two years.

The question arises as to not only why the Baltic governments prefer to push through these drastic austerity measures, which accelerate the economic downturn and will prolong the period of depression, in order to keep their apparently overvalued currencies pegged, but also why the EU and the IMF are assisting them in doing so. The key argument for the choice of the 'peg and deflate' option instead of devaluation, presented not only by the Baltic authorities but especially by representatives of Swedish banks, has been that the bulk of the region's loans are denominated in foreign currency (see Table 6). A devaluation would therefore lead to a sudden rise in the private debt burden, putting Scandinavian banks under pressure as well. Yet if, as expected, GDP falls by about 30% by 2011, the default rate of debtors may be even higher in the 'peg and deflate' scenario. However, the EU presumed that the forced abandonment of the Latvian euro peg would not only lead to a devaluation of the currencies of Latvia's Baltic neighbours but could have contagion effects on Bulgaria, also operating a currency board regime, and on other countries with hard pegs, as well as on Hungary and Romania, two further EU members on the lifeline of an IMF/EU package. Such a scenario sends shivers down the spines of Western European bankers and politicians.

The adoption of the second austerity package in Latvia and the reassurance of the EU and the IMF regarding delivery of the second credit tranche slightly diminished the pressure on the Latvian lats. However, the situation remains strained and devaluation may eventually have to follow. First of all, as already mentioned, short-term foreign debt amounts to up to 2.5 times the forex reserves of the central bank, which fell by 40% year on year up to May 2009. The rollover of debt in 2009 will not be possible without further debt restructuring. Moreover, in the autumn of 2009 Latvia will have to ask the IMF and EU for the next instalment of the rescue package. Further expenditure cuts may be necessary (also in Estonia and Lithuania), but public pressure will certainly increase with unemployment rates and other severe social hardship on the rise.

The exit option of euro adoption is still far away, especially for Latvia and Lithuania. However, due to the above-mentioned fear of contagion, the EU might well be prepared to prop up the support package for Latvia in 2010. Irrespective of the ability or inability of the governments to defend the currency pegs, the trouble in the Baltic States boils down to the fact that the currency board and hard peg experiments led to external debt burdens that were unsustainable. A feasible solution in this respect, which would be of utmost importance for the future development of the Baltics' economies, is not only an economic but also a political question. Sweden and the Baltic States must, with the help of the EU, come to an agreement on how to share the costs of reckless lending by Swedish banks and imprudent borrowing by Baltic households. The Baltic States were not the first ones to falter by choosing currency board or hard peg regimes, which they did in times when Argentina's board was still being praised to the skies. In doing so, however, they deprived themselves of essential policy instruments especially required during transition. Unfortunately, they won't be the last countries (especially if the Baltics manage against all odds and reasoning to enter the euro zone as envisaged) to adopt highly controversial economic ideas while ignoring probable social disasters and economic losses.

Fiscal prudence versus demand management

While governments in the US, Japan, China, Russia and in some Western European countries are spending astronomical sums to revitalize domestic demand,[8] their counterparts in the NMS countries are less enthusiastic about (or capable of) applying the Keynesian recipe to battle the crisis.

A clear-cut anti-cyclical fiscal policy appears only in three of the 10 NMS: the Czech Republic, Bulgaria and Slovenia. The Czech Republic, in contrast to several other countries in the region, has favourable preconditions for some fiscal relaxation. Exposure of the Czech banks to sub-prime securities is negligible. Despite quite vigorous GDP growth, the domestic credit expansion has been rather sluggish when compared with other NMS. The deposit/loans ratio exceeds 1 by a large margin and the net external position of Czech banks is positive (uniquely among the NMS). Moreover, unlike the situation in other NMS, loans denominated in foreign currencies were not attractive at all since Czech interest rates have tended to be lower than the foreign ones. Unfortunately all these merits will not save the small export-oriented Czech economy from the effects of global recession, which explains the government's measures (lowering social security contributions, faster depreciations, one-off subsidies e.g. to credits for SME) to dampen the impact. All in all, the fiscal package will amount to 1.1% of GDP this year. This fiscal expansion is as cautious as the Czech economic policy has traditionally been in recent years.

Bulgaria pursued a highly prudent fiscal policy in recent years (it was the only NMS with a budget surplus in 2008). Thanks to this, the government has been in the comfortable position of being able to afford relatively lavish counter-cyclical spending without jeopardizing the fiscal balance. In the first quarter of 2009, consolidated general government revenues were 5% lower than in the same period

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8 The share of up-front government financing, relative to the 2008 GDP, amounts to 18.9% in the UK, 3.7% in Germany and 8.9% in Austria as of 19 May. *Fiscal Implications of the Global Economic and Financial Crisis* IMF Staff Position Note SPN/09/13, 9 June 2009, p. 7.

in 2008, while expenditures were up 22.5%, and the general government balance was still in surplus, reflecting the sizeable buffers in Bulgaria's public finances. Bulgarian fiscal expansion is focused on infrastructure development programmes, at both national and local levels. A newly established bank with public funding aims to support SMEs through various financial instruments. In early 2009, these programmes were supplemented by a package in support of the labour market. Although the authorities have been financing some of the anti-crisis measures from the fiscal reserve, the latter has still remained at a respectable level (over 10% of GDP). Despite the loosening of the fiscal stance, the authorities have stated their commitment to overall fiscal discipline and have not abandoned the target of maintaining a surplus in the general government balance for 2009 as a whole; the target, however, was reduced from the initially envisaged 3% to a mere 1%. Nevertheless, the extremely high current deficit of the country prior to the crisis must be a warning sign that the ambitious undertakings of the government to support domestic demand may be jeopardized by the external financing constraints.

The Slovene government, with regard to the sharp decline in output and exports, found the courage to undertake deficit spending amounting to over 2% of GDP. Contrary to other countries of the region which still have flexible exchange rate regimes, Slovenia, having introduced the euro in 2007, has no way out of the crisis via devaluation of the exchange rate. Sustaining domestic demand therefore has a special significance. The measures include support for stabilizing the financial sector, wage subsidies to companies for shorter working time, the elimination of payroll tax and a reduction of corporate taxation. Public funds have been earmarked for the protection of some endangered industrial sectors, e.g. for SME and R & D in technologically advanced industries. The price of these decisions will be high in terms of public debt (an increase from 23% to 30% of GDP), but thanks to the intervention, the recession is expected to be less deep than it would be without these measures.

In Poland, and to a lesser extent in Slovakia, the anti-cyclical policy is nominally present but it is more virtual than real. In Poland, a Stability and Development Plan promoting pro-investment impulses was elaborated, in nominal value equivalent to an impressive EUR 20 billion. However, on closer examination it turns out that there is a minimum of real fiscal stimulus in the programme. Instead, it represents the sum of additional amounts of guarantees that could be extended to the economy, including its financial sector, and the additional volume of credit and credit guarantees that the state-owned BGK bank could extend to small and medium sized enterprises. The value also included the volume of investments co-financed by the EU, to be spent ahead of the initial schedules. The essential point about the Plan was that it claimed to have left the public sector deficit unchanged as compared with the original budget for 2009.

The preceeding appreciation and the introduction of the euro in Slovakia in January 2009 has deteriorated the relative competitiveness of the export sector, which is reflected in a huge change in the GDP growth rate, from +7.9% in the second quarter 2008 to -5.6% in the first quarter of 2009. Compared to this growth collapse, the initiated fiscal measures, amounting to not more than half a percent of GDP this year and next year, are indeed modest.

In other NMS the fiscal policy is pro-cyclical. In Hungary, which has a poor record of fiscal discipline and accordingly high public debt, or in Romania and the three Baltic States, which accumulated unsustainably high current account deficits in recent years, the governments concerned cannot simply increase expenditures and reduce taxes to boost domestic demand. These countries must first of all regain the confidence of international financial investors. It is of vital importance for them to ensure the rollover of their public and private debt, to secure financing of the private sector *inter alia* through credit provided by foreign-owned banks, and to remain an attractive target for potential portfolio and foreign direct investments. Prudent fiscal policy is a key issue in regaining confidence and credibility. Moreover, it is a cornerstone of the IMF stand-by agreements in force with Hungary, Romania and Latvia.

Unchanged government expenditures and, due to declining economic performance, sinking revenues, increase budget deficits automatically. Under the current circumstances, prudential fiscal policy in Hungary, Romania and Latvia does not mean a reduction of public deficit but rather allowing for its minimum necessary increase. But even the deceleration of the deterioration in the fiscal stance requires painful measures, namely a reduction of expenditures and an increase in tax revenues, in short: pro-cyclical policies.

In Hungary the 13th month pension payment was abolished this spring. The indexation rules of the pensions will follow only the inflation. The retirement age will gradually be raised from 62 to 65 . A planned upward correction of pensions has been postponed. Sick allowance will be reduced from 70% to 60% of the salary. On the revenue side, the VAT rate will increase from 20% to 25%. Next year a new tax on real estate is to be introduced. In Romania, expenditure cuts include the curtailing of rises in public sector wages and pensions. Significant cuts in expenditures were made in the budgets of the ministries of defence, agriculture, internal affairs and education.

Although in these countries fiscal policies are primarily pro-cyclical, within the individual packages of government measures serious attempts are being made to mitigate the shrinkage of domestic demand. In Hungary, the social security contribution paid by employers is being reduced by 5 percentage points in 2009. In Romania expenditures will be redirected to investments; the share of investments in government expenditures is intended to increase from 17% to 20%. Both in Hungary and Romania, special financing schemes were elaborated and programmes with topped-up funds were launched for assisting the SME. In Hungary, increased taxes on consumption (VAT, excise taxes) are thought to draw better on the huge unreported incomes than the personal income tax. Simultaneously reported personal incomes are relieved through changing tax brackets. The planned tax on real estate follows the same philosophy, as luxury housing is the most frequented spending target of owners of unreported incomes.

Latvia is the extreme case for pro-cyclical fiscal policy. Here the government expenditures have been reduced by 40% in nominal terms in 2009 compared to the previous year. Public wage bills have been cut by 35%, pensions by 10% and the VAT rate was increased from 18% to 21%. This must be seen in the context of the economic collapse this country is undergoing, with a decline in GDP of 18% in the first quarter. In December 2008, Latvia received an international rescue package of

EUR 7.5 billion provided by the IMF, the European Commission and the Nordic countries. The package targets the public finance crisis. Half of the funds are targeted to cover the budget deficit, one third for rolling over public debt and only the rest for the re-capitalization of banks and the fight against the credit crunch. The agreement with the donors envisaged a budget deficit of 5% of GDP. By April 2009 it turned out that the government revenues had fallen even more steeply, e.g. income from VAT declined by 30%. In order to get the second tranche of the IMF/EU package, which rescues the country from sovereign default, the Latvian government had to agree on a second austerity package (after having already reduced planned expenditures at the beginning of 2009) including the above-cited harsh measures.

The mixture of pro-cyclical fiscal policies in Estonia and Lithuania resembles those of its Baltic neighbour Latvia, only the magnitude of the budget cuts is somewhat lower. A two percentage point rise in the VAT rate, a cut in public wages of not less then 20% and a reduction of social benefits were passed. In total the expenditure reduction amounts to about 4% of GDP in both countries. One important reason for the outstanding pro-cyclical measures introduced by the Baltics is the eagerness of the countries' governments to manage joining the euro zone, which they interpret as a safe haven, as early as possible.

It is an important feature of the crisis-related fiscal measures in the NMS that re-capitalization of banks in trouble has, up to now, played a subordinated role (except for Latvia). This raises the question of whether predominating foreign ownership in the banking sector of the NMS (except for Poland) is a liability in the current crisis or an asset. A recent survey's results suggest that so far foreign banks have continued to support their subsidiaries in the NMS and this behaviour corresponds to expectations based on historical patterns seen in earlier crises.[9] Although the health of the parent banks matters a great deal, even in the case of troubled parent banks their affiliates in the NMS benefit indirectly from fiscal support for these parent banks in the home countries financed by the budget of the respective home country.

It is remarkable that in the case of those NMS where international rescue packages are in place, a change in the attitude of the IMF vis-à-vis fiscal policy can be observed.[10] Contrary to its past record, the IMF is relatively flexible towards fiscal policy measures to support domestic demand. Main stumbling blocks in the way of fiscal expansion are, rather, the implied increase of imports under the circumstances when current account deficits must be radically cut, the need to regain the confidence of international investors, for example through prudential fiscal policy, and, in the case of Hungary, a menacing upward spiral of already very high public debt. Ideology does not play a role anymore, except perhaps in Poland, where neglecting fiscal policy in demand management seems still to be considered a merit in itself.

A common feature of crisis management in all the NMS is that EU-co-financed projects play a central role in initiated infrastructure programmes. These programmes were partly in preparation anyway.

9 De Haas, Ralph: In defence of foreign banks. VOX (www.voxeu.org) May 28, 2009.

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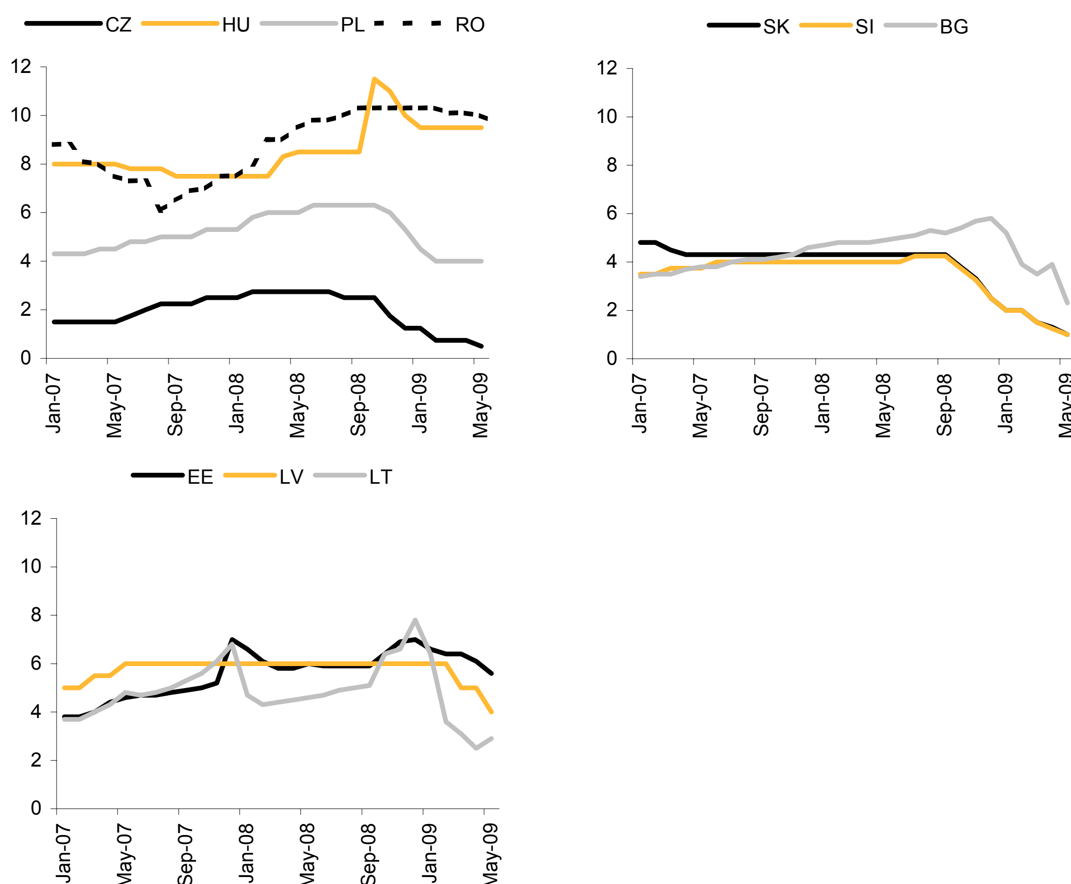
With the permission of the European Commission, the allocation of EU transfers across the years 2007-2013 was re-designed so that more will be spent in the first half of the period than originally planned. More important, receiving countries simplified their bureaucratic procedures with regard to committing allocations and are now willing to provide substantially higher advance payments than earlier. Advantages of EU membership came into the foreground in this respect: EU transfers will inject additional demand amounting to between 1.5% and 3% of the receiving countries' GDP.[11] The other side of the coin is that a substantial portion of primarily EU-co-financed projects are politically 'sold' under the umbrella of spectacular national crisis management programmes.

Figure 6

Leading NB/ECB-interest rates, 2007-2009

in % p.a.



Note: For Estonia: 1-month interbank lending rate (Talibor); for Lithuania: 1-month interbank lending rate (Vilibor); Slovenia: from 2007 Euribor; Slovakia: from 2009 Euribor

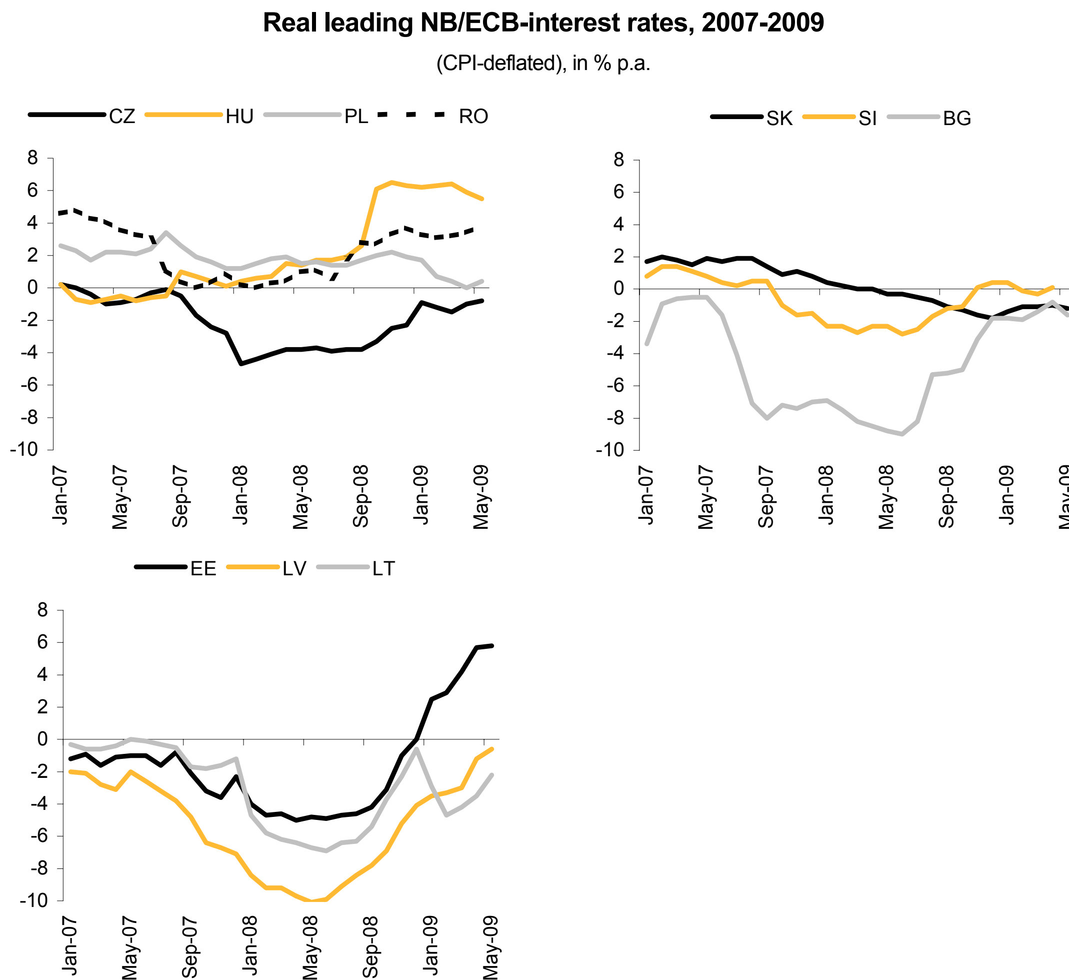
Source: wiiw Monthly Database incorporating national statistics.

[11] It must be mentioned here that part of the EU transfers for Bulgaria were suspended due to problems with the institutional background and corruption.

Figure 7

Real leading NB/ECB-interest rates, 2007-2009

(CPI-deflated), in % p.a.



Note: For Estonia: 1-month interbank lending rate (Talibor); for Lithuania: 1-month interbank lending rate (Vilibor).

Source: wiiw Monthly Database incorporating national statistics.

High and low interest rates – diversified monetary policies in the NMS

Leading policy interest rates are quite different across the NMS. The rates varied even before the crisis, because they depended not only on inflation, but also on the required support for exchange rate stability and the placement of government securities. Policy rates were high in Hungary and Romania, at one extreme, and lower than the ECB rate in the Czech Republic, at the other extreme (see Figure 6). As in many countries of the world where the circumstances allowed it, the central banks in the Czech Republic, Poland and, with some delay, in Bulgaria cut the policy rate to counteract the emerging recession and mitigate the danger of a credit crunch. Romania and Hungary were unable to follow suit; moreover, exchange volatility and capital flight forced the Hungarian monetary authorities to raise the policy rate by 300 basis points in October last year. The curve in Figure 7 shows that monetary relaxation was successful in the Czech Republic, Poland and Bulgaria, where real policy interest rates became negative or close to zero. In the two euro area

NMS members – Slovenia and Slovakia – low inflation coupled with the lowered ECB rate also ensured negative real policy interest rates. Not so in Hungary and Romania, where real policy interest rates remained painfully high, 6% and over 3%, respectively. In both countries, restrictive monetary policy is coupled with pro-cyclical fiscal policy, an unfortunate combination.

Box 2

From labour shortages to increasing unemployment[12]

The economic downturn has had different effects on the various NMS labour markets. In the Baltic States, employment started to decline only in the final quarter of 2008, while Hungary had already suffered job losses since the end of 2007. In the other countries of the region the labour market situation has weakened from the beginning of 2009, with employment declining in all countries except Poland. With the exception of the Baltic States, which have experienced dramatic job losses, employment cuts have so far remained moderate in all other countries (Table 7). The introduction of short-time work, subsidies to enterprises, temporary suspension of production and the reduction of foreign and contract work has helped to mitigate the impact of the overall economic crisis. However, considering the strong output declines coupled with respectively smaller employment cuts, labour productivity has dropped in all countries except Poland.

Table 7

Employment and unemployment

LFS definition, annual averages

	employed persons change in % against preceding year			unemployment rate in %							
	2007	2008 1)	2009 1Q	2006	2007	2008 1)	2008 1Q	2009 1Q	2009 Forecast	2010 Forecast	2011 Forecast
Czech Republic	1.9	1.6	-0.2	7.1	5.3	4.4	4.7	5.8	7	7	6.5
Hungary	-0.1	-1.2	-2.1	7.5	7.4	7.8	8.0	9.7	10.5	11	10
Poland	4.4	3.7	1.3	13.8	9.6	7.1	8.1	8.3	9	10	9
Slovak Republic	2.4	3.2	-0.1	13.4	11.1	9.5	10.5	10.5	13	14	14
Slovenia	2.5	1.1	-0.9	6.0	4.8	4.4	5.1	5.4	7	7.5	7
NMS-5 2)	*3.1*	*2.5*	*0.3*	*11.5*	*8.5*	*6.9*	*8.9*	*8.2*	*9.2*	*9.9*	*9.1*
Bulgaria	4.6	3.3	-0.8	9.0	6.9	5.6	6.5	6.4	9	9	8
Romania	0.7	0.2	.	7.3	6.4	5.8	6.3	.	9	9	8
Estonia	1.4	0.2	-6.8	5.9	4.7	5.5	4.2	11.1	15	18	18
Latvia	2.8	0.6	-8.0	6.8	6.0	7.5	6.5	13.9	18	22	20
Lithuania	2.3	-0.9	-5.1	5.6	4.3	5.8	4.9	11.9	15	19	18
NMS-10 2)	*2.6*	*1.8*	*.*	*10.0*	*7.7*	*6.5*	*8.2*	*.*	*9.4*	*10.0*	*9.1*

1) Preliminary. - 2) wiiw estimate.

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

[12] The text in Box 2 was written by Hermine Vidovic, wiiw.

Unemployment will rise considerably in all countries of the region, but at different rates. wiiw expects major increases in the Baltic States, where unemployment will more than double in 2009 and the situation will further deteriorate in 2010, suggesting the highest unemployment levels within the EU (close to or even above 20%). In the other countries, too, unemployment growth is expected to accelerate in the months to come. Given the rather gloomy economic prospects for this year and the next, the unemployment rate will exceed the 10% mark in Hungary, in the Slovak Republic and in Poland in 2010. Considering a rebound of economic growth in mid/late 2010 and a more robust growth in 2011, the situation on the labour market will improve only with a lag. Prospects for a recovery are brighter for the Czech Republic and Slovenia, while the Baltic States may continue to suffer for quite a long time. On average, the NMS unemployment rate is expected to reach the level experienced in 2006.

At the sectoral level, job reductions have occurred mainly in manufacturing, the car industry in particular, construction and transport services, while in a number of countries employment has expanded in the health and education sectors. As a result, the incidence of unemployment has been higher for men than for women since the sectors hardest hit by the crisis are dominated by men in terms of employment. As in other EU countries, young people working frequently on temporary contracts are disproportionately affected by employment cuts and consequently rising unemployment.

The initial fear that returning labour migrants might aggravate the situation on the labour markets of the sending countries has not yet materialized. Although disproportionally affected by unemployment, the living and working conditions of migrants are apparently still better in the host countries than at home. For example, in the UK, one of the major destination countries of NMS migrants, nationals are much more affected by employment cuts and unemployment than foreign-born workers.

Fragile financial stability – external financing remains a critical issue

Over the last few months, bailouts of major financial institutions in the US and highly developed EU economies brought a certain relaxation in global financial intermediation and in national markets as well. Since the end of March, leading stock exchange indices have been rising and the risk appetite of international investors has improved. Affiliates of foreign owned banks in the NMS benefited from consolidation (with or without government assistance) of parent companies in Austria, Italy, Germany, Sweden and Belgium and the cautiously improving investor mood. Major foreign banks with affiliates in Hungary and Romania, respectively, reconfirmed their engagement in these two countries in the 'Vienna Initiative'.[13] NMS central banks and governments introduced various instruments to increase liquidity (both in national currency and foreign currency) in the domestic banking system and to mitigate the increased costs of borrowing. Notwithstanding the stability of the NMS banking system it has remained fragile; the volume and depth of financial intermediation is far

13 For more details see p. 134, IMF http://www.imf.org/external/np/cm/2009/032609.htm and http://www.imf.org/external/np/cm/2009/052009.htm.

from those in the pre-crisis era and further financial assistance for parent banks or their affiliates in the NMS may be needed.

The NMS have been highly dependent on external financing. Foreign capital inflow reaches the NMS through various channels: governments raise money through placements of government securities in foreign or national currencies, non-financial businesses in the form of FDI and credit from abroad (foreign owned companies, often through intra-firm loans), banks from the international markets, and, if they are affiliates of parent companies abroad, from their parent companies. Last but not least, NMS receive net transfers from the EU budget. Of these usually utilized channels of external financing, all but the EU transfers have narrowed or gotten clogged for shorter or longer periods since October 2008. The drying out of external finances compelled Hungary, Latvia and Romania to turn to the IMF for help. Poland, though not in danger of immediate closure of external financing, applied for the new Flexible Credit Line facility of the IMF (EUR 20.5 billion) as a precaution. These countries, together with those not turning to the IMF, must adjust to the changed international environment, i.e. to the fact that the era of extensive current account deficits that characterized the pre-crisis years has come to an end (see Table 8).

Table 8

Foreign financial position

in % of GDP

	Current account						Gross external debt 1)			Reserves of National Bank (excluding gold) 1)2)		
	2007	2008	2009 1Q	2009 Forecast	2010 Forecast	2011 Forecast	2006	2007	2008	2006	2007	2008
Czech Republic	-3.2	-3.1	2.8	-1.8	-1.4	-1.9	37.1	39.0	41.9	20.2	17.7	19.1
Hungary	-6.4	-8.4	-3.5	-4.4	-4.0	-3.9	86.2	97.8	121.8	17.3	16.2	24.0
Poland	-4.7	-5.5	-0.1	-1.7	-2.2	-2.9	46.6	48.4	56.1	12.7	13.0	13.8
Slovakia	-5.7	-6.6	-4.0	-4.7	-5.1	-5.3	50.7	54.7	55.4	20.0	22.3	18.8
Slovenia	-4.2	-5.5	-1.9	-2.8	-3.2	-4.1	77.6	100.8	105.3	17.2	1.9	1.7
Bulgaria	-25.2	-25.3	-17.8	-13.9	-12.2	-10.7	81.9	100.2	107.7	32.9	38.8	35.0
Romania	-13.5	-12.2	-3.1	-5.0	-5.3	-5.9	40.4	51.2	58.3	20.9	22.1	20.7
Estonia	-18.1	-9.2	0.0	1.1	1.8	-0.9	97.7	112.4	120.2	16.1	14.6	17.8
Latvia	-22.5	-12.7	1.1	0.5	1.9	2.8	113.1	126.4	129.2	20.9	18.2	15.3
Lithuania	-14.6	-11.6	0.4	0.7	-2.1	-2.6	60.2	72.3	71.4	18.0	18.2	13.8

1) End of period. - 2) Forex reserves, SDR and reserve position with the IMF. Slovenia: from 2007 (euro introduction) only foreign currency reserves denominated in non-euro currencies.

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

Recent developments show a mixed picture. Spreads on emerging market government bonds have been shrinking, CDS indices and risk premia have been dropping, risk appetite is on the rise. NMS currencies have strengthened. The Czech Republic, Poland and Slovenia managed to issue euro bonds (EUR 1.5 billion, EUR 0.75 billion and EUR 2.5 billion, respectively), Hungary made its first

steps to return to regular placement of HUF-denominated government securities. In the first quarter of 2009, the FDI inflow declined to a large extent in six of the altogether eight NMS where respective data were available (Table 9).

Table 9

FDI inflow at the beginning of 2009

based on EUR

	Period, month	change in % against preceding year
Bulgaria	Jan-Apr	-50
Czech Republic	Jan-Apr	8
Estonia	Jan-Apr	-76
Latvia	Jan-Apr	-95
Lithuania	Jan-Apr	4
Poland	Jan-Apr	-60
Romania	Jan-Apr	-52
Slovenia	Jan-Feb	-67

Source: National bank statistics of respective countries.

There is no clear picture on the cross-border financing of financial and non-financial NMS companies. Reduced credit flows may be caused both by a lack of readiness to lend or a lack of ability or readiness to borrow. The banks have become much more cautious than they were earlier, and keen to decrease leverage and minimize risks. For the firms, risk premia make loans more expensive than previously; reduced demand due to the recession, both in domestic and foreign markets, makes them think twice before taking up loans. With investments declining across the board, demand for longer-term credit is also waning. Demand for household loans (mortgages, cars, etc.) may be negatively affected by rising costs and increasing general uncertainty concerning jobs and wages.

Outlook: 2009 recession, 2011 recovery, 2010 betwixt and between

Financial and real economy conditions of recovery

The timing and speed of NMS recovery from the crisis will be influenced by the following factors:

– how supportive the global and, in particular, the European environment will be in terms of demand for imported goods and services from and export of capital to the NMS,

– what domestic resources (fiscal expansion, measures to increase competitiveness) governments in the NMS are able and ready to mobilize for domestic demand management and for the preservation or extension of market shares abroad, and

– how current frictions and possible future troubles in financial intermediation in individual NMS will be addressed by the governmental and monetary authorities, international organizations (European Commission, ECB, IMF), foreign parent companies of the financial institutions and, last but not least, the banks concerned themselves.

Short-term growth prospects for Europe are highly uncertain and mostly bleak. The EU is expected to suffer a recession of 3.9% in 2009 and a further smaller contraction (0.1%) in 2010 (see Table I). It is assumed that the main NMS export markets will report negative growth this year: Germany -5.6%, Italy -4.4%, Austria -3%, Sweden -4.3%. Of these four countries, only Austria and Sweden are expected to have positive, though only marginal, economic growth in 2010.[14] These GDP decline figures mean much stronger contraction of imports; hence, export-oriented NMS industries will have to cope with a serious drop in export sales.

The foreign trade data of the last couple of months (Table 4) show that the serious decline in NMS exports has been accompanied by an even greater decline in imports caused by strong contraction of domestic demand and also by lower demand for imported inputs for the production of goods for sale abroad. This lets us assume that trade balances in the NMS will improve to a considerable extent this year. Foreign owned companies located in the NMS will be affected by the recession just as domestic owned companies will. Foreign owned companies' profits (reinvested and repatriated alike) are accounted for as outflow in the current account. As profits will be much smaller in 2009 than in previous years and trade balances are improving to a considerable extent, the result is an abrupt contraction of current account deficits in the NMS (see Table 8). The reversal of the current account is extremely sharp in the Baltic countries, up to 13 percentage points of GDP (in Latvia). In Bulgaria the improvement is also huge; nevertheless the current account deficit here remains close to 14% of GDP. This will be partly financed through a cutback of the considerable amount of accumulated foreign exchange reserves.

Table 10

Short-term foreign debt in % of foreign reserves (excluding gold)

	q1'07	q2'07	q3'07	q4'07	q1'08	q2'08	q3'08	q4'08	q1'09
Czech Republic	46.2	54.5	58.3	65.3	70.5	87.1	80.0	70.4	.
Hungary	67.2	78.9	80.4	88.3	92.6	101.8	105.1	76.6	71.1
Poland	78.7	89.4	93.6	95.9	107.8	110.8	111.0	109.4	.
Slovak Republic	116.9	108.3	113.0	130.9	134.9	135.7	169.1	152.3	.
Bulgaria	81.9	79.0	73.6	84.3	87.7	96.8	94.7	111.4	120.6
Romania	53.0	61.0	62.8	69.0	69.1	70.3	69.7	71.9	68.2
Estonia	235.4	240.7	207.2	234.4	229.4	256.0	261.4	253.2	250.3
Latvia	277.8	276.0	281.1	302.7	235.8	255.0	249.3	280.2	250.7
Lithuania	101.9	107.0	112.9	102.6	120.3	126.8	143.0	130.1	125.2

Source: National bank statistics, wiiw own calculations.

Concerning capital flows, we have preliminary data about FDI up to April of this year for eight NMS (see Table 9). This indicates extreme decline for all but two countries, the Czech Republic and Lithuania, where negligible growth was reported. Strong decline was reported in the number of

[14] IMF World Economic Outlook, April 2009, p. 190.

initiated FDI projects as well.[15] Forecasting the amount of FDI inflows for 2009 is not really feasible under the present circumstances. Based on global trends and the results in the first quarter of 2009 outlined above, we can expect FDI inflow in the region as a whole to shrink by at least 50% to half of last year's level or less. Despite a considerable drop, the amount of FDI to flow into the NMS may be about EUR 20 billion, which is similar to the sum these countries received at the beginning of the 2000s.[16] In general, NMS still remain attractive targets for FDI in Europe. Up to now we have no clear picture about the development of other components in the capital flow (portfolio investments, loans, financial derivatives).

As discussed earlier, of the NMS only the Czech Republic, Slovenia and Bulgaria will apply fiscal expansion, albeit to a modest extent, to counteract shrinking domestic demand. These countries can afford such measures, since they had, up to 2008, prudent fiscal policies with small budget deficits (Bulgaria even had a surplus) and low public debt (see Table 11). But the budget deficit will increase in all NMS, since revenues will fall as a result of the recession while expenditures will hardly change. This automatic process will, however, be counteracted by expenditure cuts in Hungary, Romania and Latvia, which depend on the support of the IMF and are struggling with serious credibility problems. For Hungary, alone in this group, an important mission is to halt the upward spiral of public debt.

Table 11

Fiscal balance and public debt, 2005-2011

	General government balance in % of GDP 1)2)					Public debt in % of GDP 1)			
	2007	2008 3)	2009	2010 Forecast	2011	2005	2006	2007	2008 3)
Czech Republic	-0.6	-1.4	-4.5	-4	-3.5	29.8	29.6	28.9	29.8
Hungary	-4.9	-3.4	-4	-4	-3	61.7	65.6	65.8	73
Poland	-1.9	-3.9	-4.5	-3.5	-2.5	47.1	47.7	44.9	47.1
Slovakia	-1.9	-2.2	-5	-5	-3	34.2	30.4	29.4	27.6
Slovenia	0.5	-0.9	-5.5	-6	-4.5	27	26.7	23.4	22.8
Bulgaria	0.1	1.5	-2	-2	-1	29.2	22.7	18.2	14.1
Romania	-2.5	-5.4	-5.5	-4	-4	15.8	12.4	12.7	13.6
Estonia	2.7	-3.0	-8	-7	-4	4.5	4.3	3.5	4.8
Latvia	-0.4	-4.0	-10	-8	-4	12.4	10.7	9	19.5
Lithuania	-1.0	-3.2	-7	-4	-3	18.4	18	17	15.6

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

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

[15] http://www.fdimarkets.com

[16] Hunya, G. *FDI in the CEECs under the Impact of the Global Crisis: Sharp Declines in Central, East and Southeast Europe* wiiw Database on Foreign Direct Investment 2009, May 2009, p. 12.

Financial intermediation in the NMS will remain, in the short and medium term, an area characterized by uncertainties and frictions. Loans to businesses and households, which were growing very dynamically before the crisis, are now in low gear. The growth rates displayed in Table 12 show deceleration in all but two countries, Hungary and Poland. In Hungary and Poland, due to the high share of foreign currency loans and the depreciation of the domestic currency, the nominal data unadjusted for the exchange rate do not show the actual slowdown in lending activities. For the same reason, real deceleration of credit growth is stronger in Romania than seen in the mirror of the table's figures.

Table 12

Bank loans to non-financial private sector growth in %, end of period (year-on-year)

	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09
Czech Republic	24.8	24.5	23.9	22.1	21.9	21.4	20.0	18.7	16.2	16.0	15.3	13.4	11.6
Hungary	22.1	16.6	15.8	12.3	13.3	17.0	24.9	18.3	19.5	24.1	21.3	22.2	17.8
Poland	30.6	30.1	29.7	27.1	28.4	29.1	34.5	33.3	37.5	37.2	38.6	35.7	31.2
Slovak Republic	27.1	24.1	23.3	23.4	24.0	22.1	20.3	19.4	16.3	13.2	12.5	11.0	9.1
Slovenia	30.4	28.5	27.2	25.4	23.6	23.2	22.1	18.9	18.1	16.1	15.8	13.6	11.7
Bulgaria	55.8	55.2	53.0	52.5	49.3	47.8	44.2	39.2	32.5	30.6	27.0	24.5	20.2
Romania	51.5	52.8	52.5	43.3	39.7	38.2	37.5	32.3	26.7	29.4	32.2	25.2	21.2
Estonia	24.4	22.2	20.2	18.4	16.3	14.8	12.6	10.8	8.4	6.5	5.2	3.9	2.3
Latvia	25.0	22.8	21.4	18.8	17.6	16.5	14.9	13.5	11.1	9.8	7.9	6.3	4.6
Lithuania	39.3	36.6	35.1	32.4	30.1	27.6	24.2	22.2	18.3	16.0	12.8	8.7	5.0

Source: National bank statistics, wiiw own calculations.

Table 13

3-month 'country'-BOR minus 3-month EURIBOR spread in percentage points, average

	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09
Czech Republic	-0.7	-0.7	-0.7	-0.9	-1.2	-1.2	-0.9	0.0	0.6	0.7	0.6	0.9	1.1
Hungary	3.8	3.5	3.9	4.0	3.4	3.6	3.8	4.7	7.9	7.3	7.9	8.2	8.1
Poland	1.5	1.6	1.6	1.7	1.6	1.5	1.7	2.5	3.1	3.0	2.8	2.7	2.8
Slovak Republic	-0.5	-0.5	-0.6	-0.6	-0.7	-0.8	-0.9	-0.6	.	.	.	.	.
Slovenia	.	.	.	.	.	.	.	.	.	.	.	.	.
Bulgaria	2.0	2.0	2.1	2.2	2.3	2.3	2.6	3.7	4.5	4.6	4.7	4.9	4.6
Romania	6.8	6.0	6.4	6.5	7.1	8.0	13.1	11.0	11.4	12.0	12.7	12.9	12.2
Estonia	1.6	1.5	1.5	1.4	1.4	1.3	1.6	3.0	4.6	4.8	5.0	5.5	5.1
Latvia	1.2	0.9	1.2	1.3	1.3	1.3	4.9	8.0	10.7	9.4	8.7	10.4	11.0
Lithuania	0.3	0.3	0.5	0.8	0.8	0.8	1.9	3.6	5.9	6.2	5.3	5.5	5.5

Source: Eurostat and national bank statistics, wiiw own calculations.

High interest rates are important indicators of persisting uncertainties and risks. Table 13 displays the development of interbank rates in the NMS. Even the latest available data from April of this year show that no sign of return to low pre-crisis interbank rates is in sight. Nevertheless, differences across countries are considerable, ranging from the excellent record of the Czech Republic to two-digit rates in Romania and Latvia.

In estimating the growth prospects of the NMS in the short and medium term, the monthly development of new orders in manufacturing provides an insight into an important segment of the economies concerned. The data in Table 14 include indices of both domestic and export orders. The number of new orders decreased between July 2008 and April 2009. Several countries seem to have touched bottom in December 2008 (the Czech Republic, Slovakia), in January 2009 (Lithuania), or in February 2009 (Poland, Bulgaria, Latvia) and attained modest improvement since then. In other countries, either no improvement can be observed or the data indicate no unambiguous tendency. The decline in new orders for manufacturing in the NMS was generally not stronger than in the EU-15 and comparable data in March show more rapid recovery in the Czech Republic, Poland and Romania than in the EU-15.

Table 14

New orders index for total manufacturing

July 2008=100

	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09
Czech Republic	100	93.3	107.0	99.6	80.0	70.3	87.5	82.2	90.5	.
Hungary	100	89.3	109.4	110.6	94.7	75.7	95.9	70.6	93.1	72.9
Poland	100	104.3	109.4	104.6	98.0	90.7	80.4	76.2	83.9	81.8
Slovakia	100	83.2	108.0	99.6	87.8	63.4	63.7	67.1	77.5	70.4
Slovenia	100	98.8	114.9	90.2	67.4	68.1	75.2	80.5	68.5	71.1
Bulgaria	100	81.8	93.7	89.2	77.0	73.6	66.3	58.1	66.7	69.2
Romania	100	85.4	112.0	109.6	90.1	87.6	75.4	75.0	78.2	74.6
Estonia	100	94.1	111.1	99.7	79.2	68.1	61.6	60.8	66.4	60.6
Latvia	100	126.1	145.8	132.5	112.9	89.5	101.4	73.8	99.1	108.5
Lithuania	100	101.6	107.0	96.0	78.7	70.5	62.2	65.4	66.6	68.3
Austria	100	82.6	96.7	91.5	74.5	64.2	65.1	61.6	67.5	.
Germany	100	88.1	95.6	88.2	78.9	70.1	65.8	64.8	74.3	66.0
Italy	100	45.6	83.5	75.4	62.7	61.6	55.2	63.1	66.6	55.2
Sweden	100	107.1	122.7	116.4	100.7	94.0	91.7	89.4	104.0	91.6
EU-15	100	74.4	93.6	86.9	75.2	71.2	67.6	67.6	74.8	.
EU-27	100	76.1	95.1	88.3	76.4	71.9	68.7	68.2	75.6	.

Source: Eurostat based on NACE Rev. 2; own calculations.

The wiiw forecast for 2009 to 2011

With the obscurity concerning the current international environment, the unclear efficiency of domestic crisis management and the stress tolerance of the weakened financial institutions in the NMS and the parent banks abroad, any forecasts for the short and medium term are necessarily extremely uncertain. The current wiiw baseline scenario for the NMS-10 is based on the assumptions that no further deterioration in international financial intermediation will take place and that in the second half of the year a slow improvement of growth indicators in the highly developed EU members will begin.

Table 15

Gross domestic product

real change in % against preceding year

	2006	2007	2008 [1)]	2008 1Q	2009 1Q	2009 Forecast	2010 Forecast	2011 Forecast	Index 2000=100 2008	Index 2000=100 2010
Czech Republic	6.8	6.0	3.2	3.5	-3.3	-1.5	1.0	3.0	140.3	140
Hungary	4.0	1.2	0.5	1.8	-6.7	-6.5	-1.5	3.0	130.4	120
Poland	6.2	6.6	5.0	6.1	0.8	0.8	1.5	3.0	138.4	142
Slovak Republic	8.5	10.4	6.4	9.3	-5.6	-5.0	0.0	1.0	162.0	154
Slovenia	5.9	6.8	3.5	5.7	-8.5	-4.0	1.0	3.0	140.1	136
NMS-5 [2)]	*6.2*	*6.0*	*4.0*	*5.2*	*-2.0*	*-1.5*	*0.8*	*2.8*	*139.6*	*139*
Bulgaria	6.3	6.2	6.0	7.0	-3.5	-3.0	0.0	3.0	154.8	150
Romania	7.9	6.2	7.1	8.2	-6.2	-6.0	0.0	3.0	162.1	152
Estonia	10.4	6.3	-3.6	0.2	-15.1	-16.0	-10.0	-2.0	165.1	125
Latvia	12.2	10.0	-4.6	0.5	-18.0	-20.0	-12.0	-2.0	174.6	123
Lithuania	7.8	8.9	3.0	7.0	-13.6	-16.0	-13.0	-3.0	176.1	129
NMS-10 [2)]	*6.7*	*6.2*	*4.3*	*5.6*	*-3.0*	*-3.3*	*-0.1*	*2.5*	*145.6*	*141*

1) Preliminary. - 2) wiiw estimate.

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

Table 15 shows that in 2009 three NMS – the Czech Republic, Poland and Bulgaria – are expected to have a smaller decline than the EU average of 3.9%.[17] Poland, alone among the NMS, will achieve a moderate 0.8% growth, while the decline will be relatively modest in the Czech Republic. In Bulgaria, the forecast 3% decline will still be better than the EU average. In Poland and the Czech Republic, consumption will contribute positively to the change in GDP.[18] In Bulgaria, the contribution

[17] See the Overview table on page viii. The wiiw forecast for the EU-27 combines the European Commission's Spring forecast for the 'old' EU members with the wiiw forecast for the NMS. The European Commission's forecast for the EU-27 GDP change in 2009 is -4%. (European Commission, Directorate-General for Economic and Financial Affairs *Economic Forecast Spring 2009,* p. 1.)

[18] The calculations of contributions to GDP change are based on data of the individual country tables and the wiiw forecasts.

of consumption is expected to be deeply negative; here a major improvement in net exports will be the supportive GDP component in achieving a relatively mild decline in economic performance. The contribution of investments will be negative in all three countries. It is notable that two members of this group are pursuing a cautiously expansive fiscal policy (the Czech Republic and Bulgaria). Poland's good performance is explained, as already mentioned, rather by the country's size, its relatively low levels of exports and imports and a production structure more diversified than in other NMS, coupled with a robust domestic financial system, than by economic policy measures.

The second group of NMS consists of Hungary, Slovakia, Slovenia and Romania. Here it is assumed that the recession will be deeper than the EU average in 2009, between -4% (Slovenia) and -6.5% (Hungary). In Hungary and Romania, the contribution of consumption to GDP change will be deeply negative, in Slovenia moderately so, in Slovakia inconsequential. In turn, the trade balance will positively contribute to GDP change in Hungary and Romania. In Slovenia the trade balance contribution will be positive; here the main cause of decline is the negative contribution of investments. Slovenia is among the three NMS where expansive fiscal policy measures were introduced, but this will only be sufficient to soften the decline.

The Baltic States are the members in the third group of the NMS-10. In these countries it is expected that the GDP decline will assume catastrophic proportions: 16% in Estonia and Lithuania and 20% in Latvia. In all three countries both consumption and investment will deliver negative contributions, while the trade balance is expected to make a robust positive contribution to GDP change as a result of the subsequent sharp decline in imports. All in all, the Baltic countries will fall back at least 5 years in terms of GDP levels by 2011.

The NMS with flexible exchange rates and consequently more leeway for adjustment to the changed global environment have been performing better and have better chances for an early recovery from the crisis than NMS with fixed exchange rates. In the worst performing group, the Baltic countries, each has a fixed exchange regime, and the earlier shooting stars of the region, Slovakia and Slovenia, are trapped via their euro currency. Bulgaria alone will, hopefully, suffer a relatively modest GDP decline despite its currency board regime, mostly thanks to its fiscal reserves and the government's readiness to deplete them. Certainly the flexible exchange rate regime is not a guarantee for successful management of the crisis, as the deep recession in Hungary and Romania demonstrates. The current problems of all but one (Bulgaria) NMS with a fixed exchange rate or the euro raise questions not only about the sustainability of the fixed exchange rate regimes but also about the rationality of plans for a rapid introduction of the euro in the eight NMS which still have national currencies.

Forecasts for 2010 and 2011 are even more uncertain than the outlook for this year. In 2010 the wiiw expects a practically unchanged level of economic performance in the NMS as a whole. In detail, this means moderate growth in Poland, the Czech Republic and Slovenia, and stagnation in the case of Slovakia, Bulgaria and Romania. Hungary will still be unable to avoid further decline, though a much smaller one than this year. Finally, the Baltic countries' ordeal will not come to an end in 2010 either; the prediction is for continued decline with two-digit rates. 2011 is expected to bring a

nearly uniform (3%) rate of expansion in the region, except for the Baltic States, which will still see further – though mild – contraction, and Slovakia, where the recovery will be relatively weak.

In the deflationary global environment, inflation in the NMS will remain a matter of no major concern in the period up to 2011. The contrary is true for unemployment. Part of the improvement achieved in this field in the last couple of years, due to dynamic expansion of the economy, is now gone. A decline in unemployment rates can be expected no sooner than 2011. In 2009 the current account deficits will be halved compared to the previous years and as a result of the expected longer-lasting bottlenecks in external financing, they will remain on this new lower level throughout the whole period of 2009-2011.

Abundant downward risks

Considering the extent of global, European and regional uncertainties, high forecast risks are unavoidable. The main downward risk is a deeper and longer recession in the West (especially EU) than assumed in our baseline scenario. That would delay the predominantly export-led recovery that is currently foreseen. Recurring risk aversion of international financial investors towards emerging markets or individual NMS may cut capital inflow below the level NMS need to roll over private and public debt and to finance production and investment. Huge placements of government securities in the wake of ongoing projects and those still to be launched in the framework of fiscal expansion in the US, Japan and several West European countries may make access to foreign financing for the NMS difficult and/or expensive. Finally, though no immediate danger is in sight, foreign parent banks in the NMS may still encounter problems that they may be tempted to solve to the detriment of their foreign affiliates. Maintaining the fixed exchange rate in individual NMS may necessitate severe cuts in wages and social transfers, bearing the risk of political unrest. Strong devaluation of fixed exchange rates, like market-driven depreciation of flexible exchange rates, would increase the burden of debt service for foreign currency denominated loans both for businesses and households. Possible mass insolvencies have the potential of creating grave social tensions and destabilizing the financial institutions involved.

One of the much less numerous upward risks is related to a successful free rider attachment of NMS exporters to import-generating fiscal expansion programmes in the EU. Especially the car scrapping subsidies in several EU countries offer a short-term opportunity for car manufacturers and sub-contractors in the NMS automotive cluster. The NMS automotive cluster may also gain from possible additional relocation of production sites from Western Europe under the increasing competitive pressures in the current situation. Successful mobilization of re-designed and front-loaded EU transfers may facilitate an early recovery of investment.

Anton Mihailov

Bulgaria:
countercyclical measures help mitigate the shocks of the crisis

Bulgaria's economy experienced a notable downturn in the first quarter of the year but the depth of the recession was probably not as great as had been prompted by the slump in exports and industrial production. According to the preliminary national accounts figures (which may still be revised), GDP in the first quarter dropped by 3.5% from a year earlier, while in the same period the decline in real industrial output was close to 18% year-on-year whereas total exports in nominal terms dropped by some 20% year-on-year. The national accounts figures also indicate a notable downturn in the main components of domestic demand (both private consumption and fixed investment). Real retails sales in the first quarter were some 9% below their level in the same period of 2008.

The economic downturn has been associated with a certain deterioration of the situation in the labour market but so far it has been far from dramatic. Nevertheless, expectations are that the rise in unemployment will accelerate in the months to come. Since the start of the crisis, there has been a sharp change in the price dynamics, especially as regards producer prices: the PPI level in April 2009 was 7% below the level of April 2008. Consumer prices have notably slowed down their pace as well.

This type of macroeconomic performance reflects a major shift in the patterns of growth as a result of the crisis. During the previous eight years (from 2001 to 2008), economic growth in Bulgaria was exclusively driven by domestic demand. The first quarter of 2009 marked a striking departure from this pattern: while domestic absorption made a hefty negative contribution (-12.3%) to GDP growth (with almost identical contributions of private consumption and gross fixed capital formation), the positive contribution of net exports amounted to 8.8%. This positive contribution resulted from a structural adjustment, namely, a considerable reduction of the deficit in the trade balance (which still remained negative). Compared to the same period of the previous year, the current account deficit in the first quarter also dropped considerably.

The massive countercyclical measures initiated by the government may have also contributed to the softening of the negative shocks. Already in October 2008, the government announced a series of anti-crisis measures, some of which were subsequently incorporated in the 2009 budget. The core of the programme is public investment in infrastructure with a target figure of total public capital expenditure in 2009 amounting to BGN 5.6 billion (over 8% of GDP), which is a significant increase both in absolute and in relative terms. Another important component of crisis management was the launching of a Development Bank (initially funded with BGN 500 million), a public fund aimed at supporting SMEs through different financial instruments.

In March, the government adopted a new infrastructure package (amounting to BGN 250 million) including supplementary funding of national and local projects. In particular, additional targeted subsidies amounting to BGN 155 million are to be allocated among some 200 municipalities in support of local infrastructure projects. The newly established Development Bank was given a swift start and began operational activity at the beginning of 2009. By mid-May, it had disbursed some BGN 151 million of funding (or more than 60% of its initial endowment of disbursable funds) to projects initiated by 246 small businesses. The maximum amount of funding to a borrower is BGN 2 million and the interest rate is fixed at 8% for a period of up to 10 years with a 3-year grace period (some 3.5 percentage points below the current market interest rate on new commercial loans of similar maturity). The Bank now envisages a bond issue in order to be able to finance new projects. In addition to this, public subsidies for research and innovation in 2009 were increased by 50% compared to 2008 to reach BGN 120 million.

In early 2009, the anti-crisis programme was supplemented with a wide-ranging package of measures – both new and expanded existing ones – in support of the labour market, covering several areas:

- Employment protection and support. These include: partial compensation of lost income to employees obligated to switch to part-time work due to the crisis; career start support to both university and school graduates; hiring additional social workers from within the pool of unemployed, etc.
- Human resources development. Measures include: extended forms of support to vocational training and new career start to laid off workers and various categories of employed and unemployed persons; hiring additional child care personnel from among older-age unemployed; support to part-time vocational training to young employees forced to work part-time; support for the start of new businesses.
- Unemployment benefits have been reorganized to stimulate active job search. The entitlements have been differentiated over time (higher at the beginning and lower at the end of the period) while the maximum duration of the unemployment benefit has been reduced.

As regards incomes policy, the government has manifested relative restraint and has managed to avoid excessive, populist pre-election spending. Thus the increase in public sector wages planned for 2009 has been put on hold. At the same time, two steps of increases in different types of pensions (one in January and another one in July) are being implemented as envisaged in the 2009 budget.

The anti-crisis measures have been associated with a considerable loosening of the fiscal stance compared to the pre-crisis period (in the first quarter of the year, consolidated general government revenue was 5% down from the same period of 2008, while expenditure was 22.5% up). Nevertheless, the general government balance still remained in surplus, reflecting the existing ample cushion in Bulgaria's state coffers. The authorities have been financing some of the anti-crisis measures from the fiscal reserve, which dropped by BGN 427 million between end-December and end-March. Despite this spending, the fiscal reserve remained at the respectable level of BNG 7.95 billion at the end of the first quarter.

Overall, Bulgarian banks have preserved financial stability and remain fairly sound despite the substantial reduction in the access to external funding related to the global financial squeeze. The key factor contributing to the stability in the banking system has been the stringent prudential regulation introduced after the 1996-1997 crisis, which is much stricter than what is required from Basel II regulations. Since the start of the crisis, there has been some increase in the amount of non-performing loans in the banking system (from 2% in 2008 to some 3.5% in March 2009); however, they still remain at a level which does not pose systemic risks. Thanks to this financial stability, there has been no need of government intervention in the financial sector and such need is unlikely to emerge in the immediate future.

Within the existing constraints, the Bulgarian National Bank adopted some regulatory measures equivalent to a moderate monetary easing aiming to soften the credit squeeze. In particular, the provisioning requirements for credit risk were relaxed somewhat in February, allowing the banks to release some previously blocked funds and re-allocate them for credit activity. Credit activity has slowed down considerably but has not come to a halt: in April 2009 the stock of outstanding credit to the corporate sector was up 21% compared to April 2008 while the stock of outstanding credit to the household sector was 20% higher than a year earlier. Actually, after an abrupt downfall in the second half of 2008, new credit to households started to accelerate again in the first months of 2009.

Despite the loosening of the fiscal stance, the authorities have stated their commitment to overall fiscal discipline and have not abandoned the target of maintaining a surplus in the general government balance for 2009 as a whole (however, the target was reduced to 1% from the initially envisaged 3%). In view of this, in early June the government announced its intention to cut planned public expenditure in 2009 by BGN 500 million. It remains to be seen, however, what the policy stance of the new government due to take over after the parliamentary elections in July will be.

The outlook for the Bulgarian economy continues to be dominated by downside risks. Needless to say, Bulgaria’s short-term economic prospects depend to a large degree on how the overall economic situation in Europe will evolve in the months ahead. This notwithstanding, the most likely scenario for 2009 is the recessionary one, but probably Bulgaria will not be among the countries with the deepest recessions. Given the magnitude of the negative shock, it is not very likely to see positive GDP growth in Bulgaria in 2010 either.

While the labor market still has not experienced the full shock of the recession, this is likely to happen in the second half of the year. These negative effects will probably be of a more lasting nature, suggesting that unemployment rates both in 2009 and in the following years will remain on the higher side. By contrast, given the weak domestic demand and absence of imported inflationary pressure, the price dynamics will be dominated by disinflation or even deflation. The adjustment in the balance of payments is likely to continue and it can be expected that the current account deficit in 2009 and the following years will be substantially lower than that seen in 2007-2008.

Table BG

Bulgaria: Selected Economic Indicators

	2005	2006	2007	2008 [1]	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average	7739.9	7699.0	7659.8	7621.2	.	.	.	.	.
Gross domestic product, BGN mn, nom. [2]	42797.4	49361.0	56519.8	66728.1	13483.5	13961.1	66000	67300	71500
annual change in % (real) [2]	6.2	6.3	6.2	6.0	7.0	-3.5	-3	0	3
GDP/capita (EUR at exchange rate)	2800	3300	3800	4400	.	.	.	.	.
GDP/capita (EUR at PPP)	7800	8600	9300	9800	.	.	.	.	.
Consumption of households, BGN mn, nom. [2]	29841.5	34554.3	38826.5	45200.7	10343.8	10260.3	.	.	.
annual change in % (real) [2]	6.1	9.5	5.3	4.9	6.5	-6.3	0	1	3
Gross fixed capital form., BGN mn, nom. [2]	10346.5	12805.2	16832.5	22253.9	4100.8	3615.7	.	.	.
annual change in % (real)	23.3	14.7	21.7	20.4	15.5	-14.1	-8	0	6
Gross industrial production									
annual change in % (real) [3][4]	6.7	5.9	9.2	0.8	3.6	-17.6	-14	-3	6
Gross agricultural production									
annual change in % (real)	-6.0	-0.1	-21.0	32.4	.	.	.	.	.
Construction industry (build.& civil engin.) [4][5]									
annual change in % (real)	31.8	13.5	20.0	11.9	-2.5	-6.5	.	.	.
Employed persons - LFS, th, average	2981.9	3110.0	3252.6	3360.7	3289.9	3262.8	3220	.	.
annual change in %	2.0	4.3	4.6	3.3	4.9	-0.8	-4.2	.	.
Unemployed persons - LFS, th, average	334.4	305.7	240.2	199.7	228.8	222.2	280	.	.
Unemployment rate - LFS, in %, average	10.1	9.0	6.9	5.6	6.5	6.4	9	9	8
Reg. unemployment rate, in %, end of period	10.7	9.1	6.9	6.3	6.8	6.9			
Average gross monthly wages, BGN	323.7	360.3	431.2	524.5	484.3	563.0	.	.	.
annual change in % (real, gross)	5.4	3.7	10.4	8.3	11.2	10.6	.	.	.
Consumer prices (HICP), % p.a.	6.0	7.4	7.6	12.0	12.4	5.1	2	2	3
Producer prices in industry, % p.a. [4]	7.9	12.1	8.4	10.6	13.9	-3.2	-5	.	.
General governm.budget, EU-def., % GDP [6]									
Revenues	41.2	39.5	41.5	39.0	.	.	.	.	.
Expenditures	39.3	36.5	41.5	37.4	.	.	.	.	.
Net lending (+) / net borrowing (-)	1.9	3.0	0.1	1.5	.	.	-2.0	-2.0	-1.0
Public debt, EU-def., in % of GDP [6]	29.2	22.7	18.2	14.1	14.0	12.7	.	.	.
Base rate of NB % p.a., end of period [7]	2.1	3.3	4.6	5.8	4.8	3.5	.	.	.
Current account, EUR mn	-2705.7	-4652.0	-7268.0	-8634.0	-1980.1	-1272.0	-4700	-4200	-3900
Current account in % of GDP	-12.4	-18.4	-25.2	-25.3	-24.2	-17.8	-13.9	-12.2	-10.7
Exports of goods, BOP, EUR mn	9466.3	12012.0	13512.0	15278.0	3648.7	2669.5	12000	11800	12500
annual growth rate in %	18.6	26.9	12.5	13.1	25.8	-26.8	-21.5	-2	6
Imports of goods, BOP, EUR mn	13876.1	17575.0	20758.0	24036.0	5427.4	3808.2	18000	17500	18000
annual growth rate in %	26.9	26.7	18.1	15.8	21.9	-29.8	-25	-2.8	2.9
Exports of services, BOP, EUR mn	3564.1	4186.0	4743.0	5372.0	826.3	780.7	4300	4300	4500
annual growth rate in %	9.3	17.4	13.3	13.3	14.8	-5.5	-20	0	4.7
Imports of services, BOP, EUR mn	2745.2	3264.0	3990.0	4544.0	1069.5	835.4	3300	3100	3200
annual growth rate in %	5.3	18.9	22.2	13.9	22.5	-21.9	-27	-6	3
FDI inflow, EUR mn	3152.1	6159.0	8480.0	6163.0	1202.1	750.4	3300	3000	3000
FDI outflow, EUR mn	249.1	138.0	198.0	477.0	410.1	15.6	.	.	.
Gross reserves of NB excl. gold, EUR mn	6813.9	8309.1	11215.9	11927.6	11355.5	10928.6	.	.	.
Gross external debt, EUR mn	15506.9	20674.3	28952.7	36729.8	30250.4	36410.8	.	.	.
Gross external debt in % of GDP	70.9	81.9	100.2	107.7	88.7	107.9	.	.	.
Average exchange rate BGN/EUR	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956
Purchasing power parity BGN/EUR	0.715	0.743	0.791	0.869	.	.	.	.	.

1) Preliminary. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices). - 3) Enterprises with more than 10 employees. - 4) Quarterly data and forecasts according to NACE Rev. 2. - 5) Enterprises with more than 5 employees. - 6) According to ESA'95, excessive deficit procedure. - 7) The BNB basic interest rate is not a policy rate but a monthly reference rate computed by the BNB as the average interbank LEONIA rate of previous month (valid from 2005).

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

Leon Podkaminer

The Czech Republic:
policy eased to limit the damage

In the first quarter of 2009 the GDP declined by 3.3% (over the same period of 2008). In real terms exports of goods and services fell faster than their imports. Foreign trade in goods and services contributed -1.7 percentage points (p.p.) to the overall GDP growth. Gross fixed investment fell moderately, but a massive contraction in inventories resulted in gross capital formation contributing -4.1 p.p. Rising consumption (public and private combined) limited the GDP decline, contributing +2.5 p.p.

The decline in industrial production which started already in October 2008 has been deepening: in April production was down 22%, year-on-year, from 17% in March. The value of new orders placed with industry was lower than a year earlier by 26.7%. Production of intermediate and durable consumer goods is most affected, followed by capital goods. Production of non-durable consumer goods is also declining, though less so. Employment in larger industrial firms (i.e. staffed with over 50 persons) was down 11% year-on-year in April, the average monthly wage was up 2.3%.

In nominal terms, foreign trade in goods contracted massively. The decline in imports was only marginally faster than that of exports. In CZK terms the trade surplus increased. The depreciation of the koruna, which had started in July 2008 and culminated in February 2009, turned out too weak to reduce imports much more strongly. Nevertheless, that depreciation was sufficient to reduce the trade and current account surpluses expressed in euro.[19] (In CZK terms the surpluses in question rose in the first quarter of 2009.)

The levels of risks facing the Czech banking system remain quite low. At the end of March 2009, most prudential indicators stood at highly satisfactory levels, generally much better than reported a year earlier. The capital adequacy ratio is 12.9, the share of liquid assets in total assets is over 25%. The deposit/loans ratio exceeds 1 by a wide margin, the net external position of Czech banks is positive (uniquely among the NMS). Moreover, unlike in other NMS, the value of loans denominated in foreign currencies has been limited.[20] The share of non-performing loans is fairly low – but it is likely to rise to about 5-6% if the real activity

[19] In July 2008 the CZK/EUR rate fell below 23, in February 2009 it touched 29.5. Since early March 2009, the rate oscillates around 26.6. The period of the weakening Czech koruna was marked by increased outflows of portfolio capital and falling official reserves. The recent (moderate) strengthening of the koruna is associated with the return of larger capital inflows and a renewed rise in official reserves.

[20] The share of foreign exchange-denominated loans to business is about 18%. The share of such loans to households has been negligible.

contracts further. Net post-tax profits earned by banks in the first quarter of 2009 stood at CZK 11.9 billion (6.3% less than a year earlier). The good position of banks notwithstanding, some precautionary measures were taken by the authorities. These measures include an increased level of deposit guarantee (50 thousand euro) and the introduction of repurchase facilities to improve the distribution of liquidity. The range of instruments acceptable as collateral has been quite narrow (limited to treasury bonds). This does not seem to matter so far because of the persisting excess liquidity of the banking sector. In anticipation of harder times ahead, the Czech National Bank (CNB) has been easing its policy. The most recent CNB decision (May 2009) lowered its basic interest rate to 1.5% and the deposit rate to 0.5%. Further cuts in CNB rates are very likely soon because of rising dangers of price deflation.

The ongoing easing of monetary policy has proved incapable of stopping unfavourable monetary developments. One reason for this is the banks' response to the eased monetary policy. So far banks fail to pass the CNB interest rate cuts on to their lending rates. The latter remain flat. Because of the ongoing fast disinflation, the real lending rates are becoming quite high. Given the developing massive slack in the non-financial business sector, its demand for credit cannot be strong. But rising real interest rates surely suppress the corporates' demand for credit even further. The nominal stock of loans to the real economy rose a mere 0.3% in the first quarter of 2009. (Prior to the outbreak of the crisis, the stock of loans kept rising much faster – on average by 5.5% quarterly in 2006-2008.) The stock of loans to households has been performing quite well, rising by 3% during the first quarter of 2009 (and by 4.4% in the last quarter of 2008). But the non-financial business sector is doing badly. The stock of loans to the sector which contracted by 0.9% already during the last quarter of 2008 fell by another 2% in the first quarter of 2009.[21] The figures for April are even less encouraging.

While the monetary policy appears unable do much more to stimulate the real economy, higher hopes are staked on the fiscal policy. Two fiscal packages have so far been introduced. The first, approved already in December 2008, lowered the fiscal revenues by decreasing the social security contributions paid by employees and raised the expenditure – primarily on various items related to infrastructure investment. Overall, the package claimed to have raised the deficit/GDP ratio by about 0.7 percentage points. Apart from that, according to that package, the Czech Export Bank and an agriculture support fund received some capital injections. In January the government decided on one-off measures extending additional subsidies and, at the same time, streamlining the planned ordinary expenditure. The net effect of these measure reduces the deficit/GDP ratio by 0.1 percentage points. The last (as yet) stimulation package was proposed in February 2009. Most of its measures do not need Parliament's approval. (But some, e.g. on the reduction of social security contributions, await such approval.) On the revenue side, the package reduces the employers' social security contributions, allows faster depreciation of fixed assets and extends the VAT deductions on personal vehicles. On the expenditure side, the package stipulates the extension of various subsidies, also to credits to

[21] The recent rates of decline of the nominal stock of loans to the business sector underestimate the true size of credit contraction. The stocks of these loans are inflated on account of the strong depreciation of CZK which started in July 2008 and culminated in February 2009.

small and medium-sized enterprises. Some provisions of the package are one-off, some (e.g. relating to VAT) are permanent. In total, the package will increase the deficit/GDP ratio by 1.1 percentage points in 2009. The public sector deficit in 2009 would thus rise to at least 4.5% of the GDP. Of course it is hard to assess the eventual longer-term consequences for growth of the fiscal stimuli described above. In the shorter term, these stimuli will certain to be helpful. This is evidenced by the data for the first quarter of 2009 – with the growth of public consumption accelerating to 5.3%.[22]

Several unknowns enter the equation determining GDP growth in 2009 and thereafter. The first is the GDP growth rate in the EU itself which, to a large extent, will affect the Czech export performance. While it is now clear that exports are unlikely to recover anytime soon, uncertainties about imports persist. In the first quarter of 2009 imports trailed behind exports – but this is likely to be corrected. If the Czech koruna remains relatively weak, domestic production should become sufficiently competitive to replace at least some imports. Weak exports may also reduce the demand for imported components and raw materials. All in all, the (negative) contribution of foreign trade to GDP growth is likely to become smaller in the course of 2009. Gross fixed investment is likely to continue declining, but the reductions in inventories may become less pronounced.

Private consumption will probably carry the day. Aided by continuing growth of lending to households, 3% growth of private consumption in 2009 continues to be quite likely. Rapid disinflation and cuts in social security premia support private spending. In addition, public consumption is likely to be supportive – just as in the first quarter.

The overall wiiw point-estimate of the GDP growth in 2009 is -1.5%. This is more optimistic than recently projected by the Czech Ministry of Finance and the Czech National Bank. The former expected (in its forecast announced in April 2009) a GDP growth rate of -2.3%. For the first quarter the Ministry's forecast envisaged growth rates of private and public consumption much lower than actually recorded. The Ministry had expected total consumption to rise by 2%, while actually consumption rose by 3.6%.[23] The entire 2009 growth rates of private and public consumption envisaged by the Ministry's forecast (0.9% and 1.8% respectively) may now need to be revised upwards. (The same applies to the May 2009 CNB forecast which envisaged 0.4% decline in private consumption in 2009.)

[22] Public consumption stagnated in 2006 through 2008. The last time public consumption rose in excess of 5% was the third quarter of 2005.

[23] The Ministry's forecasts for gross fixed investment, exports and imports in the first quarter of 2009 turned out fairly accurate. But the Ministry failed to predict the abrupt fall in inventories: in effect it expected only a moderate decline in gross capital formation (-1.2%) – far off the true one (-13.9%).

Table CZ

Czech Republic: Selected Economic Indicators

	2005	2006	2007	2008 [1]	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average	10235.8	10269.1	10334.2	10427.9	.	.	10500	10550	10600
Gross domestic product, CZK bn, nom. [2]	2983.9	3215.6	3530.2	3705.9	874.2	878.0	3690	3800	4010
annual change in % (real) [2]	6.3	6.8	6.0	3.2	3.5	-3.3	-1.5	1	3
GDP/capita (EUR at exchange rate)	9800	11100	12300	14200	.	.	.	.	.
GDP/capita (EUR at PPP)	17100	18300	20000	20400	.	.	.	.	.
Consumption of households, CZK bn, nom. [2]	1442.7	1543.0	1669.3	1812.3	419.3	437.0	.	.	
annual change in % (real) [2]	2.5	5.4	5.2	2.9	2.8	3.0	2	3	3
Gross fixed capital form., CZK bn, nom. [2]	741.9	792.4	857.7	888.3	201.7	203.0	.	.	.
annual change in % (real) [2]	1.8	6.5	6.7	3.1	0.5	-3.4	-8	0	4
Gross industrial production									
annual change in % (real) [3)4)]	6.7	11.1	9.0	0.4	2.2	-21.0	-12	1	4
Gross agricultural production									
annual change in % (real)	-2.0	-4.2	3.1	6.9	.	.	.	.	.
Construction industry (build.& civil engin.)									
annual change in % (real) [3)4)]	2.4	6.6	5.8	0.1	0.7	-11.5	.	.	.
Employed persons - LFS, th, average	4764.0	4828.1	4922.0	5002.5	4958.4	4946.8	.	.	.
annual change in %	1.2	1.3	1.9	1.6	1.9	-0.2	-0.5	-0.5	0.5
Unemployed persons - LFS, th, average	410.2	371.7	276.6	229.8	244.5	302.8	.	.	.
Unemployment rate - LFS, in %, average	7.9	7.1	5.3	4.4	4.7	5.8	7	7.0	6.5
Reg. unemployment rate, in %, end of period	8.9	7.7	6.0	6.0	5.6	7.7	.	.	.
Average gross monthly wages, CZK [5]	18992	20219	21694	23542	22407	22941	.	.	.
annual change in % (real, gross)	3.3	3.9	4.4	2.1	2.6	0.3	1.5	3.5	4
Consumer prices (HICP), % p.a.	1.6	2.1	2.9	6.3	7.6	1.5	1.0	2.0	2.5
Producer prices in industry, % p.a. [4]	1.4	0.1	2.6	0.0	1.1	1.9	.	.	.
General governm. budget, EU-def., % GDP [6]									
Revenues	41.4	41.2	42.0	40.9	.	.	38.0	38.5	.
Expenditures	45.0	43.8	42.6	42.4	.	.	42.5	42.5	.
Net lending (+) / net borrowing (-)	-3.6	-2.6	-0.6	-1.4	.	.	-4.5	-4.0	-3.5
Public debt, EU-def., in % of GDP [6]	29.8	29.6	28.9	29.8	.	.	34.0	37.0	.
Discount rate of NB, % p.a., end of period	1.0	1.5	2.5	1.25	2.75	0.75	0.5	1	2.5
Current account, EUR mn	-1346	-2924	-4024	-4610	1185	897	-2500	-2000	-3000
Current account in % of GDP	-1.3	-2.6	-3.2	-3.1	3.5	2.8	-1.8	-1.4	-1.9
Exports of goods, BOP, EUR mn	62781	75706	89379	98824	25186	18982	84000	90000	97000
annual growth rate in %	16.1	20.6	18.1	10.6	17.4	-24.6	-15	7	8
Imports of goods, BOP, EUR mn	60797	73415	85038	94677	23508	17432	78000	83000	88000
annual growth rate in %	11.5	20.8	15.8	11.3	18.6	-25.8	-18	7	6
Exports of services, BOP, EUR mn	9491	11086	12493	15133	3497	2974	14200	.	.
annual growth rate in %	22.3	16.8	12.7	21.1	31.5	-15.0	-6	.	.
Imports of services, BOP, EUR mn	8254	9449	10459	11847	2625	2413	11000	.	.
annual growth rate in %	13.9	14.5	10.7	13.3	17.8	-8.1	-7	.	.
FDI inflow, EUR mn	9354	4363	7667	7356	1137	1305	.	.	.
FDI outflow, EUR mn	-12	1172	1187	1299	295	669	.	.	.
Gross reserves of NB excl. gold, EUR mn	24868	23684	23456	26377	23761	27413	26000	.	.
Gross external debt, EUR mn	39379	43415	51642	57778	54281	.	72000	.	.
Gross external debt in % of GDP	38.3	37.1	39.0	41.9	39.4	.	43	42	42
Average exchange rate CZK/EUR	29.78	28.34	27.77	24.95	25.55	27.62	26.5	26.0	25.5
Purchasing power parity CZK/EUR	17.09	17.12	17.13	17.40	.	.	.	.	.

1) Preliminary. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices). - 3) Enterprises with more than 20 employees. - 4) Quarterly data and forecasts according to NACE Rev. 2. - 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 Eurostat and national statistics. Forecasts by wiiw.

Sándor Richter

Hungary:
little manoeuvring room to cope with the recession

In early summer 2009 Hungary features an economy sliding into recession, a new government with a rescue package for a period less than a year and minimum popular support and, finally, an extremely strong parliamentary opposition on the threshold of taking over the political power. The latter has no (revealed) idea how it wants to cope with the crisis once in office.

On 14 April the Hungarian parliament elected Gordon Bajnai for Prime Minister in the course of a constructive vote of no confidence against Ferenc Gyurcsány. Mr. Gyurcsány had to go because in the wake of the mounting economic difficulties related to the global financial crisis he did not manage to gain support in his own (Socialist) party for a second round of austerity measures, unavoidable for securing the support of the IMF (plus European Commission and World Bank). In the current situation the IMF stand-by credit is indispensable for rolling over the country's external debt and thus preserving Hungary's solvency.

Mr. Bajnai's main task is to accommodate the fiscal policy to the changed conditions. The stand-by agreement with the IMF signed last November still reckoned with a GDP decline of less than 1%. However, along with the continuous and increasing deterioration of the international environment and of the growth prospects of the main trading partners, first of all Germany, it has become obvious that Hungary with its shrinking domestic *and* external demand will suffer a much stronger GDP decline than previously assumed. With the recession-related decline of the general government revenues and the unchanged level of expenditures, the targeted deficit for 2009 (2.5% of GDP in the original stand-by agreement, later revised to 2.9%) proved impossible to be achieved without immediate fiscal policy steps.

The first set of measures was approved by the parliament on 11 May. These include, among others, the abolition of the 13th month pension, a pension indexation which follows only the inflation, and the gradual raising of the retirement age from 62 to 65 years. Sickness allowance is reduced from 70% to 60% of the salary. In the field of taxation the standard VAT rate will be increased, as of 1 July, from 20% to 25%. Social security contributions paid by employers are reduced by 5 percentage points. The personal income tax brackets are changed so that more people will be covered by the lowest (18%) tax rate. There are plans to introduce a tax on real estate from next year onwards. These measures are supplemented by government decisions to freeze nominal wages for two years and skip the 13th month salary in the public sector, simultaneously with the abolition of the preferential (state-supported) financing of housing credits.

These measures are primarily expected to decrease fiscal expenditures. The secondary goal is to increase revenues from taxes on consumption which ought to draw on the huge unreported personal incomes. At the same time reported personal incomes are relieved through widening the lower personal income tax bracket. The planned tax on real estate follows the same philosophy, as luxury housing is the most frequent spending target of owners of unreported incomes. A further goal is to maintain employment and thus stimulate economic growth (or at least diminish its decline) by reducing the tax burden on labour.

Given the latest official GDP forecast revisions (6.7% decline this year, 0.9% in 2010) the earlier set 2.9% deficit target became unrealistic. This was acknowledged by the IMF and the European Union in the course of the last review of the IMF stand-by agreement in mid-May. A raising of the general government deficit target from 2.9% to 3.9% of the GDP in 2009 was approved, next year the budget deficit is required to be diminished only by a symbolic 0.1 percentage point to 3.8% of the GDP. This means that the fiscal policy can be somewhat less pro-cyclical in 2009 and 2010 than it would have been in the case of the former deficit target.

Both the monetary authorities and the government made serious efforts to prevent financial intermediation from collapsing. Several measures were taken to ensure liquidity of the banking system. Of the funds provided by the IMF-led international consortium, more than EUR 2 billion was earmarked for actions to bail out the banking system (guarantees, recapitalization). Relying on this source, the government offered recapitalization for the Hungarian banks. Less than happy with allowing more state influence, the banks did not want to make use of this opportunity, except for one bank, FHB. Other banks (MKB, Raiffeisen) received capital injections from their mother companies, the only significant domestic-owned bank, OTP, is in negotiations about a capital injection in the form of a subordinated loan from the EBRD. The government has introduced four new programmes and has eased the conditions of some existing ones to provide additional funds for the banking system so that it can refinance corporate loans. Other measures, through providing subsidies on interest or guarantee schemes, turn the conditions on banks' existing offers more favourable. These programmes are focused on small and medium-sized enterprises. The new funds to refinance banks' corporate loans originate mainly from EU sources: Hungarian government budget financing is used for guarantees and interest subsidies. With the help of government guarantees the commercial banks may reschedule credits for selected households indebted either in forint or foreign exchange (eligible are debtors who have lost their job after 30 September 2008).

In order to stimulate investment the government initiated a programme for the construction industry. This consists primarily of EU Structural and Cohesion Fund co-financed projects whose implementation will be accelerated. The government provides advance payments for the investors between 25% and 40% of the investment value. Unjustified delay of due disbursements of EU funds for investors will be penalized. Lack of advance payments and delays in payments have both been important bottlenecks in the realization of EU co-financed projects, thus these measures will indeed create additional demand for this and the next year compared to the earlier situation.

The monetary policy has other considerations than boosting domestic demand. On 22 October last year the central bank raised the policy rate by 300 basis points to 11.50% as an immediate reaction to the weakening of the exchange rate and the drying out of the market for Hungarian government securities. More than half a year later the policy rate stands at 9.50%, still 100 basis points higher than before the upward jump in October 2008. This rate is exceptionally high in the NMS. With regard to the extreme volatility of the exchange rate[24] the policy rate will probably be cut only cautiously in the second half of the year, maintaining the exceptionally restrictive monetary environment for borrowers in forint. This is coupled with much stricter conditions for loans. It is not surprising then that banks' lending activity has dropped, simultaneously with the strong decline in demand for credits. The net change in loans for non-financial enterprises was negative in the last quarter of 2008 and the first quarter of this year. By denomination, lending in forint declined while in the case of loans denominated in foreign exchange only the increment became smaller. For households the net increase of loans decelerated to less than one third of the pace characterizing the first half of 2008. At the end of March 2009 the share of forex loans in total loans amounted to 68%, 10 percentage points more than last September.

In the first quarter of 2009 the GDP contracted by 6.7%. Contrary to 2007 and 2008 when Hungary's growth performance was substantially weaker than that of the other new EU member states, the county's 'contraction performance' is comparable to the respective indicators of Slovenia, Slovakia and Romania, the shooting stars of the region less than a year ago. With fiscal stabilization underway in Hungary also the gap in the general government deficit compared to other NMS will be closed by the end of the year.

First quarter data about the final use of the GDP show that the 6-7% decline was nearly uniform in household consumption and investment. There was a much stronger decline in inventories. Public consumption, however, remained unchanged. The gap between export and import growth rates widened to 3.4% percentage points, indicating a positive change in net exports. On the production side of the GDP the decline of value added in industry was strong, 20.5% in manufacturing. Construction and services contracted much less, by 4.2% and 3.2% respectively. Stagnating output in public services helped to dampen the overall decline.

Industrial sales declined at a substantially higher rate for exports than for the domestic markets (26.2% vs. 6.9%). The contraction was particularly strong (37.2%) in export sales of transport equipment. This industry alone has been providing more than a quarter of Hungarian industrial exports.

January-April foreign trade data reflect the shrinking foreign demand and the even more rapidly contracting demand for imports. In the first four months of 2009 exports declined by 29%, imports by 35%, the trade balance improved considerably (in euro terms, at current prices).

[24] In March the HUF/EUR rate weakened to a historical low of 316, then strengthened to below 290 by June.

The shrinking output is reflected in employment figures. In the first quarter of the year employment in the overall economy declined by 2.1%, in the business sector by 4.6%, in industry alone by 7.8%. The unemployment rate increased by 1.7 percentage points year on year, by the end of the year it may reach 10.5%.

Fiscal prudence, indispensable to restore the international investors' confidence, will diminish domestic demand both in 2009 and 2010. Foreign demand, assumed to bottom out in the second half of 2009 and to increase modestly in 2010, will thus determine the depth of the recession this and the next two years. Positive growth in Hungary can be expected only in 2011, when the fiscal consolidation has been completed and the world economy is assumed to have entered a new growth period. The downward growth risks are considerable yet. The output effects of the expenditure cuts may be larger than assumed, and foreign demand may remain depressed. Financial intermediation, though kept from collapsing, is far from functioning without frictions. Extremely high interest rates and surcharges related to the increased risks may block economic activities where short-term credits are of vital importance. In the worst-case scenario the GDP decline may be substantially stronger than the 6% to 7 % baseline scenario.

The IMF stand-by credit currently solves the rollover problem of public debt. Nevertheless, a return to market-based financing (issue of bonds denominated in forint and in foreign exchange) is a must. The government's austerity measures have prepared the ground for this and the first experimental placements are encouraging. Still, a resumption of full-scale market financing is dependent on external factors as well, such as the risk appetite of potential investors and yields on alternative investments. Last but not least the development of Hungarian domestic policy up to and after the general elections (to be held in Spring 2010 at the latest) is of critical importance.

Table HU

Hungary: Selected Economic Indicators

	2005	2006	2007	2008 1)	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average	10087.1	10071.4	10055.8	10037.6	10038	10023	.	.	.
Gross domestic product, HUF bn, nom. 2)	21993.1	23775.3	25479.4	26470.0	6102.7	5763.9	25900	26600	28200
annual change in % (real) 2)	3.9	4.0	1.2	0.5	1.8	-6.7	-6.5	-1.5	3
GDP/capita (EUR at exchange rate)	8800	8900	10100	10500	.	.	.	.	.
GDP/capita (EUR at PPP)	14200	15000	15600	15700	.	.	.	.	.
Consumption of households, HUF bn, nom. 2)	11764.0	12384.4	13225.9	13891.1	3351.8	3239.1	.	.	.
annual change in % (real) 2)	3.4	1.9	0.5	-0.5	0.6	-7.3	-7	-3.3	1
Gross fixed capital form., HUF bn, nom. 2)	5040.2	5130.8	5359.1	5343.1	936.1	904.7	.	.	
annual change in % (real) 2)	5.8	-3.7	1.8	-2.9	-5.1	-6.9	-9.5	-1	9
Gross industrial production 3)									
annual change in % (real)	6.9	10.0	8.2	-1.1	7.9	-22.4	-14	-2	10
Gross agricultural production									
annual change in % (real)	-7.1	-2.9	-11.3	27.3	.	.	.	.	.
Construction industry (build.& civil engin.) 3)									
annual change in % (real)	16.1	-1.5	-14.7	-5.2	-17.5	-4.5	-5	4	10
Employed persons - LFS, th, average	3901.5	3930.0	3926.2	3879.4	3844.2	3764.1	.	.	.
annual change in %	0.0	0.7	-0.1	-1.2	-1.6	-2.1	.	.	.
Unemployed persons - LFS, th, average	302.2	316.7	312.0	329.1	332.6	402.8	.	.	.
Unemployment rate - LFS, in %, average	7.2	7.5	7.4	7.8	8.0	9.7	10.5	11	10
Reg. unemployment rate, in %, end of period	9.3	9.1	10.1	10.8	10.5	12.8	.	.	.
Average gross monthly wages, HUF 4)	158343	171351	185017	198942	195331	195827	.	.	.
annual change in % (real, net)	6.3	3.5	-4.6	0.7	-1.1	-2.7	.	.	.
Consumer prices (HICP), % p.a.	3.5	4.0	7.9	6.0	6.9	2.7	4.7	4.3	3
Producer prices in industry, % p.a. 3)	4.7	6.5	1.9	5.6	4.5	7.6	.	.	.
General governm.budget, EU-def., % GDP 5)									
Revenues	42.3	42.7	44.8	46.5	.	.	.	.	.
Expenditures	50.1	51.9	49.7	49.8	.	.	.	.	.
Net lending (+) / net borrowing (-)	-7.8	-9.3	-4.9	-3.4	.	.	-4	-4	-3
Public debt, EU-def., in % of GDP 5)	61.7	65.6	65.8	73.0	.	.	.	.	.
Base rate of NB, % p.a., end of period	6.0	8.0	7.5	10.0	7.5	9.5	.	.	.
Current account, EUR mn 6)	-6655.0	-6857.0	-6511.0	-8865.0	-1602.9	-694.3	-3900	-3700	-4000
Current account in % of GDP	-7.5	-7.6	-6.4	-8.4	-6.8	-3.5	-4.4	-4.0	-3.9
Exports of goods, BOP, EUR mn 6)	49672.3	58381.0	68371.0	72259.0	18630.5	13682.3	61400	64800	71300
annual growth rate in %	11.6	17.5	17.1	5.7	15.1	-26.6	-15	5.5	10
Imports of goods, BOP, EUR mn 6)	51882.4	60433.0	68051.0	72159.0	18258.6	12997.3	60300	62700	69100
annual growth rate in %	9.5	16.5	12.6	6.0	12.7	-28.8	-16.5	4	10
Exports of services, BOP, EUR mn 6)	10351.2	10626.0	12443.0	13667.0	2838.2	2714.0	13000	13700	14800
annual growth rate in %	19.4	2.7	17.1	9.8	9.2	-4.4	-5	5	8
Imports of services, BOP, EUR mn 6)	9218.7	9376.0	11392.0	12755.0	2760.7	2576.7	11500	12100	13100
annual growth rate in %	12.6	1.7	21.5	12.0	13.5	-6.7	-10	5	8
FDI inflow, EUR mn 6)	6172.1	15991.0	52712.0	32869.0	6740.5	21.2	.	.	.
FDI outflow, EUR mn 6)	1755.5	15031.0	49248.0	30338.0	6794.2	411.6	.	.	.
FDI inflow, excl. SPE, EUR mn	6172.1	6024.0	4429.2	4405.5	822.3	535.7	2200	2500	4500
FDI outflow, excl. SPE, EUR mn	1755.5	3126.3	2728.8	1151.1	340.2	273.4	100	500	1000
Gross reserves of NB, excl. gold, EUR mn	15669.7	16383.5	16305.2	23806.5	16756.8	27821.2	.	.	.
Gross external debt, EUR mn 7)	66607.8	81428.1	98256.7	120858.2	103834.5	125388.8	.	.	.
Gross external debt in % of GDP 7)	76.6	86.2	97.8	121.8	104.6	142.8	.	.	.
Average exchange rate HUF/EUR	248.05	264.26	251.35	251.51	259.36	294.24	295	285	275
Purchasing power parity HUF/EUR	153.53	157.23	162.20	167.92	.	.	.	.	.

1) Preliminary. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices). - 3) Quarterly data and forecasts according to NACE Rev. 2. - 4) Enterprises with more than 5 employees. - 5) According to ESA'95, excessive deficit procedure. - 6) From 2006 including Special Purpose Entities (SPE). - 7) Excluding SPE.

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

Leon Podkaminer

Poland:
resisting recession

Economic performance in the first quarter of 2009 proved much stronger than widely expected. The GDP growth rate, though of unimpressive magnitude, turned positive (+0.8%). This is consistent with the earlier wiiw expectations. Consumption, both private and public, has been robust, contributing 3.5 percentage points (p.p.) to the overall GDP growth. The strong rise in private consumption was a natural consequence of rising wages and employment (the latter primarily outside the corporate sector). The GDP share of private consumption recorded in the first quarter of 2009 is unchanged as compared with the same periods of 2008 and 2007. This may suggest that the household saving propensity has not so far been affected by the events. Apparently, households did not engage in precautionary saving. The public mood may have been influenced by the government's persistence in claiming that Poland would remain an island of prosperity.

Exports of goods and services fell almost 15% in real terms – less than imports which fell close to 18%. After several years of having been a major drag on overall growth, foreign trade has now been actively supportive, adding another +1.9 p.p. to the GDP growth rate. Finally, while gross fixed investment increased by some 1.2%, a massive decline in inventories resulted in the contraction of overall gross capital formation by close to 24% – which shaved off some 4.6 p.p. from the overall GDP growth rate. Gross value added in industry contracted by close to 5%, but rose in construction (by 3.4%) and market and non-market services (by 3.1% and 4.9% respectively).

Industrial sales fell by 10% in the first four months of the year. Sales in branches producing primarily intermediate and investment goods dropped by some 15%. Sales of nondurable and durable consumer goods rose by 2.6% and 0.3% respectively. (Sales of pharmaceuticals, computers, electronic and optic equipment performed quite well, but the volume of sales of the motor vehicles branch shrank by 27%.) Employment in industry fell by some 4%, pulling the labour productivity (sales per employee) down by some 6%. Unit labour cost in industry rose about 7%. Industry's financial result from the sale of products (sale revenues minus own costs) did not fall much in the first quarter, by 3% only vs. the same period of 2008. However, the consolidated post-tax net profit in industry declined by 62%. Other segments of the non-financial corporate sector performed similarly. The whole non-financial corporate sector's result on the sale of goods and services reached PLN 22 billion – but the consolidated net profit was PLN 9.8 billion (less than half of that earned a year earlier).

The discrepancy between these two magnitudes is attributed to losses suffered on financial operations, which rose 20-fold in the first quarter of 2009 (from less than PLN 0.5 billion a year earlier). Prominent among these operations was speculation against the euro/Swiss franc.[25]

Lower profits have not substantially impaired the liquidity position of non-financial firms. According to the April business climate survey of the National Bank of Poland, close to 40% of non-financial corporations dispose of cash reserves in excess of current needs, close to 70% of firms do not report liquidity problems.

No crisis of any sort has occurred in the banking sector, and no commercial bank has obtained any tangible public support. (The PLN 5 billion transferred recently to the state-owned BGK bank is planned to facilitate the extension of loans – and especially loan guarantees – to small and medium-sized enterprises.) The easing of monetary policy, lowering the reserve ratio and the facilitation of access to liquidity (also foreign exchange) from the National Bank of Poland proved sufficient to avert potential difficulties.[26] Nonetheless, banks' financial position has weakened. Their net profits totalled slightly over PLN 2 billion in the first quarter of 2009. This is about half of the amount reported a year earlier. It must be added though that banks have made large provisions whose level has risen to PLN 2.6 billion recently (from 0.7 billion at the end of the first quarter of 2008). Larger provisions are to counter higher risks following the deterioration of banks' balance sheets. That deterioration has much to do with the depreciation of the zloty which augmented the weight of banks' fairly large foreign liabilities. Also, banks' current activities are less lucrative than in 2008 when interest costs were much lower. Moreover, the share of problematic loans has been on the rise. The scale of that rise is still moderate: at the end of March 2009 the share of such loans stood at 5.3%, up from 4.4% at the end of 2008. At the same time the structure of banks' financing has somewhat deteriorated. The loans/deposit ratio stands at 1.12 (from 1.0 a year ago). But it must be remembered that the current ratio is still very low by international standards.

The stock of bank loans to households, non-financial corporations and non-monetary financial corporations rose by 5.7% nominally in the first quarter of 2009. In the same period of 2008 the stock of loans had increased by 7.2%. Obviously, the demand for (and supply of) loans is weaker than a year ago. Significantly though, the interest rates on loans of any maturity (and also on deposits) have been declining in the first quarter of 2009 (after having risen strongly in the second half of 2008). This would suggest that banks are in fact willing to expand credits (to creditworthy firms at least). But such firms may tend to be even more risk-averse. This is understandable, for the time being. The stock of credit to non-financial corporations increased by 4.4% in the first quarter of 2009 – while the

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[25] Throughout the first half of 2008 the continuing steep appreciation of the zloty seduced very many managers and entrepreneurs to enter into currency (call) option contracts with banks (primarily those located abroad). The steep depreciation of the zloty in the closing months of 2008 and in January/February 2009 taught a painful lesson to the hapless newcomers to the financial markets.

[26] The measures taken to strengthen the financial system include, among others, the introduction of the deposit guarantee (up to EUR 50,000), increased frequency of open market operations, extended maturity of liquidity provisions, availability of foreign exchange swaps, lower haircut on Lombard credit, widened range assets accepted as collateral.

stock of credit to households rose by 7%. Even if these numbers are somewhat inflated on account of the depreciation of the zloty (and the implied rise in the value of credit assets denominated in foreign currencies[27]) it is clear that the Polish credit market is far from frozen. The credit liabilities/GDP ratios remain fairly low (less than half of the EU-27 levels), the costs servicing these liabilities are correspondingly less painful.

The local repercussions of the global financial crisis that were felt very strongly in the fourth quarter of 2008 included massive outflows of portfolio investment, a precipitous fall in equity prices on the Warsaw Stock Exchange, rising yields on government bonds, and contracting official foreign reserves. The most visible of the repercussion was the spectacular weakening of the Polish currency: The average monthly PLN/EUR exchange rate rose from 3.37 in September to 4.02 in December – the level that had previously obtained in 2000 and 2005. These tendencies continued well into 2009. The turning point came in late February after the PLN/EUR rate touched the level of 5. Soon thereafter the zloty started strengthening. For some time now it has been oscillating around 4.5. The stock exchange has recovered as well, the WIG indices have returned to their pre-crisis (October) levels. Profitability of government bonds has declined significantly, capital inflows have strengthened. In the first quarter of 2009 Poland received, according to preliminary estimates, EUR 3.7 billion in capital inflows, up from 2.3 billion in the preceding quarter.

There have been some good grounds for the recovery of confidence of foreign investors. Apart from the absence of any turmoil in the domestic banking system and the absence of any signs of public sector deficits running out of control, there has been a spectacular improvement on the current account. A current account deficit of a mere EUR 79 million is reported for the first quarter of 2009 – to be compared with EUR 4.7 billion a year earlier and 5.1 billion in the last quarter of 2008. Foreign trade did the trick. The balance of payments deficit in goods trade stands now at EUR 0.5 billion (down from 3.2 and 4.7 billion respectively).

The confidence in the Polish economy is likely to be further strengthened by the recent (May) IMF decision to grant the access to a Flexible Credit Line of USD 20.6 billion. There are no conditions attached to that credit and the costs involved are fairly low (0.27% per annum). The credit, which represents an additional reserve that the Polish authorities could use under extraordinary circumstances (e.g. to counter a major speculative attack), will undoubtedly facilitate access to cheaper foreign borrowing. Poland's standing should increase. Any remaining doubts about the country's ability to service its short-term foreign debt should be dispelled. However, the IMF credit comes long after the Polish currency and stock exchange have returned to quite satisfactory levels entirely on their own. It would be unfortunate if the IMF credit contributed to a return of excessive appreciation of the zloty, excessive capital inflows and to a build-up of another bubble on the Warsaw Stock Exchange.

[27] At the beginning of the fourth quarter of 2008 some 32% of household debt was denominated in foreign currencies, the respective figure for the non-financial corporations was 18.7%. The share of foreign-denominated loans and other claims in total debt of households and non-financial corporations was 27.8%, fairly low if compared with ratios reported in other NMS.

The public sector fiscal deficit in 2008 turned out to be larger than maintained by the Finance Ministry. The deficit in 2009 will certainly be even larger, quite possibly in excess of 5% of the GDP. The rise in the deficit quite automatically follows from the GDP growth falling short of the levels underlying the current budget plan. One can expect the revision of the budget plan some time this coming summer. It is certain that the eventual revisions will attempt to contain the deficit (possibly via higher taxes). Given the restraints perceived by the government, and its cherished beliefs, no meaningful[28] additional fiscal stimulus is to expected.

The chances of Poland resisting recession in the coming quarters are fairly high. Individual GDP components may behave well. Further reductions in inventories, coming on top of the dramatic reductions in the first quarter, may be more moderate. The overall impact of gross capital formation may be more benign, even if gross fixed investment stagnates. Given low household debt and still encouraging labour market/wage developments so far, private consumption will probably perform not much worse that in the first quarter. Exports of goods and services are unlikely to perform any better, even if the domestic currency does not strengthen much. But, if the zloty remains properly weak, imports may be expected to fall further.[29] On the whole foreign trade may continue to strongly support the overall growth. Whether or not this scenario will materialize depends primarily on the behaviour of the zloty exchange rate.

That Poland is currently performing much better than other NMS is, to some extent, a matter of the country's size, its relatively low levels of exports and imports and the quite diversified production structure. Under deep depreciation of the domestic currency, these features turn out to be advantageous: the fall in exports is overcompensated by the fall in imports – the latter being at least partly substituted by domestic production. In smaller, more export-specialized countries the adjustments in imports are less pronounced even under quite strong currency depreciation.

Apart from that, Poland's domestic financial system turns out to be in good shape, with the debt levels (households', government's and the corporate sector's) significantly lower than elsewhere. This fact is not a sign of an exceptionally clever policy. Instead, it follows from the brevity of the preceding GDP growth speed-up which started only in 2006 and did not have time to reach unsound proportions which characterized most other NMS.

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28 The draft 'anti-crisis package' presented recently (2 June 2009) stipulates, among others, temporary subsidization of employment in firms that otherwise would have to fire workers. The package's estimated cost is about PLN 1 billion – equivalent to 0.08% of the GDP.

29 The current import propensity (imports/GDP) is 43.4%. This is less than observed in the first quarters of 2007 and 2008 when the strong zloty resulted in propensities equal to 44.6% and 45.6% respectively. Earlier on the economy prospered very well with much lower import propensities (e.g. 41% in 2006 or 37.3% in 2005). Should the zloty stay weak, the domestic production has good chances to replace a great deal of import items.

Table PL

Poland: Selected Economic Indicators

	2005	2006	2007	2008 [1]	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average	38165.4	38141.3	38120.6	38123.0	38110	38138	.	.	.
Gross domestic product, PLN bn, nom. [2]	983.3	1060.0	1175.3	1271.7	298.0	314.5	1320	1370	1450
annual change in % (real) [2]	3.6	6.2	6.6	5.0	6.1	0.8	0.8	1.5	3
GDP/capita (EUR at exchange rate)	6400	7100	8100	9500	.	.	.	.	.
GDP/capita (EUR at PPP)	11500	12400	13400	14100	.	.	.	.	.
Consumption of households, PLN bn, nom. [2]	614.3	652.8	701.5	768.2	193.9	205.9	.	.	.
annual change in % (real) [2]	2.1	5.0	5.0	5.4	5.6	3.3	3	3	5
Gross fixed capital form., PLN bn, nom. [2]	179.2	208.3	253.8	279.4	45.1	46.8	.	.	
annual change in % (real) [2]	6.5	14.9	17.6	8.1	15.7	1.2	-4	4	8
Gross industrial production (sales) [3)4)]									
annual change in % (real)	4.1	12.0	9.6	3.6	8.2	-10.0	-5	4	6
Gross agricultural production									
annual change in % (real)	-0.7	-1.1	5.2	-4.0	.	.	.	.	.
Construction industry (build.& civil engin.) [3)4)]									
annual change in % (real)	9.1	15.0	16.1	12.7	15.9	3.1	.	.	.
Employed persons - LFS, th, average	14115.6	14593.6	15240.5	15799.6	15515.0	15714.0	.	.	.
annual change in %	2.3	3.4	4.4	3.7	4.6	1.3	-1	0.5	1
Unemployed persons - LFS, th, average	3045.4	2344.3	1618.8	1210.7	1361.0	1414.0	.	.	.
Unemployment rate - LFS, in %, average	17.7	13.8	9.6	7.1	8.1	8.3	9	10	9
Reg. unemployment rate, in %, end of period	17.6	14.8	11.4	9.5	10.9	11.2	.	.	.
Average gross monthly wages, PLN	2360.6	2476.9	2691.0	2960.0	3057.8	3249.3 [3]	.	.	.
annual change in % (real, gross)	1.8	4.0	6.3	5.5	7.5	3.2 [3]	3.5	3.5	4
Consumer prices (HICP), % p.a.	2.1	1.3	2.6	4.2	4.5	3.6	3.3	2.6	2.5
Producer prices in industry, % p.a. [4]	0.7	2.2	2.3	2.6	2.6	5.0	.	.	.
General governm.budget, EU-def., % GDP [5]									
Revenues	39.1	39.9	40.2	39.2	.	.	38.5	39.5	40.0
Expenditures	43.4	43.8	42.1	43.1	.	.	43.0	43.0	42.5
Net lending (+) / net borrowing (-)	-4.3	-3.9	-1.9	-3.9	.	.	-4.5	-3.5	-2.5
Public debt, EU-def., % of GDP [5]	47.1	47.7	44.9	47.1	.	.	46.0	45.5	45.0
Discount rate of NB % p.a., end of period	4.8	4.3	5.3	5.3	6.0	4.0	3.5	3.5	4
Current account, EUR mn [6]	-3016	-7443	-14587	-19753	-4732	-79	-5000	-7000	-10000
Current account in % of GDP	-1.2	-2.7	-4.7	-5.5	-5.7	-0.1	-1.7	-2.2	-2.9
Exports of goods, BOP, EUR mn [6]	77562	93382	105883	120146	30144	23248	102100	114000	122600
annual growth rate in %	17.8	20.4	13.4	13.5	21.2	-22.9	-15	12	7.5
Imports of goods, BOP, EUR mn [6]	79804	98918	118249	136798	33391	23750	109400	118700	127000
annual growth rate in %	13.4	24.0	19.5	15.7	22.5	-28.9	-20	8.5	7
Exports of services, BOP, EUR mn [6]	13105	16349	20930	24156	5102	4399	20000	.	.
annual growth rate in %	21.2	24.8	28.0	15.4	14.9	-13.8	.	.	.
Imports of services, BOP, EUR mn [6]	12520	15768	17523	20688	4578	3829	13000	.	.
annual growth rate in %	16.1	25.9	11.1	18.1	23.3	-16.4	.	.	.
FDI inflow, EUR mn [6]	8330	15737	16672	11058	3442	1925	.	.	.
FDI outflow, EUR mn [6]	2767	7122	3500	2358	893	454	.	.	.
Gross reserves of NB excl. gold, EUR mn	34535	35237	42675	42299	46729	43852	.	.	.
Gross external debt, EUR mn	112316	128870	158441	171826	169884	.	.	.	.
Gross external debt in % of GDP	44.1	46.6	48.4	56.1	55.5	.	.	.	.
Average exchange rate PLN/EUR	4.02	3.90	3.78	3.51	3.58	4.50	4.5	4.3	4.2
Purchasing power parity PLN/EUR	2.23	2.25	2.31	2.37	.	.	.	.	.

1) Preliminary. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices). - 3) Enterprices with more than 10 employees. - 4) Quarterly data and forecasts according to NACE Rev. 2. - 5) According to ESA'95 excessive deficit procedure; forecast wiiw estimate. - 6) 2005-2007 including Special Purpose Entities (SPE).

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

Gábor Hunya

Romania:
contraction in all fields

In the first quarter of 2009 the GDP contracted by 6.2% compared to the same period a year earlier, first of all due the strong fall in private consumption (-12.3%) and an even more serious decline in inventories. Gross fixed capital formation was maintained at almost the same level as in the previous year, while public consumption increased and the trade balance improved. The first-quarter GDP downturn was more severe than expected and the decline is not going to bottom out before the last quarter of the year when the base from the previous year will become lower.

In April, the government revised its February estimation of the GDP decline for 2009 from 2% to 4.1%. Also wiiw has followed this course in view of the shrinking industrial production: currently we expect a decline of about 6%. This forecast is based not only on the performance in the first quarter of the year, but also takes into account the expected output decline in agriculture. The extreme drought in several parts of the country will cause agricultural production to drop, triggering a fall in the food industry and on-the-farm consumption as well. Weather conditions may have a plus-minus 2 percentage point impact on the Romanian GDP and 2008 was an extremely good year, thus the decline in 2009 can be all the more severe. Further hardship is looming in the corporate sector. Currently SMEs credit each other involuntarily in the absence of affordable loans on a massive scale, but this may not last for long and a wave of bankruptcies may set in. In the first five months of the year the number of filed insolvency cases was already up by 60% compared with the previous year.

Industrial production fell due to shrinking demand both within the country and abroad. In the first quarter of 2009 it was 13% lower than in the same period a year earlier, in the first four months by 12% – a negligible improvement. Nevertheless, compared with other NMS, industrial production has suffered a less severe setback as it is less dependent on foreign demand. Declines were registered for all main categories of products, more strongly so in manufacturing than in mining and the energy sector. The output of the construction sector and investments as a whole almost reached the level of the previous year in the first quarter of 2009. Projects launched earlier were finished but very few building permits were issued and in April there was already a marked decline in housing construction.

In April 2009, Romania posted the highest annual inflation rate within the EU, 6.5%. Due to the depreciation of the local currency after December 2008 import prices rose and compensated for the deflationary effect of the recession. As the exchange rate broadly stabilized from April onwards and the deflationary effects of the recession became stronger, prices remained stable in May compared

to the previous month. A return of depreciation is still likely, thus a resumption of inflation cannot be ruled out.

The population has been confronted with small or no wage increases at all this year as the new government invalidated the generous promises made by the former one which lost power in December. Still, in March 2009, the nominal average net salary was 17.6% and the real salary 10.2% higher than a year earlier. But this strong increase was the result of last year's hikes; the restrictive wage policies of the current year will show their effects with some delay. The increase in unemployment was modest in the first quarter of the year, companies introduced short working weeks rather than laying off people, at least for the time being.

In view of the rapid currency depreciation and the increasing possibility of a sudden stop of external financing, Romania asked for a loan agreement from the IMF, World Bank and the EU in February. The accord with the IMF approved in May 2009 puts a cap on the fiscal deficit but does not recommend it to be cut from the 5.1% attained last year. The target has to be kept no matter how strongly GDP is going to contract in addition to the 4.1% decline calculated in the stand-by agreement – which in fact means a curtailment of the deficit. In expenditures there is shift from public wages to investments. According to the accord with the IMF, fiscal reforms include measures to improve budgeting, streamline public wages and pensions, and make public enterprises more efficient to ensure that the deficit will remain low in the future. These reforms should help produce a leaner, more efficient, and more transparent public sector. To make sure that weak social groups are not hit overly hard, the government promised to make arrangements to protect the lowest paid public employees, the poorest pensioners, and others exposed to the economic downturn by boosting social safety net spending.

The current account posted a deficit of only EUR 709 million for the first quarter of 2009, improving by 82.1% compared to the first quarter of 2008. This improvement, from an excessive 16% of GDP to a mere 3% of GDP, came abruptly and reflects the sharp decline in domestic demand. The trade balance accounted for the main impact: it amounted to EUR 1.337 billion, down 67.2% as against the first three months of 2008. (In April, exports and even more so imports kept falling, thus the trade deficit contracted further.) The income of foreign investors declined sharply in the first quarter while the transfers of emigrants remained at the previous year's level. The latter is quite surprising in view of the rising unemployment in the host countries and Spain even offering a return-subsidy for migrants. It seems that migrants are still hoping for a better future abroad and do not expect any better opportunities at home. The current account deficit in the first quarter of 2009 was fully financed by direct investments (as against 42.8% in the first quarter of 2008): these amounted to EUR 1.456 billion, compared to EUR 1.691 billion a year earlier. It is expected that the current account deficit may climb to about 5% of GDP; FDI will finance about three quarters of it, the rest will be covered by EU and IMF funds.

In May Romania received a first instalment of the stand-by credit worth EUR 4.9 billion which was added to the central bank's foreign currency reserves. Reserves thus stocked up, and the BNR could reduce its own reserve collection activity. As of May the monetary policy interest rate was cut

by 0.5 percentage points, to 9.5% per year. The mandatory minimum reserves rates applicable for RON and foreign currency liabilities were maintained at 18% and 40% respectively, but it was abolished for foreign-denominated liabilities with residual maturities of over two years, starting with 24 May. This has effectively reduced the reserve building obligations of commercial banks and allowed to pump new liquidity into the system.

On 26 March, in Vienna, the parent banks of the nine largest foreign banks incorporated in Romania (Erste Group Bank, Raiffeisen International, Eurobank EFG, National Bank of Greece, Unicredit Group, Société Generale, Alpha Bank, Volksbank, Piraeus Bank) gave a general declaration on maintaining their overall exposure to the country and on increasing the capital of their subsidiaries. As a result of the discussions held in Brussels on 19 May, the nine parent banks agreed to submit specific bilateral commitment letters in the coming weeks to fulfil the objectives agreed upon in Vienna. These commitments include a precautionary increase in the minimum capital adequacy ratio for each subsidiary from 8% to 10% for the duration of the IMF programme. The banks will have to provide recapitalization of altogether EUR 1 billion until September 2009 and undergo another stress test in March next year.

As of mid-2009 the Romanian economy's contraction has not reached its bottom yet, but its stability has improved as a result of fiscal and current account adjustments. The IMF support protects the country in case of a sudden stop imposed by market sentiment. The recovery of the economy is dependent on the demand in its main export markets and on international financial flows to the country. Even if a recovery takes place in the main foreign markets, the inflow of financing may stay restricted compared with earlier years. Under such conditions, we expect a stagnation of the economic performance in 2010 and only a modest upswing in the following years. The introduction of the euro is approached cautiously with the target date 2014.

Table RO

Romania: Selected Economic Indicators

	2005	2006	2007	2008 1)	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average	21634	21588	21547	21513	.	.	.	.	.
Gross domestic product, RON mn, nom. 2)	288955	344651	412762	503959	91130	96521	521100	559100	607300
annual change in % (real) 2)	4.2	7.9	6.2	7.1	8.2	-6.2	-6	0	3
GDP/capita (EUR at exchange rate)	3700	4500	5700	6400	.	.	.	.	.
GDP/capita (EUR at PPP)	7900	9100	10500	11300	.	.	.	.	.
Consumption of households, RON mn, nom. 2)	197069	233135	273063	325041	69073	64812	.	.	.
annual change in % (real) 2)	10.1	12.9	11.7	9.2	15.6	-12.3	-8	0	3
Gross fixed capital formation, RON mn, nom. 2)	68527	88272	125645	167942	21484	23287	.	.	.
annual change in % (real) 2)	15.3	19.9	29.0	19.3	33.2	-0.3	-5	3	10
Gross industrial production 3)4)									
annual change in % (real)	2.0	7.1	5.4	0.9	6.4	-13.0	-10	3	5
Gross agricultural production									
annual change in % (real)	-13.1	2.4	-17.7	19.4	.	.	.	.	.
Construction industry (build.& civil engin.) 3)4)									
annual change in % (real)	8.6	20.5	34.0	26.0	35.1	4.4	.	.	.
Employed persons - LFS, th, avgerage	9114.6	9291.2	9353.3	9369.1	9118.6	.	.	.	.
annual change in %	-0.5	1.9	0.7	0.2	0.1	.	.	.	.
Unemployed persons - LFS, th, average	704.5	728.4	640.9	575.5	616.7	.	.	.	.
Unemployment rate - LFS, in %, average	7.2	7.3	6.4	5.8	6.3	.	9	9	8
Reg. unemployment rate, in %, end of period	5.9	5.2	4.0	4.4	4.1	5.6	.	.	.
Average gross monthly wages, RON	968.0	1146.0	1396.0	1742.2	1601.0	1865.7	.	.	.
annual change in % (real, net)	14.3	9.0	14.7	14.2	13.7	9.3	.	.	.
Consumer prices (HICP), % p.a.	9.1	6.6	4.9	7.9	8.0	6.8	6	4	3
Producer prices in industry, % p.a. 4)	10.5	11.6	8.1	15.8	14.2	5.7	.	.	.
General governm.budget, EU-def., % GDP 5)									
Revenues	32.3	33.1	34.0	33.1	.	.	.	.	.
Expenditures	33.5	35.3	36.6	38.5	.	.	.	.	.
Net lending (+) / net borrowing (-)	-1.2	-2.2	-2.5	-5.4	.	.	-5.5	-4	-4
Public debt, EU-def., % of GDP 5)	15.8	12.4	12.7	13.6	.	.	.	.	.
Discount rate of NB, % p.a., end of period 6)	7.50	8.75	7.50	10.25	9.00	10.14	.	.	.
Current account, EUR mn	-6888	-10220	-16715	-16744	-3955	-709	-6000	-7000	-9000
Current account in % of GDP	-8.6	-10.5	-13.5	-12.2	-16.0	-3.1	-5.0	-5.3	-5.9
Exports of goods, BOP, EUR mn	22255	25953	29542	33560	8143	6561	26800	27600	29500
annual growth rate in %	17.5	16.6	13.8	13.6	15.8	-19.4	-20	3	7
Imports of goods, BOP, EUR mn	30061	37765	47365	51895	12221	7898	36300	36700	38900
annual growth rate in %	23.9	25.6	25.4	9.6	15.9	-35.4	-30	1	6
Exports of services, BOP, EUR mn	4102	5585	6931	8766	1877	1789	8300	9100	10000
annual growth rate in %	41.3	36.2	24.1	26.5	12.5	-4.7	-5	10	10
Imports of services, BOP, EUR mn	4451	5581	6450	7921	1732	1732	7500	8300	9100
annual growth rate in %	42.8	25.4	15.6	22.8	26.0	0.0	-5	10	10
FDI inflow, EUR mn	5213	9060	7271	8902	1690	1457	4000	.	.
FDI outflow, EUR mn	-24	338	206	-188	-98	-22	0	.	.
Gross reserves of NB excl. gold, EUR mn	16785	21299	25325	25978	25158	25121	.	.	.
Gross external debt, EUR mn	30914	41196	58537	73004	61027	71632	.	.	.
Gross external debt in % of GDP	39.4	40.4	51.2	58.3	48.7	59.1	.	.	.
Average exchange rate RON/EUR	3.6209	3.5258	3.3328	3.6776	3.6892	4.2662	4.3	4.2	4.0
Purchasing power parity RON/EUR	1.6990	1.7618	1.8273	2.0813	.	.	.	.	.

1) Preliminary. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices). - 3) Enterprises with more than 3 employees. - 4) Quarterly data and forecasts according to NACE Rev. 2. - 5) According to ESA'95, excessive deficit procedure. - 6) Reference rate of NB.

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

Zdenek Lukas

Slovakia:
late revenge of the overambitious conversion rate

The strongly export-oriented Slovak economy was hit hard by the sharp contraction in foreign demand in the wake of the global financial and economic crisis. GDP contracted by 5.6% in the first quarter of 2009, whereas it had still increased by 2.5% in the last quarter of 2008. Germany and the Czech Republic, whose markets are of key importance for Slovak exports, are both in recession. The volume of Slovak exports and imports (goods and services) dropped by 24.3% and 22.6%, respectively. Gross capital formation declined by 16.4%, gross fixed capital formation was down by 4.1%. The difference is accountable to falling inventories, which were the main explanatory component of the GDP decline. Only modestly (by 1.6%) rising real wages and consumers' caution resulted in a slight decline in private consumption. Stimulated by relatively weak currencies in neighbouring Hungary, Poland and the Czech Republic, cross-border shopping of Slovaks increased strongly and as a consequence domestic retail sales (except for motor vehicles) dropped by some 10% in the first quarter of the year.

On the supply side, the GDP contraction followed chiefly from a decline in gross value-added in industry. Unlike the Czech automotive industry, Slovak car makers have so far not been strongly profiting from the car scrapping subsidies introduced in several EU countries. As yet, foreign demand for low-cost cars (such as small models of KIA, Citroen or Peugeot) and luxury cars (VW Touareg, Audi Q7 and Porsche Cayenne) produced by foreign-owned companies in Slovakia has been disappointing. Driven by the fall in car production (-44.3%), gross industrial production was down by 23.5% in the first four months of 2009, accompanied by decline by some 4% in industrial employment and stagnating real wages. Labour productivity in industry plunged by double-digit percentages. In addition, shortly before fixing the conversion rate, the Slovak koruna (SKK) appreciated by around 10% against the euro in the second quarter of 2008. As a result unit labour costs rose by about one-quarter in the first quarter of 2009 and consequently Slovak export goods became less competitive. This is reflected in exports falling more rapidly than imports.

After a period of strong growth, the inflow of foreign direct investment has been sharply declining this year. According to the Slovak Agency for Investment and Business Development (SARIO), in the first quarter of 2009 there were only two FDI projects in the pipeline, in the total value of EUR 8 million – as compared to nine foreign investment projects worth EUR 103 million which were assisted by SARIO in the first quarter of 2008.

Since the end of 2008 the cabinet has taken a number of fiscal policy steps targeted at lessening the impact of the global crisis on the economy.[30] A social package (higher child-birth benefits, pension indexation) focusing on boosting domestic demand was implemented at the beginning of 2009. The measures with the largest burden on the general government budget include a higher basic tax allowance on personal income tax and higher tax credit. Slovakia has also introduced a car-scrapping bonus (EUR 2000 per new car with a ceiling price of EUR 25,000). Efforts at improving the business environment have focused on (1) relieving the tax burden by way of a higher non-taxable part of the income-tax base or by a shortened period to refund excess VAT paid by corporation and (2) raising the limit for state-guaranteed loans for enterprises (in particular SMEs). Measures of employment support include subsidies provided to employers who temporarily curb their operations.

Slovakia's commercial banks have so far not been directly affected by the global financial and economic crisis, because Slovak banks' exposure to highly toxic assets is marginal. Anti-crisis measures in the banking sector are therefore minimal and comprise (1) an unlimited deposit guarantee for private persons and (2) stricter supervisory rules for liquidity transfers by daughter banks to their foreign mother banks.

Besides, there have been cash injections for the Slovak cargo and railway company, the Slovak Guarantee and Development Bank as well as the Export-Import Bank in the value of EUR 310 million. According to the ESA 95 EU methodology, these expenditures do not represent a burden on the general government deficit but increase the debt. To support economic growth the government intends to facilitate a more effective absorption of EU funds with the help of better prepared big investment projects including public-private partnership (PPP). Co-financing is to be secured.

The projected public expenditures for the anti-crisis package amount to EUR 0.7 billion in 2009-2010 (according to the ESA 95 EU methodology). Calculated per year, that would correspond to some 0.5% of annual GDP. Furthermore, the government is expecting additional financial transfers of EU funds in the total amount of EUR 242 million for 2009-2010 attached to the anti-crisis package. Should the drawing of EU funds really rise in line with the projections, a pro-growth effect of 2.4% in 2009 and 1.9% in 2010 can be expected. However, given the current delay in the preparation of a very large and ambitious infrastructure project (highway construction via PPP), that target does not appear very realistic.

Despite the anti-crisis package, GDP will contract by about 5% this year, mostly on account of the slump in foreign demand. Worsening labour market conditions will result in rising unemployment, although the support for employment may mitigate this development. Given the pro-growth and stabilization measures and the co-financing needs of the EU-funded projects, as well as lower budgetary revenues due to the recession, the general government deficit will exceed 5% of the GDP

[30] The bulk of them has been summarized in the 'Stability Programme of the Slovak Republic for 2008-2012', authorized by government decision No. 316 on 29 April 2009; see parts I.4 and I.5.

both in 2009 and 2010. Public debt will rise and account for nearly 40% of the GDP in 2010. FDI inflows will decline sharply in 2009. The trade balance will slightly improve, as imports will drop more strongly than exports. In addition, shrinking profit for foreign investors will improve the balance of income and in this way contribute to the lessening of current account deficit. Should the global economic rebound projected for 2010 really materialize, the Slovak economy may stagnate in 2010 and slightly expand in 2011.

The most challenging issue in the future relates to the excessively strong SKK/EUR conversion rate that was fixed in June 2008. Nevertheless, the government cheered the strong central parity, because wages converted to euro have been higher than otherwise – and the campaign for the 2010 parliamentary elections has already started. Based on the strong currency appreciation, GDP per capita calculated in euro rose by 18% to EUR 12000 in 2008 as compared to 2007.

One year ago the government also made use of currency appreciation to eliminate inflationary risks and thus to comply with the Maastricht inflation criterion. Today, however, Slovak exporters are disadvantaged compared to their competitors in the Czech Republic, Poland and Hungary, where the local currencies have depreciated. In addition, a high proportion of domestic demand has been covered by imports from cheaper sources, mostly Hungary and Poland. The excessively strong Slovak koruna at the time of the conversion has rendered the highly export-oriented Slovak manufacturing sector (in particular the automotive industry) vulnerable in the future.

In the short and medium term, Slovakia’s competitiveness may theoretically be restored by domestic wage and price deflation. However, the wage drop would diminish consumer demand and, in terms of GDP growth, would counteract possible gains in foreign trade achieved through improving competitiveness. Lowering the deliberately elevated purchasing power of the population in the wake of the approaching parliamentary elections in 2010 may be a difficult task. In the long run, sustainable economic growth has to be backed by investments in new, advanced technology for the knowledge economy in order to regain competitiveness and to revitalize export expansion.

Table SK

Slovak Republic: Selected Economic Indicators

	2005	2006	2007	2008 [1]	2008	2009	2009	2010	2011
					1st quarter		Forecast		
Population, th pers., average	5387.0	5391.4	5397.3	5406.0	.	.	.	.	.
Gross domestic product, EUR-SKK mn, nom. [2]	49315.2	55081.9	61501.1	67331.0	15602.0	14648.0	64200	64500	65700
annual change in % (real) [2]	6.5	8.5	10.4	6.4	9.3	-5.6	-5	0	1
GDP/capita (EUR at exchange rate)	7100	8300	10200	12000	.	.	.	.	.
GDP/capita (EUR at PPP)	13500	15000	16700	17700	.	.	.	.	.
Consumption of househ., EUR-SKK mn, nom. [2]	27691.8	30753.1	33795.3	37436.5	9072.0	9272.0	.	.	.
annual change in % (real) [2]	6.6	5.9	7.1	6.1	8.4	-1.2	0	2	2
Gross fixed capital form., EUR-SKK mn, nom. [2]	13089.5	14588.8	16048.5	17465.3	3556.0	3419.0	.	.	.
annual change in % (real) [2]	17.6	9.3	8.7	6.8	7.5	-4.1	-2	1	3
Gross industrial production									
annual change in % (real) [3)4)]	3.6	9.8	13.2	1.3	12.7	-23.0	-18	0	2
Gross agricultural production									
annual change in % (real)	-8.7	-2.9	-4.5	5.0	.		.	.	.
Construction industry (build.& civil engin.)									
annual change in % (real) [3)4)]	14.7	14.9	5.7	11.9	11.2	-13.6	.	.	.
Employed persons - LFS, th, average	2215.2	2302.3	2357.7	2433.7	2391.3	2388.2	.	.	.
annual change in %	2.1	3.9	2.4	3.2	2.8	-0.1	.	.	.
Unemployed persons - LFS, th, average	430.0	355.4	295.7	255.7	280.5	281.0	.	.	.
Unemployment rate - LFS, in %, average	16.3	13.4	11.1	9.5	10.5	10.5	13	14	14
Reg. unemployment rate, in %, end of period	11.4	9.4	8.0	8.4	7.6	10.3	11	12	12
Average gross monthly wages, EUR-SKK [5]	573	623	669	723	679	710	.	.	.
annual change in % (real, gross)	6.3	3.3	4.3	3.3	6.2	1.6	.	.	.
Consumer prices (HICP), % p.a.	2.8	4.3	1.9	3.9	3.4	2.3	2	2	3
Producer prices in industry, % p.a. [4)6)]	5.4	5.7	-1.2	2.8	3.2	-5.1	-3	0	2
General governm.budget, EU-def., % GDP [7]									
Revenues	35.4	33.5	32.5	32.7	.	.	.	.	.
Expenditures	38.2	36.9	34.4	34.9	.	.	.	.	.
Net lending (+) / net borrowing (-)	-2.8	-3.5	-1.9	-2.2	.	.	-5.0	-5.0	-3.0
Public debt, EU-def., in % of GDP [7]	34.2	30.4	29.4	27.6	.	.	.	.	.
Discount rate of NB, % p.a., end of period	3.0	4.8	4.3	2.5	4.3	1.5	.	.	.
Current account, EUR mn	-3268	-3636	-3141	-4279	-392	-582	-3000	-3300	-3500
Current account in % of GDP	-8.5	-8.2	-5.7	-6.6	-2.8	-4.0	-4.7	-5.1	-5.3
Exports of goods, BOP, EUR mn	25654	33349	42171	47722	11575	9089	41000	41000	42000
annual growth rate in %	15.3	30.0	26.5	13.2	.	-21.5	-15	1	3
Imports of goods, BOP, EUR mn	27571	35817	43009	48435	11385	9141	40000	41000	43000
annual growth rate in %	17.4	29.9	20.1	12.6	.	-19.7	-17	2	5
Exports of services, BOP, EUR mn	3542	4322	5140	5796	1265	1026	5900	6000	6200
annual growth rate in %	18.1	22.0	18.9	12.8	.	-18.9	2	2	3
Imports of services, BOP, EUR mn	3285	3790	4752	6269	1350	1417	6500	6700	6900
annual growth rate in %	18.0	15.4	25.4	31.9	.	5.0	3	3	3
FDI inflow, EUR mn	1952	3311	2108	2395	-133	.	.	.	.
FDI outflow, EUR mn	120	292	149	177	44	.	.	.	.
Gross reserves of NB excl. gold, EUR mn	12567	9639	12280	12674	12018	182	.	.	.
Gross external debt, EUR mn	22705	24449	30156	37286	31261	39028 Feb	.	.	.
Gross external debt in % of GDP	57.9	50.7	54.7	55.4	46.4	60.8	.	.	.
Average exchange rate EUR-SKK/EUR	1.281	1.236	1.121	1.038	1.097	1.00	1.00	1.00	1.00
Purchasing power parity EUR-SKK/EUR	0.676	0.681	0.683	0.702	.	.	.	.	.

Note: Slovakia has introduced the Euro from 1 January 2009. For statistical purposes all time series in SKK as well as the exchange rates and PPP rates have been divided by the conversion factor 30.126 (SKK per EUR) to EUR-SKK.

1) Preliminary. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices). - 3) Enterprises with more than 20 employees. - 4) Quarterly data and forecasts according to NACE Rev. 2. - 5) From 2006 including wages of armed forces. - 6) Until 2003 domestic output prices. - 7) According to ESA'95, excessive deficit procedure.

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

Hermine Vidovic

Slovenia:
hit hard despite recovery package

Slovenia's economy has slipped into its deepest crisis since the country's gaining independence. During the first quarter of 2009 the GDP contracted by 8.5% owing primarily to shrinking domestic demand, investments in particular. Gross fixed capital formation fell by nearly 24%, affecting all types of investment: the strongest decline, by 28%, occurred in machinery and equipment, investment in construction fell by 22%. The investment slump was probably a consequence of the sharp decline in export orders along with a running down of stocks built up in the past couple of years. Final consumption rose by 1%, mainly due to rising government consumption while household consumption remained stagnant. Though shrinking significantly, the contribution of foreign trade to GDP growth remained positive. Industrial production slowed down from month to month and dropped by 21% during the first four months of the year, in manufacturing even by 22.4%. Manufacturing output declined in all branches, particularly in the wood, leather and textile industries (by over 30%). In the car industry, Slovenia's main exporting sector, production was down by 20%.

The impact of the economic downturn on the labour market is becoming increasingly visible, although the implementation of short-time work has apparently helped keeping people in employment. So far more than 650 companies have decided to cut labour hours due to shrinking demand. Depending on the source used, labour market results differ considerably. Information obtained from registration data shows a steady increase in unemployment since September 2008, putting the unemployment rate at close to 9% in May. Based on Labour Force Survey data the number of employed fell by a mere 0.9% in the first quarter of the year and the unemployment rate, at 5.4%, was only slightly higher than in the same period a year earlier. National account data on the other hand show that employment even slightly increased in the first quarter of the year. In order to relieve the labour market, the government approved a decree on limiting the work of foreign citizens (mostly from the Western Balkan countries) by reducing quotas in June this year.

Merchandise trade contracted significantly, with goods exports down by 23% and imports showing an even stronger decline, by 28%, in the first quarter of the year, thus resulting in a substantial narrowing of the trade deficit. In contrast to goods trade, exports of services fell faster than imports resulting in a reduction of the services trade surplus. Owing to the sharp decline in the trade deficit, the current account deficit fell to EUR 155 million, from EUR 470 million in the first quarter of 2008. Like in most years of the recent past Slovenia was a FDI net exporter during the first months of the year. Gross foreign indebtedness fell by EUR 1.6 billion compared to December last year and amounted to EUR 37.5 billion by the end of March 2009. In order to boost liquidity Slovenia raised a

three-year Eurobond worth EUR 1 billion in January and EUR 1.5 billion in March. According to the Minister of Finance, Slovenia may issue another Eurobond later this year to strengthen the financial system.

In order to counter the effects of the global financial and economic crisis, the government established a crisis group consisting of key ministers in November 2008. So far this group has elaborated two anti-crisis packages which were adopted by the government in November and December 2008 and in February 2009. The initial fiscal stimulus package worth EUR 800 million (an estimated 2.1% of the GDP) was launched at the end of 2008, out of which most will be spent in 2009. These measures include support for stabilizing the financial sector by injecting liquidity, wage subsidies to companies for shorter working time, the elimination of payroll tax and reduction of corporate taxation. In order to partially offset declining budgetary revenues, excise duties on fuels, tobacco and alcohol were increased. Public funds have been earmarked for the protection of some endangered industrial sectors, e.g. for SMEs and R&D in technologically advanced industries. Along with the second package the government introduced a series of saving measures, of which lower than initially agreed wage increases in the public sector were the most important one. Coupled with the full operation of automatic stabilizers and a significant decline in GDP, these measures may lead to a widening of the general government deficit to 5-6% of the GDP in 2009 (from 0.9% in 2008), but that deficit should narrow again in 2010. Owing to the rising deficit the public debt to GDP ratio will rise from about 23% in 2008 to about 30% in 2010. Figures for the first quarter of the year point to a substantial deterioration of the general government deficit, owing to a sharp decline in (tax) revenues coupled with rising expenditures, particularly for transfers and public sector wages. A first supplementary budget was passed in March 2009, a second revision is envisaged for the end of June.

Owing to the deterioration of the economic situation, a third package is under discussion. Measures will also include plans for medium- and long-term structural reforms (such as modernization of the pension system, changes in social expenditures). The government has also proposed to establish an emergency fund which should provide funds for temporarily laid-off workers: Firms should re-hire those workers after the crisis is over, in the meantime the government should provide the unemployment benefits.

wiiw expects GDP to contract by 4% in 2009 owing to weaker domestic and foreign demand. Particularly investment growth, which has been a key driving force over the past few years, will shrink considerably. The poor economic prospects for Slovenia's main export partners such as Germany and Italy will govern the country's export performance. This affects most manufacturing and some services sectors, such as transport and tourism. Construction as well will be hit hard by credit restrictions – the strong expansion over the past few years has been mainly credit-financed. Considering the usual lag between changes in production and employment, the latter is expected to contract over the coming two years; at the same time, LFS unemployment will increase to some 8.5% in 2010. These developments may also lead to a slowdown in household consumption as households are tending to postpone their purchasing decisions. Following the strong contraction in investment growth, imports will decline faster than exports. Hence, both the trade and the current account deficits will diminish considerably.

Table SI

Slovenia: Selected Economic Indicators

	2005	2006	2007	2008 [1]	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average	2000.5	2006.9	2018.1	2039.6	.	.	.	.	.
Gross domestic product, EUR mn, nom. [2]	28703.6	31008.0	34470.9	37126.0	8725.7	8249.8	36180	37270	39160
annual change in % (real) [2]	4.4	5.9	6.8	3.5	5.7	-8.5	-4	1	3
GDP/capita (EUR at exchange rate)	14400	15400	17100	18200	.	.	.	.	.
GDP/capita (EUR at PPP)	19600	20700	22200	22800	.	.	.	.	.
Consumption of households, EUR mn, nom. [2]	15323.8	16135.1	17691.4	19244.3	4390.5	4380.3	.	.	.
annual change in % (real) [2]	2.8	2.8	5.3	2.2	3.7	0.1	-2	1	3
Gross fixed capital form., EUR mn, nom. [2]	7263.2	8161.5	9477.5	10404.8	2451.1	1917.5	.	.	.
annual change in % (real) [2]	3.8	10.3	11.9	6.2	16.9	-23.6	-15	1	4
Gross industrial production									
annual change in % (real) [3]	3.3	6.1	6.2	-1.5	2.2	-18.9	-10	2	3
Gross agricultural production									
annual change in % (real)	-1.2	-7.4	2.6	-4.5	.	.	.	.	.
Construction industry (build.& civil engin.)									
annual change in % (real) [3][4]	3.0	15.3	18.4	15.1	32.5	-20.6	.	.	.
Employed persons - LFS, th, average	949	961	985	996	971	962	.	.	.
annual change in %	0.7	1.3	2.5	1.1	1.4	-0.9	.	.	.
Unemployed persons - LFS, th, average	66	61	50	46	52	55	.	.	.
Unemployment rate - LFS, in %, average	6.5	6.0	4.8	4.4	5.1	5.4	7	7.5	7
Reg. unemployment rate, in %, end of period	10.2	8.6	7.3	7.0	6.9	8.4	8	8	7
Average gross monthly wages, EUR [5]	1157	1213	1285	1391	1335	1408	.	.	.
annual change in % (real, net) [5]	3.5	2.5	4.2	2.0	0.9	3.1	.	.	.
Consumer prices (HICP), % p.a.	2.5	2.5	3.8	5.5	6.6	1.7	1.5	2	2
Producer prices in industry, % p.a. [3]	1.9	2.3	4.1	3.9	3.4	1.1	2	2.3	2
General governm.budget, EU-def., % GDP [6]									
Revenues	43.8	43.3	42.9	42.7	40.8	43.4	.	.	.
Expenditures	45.3	44.6	42.4	43.6	42.1	49.4	.	.	.
Net lending (+) / net borrowing (-)	-1.4	-1.3	0.5	-0.9	-1.3	-6.0	-5.5	-6	-4.5
Public debt, EU-def., in % of GDP [6]	27.0	26.7	23.4	22.8	.	.	.	.	.
Discount rate of NB, % p.a., end of period [7]	3.8	3.8	4.0	2.5	4.0	1.5	.	.	.
Current account, EUR mn	-497.6	-772.0	-1455.0	-2054.6	-467.8	-154.9	-1000	-1200	-1600
Current account in % of GDP	-1.7	-2.5	-4.2	-5.5	-5.4	-1.9	-2.8	-3.2	-4.1
Exports of goods, BOP, EUR mn	14599.2	17028.0	19799.0	20033.2	5082.8	3916.9	17000	17700	19100
annual growth rate in %	12.9	16.6	16.3	1.2	6.3	-22.9	-15	4	8
Imports of goods, BOP, EUR mn	15625.0	18179.0	21465.0	22655.2	5567.5	4017.5	18100	19000	20500
annual growth rate in %	12.1	16.3	18.1	5.5	10.8	-27.8	-20	5	8
Exports of services, BOP, EUR mn	3213.5	3573.0	4291.0	5181.7	1086.7	947.2	4700	4900	5300
annual growth rate in %	15.5	11.2	20.1	20.8	21.1	-12.8	-9	4	8
Imports of services, BOP, EUR mn	2293.5	2580.0	3098.0	3400.0	719.0	678.7	3200	3500	3850
annual growth rate in %	9.5	12.5	20.1	9.7	15.6	-5.6	-6	9	10
FDI inflow, EUR mn	472.6	514.0	1050.0	1239.0	306.4	-48.1	.	.	.
FDI outflow, EUR mn	515.6	687.0	1318.0	983.0	158.5	114.1	.	.	.
Gross reserves of NB excl. gold, EUR mn [8]	6824.1	5341.7	665.6	623.6	710.9	531.6	.	.	.
Gross external debt, EUR mn	20496	24067	34752	39096	37037	37495	.	.	.
Gross external debt in % of GDP	71.4	77.6	100.8	105.3	99.8	103.6	.	.	.
Average exchange rate EUR/EUR	1.000	1.000	.	.	.	.	.	.	.
Purchasing power parity EUR/EUR	0.730	0.745	0.768	0.798	.	.	.	.	.

1) Preliminary. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices). - 3) Quarterly data and forecasts according to NACE Rev. 2. - 4) Enterprises with at least 20 employees . - 5) From January 2005 including legal persons with 1 or 2 employees in private sector. - 6) According to ESA'95, excessive deficit procedure. - 7) Main refinancing rate, from 2007 for euro area. - 8) From January 2007 (euro introduction) only foreign currency reserves denominated in non-euro currencies.

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

Sebastian Leitner

Baltic States:
squashed hopes in the realm of depression

Latvia: a sovereign meltdown scenario

Latvia is hit by an extraordinary economic depression which put pressure on the Latvian government in May and June to abandon the euro peg of the lats and to devalue. In the first quarter of 2009 GDP fell by 18% year-on-year, and the rate of unemployment jumped to 18.3% in April compared to 6.3% in the same period a year earlier. Short-term indicators of economic activity show that the deterioration of internal and external demand has even aggravated in the second quarter of 2009. The additional austerity measures approved by the Latvian government, which were demanded by the IMF and the EU in order to deliver the second tranche of the rescue package, may allow to keep the euro peg, but will lead to deflationary developments, a prolongation of the economic crisis and severe social consequences for the Latvian population.

The effects of the worldwide financial and economic crisis were aggravated in Latvia due to two particularities: The first one is the Baltic bust following the boom period, which was characterized by an enormous inflow of credits from predominantly Nordic banks. This triggered an enormous increase of private consumption and of investment in the real estate sector. Now that housing and credit bubbles have burst due to the credit crunch, the downturn is sharper than in other countries in the Central and East European region. Given the fact that the inflow of capital together with the fixed exchange rate regime led to a sharp rise of inflation in the boom period, the subsequent rise in the real exchange rate has resulted in ballooning current account deficits and a loss of external competitiveness.

The second distinctive reason for the Latvian slump is the liquidity crisis of Parex Bank, the second largest institute of the country, which had to face substantial withdrawals of non-resident deposits in the second half of 2008. In order to prevent bankruptcy, Parex Bank was nationalized. This resulted in a deterioration of the refinancing situation of the Latvian government and a sharp rise of the RIGIBOR indicating the increased probability of the Latvian currency to be devalued alongside the fall of foreign currency reserves of the Bank of Latvia.

In December 2008 the IMF, the EU Commission and Nordic countries approved a rescue package for Latvia, worth EUR 7.5 billion, equalling one third of Latvia's GDP in 2008. The credit is to be delivered in several tranches, from end-2008 until mid-2011. About half of the money is envisaged for covering the budget deficits, another third for financing the government debt and the rest for further bank recapitalization and loans to enterprises. In return, the Latvian government committed itself to curb government expenditures and reduce the fiscal deficit to 5% of GDP. In order to limit the

expected fall of government revenues, the standard VAT rate was increased from 18% to 21% on 1 January 2009 alongside an increase of excise taxes. The announcement of spending cuts, however, led to riots in the streets of Riga in January and in the following to the demise of the government. The new five-party coalition government led by Valdis Dombrovskis, taking power in March 2009, imposed pubic wage cuts of 15%. On 16 April the EBRD signed an agreement with the government of Latvia to take over 25% plus one share of the total share capital of Parex Bank thereby alleviating the public recapitalization burden. The EBRD furthermore announced that it plans to acquire a minority share of about 10% in two other Latvian banks, but details have not been published up to now.

The looming of an immediate currency crisis

However, by the end of April it was obvious that the fall in government revenues was more dramatic than expected; in particular, the income from VAT declined by about 30% in the first quarter, year-on-year. The Minister of Finance announced that the GDP deficit is expected to amount to at least 9% of GDP in 2009, even when taking into account the planned additional, drastic expenditure cuts. The reaction of EU Economic and Monetary Affairs Commissioner Almunia and the IMF was to refuse the release of the second tranche of the rescue package, worth about EUR 1.7 billion (when adding the contributions of the Nordic neighbours), which was envisaged for end of May. Hence, during the first two weeks of June, the rumours of a looming currency crisis amplified. Suddenly managers of Swedish parent banks, Latvian politicians and e.g. Bengt Dennis, a former governor of Sweden's Riksbank and economic advisor of the Latvian government, began to question the euro peg, which had become a dogma not only in Latvia but also in its Baltic neighbours in the years of high growth rates. By the end of May forex reserves of the Bank of Latvia had dropped by almost 40% year-on-year and were dwindling day by day. In the first week of June the sovereign default of Latvia was looming, when the authorities failed to sell any Treasury bills in a public debt auction. In the following week the development of the overnight Rigibor, escalating to more than 20%, showed that interbank lending was drying up and in forward markets the Latvian lats was traded for 50% of its nominal value.

Nevertheless, Prime Minister Valdis Dombrovskis and the Governor of the Bank of Latvia Ilmars Rimsevics have been reiterating on a daily basis that the currency peg will be maintained until the introduction of the euro, now envisaged for 2013. The government opted for further austerity amendments to the budget for 2009, fixing a cut of government expenditures by 40% in 2009 as compared to 2008, in nominal terms. Public wage bills will be reduced by another 20% nominally (i.e. in total by 35% year-on-year, taking into account the cuts already approved in March), pensions by 10% for non-working pensioners, for those working by 70%. Expenses for health and education are cut severely, two-thirds of the nation's 73 inpatient hospitals and dozens of schools are announced to be closed. The non-taxable minimum for the personal income tax is reduced by 60% and child benefits by 10%, to name just a few of the harsh measures, which even Dominique Strauss-Kahn identified as disputable due to their impact on the country's poor. The amendments will be implemented from 1 July 2009 onwards, and in addition the government announced the plan of additional cuts in public expenditures by about 15% for 2010. Nevertheless the government deficit

is expected to soar to 10% in 2009, since the procyclical fiscal policies will further dampen internal demand and thus tax revenues.

Devaluation or deflation?

The question arises why the Latvian government prefers to push through those drastic austerity measures, which have already passed the parliament on 16 June, in order to keep the euro peg – a decision that is bound to hamper a revival of growth. To opt for devaluation of the obviously overvalued currency would have been more straightforward. One argument cited time and again by Latvian representatives is that the economy is highly 'eurorized', about 70% of deposits and 90% of loans are denominated in foreign currencies and the foreign debt burden, being mostly private, reaches close to 150% of GDP. A devaluation of, e.g., 30% would result in external debt rising to about 250% of GDP and in the default of many private borrowers. Therefore not only the Latvian government, but especially Swedish bank representatives as well as the Swedish National Bank have always been eager to argue that maintaining the euro peg would be the best option for Latvia, also in order to guarantee further inflows of capital through the banking system.

However, given the depth of the depression in Latvia, it is likely that the outcome of the 'peg and deflate' scenario will be the same or even worse compared to the devaluation scenario. If GDP falls by 30%, with nominally lower incomes of employees and unemployment rates surpassing 20%, which can reasonably be expected, then the debt burden will exceed 200% of GDP respectively, i.e. Latvian creditors are in the same position as if a devaluation had been executed. The development of the share of overdue (and non-performing) loans, which has already soared to 13% by the end of March 2009, underlines the argument. Yet, an important difference between the devaluation and the 'peg and deflate' scenarios is that, in the case of the latter, the hardships will last longer and will be higher for the unemployed and the poorer part of the population. However, since the higher income group of the society has a higher debt to income burden than the households with lower income, but is hit to a lower extent by unemployment if the euro peg is kept, the devaluation scenario is less attractive for those with higher incomes, for whom the articulation of their interests is obviously easier.

Moreover, the envisaged exit option of euro adoption in 2013 is still far away and it is highly questionable if and how the aim of reducing the budget deficit to 3% as well as keeping the public debt level below 60% of GDP, as laid down in the Maastricht treaty, can be achieved by 2012. Apart from probabilistic arguing, the path chosen by the public authorities means that Latvia will face another three years of austerity packages to adjust government expenses to nominally shrinking public revenues. It may well be, therefore, that public pressure leads to a devaluation in late 2010, since the parliamentary elections in October next year could end in a landslide of the political sphere. The same may already happen in autumn 2009, when Latvia will have to ask the IMF and EU for the next instalment of the rescue package. Considering not only the high external debt burden, but also the short-term foreign debt as a share of foreign reserves exceeding 200%, the roll-over of debt will be a task permanently difficult to fulfil.

The main reason for the EU to support Latvia in sticking to the questionable dogma of the currency peg seems to be the Commission's fear of contagion and an Asian-style financial crisis. A devaluation of the lats would without much doubt force Estonia and Lithuania to follow suit. The Swedish banks, which are highly exposed in all three Baltic countries, would suffer most from the defaults; however, according to a stress test recently performed by the Swedish financial supervisory authority, banks should be able to cope even with a loss of a third of Baltic credits (in addition to further defaults of credits in the region). In order to provide for the looming dangers, the Swedish National Bank propped up its currency reserves by 50% at the beginning of June, funded by a EUR 3 billion credit by the ECB, and the Swedish government announced that, if necessary, it would even be prepared to nationalize banks to prevent them from bankruptcy. Apart from the Baltics and a possible contagion of Sweden, Bulgaria, which operates a currency board regime like Estonia and Lithuania, could be under considerable strain in the case of the Baltics devaluing; the same holds for Hungary and Romania, both on an EU/IMF rescue package lifeline – a hair-raising scenario for bankers engaged in Eastern Europe. It is likely therefore that the EU may even supplement the Latvian rescue package, which is relatively small in total, should the danger of a currency crisis or sovereign default prevail or loom in the following years.

However, the fact that the private debt burden of Latvia is too high to be serviced by borrowers is obvious. A restructuring and writing-off of a substantial part has to be arranged, irrespective of how and if the currency peg can be sustained or not. Keeping the lats pegged to the euro only defers the problem until better times that will not come. In the end a feasible solution in this respect, which would be of utmost importance for the future development of Latvia's economy, is not only an economic but also a political question. Sweden and the Baltic countries must, with the help of the EU, come to an agreement concerning which one of the acting parties is able and due to bear which part of the expenses of reckless lending by Swedish banks and imprudent borrowing by Baltic households based on implausible expectations of future income growth in the phase of the Baltic boom. Waiting until households, enterprises and in the end banks or even states default on non-performing loans is to turn a blind eye to an obvious problem. If steps in that direction had been taken already at the end of 2008 in the course of the negotiations on the IMF/EU rescue package, this report would have a much rosier outlook.

Economic development in the near to medium-term future

The forecast scenario chosen is that Latvia will, most likely with the need of additional aid from the international community, maintain the euro peg and push through the austerity packages necessary to remain solvent. However, as described above, the level of probability that this plan will fail remains high throughout the next couple of years. The defence of the peg together with the slump of the economy has already brought forth a fall of all monetary aggregates; in particular, M1 fell by more than 16% year-on-year in the first quarter of 2009, after a reduction of nearly 10% already in 2008. The simultaneous fall of monetary supply and demand will lead to a deflationary period starting in the second half of this year and lasting for at least two years.

The choke-off of demand by the government is accompanied by a slump in investment and private consumption, which is due to the current credit crunch, the reduction of household incomes and the lack of any light at the end of the tunnel for entrepreneurs and households. Taken together this will lead to a GDP contraction of not less than 20% in 2009 – although considering the circumstances described above, this still has to be seen as the 'optimistic' scenario. Also in 2010 and 2011 Latvia will face substantial recession, since the refinancing situation of private agents and the state are not going to ameliorate particularly under deflationary conditions and further public expenditure cuts.

Since external demand is in general very sluggish these days, it is questionable how 'internal devaluation' can help a lot in triggering export growth. Moreover, as some of Latvia's main trading partners (such as Sweden, Poland, Russia, Ukraine and other CEE countries) have devalued and export prices of Latvian goods still have grown until recently, Latvia's real effective exchange rate has appreciated until April 2009. Therefore only a revival of growth in the EU countries, which could effect also a revaluation of the currencies of CEE countries, may provide for a gain in Latvia's external competitiveness. However, with or without devaluation, a modification of the Baltic growth model from import-oriented (capital-inflow-induced) to a more export-oriented one will, if possible, bring along years of slow growth. In the course of transition Latvia has become an almost de-industrialized country, with manufacturing accounting for less than 10% of GDP in 2008 and an export structure that is oriented towards labour- and resource-intensive goods (e.g. wood products). Due to the lax inflow of FDI into industrial sectors already in former times and apparent difficulties of entrepreneurs to finance investments, an accelerated restructuring of the economy towards the tradable goods sector is unlikely. The prospects of the services export sectors, which have performed quite well in the past several years, will not only depend on the economic development of the neighbouring Baltic countries and the Baltic Sea region in general, but to a substantial extent also on the quality of the relationship with Latvia's Eastern neighbour Russia, a delicate matter during the whole transition period.

As mentioned above, unemployment has already tripled year-on-year; therefore, we expect an overall annual LFS rate of 18% in 2009, and a further rise in 2010. In view of the fact that youth LFS unemployment rates have already surpassed 30%, an increase in migration is most likely in the years to come. This development is highly unfavourable to Latvia's further growth prospects in the medium- to longer-term future.

Estonia and Lithuania: Baltic Tigers in agony

The current economic situation of Estonia and Lithuania is only marginally less depressing when compared to neighbouring Latvia. The plummeting of investment and household consumption resulted in a severe contraction of GDP in the first quarter of 2009 (-15.1% in Estonia and -13.6% in Lithuania). For the following quarters of 2009 even an aggravation of the downturn is expected. Nevertheless, there are two significant differences when comparing those countries' situation with the turmoil in Latvia. The former two Baltic States did not have to rescue one of the major banks in the region from going bankrupt and, in the case of Estonia, the fiscal policies conducted in the boom

period were more prudent. As a consequence, for the Estonian and Lithuanian governments the refinancing situation is more favourable than that of Latvia. In addition, the pressure on the Estonian kroon and the Lithuanian litas, both pegged to the euro in the arrangement of a currency board, was much less pronounced in previous months, despite the discussion on contagion due to a possible devaluation of the lats.

However, the fall in government revenues caused by the depression forced also the Estonian and Lithuanian authorities to agree on further cuts in public expenditure, in addition to the ones already implemented at the beginning of the year. In the case of Lithuania, the parliament already adopted budget revisions in May, cutting expenditure by 3% of GDP. On 17 June the government approved a further reduction of the budget of about 1% of GDP for 2009, comprising a cut in public wages by 10% as well as parental benefits by 50%. Moreover, it announced an increase in the VAT rate from 19% to 21% from 1 July 2009 onwards. Those new budget amendments are driven by the wish of the Lithuanian authorities to keep the budget deficit below 6% in 2009, in order to reach their goal of entering the eurozone in 2012. Besides, the government wants to avoid having to approach the IMF and EU for a rescue package. As for Estonia, the government ran budget surpluses in the years of the Baltic boom and built up a reserve fund of about 10% of GDP, which would allow them to balance some of the falling revenues in 2009 as well as next year. Nevertheless, the austerity package of the Estonian authorities to be implemented on 1 July is also quite severe, with cuts of 2.5% of GDP or 5% of public expenditures, including a further cut in state salaries, an increase in the VAT rate from 18% to 20% and a reduction of payments into the pension system. The reason for this second package of 2009 (at the beginning of the year expenditure plans have already been reduced by 10%) is that Estonia is eager to keep the deficit below 3% of GDP to allow for adopting the euro as early as 2011. Obviously, the procyclical reduction of public demand will both in Estonia and Lithuania amplify the slump of GDP not only in 2009 but also in the following two years, when deflation will further enforce the fall of government revenues in nominal terms. However, particularly in Estonia future budget cuts – which may be necessary if the goal of euro adoption is to be reached – will be more difficult to implement. After falling out with the former Social Democratic coalition partner, who opposed the proposed austerity package and the planned liberalization of employment laws, Prime Minister Andrus Ansip leads a conservative minority government.

In both Estonia and Lithuania GDP is expected to decline by at least 16% in 2009. In both countries this reduction is driven by all components of internal demand. Due to imports falling more substantially than external demand, the current accounts are even in surplus this year and future deficits will remain much lower than seen in previous years, owing to low growth of GDP and therefore also of imports. Moreover, the inflow of capital, financing the trade deficits in former years, has ceased and doubts arise how the foreign debt burdens built up in times of high growth can be serviced in the near to mid-term future. In Estonia foreign debt (mostly private) amounted to more than 130% of GDP at the end of March 2009, in Lithuania with a ratio of 70% of GDP the situation is less severe. However, with GDP declining this and the next year by 20-30% in the Baltic States, the roll-over of the debt burden may well exceed the means of Estonia and Lithuania, as seen in the case of Latvia.

After the inflation rate spiked at more than 10% in 2008, Estonia and Lithuania are now heading for deflation, which is also driven by the dramatic wage cuts imposed by the government. Although salaries in the private sector will fall less substantial, deflation will reach 5%. In Lithuania the period of falling prices is expected to end already at the beginning of 2010, after the shutdown of the Ignalina nuclear power plant as agreed upon in the country's EU accession treaty. From thereon a substantial part of Lithuania's electricity consumption will have to be covered by imports, which will lead to an increase in the current account deficit.

The budget cuts and especially the increase in indirect taxation are due to curb household consumption even more than seen up to now, not only in the second half of 2009 but also in 2010 and the following year. Public consumption will be curbed by further austerity measures and investment will remain sluggish in a phase of deflationary depression. Therefore we expect an upswing of economic activity to take place in Estonia and Lithuania not earlier than 2012. However, growth prospects will to a large extent depend on the development of external demand from West European countries and Scandinavia. In the case of Lithuania, also Russia and other CIS countries are important trading partners whose economic performance will influence the southernmost Baltic state.

In both Estonia and Lithuania the unemployment rate doubled year-on-year to almost 12% in the first quarter of 2009 and is expected to increase substantially in the rest of the year and in 2010. At the end of this year, when unemployment benefits are due to phase out for those having lost their jobs recently, the governments will have to face not only looming fiscal problems, but also an upswing of resistance against their 'peg and deflate to adopt the euro' plan, which will require further austerity packages and raise (especially youth-) unemployment even further. Without good chances to find a job abroad nowadays, due to sluggish labour demand in all EU member states, social unrest will intensify as the crisis will throw the Baltic economies several years back. Therefore it may well be that the end game of the currency boards and hard pegs of the Baltic currencies is decided not only on the financial markets but on the streets of first and foremost Riga, but also Tallinn and Vilnius.

Table LV

Latvia: Selected Economic Indicators

	2005	2006	2007	2008 1)	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average	2300.5	2287.9	2276.1	2266.0	2269.1	2259.4	.	.	.
Gross domestic product, LVL mn, nom. 2)	9059.1	11171.7	14779.8	16243.2	3742.0	3286.8	13300	11000	10200
annual change in % (real) 2)	10.6	12.2	10.0	-4.6	0.5	-18.0	-20	-12	-2
GDP/capita (EUR at exchange rate)	5700	7000	9300	10200	.	.	.	.	.
GDP/capita (EUR at PPP)	10900	12400	14400	13800	.	.	.	.	.
Consumption of households, LVL mn, nom. 2)	5578.2	7184.2	9104.3	9360.0	2332.6	2119.6	7500	6000	5600
annual change in % (real) 2)	11.3	21.4	14.8	-11.1	-0.5	-17.4	-21	-15	-2
Gross fixed capital form., LVL mn, nom. 2)	2773.8	3644.1	4975.1	4911.4	1000.8	662.9	3500	3000	2800
annual change in % (real) 2)	23.6	16.3	7.5	-13.2	-7.2	-34.1	-30	-8	-1
Gross industrial production 3)4)									
annual change in % (real)	5.9	5.3	0.7	-6.7	-0.1	-23.8	-20	-5	2
Gross agricultural production									
annual change in % (real)	11.8	-1.9	10.8	0.1	.	.	.	.	.
Construction industry 4)									
annual change in % (real)	15.4	13.3	13.6	-3.1	11.1	-29.7	.	.	.
Employed persons - LFS, th, average	1033.7	1087.1	1118.0	1124.5	1137.8	1046.7	.	.	.
annual change in %	1.6	5.2	2.8	0.6	4.9	-8.0	.	.	.
Unemployed persons - LFS, th, average	101.0	79.5	71.3	90.5	79.7	168.8	.	.	.
Unemployment rate - LFS, in %, average	8.9	6.8	6.0	7.5	6.5	13.9	18	22	20
Reg. unemployment rate, in %, end of period	7.4	6.5	4.9	7.0	4.9	10.7	.	.	.
Average gross monthly wages, LVL	246	302	398	479	453	469	.	.	.
annual change in % (real, net)	9.7	15.6	19.9	6.1	11.5	2.0	.	.	.
Consumer prices (HICP), % p.a.	6.9	6.6	10.1	15.2	16.3	9.0	3	-5	-4
Producer prices in industry, % p.a. 4)	7.8	10.3	16.1	11.5	10.9	4.2	.	.	.
General government budget, EU-def., % GDP 5)									
Revenues	35.2	37.7	35.5	35.5	.	.	.	.	.
Expenditures	35.6	38.2	35.9	39.5	.	.	.	.	.
Net lending (+) / net borrowing (-)	-0.4	-0.5	-0.4	-4.0	.	.	-10	-7	-4
Public debt, EU-def., in % of GDP 5)	12.4	10.7	9.0	19.5	.	.	.	.	.
Refinancing rate of NB, % p.a., end of period	4.0	5.0	6.0	6.0	6.0	5.0	.	.	.
Current account, EUR mn	-1610.1	-3603.0	-4754.0	-2925.0	-893.1	53.6	100	300	400
Current account in % of GDP	-12.4	-22.5	-22.5	-12.7	-16.8	1.1	0.5	1.9	2.8
Exports of goods, BOP, EUR mn	4313.1	4929.0	6020.0	6476.0	1585.5	1160.7	4700	4600	4800
annual growth rate in %	27.1	14.3	22.1	7.6	12.0	-26.8	-27	-2	4
Imports of goods, BOP, EUR mn	6753.5	9032.0	11074.0	10400.0	2576.3	1661.0	6900	6500	6800
annual growth rate in %	19.9	33.7	22.6	-6.1	1.4	-35.5	-34	-6	5
Exports of services, BOP, EUR mn	1743.0	2121.0	2682.0	3100.0	677.1	679.1	3100	3000	3200
annual growth rate in %	21.8	21.7	26.4	15.6	25.1	0.3	0	-3	7
Imports of services, BOP, EUR mn	1255.6	1586.0	1974.0	2174.0	508.3	382.1	1600	1500	1600
annual growth rate in %	32.5	26.3	24.5	10.1	22.3	-24.8	-26	-6	7
FDI inflow, EUR mn	567.9	1339.0	1656.0	921.0	371.1	23.5	150	.	.
FDI outflow, EUR mn	103.0	136.0	237.0	144.0	4.8	-16.0	50	.	.
Gross reserves of NB excl. gold, EUR mn	1901.8	3346.2	3859.9	3739.0	3988.9	3163.7	.	.	.
Gross external debt, EUR mn	12807.7	18127.7	26826.6	29619.4	26953.9	28760.4	.	.	.
Gross external debt in % of GDP	98.4	113.1	126.4	129.2	117.5	152.0	.	.	.
Average exchange rate LVL/EUR	0.6962	0.6962	0.7001	0.7027	0.7027	0.7027	0.7027	0.7027	0.7027
Purchasing power parity LVL/EUR	0.3605	0.3932	0.4506	0.5184	.	.	.	.	.

1) Preliminary. - 2) According to ESA'95 (FISIM adjusted). - 3) Enterprises with more than 20 employees. - 4) Quarterly data and forecasts according to NACE Rev. 2. - 5) According to ESA'95, excessive deficit procedure.

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

Table EE

Estonia: Selected Economic Indicators

	2005	2006	2007	2008 [1]	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average	1346.1	1343.5	1341.7	1340.6	.	.	.	.	.
Gross domestic product, EEK mn, nom. [2]	173530	205038	238929	248149	59100	52229	206400	176500	167800
annual change, % (real) [2]	9.2	10.4	6.3	-3.6	0.2	-15.1	-16	-10	-2
GDP/capita (EUR at exchange rate)	8200	9700	11400	11800	.	.	.	.	.
GDP/capita (EUR at PPP)	13700	15400	16900	16300	.	.	.	.	.
Consumption of households, EEK mn, nom. [2]	94112	110497	128533	135973	33402	28632	110400	94400	88800
annual change in % (real) [2]	9.7	12.8	7.9	-4.0	0.1	-17.6	-18	-10	-3
Gross fixed capital form., EEK mn, nom [2]	53281	69440	77556	70457	17276	12410	50200	42000	39500
annual change in % (real) [2]	8.3	20.1	7.6	-10.4	0.6	-26.6	-28	-12	-3
Gross industrial production [3]									
annual change in % (real)	11.0	9.9	6.6	-6.5	-0.2	-28.7	-28	0	5
Gross agricultural production									
annual change in % (real)	6.6	-2.1	12.3	-9.9	.	.	.	.	.
Construction industry [3]									
annual change in % (real)	23.0	27.8	13.6	-12.0	-5.4	.	.	.	.
Employed persons - LFS, th, average	607.4	646.3	655.3	656.5	656.5	612.1	.	.	.
annual change in %	2.0	6.4	1.4	0.2	-6.8	-6.8	.	.	.
Unemployed persons - LFS, th, average	52.2	40.5	32.0	38.4	28.7	79.0	.	.	.
Unemployment rate - LFS, in %, average	7.9	5.9	4.7	5.5	4.2	11.1	15	18	18
Reg. unemployment rate, in %, end of period	2.7	1.4	2.2	4.7	2.7	13.2	.	.	.
Average gross monthly wages, EEK	8073	9407	11336	12818	12337	12147	.	.	.
annual change in % (real, gross)	6.4	11.6	13.0	2.4	7.6	-4.5	.	.	.
Consumer prices (HICP), % p.a.	4.1	4.5	6.7	10.6	11.3	3.7	0	-4	-2
Producer prices in industry, % p.a. [3]	2.1	4.5	8.3	7.2	8.3	2.0	.	.	.
General governm. budget, EU-def., % GDP [4]									
Revenues	35.5	37.1	38.2	37.9	.	.	.	.	.
Expenditures	34.0	34.2	35.5	40.9	.	.	.	.	.
Net lending (+) / net borrowing (-)	1.5	2.9	2.7	-3.0	.	.	-5	-3	-3
Public debt, EU-def., in % of GDP [4]	4.5	4.3	3.5	4.8	.	.	.	.	.
Money market rate, % p.a., end of period [5]	2.5	3.8	7.0	7.0	5.8	6.2	.	.	.
Current account, EUR mn	-1110.3	-2193.0	-2758.0	-1463.0	-618.0	-0.1	150	200	-100
Current account in % of GDP	-10.0	-16.7	-18.1	-9.2	-16.4	0.0	1.1	1.8	-0.9
Exports of goods, BOP, EUR mn	6280.1	7761.0	8076.0	8544.0	2033.1	1512.9	6400	6400	6500
annual growth rate in %	32.8	23.6	4.1	5.8	5.7	-25.6	-25	0	2
Imports of goods, BOP, EUR mn	7822.6	10159.0	10761.0	10376.0	2529.6	1682.1	7500	7300	7500
annual growth rate in %	23.5	29.9	5.9	-3.6	-2.2	-33.5	-28	-3	3
Exports of services, BOP, EUR mn	2571.1	2787.0	3199.0	3476.0	756.7	680.0	3100	3000	3100
annual growth rate in %	12.1	8.4	14.8	8.7	16.3	-10.1	-11	-3	3
Imports of services, BOP, EUR mn	1733.7	1938.0	2237.0	2324.0	525.9	451.5	2000	2000	2100
annual growth rate in %	23.5	11.8	15.4	3.9	5.8	-14.1	-14	0	5
FDI inflow, EUR mn	2302.2	1432.0	1963.0	1365.0	584.1	167.3	400	.	.
FDI outflow, EUR mn	556.0	883.0	1152.0	664.0	302.6	117.7	500	.	.
Gross reserves of NB excl. gold, EUR mn	1643.6	2115.0	2233.8	2900.0	2365.2	2651.7	.	.	.
Gross external debt, EUR mn	9553.3	12802.4	17165.6	19060.2	19101.6	18400.5	.	.	.
Gross external debt in % of GDP	86.1	97.7	112.4	120.2	120.4	139.5	.	.	.
Average exchange rate EEK/EUR	15.6466	15.6466	15.6466	15.6466	15.65	15.65	15.65	15.65	15.65
Purchasing power parity EEK/EUR	9.3775	9.8833	10.5251	11.3313	.	.	.	.	.

1) Preliminary. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices). - 3) Quarterly data and forecasts according to NACE Rev. 2. - 4) According to ESA'95, excessive deficit procedure. - 5) TALIBOR 1 month interbank offered rate.

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

Table LT

Lithuania: Selected Economic Indicators

	2005	2006	2007	2008 [1)]	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average	3414.3	3394.1	3375.6	3358.4	3363.1	3345.6	.	.	.
Gross domestic product, LTL mn, nom. [2)]	72060.4	82792.8	98138.7	111498.7	24461.0	20652.5	96900	81800	78600
annual change in % (real) [2)]	7.8	7.8	8.9	3.0	7.0	-13.6	-16	-13	-3
GDP/capita (EUR at exchange rate)	6100	7100	8400	9600	.	.	.	.	.
GDP/capita (EUR at PPP)	11900	13100	14800	15200	.	.	.	.	.
Consumption of households, LTL mn, nom. [2)]	46312.0	53268.6	63237.8	72697.0	16986.0	15520.1	61700	52700	50600
annual change in % (real) [2)]	12.3	10.6	12.3	4.7	11.1	-15.1	-18	-12	-3
Gross fixed capital form., LTL mn, nom. [2)]	16405.0	20840.8	27453.9	27600.8	5728.2	3510.8	20000	16900	16900
annual change in % (real) [2)]	11.2	19.4	20.8	-6.1	1.6	-37.1	-30	-13	1
Gross industrial production (sales) [3)]									
annual change in % (real)	7.1	7.3	4.0	2.7	9.7	-13.8	-18	-10	3
Gross agricultural production									
annual change in % (real)	10.5	-4.1	8.2	0.7	.	.	.	.	.
Construction industry [3)]									
annual change in % (real)	11.5	21.2	21.6	1.4	.	.	.	.	.
Employed persons - LFS, th, average	1473.9	1499.0	1534.2	1520.0	1510.3	1433.1	.	.	.
annual change in %	2.6	1.7	2.3	-0.9	0.2	-5.1	.	.	.
Unemployed persons - LFS, th, average	133.0	89.4	69.0	94.3	77.5	193.9	.	.	.
Unemployment rate - LFS, in %, average	8.3	5.6	4.3	5.8	4.9	11.9	15	19	18
Reg. unemployment rate, in %, end of period	4.1	3.7	4.3	5.7	4.7	8.2	.	.	.
Average gross monthly wages, LTL	1276.2	1495.7	1802.4	2174.0	2151.3	2193.1	.	.	.
annual change in % (real, net)	6.8	15.0	17.0	11.2	14.2	-5.2	.	.	.
Consumer prices (HICP), % p.a.	2.7	3.8	5.8	11.1	10.9	8.4	4.5	-2	0
Producer prices in industry, % p.a.	11.5	7.4	6.9	18.2	21.9	-10.0	.	.	.
General goverm.budget, EU-def., % GDP [4)]									
Revenues	32.8	33.1	33.9	34.0	.	.	.	.	.
Expenditures	33.3	33.6	34.9	37.2	.	.	.	.	.
Net lending (+) / net borrowing (-)	-0.5	-0.4	-1.0	-3.2	.	.	-7	-4	-3
Public debt, EU-def., in % of GDP [4)]	18.4	18.0	17.0	15.6	.	.	.	.	.
Money market rate, % p.a., end of period [5)]	2.5	3.7	6.8	7.8	4.5	3.1	.	.	.
Current account, EUR mn	-1481.3	-2551.0	-4149.0	-3737.0	-1324.1	23.5	200	-500	-600
Current account in % of GDP	-7.1	-10.6	-14.6	-11.6	-18.7	0.4	0.7	-2.1	-2.6
Exports of goods, BOP, EUR mn	9490.0	11262.0	12509.0	16068.0	3643.8	2731.3	12000	12000	12400
annual growth rate in %	26.9	18.7	11.1	28.5	30.3	-25.0	-25	0	3
Imports of goods, BOP, EUR mn	11849.0	14600.0	16788.0	19817.0	4897.3	2874.1	13000	13500	14000
annual growth rate in %	26.1	23.2	15.0	18.0	30.6	-41.3	-34	4	4
Exports of services, BOP, EUR mn	2502.8	2879.0	2931.0	3302.0	673.2	551.6	2300	2300	2400
annual growth rate in %	27.1	15.0	1.8	12.7	14.8	-18.1	-30	0	4
Imports of services, BOP, EUR mn	1655.3	2018.0	2471.0	2959.0	629.6	441.0	2100	2100	2200
annual growth rate in %	26.0	21.9	22.4	19.7	30.6	-30.0	-29	0	5
FDI inflow, EUR mn	826.0	1448.0	1473.0	1223.0	236.0	190.2	200	.	.
FDI outflow, EUR mn	277.7	232.0	437.0	229.0	67.2	78.0	50	.	.
Gross reserves of NB excl. gold, EUR mn	3135.7	4307.5	5165.1	4457.0	4426.2	4181.5	.	.	.
Gross external debt, EUR mn	10586.5	14441.8	20547.2	23045.2	21185.5	22683.4	.	.	.
Gross external debt in % of GDP	50.7	60.2	72.3	71.4	65.6	80.8	.	.	.
Average exchange rate LTL/EUR	3.45	3.45	3.45	3.45	3.45	3.45	3.45	3.45	3.45
Purchasing power parity LTL/EUR	1.77	1.86	1.96	2.18	.	.	.	.	.

1) Preliminary. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices). - 3) Quarterly data and forecasts according to NACE Rev. 2. - 4) According to ESA'95, excessive deficit procedure. - 5) VILIBOR 1 month interbank offered rate.

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

*Josef Pöschl and Vladimir Gligorov**

Future EU member states: concerns shifting from external to fiscal deficits

Contrasts are rather pronounced in the group of Southeast European countries that are either candidates for EU accession (Croatia, Macedonia, Turkey) or potential candidates (Albania, BiH – Bosnia and Herzegovina, Montenegro and Serbia). The degree to which these Future Member States (FMS) are hit by the current global crisis varies greatly: in 2009, GDP in Albania may decline only slightly, whereas it is likely to shrink by at least 7% in Turkey (Table I). Should GDP decline remain approximately in this range, it would mean that the degree to which the international financial and economic crisis has hit the region is substantial, but not extreme in comparison with other parts of Europe.

Modest GDP decline thanks to a predominance of less flexible sectors

In the West Balkan countries, the relatively small GDP decline that we forecast for 2009 follows from the fact that in these countries only a small proportion of GDP comes from economic sectors producing tradables. The largest GDP contributors are sectors whose output is less volatile, such as public utilities, government services and other non-tradable services. Exports of goods and services account for a smaller proportion of GDP than in most NMS. (see Tables II and III). Albania is a prime example of such a country. Croatia and Montenegro are also weak producers of tradable goods, but can compensate part of this weakness through their specialization in tourism. Tourism is likely to experience a setback in 2009, albeit possibly a minor one compared to, say, global car production. For Turkey, tourism plays a role as well, but the production of durable and non-durable consumer goods is much more important as is reflected in trade figures (see Table III). A number of Turkish producers hold a relatively strong position in domestic and international markets.

The strength or weakness of producers of tradable goods becomes visible from foreign trade figures. One would expect a relatively high export-GDP ratio for small economies, but it is remarkably low in Albania and Montenegro, around 10 and 16 percent respectively in 2008, nor is it high in the other FMS (with the exception of Macedonia – see Table III). In addition, all of the FMS are characterized by large trade deficits – as high as 40% of GDP in Montenegro and BiH. Especially in the West Balkan countries, export revenues cover merely a fraction of import expenditures.

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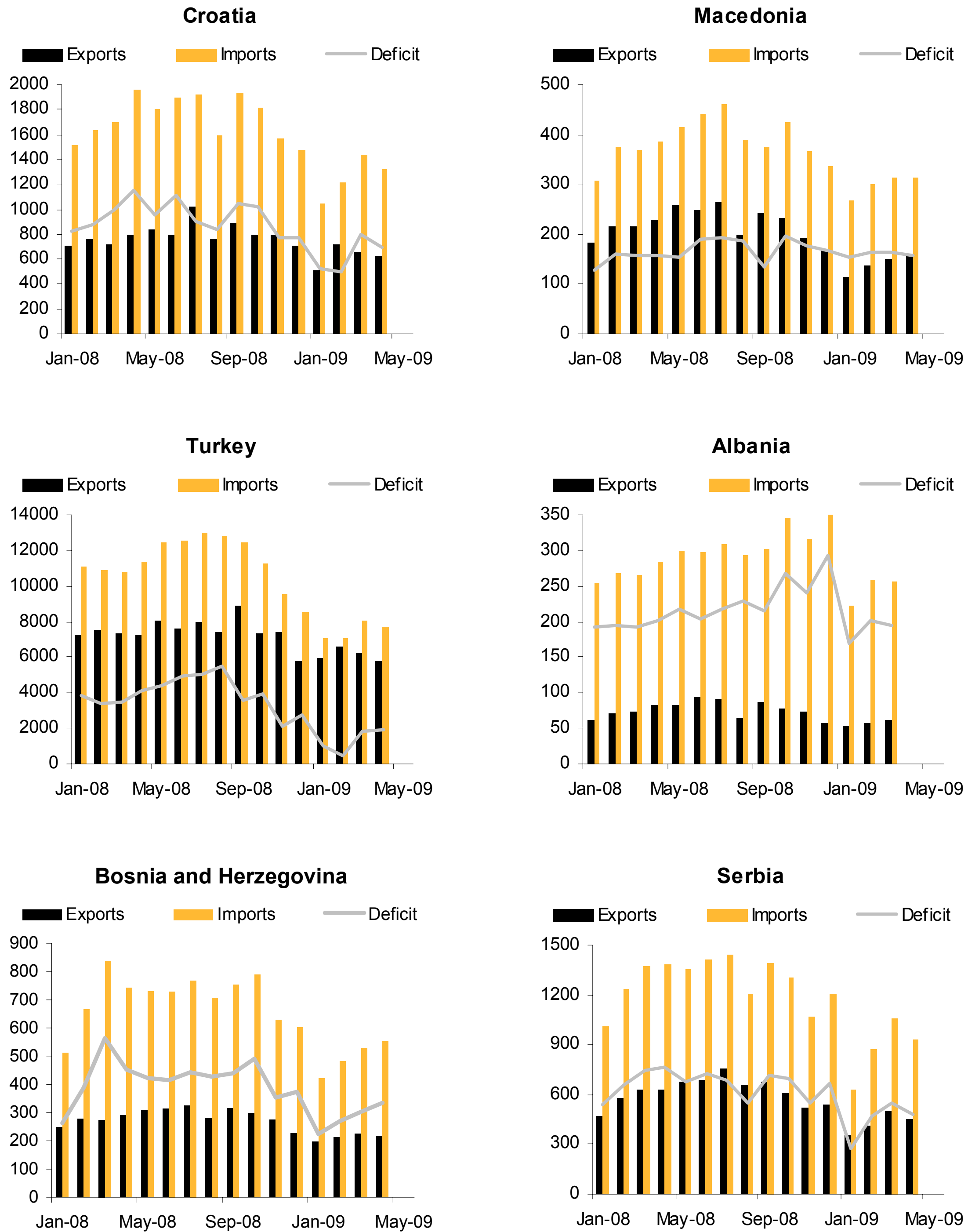
* The research on this overview was completed on 30 June 2009. Peter Havlik, Kazimierz Laski, Michael Landesmann and the authors of the individual country reports provided useful comments on the earlier draft.

Figure 1

Foreign trade, 2008-2009

EUR mn

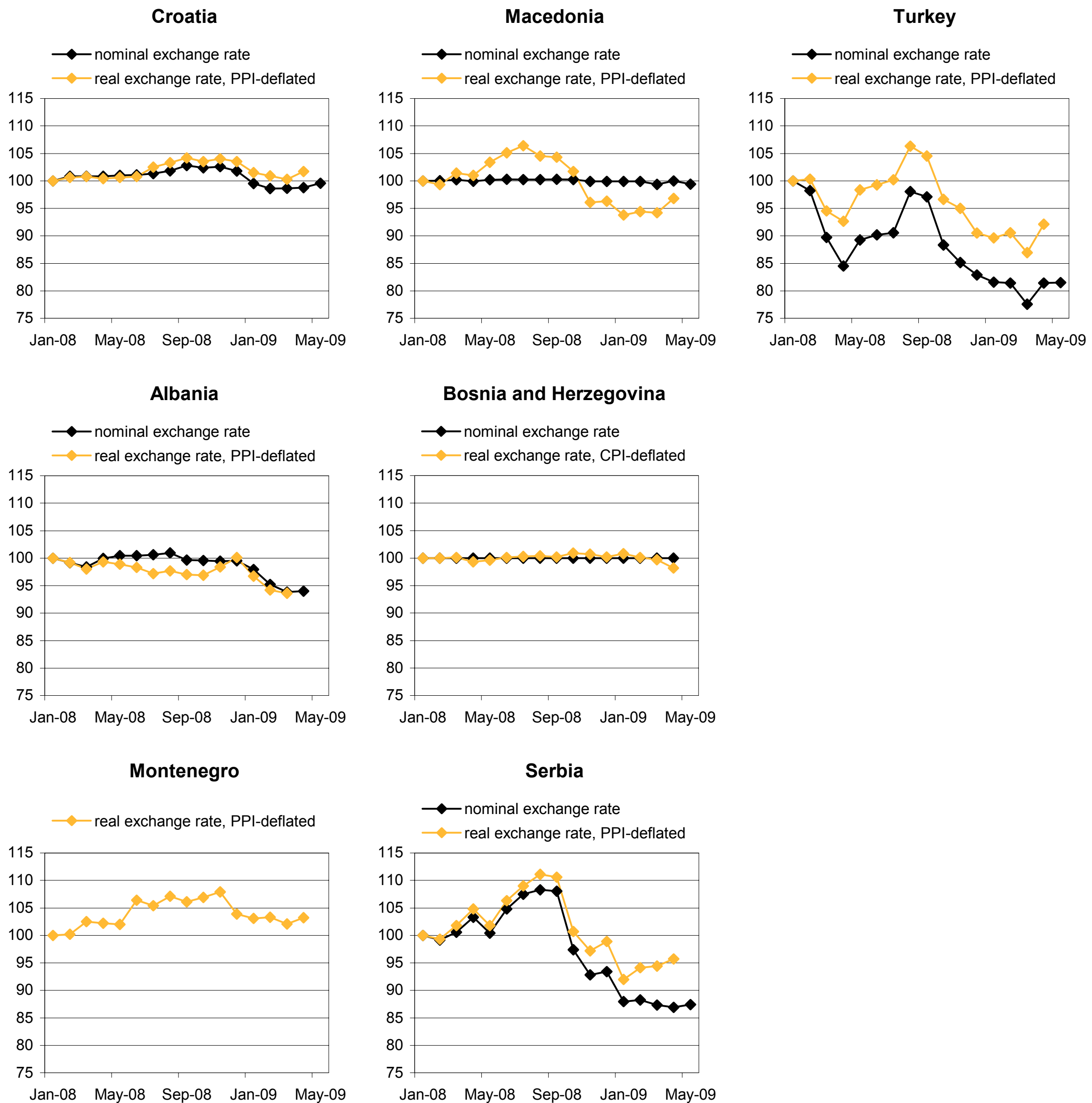


Source: wiiw Monthly Database incorporating national statistics.

Figure 2

Exchange rates*, 2008-2009

EUR per NCU, January 2008 = 100



*Values over 100 indicate appreciation relative to January 2008.

Source: wiiw Monthly Database incorporating national statistics.

Diminishing trade deficits as a by-product of the current crisis

In the course of the current crisis, Turkey's imports shrank much more than its exports (Figure 1), so that the trade deficit was very small in the first quarter of 2009 (EUR 0.81 billion compared to EUR 8.1 billion in the same period in 2008). A similar tendency became visible in the West Balkan

countries, but was less pronounced: the trade deficit diminished, but was far from becoming merely marginal. Almost everywhere, it was lowest in the first two months of 2009. Afterwards, imports started rising again. Mainly three factors influenced the import development after September 2008, the month in which the global economy experienced a serious shock: the drop in international energy prices, the extent of GDP decline and, in some FMS, also exchange rate developments.

Montenegro has used the euro as the sole legal tender since 2002. BiH maintains a currency board regime, whereas the currencies of Serbia and Turkey are allowed to float. The other countries – Albania, Croatia, and Macedonia – maintain a more or less stable exchange rate against the euro, although Albania allowed for a slight depreciation in the first months of 2009. In both Serbia and Turkey, the currency depreciated after September 2008 (Figure 2) by about 20% (March 2009 over August 2008). This caused some difficulties for households and enterprises that had taken foreign currency loans, and it fuelled inflation, but at the same time it also helped export-oriented companies. After September 2008, real depreciation against the euro was strong in Serbia and Turkey and supportive to domestic producers. In the other FMS, the decline of producer prices in relation to EU prices was modest.

Large current account deficits becoming untenable

For years, the entire region has been following a development pattern characterized by large current account deficits (Overview Table I and Table 1), thus relying on net borrowing from abroad. Whereas in Turkey, Serbia, Croatia and BiH the deficit was much lower in the first quarter of 2009 than it had been in the same period in 2008, it increased in Macedonia and Albania. For Montenegro, no current account data are yet available for 2009. Current transfers increased in Turkey, but went down in Macedonia and Serbia, so no general trend is visible yet. Less money flowed into the countries (with the exception of Albania) from foreign direct investments, and the currency reserves shrank everywhere. Turkey had to face an increased net outflow of portfolio capital, and other investment turned negative. A EUR 4 billion inflow of funds registered as errors and omissions helped to keep the fall of currency reserves below one billion euros. Fears that high current account deficits may not be sustainable in the medium and long run have gained ground due to the recent experiences of the Baltic States. The availability of external funds for financing high trade and current account deficits has diminished; this may not change much during the next few months or even years. Adjustment to this new situation is underway and is likely to have far-reaching consequences.

There is now more risk awareness concerning private agents' borrowing. In the FMS with a fixed exchange rate, agents have tended, until recently, to assess the exchange rate risk as low or non-existent. Whether this is justified is yet to be seen. Awareness of this risk is certainly higher in Turkey where the population has learned to live with attempts to stabilize the exchange rate, all of which have ended in failure sooner or later. Most visibly in Croatia, a lack of confidence in the long-term stability of the exchange rate has led to the practice of adding a foreign currency (mainly euro) clause to contracts with longer time horizons, and this has become a trap in which monetary policy is caught.

Table 1

Components of the Balance of Payments (BOP)

EUR mn

	Croatia		Macedonia		Turkey		Abania		Bosnia & Herzegovina		Montenegro		Serbia	
	1Q 2008	1Q 2009	1Q 2008	1Q 2009	1Q 2008	1Q 2009	1Q 2008	1Q 2009	1Q 2008	1Q 2009	1Q 2008	1Q 2009	1Q 2008	1Q 2009
Current account	**-2556**	**-1820**	**-173**	**-341**	**-8203**	**-887**	**-267**	**-334**	**-376**	**-157**	**-294**	.	**-1290**	**-798**
Trade balance of goods	-2565	-1729	-371	-444	-8093	-811	-527	-516	-1058	-786	-306	.	-1813	-1286
Services, net	99	127	-1	-2	847	955	-3	-27	153	131	-6	.	35	-37
Income, net	-311	-418	23	-24	-1284	-1417	21	-4	128	91	6	.	-138	-123
Current transfers, net	221	200	176	129	326	386	243	213	401	408	12	.	625	648
Capital and financial account	**2063**	**2028**	**185**	**325**	**7755**	**-3230**	**194**	**378**	**369**	**171**	**383**	.	**1337**	**837**
Capital transfers, net	5	5	-1	1	0	0	13	20	46	40	0	.	5	-1
Foreign direct investment, net	1138	410	130	55	2334	1453	81	122	79	28	138	.	831	643
Portfolio investment, net	160	-491	-8	-19	-877	-2464	1	3	0	-5	-8	.	-48	-4
Other investment, net	1456	1693	56	35	6338	-3126	72	102	196	-15	248	.	581	-41
Reserve assets	-696	411	8	253	-39	908	27	131	49	123	5	.	-32	240
Errors and omissions	**492**	**-208**	**-12**	**16**	**449**	**4117**	**73**	**-43**	**6**	**-14**	**-89**	.	**-46**	**-39**

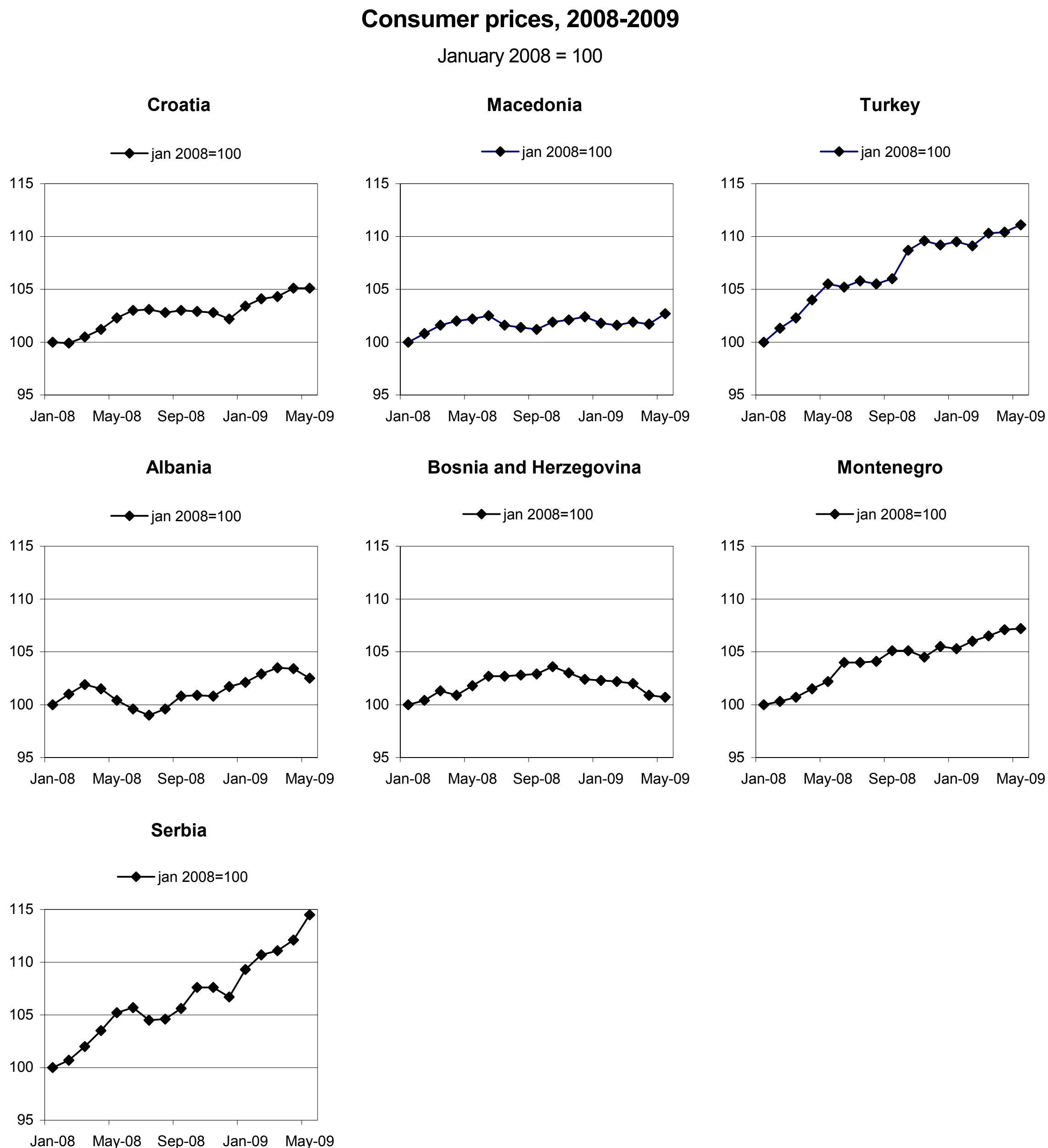
Source: National banks of respective countries.

Removing the currency misalignment would adversely affect a large proportion of the population. Trust in domestic currency is quite different in BiH, where the architects of the currency board arrangement managed to convince the population of its long-term reliability. The new stand-by agreement with the IMF supports this confidence.

Figure 3

Consumer prices, 2008-2009

January 2008 = 100



Source: wiiw Monthly Database incorporating national statistics.

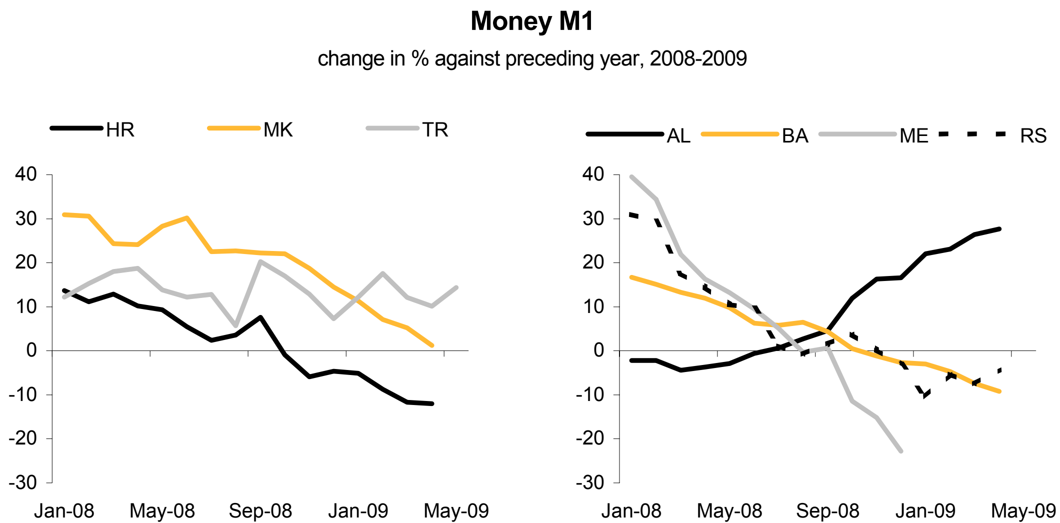
Low inflation pressure

The contrast between different exchange rate regimes has led to different patterns of price behaviour. In BiH, after October 2008, the consumer price index gradually declined from one month to the next (Figure 3). In Macedonia, prices in May 2009 were only marginally higher than twelve months before. In Turkey, the cases of month-on-month price stability or decline were less frequent, but here again, a relaxation of inflation pressure was visible. Serbia is the only future member state where inflation accelerated in 2009.

Figure 4a

Money M1

change in % against preceding year, 2008-2009

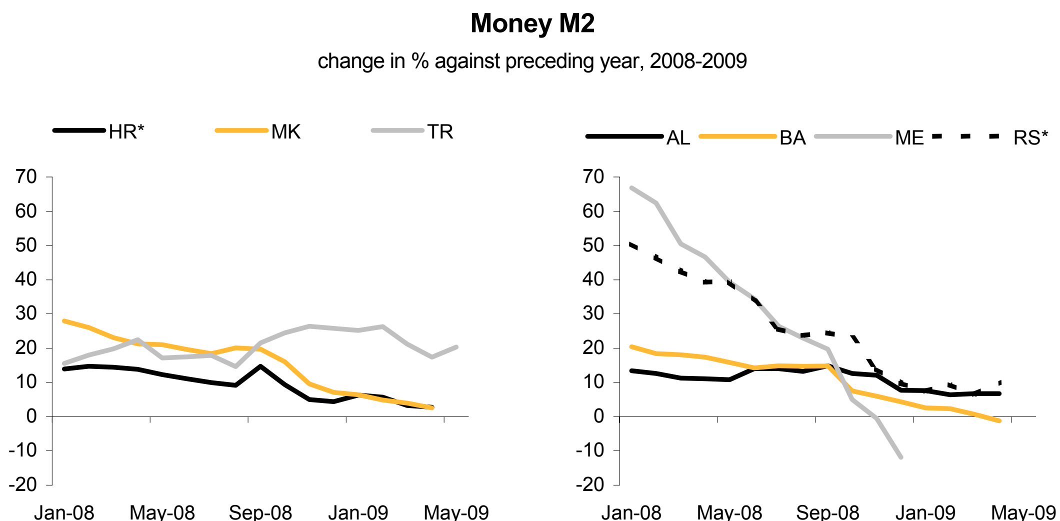


Source: wiiw Monthly Database incorporating national statistics.

Figure 4b

Money M2

change in % against preceding year, 2008-2009



Note: *Croatia, Serbia M3.

Source: wiiw Monthly Database incorporating national statistics.

After September 2008, the expansion of bank loans decelerated strongly. In the entire region, the ratio between bank loans and GDP has never climbed to West European levels, despite a strong rise in recent years. Apart from the Istanbul Stock Exchange, the FMS' stock markets do not attract much attention from international investors. The degree of sophistication of financial markets is low, which in the current situation may be an advantage. Turkey's banking sector went through restructuring after the crisis in 2001 and is perceived as relatively sound. Part of it is foreign owned, but in the West Balkan countries the share of foreign-owned banks is much higher. Whereas foreign ownership used to be interpreted as a guarantee for sound banking practices, the crisis raised fears the parent banks might withdraw capital. Another fear is that a parent bank's difficulties in one country might have a negative influence on its activities in others. So far, neither of these fears has materialized to any great extent, and the international financial institutions are trying to make sure that this will not be the case in future, as, for example, through gentlemen agreements in the context of the 'Vienna Initiative'[31].

Table 2

Nominal stability indicators, 1st quarter 2009

change in % against preceding year

	Consumer price inflation	Nominal growth of gross monthly wages	Nominal currency appreciation EUR/NCU
Croatia	3.8	4.6	-1.6
Macedonia	1.0	17.5	-0.4
Turkey	8.4	.	-16.3
Albania	1.8	.	-3.6
Bosnia and Herzegovina	1.6	14.9	0.0
Montenegro	5.2	12.8	0.0
Serbia	9.4	0.3	-12.1

1) Preliminary.

Source: wiiw Database incorporating national statistics.

Since September 2008, in the FMS region as well as in most parts of the globe, enterprises, depending on their field of activity, have seen themselves confronted with a volume of demand that is lower than it was in recent years. Some input prices (as, for example, for energy and steel) have gone down, others have stopped rising or begun rising more slowly (wages, for example). This is the background for the deceleration of inflation or even slight deflation worldwide (Figure 3). The fear that in the near future the global economy might be plagued by rather high inflation is widespread, but not necessarily justified. A precondition for this to happen would be a growth of global demand strong enough to over-stretch existing capacities. This is not in sight, or may occur, potentially, only in certain segments such as the energy sector. For the West Balkan countries, even a simplistic quantity-of-money-based inflation fear has no adequate background – there is not much going on which one could nickname 'money printing'. The stock of money measured in M1 terms has stopped

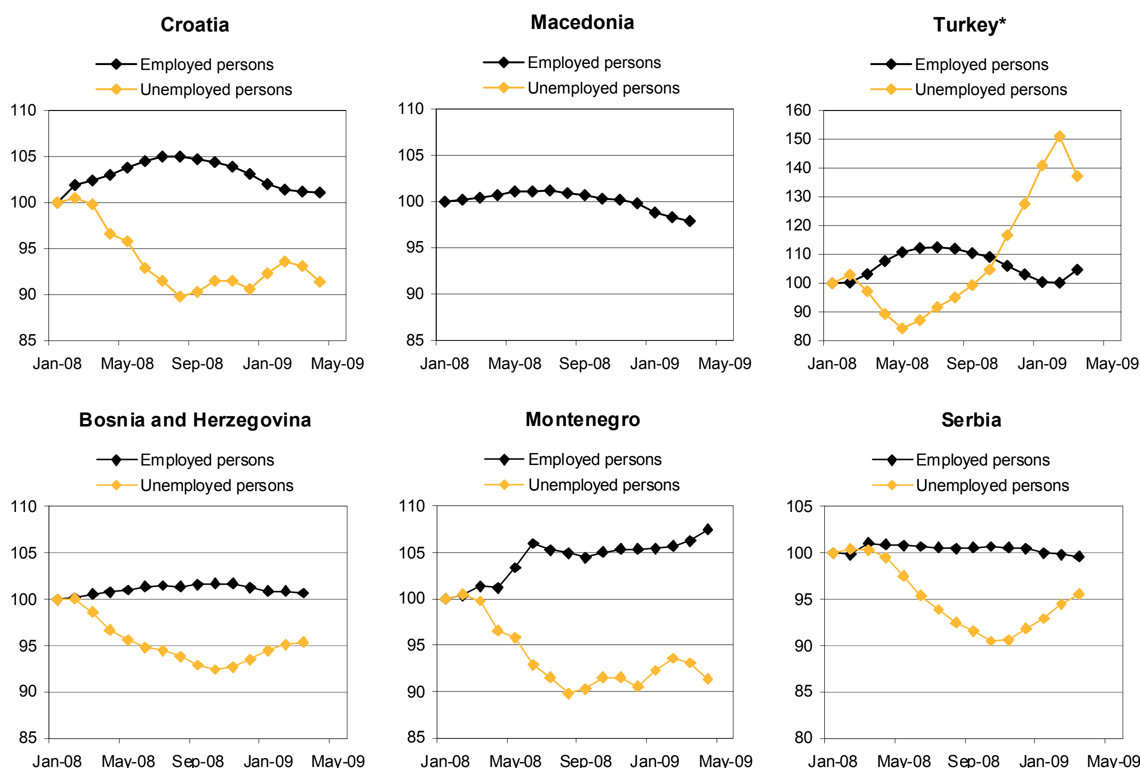
31 Joint initiative of international financial institutions aimed at promoting regional financial sector stability – for more details see p. 134 and footnote 13 on p. 20.

growing or has started shrinking (year on year) in all FMS except for Turkey and Albania (Figure 4a), and in May 2009 Turkey was the only country with significant M2 growth, even if we take inflation into account (Figure 4b). The strong shrinkage of Montenegro's money stock, which started shortly after September 2008, is particularly noteworthy, as is the sharp contrast between accelerating inflation and shrinking M1 in Serbia in 2009. Also quite remarkable is the fact that in Bosnia and Herzegovina, Macedonia and Montenegro, gross nominal wages in the first quarter of 2009 rose by 12-18% as compared with the first quarter of 2008 (Table 2). This meant a real wage increase of over 16% in Macedonia, over 13% in Bosnia and Herzegovina and close to 8% in Montenegro. This is not what one would expect in the case of a serious recession.

Figure 5

Employed and unemployed persons, 2008-2009

Registration data, Jan 2008=100



Note: *Turkey: LFS data and break in 2009.

Source: wiiw Monthly Database incorporating national statistics.

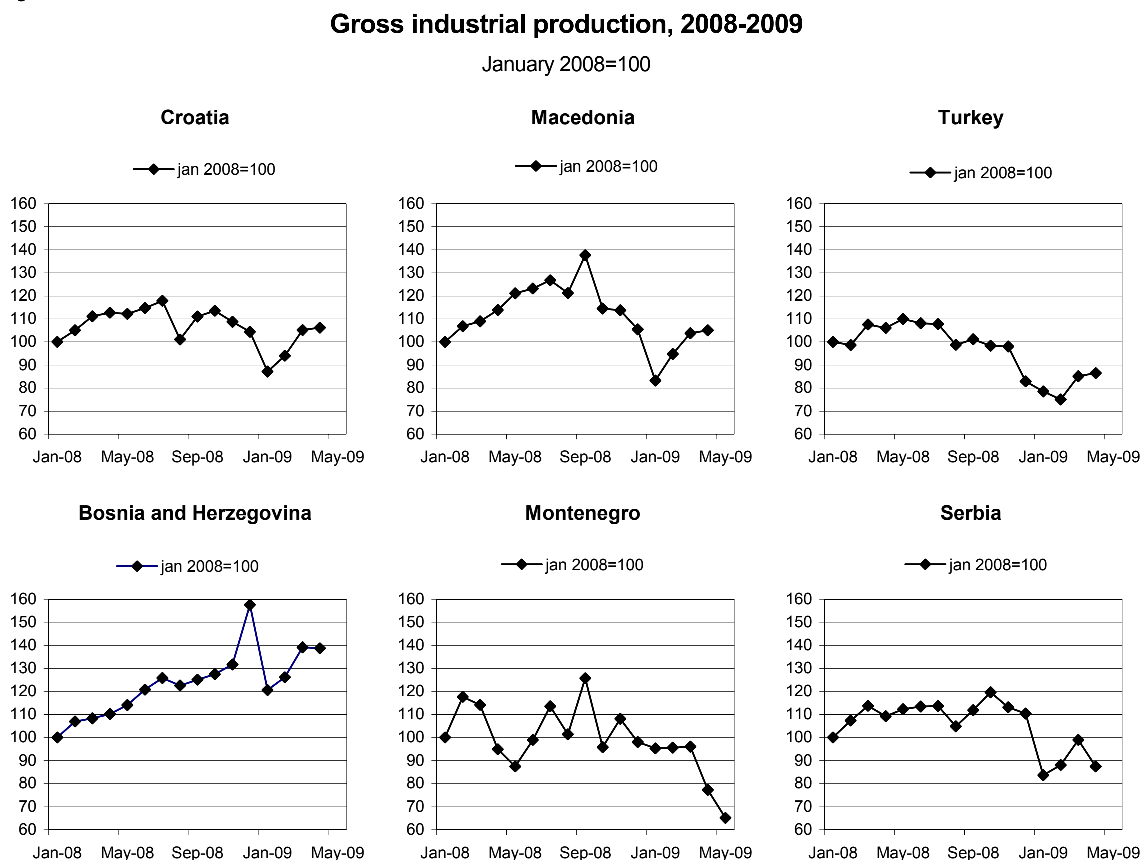
Impact on labour markets still to rise

The crisis impact on the labour market in the West Balkans, a region characterized by extremely high unemployment, has been relatively mild so far, if we trust registration figures for the first quarter of 2009 (Figure 5). Employment declined slightly after mid-2008 (BiH, Macedonia, Serbia) or even showed slight growth (Montenegro). Unemployment grew after September 2008, but in the first months of 2009 it was still far below the January 2008 level in all West Balkan countries. Producers

of non-tradables employ the core of the labour force; this is why these changes were relatively modest. In contrast to the West Balkans, in Turkey unemployment rose drastically.

Industry, as the main producer of tradables, experienced strong fluctuations in the West Balkan countries as well (Figure 6), but due to its small size this had a modest impact on the GDP development. In Macedonia, industrial output fell by 40% (January 2009 over September 2008). Bosnia and Herzegovina's figures give a poorly justified impression of strong performance.[32]

Figure 6



Note: Croatia from 2009 according to NACE Rev. 2.

Source: wiiw Monthly Database incorporating national statistics.

In Turkey, the tradable sector plays a more important role, and the change in employment and especially in the number of jobless persons was much more pronounced. In the longer run, rising unemployment may become a very serious problem in all the countries discussed here, as the rate of unemployment was high even before the crisis broke out. Increasingly, producers of non-tradables, including governments, will also be confronted with a decline in revenues and need to find

[32] An oil refinery's restart of production is mirrored in the industrial output figure of December 2008 as a massive upward shift. In most other segments of industry, output has declined as much as in neighbouring countries.

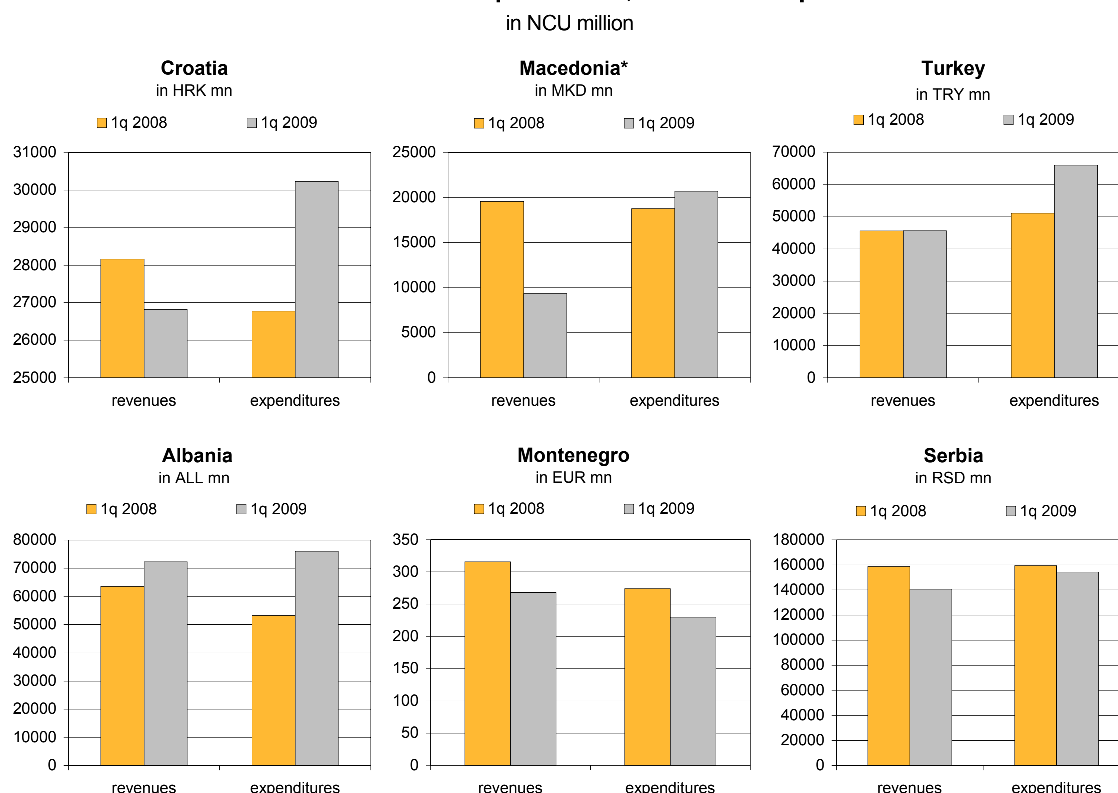
a response. If lack of demand persists for a long time, companies will have no other choice than to dismiss part of their work force. As experience in many countries shows, it can take several years until GDP growth translates into employment growth.

Fiscal issues, a major concern in the years to come

Until recently, large current account deficits were regarded as accelerators of development due to their making external funding sources available, whereas a large fiscal deficit was seen as a reason for alarm. In recent years, fiscal discipline was quite strong in the FMS, and the debt-GDP ratio declined. In 2009, this will change again – as will be the case in most parts of the world. Reintroducing fiscal discipline will be of major concern during the next few years, whereas large current account deficits may disappear. GDP decline in all FMS and low inflation in most of them are translating into low fiscal revenues, and revisions of revenue forecasts are a common feature. As far as data are available, in most cases they point to 2009 revenues that are below those collected in the same period in 2008 (Figure 7). At the same time, there is no space for cuts in expenditures, as in most cases is visible from Q1 data, and in any case, governments should rather be expanding their expenditures than cutting them.

Figure 7

Government revenues and expenditures, Q1 2009 compared to Q1 2008



Note: Croatia, Serbia Central government budget. Macedonia data refer to Jan-Feb.

Source: wiiw Monthly Database incorporating national statistics.

Among the countries under consideration in this overview, the governments of Macedonia and Turkey have engaged in fiscal stimulation measures. Croatia's government announced an anti-crisis package, but up to now has not realized most of it. Macedonia has increased investment in infrastructure. Turkey may be the only country that can afford to pursue such a policy to a considerable extent for more than merely a few months. In any case, the authorities seem to be dedicated to stimulating economic activities through monetary and fiscal measures. The Turkish central bank has taken the low inflation pressure as an occasion to gradually lower its interest rates and in this way is managing to keep reappreciation pressure within limits. In early 2009, the government had introduced temporary cuts in value added taxation of certain product categories. In June, it announced a broader programme of investment and employment stimulation. Turkey remains hesitant to sign an agreement with the IMF, as this may be incompatible with the government's economic stimulation efforts.

In a recent stand-by agreement, Bosnia and Herzegovina agreed with the IMF on fiscal expenditure cuts. These are supposed to be true cuts instead of simply not meeting some of the country's payment obligations, which would lead to a build-up of arrears. Problems with the execution of the envisaged expenditure cuts became obvious soon after the deal was signed and are likely to cause delays. Serbia has also signed a stand-by agreement, which, however, has not provided much relief in this difficult situation, due to the government's lack of policy orientation.

A cautiously positive outlook

Should the situation of low capacity utilization due to lack of demand turn out to be long-term, payment delays could become widespread within the private sector, and possibly within the public sector as well. Some parts of the economy could shift towards a kind of emergency mode, in which activities would continue under 'soft budget constraint'. In the current situation, there is not much information about relations between commercial banks and their clients, but we can assume that a considerable proportion of clients are declaring their inability to service their debts as contracted and are demanding reschedulings. This is true not only for FMS, but for many others as well.

There are signs of a bottoming out of the crisis also in the FMS. The rate of industrial output decline, year on year, has diminished slightly. Business confidence seems to be on the rise in at least some of the countries. On stock markets, a slight rising tendency seems to be prevailing after the deep descent of past months. At present, it is an open question whether the next phase will be stagnation or recovery. For the FMS, or at least the West Balkan countries, the answer will largely depend on what happens outside the region, particularly in the EU. Even in the case of an improving global business climate, FMS households and enterprises will have to finance consumption and investment predominantly from domestic sources, and the adaptation to these new conditions may decelerate recovery.

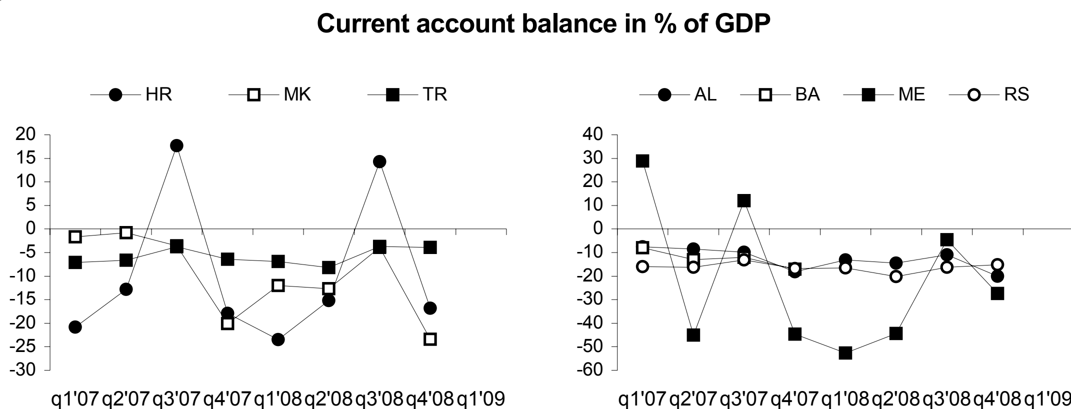
Financial indicators for future member states

An attempt has been made for the purposes of this forecast to collect some of the indicators of vulnerability and in particular some short-term indicators, particularly those that suggest

developments in the financial sector. In the following, some short comments will be made on what can be read from them.

Figure 8

Current account balance in % of GDP



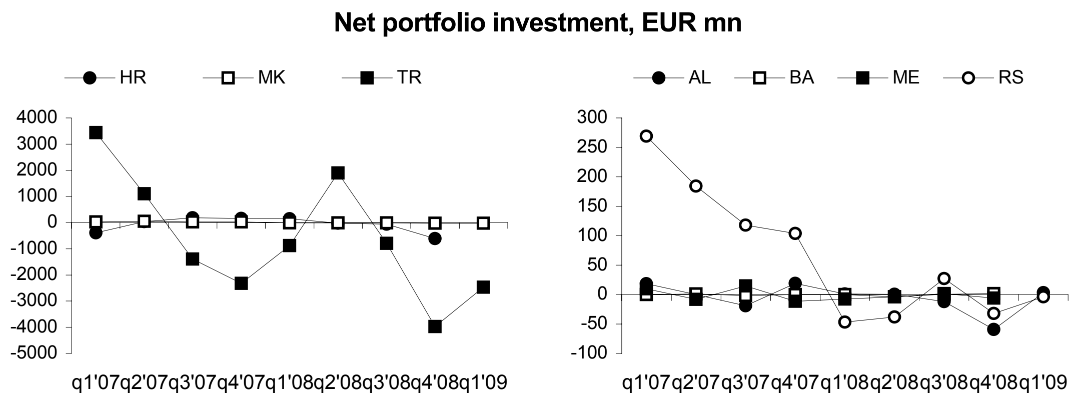
Source: National statistics, Eurostat

The main source of vulnerabilities in the FMS is the current account deficits (Figure 8). It is debatable whether the causality runs from the current or the capital account and that may depend partly on the equilibrating power of the relative prices, the interest rate and the exchange rate, and on the policy mix that is being implemented. Here, it should just be noted that current account deficits have been clearly large and unsustainable, at least on the face of it, but are improving rather quickly in most countries.

That there is something to the reverse causality can be seen from Figures 9 and 10 which indicate significant decline in portfolio and other investments (loans). It is also well known that foreign direct investments have declined sharply. Thus, there has been significant deceleration of foreign investments altogether. As a consequence, current account deficits have been shrinking in the first part of 2009.

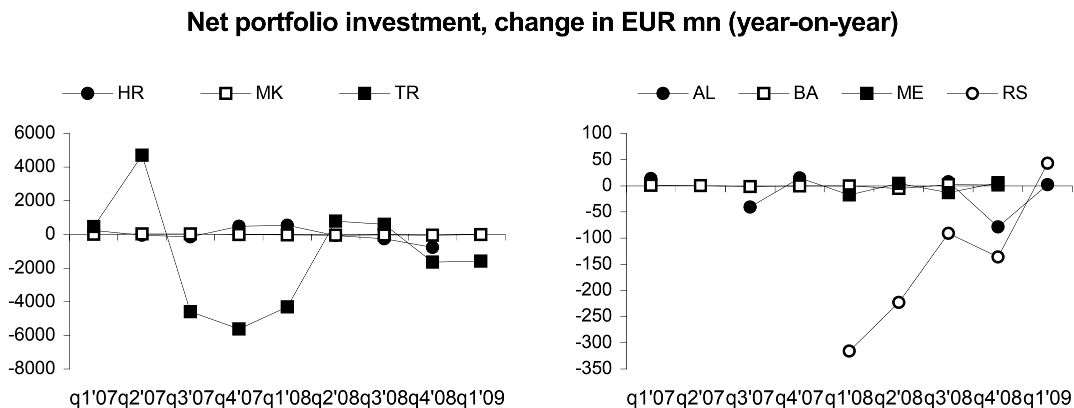
In Figures 11a and 11b, the development of the debt can be followed. In most cases, it may not have been unsustainable, though in some cases the development was worrisome. Data for Croatia suggest that foreign debt sustainability was clearly an issue, which had been recognized by the central bank, and its restrictive monetary policy was partly responsible for the slowdown of growth, which had occurred even before the outbreak of the financial crisis in the second half of 2008. In any case, this is certainly the relationship to watch: the development of the current account deficit and the impact it may have on the sustainability of the foreign debt and consequently on the policy mix and on the influence that might have on medium-term growth prospects. The problem here is that a stable currency supports additional borrowing, because the debt accumulation appears to be sustainable, while interest rate hikes or exchange rate depreciation can quickly lead to illiquidity and even to insolvency.

Figure 9a



Source: National statistics, Eurostat

Figure 9b



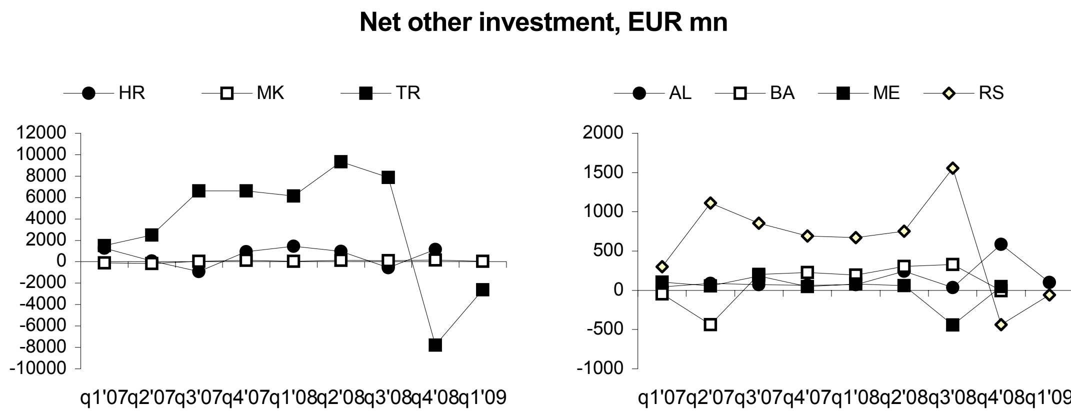
Source: National statistics, Eurostat

Figure 11 suggests that short-term debt is a problem in some countries, at least according to the international data source (Croatia, Turkey, Montenegro and perhaps Serbia). This is more an indication of the slower accumulation of reserves than of the deterioration of the term structure of debts. However, this is certainly changing for the worse because of the decline in reserves and the larger accumulation of short-term debt.

Governments have been decreasing their share in the foreign debts (Figure 12), but this is bound to change in the near future. That is partly the consequence of the increase in fiscal deficits, which are still not visible in the data, but are generally anticipated (Figure 13).

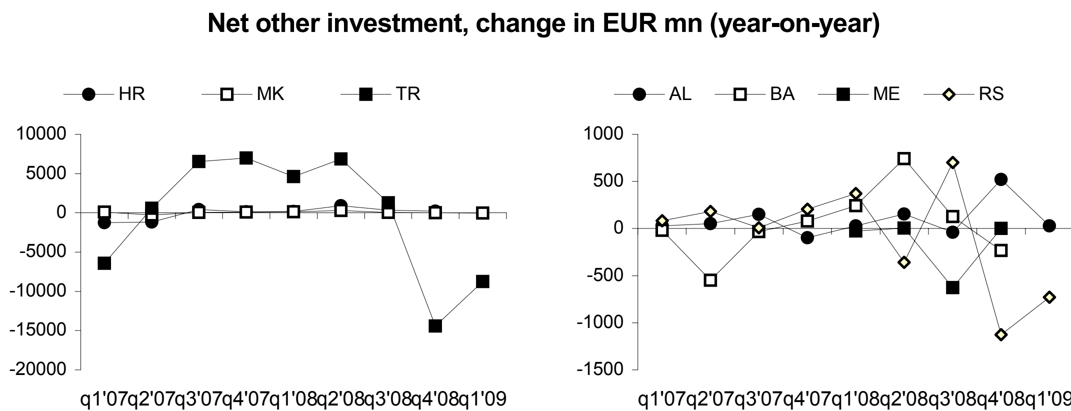
The activity of the banks is shrinking and the costs of borrowing are increasing. This is documented in Figures 14 through 17. The developments may not seem dramatic, but the trends are rather clear. Some of the indicators are less informative than in the more developed countries, because these usual measures are not all that important for most FMS due to the underdevelopment of the financial sector and of the capital markets.

Figure 10a



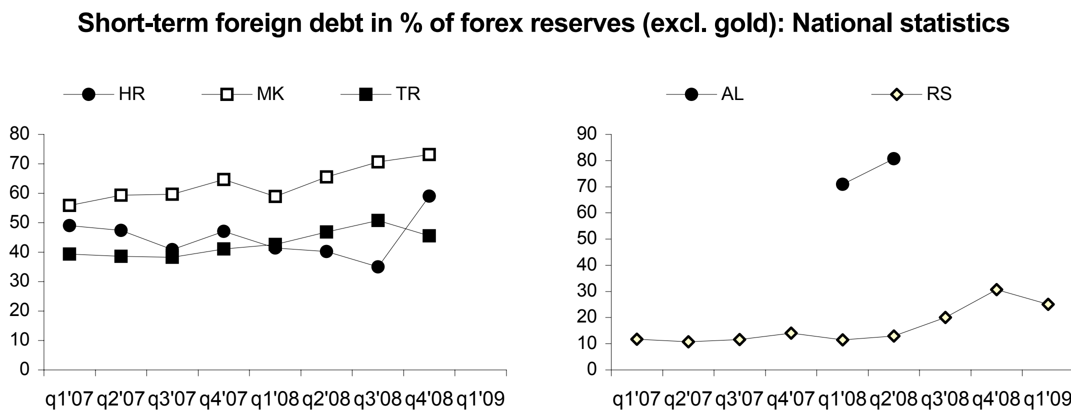
Source: National statistics, Eurostat

Figure 10b



Source: National statistics, Eurostat

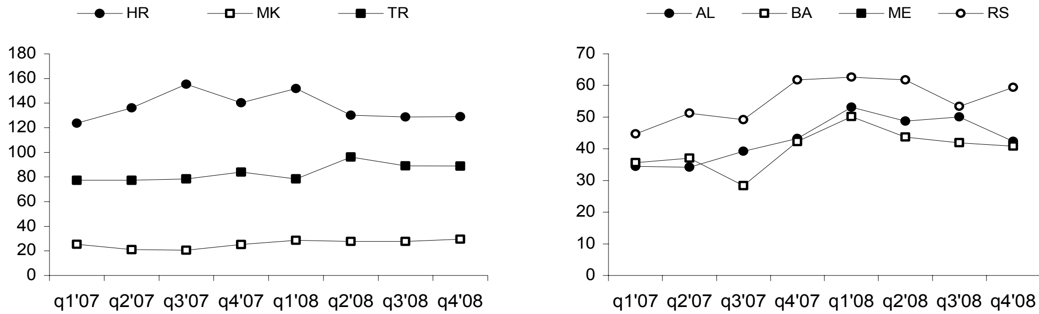
Figure 11a



Source: National bank the respective country.

Figure 11b

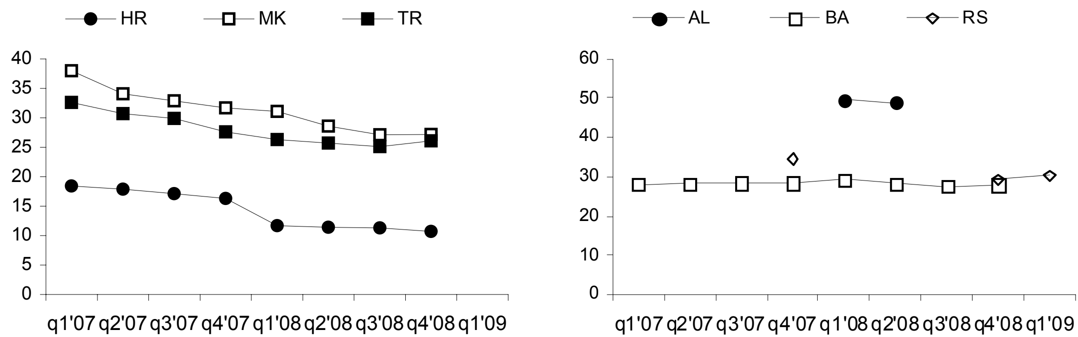
Short-term foreign debt in % of forex reserves (excl. gold): International statistics



Source: Joint External Databas Hub (JEDH).

Figure 12

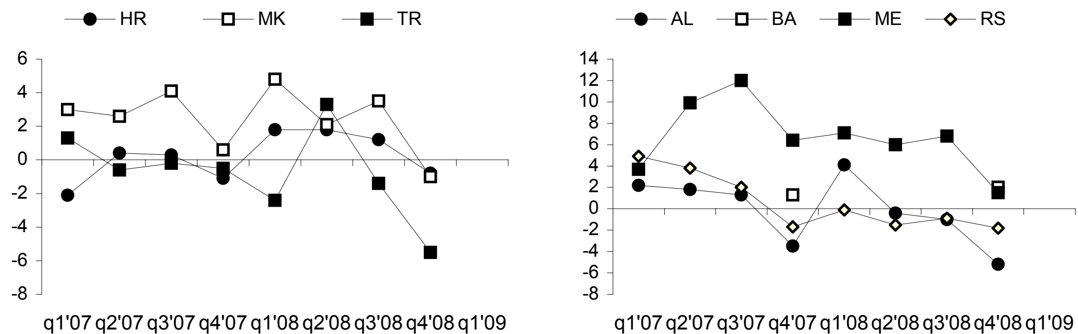
General government share in gross external debt in %



Source: National bank of the respective country

Figure 13

General government balance in % of GDP

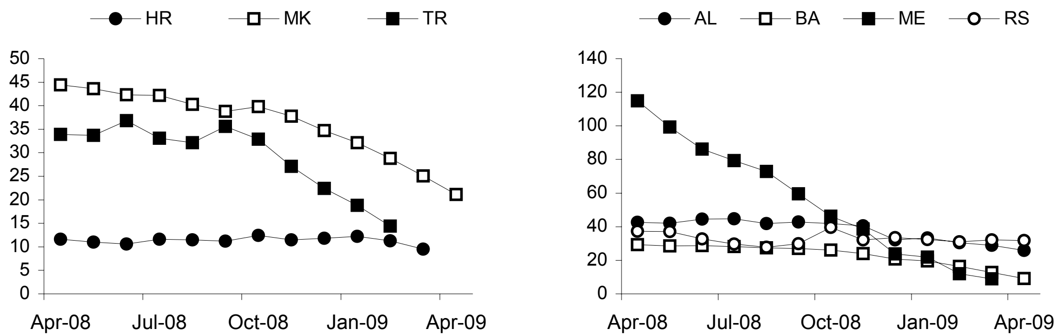


Note: Croatia and Serbia: Central government balance.

Source: National bank of the respective country.

Figure 14

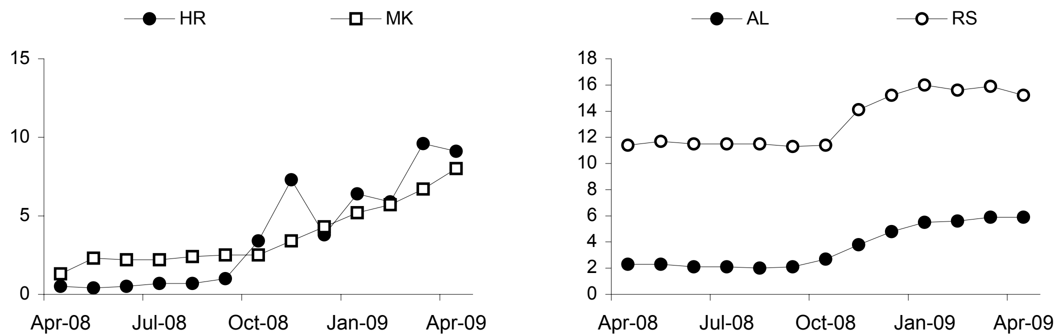
Bank loans to non-financial private sector, growth in %, end of period (year-of-year)



Source: National bank statistics, wiiw: own calculations

Figure 15

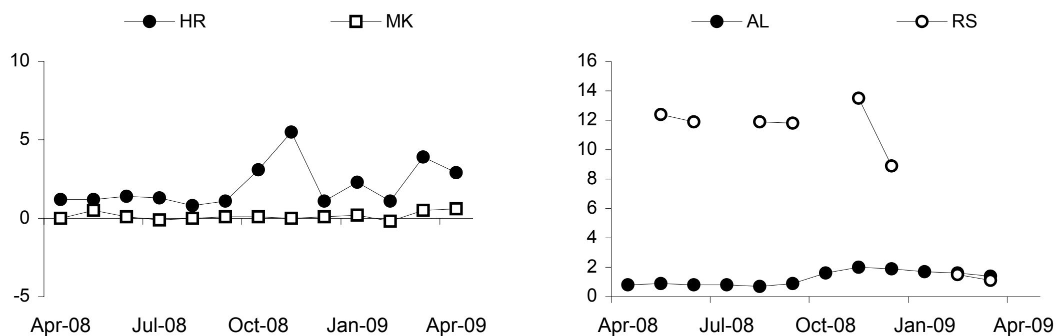
3m …BOR-3mEURIBOR spread in percentage points, average



Source: National bank statistics, wiiw: own calculations

Figure 16

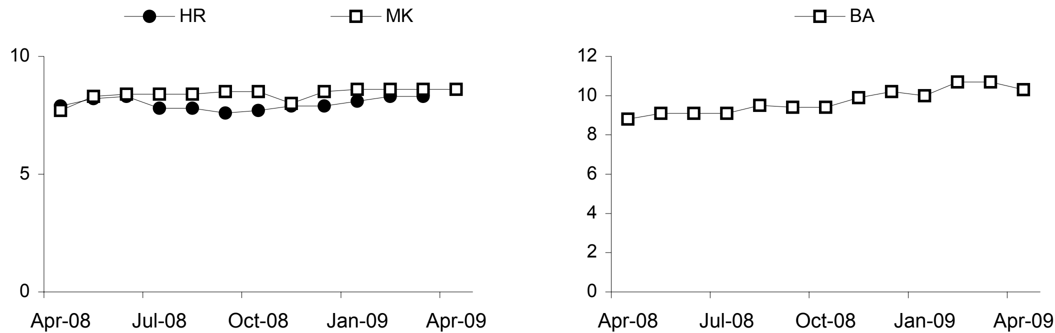
TED spread (3m …BOR-3mT-Bill) in percentage points, average



Source: National bank statistics, wiiw: own calculations

Figure 17

Household long-term foreign currency interest lending rate, average

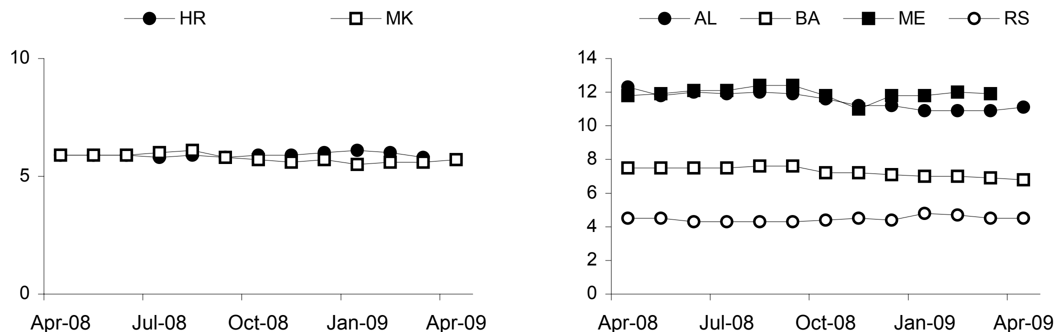


Source: National bank statistics, wiiw: own calculations

Indicators of the soundness of the banking sector in Figures 18 to 21 show that the conventional measures indicate soundness, but there are some reasons for concern when it comes to the exchange rate risks, due to high exposure to loans in foreign currency and to foreign currency sources for deposits and other liabilities.

Figure 18

Leverage, banking sector assets to capital ratio (NCU), end of period

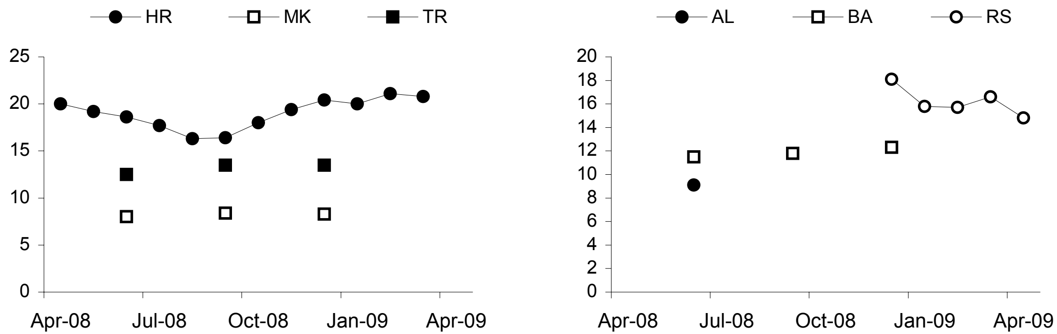


Source: National bank statistics, wiiw: own calculations

The overall conclusion is that there is a process of deleveraging that is causing or is caused by the fast change in the current account deficits. As opposed to the private sector, the public sector is increasing its debt exposure. Given that public sector credit is not going to increase all that fast in the medium term, the accumulated public debt will be a constraint on growth if risks to its financing stay high, which is quite likely. Finally, there are still risks to short-term sharp adjustments in relative prices (e.g. exchange rate depreciation) in countries with a large exposure to short-term credit and insufficient reserves.

Figure 19

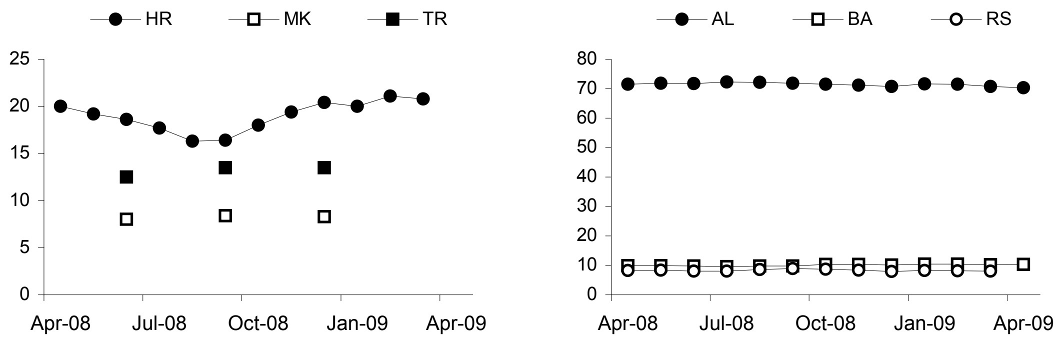
Share of banks' external debt in assets in %, end of period



Source: National bank statistics, wiiw: own calculations

Figure 20

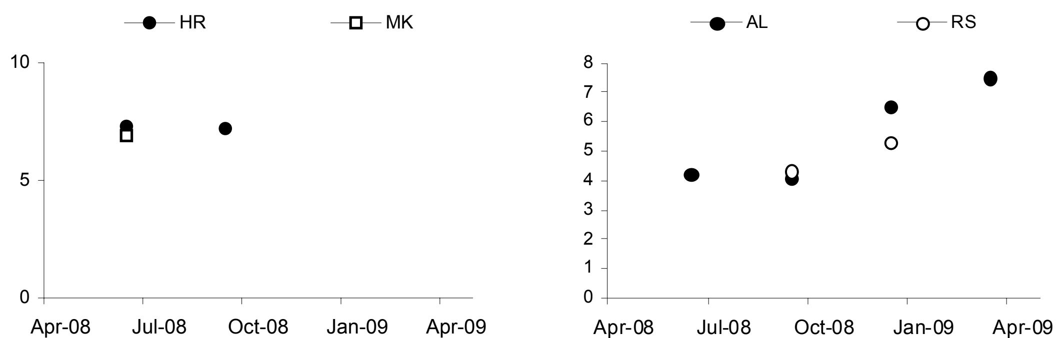
Share of loans in foreign currency in % of total loans, end of period



Source: National bank statistics, wiiw: own calculations

Figure 21

Share of non-performing loans in % of total loans, end of period



Source: National bank statistics, wiiw: own calculations

Mario Holzner

Albania:
you too my son?

Originally one of the few countries in Europe with a still positive GDP growth forecast for 2009, recent data updates suggest that Albania too will face recession this year. Most importantly, first quarter data on remittances sent home by Albanian workers abroad register an 8% drop as compared to the same period of the previous year. This is much more than expected in earlier forecasts. Remittances are an important source of growth in the construction sector as well as in the private consumption of Albanians. Pre-election government overspending in the first half of 2009 will somewhat outweigh the loss of income. However, for the whole year we expect economic growth to drop by 1%.

Parliamentary elections are scheduled for 28 June 2009. For more than a year the current government of conservative Prime Minister Sali Berisha has been heavily investing in prestigious projects such as the national motorway from the main harbour of Durres to the Kosovo border. In the latest polls the conservatives and the socialists are neck and neck. Government expenditures were financed, on the one hand, by recent privatization receipts from the state oil company ARMO and the mobile phone operator AMC, on the other hand by massive government lending. This has led to a strong increase in the monetary base and to speculations about the future payback of government debts. The Turkish rating agency JCR Eurasia Rating has therefore placed a ‘negative outlook’ on Albanian short- and long-term sovereign rating.

Moreover, the Economic Sentiment Indicator as calculated by the Bank of Albania, which is based on the results of a regular business and consumer survey, dropped by 33 percentage points during the first quarter of 2009. The strongest fall in confidence was recorded in the services and construction sector. At the same time, the Construction Cost Index is decelerating on a month-to-month basis; it increased by a mere 1% in the first quarter of 2009 as compared to the same quarter of the previous year. An additional crisis indicator is the fact that the Albanian banking system registered net losses in April 2009. These were mainly the result of massive write-offs. Problematic loans jumped to 8% of the total loans portfolio. Lost loans doubled on a year-to-year basis. The 3-month TRIBOR to 3-month EURIBOR spread tripled to some 6 percentage-points in April 2009 as compared to the same month last year.

Nevertheless, according to unofficial information, Albania still recorded some slightly positive GDP growth in the first quarter of 2009. This makes Albania one of the few European countries, together with Greece, Cyprus and Poland, to record positive first quarter growth. However, it is important to note that latest revised quarterly national accounts data from the Albanian Institute of Statistics

suggest that in the last three quarters of 2008 growth was exceptionally high. While previous quarters had shown real year-on-year increases of about 5% to 6%, growth in the second to fourth quarters of 2008 picked up to some 8% to 9%. This is mainly attributed to the government road-building programme. Thus, given the overall economic situation, the downturn of confidence of economic agents and the drop in government expenditures after the elections, it will be almost impossible to reach the same level of economic activity in the remaining quarters of 2009 as compared to the last three quarters of the previous year. By the end of 2009 at the latest, we expect Albania to technically enter recession.

Thus, a certain reduction of the high current account deficit by the end of the year appears to be inevitable. Lower imports will follow the drop in remittances and the decrease of domestic demand. However, in the first quarter of 2009 we still observe a substantial increase of the current account deficit by more than a quarter as compared to the same period of last year. The decline of remittances (-8%) as a source of financing of the trade deficit was more than absorbed by strong increases in net FDI inflows (+50%) and (mainly public sector) net credit growth (+38%). Lending of the public sector abroad for infrastructure investment is likely to decrease abruptly after the end of the parliamentary elections. The sole hope is that FDI inflow does not decline sharply.

The prospects for continuing FDI flows are not too bad. There are several investment projects in the mining and energy sector close to implementation. Austrian-Russian ACR announced additional investment in its main ferrochrome mine in Bulqiza. Three Italian firms plan to develop a liquid biomass power plant, a wind farm and a gas powered electricity plant. The three projects together are estimated to be worth about EUR 3 billion. If only a fraction of these investments could be realized in 2009 and 2010, the financing of Albania’s current account deficit at the current level could be secured and slow growth of about 1% could start in 2010. By 2011 Albania should return to its lower range of medium-term average growth of about 5% to 6%.

Table AL

Albania: Selected Economic Indicators

	2005	2006	2007	2008 [1]	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average	3149	3135	3170	3170	.	.	.	.	.
Gross domestic product, ALL bn, nom.	814.8	891.0	983.1	1100.0	250	.	1110	1140	1230
annual change in % (real) [2]	5.7	5.5	6.2	8.0	5.7	.	-1	1	5
GDP/capita (EUR at exchange rate)	2100	2300	2500	2800	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	5000	5600	5900	6400	.	.	.	.	.
Consumption of households, ALL bn, nom.	634.5	696.5	728.8	.	.	.	.	.	.
annual change in % (real)	6.0	7.2	6.0	7	.	.	-1	1	4
Gross fixed capital form., ALL bn, nom.	301.4	313.2	380.2	.	.	.	.	.	.
annual change in % (real)	4.9	9.3	8.0	12	.	.	1	2	7
Gross industrial production									
annual change in % (real) [3]	11.7	12.1	-11.4	2	4.4	.	-15	3	5
Gross agricultural production					.	.	.	.	.
annual change in % (real) [3]	0.9	3.0	1.1	1	0.4	.	1	2	3
Construction output total					.	.	.	.	.
annual change in % (real) [3]	6.3	11.0	6.2	7	1.3	.	0	1	11
Employed persons - LFS, th, June	.	.	1188.3	1230.0	.	.	.	.	.
annual change in %	.	.	.	3.5	.	.	.	.	.
Employment reg. total, th pers., end of period	932.1	935.1	965.5	974.1	.	.	.	.	.
annual change in %	0.1	0.3	3.3	0.9	.	.	.	.	.
Unemployed persons - LFS, th, June	.	.	185.0	180.0	.	.			
Unemployment rate - LFS, in %, June	.	.	13.5	12.8	.	.	15	16	14
Reg. unemployment rate, in %, end of period	14.1	13.8	13.2	12.7	13.0	.	.	.	.
Average gross monthly wages, ALL [4]	19993	21493	23234	25300	35800	.	.	.	.
annual change in % (real, gross) [4]	2.5	5.0	15.3	8.9	12.4	.	.	.	.
Consumer prices, % p.a.	2.4	2.4	2.9	3.4	3.7	1.8	2	2	3
Producer prices in industry, % p.a.	4.9	0.8	3.5	6.5	7.4	-1.2	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	25.1	25.8	25.6	26.4	.	.	.	.	.
Expenditures	28.5	29.0	29.1	31.6	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-3.5	-3.3	-3.5	-5.2	.	.	-4	-4	-3
Public debt in % of GDP [5]	58.1	55.0	54.5	53.6	.	.	.	.	.
Base rate of NB, % p.a., end of period [6]	5.0	5.5	6.3	6.3	6.3	5.8	.	.	.
Current account, EUR mn	-589.1	-471.0	-831.0	-1290.6	-267.3	-334.2	-1200	-1200	-1300
Current account in % of GDP	-9.0	-6.5	-10.5	-14.4	-13.2	.	-14.5	-13.7	-13.2
Exports of goods, BOP, EUR mn	530.2	630.6	786.3	915.9	206.5	176.1	730	750	930
annual growth rate in %	9.2	18.9	24.7	16.5	13.3	-14.7	-20	3	24
Imports of goods, BOP, EUR mn	2006.9	2289.6	2890.4	3331.4	733.9	692.5	2900	2800	3200
annual growth rate in %	13.9	14.1	26.2	15.3	17.4	-5.6	-13	-3	14
Exports of services, BOP, EUR mn	967.3	1156.6	1415.1	1524.0	351.9	303.2	1300	1350	1600
annual growth rate in %	19.8	19.6	22.3	7.7	32.7	-13.8	-15	4	19
Imports of services, BOP, EUR mn	1107.7	1188.0	1402.3	1538.7	355.2	330	1400	1400	1500
annual growth rate in %	30.6	7.2	18.0	9.7	21.4	-7.1	-9	0	7
FDI inflow, EUR mn	212.6	258.6	481.1	681.9	103.8	123.6	.	.	.
FDI outflow, EUR mn	1.7	8.2	11.0	62.6	22.4	1.4	.	.	.
Gross reserves of NB excl. gold, EUR mn	1171.6	1329.2	1415.9	1626.1	1352.8	1595.0	.	.	.
Gross external debt, EUR mn [5]	1373.5	1445.4	1445.7	1700.0	.	.	.	.	.
Gross external debt in % of GDP	20.7	20.1	17.9	19.1	.	.	.	.	.
Average exchange rate ALL/EUR	124.2	123.1	123.6	122.8	123.6	128.2	134	130	125
Purchasing power parity ALL/EUR [7]	52.1	51.2	52.6	54.4	.	.	.	.	.

1) Preliminary. - 2) Quarterly data refer to seasonally adjusted gross value added including FISIM. - 3) Gross value added. - 4) Quarterly data exclud private sector. - 5) Based on IMF data. - 6) One week repo rate. - 7) Benchmark results 2005 from Eurostat and wiiw estimates.

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

Josef Pöschl

Bosnia and Herzegovina: relative stability

Bosnia and Herzegovina (BiH) managed to negotiate a stand-by agreement with the IMF. This was no easy undertaking for two main reasons. First, the IMF team relied on the traditional conditionality approach, thus there was no escaping cuts in fiscal expenditures. Secondly, the country's constitutional setting is aimed more at forestalling decisions than facilitating the decision-making process – all agreements require that positive feedback be obtained from simply too many BiH governments (BiH government, entity governments). The stand-by agreement constitutes support for and consolidation of the currency board arrangement, which since 1995 has stood firm as the central pillar of economic stability.

Stability is also the characteristic feature of the price level. Not only did consumer prices not rise during the second half of 2008 and the first five months in 2009, but they even declined slightly over most of that period. In May 2009, the price index was by 2.8% lower compared to October 2008. Real estate prices also dropped. Like everywhere else, stock markets registered a steep decline. The banking sector is predominantly foreign-owned. In the context of the Vienna Initiative, in June the parent banks agreed to abstain from withdrawing major amounts of capital under the condition that the stand-by arrangement with the IMF comes into operation. The latter could take time, as the envisaged cuts in disability allowances to veterans triggered fierce protests.

The increase in industrial output ended abruptly by January 2009, and in the first three months the output was by 3% lower than in the first quarter 2008. The decline was relatively modest given a 13% year-on-year (first quarter 2009) rise in industrial production in the Republika Srpska (RS). In that entity, the re-launch of production in the refinery sector raised the output index in December 2008. On reviewing other segments of the industry, a decline similar to that in the other entity (FBiH, Federation of BiH) is to be observed. It is thus not surprising that RS entrepreneurs have expressed deep discontent with the situation they face. In BiH as a whole, the manufacturing sector has re-aligned much of its pre-war specialization: metals and wood processing, and the metal industry in particular, have had to reduce output drastically. For example, exports of the aluminum producer Aluminij dropped by 60% year-on-year (Q1 2009). Food production, which tends to be affected less by a recession, is weak in BiH; the country's food imports far outstrip exports. Agrifood producers point to the low levels of subsidization compared to neighbouring countries which, they claim, undermine their competitiveness. They maintain, furthermore, that free trade under the CEFTA rules has stripped them of protection. As for agrifood and fishery products (livestock, fresh fish, meat, milk, poultry), in May a trade conflict erupted between BiH and Croatia, with food security arguments being used on both sides to justify import bans. On 18 June, the House of Peoples adopted the

Protection of Domestic Production Act, introducing import tariffs on a number of items from Croatia and Serbia including meat, milk and dairy products. Protests from CEFTA partner countries and the WTO were not successful. Ploys aimed at obstructing trade have become increasingly frequent in the West Balkan region: At a meeting in May, representatives of chambers of commerce from BiH, Croatia and Serbia identified non-tariff barriers of an administrative and technical nature as the largest obstacle to the implementation of CEFTA. The main reason for the poor export performance of BiH, however, is the low proportion of companies that meet internationally certified quality standards. The situation would be better, had the manufacturing sector attracted more foreign investment.

Export figures testify that the country's industry was hard hit by the global economic crisis. Exports declined by 21% in the first quarter of 2009. Imports fell even more, by 24%, so that the trade deficit was unusually low: EUR 780 million compared to EUR 1,050 million one year ago. The value of construction work completed abroad in the first quarter of 2009 was also 32% lower than in the same period of the previous year. The current account deficit, which amounted to EUR 1.9billion in 2008, may come down to about EUR 1.1 billion in 2009. Tourism revenues in the first quarter of 2009 also declined; the trend is likely to continue throughout the current year. The inflow of remittances may also decrease. With regard to capital flows, too, conditions have worsened. The inflow of FDI will remain meagre despite an 8% year-on-year increase in the period January-April 2009. Funds needed for debt servicing purposes are scarce, as a result of which the country's currency reserves on 31 March 2009 were lower than one year previous (EUR 3.1 billion compared to 3.4 billion). Ideally, the current account deficit should fall significantly below one billion euro, as larger gaps might gobble up currency reserves within a few years. BiH will have to find ways and means of securing better balanced current accounts.

Our projection of a 3% decline in GDP in 2009 may create the impression that we consider the recession in BiH to be moderate compared to many other European countries. This is true. However, were it to materialize, that modest decline in GDP would certainly not be attributable to the competitive strength of local producers. It simply means that the contribution of producers of tradables to the GDP is low. Producers of non-tradables, including public utilities and government services, generate a large part of the country's GDP and their output does not fluctuate that much. An engine that would bring the economy back to the growth path is not yet visible – either outside the country or inside it – so that GDP is likely to stagnate, more or less, in 2010 and 2011.

In December 2008, the Government of BiH and the employers' federation agreed on an anti-crisis package. However, implementation is still lacking. In the period October 2008 to April 2009, over 40,000 persons lost their jobs. A further 50,000 persons might be laid off by the end of 2009. Even now, more than one million citizens are considered poor, according to the Coordinating Committee of Charity Organizations.

The government of Republika Srpska is bent on projecting an image of the emphasis it places on business stimulation; it is difficult, however, to distinguish between words and deeds. The Federation (FBiH) government finds it difficult to fund its expenditures (government salaries, social security

expenditures etc.). The entity agreed with the IMF to cut its budget by just over EUR 200 million. The uppermost formal level of administration, the BiH government, is too weak to develop firm initiatives. A clear demonstration of that weakness is the government's inability to agree on a candidate to head up the Directorate for European Integration, a position that has been vacant since January 2009. Poor governance also explains the country's low degree of absorption of EU and IFI funds. The political stalemate continues to impinge on the success of the private sector's economic activities, which tend to be strong. Although this makes for stability, it slows down any dynamic. In this way, much of the country's potential remains unexploited. Given that a major violent uproar or outbreak of hostilities is unlikely, BiH will attract but little international attention over the next few years in spite of continuous political quarrels. The High Representative, with his Bonn powers, who at the same time is currently also the EU Special Representative without Bonn powers, will have no easy life. The job may become even more troublesome after the shutdown of the High Representative's Office. Within the country, nationalistic rhetoric serves the ruling elites in masking efforts to protect the sinecures they acquired in the course of the nineties. Outside the country, views regarding an adequate response are split.

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	2005	2006	2007	2008 [1]	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average	3843	3843	3843	3843	.	.	.	.	.
Gross domestic product, BAM mn, nom.	16927.9	19121.1	21640.6	24400	.	.	23500	23300	23800
annual change in % (real)	3.9	6.9	6.8	5.0	.	.	-3	-1	1
GDP/capita (EUR at exchange rate)	2300	2500	2900	3200	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	5100	5700	6300	6700	.	.	.	.	.
GDP by expend. approach, BAM mn, nom.	18177.6	21151.3	24161.2	.	.	.	.	.	.
Consumption of households, BAM mn, nom.	16513.9	18064.3	19802.3	.	.	.	.	.	.
annual change in % (real)	6.2	4.5	8.3	5	.	.	0	-1	0
Gross fixed capital form., BAM mn, nom.	4889.5	4756.8	6382.5	.	.	.	.	.	.
annual change in % (real)	18.5	-9.4	27.5	5	.	.	-9	0	4
Gross industrial production									
annual change in % (real) [2]	10.8	11.5	6.4	11.0	5.3	-2.5	-11	0	3
Gross agricultural production, total									
annual change in % (real)	-0.5	2.3	.	.	.	.	.	.	.
Employed persons - LFS, th, April	.	811.0	849.6	890.2	.	.	.	.	.
annual change in %	.	.	4.8	4.8	.	.	.	.	.
Employees total - reg., th, average	642.8	653.3	686.1	705.6	699.8	703.8	.	.	.
annual change in %	0.9	1.6	5.0	2.9	3.5	0.6	.	.	.
Unemployed persons - LFS, th, April	.	366.8	346.7	272.0	.	.	.	.	.
Unemployment rate - LFS, in %, April	.	31.1	29.0	23.4	.	.	27	28	27
Reg. unemployment rate, in %, end of period	44.1	44.1	42.5	40.6	42.1	41.2	.	.	.
Average gross monthly wages, BAM [3]	798	869	939	1070	1045	1200	.	.	.
annual change in % (real, net) [3][4]	3.4	2.3	8.5	6.1	7.2	13.1	.	.	.
Consumer prices, % p.a. [5]	3.0	6.2	1.5	7.5	6.4	1.6	-0.5	0	1
Producer prices in industry, % p.a.	.	.	.	.	.	.	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	42.1	44.9	45.4	45	.	.	.	.	.
Expenditures	39.6	42.0	44.1	43	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	2.4	2.9	1.3	2	.	.	-2	-3	-1
Public debt in % of GDP [6]	25.6	22.0	30.5	34.3	.	.	.	.	.
Base rate of NB, % p.a., end of period	.	.	.	.	.	.	.	.	.
Current account, EUR mn [7]	-1500.1	-769.6	-1152.0	-1879.1	-375.6	-156.9	-1100	-900	-1000
Current account in % of GDP	-17.3	-7.9	-10.4	-15.1	.	.	-9	-8	-8
Exports of goods, BOP, EUR mn [7]	2059.7	2687.3	3091.6	3522.0	823.2	652.9	3000	3100	3260
annual growth rate in %	22.8	30.5	15.0	13.9	16.6	-20.7	-15	3	5
Imports of goods, BOP, EUR mn [7]	6021.6	6093.0	7233.6	8341.3	1880.7	1433.9	6500	6400	6500
annual growth rate in %	12.5	1.2	18.7	15.3	26.6	-23.8	-22	-2	2
Exports of services, BOP, EUR mn [7]	798.6	903.9	1062.0	1126.1	231.2	207.9	1000	1030	1080
annual growth rate in %	14.7	13.2	17.5	6.0	13.7	-10.0	-11	3	5
Imports of services, BOP, EUR mn [7]	352.6	375.0	442.7	438.6	78.3	76.9	400	400	410
annual growth rate in %	1.0	6.3	18.0	-0.9	3.3	-1.8	-9	0	2
FDI inflow, EUR mn [7]	493.1	572.3	1546.2	689.5	78.9	27.6	.	.	.
FDI outflow, EUR mn [7]	0.4	3.2	17.2	.	.	.	.	.	.
Gross reserves of NB excl. gold, EUR mn [8]	2160.0	2787.4	3424.9	3218.9	3376.3	3095.8	.	.	.
Gross external debt, EUR mn	2222.6	2085.6	2029.3	2143.8	2002.7	.	.	.	.
Gross external debt in % of GDP	25.7	21.3	18.3	17.2	16.1	.	.	.	.
Average exchange rate BAM/EUR	1.956	1.956	1.956	1.956	1.956	1.956	1.96	1.96	1.96
Purchasing power parity BAM/EUR [9]	0.857	0.878	0.889	0.952	.	.	.	.	.

1) Preliminary. - 2) wiiw estimates based on weighted averages for the two entities (Federation BH and Republika Srpska). - 3) From 2005 District Brcko included. - 4) wiiw calculation. - 5) Until 2005 costs of living, from 2006 harmonized CPI. - 6) Based on IMF data. - 7) Converted from national currency. - 8) From 2006 including investment in foreign securities. - 9) Benchmark results 2005 from Eurostat and wiiw estimates.

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

Hermine Vidovic

Croatia:
servicing foreign debt remains major weak point

Economic activities have continued to contract in 2009. GDP fell by 6.7% in the first quarter of the year resulting primarily from a strong decline in domestic demand, with household consumption down by almost 10% and investments by 12.4%. Retail trade turnover was declining for seven months in a row and shrank by 16% in real terms, of which most markedly in the sale of cars (down by more than half). Government consumption by contrast was up by almost 4%. Industrial output shrank by 10% during the first four months of the year, construction by 4%.Consumer price inflation continued to decelerate, reaching 3.8% in March, and real wage growth was only moderate.

The impact of the overall economic downturn is already visible in labour market indicators. Unemployment (based on registration) has been growing from month to month; in March the unemployment rate reached 15%. The sectors hit hardest by employment cuts were manufacturing, where 15 thousand jobs were lost in the first four months of the year alone, followed by construction, trade and public administration. At the same time job gains were reported in the health and education sectors. Final Labour Force Survey data for 2008 indicate a decline in the overall unemployment rate to 8.4%.

In February the Croatian government launched a package of ten anti-recession measures, including a revision of the state budget, the strengthening of the Croatian Bank for Reconstruction and Development (HBOR) and support to the tourism sector and the real estate market. So far only some of these measures, e.g. the budget revision and the action plan for tourism have been fully implemented. The revision of the budget foresees a reduction of expenditures, particularly by cutting civil servants' salaries, and a reduction of subsidies and investments. At the same time revenues were revised downwards to the previous year's level. According to the revised budget, the general government deficit will rise to 2.7% of the GDP (from 2.6% in 2008). However, taking into account that the budget is based on a GDP decline of 2%, the deficit target appears over-optimistic. Thus, a further revision of the budget is quite likely.

The growth of bank lending continued to slow and amounted to 9.2% in March, year on year. Lending to the household sector decelerated to 8.3% with respect to almost all types of loans. At the end of March housing loans accounted for almost 42% of total household loans. At the same time corporate sector loans were up 10.8%, indicating a rising demand for domestic loans due to the more limited access to foreign sources of funding. Because of companies' growing difficulties, the share of bad loans has been on the rise over the past couple of months, to 5.1% as compared to

4.8% last year. According to expectations of Croatian bankers, this percentage may rise up to 9% by the end of the year.

Based on balance of payments statistics, both exports and imports of goods shrank considerably during the first quarter of the year, by 14% and 24% respectively. Thus, the foreign trade deficit fell by EUR 836 million compared with the same period a year earlier. A breakdown of exports by commodity groups shows a strong drop in exports of oil derivatives, chemical products and machinery, while exports of agricultural products nearly doubled. On the import side, the most pronounced decline was registered in imports of ships, cars and fuel. Considering the narrowing of the trade deficit, the current account deficit fell to EUR 1.8 billion during the first quarter of the year. The overall economic crisis has already translated into a downturn in tourism, with the number of tourists declining by 14% and overnight stays down by 17%.

In March 2009 foreign debt stood at EUR 39 billion, almost the same level as in December last year. Enterprises account for more than half of the debt, about one quarter is owed by banks. The share of government debt fell for the first time below 10%. In order to secure the repayment of debts, the Ministry of Finance borrowed money on the domestic but also on the foreign market. At the end of May Croatia issued a five-year Eurobond worth EUR 750 million with a fixed interest rate of 6.5%, out of which the biggest part (EUR 550 million) will be used for debt repayment and the remainder for covering part of the budget deficit. Another Eurobond issue may follow in autumn. Assistance from the IMF has been mentioned by various sources, but it is still an open issue whether Croatia will have to resort to that support.

The high foreign debt service has put the Croatian currency under devaluation pressure in the first quarter of 2009. In response, the National Bank has increased the commercial banks' calculated foreign exchange component of the reserve requirement (allocated in kuna) from 50% to 75% in January and, in addition, intervened heavily on the foreign exchange market by selling more than EUR 500 million. Since April the Croatian kuna has slightly appreciated.

In April 2009 Croatia, together with Albania, became a member of NATO. Croatia's EU accession talks are currently blocked because of a Slovenian veto based on border disputes over territory and access to the sea. Attempts by the Commission at mediation have failed so far. Hence, plans completing the negotiations by the end of 2009 – as envisaged by the roadmap suggested by the Commission – and entering the EU by 2011 moved beyond reach.

On 1 July 2009 Croatia's prime minister Ivo Sanader resigned unexpectedly and was succeded by his deputy Jadranka Kosor.

For the full year 2009 wiiw expects GDP to contract by about 4%, caused by a slowdown in domestic demand and a decline of both goods and services exports. These developments have already translated into a drop of industrial production and consequently in declining industrial employment – a trend we expect to continue. In addition, tourism is highly vulnerable to external shocks: it will, therefore, be significantly affected by the deteriorating economic situation in Western

Europe. Shrinking foreign trade will trigger a reduction in the trade and current account deficits. Considering the slowdown in tourism and the worsening labour market situation, private consumption is also set to further decline. In view of the deterioration of the overall financial environment, the main challenges for the near future will be to service (or restructure) the high foreign debt and maintain the exchange rate of the Croatian kuna. Assuming an international economic turnaround by mid/end-2010, exports may gradually improve.

Table HR

Croatia: Selected Economic Indicators

	2005	2006	2007	2008 [1]	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average	4442	4440	4436	4435	.	.	.	.	.
Gross domestic product, HRK mn, nom. [2]	264368	286341	314223	342159	79068	77867	338300	348500	364400
annual change in % (real) [2]	4.2	4.7	5.5	2.4	4.3	-6.7	-4	0.5	2
GDP/capita (EUR at exchange rate)	8000	8800	9700	10700	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	12700	13800	15200	15600	.	.	.	.	.
Consumption of households, HRK mn, nom. [2]	162165	172744	188952	202194	49382	46474	.	.	.
annual change in % (real) [2]	4.4	3.5	6.2	0.8	4.2	-9.9	-6	0	2
Gross fixed capital form., HRK mn, nom. [2]	65008	74792	82386	94281	22410	19644	.	.	.
annual change in % (real) [2]	4.8	10.9	6.5	8.2	9.8	-12.4	-8	2	5
Gross industrial production [3)4)]									
annual change in % (real)	5.1	4.5	5.6	1.6	3.6	-10.9	-8	1	3.5
Gross agricultural production									
annual change in % (real)	-8.7	4.4	-3.9	.	.	.	.	.	.
Construction industry, hours worked [3)4)]									
annual change in % (real)	-0.8	9.3	2.4	11.8	10.2	-3.7	.	.	.
Employed persons - LFS, th, average	1573	1586	1615	1636	1591	.	.	.	.
annual change in %	0.7	0.8	1.8	1.3	1.8	.	.	.	.
Unemployed persons - LFS, th, average	229	199	171	149	176	.	.	.	.
Unemployment rate - LFS, in %, average	12.7	11.1	9.6	8.4	10.0	.	10.5	11	10
Reg. unemployment rate in %, end of period	17.8	17.0	14.7	13.7	14.5	15.0	.	.	.
Average gross monthly wages, HRK	6248	6634	7047	7544	7367	7708	.	.	.
annual change in % (real, net)	1.5	1.9	2.2	0.8	0.3	1.8	.	.	.
Consumer prices, % p.a.	3.3	3.2	2.9	6.1	5.9	3.8	3	2.5	2.5
Producer prices in industry, % p.a. [4)5)]	3.0	2.9	3.4	8.4	7.6	1.1	.	.	.
General governm.budget, nat.def., % GDP [6]									
Revenues	38.9	39.2	40.3	.	.	.	.	.	.
Expenditures	42.3	41.6	42.3	.	.	.	.	.	.
Deficit (-) / surplus (+), % GDP [7]	-3.5	-2.6	-2.0	-2.6	.	.	-3.5	-3	-2.5
Public debt in % of GDP [8]	45.7	43.3	41.7	40.3 [XI]	38.3	.	.	.	.
Discount rate of NB, % p.a., end of period	4.5	4.5	9.0	9.0	9.0	9.0	.	.	.
Current account, EUR mn	-1975.6	-2715.2	-3236.7	-4454.2	-2555.5	-1819.8	-2700	-2800	-3200
Current account in % of GDP	-5.5	-6.9	-7.6	-9.4	-23.6	-17.3	-6	-6	-6.5
Exports of goods, BOP, EUR mn	7220.3	8463.6	9192.5	9743.4	2226.2	1921.6	8800	9000	9500
annual growth rate in %	9.3	17.2	8.6	6.0	8.8	-13.7	-10	2	5
Imports of goods, BOP, EUR mn	14738.3	16807.8	18626.5	20609.6	4791.2	3651.1	16500	17000	18000
annual growth rate in %	10.6	14.0	10.8	10.6	13.9	-23.8	-20	3	6
Exports of services, BOP, EUR mn	8052.6	8528.5	9124.8	10091.2	846.5	761.9	9600	9800	10000
annual growth rate in %	5.4	5.9	7.0	10.6	9.7	-10.0	-5	2	2
Imports of services, BOP, EUR mn	2734.9	2823.9	2858.9	3129.5	747.4	634.5	3000	3100	3200
annual growth rate in %	-4.6	3.3	1.2	9.5	11.3	-15.1	-3	2	4
FDI inflow, EUR mn	1467.9	2764.8	3666.9	2930.1	1005.3	399.0	.	.	.
FDI outflow, EUR mn	191.8	208.2	184.1	118.9	132.7	10.9	.	.	.
Gross reserves of NB excl. gold, EUR mn	7438.4	8725.3	9307.4	9120.9	9841.7	8869.5	.	.	.
Gross external debt, EUR mn [9]	25747.7	29273.9	32929.2	39124.6	34963.2	39224.2	.	.	.
Gross external debt in % of GDP [9]	71.8	75.1	76.8	83.8	74.8	85.8	.	.	.
Average exchange rate HRK/EUR	7.4002	7.3226	7.3362	7.2230	7.2867	7.4071	7.4	7.4	7.4
Purchasing power parity HRK/EUR	4.6746	4.6748	4.6559	4.9475	.	.	.	.	.

1) Preliminary. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices). - 3) Enterprises with more than 20 employees. - 4) Quarterly data and forecasts according to NACE Rev. 2. - 5) Based on domestic output prices. - 6) On accrual basis. - 7) Including change in arrears and non-recorded expenditures. - 8) Including guarantees. - 9) From 2008 new reporting system.

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

Vladimir Gligorov

Macedonia:
lack of clarity

Available data suggest that recession is on the way in Macedonia. This is in contrast to the official proclamations, which are still rather positive. In that sense, Macedonia is an outlier: the governments in most other countries are coming out with increasingly realistic and objective assessments of the developments in their economies. Recently, the IMF has suggested that Macedonia's GDP will decline by 2%, while the government is still expecting growth of 1% this year. We have been forecasting a decline of 2% for some time now, but prospects are deteriorating and a revision may be needed soon.

As in other countries, industrial production and exports are the main victims of the current crisis. The contribution of industry to GDP is not so high, thus the sharp decline may not translate into too much GDP lost. Exports are more important and they have been falling quite strongly. Like most other countries in the Balkan region, Macedonia exports just a few products and mostly those that are the hardest hit by the crisis – metals and raw materials. Other exporting goods, such as textiles, are also having a hard time on the European and regional markets.

The deterioration is perhaps coming with a delay because the government intended to pursue a countercyclical policy with large increases in public expenditures, mainly aiming at investments in infrastructure and other development projects. This has led to a slower decline of imports than in most other countries, so that the trade deficit is actually increasing. This is probably a development supported by the steady inflow of remittances so far. Though data are not available and not all that reliable anyway, it does not seem that there has been a significant decline in the inflow of remittances as yet. Usually, remittances increase in the time of domestic crisis, but this crisis is different because of the recession in most of the major immigrant countries. Thus, at some point, a slowing down of the inflow of remittances may have to be reckoned with.

Labour markets are responding as expected, with falling employment and rising unemployment. This negative development is exacerbated by the decline of demand for migrant labour in the region, mainly in Montenegro, but also in other neighbouring countries. There was significant seasonal migration, for work in construction and in tourism, but those jobs may prove not to be available this summer.

The policy response has been somewhat slow and shifting. The central bank has been weary of the continuous loss of reserves and has suggested that an IMF programme may prove helpful. Macedonia has a hard peg regime with the euro and cannot afford to lose reserves, which are not

plentiful to begin with. The government has been opposed to the idea, but seems to be slowly moving in that direction. The latest official position is that if the situation continues to deteriorate, a programme with the IMF may prove to be useful. It is possible that with the next budget revision, e.g. in the early autumn, Macedonia may decide to ask the IMF for support.

Short-term prospects are worsening with GDP set to decline by 2% if not more. First quarter data are still not available, so it is hard to make a forecast with any reliability. Stabilization and recovery cannot be expected to happen soon. Thus, prospects for the next year are also negative with further GDP decline of 1%. In the medium run, a recovery of exports will be crucial, but that may prove to be hard to obtain. It certainly has been a problem when external demand was high and it will be much more of a daunting task if external demand remains weak as currently forecasted.

Table MK

Macedonia: Selected Economic Indicators

	2005	2006	2007	2008 1)	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average	2036.9	2040.2	2045.0	2048.0	.	.	.	.	.
Gross domestic product, MKD mn, nom.	286619	310915	354322	398640	88012	89919.	402000	414000	435000
annual change in % (real)	4.1	4.0	5.9	5.0	5.6	-0.9.	-2	0	2
GDP/capita (EUR at exchange rate)	2300	2500	2800	3200	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	6400	6900	7800	8200	.	.	.	.	.
Consumption of households, MKD mn, nom.	222726	243131	273296	316121	70770	71797	326000	336000	353000
annual change in % (real)	5.7	6.0	9.8	7.8	6.4	3.5	0	0	2
Gross fixed capital form., MKD mn, nom.	48868	56485	71557	80600	.	.	81000	83000	88000
annual change in % (real)	-5.4	11.6	13.1	4.0	.	.	-2	0	3
Gross industrial production									
annual change in % (real) 2)	7.1	3.6	3.7	5.5	5.8	-10.8	-3	0	3
Gross agricultural production							.	.	.
annual change in % (real)	0.3	4.8	-3.0	6.9	.	.	.	.	.
Construction industry									
annual change in % (real)	-20.5	-11.9	9.7	-9.6	-17.9	.	.	.	.
Employed persons - LFS, th, average	545.3	570.4	590.2	609.0	600.6	.	.	.	.
annual change in %	4.3	4.6	3.5	3.2	3.7	.	.	.	.
Unnemployed persons - LFS, th, average	323.9	321.3	316.9	311.5	319.9	.	.	.	.
Unemployment rate - LFS, in %, average	37.3	36.0	34.9	33.8	34.8	.	34	33	33
Reg. unemployment rate, in %, end of period	.	.	.	.	.	.	.	.	.
Average gross monthly wages, MKD	21330	23036	24136	26229	25146	29540	.	.	.
real growth rate, % (net wages)	2.0	3.9	5.5	1.9	0.9	26.1	.	.	.
Consumer prices, % p.a.	0.5	3.2	2.3	8.3	9.5	1.0	3	3	3
Producer prices in industry, % p.a. 3)	3.2	7.3	2.5	10.3	10.5	-6.2	.	.	.
General governm. budget, nat.def., % GDP 4)									
Revenues	35.2	33.5	33.8	33.3	37.6	.	.	.	.
Expenditures	35.0	34.0	33.2	34.2	32.9	.	.	.	.
Deficit (-) / surplus (+), % GDP	0.3	-0.5	0.6	-0.9	4.8	.	-2	-2	0
Public debt in % of GDP	46.9	39.9	33.3	28.2	24.5	26.5	.	.	.
Discount rate of NB, % p.a., end of period	6.5	6.5	6.5	6.5	6.5	6.5	.	.	.
Current account, EUR mn	-121.3	-44.9	-414.8	-851.2	-173.0	-340.7	-460	-540	-570
Current account in % of GDP	-2.6	-0.9	-7.2	-13.1	-12.0	-23.3	-7	-8	-8
Exports of goods, BOP, EUR mn	1642.9	1902.7	2441.5	2684.2	611.6	400.3	2400	2400	2500
annual growth rate in %	22.2	15.8	28.3	9.9	9.5	-34.5	-10	0	5
Imports of goods, BOP, EUR mn	2501.4	2923.1	3616.3	4420.9	982.6	844.3	4400	4600	4800
annual growth rate in %	10.7	16.9	23.7	22.2	27.6	-14.1	0	5	5
Exports of services, BOP, EUR mn	416.2	477.3	594.3	688.1	144.2	.	700	700	700
annual growth rate in %	14.4	14.7	24.5	15.8	21.8	.	-5	0	5
Imports of services, BOP, EUR mn	440.8	455.1	568.7	688.1	145.0	.	700	700	700
annual growth rate in %	8.3	3.2	25.0	21.0	21.2	.	-5	0	5
FDI inflow, EUR mn	77.2	344.8	506.0	412.5	117.6	.	.	.	.
FDI outflow, EUR mn	2.3	0.1	-0.9	-9.5	-12.5	.	.	.	.
Gross reserves of NB, excl. gold, EUR mn	1028.0	1311.3	1400.1	1361.0	1389.8	.	.	.	.
Gross external debt, EUR mn	2518.1	2493.8	2832.0	3318.4	2837.2	3372.3	.	.	.
Gross external debt in % of GDP	53.7	49.1	48.9	51.1	43.7	51.3	.	.	.
Average exchange rate MKD/EUR	61.30	61.19	61.18	61.27	61.29	61.51	61.2	61.2	61.2
Purchasing power parity MKD/EUR	21.96	21.94	22.28	23.85	.	.	.	.	.

1) Preliminary. - 2) Enterprises with more than 10 employees, - 3) Based on domestic output prices. - 4) Refers to central government budget and extra-budgetary funds.

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

Vladimir Gligorov

Montenegro:
stability in crisis

The Montenegrin leadership anticipated the possibility that the crisis may lead to political instability and held early elections before the worst effects transpired. The incumbent government scored a resounding victory and is now facing the crisis with renewed legitimacy. However, while the space of policy manoeuvring does not shrink with political stability, it does not necessarily increase either. Therefore, the government is facing some tough choices.

How tough they turn out to be will depend on how deep the crisis will prove to be. The first problem that the government faced already at the beginning of this year was the need to bail out one major bank, in which the prime minister has a minority equity stake. It was judged that the bankruptcy of that bank would present a systemic risk and EUR 40 million of government credit was used to stabilize the banking sector. That still does not mean that all financial problems have been solved because the banking sector remains shaky.

The next challenge was the fate of the aluminium producer, which accounts for a rather large part of total exports of goods. Due to the fall in commodity prices, the owner, Mr Oleg Deripaska, was not able to meet his obligations towards the employees and the government again had to come to the rescue. The rescue package is reportedly worth EUR 130 million, a very large sum given the fact that Montenegro is quite a small economy. This support should come with an ambitious programme of restructuring, but it does suggest a commitment on the part of the government to this sector. This may prove to be even more costly if the prices on the world market do not recover soon enough and well enough.

When it comes to overall economic activity, GDP is expected to decline by about 3% this year, though some forecasts are bleaker than that. There is no doubt that there is a need to find foreign financing to support consumption and investment, because domestic savings are far from being enough and exports may disappoint this year as well. The main exporting sector is tourism and the outlook for this year's tourist season is uncertain. A decline compared to last year seems inevitable, but if it turns out to be large, as is quite possible, there will be additional problems for the banks and for the public finances.

As in other countries, industrial production is declining strongly as are exports. The current account and trade deficits are shrinking together with the inflow of foreign investment and foreign credits. So, short-term prospects are rather negative, with possibly negative GDP growth even in the next year. Industrial production, as well as exports of goods, will not recover. It will all depend on public

investment and on tourism, which have uncertain prospects in the short run. Some support may come from an IMF programme, but it is not obvious how this is going to be helpful given that Montenegro uses the euro and does not need money for reserves. The government is rather looking for investors in the energy sector and in tourism, but so far there have been few takers. Sovereign creditors may be easier to find with an IMF programme, which may turn out to be the decisive reason to have one later this year.

In the medium run the outlook depends on the recovery of foreign investment and of tourism trade. So far, prospects are not good. Montenegro has taken the step to apply for EU membership and its application is being reviewed in the usual way. It is expected that its candidacy will get a favourable assessment by the European Commission. That should stabilize the expectations of foreign investors and should be helpful.

Table ME

Montenegro: Selected Economic Indicators

	2005	2006	2007	2008 [1]	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average [2]	623.3	624.2	626.2	628.0	.	.	.	.	.
Gross domestic product, EUR mn, nom. [3]	1815.0	2149.0	2807.9	3340.0	586.6	.	3300	3400	3600
annual change in % (real) [3]	4.2	8.6	10.7	8.1	8.1	.	-3	-1	2
GDP/capita (EUR at exchange rate)	2900	3400	4500	5300	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	6900	8300	10300	11100	.	.	.	.	.
Consumption of households, EUR mn, nom.	1268.0	1660.9	2157.6	.	.	.	.	.	
annual change in % (real) [4]	3	10	8	7	.	.	-2	0	2
Gross fixed capital form., EUR mn, nom.	326.3	469.8	683.6	.	.	.	.	.	.
annual change in % (real) [4]	12	8	10	8	.	.	-2	0	3
Gross industrial production									
annual change in % (real)	-1.9	1.0	0.1	-2.0	11.1	-14.1	-5	0	0
Net agricultural production	.	.	.	.	.	.			
annual change in % (real)	-0.9	1.9	-11.0	.	.	.	.	.	.
Construction industry	.	.	.	.	.	.	.	.	.
annual change in % (real)	.	.	.	.	.	.	.	.	.
Employed persons - LFS, th, average [5]	178.8	178.4	217.4	218.8	213.1	.	.	.	.
annual change in %	-4.5	-0.3	21.9	0.7	.	.	.	.	.
Unemployed persons - LFS, th, average [5]	77.8	74.8	52.1	45.3	46.7	.	.	.	.
Unemployment rate - LFS, in %, average [5]	30.3	29.6	19.3	17.2	17.98	.	19	20	20
Reg. unemployment rate, in %, end of period [6]	25.2	20.5	16.5	14.4	16.1	14.6	.	.	.
Average gross monthly wages, EUR [7]	326	377	497	609	576.0	649.0	.	.	.
annual change in % (real, net)	6.7	12.0	15.0	14.6	15.6	12.6	.	.	.
Consumer prices, % p.a. [8]	2.3	3.0	4.2	7.4	7.2	5.3	3	3	3
Producer prices in industry, % p.a. [9]	2.1	3.6	8.5	14.0	12.0	3.6	.	.	.
General governm.budget, nat.def., % GDP [10]									
Revenues	39.4	45.4	47.7	45.4	.	.	.	.	.
Expenditures	42.0	42.7	41.4	43.8	.	.	.	.	.
Deficit(-)/Surplus(+) in % of GDP	-2.6	2.7	6.4	1.5	.	.	-2	0	0
Public debt in % of GDP	.	.	29.0	.	.	.	.	.	
Base rate of NB, % p.a., end of period	.	.	.	.	.	.	.	.	.
Current account, EUR mn [11]	-154.0	-531.2	-825.1	-975.8	-308.7	.	-330	-340	-360
Current account in % of GDP	-8.5	-24.7	-29.4	-29.2	-52.6	.	-10	-10	-10
Exports of goods, BOP, EUR mn	460.6	648.3	659.7	529.6	110.6	.	480	460	480
annual growth rate in %	1.9	40.7	1.8	-19.7	-28	.	-10	-5	5
Imports of goods, BOP, EUR mn	974.3	1497.7	2001.4	1970.7	431.2	.	1770	1590	1750
annual growth rate in %	12.2	53.7	33.6	-1.5	41.9	.	-10	-10	10
Exports of services, BOP, EUR mn	329.8	418.0	674.1	753.4	64.0	.	750	790	870
annual growth rate in %	32.2	26.8	61.2	11.8	29.9	.	0	5	10
Imports of services, BOP, EUR mn	134.3	220.9	233.9	351.2	69.6	.	320	300	330
annual growth rate in %	32.5	64.6	5.9	50.1	54.0	.	-10	-5	10
FDI inflow, EUR mn	392.7	644.3	1007.7	668.5	.	.	.	.	.
FDI outflow, EUR mn	11.5	177.6	482.8	100.9	.	.	.	.	.
Gross reserves of NB, excl. gold, EUR mn	.	.	.	.			.	.	.
Gross external public debt, EUR mn	513.3	504.0	462.1	481.7	.	.	.	.	.
Gross external public debt in % of GDP	28.3	23.5	16.5	14.4	.	.	.	.	.
Purchasing power parity EUR/EUR [12]	0.42	0.41	0.44	0.48	.	.	.	.	.

1) Preliminary. - 2) wiiw estimate in 2008. - 3) Including non-observed economy. - 4) wiiw estimate. - 5) Until 2007 as of October. - 6) In % of unemployed plus employment (excluding individual farmers). - 7) From 2007 wage data refer to employees who received wages (previously wages were divided by all registered employees in enterprises); comparable value for 2006: 433. - 8) From 2008 according to COICOP classification. - 9) Based on domestic output prices. - 10) Revenues excluding grants, expenditures excluding net lending. - 11) Including all transactions with Serbia. - 12) Benchmark results 2005 from Eurostat and wiiw estimates.

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

Vladimir Gligorov

Serbia:
continuous deterioration

The crisis has hit Serbia harder than has been expected. Given that the economy is quite closed, in terms of exports, the decline in foreign trade was not believed to have a large influence on domestic consumption and investment and thus on production. However, reliance on foreign financing is heavy and that dried out in the first quarter of 2009 and has not recovered since. This has led to high illiquidity in the economy and thus to a sharp decline in consumption and investment. In sum, GDP is contracting by 5% to 6% year-on-year. Investment is falling even more, though the data are not very reliable. Consumption is also declining, which can be seen from the sharp fall in imports.

Public consumption is under significant pressure because expenditure obligations were increased at the end of last year, while revenues have been falling throughout this year. In mid-year, the fiscal deficit is headed towards 5% of GDP. There will be some more clarity once the new budget revision is done, probably in early autumn. Though the deficit is increasing, public expenditures are not, in real terms. Thus, public spending has a pro-cyclical influence and the chances are that it will continue to contribute to the recession because further budget cuts will in most probability be necessary.

Serbia has concluded its second IMF stand-by agreement only few months after the first one was approved. The current one may prove to be adequate not because of its policy content, but because external balances are improving faster than expected. This is the consequence of the recession being deeper than anticipated. Thus, imports are declining faster and the exchange rate has stabilized without too much support from the reserves of the central bank. This, however, is not good news because it is a symptom of widespread lack of financial resources, both in the private and in the public sectors. Indeed, the government is trying to borrow money left and right not only on its own behalf but on the behalf of the corporate and the household sectors too. This is because only sovereign and multilateral sources of credit are really available, though it cannot be expected to be very generous. Thus, Serbia is expecting budget support from the EU of about EUR 100 million, has increased its borrowing from the World Bank and the EBRD and has asked Russia for a loan of about EUR 1 billion. These loans, even if they are realized as intended, will not be enough and certainly provide only temporary respite from the financial problems.

At the turn between the first and the second quarter there was some indication that the worst might be over and that the decline had slowed down. Later data, especially on monthly growth of industrial production, have however not proved supportive of this conclusion. The decline seems to have accelerated in April and the same may turn out to be true for May. Similarly, figures on foreign trade

and on the development in the labor market point to a continuing deterioration. Particularly suggestive is the sharp decline in manufacturing, but there are signs that the services sector is also continuing to shrink. The hope is that agriculture will do well and will support exports of food and food products which have proved stable so far.

The inflation rate is still rather high and there has even been some acceleration of price increases. The fastest growth appears to be in controlled prices. In a number of cases, public and communal services are pricing their services higher because the transfers from the budgets are less generous. Also, prices of oil, gas and gasoline are not declining as fast as the world market prices would suggest because these monopolies have been incurring losses that they are trying to cover by keeping the prices high. How successful they are is hard to tell because of growing illiquidity and debt arrears. So, Serbia seems to be suffering from both deflation and inflation at the same time. Prices of goods and services and wages are under pressure to decline, while taxes, prices of public services and utilities and of the monopolies are going up. The latter will deepen the former if recovery disappoints – as it seems all but certain at the moment.

Policy response has been slow and confused so far. Monetary policy has been tight and will continue to be so because of the central bank's belief that it can pursue inflation targeting. Thus, it is trying to slow down inflation by keeping the interest rates high. Also, it aims to stabilize the exchange rate in that way, which in turn should help stabilize the prices too. So far, success has been limited. Lately, the central bank has started to cut the rate of its key policy instrument, the two-week repo-rate; it has indicated that it will continue to do so as long as the prospect for inflation improves. Arguably, it could have been more aggressive in monetary easing as inflation is not really the key worry at the moment. Indeed, it is providing additional revenues, as explained, is reducing real wages and pensions and is contributing to an increase in competitiveness in that way.

The prospects for a short-term recovery are not overwhelming because of the persistent volatility in most short-term real and financial indicators. Prospects for a short-term stabilization of the decline are better, but it is hard to say whether the bottom is going to be touched this summer or maybe a bit later. GDP may decline by 4% in an optimistic scenario and by as much as 6% in a more pessimistic one. Investments will fall even more and consumption may decline as much as GDP. Net exports will play a more positive role with a sharp reduction in the foreign trade deficit.

In the next couple of years, stagnation seems more likely than recovery. Serbia will have to rely more on domestic savings and on exports, and it will take a while for that turnaround to take place.

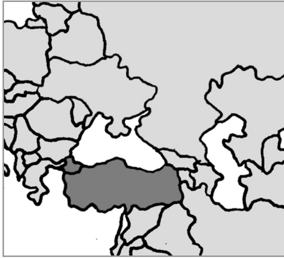
Table RS

Serbia: Selected Economic Indicators

	2005	2006	2007	2008 [1]	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average [2]	7441	7412	7382	7350	.	.	.	.	.
Gross domestic product, RSD bn, nom.	1688	1980	2363	2761	.	.	2900	3100	3300
annual change in % (real)	5.6	5.2	6.9	5.4	8.5		-4	0	2
GDP/capita (EUR at exchange rate)	2700	3200	4000	4600	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	7200	7800	8600	9100	.	.	.	.	.
Consumption of households, RSD mn, nom.	1281014	1492693	1714040	.	.	.	.	.	.
annual change in % (real) [3]	5.0	5.4	6	6	.	.	-2	0	2
Gross fixed capital form., RSD mn, nom.	319859	412752	552271	.	.	.	.	.	.
annual change in % (real) [3]	5.0	15.2	12	8	.	.	-5	0	3
Gross industrial production									
annual change in % (real)	0.8	4.7	3.7	1.1	6.1	-16.9	-5	0	3
Gross agricultural production									
annual change in % (real)	-3.4	-2.6	.	.	.	.	.	.	.
Construction output total									
annual change in % (real) [4]	2.0	7.7	10.8	1.7	4.8	.	.	.	.
Employed persons - LFS, th, Oct [5]	2733.4	2630.7	2655.7	2805.3	.	.	.	.	.
annual change in %	.	-3.8	1.0	5.6	.	.	.	.	.
Unemployed persons - LFS, th, Oct [5]	719.9	693.0	585.5	457.2	.	.	.	.	.
Unemployment rate - LFS, in %, Oct [5]	20.8	20.9	18.1	14.0	.	.	18	20	20
Reg. unemployment rate, in %, end of period	27.1	27.9	25.1	23.7	25.2	24.6	.	.	.
Average gross monthly wages, RSD	25514	31745	38744	45674	41807	41933	.	.	.
annual change in % (real, net)	6.4	11.4	19.5	3.9	5.4	2.4	.	.	.
Consumer prices, % p.a. [6]	16.2	11.7	7.0	11.7	13.6	9.4	8	6	3
Producer prices in industry, % p.a. [7]	14.2	13.3	5.9	12.4	11.7	4.9	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	42.9	43.8	42.4	42.5	.	.	.	.	.
Expenditures	41.9	45.4	44.3	45.0	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	0.9	-1.7	-1.9	-2.5	.	.	-5	-2	-1
Public debt in % of GDP	50.2	36.2	29.4	25.9	30.2	28.9	.	.	.
Discount rate of NB, % p.a., end of period	8.5	8.5	8.5	8.5	8.5	8.5	.	.	.
Current account, EUR mn [8]	-1766.1	-2382.1	-4628.9	-5949.4	-1290.4	-797.8	-2900	-2700	-3100
Current account in % of GDP	-8.7	-10.1	-15.7	-17.6	.	.	-10	-10	-11
Exports of goods, BOP, EUR mn [8)9)]	3998.9	5137.4	6399.0	7474.8	1672.6	1290.5	6700	6700	7400
annual growth rate in %	21.8	28.5	24.6	16.8	21.4	-22.8	-10	0	10
Imports of goods, BOP, EUR mn [8)9)]	8255.3	10138.4	13071.2	15153.6	3485.4	2576.4	13600	13600	15000
annual growth rate in %	-2.7	22.8	28.9	15.9	22.2	-26.1	-10	0	10
Exports of services, BOP, EUR mn [8)9)]	1315.5	1851.0	2314.5	2751.3	687.6	568	2600	2600	2900
annual growth rate in %	10.9	40.7	25.0	18.9	38.1	-17.4	-5	0	10
Imports of services, BOP, EUR mn [8)9))]	1321.2	1892.4	2568.8	2925.2	652.1	604.6	2600	2600	2900
annual growth rate in %	25.2	43.2	35.7	13.9	18.0	-7.3	-10	0	10
FDI inflow, EUR mn [8]	1265.3	3515.7	2530.1	2042.5	850.1	844.7	.	.	.
FDI outflow, EUR mn [8]	18	17	686	189	19.3	1.4	.	.	.
Gross reserves of NB, excl. gold, EUR mn	4753.7	8841.3	9422.2	7908.8	9321.1	7828.2	.	.	.
Gross external debt, EUR mn	13064.0	14884.6	17790.5	21800.5	17957.3	21445.0	.	.	.
Gross external debt in % of GDP	66.2	59.4	59.7	70.0	57.6	73.9	.	.	.
Average exchange rate RSD/EUR	82.91	84.19	79.98	81.90	82.8	94.5	100	110	120
Purchasing power parity RSD/EUR [10]	31.72	34.34	37.30	41.30	.	.	.	.	.

1) Preliminary. - 2) wiiw estimate in 2008. - 3) wiiw estimate. - 4) Gross value added. - 5) From 2004 according to census 2002 and revisions based on ILO and Eurostat methodology. - 6) From 2008 according to COICOP-classification. - 7) Based on domestic output prices. - 8) Converted from USD with the average exchange rate. - 9) From 2006 including transactions with Montenegro. - 10) Benchmark results 2005 from Eurostat and wiiw estimates.

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



Josef Pöschl

Turkey: a show of confidence – or a struggle for survival?

For months now, the IMF has been extending a helping hand, yet the Turkish government is still reluctant to grasp it. However much the government's aloof attitude may impress the Turkish electorate, it annoys both domestic and foreign financial investors. When in early June, Ali Babacan, the Minister for Economic Affairs, announced that Turkey was preparing for a future 'with or without lending' from the IMF, stocks plummeted, while bond yields rose. At the same time, Prime Minister Erdoğan voiced yet again his concern that a stand-by deal might contain conditions 'harming the country's interests' or it might have 'political content'. He put forward these views when presenting a new economic stimulus package. Turkey's government is heavily engaged in economic stimulation policies; the central bank has adopted a similar approach.

The self-confidence of Turkish policy makers may come as a surprise given the major setback that the Turkish economy has suffered. The shock waves after the collapse of Lehman Brothers hit the Turkish economy in a critical phase: an extended period of high industrial and GDP growth was just beginning to lose momentum. As a result, GDP declined by 6.2% in real terms (year-on-year) in the final quarter of 2008. Industrial production had already started declining in August, whereafter it dropped massively to 25.9% (year-on-year) in February 2009. In subsequent months, the situation improved somewhat. Whereas in February industrial output was some 15% below the 2005 average, by April it had almost regained that former level. This fuels hopes that the crisis may have bottomed out during the first quarter of 2009, when the GDP declined by 13.8% (year-on-year). Whereas in January and February the manufacturing sectors used only 64% of their capacity, the capacity utilization rate rose to 70% in May. The central bank's business confidence indicator also bolsters hopes of improvement. After dropping sharply in the last quarter of 2008, down to 52 in December, the confidence index was back to the norm level of 100 in June 2009.

Export figures, however, offer no sign of the crisis relaxing. In contrast to industrial output, exports did not rise after February. In April, they were lower than in previous months, and the year-on-year decline was 33% (but 41% for exports to the EU). Imports were more in line with the industrial output trends. In March and April, their volume was higher compared to January and February (yet 38 and 43% lower year-on-year).

It was in November 2008, when foreign trade went into massive decline. Since then imports have contracted more than exports, with the result that the current account deficit came down to EUR 0.9 billion in the first quarter of 2009 (compared to EUR 8.2 billion in the same quarter of 2008) and is no longer the main concern. In the latter respect, Turkey's need for external financing has diminished.

This is helpful given that the net inflow of FDI diminished (EUR 1.5 billion compared to 2.3 billion); the net outflow of portfolio investment rose (from EUR 0.9 to 2.5 billion); and other investment (net) turned negative (EUR –3.1 billion compared to +6.3 billion in Q1 2008). Thanks to a major capital inflow registered under ‘errors and omissions’ (EUR 4.1 billion compared to 0.4 billion a year earlier), the decline in currency reserves was small (EUR 0.9 billion). Today, external funds are mainly needed to service external debt. So far, this has been manageable. Following substantial depreciation in the second half of 2008, the exchange rate has since stabilized and even come under slight appreciation pressure. In mid-2008, inflation started to decelerate. Initially, the main reason was the decline in world market prices for energy, while later on the deteriorating business climate assumed a major role. The central bank has exploited this trend to reduce gradually its interest rates[33]. In May 2009, consumer prices were only by 1.3% higher compared to November 2008. There is a convention calling for monetary tightening as a response to rising government deficits. So far, its violation has had no adverse effect.

Government revenues will be much lower than those envisaged when the budget for 2009 was drawn up. Observers’ concerns may shift in focus from the balance of payments to the government budget. The deficit is likely to rise to around 6% of GDP in 2009. Were expenditures to be kept at the level planned, automatic stabilizers would be free to do their jobs. The government, however, is determined to actively improve economic performance by increasing expenditures and temporarily reducing tax and social security rates. To date, the stimulus packages have mainly consisted of measures such as temporary cuts in sales tax on cars and domestic appliances. Scheduled to expire at the end of June, a decision as to their prolongation was still pending in the middle of the month. The new stimulus package that Prime Minister Erdogan announced in early June adopts a rather systematic approach; it is supposed to strengthen economic recovery in 2010. It introduces three different investment categories: large project investments, regional investments and sectoral investments. It also envisages incentives designed to boost employment.

The stimulation of large investment projects offers tax breaks for projects larger than 250 million lira (EUR 115 million) in twelve capital or technology intensive sectors, including transit pipeline, air transport equipment, metals, mining, transportation and oil refining.

The programme divides the country into four regions according to the level of socio-economic development. Tailor-made measures are supposed to reduce regional disparities and strengthen the country’s competitive power. A new set of investment incentives, which is envisaged to expire at the end of 2010, will promote specific industries in particular regions of the country. It gives priority to agriculture, textiles, leather, metal and plastic goods in the east and high-technology manufacturing in the west.

In provinces to the east of the country, the programme offers investors free land, cheap loans and reductions in the corporate tax rate (2% instead of 20%) for a longer period of time. It also exempts

[33] On 16 June, the central bank lowered the overnight interest rates by 50 basis points, down to to 8.75% (borrowing rate) and 11.25% (lending rate).

them from social security employment premiums that they would normally have to pay for new employees. Provinces to the west are better developed, and incentives will thus be less pronounced.

The new stimulus package could cost, over the years, the government up to TRL 60 billion (approximately EUR 28 billion or 6.3% of the GDP in 2008). A second, much smaller package aims at increasing employment, given that in February the rate of unemployment exceeded 16%. Companies will be exempt from paying social security premiums for workers hired after April 30. The programme also envisages employing jobless persons for six months to repair public buildings (e.g. schools and hospitals) and plant trees. It will support vocational schools and apprenticeship schemes. The package could cost close to TRL 1 billion (about EUR 460 million or 0.1% of the GDP in 2008). Claims that it will create half a million additional jobs seem to be exaggerated.

Increasingly, Turkey is becoming aware of the economic and political opportunities offered by the countries in the neighbouring regions to the north, east and south. The EU membership option remains on Turkey's agenda; however, EU politicians have repeatedly expressed their objections to Turkey joining the EU: an attitude that the Turkish public regards as humiliating. The government's EU integration efforts have become less popular. So far, only one chapter (science and research) has been preliminarily closed. Nine more chapters have been opened, but have yet to be concluded (company law; intellectual property law; statistics; trans-European networks; enterprise and industrial policy; consumer and health protection; financial control; information society and media; and free movement of capital).

In our view, recession reached its deepest point in the first quarter of 2009. Recovery can be fast and intensive if a positive global trend – which is not yet in sight – reinforces the stimulation efforts. Should the country's economy be swift to overcome recession, the ruling Justice and Development Party (AKP) will be able to maintain its popularity and avoid internal tensions. Longer-term stagnation would push unemployment up to a politically intolerable level. The government is thus committed to furthering economic recovery in any way it can and wants to ensure that any future deal with the IMF supports the government's stimulus efforts. Should that deal materialize, its impact might not be purely positive. It might well imply tighter monetary policy and nudge the lira towards appreciation. If that happens, it could harm the competitive strength of Turkish producers of tradables. Whereas financial risks would lessen, the likelihood of longer-term real sector stagnation might even increase. The popularity of the AKP would falter: a trend that might induce a return to weak unstable coalition governments and generate more votes for radical parties.

Table TR

Turkey: Selected Economic Indicators

	2005	2006	2007	2008 [1)]	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average [2)]	72065	72971	73436	74414	.	.	.	.	.
Gross domestic product, TRY bn, nom.	648.9	758.4	843.2	950.1	215.8	211.0	940	1000	1070
annual change in % (real)	8.4	6.9	4.7	1.1	7.3	-13.8	-7.0	1	3
GDP/capita (EUR at exchange rate)	5400	5700	6400	6700	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	9100	10100	10700	10700	.	.	.	.	.
Consumption of households,TRY bn, nom.	465.4	534.8	597.7	662.2	158.5	156.3	.	.	.
annual change in % (real)	7.9	4.6	4.6	0.3	6.1	-9.2	-4	-0.3	1
Gross fixed capital form., TRY bn, nom.	136.5	169.0	184.1	192.8	48.7	40.1	.	.	.
annual change in % (real)	17.4	13.3	5.4	-4.6	9.5	-29.7	-11	4	7
Gross industrial production									
annual change in % (real)	5.4	7.8	6.9	-0.9	7.3	-22.0	-15	2	5
Gross agricultural production									
annual change in % (real)	6.6	1.3	-7.3	.	.	.	.	.	.
Construction industry									
annual change in % (real)	21.5	.	.	.	.	.	.	.	.
Employed persons - LFS, th, avg. [3)]	22046	22330	21189	21571	19831 [I-II]	19826 [I-II]	.	.	.
annual change in %	1.2	1.3	1.1	1.8	.	0.0			
Unemployed persons - LFS, th, average [3)]	2520	2446	2333	2558	2634 [I-II]	3276 [I-II]	.	.	.
Unemployment rate - LFS, in %, average	10.3	9.9	9.9	10.6	11.8 [I-II]	15.8 [I-II]	16	17	17
Reg. unemployment rate, in %, average	.	.	.	.			.	.	.
Average gross monthly wages, manuf.ind., TRY [4)]	1162	1301	1437	1590	.	.	.	.	.
annual change in % (real) [4)]	4.3	2.1	1.6	0	.	.	.	.	.
Consumer prices, % p.a.	8.2	9.6	8.8	10.4	8.8	8.4	6	5	4
Producer prices in industry, % p.a.	7.1	9.7	6.0	13.0	6.7	7.8	.	.	.
General governm. budget, EU-def., % GDP [5)]									
Revenues	.	22.5	19.6	18.2	.	.	.	.	.
Expenditures	.	21.4	20.6	20.4	.	.	.	.	.
Deficit (-) / surplus (+)	-0.6	1.1	-1.0	-2.2	.	.	-5.5	-5	-2
Public debt, EU-def., in % of GDP [5)]	52.3	46.1	39.4	39.5	.	.	.	.	.
Discount rate of NB % p.a., end of period [6)]	17.5	22.5	20.0	17.5	19.3	13.0	.	.	.
Current account, EUR mn	-17761	-25595	-27846	-27872	-8203	-887	-9200	-12000	-14000
Current account in % of GDP	-4.6	-6.1	-5.9	-5.6	-6.9	-0.9	-2.1	-2.5	-2.7
Exports of goods, BOP, EUR mn	63157	74397	84003	95447	23457	20067	90000	93000	102000
annual change in %	14.6	17.8	12.9	13.6	23.5	-14.5	-6	3	10
Imports of goods, BOP, EUR mn	89839	106996	117969	131169	31550	20878	94000	95000	103000
annual change in %	22.4	19.1	10.3	11.2	22.4	-33.8	-28	1	8
Exports of services, BOP, EUR mn	21691	20165	20887	23734	3523	3814	23000	23000	25000
annual growth rate in %	17.1	-7.0	3.6	13.6	14.8	8.3	-4	2	7
Imports of services, BOP, EUR mn	9224	9352	11195	11878	2676	2858	11000	11000	12000
annual growth rate in %	13.0	1.4	19.7	6.1	19.3	6.8	-4	0	9
FDI inflow, EUR mn	8289	15916	16237	12223	2996	1726	.	.	.
FDI outflow, EUR mn	863	713	1568	1732	662	273	.	.	.
Gross reserves of CB, excl. gold, EUR mn	42820	46251	49804	51022	48366	50436	.	.	.
Gross external debt, EUR mn	143683	157422	169118	198918	167606	.	.	.	.
Gross external debt in % of GDP	35.3	38.7	34.4	45.0	37.9	.	.	.	.
Average exchange rate TRY/EUR	1.6771	1.8090	1.7865	1.9064	1.8036	2.1635	2.1	2.1	2.1
Purchasing power parity TRY/EUR	0.9917	1.0332	1.0732	1.1954	.	.	.	.	.

1) Preliminary. - 2) SIS projections. 2007 figure: Eurostat. SIS figure 2007 (end of year): 70586 th. persons based on new census methodology. - 3) From 2007 according to census 2006. Quarterly data and forecasts according to new methodology starting from January 2009. - 4) From 2004 including overtime payment. - 5) According to ESA'95 excessive deficit procedure. - 6) Overnight lending rate.

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

Peter Havlik

Russian Federation: heading for crash and clash?

Russia has been seriously hit by the current global crisis. In 2008, economic growth still reached nearly 6%; fixed investment rose by 10% and household consumption by 11%. Export revenues grew by 24% (imports by 22%, both in euro terms) and the current account surplus increased as well. In the fourth quarter of 2008, however, growth virtually collapsed and the economy plunged into a deep recession. GDP contracted by nearly 10% in the first quarter of 2009, investment and construction dropped by 15-20%, exports and imports revenues by 30-40% in the same period. ROSSTAT also reports a 40% decline in FDI inflows in the first quarter of the year and a huge increase in FDI outflows. Industrial output, in particular in manufacturing, fell at double-digit rates as well. The decline in household consumption and retail sales (both dropped by about 2% compared to the first quarter of the previous year) could be mitigated by government anti-crisis measures (see below). At the same time, unemployment (as well as wage arrears) increased and consumer price inflation remained at double-digit rates – in part as a result of the rouble devaluation at the beginning of the year.

The stock market dropped by more than 70% between May 2008 and January 2009 – one of the largest declines among the emerging markets. A number of Russian blue chip companies (such as Gazprom, Rosneft, Lukoil, Sberbank, Norilsk Nickel) were initially hit particularly hard, reflecting partly investors' overreaction, although fundamental factors played a role as well (a decline in world prices for oil and metals and high exposure to short-term foreign debts). The adverse external shocks that triggered these events may have been compounded by domestic political factors, such as the Mechel and TNK-BP affairs of early summer 2008, the August war in Georgia and the gas conflict with Ukraine at the beginning of 2009. However, the shallow depth and relative immaturity of the domestic stock market should keep repercussions on the real economy in check. Yet the stock market developments reflected more a temporary overreaction on the part of the market participants rather than a lasting deterioration of the domestic investment climate (the stock market increased by more than 50% between January and end-June 2009).[34]

Indeed, potentially more serious than the highly volatile performance of the stock market – especially as far as repercussions on the real economy are concerned – is the tightening of credit conditions. There is no doubt that several large Russian companies (such as Mr Deripaska's Basic Element) and smaller Russian banks in particular have been facing difficulties servicing and refinancing their outstanding foreign debts. The lack and/or dearth of domestic, especially long-term credit financing –

[34] See *The Economist*, 27 June 2009, p. 106.

a by-product of past restrictive monetary policies in Russia and easy credits abroad – have motivated Russian companies, even the state-owned or state-controlled ones such as Gazprom or Rosneft, to seek external financing. Private foreign debt reached some USD 400 billion as of end-March 2009 with short-term obligations declining (to 16% of the total at the beginning of 2009) and refinancing becoming more difficult.

Similar to the USA, the EU and China, the Russian government has adopted various rescue and stimulus packages in order to improve the liquidity of the banking sector, restore confidence and to support domestic consumption. The Central Bank released more than USD 200 billion out of its reserves in order to provide additional liquidity and to support the rouble exchange rate. New loans to the banking sector with a maturity of up to six months are provided via the state-owned Vneshekonombank (VEB) with no collateral required. In addition, the VEB is providing credit for refinancing short-term foreign loans, while acquiring shares in those companies as collateral. The bank guarantee on private deposits was raised to RUB 700,000 (EUR 20,000). Altogether, more than USD 200 billion of state assistance in various forms were earmarked in an endeavour to ease liquidity in the financial sector. Critics point to the usual dangers of misappropriation and corruption; they also expect that in the main the large (or well-connected) banks and companies stand to gain disproportionately. They wonder in fact – up until June with some justification – whether the money will reach the companies facing the liquidity squeeze. It is to be expected that a number of small and medium-sized banks will eventually collapse, the banking sector will be streamlined and the state will exert greater influence on companies seeking and obtaining financial help.

The revised federal budget for 2009 also entails a huge fiscal stimulus as it reckons with a rise of expenditure (+7%) despite falling revenues. As a result, the budget is expected to shift from a surplus (6% of GDP in 2008) to a deficit of 7% of GDP in 2009. Previously accumulated resources in the Reserve Fund and the issuance of domestic debt will be used to support government expenditures on various investment and social programmes. In sum, the above anti-crisis measures cost about 10% of Russian GDP but their effects are hard to measure.

Russian authorities, as well as the IMF, OECD, The World Bank and others (including wiiw) have been busily revising GDP forecasts downwards. The range of GDP growth forecasts for the year 2009 fluctuates between -2% and -10%, largely depending on assumptions regarding the level of energy prices (the official data for May were very bad). In the past couple of years, Russian GDP growth has been driven mainly by booming private consumption and, increasingly, also by expanding investments. The contributions of real net exports to GDP growth has become negative as the volume of exports was growing only at a modest pace whereas import volumes were surging by more than 20% per year. On the supply side, the major part of the overall GDP growth resulted from booming trade, financial services, telecoms and construction activities while the manufacturing industry and agriculture expanded less than the overall gross value-added.

With export revenues down by about 30% as a result of lower energy prices and rapidly falling investments, GDP growth will not only slow down substantially in 2009 (as previously expected) but will even turn negative. The revised wiiw forecast reckons with a GDP decline by about 5% in 2009,

largely due to a reduction of investment, and growth will resume towards the end of the year. The outcome, however, may also be much worse. Most current forecasts of Russian GDP reckon with negative growth for 2009 (-6.5% according to the IMF, -7.9% according to The World Bank), with stabilization or even some modest increase possible in 2010. The domestic financial market may stabilize and even recover fairly soon, yet the investment climate (including financing and the climate for investments in general) will remain difficult. Nominal exports and imports will contract substantially; the volume of exports and imports will also decline in 2009 – possibly even in 2010.

GDP growth slowdown appears inevitable also in the medium term, before any (uncertain) modernization and diversification efforts start to bear fruit. Our forecast for 2010 is based on a modest recovery of oil prices (Urals costing not more than USD 70 per barrel) and a limited lasting impact of the current financial market turmoil. Both private consumption and investment are expected to grow faster than GDP; real exports will continue to be sluggish at best since the volumes of exported oil and gas will hardly increase, while imports will grow at a faster rate – roughly in line with private consumption and investment. This implies an ongoing negative (albeit diminishing) contribution of real net exports to GDP and, in nominal terms, a gradual reduction of the trade and current account surpluses. In fact, the current account surplus, which leapt to EUR 70 billion in 2008 (about 6% of GDP), will diminish. Inflation will remain above 10% in 2009 and stubbornly close to 10% thereafter.

More than the direct effects of the global financial crisis, the oil price in particular constitutes a crucial variable for Russia in the short, medium and possibly even long term. The current global turmoil notwithstanding, the main challenge for the Russian economy is whether it will succeed in replacing energy exports as the key growth driver by developing other sectors (diversifying towards manufacturing, high-tech branches, services, etc.) and the manner in which it will cope with the acute demographic crisis. The major challenges for the Russian economy – institutional developments, economic diversification and modernization – thus remain unchanged. The accession to WTO was postponed again, this time after the agreement about forming a Customs Union with Belarus and Kazakhstan starting from January 2010 was finalized.

Apart from energy issues, it is probably the EU's (and NATO's) Eastern enlargement as well as the EU's Neighbourhood (Eastern) Policy (ENP) vis-à-vis the CIS countries (in particular Ukraine and Georgia) where Russian and EU interests are clashing. Russia is considering its 'near abroad' as its traditional sphere of influence and the ENP is perceived by Russia as an unwelcome foreign inroad. Also the Western support of the 'colour' revolutions in several CIS countries is perceived by Russia as a deliberate attempt at regime change, ultimately aiming at the reduction of Russian influence in the CIS. It remains to be seen how successful a 'reset' of Russian relations with the USA will be. For the time being, Russian external relations have been deteriorating across the board (even with Belarus there are disputes over trade and relations with the EU). In sum, neither the economic nor political prospects for Russia are currently encouraging.

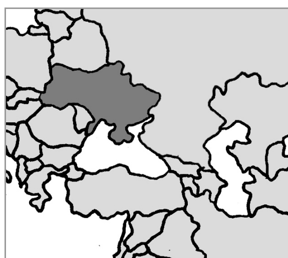
Table RU

Russia: Selected Economic Indicators

	2005	2006	2007	2008 [1]	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average [2]	143114	142487	142115	141956	141820	141900	140500	140000	139500
Gross domestic product, RUB bn, nom.	21625.4	26903.5	33111.4	41668.0	8891.0	8482.8	42000	46700	52000
annual change in % (real)	6.4	7.7	8.1	5.6	8.7	-9.8	-4.7	4.0	4.1
GDP/capita (EUR at exchange rate)	4300	5500	6700	8100	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	10000	11100	12400	13100	.	.	.	.	.
Consumption of households, RUB bn, nom.	10590.0	12887.9	15900.9	20054.2	4258.1	.	.	.	.
annual change in % (real)	11.8	11.4	13.7	11.3	12.2	.	-2.2	4	5.6
Gross fixed capital form., RUB bn, nom.	3836.9	4980.6	6982.5	9136.4	1433.9	.	.	.	.
annual change in % (real)	10.6	18.0	21.1	10.0	23.5	-15	-16	10	10
Gross industrial production									
annual change in % (real)	5.1	6.3	6.3	2.1	6.2	-14.3	-15	5	5
Gross agricultural production									
annual change in % (real)	2.3	3.6	3.4	10.8	2.1	5.5	.	.	.
Construction industry									
annual change in % (real)	10.5	18.1	18.2	12.8	29.0	-19.2	.	.	.
Employed persons - LFS, th, average	68169.0	68855.0	70570.5	70965.0	69491.0	67664.0	68000	68500	69000
annual change in %	1.3	1.0	2.5	0.6	0.4	-2.6	.	.	.
Unemployed persons - LFS, th, average	5262.8	5312.0	4589.0	4791.0	5308.0	7107.0	8000	7500	7000
Unemployment rate - LFS, in %, average	7.2	7.2	6.1	6.3	7.1	9.5	10.5	10	9
Reg. unemployment rate, in %, end of period	2.5	2.3	2.0	2.0	2.0	2.9	.	.	.
Average gross monthly wages, RUB	8554.9	10633.9	13593.4	17226.0	15424.0	17441.0	.	.	.
annual change in % (real, gross)	12.6	13.3	17.0	10.3	-2.3	13.4	.	.	.
Consumer prices, % p.a.	12.5	9.8	9.1	14.1	13.9	12.8	12	10	8
Producer prices in industry, % p.a. [3]	20.7	12.4	14.1	21.4	25.7	-8.3	-5	5	5
General governm.budget, nat.def., % GDP									
Revenues	39.7	39.5	40.4	38.4	37.5	35.8	.	.	.
Expenditures	31.5	31.1	34.4	33.6	26.3	33.1	.	.	.
Deficit (-) / surplus (+), % GDP	8.1	8.4	6.0	4.8	11.2	2.7	-5	.	.
Public debt, nat.def., in % of GDP [4]	14.9	8.6	7.2	5.7	5.4	.	.	.	.
Base rate of NB % p.a., end of per.	12	11	10	13	10.3	13.0	.	.	.
Current account, EUR mn [5]	67858	75474	56266	69824	25405	8486	30000	25000	25000
Current account in % of GDP	11.1	9.6	5.9	6.1	10.4	4.4	3.1	2.4	2.2
Exports of goods, BOP, EUR mn [5]	195545	241960	258930	321792	73626	44200	220000	240000	280000
annual growth rate in %	32.7	23.7	7.0	24.3	34.6	-40	-32	9	17
Imports of goods, BOP, EUR mn [5]	100608	130948	163282	199148	40257	29100	140000	160000	190000
annual growth rate in %	28.4	30.2	24.7	22.0	23.4	-28	-30	14	19
Exports of services, BOP, EUR mn [5]	20028	24791	28798	35008	6881	.	33000	35000	38000
annual growth rate in %	20.9	23.8	16.2	21.6	17.5	.	-6	6	9
Imports of services, BOP, EUR mn [5]	31077	35643	43151	52096	9953	.	50000	55000	60000
annual growth rate in %	16.1	14.7	21.1	20.7	20.0	.	-4	10	9
FDI inflow, EUR mn [5]	10336	23675	40237	47982	13730	.	25000	35000	45000
FDI outflow, EUR mn [5]	10240	18454	33547	35748	10575	.	30000	35000	40000
Gross reserves of NB, excl. gold, EUR mn	148094	224306	318840	292483	316495	278624	.	.	.
Gross external debt, EUR mn	216553	235714	317918	343637	303877	343223	.	.	.
Gross external debt in % of GDP	34.2	30.4	34.5	34.2	30.2	36.0	.	.	.
Average exchange rate RUB/EUR	35.26	34.11	35.01	36.43	36.29	44.46	44	45	46
Purchasing power parity RUB/EUR, wiiw [6]	15.06	17.01	18.84	22.38	.	.	.	.	.

1) Preliminary. - 2) Resident population, quarterly data: end of period. - 3) Based on domestic output prices. - 4) wiiw estimate. - 5) Converted from USD with the average exchange rate. - 6) wiiw estimates based on the 2005 International Comparison Project benchmark.

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



Vasily Astrov

Ukraine:
back to external equilibrium

Ukraine's economy has been hit hard by the falling world steel prices and the international credit crunch since September 2008. However, the latest data offer a mixed picture of the current situation. On the one hand, the developments in real GDP (-20.3% in the first quarter 2009 year-on-year), industrial production (-31.9% in January-May 2009), retail trade turnover (-15.3%), construction (-55.8%), fixed capital investments (-39.5% in the first quarter) and foreign trade (according to the customs statistics, in January-April 2009, merchandise exports and imports fell by 41.1% and 50.1% respectively, in US dollar terms) provide evidence of a near-collapse of the economy. The decline in industrial output has been broad-based, with machine-building falling by 53.6% in January-May, metals by 43.7% and chemicals by 35.8%, although the predominantly domestically-oriented food industry has performed much better (-7.3%). Also, unemployment has risen: in the first quarter 2009, the unemployment rate (according to LFS) stood at 9.5% – some 2 percentage points higher than in the first quarter 2008. Still, the surge in unemployment appears to be relatively small compared to what the dramatic contraction in output might suggest, which is partly due to the substantial wage flexibility (in January-May 2009, real wages fell by 10.4% year-on-year)[35] but also to the reluctance to undertake large-scale layoffs in big industrial enterprises, such as steel mills, forming the backbone of the local economy.

On the other hand, the combined effect of a pronounced devaluation (by about 50% against the US dollar since October 2008) and a deep domestic recession has made imports increasingly unaffordable[36] and thus has nearly restored the external equilibrium. According to preliminary estimates, in January-April 2009 the current account deficit stood at a mere USD 594 million (down from USD 5.6 billion in January-April 2008). The radical improvement in the current account and the National Bank's policy of targeted auctions (the sale of foreign exchange for special purposes such as foreign debt repayment, payment for import contracts, and the servicing of foreign-currency loans by private individuals) have brought about a turnaround to the depreciation expectations, reducing the incentives of households to withdraw bank deposits and convert them into foreign currency. In April-May 2009, the volume of private deposits rose by UAH 2.5 billion (after declining by some UAH 20 billion in the first three months of the year), and in May 2009 the National Bank abolished the

[35] Of course, the falling wages reduce domestic consumer demand and thus aggravate the recession.

[36] Imports have also been dampened by the Russian natural gas supply cuts in January 2009 in the wake of the Russian-Ukrainian gas price dispute, by Ukraine's strategy over the following months to minimize gas imports in anticipation of declining prices (in line with the new formula linking the gas price to that of oil), and by a temporary 13% extra import duty imposed at the end of 2008 (for a number of goods such as cars and refrigerators, the duty is still in place).

moratorium on premature deposits withdrawal. At the same time, the hryvnia strengthened somewhat in May 2009, stabilizing at around 7.6 UAH per USD.

Concerns over the prospects of a sovereign default have subsided, too, resulting in plummeting credit-default-swaps spreads (from exorbitant levels in excess of 50% to below 20%) and allowing the government to resume borrowing, at least in domestic capital markets. Also, after the initial devaluation-driven spike, consumer price inflation has calmed down (in the first five months of 2009, consumer prices rose by 7.4%), permitting the National Bank to marginally cut its discount rate to 11% p.a. in June. Last but not least, consumer confidence has been improving (although it remains to be seen to what extent this will actually translate into higher consumption propensity, particularly given the ongoing credit crunch in the retail segment – more on that, see below).

Given limited own fiscal resources and the blocked access to international capital markets, Ukraine – unlike e.g. advanced OECD countries or Russia – is hardly in a position to implement a fiscal stimulus programme to mitigate the impact of the crisis on the real economy. Until recently, its concerns have been largely on the external front, making it seek an IMF stand-by loan worth USD 16.4 billion (of which USD 4.5 billion were transferred in November 2008). Indeed, even with the sharply improved trade and current accounts, the overall balance of payments has been deeply in the red due to substantial net capital outflows (USD 5.7 billion in January-April 2009), resulting initially from household demand for foreign cash and more recently from a hike in external debt repayments. The fact that originally the IMF package was aimed exclusively at solving the balance of payments problems – rather than at easing the impact of the crisis on the real economy – was exemplified by the IMF conditionality of a deficit-free budget for 2009 (ultimately ignored by the Ukrainian government).

However, more recently, the marked improvement of the external position and the seemingly mounting problems on the fiscal side[37] have brought about an important shift in the IMF priorities. Thus, USD 1.5 billion of the USD 2.8 billion worth second IMF tranche released in May 2009 is to be used for covering the 2009 central budget deficit targeted at 4% of GDP. In reality, the deficit will probably turn out to be higher – even despite the fiscal consolidation measures approved in order to meet the IMF requirements.[38] So far, the government strategy in the fiscal area has been to focus on social expenditures – not least due to prime-minister Ms Tymoshenko running for presidency. Budget cuts fall mostly on investment programmes and partly explain the above-mentioned collapse in investment activity.

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[37] Although the Ministry of Finance reports on the favourable fiscal situation (e.g., in January-April 2009, the central budget revenue target was over-fulfilled by 3.9%), this appears to be due to a number of accounting tricks and continuous downward revisions of revenue targets. In any case, in the first quarter of 2009, revenues of the consolidated budget were down 11.5% year-on-year. It was particularly import duties which have recorded a strong decline in line with the plummeting imports, while excise taxes collection has actually gone up.

[38] These measures, summing up to nearly 1% of GDP, included *inter alia* raising the revenues of the Pension Fund and adopting a financial plan for the state-owned energy monopoly Naftogaz.

The 4% budget deficit target does not take into account the costs of the bank recapitalization programme (UAH 44 billion envisaged for 2009), which is also a key IMF requirement. The government has drafted a list of five big domestically-owned banks in need of recapitalization and has already taken decision on acquiring the majority stakes in three of them (Rodovid Bank, Ukrgazbank and Bank Kyiv) for a total of UAH 9.6 billion, to be financed by the National Bank.[39] At the same time, the foreign-owned banks (accounting for some 40% of the sector's assets) started receiving parent funding for the purpose of recapitalization. Despite that, credit activity remains virtually frozen: between January and April 2009, the volume of total credits declined by 2.6%, and of those denominated in foreign currency by 7.9%. Besides, there is evidence of a declining loan quality, which is hardly surprising against the background of the severe output slump and the pronounced currency devaluation given that more than half of all loans are denominated in foreign exchange (58.2% at the end of March 2009). According to the IMF methodology (taking into account sub-standard loans), the share of non-performing loans stood at 24% at the end of March 2009, up from 17.7% at the beginning of the year. In the retail lending segment, insolvencies and debt restructurings have already been widely reported, while large-scale defaults in the corporate sector are still likely to come.

Despite the 20% fall in real GDP in the first quarter 2009, we expect the GDP decline for the year as a whole to be somewhat smaller, albeit still double-digit. This is not least due to the fairly good grain harvest expectations and the very low statistical base in the fourth quarter of last year.[40] The good harvest should also help further disinflation (to around 16% on an annual average) and boost the current account which may well turn positive throughout the rest of this year (for 2009 as a whole, we expect the current account to be broadly balanced). In the medium term, the country's exporters (in the food and machinery sectors, for example) could take advantage of the new competitive exchange rate and thus become a locomotive for the modest economic recovery projected for next year. Any recovery in steel prices (as well as the prices of other commodities) would also be crucial for both the medium- and the long-term prospects. Helped by the growing export revenues, domestic demand may also pick up gradually, albeit not as rapidly as over the past few years, since access to credit will ease only gradually and unemployment will initially hardly recede, making upward wage pressures rather unlikely. (This export-led growth scenario hinges on the external environment not being too unfavourable – otherwise the economic recession will continue well into 2010 and possibly thereafter.)

Protracted efforts to create a coalition between the party of the current prime-minister Yuliya Tymoshenko (BYuT) and the pro-Russian opposition Party of Regions (led by Viktor Yanukovych) – which would have involved major constitutional amendments turning Ukraine into a parliamentary republic – have failed, opening the door to the next presidential elections probably taking place in January 2010. With the popular rating of incumbent president Yushchenko in the one-digit range, the two favourites to win the elections are currently Mr Yanukovych, followed by Ms Tymoshenko. Either

[39] Two other banks – Nadra and Ukrprombank – should follow suit once they reach agreements on the restructuring of their foreign debt.

[40] In the fourth quarter of 2008, real GDP contracted by 8% year-on-year.

way, the country's foreign policy orientation following the elections should become more multi-vectoral, although this may not necessarily have direct implications for the economy (the lower probability of further 'gas wars' with Russia being an important exception). In any case, more than half a year left until the elections is a long time span, particularly by Ukrainian standards.

Table UA

Ukraine: Selected Economic Indicators

	2005	2006	2007	2008 [1]	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average	47105	46788	46509	46258	46330	46112	46000	45800	45600
Gross domestic product, UAH mn, nom.	441452	544153	720731	949864	187717	.	980600	1114700	1281300
annual change in % (real)	2.7	7.3	7.9	2.1	6.3	-20.3	-11.0	1.5	4.5
GDP/capita (EUR at exchange rate)	1500	1800	2200	2700	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	4700	5200	5900	6400	.	.	.	.	.
Consumption of households, UAH mn, nom.	252624	319383	423174	576565	125825	.	.	.	.
annual change in % (real)	16.6	15.9	17.2	11.8	22.5	-11.6	-12.5	2	6
Gross fixed capital form., UAH mn, nom.	96965	133874	198348	258176	49604	.	.	.	.
annual change in % (real)	3.9	21.2	23.9	1.9	19.4	-48.7	-30	2.5	12
Gross industrial production									
annual change in % (real)	3.1	6.2	10.2	-3.1	7.8	-31.9	-18	3	7
Gross agricultural production									
annual change in % (real)	0.1	2.5	-6.5	17.5	0.2	1.7	.	.	.
Construction industry									
annual change in % (real)	-6.6	9.9	15.6	-16.0	1.7	-56.7	.	.	.
Employed persons - LFS, th, average	20680.0	20730.4	20904.7	20972.3	20715.2	20005.1	.	.	.
annual change in %	1.9	0.2	0.8	0.3	0.9	-3.4	.	.	.
Unemployed persons - LFS, th, average	1600.8	1515.0	1417.6	1425.1	1578.2	2096.9	.	.	.
Unemployment rate - LFS, in %, average	7.2	6.8	6.4	6.4	7.4	9.5	8.5	8	7.5
Reg. unemployment rate, in %, end of period	3.1	2.7	2.3	3.0	2.3	3.1	.	.	.
Average gross monthly wages, UAH [2]	806.2	1041.4	1351.0	1806.0	1619.0	1736.0	.	.	.
annual change in % (real, gross)	20.4	18.4	15.0	6.8	13.3	-12.3	.	.	.
Consumer prices, % p.a.	13.5	9.1	12.8	25.2	22.5	20.4	16	12	10
Producer prices in industry, % p.a. [3]	16.7	9.6	19.5	35.5	26.9	17.3	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	30.4	31.6	30.5	31.3	32.5	.	.	.	.
Expenditures [4]	32.2	32.3	31.6	32.8	29.5	.	.	.	.
Deficit (-) / surplus (+), % GDP	-1.8	-0.7	-1.1	-1.5	3.0	.	.	.	.
Public debt in % of GDP	17.7	14.8	12.5	19.9	9.4	19.1	.	.	.
Discount rate of NB, % p.a., end of period	9.5	8.5	8.0	12.0	10.0	12.0	.	.	.
Current account, EUR mn [5]	2030	-1289	-4320	-8838	-2472	-627	-800	500	1000
Current account in % of GDP	2.9	-1.5	-4.1	-7.2	-10.0	.	-0.8	0.4	0.7
Exports of goods, BOP, EUR mn [5]	28093	31048	36383	46274	9327	6494	35000	38500	42400
annual growth rate in %	4.4	10.5	17.2	27.2	12.7	-30.4	-24	10	10
Imports of goods, BOP, EUR mn [5]	29004	35188	44100	57846	12447	7367	39000	41300	45400
annual growth rate in %	21.4	21.3	25.3	31.2	29.6	-40.8	-33	6	10
Exports of services, BOP, EUR mn [5]	7503	9000	10337	12228	2384	2163	11600	11600	11600
annual growth rate in %	18.6	19.9	14.9	18.3	23.9	-9.3	-5	0	0
Imports of services, BOP, EUR mn [5]	6054	7305	8369	10579	2237	1959	9500	9500	9500
annual growth rate in %	13.6	20.7	14.6	26.4	21.2	-12.4	-10	0	0
FDI inflow, EUR mn [5]	6263	4467	7220	7457	1734	732	.	.	.
FDI outflow, EUR mn [5]	221	-106	491	690	111	12.2	.	.	.
Gross reserves of NB excl. gold, EUR mn	16058	16587	21634	21847	20535	18647	.	.	.
Gross external debt, EUR mn	33504	41391	54421	74287	55585	75160	.	.	.
Gross external debt in % of GDP	45.3	50.6	56.0	84.9	63.5	76.6	.	.	.
Average exchange rate UAH/USD	5.125	5.050	5.050	5.267	5.050	7.700	6.2	6.2	.
Average exchange rate UAH/EUR	6.389	6.335	6.918	7.708	7.559	10.065	10	9.5	9
Purchasing power parity UAH/EUR, wiiw [6]	1.986	2.229	2.639	3.211	.	.	.	.	.

1) Preliminary. - 2) Excluding small enterprises. - 3) Based on domestic output prices. - 4) Including lending minus repayments. - 5) Converted from USD with the average exchange rate. - 6) wiiw estimates based on the 2005 International Comparison Project benchmark.

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

Olga Pindyuk

Kazakhstan:
slipping into a mild recession

We revise downwards our forecast for Kazakhstan's economy as exports are hit more severely by a drop in external demand, and problems in the banking system turn out to be even more profound than previously expected. The GDP will decline in 2009, though only by a relatively modest 2%. Recovery will start already in 2010, when real GDP will bounce by 2%, in particular owing to the expected increase in world oil prices. In 2011, economic growth may speed up to 4.5%.

In the first quarter of 2009, by preliminary estimates the GDP contracted by 2.2% year-on-year, with a decline recorded in almost all sectors apart from agriculture and communications. The continuing fall in housing prices, and a virtual halt of issuing mortgage loans and loans to the construction sector caused a decline of construction output in the first quarter of 2009 by 4% y-o-y.

Export of goods fell by more than 40% y-o-y (in EUR terms) during the first quarter of 2009, by far outpacing imports' sliding dynamics. Thus the current account reached a deficit of EUR 0.8 billion – compared to the EUR 1.9 billion surplus in the first quarter of the previous year. Plunging external demand inevitably caused a drop in industrial production, which is mostly export-oriented – by 4.6% y-o-y in the first quarter of 2009. Only the oil extraction industry was able to increase its export volume sufficiently so as to partly compensate the global oil price decline. Manufacturing output decreased by 12% y-o-y, with the strongest declines in the chemical industry, machine-building and metallurgy – sectors oriented mostly on external demand.

We forecast that, in 2009, exports will fall at a much higher rate than imports, thus the current account will again run a deficit. Insufficient external demand will cause industrial production to decline by 4%. In 2010-2011, however, a revival of the global commodity markets will allow exports to speed up their growth significantly, thus industrial production will pick up, and the current account deficit will diminish noticeably. It will take more time for the construction sector to recover, since repercussions of the burst of the housing bubble are likely to influence the market in 2010 as well.

The government has been pumping resources into the country's banking sector. About USD 2.2 billion of additional capital has already been allotted to recapitalize the four biggest Kazakh banks, an additional USD 3.5 billion were directed to thirteen banks to encourage loan refinancing programmes.[41] However, so far the success of this policy has been limited. Banks' lending to the

[41] The total anti-crisis package envisages allocating about USD 14 billion (or about 10% of the GDP) over the period 2009-2010 to help the banking sector (recapitalize banks, provide liquidity support and promote residential mortgage lending) and to finance three sector-specific programmes: small and medium-sized enterprises, agriculture and infrastructure development.

economy has been decreasing – the amount of newly issued loans during the first four months of 2009 was 10% lower than during the same period of the previous year. The share of overdue loans in the total stock of loans more than doubled during this period – from 3.3% to 7.5% (as compared with January-April of 2008).

In February 2009, the state effectively nationalized the largest bank BTA, which allegedly faced the threat of bankruptcy, by acquiring 75% of its stakes for 0.2% of their book value. The fourth largest bank Alliance agreed to sell 76% of its shares to the state for a symbolic total amount of 100 tenge (USD 0.66), but the deal has not been completed yet. Now the government has been conducting talks on sales of BTA shares to the Russian Sberbank. This move appears to contradict the government's stated plan to take minority blocking stakes in troubled domestic banks and offer them back to the shareholders once the problems are solved. Many observers believe that political motivations play an important role in the bailouts, as some other banks suffering from liquidity problems are subject to different treatment.[42]

In April 2009, both BTA and Alliance defaulted on their external debt – creating a precedent in the region. The government announced that it would not take upon itself debts of these two banks and that it would propose several options of debt restructuring to investors. Fitch downgraded three other Kazakh banks out of the top five ones following the default by BTA and Alliance, reacting to the state's limited willingness to bail out the troubled banks with its own money and the worsening of assets quality, caused in particular by the devaluation of the tenge in February 2009.

The quality of banks' assets will continue deteriorating due to the economic downturn and the worsening of the financial position of borrowers, and access to external financing will not improve in the near future. Thus the state will further need to provide support to banks and facilitate access to sources of finance for the real sector of the economy. Fortunately, the high level of accumulated foreign currency reserves (about USD 42 billion – including assets of the National Oil Fund) will allow the government to continue interventions in case of necessity. Moreover, an additional safety cushion was created by borrowing USD 10 billion as an assistance package from China – in return for allowing the China National Petroleum Corporation to purchase a major stake in the MangistauMunaiGaz concern. Half of the loan is going to be devoted to bolstering the country's energy sector, while the other half will be given to the state-owned Development Bank of Kazakhstan.

In the medium run, a reform of the banking sector is needed – a strengthening of supervision and higher reliance of banks on domestic financing (deposits in national currency), rather than primarily on external borrowing.

In June 2009, Kazakhstan officially halted negotiations with the WTO due to the decision to create a customs union with Russia and Belarus and enter the WTO as a single block. Such a decision can be hardly called favourable for Kazakhstan, as accession to the WTO will now become much more

[42] See, for example, 'Kazakhstan: Politics and finance prompted BTA takeover', *Oxford Analytica*, 3 April 2009.

difficult technically and will definitely take much longer, thus postponing the potential benefits of the country's membership in this organization.

Falling prices of oil and virtually flat food prices helped to contain annual inflation in the one-digit range during the first five months of 2005. The February devaluation of the tenge does not seem to create major inflationary pressures. We forecast that inflation will remain within the one-digit range during the whole forecasting period and will gradually subside – reflecting the expected tightening of monetary policy as the economy will be getting over the crisis.

We do not expect the National Bank of Kazakhstan to move to a more flexible exchange rate regime during the period covered as maintaining confidence of households and firms will remain a priority until the problems in the financial sector are resolved. Rising FDI inflows and foreign currency revenues from oil exports in 2010-2011 will allow the government to keep the tenge within the ±3% range of the announced 150 tenge per US dollar.

Table KZ

Kazakhstan: Selected Economic Indicators

	2005	2006	2007	2008 [1)]	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, th pers., average	15147.1	15308.1	15490.7	15684.3	15600.5	15813.5	15820	15860	8010
Gross domestic product, KZT bn, nom.	7590.6	10213.7	12763.2	15936.5	3207.2	3045.9	16400	18400	20800
annual change in % (real)	9.7	10.7	8.7	3.3	6.1	-2.2	-2	2	4.5
GDP/capita (EUR at exchange rate)	3000	4200	4900	5700	.	.	5400	6400	6800
GDP/capita (EUR at PPP - wiiw)	7300	8200	9000	9200	.	.	.	.	.
Consumption of households, KZT bn, nom.	3686	4547	5468	6652	1467	.	7500	8400	9400
annual change in % (real)	10.9	12.7	11.0	3.7	10.2	.	3	4	5
Gross fixed capital form., KZT bn, nom.	2123	3084	3857	4353	646	.	4000	4500	5200
annual change in % (real)	28.1	29.7	17.3	1.7	10.9	.	2	3	7
Gross industrial production									
annual change in % (real)	4.8	7.0	4.5	2.1	3.7	-4.6	-4	5	7
Gross agricultural production									
annual change in % (real)	7.3	7.0	8.4	-5.6	3.7	3.6	4	6	6
Construction industry									
annual change in % (real)	47.4	28.6	5.7	1.8	8.5	-4.2	-5	5	7
Employed persons - LFS, th, average	7261.0	7403.5	7631.8	7857.2	7763.9	7830.4	.	.	.
annual change in %	1.1	2.0	3.1	3.0	3.6	0.9	.	.	.
Unemployed persons - LFS, th, average	640.7	625.4	578.8	557.8	573.8	583.1	.	.	.
Unemployment rate - LFS, in %, average	8.1	7.8	7.3	6.6	6.9	6.9	7.5	7	6.5
Reg. unemployment rate, in %, end of period	1.3	1.1	0.8	0.7	0.8	0.8	.	.	.
Average gross monthly wages, KZT	34060	40790	53238	60734	55422	62671	.	.	.
annual change in % (real, gross)	11.7	10.3	17.8	-2.5	-2.3	3.9	.	.	.
Consumer prices, % p.a.	7.6	8.6	10.8	17.1	13.4	8.7	9.5	8	7
Producer prices in industry, % p.a.	23.7	18.4	12.4	36.9	20.8	-28.7	-10	9	8
General governm.budget, nat.def., % GDP									
Revenues and grants	28.1	27.9	22.6	25.3	.	.	.	.	.
Expenditures and net lending	22.3	20.4	24.3	27.4	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	5.8	7.5	-1.7	-2.1	.	.	-3.5	-3.5	-3.0
Public debt in % of GDP	9.3	11.3	7.2	8.3	.	.	.	.	.
Base rate of NB % p.a., end of period	8.0	9.0	9.0	10.5	11.0	9.5	.	.	.
Current account, EUR mn [2)]	-848.1	-1525.3	-5355.2	4700	1900	-800	-3900	-2400	-1900
Current account in % of GDP	-1.8	-2.4	-7.0	5.2	10.7	-4.8	-4.6	-2.3	-1.7
Exports of goods, BOP, EUR mn [2)]	22733.5	30880.8	35308.6	52600	10640.0	6275.6	39500	46200	50800
annual growth rate in %	37.1	35.8	14.3	48.9	37.0	-41.0	-25	17	10
Imports of goods, BOP, EUR mn [2)]	14442.2	19216.1	24288.4	28100	4864.3	4724.1	26700	29400	32900
annual growth rate in %	29.9	33.1	26.4	15.6	-3.1	-2.9	-5	10	12
Exports of services, BOP, EUR mn [2)]	1790.1	2236.7	2596.0	3200	625.0	606.4	3200	3500	4000
annual growth rate in %	10.7	25.0	16.1	23.3	13.7	-3.0	-1	10	13
Imports of services, BOP, EUR mn [2)]	6021.2	6946.7	8490.5	8000	1550.3	1442.1	7400	7900	8700
annual growth rate in %	46.5	15.4	22.2	-5.4	-1.5	-7.0	-7	7	10
FDI inflow, EUR mn [2)]	1583.5	4958.2	7440.3	9882.3	1362.6	1950.8	.	.	.
FDI outflow, EUR mn [2)]	-117.2	-308.7	2368.6	2590.2	1134.9	227.6	.	.	.
Gross reserves of NB excl. gold, EUR mn	5965	14525	11970	13711	12434	14320	.	.	.
Gross external debt, EUR mn	36643	56252	65436	77738	64004	.	.	.	.
Gross external debt in % of GDP	79.9	87.2	86.0	86.4	68.6	.	.	.	.
Average exchange rate KZT/EUR	165.42	158.27	167.75	177.0	180.36	180.88	191.8	180.0	189.6
Purchasing power parity KZT/EUR, wiiw [3)]	68.78	81.45	91.40	110.33	.	.	.	.	.

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

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

Waltraut Urban

China:
economy showing signs of bottoming out

In the first quarter of 2009, the GDP expanded at a rate of 6.1%. Although this growth rate may look high by international standards, especially in the midst of the current global economic crisis, it represents a significant slowdown of the Chinese economy, which has started already in the last quarter of the previous year. Whereas GDP growth reached 9% for the full year 2008, it decelerated to 6.8% in the last quarter of the year. The deceleration of growth was triggered by a collapse of exports which led to a rapid slowdown of industrial production and, to a lesser extent, of services as well. To curb this development, the Chinese government has adopted a comprehensive set of stimulus measures to push up domestic consumption and investment.

Due to these stimulus measures taking effect, there are certain signs that the slowdown of the economy has already bottomed out at the end of the first quarter 2009 – but there are some negative developments as well. Under the assumption that the global economy is not deteriorating further and will probably pick up by the end of the year, we expect the Chinese economy to grow at a rate of 7% in 2009 and 8% in 2010. GDP growth in 2011 may exceed 8% but will remain below pre-crisis levels, since the capacity of China's major trading partners, in particular the USA, the EU and Japan, to absorb Chinese exports may still be lower than before the crisis, and China's attempts to switch from an export-oriented to a more domestically oriented development model will take some time.

Positive signs

The strongest positive signal comes from the development of fixed asset investment. Investment has increased by about 30% in the first quarter of this year, faster than in the same period last year. Monthly data for urban investment indicate that the positive trend has further accelerated in April and May, reaching year-on-year growth rates of 31% and 33% respectively.[43] The very high investment growth is pushed by public investment in infrastructure as part of a massive 'stimulus package' of the government (see Box 1) and related private investment. Investment in real estate, which typically takes about 25% of total investment and has suffered a strong deceleration in 2008, shows signs of recovery as well (see Figure 1).[44]

[43] As prices for fixed asset investment are stagnant or declining slightly, nominal and real growth rates are approximately the same.

[44] Also, property sales in major cities saw a strong rebound in April. Probably, expectations of falling house prices, which had held back demand in the last couple of months, have come to an end now.

Box 1

Stimulus measures

'Stimulus Package' (CNY 4000 billion, about EUR 400 billion* – of which the central government will contribute 30% and the local governments and other sources 70%). The amount will be spent during the years 2009 and 2010, on the following measures: accelerated reconstruction in Sichuan, which was hit by a devastating earthquake in May 2008 (25%); basic infrastructure such as roads, railways, water supply (37.5%); affordable housing (10%); improvement of villages (9.25%); public health and education (3.75%); restructuring of industry (14.5%). The latter measures are concentrated on 11 specified industries that are considered to be hit particularly hard by the crisis** and include, for instance, tax reductions and exemptions, deferring of social security contributions, tariff reductions on key inputs and interest subsidies. For each industry, a detailed stimulus plan will be released.

Consumer subsidies (CNY 400 million, about EUR 40 million). Subsidies are granted to farmers when buying household appliances such as TV sets, washing machines, microwaves, mobile telephones.

Stimulating car sales. The purchase tax on vehicles with engines of 1.6 litres or less, corresponding to 50% of the Chinese car market, has been halved. Subsidies (CNY 5 billion, about EUR 500 million) are granted to farmers who replace three-wheeled vehicles or outdated trucks with small, 1.3 litre or less engine vehicles. Farmers and rural residents who buy a new minivan or a light truck receive subsidies as well. There exist additional subsidies by local governments, e.g. in Chongqing, to buy locally produced hybrid cars.

New health programme (CNY 850 billion, about EUR 85 billion). This amount will be spent during the next three years to offer universal, accessible healthcare to Chinese citizens.

Stimulating measures for the construction sector. Down-payments for infrastructure construction projects and certain housing projects have been lowered.

Value-added tax reform. Due to this reform, CNY 120 billion (about EUR 12 billion) less taxes were paid by consumers in the first quarter of 2009.

Measures to support exporters. E.g. increased 'tax rebates', which allow enterprises to get back a higher share of money they have paid in value-added tax and cheap loans for SMEs to help them expand into international markets.

Consumer credits will be introduced for durable goods, travel and education.

* In the whole box the exchange rate applied is 10 CNY/EUR.

**) Steel, shipbuilding, textile, machinery, IT, light industry (food, home appliances, paper making), petrochemicals, non-ferrous metals, logistics and automobile industry.

In line with the surge in investment, the amount of new loans virtually exploded during the first quarter of 2009, reaching CNY 4.6 trillion (EUR 516 billion), more than in the whole year 2008, when certain credit restrictions to dampen excessive growth had been in place.

Private consumption, which showed a significant deceleration of growth at the beginning of the year, is picking up. The growth rate of retail trade turnover (in real terms), which may be used as a proxy for consumer demand, has accelerated significantly in the past few months (see Figure 2). Notably, the growth rate of retail trade in the first quarter of 2009 (15.8%) was higher than in the same period last year (13.2%). Similar to investment, various government measures such as consumer subsidies have supported this development (see Box 1).

On the supply side, the manufacturing industry, which has suffered the heaviest slump of all sectors in the economy, seems to have hit the bottom eventually. The growth rate of industrial value-added had reached only 5.3% in the first quarter of this year, compared to 11.3% in the same period of last year. But value-added of industrial enterprises above a designated size[45] has accelerated in recent months, although there is still some ambiguity (see Figure 2). The growth rate in April was again below that of March and the acceleration in May is somewhat biased because of the low base in May last year, due to the devastating Sichuan earthquake. Further on, power generation in China is still declining (-2.7% in May), which some experts take as a hint for over-reporting of manufacturing activities in the official statistics. But in support of a more positive view, the 'purchasing manager index of manufacturing' (PMI), a leading indicator for manufacturing production, has crossed the 50% line in March this year for the first time since June 2008 and has so far stayed above that mark, although a slight drop was observed in May.[46] A reading of above 50 suggests expansion, while one below 50 indicates contraction. The overall PMI includes a package of sub-indices, such as a 'new orders index' and a 'new export orders index' – with the latter still remaining below 50 (see Figure 3).

The significant rebound of stock prices in China is interpreted as an indicator for a turn to the better as well. After continuous decline since October 2007, the Shanghai composite index (SSE composite) has started to rise again in January this year and until the end of May it gained 45% (see Figure 4). However, China experts argue that because of government interference and specific regulations on the Chinese stock markets, stock prices in China do not have the same quality as 'leading indicators' as in other countries.[47]

Negative developments

Chinese exports and imports keep shrinking and falling prices point to existing overcapacities in the economy. Unemployment has increased and will have a negative impact on incomes and the expansion of domestic consumption in the future.

Exports in euro terms declined at a rate of 7.7% and imports declined by 20% year-on-year in the first quarter of 2009. The decline was even more dramatic in dollar terms, reaching -20% and -31% respectively, compared to an increase of 21% and 29% in the first quarter of last year (see Figure 5). The contraction continued at a similar pace in April and May. As imports fell faster than exports until May, the trade balance improved significantly and the current account balance is expected to remain positive for the rest of the year.

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[45] This includes all enterprises with annual sales revenue over 5 million yuan (560,000 euro).

[46] The PMI is surveyed jointly by the China Federation of Logistics and Purchasing (CFLP) and the National Bureau of Statistics and covers purchasing and supply managers of more than 700 manufacturers across China.

[47] However, various other 'leading indicators' show a rising tendency as well. For instance, the 'Composite Leading Indicator' (CLI) for China, published by the OECD, which is designed to point to developments about six months in advance, has been rising since February in a row and the 'macroeconomic climate leading index' calculated by the National Bureau of Statistics of China showed a turn-around at the beginning of the year, too.

Producer prices began to fall in December last year, consumer prices and retail prices followed two months later. In the first three months of 2009, consumer prices declined by 0.6% and producer prices fell by 4.6% compared to the same period a year earlier. But while consumer price deflation seems to have stabilized to some extent, producer prices are decelerating further (see Figure 6). However, the steep fall of producer prices is not only a sign of supply exceeding demand, but has to be seen in the light of the extremely high world market prices for many industrial inputs such as crude oil and metals in the first half of 2008.

Although no exact figures are available on unemployment in China, a government survey conducted in February this year showed that, out of the 70 million migrant workers who went home during the Spring Festival, only 56 million returned; of these, only 45 million found a job. In addition, there are about 8 million registered unemployed in the cities and about 7 million fresh university graduates looking for a job.

Given the fact that no stimulus for the Chinese economy can be expected from external demand in the near future, the further development of the economy will have to depend largely on domestic forces, supported by government measures, to fill the external demand gap. In this light, a U-shaped recovery, or perhaps an 'asymmetric V-shaped' recovery, with a much flatter ascending than descending slope looks most likely. In case of a prolonged global recession, however, a W-shaped development path showing another downturn after some time of recovery cannot be excluded.

Selected data on China, 2007-2009

Figure 1

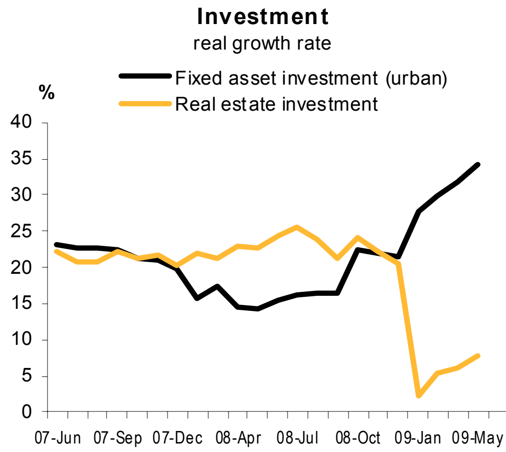


Figure 2

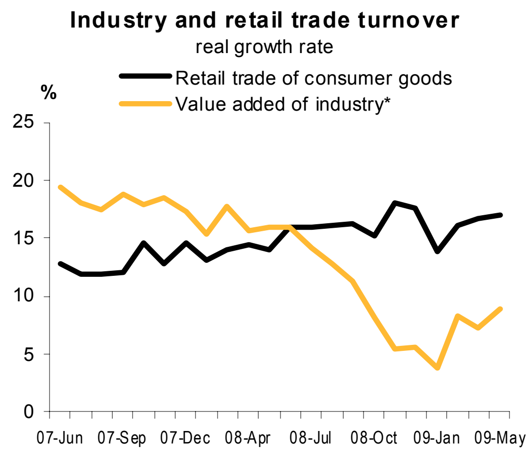


Figure 3

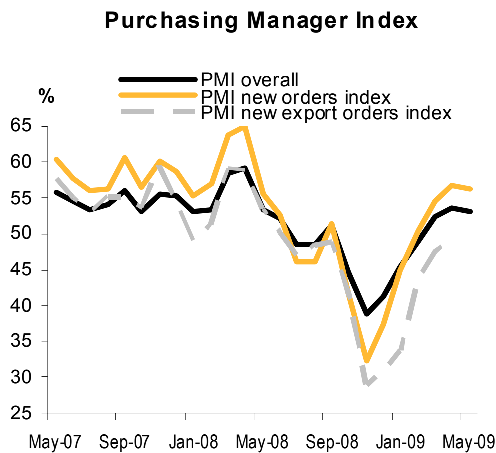


Figure 4

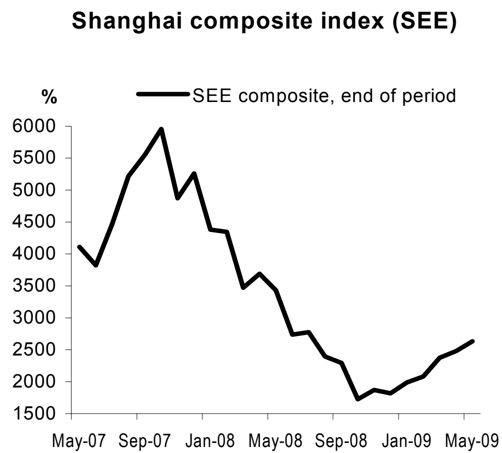


Figure 5

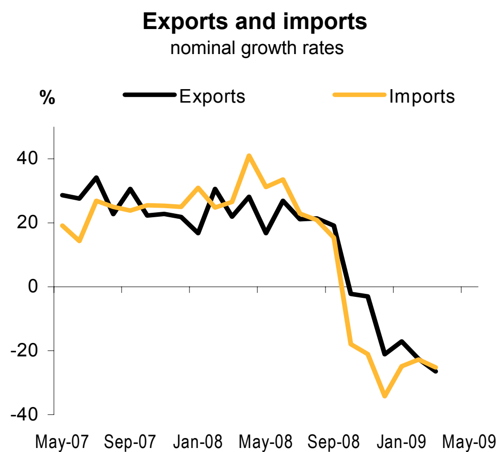
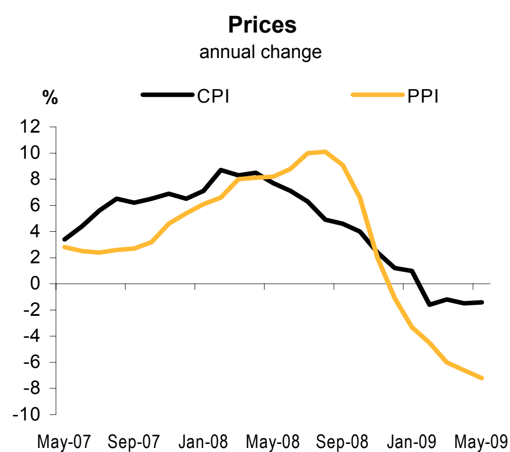


Figure 6



Note: * includes only enterprises enterprises with annual sales revenue of over CNY 5 million (EURO 560 000)

Source: National Bureau of Statistics, China Monthly Statistics, wiiw calculations

Table CN

China: Selected Economic Indicators

	2005	2006	2007	2008 [1)]	2008	2009	2009	2010	2011
					1st quarter			Forecast	
Population, mn pers., end of period	1307.6	1314.5	1321.3	1328	.	.	.	.	.
Gross domestic product, CNY bn, nom.	18321.7	21192.4	25700.0	30067.0	6347.5	6574.0	32300	35200	38800
annual change in % (real)	10.4	11.6	13.0	9.0	10.6	6.1	7	8	8.2
GDP/capita (EUR at exchange rate)	1400	1600	1900	2200	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	3400	3900	4500	4900	.	.	.	.	.
Retail trade turnover, CNY bn	6717.7	7641.0	8921.0	10848.8	2555.5	2939.8	.	.	.
annual change in % (real)	12.9	13.8	13.0	15.7	13.2	15.8	.	.	.
Total investment in fixed assets, CNY bn	8877.4	10999.8	13723.9	17229.1	2184.5	2812.9	.	.	.
annual change in % (nominal)	26.0	23.9	24.8	25.5	24.6	28.8	.	.	.
Industrial value added									
annual change in % (real)	11.6	12.9	13.5	9.3	11.5	5.3	.	.	.
Agricultural value added									
annual change in % (real)	5.2	5.0	3.7	5.5	2.8	3.5	.	.	.
Construction value added									
annual change in % (real)	12.6	13.7	12.6	.	.	.	.	.	.
Employment total -reg., mn, end of period	758.3	764.0	769.9	.	.	.	.	.	.
annual change in %	0.8	0.8	0.8	.	.	.	.	.	.
Staff and workers, mn, end of period [2)]	108.5	111.6	114.3	114.6	112.9	.	.	.	.
annual change in %	2.6	2.9	2.4	2.6	2.6	.	.	.	.
Reg. unemploym.rate (urban), in %, end of per. [3)]		4.1	4.0	4.2	.	.	4.6	4.3	4.2
Average gross annual wages, CNY [4)]	18364	21001	25932	26265	26254	.	.	.	.
annual change in % (real) [5)]	12.8	12.7	13.6	11.0	10.3	.	.	.	.
Consumer prices, % p.a.	1.8	1.5	4.8	5.9	8.0	-0.6	0.5	1	2
Producer prices in industry, % p.a.	4.9	3.0	3.1	6.9	7.4	-4.6	.	.	.
General government budget, nat.def., % GDP									
Revenues	17.3	18.3	20.0	20.4	.	.	20.6	.	.
Expenditures	18.5	19.1	19.4	20.7	.	.	23.5	.	.
Deficit (-) / surplus (+)	-1.2	-0.8	0.6	-0.3	.	.	-2.9	.	.
Base rate of NB % p.a., end of period [6)]	3.3	3.3	3.3	4.1	4.1	2.8	.	.	.
Current account, EUR bn	128.8	198.8	271.4	287.4	.	.	230	260	260
Current account in % of GDP	7.2	9.4	11.0	9.9	.	.	6.3	6.8	6.3
Exports of goods total, EUR bn [7)]	609.3	771.0	888.9	963.2	203.7	188.1	.	.	.
annual change in %	39.9	26.5	15.3	8.4	5.8	-7.7	.	.	.
Imports of goods total, EUR bn [7)]	527.8	629.7	697.8	764.5	175.8	140.3	.	.	.
annual change in %	28.1	19.3	10.8	9.6	12.0	-20.2	.	.	.
Trade balance of goods, EUR bn [7)]	81.6	141.2	191.1	198.7	27.9	47.8	.	.	.
Exports of services, BOP, EUR bn	59.5	73.2	89.2	99.2	.	.	.	.	.
annual growth rate in %	29.8	23.0	21.9	11.2	.	.	.	.	.
Imports of services, BOP, EUR bn	67.0	80.2	95.0	107.2	.	.	.	.	.
annual growth rate in %	26.6	19.7	18.4	12.9	.	.	.	.	.
FDI inflow, EUR bn [8)]	63.3	62.1	101.0	99.7	18.2	16.7	60	.	.
FDI outflow, EUR bn [8)]	9.0	16.8	12.4	36.1	.	.	44	.	.
Gross reserves of NB excl. gold, EUR bn	694.2	810.0	1038.2	1384.0	1065.0	1468.6	.	.	.
Gross external debt, EUR bn	238.2	245.4	253.8	266.5	.	.	.	.	.
Gross external debt in % of GDP	12.6	12.1	11.1	8.7	.	.	.	.	.
Average exchange rate CNY/USD	8.206	7.972	7.604	6.958	7.161	6.836	6.8	6.8	7.0
Average exchange rate CNY/EUR	10.261	10.019	10.418	10.315	10.754	8.923	9.0	9.0	9.5
Purchasing power parity CNY/USD, wiiw [9)]	3.45	3.465	3.621	3.803	.	.	.	.	.
Purchasing power parity CNY/EUR, wiiw [9)]	4.120	4.159	4.357	4.671	.	.	.	.	.

Note: CNY: ISO code for the Chinese yuan.

1) Preliminary. - 2) Staff and workers (on duty) refer to persons who work in state-owned enterprises, urban collectives, shareholding ownership and foreign invested enterprises. - 3) Ratio of registered urban unemployed in per cent of urban employed and unemployed. - 4) Average gross annual wages of staff and workers, defined as: total wages of staff and workers on duty per average number of staff and workers on duty. - 5) Staff and workers cost of living index is used as deflator for calculating real wage. For 2008 the consumer price index was used as a deflator. - 6) Overnight rate, 2008: September. - 7) According to customs statistics. - 8) Net investments drawn from the Chinese balance of payments. Quarterly data for 2008 and 2009 are gross equity investments in the non-financial sector as given by the Chinese Ministry of Commerce. - 9) wiiw estimates based on the 2005 International Comparison Project benchmark (Worldbank).

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

Vladimir Gligorov

The new IMF approach and the EU

Introduction

The IMF has concluded stand-by and other agreements (e.g. fast track credit) with a number of countries in transition – member states of the EU (Poland, Hungary, Latvia, Romania), future member states (Serbia, Bosnia and Herzegovina), and others. IMF has also introduced some changes in the way it approaches these agreements. In the case of member states and future member states, the European Union has joined the IMF with its own financial and other types of support. These developments have raised two questions: what is new in the IMF programmes and what is the EU contribution? This section discusses these two issues.

The model and the confusion

The standard IMF model was developed on the assumption that developing economies would experience secular growth with external imbalances that would be the consequence of too rapid credit expansion in the context of stable (fixed) exchange rates (Polak, 1997). Thus, a credit slowdown as a correction for external imbalances, and periodic devaluations if those proved unavoidable, was seen as the major policy instruments. Things look different if the global economy is declining, which is what is happening now. Currently, the main problem is declining availability of credit rather than its too rapid expansion. In these circumstances, the IMF has been tasked to increase lending in order to expand the availability of credit rather than to worry about setting a ceiling on credit expansion. The inherited IMF model, however, is probably not adequate in the case of decline in global demand or at least in the cases in which recession is taking place in countries with significant external imbalances. The latter are mostly the countries in Eastern Europe, quite prominently among them those that are future member states of the European Union, although most new member states from Central Europe and the Baltics are in a similar situation.

In some cases in the last few decades, the application of the usual IMF model has proved to be inadequate when the recovery was more successful than expected, usually following significant exchange rate devaluations. In those cases, credit ceilings proved to be inadequate because they turned out to be too restrictive. This is because sharp devaluations have led to fast and enduring corrections in the trade balance (through the expansion of exports) and thus to much faster accumulation of foreign currency reserves, which supported much faster relaxation of credit limitations and of monetary policy in general. In some other cases, the money demand equation has proved to be too unstable for the model to be useful. In the third type of countries, inflation was more of a problem, and the standard IMF model does not deal with that problem directly. Also, the fact that the IMF programmes for stability have not taken growth into consideration sufficiently has proved to be a limiting factor with respect to their usefulness in converging and emerging economies. On the other hand, the combined World Bank – IMF model for stability and growth is dependant on too

many parameters to be useful for policy purposes (see Blanchard 2008 on extensive macro models) and on demanding structural reforms which are often not implemented.

The problems that are being faced at the moment are different. The candidate and potential candidate countries (that is, future member states, FMS), and some new member states (NMS) are experiencing a sharp decline in the inflow of foreign finance and need to substitute it with the expansion of domestic credit. However, they are also running high current account deficits and were already facing significant external imbalances prior to the eruption of the current global financial and economic crisis. As a consequence, they are confronted with a policy dilemma, at least from the point of view of the standard IMF financial programming model.

On the one hand, external imbalances are suggesting that some tightening of domestic credit, e.g. through restrained expansion of public spending, would be desirable in order to maintain the necessary level of reserves, which may be depleting also because of the decline in foreign currency inflows or even due to net outflows due to rising risks to assets of the banks. On the other hand, recession and disinflation suggest that credit should be made available even to finance higher fiscal deficits in order to support activity. In this context, the IMF has approached the issues in various countries in a pragmatic and *ad hoc* manner. That has led to different approaches in different countries, although the circumstances do not necessarily warrant that.

In any case, for the moment, it can be argued that the IMF’s new approach is not based on a new model and in some cases reliance on the old model has proved to be part of the problem rather than part of the solution: arguably in the case of countries that choose to defend their fixed exchange rates, which may be better off with exchange rate adjustment. In these and some other cases, the IMF has continued to suggest fiscal and monetary restraint even though the exogenous influences have been recessionary (it seems that this practice is being gradually relaxed, though not in a systematic manner). Irrespective of how the causal arrow is turned (from the financial to the real sector or *vice versa*), exports are declining and capital inflows also. In the case of countries with access to credit, domestic or foreign, the IMF supports the governments in increasing public spending and domestic credit irrespective of their balance of payments position. In the case of countries that have difficulties with raising money in foreign financial markets, the IMF is ready to lend money in order to support their reserve position, but is reluctant or cautious when it comes to going along with fiscal stimuli and with the suggestions for the expansion of domestic credit.

In the new IMF approach, various things are different, but these changes are not necessarily essential. Some of them aim to improve the IMF’s reputation and make it easier for member states to seek its financial assistance. Some change the so-called ‘prior action’ criteria, which are now only monitored and not conditioned upon. As these do not constitute the core of the IMF programmes anyway, these changes are important, but not really essential. Still, it is important to note that the IMF is basically discontinuing making access to its funds conditional on structural indicators (except where it proves to be really necessary; it is not clear what the decision criterion is on that).

One change that can prove to be consequential is the introduction of sustainability as a criterion for external and fiscal imbalances. Another is the creation of a fast track financial credit line that can be used by countries with good macroeconomic and financial records. The latter one is only for countries with excellent track record and only Poland has been deemed eligible to access this type of credit. The third is the so-called Vienna Initiative that addresses the concerns of the banks operating in countries that are looking for IMF financial support.

Sustainability as a criterion of policy assessment (which comes in place of quantitative criteria) is important, but it has yet to be properly defined. For instance, current account sustainability is hard to define if exchange rates are flexible. In such a regime, it is not at all clear whether the IMF model makes sense, because the target variable is not easy to define: in principle, reserves should not be important in a country with a flexible exchange rate policy. If, however, a fixed exchange rate is used to stabilize inflationary expectations, such a policy may not be relevant in a deflationary environment, which is, in fact, characteristic of the current economic developments.

Sustainability of fiscal balances is somewhat easier to define. However, fiscal balances in a recession will almost always appear to be unsustainable because fiscal deficits will be high, interest rates will also be high too, and growth rates will be negative. If these values are projected into the future, the public debt to GDP ratio will grow without limit. Hence, some measure of potential growth is needed, but that may prove difficult to calculate for countries with relatively short records of stable growth.

In the case of most countries in transition, their fiscal balances looked quite comfortable until the current economic crisis. They were bound to deteriorate with the decline of growth and the increase of fiscal deficits. These deficits will have to be financed from domestic sources as well as from abroad and will contribute to the maintenance of the current account imbalances with the possible deterioration of the reserve positions. In those circumstances, the IMF has suggested fiscal restraint in accordance with its inherited operational model. This, however, looks like wrong advice from the point of view both of stability and of sustainability.

The reason is the following: if external demand is declining and the inflow of foreign capital is also lower, domestic credit expansion, exchange rate depreciation and high fiscal deficits are all sustainable because the main target variable should be growth rather than stability. The IMF has essentially adopted that approach for developed countries and the emerging markets, but not consistently for transition countries with relatively high external imbalances such as the Baltic Sates and the Balkan countries, i.e. some NMS and the FMS of the European Union. The traditional IMF model, if applied to these countries, will deepen their recession, which may prove destabilizing and may lead to unsustainable external and internal balances. That policy stance may also prove detrimental to medium-term recovery and long-term growth prospects. This is because private and public debt positions will deteriorate and may prove to be a constraint on recovery and growth. This is an especially risky strategy in the case of countries with fixed exchange rates that basically have to engineer a sharp deflation in order to adjust the real exchange rate.

Together with financial support in the form of stand-by agreements, the IMF has launched the Vienna Initiative to address the risk that the banks operating in countries in transition, most of which are in foreign ownership, might decide to pull out to cut their expected losses. The Vienna Initiative is a written commitment by these banks that they will continue to operate in these countries provided they commit to implementing the IMF stand-by programme. The commitment is not to pull out, it does not provide for credit expansion. This can be understood as a commitment by the banks to deleverage gradually in order not to contribute to macroeconomic destabilization. The implementation of the Vienna Initiative, however, cannot be insured by anything that the IMF can do, especially not beyond the short term.

That is why the IMF, even with the new more friendly face, cannot do what is necessary to support the recovery of transition economies and it needs the support of agents such as the EU and other international financial institutions.

The role of the EU

There was an assumption that the IMF would stay out of most economies in transition permanently and that the EU should take over some responsibilities for the stability and growth of the new and future member states of the EU. This assumption proved wrong in the current crisis. Indeed, the EU saw the need to call in the IMF again, not only in the case of FMS, but also in the case of NMS. Some of the countries in both groups proved to have problems with maintaining macroeconomic stability and needed outside support. The EU seemed not to have the knowledge, the credibility and the instruments to do it on its own. As a consequence, some of the financial support programmes within the EU have been led by the IMF and this is even truer for the FMS, where the IMF is practically the key outside stabilizer.

The problems that the EU faces as already mentioned are those of expertise, credibility and a lack of policy instruments. These will be briefly discussed in turn.

Though there are doubts about the validity of the IMF model in any of its variants, the EU lacks any model whatsoever. There is a good reason for this. The IMF model is adapted to its mission, which is to promote stability (and growth, but that is secondary) with a lending facility. The EU is supposed to provide stability and growth, but mostly in an indirect way. In the case of the euro area, there are monetary policy instruments, but there is no common fiscal agent, and banking supervision is federalized. There are even fewer possibilities to support stability in the countries outside of the euro area. Although the EU can borrow money on behalf of its member states that are outside of the euro area, it does not have an adequate way of stipulating conditions for the use of these loans (which is the reason that it is relying increasingly on the IMF). In the absence of a clear role of the EU in supporting the macroeconomic stability of its member states, there is no easy way to put together a model of financial or growth programming. In normal circumstances, the Growth and Stability Pact could be relied on, but the Pact is practically irrelevant in the case of recession, especially a severe one.

Credibility is an issue because of the lack of fiscal support and of a clear connection between financial support for macroeconomic stability and financial stability in general, i.e. in the banking sector. One role that the IMF performs is that it lends money that is not supposed to be used for fiscal purposes, but is ultimately supposed to be stabilizing the financial system and thus the banking system. In the current crisis, the IMF has coordinated the refinancing of the loans of foreign banks operating in countries that face risks of financial destabilization (the 'Vienna Initiative'). Though most of these banks are EU banks, the EU does not seem to have the needed credibility to stabilize their performance in FMS and even in NMS, let alone the countries further east. As a consequence, the EU borrows credibility from the IMF.

Finally, there is a lack of policy instruments. Again, the situation is different in the euro area than in compared to the non-euro NMS and in FMS. The IMF can influence the policy instrument, control of credit supply, because it acts as a surrogate central bank for countries that have problems with financial stability. The EU, however, lacks that instrument and generally lack instruments for short-term interventions. There is more scope for interventions that are geared towards supporting growth and medium-term developments in general. But even those are mostly indirect and not necessarily easy to implement.

These deficiencies explain the need to rely on the IMF programmes to coordinate the EU reaction to problems with stability and growth in the NMS and FMS, at least those that are outside the euro area. Still, given the high level of integration with the EU and the process of accession to the euro, as well as the process of stabilization and association that is bound to end with the joining of the EU, there are ample reasons to think about the ways in which the EU could monitor the development of these economies and in time develop the knowledge, the credibility and the policy instruments to support their stability and growth. This is also justified by the fact that since the IMF role is essentially that of a short-term stabilizer, growth and sustainability have to be taken up by others, and there is nobody else but the EU.

Conclusion

The IMF is transforming in order to be useful in a crisis of global demand. It is yet to develop the appropriate model, but it will need the support of other international financial institutions and of the EU, at least in the case of programmes for the countries in transition. The EU, however, has to develop its own model of behaviour in these circumstances and so far there is none in sight.

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Foreign trade as a transmission channel of the global crisis

Introduction

In this contribution we examine the foreign trade dimension of the current economic crisis in Central, Eastern and Southeastern Europe (CEE-SEE). Foreign trade is one of the important transmission channels through which the international business cycle impinges upon the economies of the CEE-SEE region. The slump in major export markets not only affects these economies directly through lower export earnings but makes it all the more difficult to re-equilibrate current account imbalances which – in the wake of the financial crisis – has to take place as net capital flows into the countries of the region are severely curtailed. Hence any indicators of a leveling off of falling export demand and any insights into different patterns in export earnings are important to understand how the crisis affects and will further affect the CEE-SEE economies.

In this section we shall look at five issues:

- Developments in total exports with an emphasis on whether the most recent figures suggest a bottoming out of export demand
- Differentiation between goods and services exports
- The dependence of different CEE-SEE economies upon commodities vs other categories of goods exports (more or less sophisticated exports, consumer vs. investment goods)
- Volume vs. value (or unit-price) developments in exports
- The impact of fixed vs. floating currency regimes upon trade performance of the CEE-SEE economies.

Relative openness and export developments

Figs. 1 show the monthly export developments of total goods exports in the CEE-SEE economies. We can see that all the economies in the region experienced a big slump in export earnings from September/October 2008 and in some economies – mostly commodity producers such as those heavily dependent upon metals exports such as the Ukraine and Serbia – the decline started already in the summer of 2008. Although the figures are not seasonally adjusted, it seems that since January 2009 a leveling off in the decline of export earnings has taken place and in some economies – such as the Central European economies but also Romania some recovery in exports (even seasonally adjusted) has set in.

What should be mentioned here as well is that the macroeconomic impact of export decline and export recovery depends very much upon the relative openness of the economy or the role of exports in overall demand. Figure 2 shows the differences of the economies in this respect and we can see that some of the Central European economies (Czech Republic, Hungary, Slovakia and

Slovenia) have an extremely high share of exports in GDP and hence export developments play a very important role in overall demand, while there are two types of other economies where this is much less the case: rather larger economies such as Poland, Romania, Turkey, Russia and the Ukraine on the one hand, and small economies such as Albania, Bosnia-Herzegovina, Serbia, Latvia where the export capacities in goods production are very small and which rely on a variety capital inflows to make up for this structural weakness of their economies. For other economies, such as Croatia, but also Bulgaria, Montenegro and some of the Baltic states, there is some compensation of low goods exports through services exports to which we now turn.

Goods vs. services exports

Services trade is an important part of exports in many countries of the region, with an average (non-weighted) share of services in total exports exceeding 20% (see Table 1). In Albania and Croatia services account for more than half of total exports. Countries with high tourism potential specialize on exports of travel services (Bulgaria, Bosnia & Herzegovina, and Croatia). Transportation services (which also include pipeline transportation) dominate export structures in Kazakhstan, Ukraine, and the Baltic states. Share of other services, the bulk of which are producer related ones, is relatively high only in four countries – Hungary, Romania, Slovenia, and Russia.

Table 1

Services exports in 2008

	Share of services exports in total exports, %	**Structure of services exports, %**		
		Transport	Travel	Other services
Bulgaria	26.0	28.9	**47.2**	23.9
Czech Republic	13.3	28.0	34.6	37.4
Estonia*	29.2	**40.9**	23.6	35.5
Hungary	15.9	19.7	30.0	**50.3**
Latvia	32.3	**50.4**	18.3	31.4
Lithuania*	17.0	**59.3**	27.6	13.2
Poland	16.7	30.6	33.2	36.2
Romania	20.7	30.6	15.5	**53.9**
Slovak Republic	10.8	34.3	30.5	35.1
Slovenia	20.5	27.7	23.6	**48.8**
Albania	64.8			
Bosnia & Herzegovina	24.2	19.9	**49.5**	30.7
Croatia	52.0	11.8	**74.3**	13.9
Kazakhstan	5.7	**51.1**	23.1	25.8
Russia	9.8	29.3	23.3	**47.4**
Ukraine	20.9	**42.6**	32.2	25.2

* Data on services export structure are for 2007.

Source: National Central Banks, wiiw calculations

Recent statistics on trade show that services have not reacted as strongly as goods to the slump of external demand. As Table 2 shows, in the last quarter of 2008 services trade still performed quite well in most of the countries studied – negative dynamics was recorded only in Croatia and Poland, while all the countries but four experienced merchandise exports decline. In the first quarter of 2009, falls in services exports occurred in all the countries where statistics are available apart from Latvia; however this decline was much more moderate than that of merchandise exports (with the exception of Lithuania). This shows that though the global crisis started as a financial one and caused an inevitable fall in financial services trade, the secondary repercussions of the global crisis for the merchandise trade turn out to have a stronger impact on CEE and SEE.

Table 2

Goods and services exports, change year-on-year, %

	2008Q4		**2009Q1**		**2009 forecast**	
	Goods export	Services export	Goods export	Services export	Goods export	Services export
Bulgaria	-10.0	2.3	-26.8	-5.5	-21.5	-20.0
Czech Republic	-13.7	6.4	-18.6	-8.2	-15.0	-6.0
Estonia	-3.1	10.0	-25.6	-10.1	-25.0	-11.0
Hungary	-10.2	4.4	…	…	-15	-5.0
Latvia	-15.2	4.8	-26.7	1.3	-27.0	0.0
Lithuania	3.0	4.2	-24.9	-32.3	-25.0	-30.0
Poland	-15.8	-4.9	-22.9	-13.8	-15.0	…
Romania	-2.4	32.9	-19.4	-4.7	-20.0	-5.0
Slovak Republic	-2.1	14.7	-21.5	-18.9	-15.0	2.0
Slovenia	-17.4	7.9	-32.4	-24.4	-15.0	-9.0
Albania	5.9	17.3	-14.7	-13.8	-20.0	-15.0
Bosnia & Herzegovina	2.4	2.5	…	…	-15	-11.0
Croatia	-14.1	-3.5	-13.0	…	-10.0	-5.0
Kazakhstan	8.0	12.0	-41.0	-3.0	-25.0	-1.0
Russia	-10.5	11.9	-45.4	-16.4	-32.0	-6.0
Ukraine	-1.2	4.0	-39.2	-18.3	-24.0	-5.0

Source: National Central Banks; forecast by wiiw

We expect that services trade will continue to be more resilient than merchandise one – in general, their decline in 2009 will be smaller than of goods exports. We see the following possible explanations of higher resilience of services trade to the current crisis as compared with merchandise trade:

– Demand for some services (such as auditing, consultancy, legal services, repair services, technical assistance to governments) also has some counter-cyclical components which may increase in times of crisis;

– Demand for certain services can be relatively inelastic – partly due to that demand being considered as ‘necessary’ (this would e.g. be the case with communications or pipeline transportation services) or due to the long-term nature of contracts;

- Production and trade of certain services are related to back-office activities (for example in the case of multinational corporations) and cannot be scaled back proportionately to the decline in production;
- Some countries in the region covered may become relatively more attractive as tourism destinations than more expensive alternatives.

Merchandise exports: volume and value changes and structure of commodity exports

In this section we would like to shed some light on developments of values and volumes of merchandise exports so as to distinguish the different impacts of the crisis through volume and price effects. We employ Eurostat data on countries' exports to the EU (for the CIS and Balkan countries we use the mirror statistics – i.e. Eurostat data on imports of the EU-27 from these countries). Volumes are measured in kilogrammes.

The countries we study can be broadly divided into 3 categories based on which goods dominate their export commodity structures: natural resources (Kazakhstan, Russia, Ukraine), low skill-intensive goods (Bulgaria, Latvia, Lithuania, Romania, Albania, Bosnia & Herzegovina, Croatia, Montenegro, Serbia), or relatively high skill-intensive goods (other NMS10 countries). For more details on the structure of merchandise trade of the countries see the Appendix Table A1 which shows the shares of the ten most important export commodities.

We examine indices of export values and volumes for selected product groups and countries (based on the relative importance of a product group for a given country). First, we show developments of commodities exports – oil (exported from Kazakhstan), gas (Russia), and iron and steel (Serbia and Ukraine). Second comes the group of labor intensive products – furniture (Lithuania), apparel and clothes (Bulgaria and Romania), footwear (Bosnia & Herzegovina and Romania). Finally, we look at relatively skill-intensive sectors of road vehicles and electrical machinery (Czech Republic and Slovenia). Since a 2-digit level of aggregation is too high to distinguish volume and price effects for so diverse product categories, we show the dynamics for the most important subcategories in these two groups at the 3-digit level (parts and accessories of motor vehicles and electrical apparatus for switching or protecting electrical circuits).

Finally, to see whether there are differences in unit value developments for countries with fixed and flexible exchange rates, we compare these indicators for Bulgaria and Romania (apparel and clothing), Bosnia & Herzegovina and Romania (footwear), and Czech Republic and Slovenia (various subcategories of machinery).

Let us now come to the observations we can arrive at from looking at volume, value and unit value developments of the different commodity export flows (see Figs. 3a-l).

The first observation we can make is that quite predictably – due to low demand elasticity – oil and gas exports (see Figs. 3a and b) are characterized by much lower volatility of export volumes, than

of export values. In other product groups (such as iron and steel, Fig. 3c), where quantity and price interact more strongly, export volumes fluctuate more, but export values still remain more volatile in the recent period as compared to volumes.

The severity of the current crisis can be illustrated by the fact that in most of the product groups presented in the figures the volume of exports reached a four years minimum at the end of 2008 – beginning of 2009. However, countries and sectors are not homogenous in their export dynamics – e.g. the decline has not been as profound in Lithuanian furniture exports (see Fig. 3d) as compared to other product groups; Bosnia & Herzegovina managed to avoid a big slump in its footwear export dynamics contrary to Romania (Fig. 3e); and the Czech Republic managed to keep the volume of electrical apparatus exports quite high regardless significant declines in export value – contrary to Slovenia, which suffered from noticeable export decline both in value and volume terms (Fig. 3f).

A general assessment of the dynamics of recent months allows us to conclude that trade in consumer goods turn out to be relatively more ‘crisis-proof’ than that in investment goods, as we can see some first signs of recovery in exports of the former. At the beginning of 2009, there have been quite significant month-on-month increases in export volumes of furniture, apparel and clothing (in Romania, while in Bulgaria the sector has not revived yet, Fig. 3g), footwear (especially in Romania), parts and accessories of motor vehicles (especially in Czech Republic; Fig. 3h). These changes of course contain seasonality effects, but we still consider them important due to the following considerations:

– Preservation of seasonality factors per se is a good sign since seasonality is found to be less pronounced in periods of low growth or recession[48]. Thus even a seasonal increase in exports means that the recessionary effect in this product group is less severe;
– In some sectors – footwear in Romania, parts and accessories of motor vehicles in the Czech Republic – even a year-on-year increase of export volumes was recorded in February.

Commodities and electrical apparatus exports on the contrary still continue to decline.

Trade performance and exchange rate regimes

The relatively better performance of the Czech Republic and of Romania as compared to Bosnia & Herzegovina, Bulgaria and Slovenia can be partially explained by differences in their exchange rate regimes. In general, unit values appear to move on a lower trajectory in countries with flexible exchange rates than in those with fixed exchange rates (or those in the Euro zone) in all the product groups except for the electrical apparatus sector (see Figs. 3i and 3j), but even in the latter, the growth of unit values of exports from the Czech Republic remained below those from Slovenia after November 2008, when the Czech koruna started to devalue[49]. Owing to devaluation, the Czech

[48] See, for example, D. R. Osborn and A. Matas-Mir, ‘The Extent of Seasonal/Business Cycle Interactions in European Industrial Production’, *Discussion Paper Series*, October 2003, available at http://www.socialsciences.manchester.ac.uk/cgbcr/dpcgbcr/dpcgbcr38.pdf.

[49] During November 2008 to February 2009, CZK/EUR depreciated by 16%, HUF/EUR by 17%.

Republic and Romania managed to boost their competitiveness. Though this is only a one-time effect and their currencies may not devalue further, this boost will contribute positively to cyclical recovery of their economies.

Conclusions

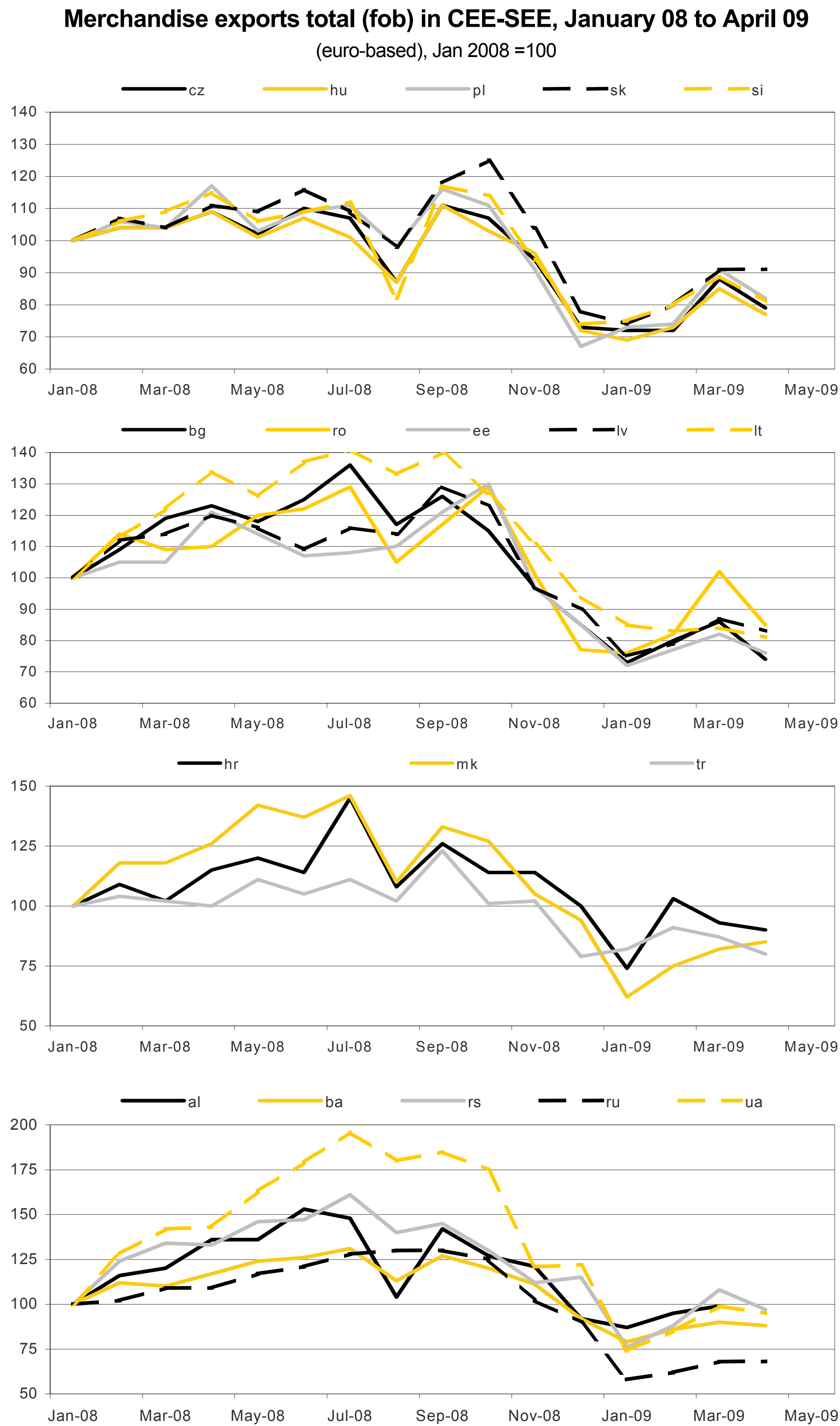
The following tentative conclusions can be drawn from the above analysis:

(i) Overall the decline of merchandise exports of CEE-SEE economies as a result of the global crisis has been dramatic bringing their levels in most cases down to a low point of the last 5 years. The macroeconomic impact of this decline is different across economies depending upon heir degree of openness, on the one hand, and their current account disequilibria, on the other hand.

(ii) There is a more moderate effect of the crisis upon services exports than upon commodity exports and, further, upon exports of consumption goods than those of investment goods (including household investments e.g. into transport equipment). This means that export commodity structure matters and countries which have been successful to specialize over the past decade in more sophisticated export products (such as engineering products and transport equipment) and have built up substantial export capacities in these – have been strongly affected by the global economic slowdown/recession. A recovery on the other hand, will benefit these economies more as investment demand will recover.

(iii) A differentiation of volume and value (and unit value) movements in important product categories has shown that, firstly, discrepancies between value and volume movements were particularly strong in raw materials or raw material based exports and, secondly, that countries with flexible exchange rates managed to keep their export unit values on lower trajectories than countries with fixed exchange rates. This implies that countries with flexible exchange rates will benefit from the devaluations which occurred in the course of the financial crisis and hence will emerge (as long as these real devaluations are not fully reversed) with more competitive trade positions than those with fixed exchange rates.

Figure 1

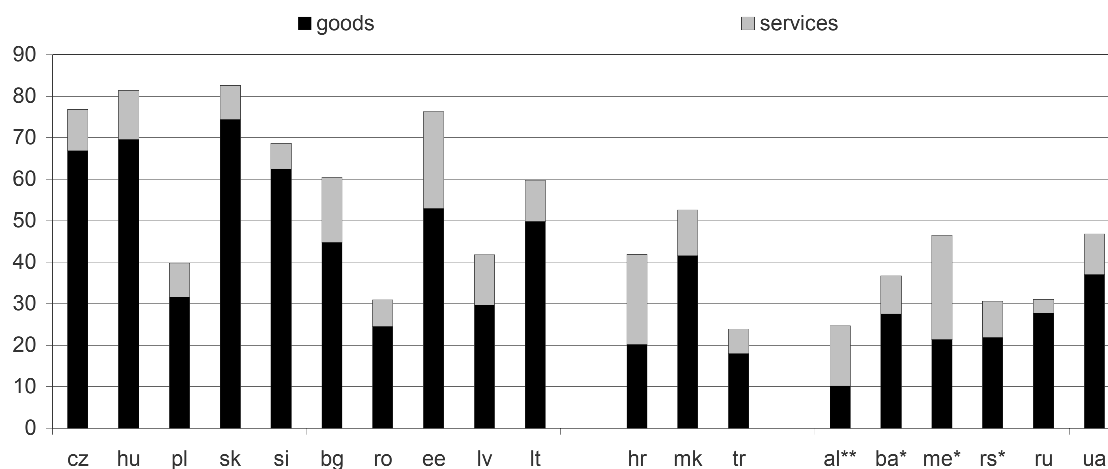


Source: wiiw Monthly Database incorporating national statistics.

Figure 2

Exports of goods and services in % of GDP, 2008

(based on customs statistics)



Note: * Data 2008 refer to 2007. ** Data 2008 refer to 2006.

Source: wiiw Annual Database incorporating Eurostat and national statistics.

Figure 3a

Petroleum and petroleum products (33 SITC group) exports of Kazakhstan to the EU, value and volume indices, Jan 2005 = 1

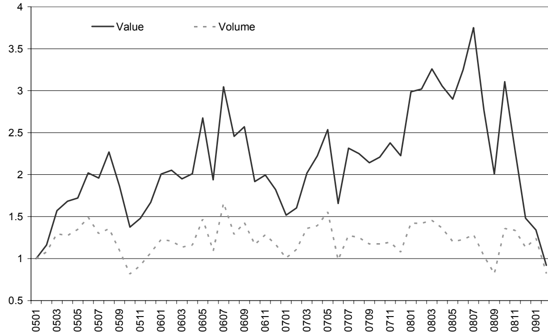


Figure 3b

Gas (34 SITC group) exports of Russia to the EU, value and volume indices, Jan 2005 = 1

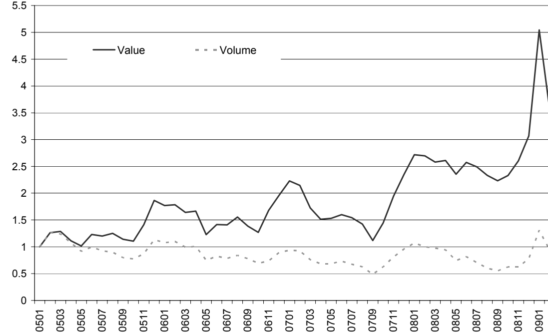


Figure 3c

Iron and steel (67 SITC group) exports of Serbia and Ukraine to the EU, value and volume indices, Jun 2005 = 1

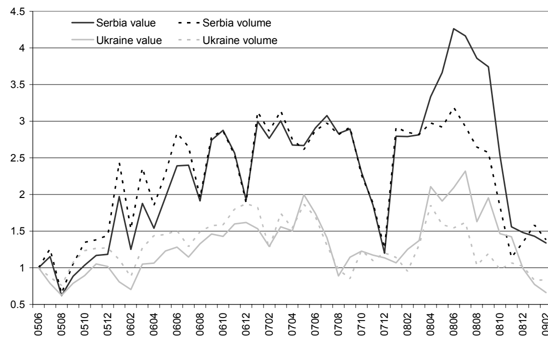


Figure 3d

Furniture and parts thereof (82 SITC group) exports of Lithuania to the EU, value and volume indices, Jan 2005 = 1

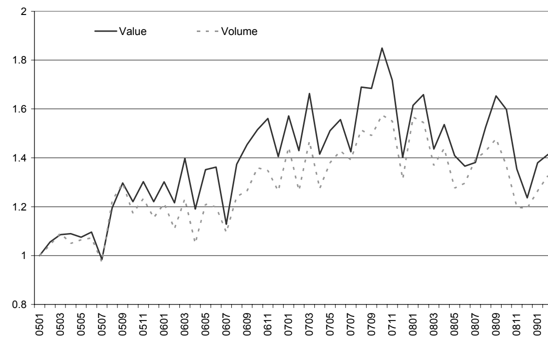


Figure 3e

Footwear (85 SITC group) exports of Bosnia & Herzegovina and Romania to the EU, value and volume indices, Jan 2005 = 1

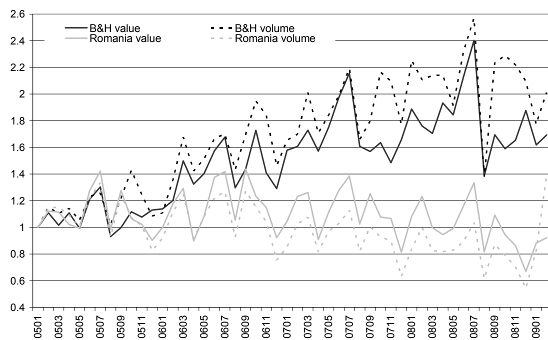


Figure 3f

Electrical apparatus for switching or protecting electrical circuits (772 SITC group) exports of the Czech Republic and Slovenia to the EU, value and volume indices, Jan 2005 = 1

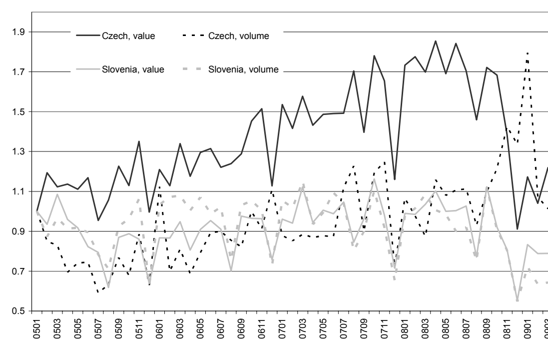


Figure 3g

Apparel and clothing (84 SITC group) exports of Bulgaria and Romania to the EU, value and volume indices, Jan 2005 = 1

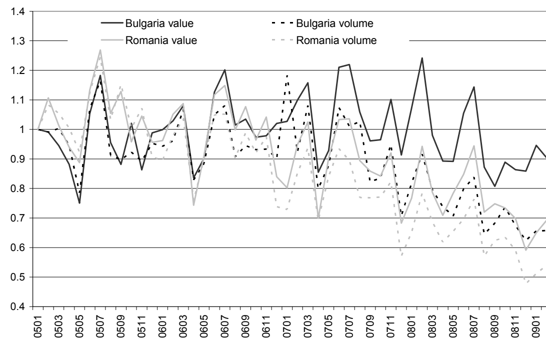


Figure 3h

Parts and accessories of motor vehicles (784 SITC group) exports of the Czech Republic and Slovenia to the EU, value and volume indices, Jan 2005 = 1

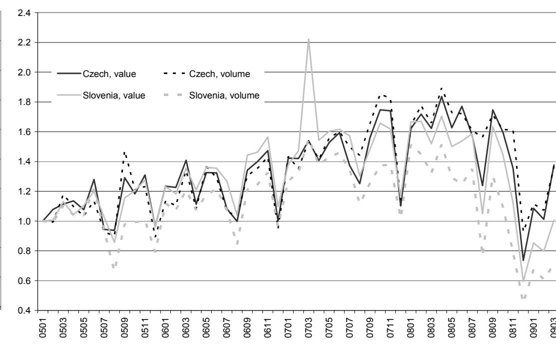


Figure 3i

Unit values of electrical apparatus for switching or protecting electrical circuits (772 SITC group) exported by Czech Republic and Slovenia to the EU, Jan 2005 = 1

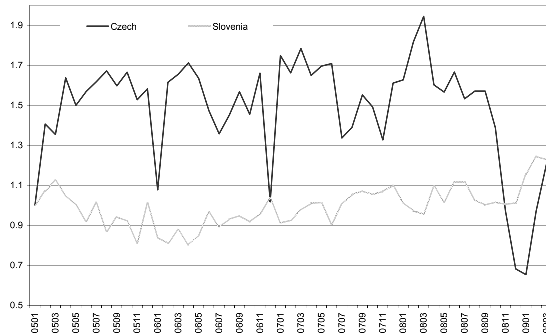
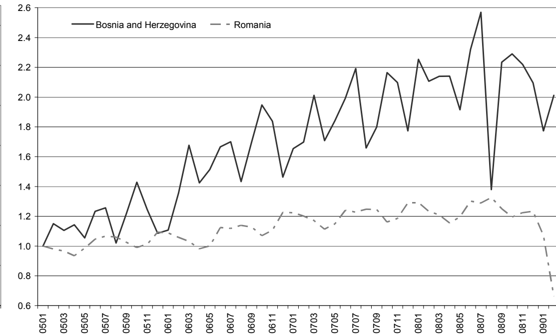


Figure 3j

Unit values of footwear (85 SITC group) exported by Bosnia & Herzegovina and Romania to the EU, Jan 2005 = 1



Source: Eurostat, COMEXT.

Appendix

Table A1

Ten most important product groups in merchandise exports to the EU-27 in 2008, SITC classification

Kazakhstan

Product label	Product code	Share in exports
Petroleum and petroleum products	33	84.6
Iron and steel	67	4.7
Non-ferrous metals	68	3.4
Gas	34	2.1
Metalliferous ores and metal scrap	28	1.4
Cereals	4	1.1
Inorganic chemicals	52	0.7
Crude ferilizers	27	0.3
Confidential trade	99	0.3
Coal, coke and briquettes	32	0.3

Russia

Product label	Product code	Share in exports
Petroleum and petroleum products	33	57.8
Gas	34	9.9
Iron and steel	67	5.9
Coal, coke and briquettes	32	4.9
Non-ferrous metals	68	4.8
Confidential trade	99	2.1
Metalliferous ores and metal scrap	28	2.0
Inorganic chemicals	52	2.0
Cork and wood	24	1.3
Fertilizers	56	1.3

Ukraine

Product label	Product code	Share in exports
Iron and steel	67	31.8
Metalliferous ores and metal scrap	28	8.0
Oil seeds	22	6.5
Cereals	4	5.9
Petroleum and petroleum products	33	5.3
Coal, coke and briquettes	32	3.8
Electrical machinery	77	3.6
Vegetable fats and oils	42	3.3
Apparel and clothing	84	2.8
Telecommunications apparatus	76	2.4

Albania

Product label	Product code	Share in exports
Apparel and clothing	84	28.0
Footwear	85	17.7
Petroleum and petroleum products	33	9.5
Metalliferous ores and metal scrap	28	7.1
Manufactures of metal	69	5.8
Iron and steel	67	4.7
Fish	3	2.5
Paper, paperboard	64	2.4
Power-generating machinery	71	2.3
Crude animal and vegetable materials	29	1.8

Bosnia & Herzegovina

Product label	Product code	Share in exports
Footwear	85	10.4
Furniture and parts thereof	82	10.3
Non-ferrous metals	68	9.4
General industrial machinery	74	7.4
Apparel and clothing	84	7.2
Manufactures of metal	69	6.8
Metalliferous ores and metal scrap	28	6.7
Cork and wood	24	4.8
Power-generating machinery	71	4.5
Iron and steel	67	4.3

Croatia

Product label	Product code	Share in exports
Electrical machinery	77	9.1
Apparel and clothing	84	7.7
Furniture and parts thereof	82	4.9
Other transport equipment	79	4.8
Manufactures of metal	69	4.6
Cork and wood	24	4.3
Specialized industrial machinery	72	4.2
Plastics in primary forms	57	3.7
General industrial machinery	74	3.5
Non-metallic mineral manufactures	66	3.4

(Table A1 ctd.)

(Table A1 ctd.)

Montenegro

Product label	Product code	Share in exports
Non-ferrous metals	68	68.6
Iron and steel	67	12.8
Metalliferous ores and metal scrap	28	3.8
Organic chemicals	51	2.3
Vegetables and fruit	5	1.5
General industrial machinery	74	1.5
Crude ferilizers	27	1.4
Specialized industrial machinery	72	1.1
Cork and wood	24	0.9
Apparel and clothing	84	0.7

Serbia

Product label	Product code	Share in exports
Iron and steel	67	19.0
Non-ferrous metals	68	8.9
Apparel and clothing	84	7.2
Vegetables and fruit	5	5.8
Organic chemicals	51	4.3
Power-generating machinery	71	4.1
Rubber manufactures	62	3.9
Electrical machinery	77	3.3
Footwear	85	3.2
Manufactures of metal	69	3.2

Bulgaria

Product label	Product code	Share in exports
Non-ferrous metals	68	15.3
Apparel and clothing	84	13.8
Electrical machinery	77	6.7
Iron and steel	67	6.5
Petroleum and petroleum products	33	4.5
General industrial machinery	74	3.1
Manufactures of metal	69	3.0
Cereals	4	2.9
Textile fabrics	65	2.9
Miscellaneous manufatured articles	89	2.5

Latvia

Product label	Product code	Share in exports
Cork and wood	24	12.3
Iron and steel	67	10.3
Cork and wood manufactures	63	7.0
Road vehicles	78	6.5
Telecommunications apparatus	76	3.7
Apparel and clothing	84	3.6
Manufactures of metal	69	3.5
Miscellaneous manufatured articles	89	3.0
Cereals	4	3.0
Metalliferous ores and metal scrap	28	2.8

Lithuania

Product label	Product code	Share in exports
Petroleum and petroleum products	33	26.4
Fertilizers	56	6.3
Furniture and parts thereof	82	4.9
Plastics in primary forms	57	4.3
Apparel and clothing	84	3.8
Miscellaneous manufatured articles	89	3.4
Road vehicles	78	3.4
Diary products	2	2.5
Electrical machinery	77	2.5
Manufactures of metal	69	2.3

Romania

Product label	Product code	Share in exports
Electrical machinery	77	14.0
Apparel and clothing	84	11.2
Road vehicles	78	8.2
Iron and steel	67	5.4
General industrial machinery	74	5.2
Footwear	85	4.9
Furniture and parts thereof	82	4.1
Petroleum and petroleum products	33	3.7
Manufactures of metal	69	3.4
Other transport equipment	79	3.4

(Table A1 ctd.)

(Table A1 ctd.)

Czech Republic

Product label	Product code	Share in exports
Road vehicles	78	15.9
Electrical machinery	77	9.2
Telecommunications apparatus	76	7.1
Office machines	75	7.0
General industrial machinery	74	6.4
Manufactures of metal	69	5.9
Miscellaneous manufatured articles	89	5.1
Iron and steel	67	4.8
Specialized industrial machinery	72	2.7
Power-generating machinery	71	2.7

Estonia

Product label	Product code	Share in exports
Electrical machinery	77	8.4
Road vehicles	78	6.6
Telecommunications apparatus	76	6.5
Manufactures of metal	69	5.6
Cork and wood	24	5.2
Furniture and parts thereof	82	4.9
Miscellaneous manufatured articles	89	4.9
Petroleum and petroleum products	33	4.6
Cork and wood manufactures	63	4.3
Iron and steel	67	3.6

Hungary

Product label	Product code	Share in exports
Telecommunications apparatus	76	13.8
Road vehicles	78	11.8
Electrical machinery	77	10.4
Power-generating machinery	71	9.4
Other transport equipment	79	4.4
General industrial machinery	74	4.2
Office machines	75	3.6
Professional, scientific instruments	87	2.8
Manufactures of metal	69	2.8
Medicinal and pharmaceutical products	54	2.2

Poland

Product label	Product code	Share in exports
Road vehicles	78	14.7
Electrical machinery	77	7.6
Telecommunications apparatus	76	6.3
Furniture and parts thereof	82	5.8
Manufactures of metal	69	5.4
Power-generating machinery	71	4.1
Iron and steel	67	4.1
Miscellaneous manufatured articles	89	3.6
General industrial machinery	74	3.3
Non-ferrous metals	68	3.0

Slovak Republic

Product label	Product code	Share in exports
Road vehicles	78	18.8
Telecommunications apparatus	76	16.6
Iron and steel	67	7.8
Electrical machinery	77	6.2
Petroleum and petroleum products	33	5.5
General industrial machinery	74	4.2
Manufactures of metal	69	3.9
Miscellaneous manufatured articles	89	2.6
Paper, paperboard	64	2.1
Rubber manufactures	62	2.0

Slovenia

Product label	Product code	Share in exports
Road vehicles	78	22.3
Electrical machinery	77	8.9
General industrial machinery	74	5.5
Iron and steel	67	5.3
Manufactures of metal	69	5.0
Furniture and parts thereof	82	4.9
Medicinal and pharmaceutical products	54	4.3
Non-ferrous metals	68	3.6
Specialized industrial machinery	72	3.0
Miscellaneous manufatured articles	89	2.9

Source: Eurostat, COMEXT

Appendix

Selected Indicators of Competitiveness

Table A/1

GDP per capita at current PPPs (EUR), from 2008 at constant PPPs

	1991	1995	2000	2005	2006	2007	2008	2009	2010	2011	2015 projection 1)
Bulgaria	4400	4700	5300	7700	8600	9300	9900	9600	9600	9900	11500
Cyprus	10700	13000	16900	20400	21300	22600	23200	23300	23500	24400	28600
Czech Republic	8800	10100	13000	17100	18300	19900	20400	20100	20300	20900	24400
Estonia	5500	5300	8500	13700	15400	16900	16300	13700	12300	12100	14100
Hungary	6800	7300	10700	14200	15000	15600	15700	14700	14500	14900	17400
Latvia	6500	4600	7000	10900	12400	14400	13800	11000	9700	9500	11100
Lithuania	7100	5000	7500	11900	13100	14800	15200	12900	11200	10900	12800
Malta	9500	12700	15900	17600	18100	19400	19900	19800	20200	21000	24500
Poland	4500	6100	9100	11500	12400	13400	14100	14200	14500	15100	17700
Romania	4000	4500	5000	7900	9100	10500	11300	10600	10600	10900	12800
Slovak Republic	5800	6900	9600	13500	15000	16700	17700	16800	16800	17000	19900
Slovenia	8500	9800	15200	19600	20700	22200	22800	21900	22100	22800	26600
NMS-12	5400	6300	8600	11700	12700	13900	14500	14300	14500	15000	17500
Croatia	7000	6700	9400	12700	13800	15200	15600	15000	15100	15400	18000
Macedonia	4300	4000	5100	6400	6900	7800	8200	8000	8000	8200	9600
Turkey	3700	4300	7600	9100	10100	10700	10700	10200	10300	10600	12400
Albania	1600	2200	3500	5000	5600	5900	6400	6300	6400	6700	7900
Bosnia & Herzeg.	.	.	3500	5100	5700	6300	6700	6500	6400	6500	7700
Montenegro	.	.	5600	6900	8300	10300	11100	10800	10700	10900	12800
Serbia	.	.	6100	7200	7800	8600	9100	8700	8700	8900	10500
Kazakhstan	.	3100	4200	7300	8200	9000	9300	9100	9300	9700	11300
Russia	7600	5300	6600	10000	11100	12400	13100	12500	13000	13500	15800
Ukraine	4600	2600	2800	4700	5200	5900	6000	5300	5400	5600	6400
China	750	1300	2100	3400	3900	4500	4900	5200	5600	6100	7200
Austria	18800	19700	25000	28100	29400	30800	31300	30900	31100	31700	34300
Germany	18100	18900	22600	26300	27400	28600	29000	28300	28500	29100	31500
Greece	12300	12300	16000	20900	22200	23600	24200	24200	24400	24900	26900
Portugal	10500	11000	14900	17300	18000	19000	19000	18700	18500	18900	20500
Spain	12800	13400	18500	22900	24600	26200	26200	25700	25600	26100	28200
USA	21500	23300	30300	35100	36700	38000	38100	37500	38100	38900	42100
EU(27) average	13700	14600	19000	22500	23600	24900	25100	24100	24100	24600	26600

European Union (27) average = 100

	1991	1995	2000	2005	2006	2007	2008	2009	2010	2011	2015 projection 1)
Bulgaria	32	32	28	34	36	37	39	38	38	39	42
Cyprus	78	89	89	91	90	91	92	93	94	96	104
Czech Republic	64	69	68	76	78	80	81	80	81	82	89
Estonia	40	36	45	61	65	68	65	55	49	47	51
Hungary	50	50	56	63	64	63	63	59	58	58	63
Latvia	47	32	37	48	53	58	55	44	39	37	40
Lithuania	52	34	39	53	56	59	61	52	45	43	47
Malta	69	87	84	78	77	78	79	79	81	82	89
Poland	33	42	48	51	53	54	56	57	58	59	64
Romania	29	31	26	35	39	42	45	42	42	43	47
Slovak Republic	42	45	51	60	64	67	71	67	67	67	72
Slovenia	62	68	80	87	88	89	91	88	88	89	97
NMS-12	39	43	45	52	54	56	58	57	58	59	64
Croatia	51	46	49	56	58	61	62	60	60	60	65
Macedonia	31	27	27	28	29	31	33	32	32	32	35
Turkey	27	29	40	40	43	43	43	41	41	42	45
Albania	12	15	18	22	24	24	25	25	26	26	29
Bosnia & Herzeg.	.	.	18	23	24	25	27	26	26	25	28
Montenegro	.	.	29	31	35	41	44	43	43	43	47
Serbia	.	.	32	32	33	35	36	35	35	35	38
Kazakhstan	.	21	22	32	35	36	37	36	37	38	41
Russia	55	36	35	44	47	50	52	50	52	53	57
Ukraine	34	18	15	21	22	24	24	21	22	22	23
China	5	9	11	15	17	18	20	21	22	24	26
Austria	137	135	132	125	125	124	125	124	124	124	125
Germany	132	129	119	117	116	115	116	113	114	114	115
Greece	90	84	84	93	94	95	96	97	98	98	98
Portugal	77	75	78	77	76	76	76	75	74	74	75
Spain	93	92	97	102	104	105	104	103	102	102	103
USA	157	160	159	156	156	153	152	150	152	153	153
EU(27) average	100	100	100	100	100	100	100	100	100	100	100

1) Projection assuming a 2 percentage point growth differential with respect to the EU from 2011.

Sources: National statistics, Eurostat, wiiw estimates.

Table A/2

Indicators of macro-competitiveness, 2001-2008

EUR based, annual averages

	2001	2002	2003	2004	2005	2006	2007	2008 prelim.
Czech Republic								
Producer price index, 2000=100	102.2	99.4	99.5	104.4	105.9	106.1	108.8	108.8
Consumer price index, 2000=100	104.5	106.1	106.0	108.6	110.4	112.7	116.0	123.3
GDP deflator, 2000=100	104.9	107.8	108.8	113.8	113.4	114.5	118.6	120.7
Exchange rate (ER), NC/EUR	34.07	30.80	31.85	31.89	29.78	28.34	27.77	24.95
ER nominal, 2000=100	95.7	86.5	89.5	89.6	83.7	79.6	78.0	70.1
Real ER (CPI-based), 2000=100	106.9	117.5	111.4	111.6	118.9	124.8	128.1	146.2
Real ER (PPI-based), 2000=100	105.6	114.3	109.9	112.6	117.0	117.4	120.0	125.2
PPP, NC/EUR	16.56	16.75	16.60	16.96	17.09	17.12	17.13	17.40
Price level, EU-27 = 100	49	54	52	53	57	60	62	70
Average monthly gross wages, NC	14793	15866	16917	18041	18992	20219	21694	23542
Average monthly gross wages, EUR (ER)	434	515	531	566	638	713	781	944
Average monthly gross wages, EUR (PPP)	893	947	1019	1064	1111	1181	1267	1353
GDP nominal, NC mn	2352214	2464432	2577110	2814762	2983862	3215642	3530249	3705868
Employed persons - LFS, th., average [1]	4750.2	4764.9	4733.2	4706.6	4764.0	4828.1	4922.0	5002.5
GDP per employed person, NC	495182	517205	544481	598046	626335	666026	717239	740803
GDP per empl. person, NC at 2000 pr.	472052	479782	500442	525523	552324	581682	604754	613756
Unit labour costs, NC, 2000=100	106.5	112.4	114.9	116.7	116.9	118.1	121.9	130.4
Unit labour costs, ER adj., 2000=100	111.3	129.9	128.4	130.2	139.7	148.4	156.3	186.0
Unit labour costs, PPP adj., Austria=100	33.6	38.5	37.3	38.6	40.7	42.2	43.7	50.6
Hungary								
Producer price index, 2000=100	105.1	103.2	105.7	109.4	114.5	122.0	124.4	131.3
Consumer price index, 2000=100	109.1	114.8	120.2	128.3	132.8	138.1	149.1	158.1
GDP deflator, 2000=100	108.3	116.7	123.5	129.1	132.1	137.3	145.4	150.3
Exchange rate (ER), NC/EUR	256.59	242.96	253.62	251.66	248.05	264.26	251.35	251.51
ER, nominal 2000=100	98.7	93.4	97.5	96.8	95.4	101.6	96.7	96.7
Real ER (CPI-based), 2000=100	108.2	117.8	115.8	122.0	125.4	119.8	132.8	135.8
Real ER (PPI-based), 2000=100	105.3	109.8	107.1	109.2	110.9	105.8	110.7	109.5
PPP, NC/EUR	128.83	134.39	142.58	149.88	153.53	157.23	162.20	167.92
Price level, EU-27 = 100	50	55	56	60	62	59	65	67
Average monthly gross wages, NC	103553	122482	137187	145520	158343	171351	185017	198942
Average monthly gross wages, EUR (ER)	404	504	541	578	638	648	736	791
Average monthly gross wages, EUR (PPP)	804	911	962	971	1031	1090	1141	1185
GDP nominal, NC bn	15238	17148	18915	20696	21993	23775	25479	26470
Employed persons - LFS, th., average	3868.3	3870.6	3921.9	3900.4	3901.5	3930.0	3926.2	3879.4
GDP per employed person, NC	3939293	4430437	4822903	5306003	5637084	6049687	6489584	6823220
GDP per empl. person, NC at 2000 pr.	3637390	3796433	3905185	4109994	4267285	4406181	4463263	4539734
Unit labour costs, NC, 2000=100	113.8	129.0	140.4	141.6	148.4	155.5	165.7	175.2
Unit labour costs, ER adj., 2000=100	115.3	138.1	144.0	146.3	155.5	153.0	171.5	181.1
Unit labour costs, PPP adj., Austria=100	30.7	36.1	36.9	38.3	40.0	38.4	42.3	43.5
Poland								
Producer price index, 2000=100	101.8	102.8	105.5	113.0	113.7	116.3	118.9	122.1
Consumer price index, 2000=100	105.3	107.3	108.1	112.0	114.4	115.9	118.9	123.9
GDP deflator, 2000=100	103.5	105.8	106.2	110.6	113.5	115.2	119.7	123.4
Exchange rate (ER), NC/EUR	3.672	3.857	4.400	4.527	4.023	3.896	3.784	3.512
ER, nominal, 2000=100	91.6	96.2	109.8	112.9	100.4	97.2	94.4	87.6
Real ER (CPI-based), 2000=100	112.4	106.9	92.6	91.3	102.7	105.1	108.5	117.5
Real ER (PPI-based), 2000=100	109.8	106.2	95.0	96.6	104.7	105.4	108.4	112.3
PPP, PLZ/EUR	2.166	2.140	2.178	2.209	2.232	2.248	2.306	2.370
Price level, EU-27 = 100	59	55	50	49	55	58	61	67
Average monthly gross wages, NC	2045	2098	2185	2273	2361	2477	2691	2960
Average monthly gross wages, EUR (ER)	557	544	497	502	587	636	711	843
Average monthly gross wages, EUR (PPP)	944	980	1003	1029	1058	1102	1167	1249
GDP nominal, NC mn	779564	808578	843156	924538	983302	1060031	1175266	1271715
Employed persons - LFS, th., average [2]	14207	13782	13617	13795	14116	14594	15241	15800
GDP per employed person, NC	54872	58669	61921	67021	69661	72637	77115	80490
GDP per empl. person, NC at 2000 pr.	53016	55453	58306	60597	61375	63053	64423	65227
Unit labour costs, NC, 2000=100	104.4	102.4	101.4	101.5	104.1	106.3	113.0	122.8
Unit labour costs, ER adj., 2000=100	113.9	106.4	92.4	89.9	103.7	109.4	119.7	140.1
Unit labour costs, PPP adj., Austria=100	49.7	45.5	38.8	38.5	43.7	44.9	48.4	55.1

1) From 2002 according to census 2001. - 2) From 2003 according to census 2002.

(Table A/2 ctd.)

(Table A/2 ctd.)

	2001	2002	2003	2004	2005	2006	2007	2008 prelim.
Slovak Republic								
Producer price index, 2000=100	106.5	108.7	117.8	120.9	127.4	134.6	133.0	136.8
Consumer price index, 2000=100	107.2	110.9	120.3	129.2	132.9	138.5	141.1	146.7
GDP deflator, 2000=100	105.0	109.1	114.9	121.6	124.5	128.2	129.6	133.4
Exchange rate (ER), NC/EUR	1.4373	1.4172	1.3772	1.3285	1.2813	1.2359	1.1211	1.0377
ER, nominal, 2000=100	101.6	100.2	97.4	93.9	90.6	87.4	79.3	73.4
Real ER (CPI-based), 2000=100	103.2	106.1	116.1	126.6	132.1	139.7	153.3	166.1
Real ER (PPI-based), 2000=100	103.6	107.9	119.5	124.3	129.9	135.8	144.3	150.2
PPP NC/ EUR	0.6074	0.6174	0.6565	0.6795	0.6757	0.6806	0.6830	0.7021
Price level, EU-27 = 100	42	44	48	51	53	55	61	68
Average monthly gross wages, NC	410	448	477	525	573	623	669	723
Average monthly gross wages, EUR (ER)	286	316	346	395	448	504	596	697
Average monthly gross wages, EUR (PPP)	676	726	726	773	849	915	979	1,030
GDP nominal, NC mn	33836	36818	40607	45212	49315	55082	61501	67331
Employed persons - LFS, th., average	2123.7	2127.0	2164.6	2170.4	2215.2	2302.3	2357.7	2433.7
GDP per employed person, NC	15933	17310	18760	20831	22262	23925	26085	27666
GDP per empl. person, NC at 2000 pr.	15174	15866	16327	17131	17881	18662	20127	20739
Unit labour costs, NC, 2000=100	105.7	110.5	114.1	119.8	125.3	130.4	129.8	136.2
Unit labour costs, ER adj., 2000=100	104.0	110.2	117.2	127.6	138.3	149.2	163.8	185.6
Unit labour costs, PPP adj., Austria=100	25.4	26.4	27.6	30.6	32.6	34.4	37.1	40.9
Slovenia								
Producer price index, 2000=100	107.2	111.2	112.6	115.5	117.7	120.4	125.3	130.2
Consumer price index, 2000=100	108.6	116.7	123.3	127.8	131.0	134.3	139.3	147.0
GDP deflator, 2000=100	108.7	117.0	123.6	127.7	129.8	132.4	137.9	143.4
Exchange rate (ER), NC/EUR	0.9063	0.9440	0.9752	0.9968	1.0000	0.9998	1.0000	1.0000
ER, nominal, 2000=100	105.9	110.3	114.0	116.5	116.9	116.9	116.9	116.9
Real ER (CPI-based), 2000=100	100.3	101.4	101.7	101.0	101.0	101.3	102.7	104.5
Real ER (PPI-based), 2000=100	100.0	100.2	97.6	95.8	93.0	90.8	92.2	89.8
PPP, NC/EUR	0.6580	0.6884	0.7275	0.7248	0.7302	0.7455	0.7683	0.7983
Price level, EU-27 = 100	73	73	75	73	73	75	77	80
Average monthly gross wages, NC	895	982	1057	1117	1157	1213	1285	1391
Average monthly gross wages, EUR (ER)	988	1041	1083	1120	1157	1213	1285	1391
Average monthly gross wages, EUR (PPP)	1361	1427	1452	1541	1585	1627	1672	1743
GDP nominal, NC mn	20654	23129	25114	27073	28704	31008	34471	37126
Employed persons - LFS, th., average	916	910	897	943	949	961	985	996
GDP per employed person, NC	22548	25416	27998	28710	30240	32260	34989	37271
GDP per empl. person, NC at 2000 pr.	20744	21723	22652	22482	23297	24365	25373	25991
Unit labour costs, NC, 2000=100	110.7	116.0	119.6	127.4	127.4	127.6	129.9	137.3
Unit labour costs, ER adj., 2000=100	104.5	105.1	104.9	109.3	109.0	109.2	111.1	117.5
Unit labour costs, PPP adj., Austria=100	65.0	64.2	62.9	66.8	65.5	64.1	64.1	65.9
Bulgaria								
Producer price index, 2000=100	103.8	105.0	110.1	116.7	125.9	141.2	153.0	169.2
Consumer price index, 2000=100	107.4	113.6	116.3	123.4	130.9	140.6	151.2	169.3
GDP deflator, 2000=100	106.7	111.4	113.3	119.2	123.6	134.1	144.7	161.1
Exchange rate (ER), NC/EUR	1.9482	1.9492	1.9490	1.9533	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2000=100	99.8	99.8	99.8	100.1	100.2	100.2	100.2	100.2
Real ER (CPI-based), 2000=100	105.3	109.1	109.5	113.5	117.7	123.7	130.0	140.4
Real ER (PPI-based), 2000=100	102.8	104.5	109.0	112.7	116.2	124.2	131.4	136.2
PPP, NC/EUR	0.6506	0.6510	0.6594	0.6847	0.7152	0.7429	0.7913	0.8802
Price level, EU-27 = 100	33	33	34	35	37	38	40	45
Average monthly gross wages, NC	240	258	273	292	324	360	431	525
Average monthly gross wages, EUR (ER)	123	132	140	150	166	184	220	268
Average monthly gross wages, EUR (PPP)	369	396	414	427	453	485	545	596
GDP nominal, NC mn	29709	32402	34628	38823	42797	49361	56520	66728
Employed persons - LFS, th.,average	2698.8	2739.6	2834.8	2922.5	2981.9	3110.0	3252.6	3360.7
GDP per employed person, NC	11008	11827	12215	13284	14352	15872	17377	19855
GDP per empl. person, NC at 2000 pr.	10317	10617	10781	11144	11612	11836	12009	12325
Unit labour costs, NC, 2000=100	99.2	103.5	108.1	111.9	118.9	129.8	153.1	181.5
Unit labour costs, ER adj., 2000=100	99.4	103.6	108.3	111.8	118.6	129.6	152.8	181.1
Unit labour costs, PPP adj., Austria=100	16.5	16.9	17.3	18.2	19.1	20.3	23.5	27.1

(Table A/2 ctd.)

(Table A/2 ctd.)

	2001	2002	2003	2004	2005	2006	2007	2008 prelim.
Romania								
Producer price index, 2000=100	138.1	169.9	203.0	241.8	267.2	298.1	322.2	373.1
Consumer price index, 2000=100	134.5	164.8	189.9	212.5	231.7	247.0	259.2	279.7
GDP deflator, 2000=100	137.8	169.0	208.6	240.9	270.2	298.8	336.8	384.0
Exchange rate (ER), NC/EUR	2.6004	3.1270	3.7551	4.0510	3.6209	3.5258	3.3328	3.6776
ER, nominal, 2000=100	130.5	157.0	188.5	203.3	181.8	177.0	167.3	184.6
Real ER (CPI-based), 2000=100	100.8	100.6	94.7	96.2	114.9	123.1	133.4	125.9
Real ER (PPI-based), 2000=100	104.6	107.6	106.4	114.9	135.8	148.5	165.7	162.9
PPP, NC/EUR	0.9570	1.1589	1.3996	1.5442	1.6990	1.7618	1.8273	2.0813
Price level, EU-27 = 100	37	37	37	38	47	50	55	57
Average monthly grross wages, NC	422	532	664	818	968	1146	1396	1742
Average monthly gross wages, EUR (ER)	162	170	177	202	267	325	419	474
Average monthly gross wages, EUR (PPP)	441	459	474	530	570	650	764	837
GDP nominal, NC mn	117946	152017	197428	247368	288955	344651	412762	503959
Employed persons - LFS, th., average [3]	10440.0	9234.2	9222.5	9157.6	9114.6	9291.2	9353.3	9369.1
GDP per employed person, NC	11297	16462	21407	27012	31702	37094	44130	53789
GDP per empl. person, NC at 2000 pr.	8198	9741	10262	11213	11733	12414	13103	14008
Unit labour costs, NC, 2000=100	139.7	148.2	175.5	198.0	223.9	250.5	289.1	337.5
Unit labour costs, ER adj., 2000=100	107.0	94.4	93.1	97.4	123.2	141.5	172.8	182.8
Unit labour costs, PPP adj., Austria=100	32.2	27.9	26.9	28.7	35.8	40.1	48.1	49.5
Estonia								
Producer price index, 2000=100	104.4	104.8	105.1	108.1	110.4	115.3	124.8	133.8
Consumer price index, 2000=100	105.6	109.4	110.9	114.3	119.0	124.3	132.7	146.7
GDP deflator, 2000=100	105.3	109.5	114.5	118.3	124.5	133.3	146.1	157.4
Exchange rate (ER), NC/EUR	15.647	15.647	15.647	15.647	15.647	15.647	15.647	15.647
ER, nominal, 2000=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2000=100	103.4	104.9	104.3	105.2	107.2	109.6	114.3	121.9
Real ER (PPI-based), 2000=100	103.2	104.2	103.8	104.4	102.0	101.6	107.4	107.8
PPP, NC/EUR	8.686	8.738	8.898	9.022	9.377	9.883	10.525	11.331
Price level, EU-27 = 100	56	56	57	58	60	63	67	72
Average monthly gross wages, NC	5510	6144	6723	7287	8073	9407	11336	12818
Average monthly gross wages, EUR (ER)	352	393	430	466	516	601	725	819
Average monthly gross wages, EUR (PPP)	634	703	756	808	861	952	1077	1131
GDP nominal, NC mn	108218	121372	136010	151012	173530	205038	238929	248149
Employed persons - LFS, th., average	577.7	585.5	594.3	595.5	607.4	646.3	655.3	656.5
GDP per employed person, NC	187326	207297	228858	253589	285693	317249	364610	377988
GDP per empl. person, NC at 2000 pr.	177898	189312	199876	214361	229473	237996	249562	240145
Unit labour costs, NC, 2000=100	105.3	110.3	114.3	115.6	119.6	134.4	154.4	181.4
Unit labour costs, ER adj., 2000=100	105.3	110.3	114.3	115.6	119.6	134.4	154.4	181.4
Unit labour costs, PPP adj., Austria=100	36.2	37.3	37.8	39.0	39.7	43.5	49.2	56.3
Latvia								
Producer price index, 2000=100	101.7	102.7	105.9	115.0	124.0	136.8	158.8	177.2
Consumer price index, 2000=100	102.5	104.5	107.6	114.3	122.1	130.2	143.3	165.2
GDP deflator, 2000=100	101.7	105.4	109.1	116.8	128.6	141.4	170.0	195.9
Exchange rate (ER), NC/EUR	0.5601	0.5810	0.6407	0.6652	0.6962	0.6962	0.7001	0.7027
ER, nominal, 2000=100	100.2	103.9	114.6	119.0	124.5	124.5	125.2	125.7
Real ER (CPI-based), 2000=100	100.2	96.4	88.3	88.4	88.4	92.2	98.6	109.2
Real ER (PPI-based), 2000=100	100.4	98.2	91.3	93.4	92.0	96.8	109.1	113.6
PPP, NC/EUR	0.2894	0.2919	0.3062	0.3251	0.3605	0.3932	0.4506	0.5184
Price level, EU-27 = 100	52	50	48	49	52	56	64	74
Average monthly gross wages, NC	159	173	192	211	246	302	398	479
Average monthly gross wages, EUR (ER)	284	298	300	317	353	434	568	682
Average monthly gross wages, EUR (PPP)	549	593	629	649	682	769	882	924
GDP nominal, NC mn	5219.9	5758.3	6392.8	7434.5	9059.1	11171.7	14779.8	16243.2
Employed persons - LFS, th., average	962.1	989.0	1006.9	1017.7	1033.7	1087.1	1118.0	1124.5
GDP per employed person, NC	5426	5822	6349	7305	8764	10277	13220	14445
GDP per empl. person, NC at 2000 pr.	5335	5524	5819	6254	6815	7268	7776	7374
Unit labour costs, NC, 2000=100	100.6	105.7	111.7	113.9	121.7	140.5	172.6	219.3
Unit labour costs, ER adj., 2000=100	100.5	101.8	97.5	95.7	97.8	112.8	137.9	174.5
Unit labour costs, PPP adj., Austria=100	34.0	33.9	31.8	31.8	32.0	36.0	43.3	53.3

3) Methodological break in 2001/2002.

(Table A/2 ctd.)

(Table A/2 ctd.)

	2001	2002	2003	2004	2005	2006	2007	2008 prelim.
Lithuania								
Producer price index, 2000=100	97.0	94.2	93.8	99.4	110.9	119.1	127.3	150.5
Consumer price index, 2000=100	101.5	101.9	100.8	102.0	104.7	108.6	115.0	127.7
GDP deflator, 2000=100	99.6	99.8	99.0	101.5	108.3	115.3	125.5	138.4
Exchange rate (ER), NC/EUR	3.5823	3.4594	3.4527	3.4529	3.4528	3.4528	3.4528	3.4528
ER, nominal, 2000=100	96.9	93.6	93.4	93.4	93.4	93.4	93.4	93.4
Real ER (CPI-based), 2000=100	102.5	104.3	101.4	100.5	100.9	102.5	106.0	113.6
Real ER (PPI-based), 2000=100	98.9	100.1	99.2	102.8	109.6	112.3	117.2	129.8
PPP, NC/EUR	1.7025	1.6617	1.6212	1.6699	1.7749	1.8589	1.9622	2.1812
Price level, EU-27 = 100	48	48	47	48	51	54	57	63
Average monthly gross wages, NC	982	1014	1073	1149	1276	1496	1802	2174
Average monthly gross wages, EUR (ER)	274	293	311	333	370	433	522	630
Average monthly gross wages, EUR (PPP)	577	610	662	688	719	805	919	997
GDP nominal, NC mn	48637	52070	56959	62698	72060	82793	98139	111499
Employed persons - LFS, th., average	1351.8	1405.9	1438.0	1436.3	1473.9	1499.0	1534.2	1520.0
GDP per employed person, NC	35979	37037	39610	43652	48891	55232	63967	73354
GDP per empl. person, NC at 2000 pr.	36124	37111	40010	43007	45144	47903	50970	53002
Unit labour costs, NC, 2000=100	91.7	92.1	90.4	90.1	95.3	105.2	119.2	138.2
Unit labour costs, ER adj., 2000=100	94.5	98.4	96.7	96.4	102.0	112.6	127.6	148.0
Unit labour costs, PPP adj., Austria=100	29.6	30.2	29.1	29.6	30.8	33.2	37.0	41.7
Croatia								
Producer price index, 2000=100	103.6	103.2	105.1	108.8	112.1	115.3	119.3	129.3
Consumer price index, 2000=100	104.9	106.7	108.6	110.9	114.6	118.2	121.6	129.1
GDP deflator, 2000=100	104.0	107.7	111.8	116.1	120.0	124.1	129.1	137.3
Exchange rate (ER), NC/EUR	7.4690	7.4068	7.5634	7.4952	7.4002	7.3226	7.3362	7.2230
ER, nominal, 2000=100	97.8	97.0	99.1	98.2	96.9	95.9	96.1	94.6
Real ER (CPI-based), 2000=100	104.9	105.4	103.1	104.0	106.5	108.7	109.0	113.4
Real ER (PPI-based), 2000=100	104.7	105.7	104.9	107.1	106.8	106.0	106.8	110.2
PPP, NC/EUR	4.3229	4.3756	4.5448	4.5803	4.6746	4.6748	4.6559	4.9475
Price level, EU-27 = 100	58	59	60	61	63	64	63	68
Average monthly gross wages, NC	5061	5366	5623	5985	6248	6634	7047	7544
Average monthly gross wages, EUR (ER)	678	724	743	799	844	906	961	1044
Average monthly gross wages, EUR (PPP)	1171	1226	1237	1307	1337	1419	1514	1525
GDP nominal, NC mn	190796	208223	227012	245550	264368	286341	314223	342159
Employed persons - LFS, th., average	1469.0	1528.0	1536.5	1562.5	1573.0	1586.0	1614.5	1635.8
GDP per employed person, NC	129882	136271	147746	157152	168066	180543	194626	209169
GDP per empl. person, NC at 2000 pr.	124849	126510	132101	135359	140102	145485	150777	152385
Unit labour costs, NC, 2000=100	94.7	99.1	99.5	103.3	104.2	106.6	109.2	115.7
Unit labour costs, ER adj., 2000=100	96.8	102.2	100.4	105.2	107.5	111.1	113.7	122.3
Unit labour costs, PPP adj., Austria=100	51.3	53.2	51.2	54.8	55.1	55.5	55.9	58.5
Macedonia								
Producer price index, 2000=100	102.0	101.1	100.8	101.7	104.9	112.6	115.4	127.3
Consumer price index, 2000=100	105.5	107.4	108.7	108.2	108.8	112.3	114.8	124.4
GDP deflator, 2000=100	103.6	107.1	107.4	108.8	113.0	117.8	126.6	135.7
Exchange rate (ER), NC/EUR	60.91	60.98	61.26	61.34	61.30	61.19	61.18	61.27
ER, nominal, 2000=100	100.3	100.4	100.9	101.0	100.9	100.8	100.7	100.9
Real ER (CPI-based), 2000=100	102.9	102.5	101.3	98.6	97.1	98.2	98.2	102.4
Real ER (PPI-based), 2000=100	100.5	100.1	98.7	97.3	96.1	98.5	98.5	101.7
PPP, NC/EUR	23.14	23.38	23.42	22.65	21.96	21.94	22.28	23.85
Price level, EU-27 = 100	38	38	38	37	36	36	36	39
Average monthly gross wages, NC	17886	19025	19950	20771	21330	23036	24136	26229
Average monthly gross wages, EUR (ER)	294	312	326	339	348	376	395	428
Average monthly gross wages, EUR (PPP)	773	814	852	917	972	1050	1083	1100
GDP nominal, NC mn	233841	243970	251486	265257	286619	310915	354322	398640
Employed persons - LFS, th., average	599.3	561.3	545.1	523.0	545.3	570.4	590.2	609.0
GDP per employed person, NC	390185	434620	461351	507189	525662	545079	600308	654565
GDP per empl. person, NC at 2000 pr.	376626	405723	429388	465992	465285	462580	474102	482469
Unit labour costs, NC, 2000=100	113.7	112.3	111.2	106.7	109.8	119.2	121.9	130.2
Unit labour costs, ER adj., 2000=100	113.3	111.8	110.3	105.6	108.7	118.3	121.0	129.0
Unit labour costs, PPP adj., Austria=100	39.6	38.4	37.1	36.3	36.7	39.0	39.2	40.7

(Table A/2 ctd.)

(Table A/2 ctd.)

	2001	2002	2003	2004	2005	2006	2007	2008 prelim.
Albania								
Producer price index, 2000=100	92.8	91.4	99.3	111.4	116.9	117.8	121.9	129.8
Consumer price index, 2000=100	103.1	108.5	111.1	114.2	116.9	119.7	123.2	127.4
GDP deflator, 2000=100	103.3	105.8	111.5	114.1	117.1	121.4	126.2	130.7
Exchange rate (ER), NC/EUR	128.47	132.36	137.51	127.67	124.19	123.08	123.63	122.80
ER, nominal, 2000=100	96.9	99.8	103.7	96.3	93.7	92.8	93.2	92.6
Real ER (CPI-based), 2000=100	104.1	104.2	100.7	109.2	112.5	113.7	113.8	114.3
Real ER (PPI-based), 2000=100	94.6	91.0	94.6	111.8	115.3	111.8	112.4	113.0
PPP, NC/EUR	49.493	49.448	51.952	51.912	52.103	51.150	52.634	54.369
Price level, EU-27 = 100	39	37	38	41	42	42	43	44
Average monthly gross wages, NC	14820	16541	18522	19039	19993	21493	23234	25300
Average monthly gross wages, EUR (ER)	115	125	135	149	161	175	188	206
Average monthly gross wages, EUR (PPP)	299	335	357	367	384	420	441	465
GDP nominal, NC mn	583369	622711	694098	750785	814797	891000	983055	1100000
Reg. employment total, th., average [4]	1066	920	923	929	932	934	950	970
GDP per employed person, NC	547458	676754	751851	808408	874565	954391	1034491	1134274
GDP per empl. person, NC at 2000 pr.	529836	639576	674287	708553	746563	785979	820048	867845
Unit labour costs, NC, 2000=100	102.7	95.0	100.9	98.7	98.3	100.4	104.0	107.0
Unit labour costs, ER adj., 2000=100	106.0	95.1	97.2	102.5	105.0	108.2	111.6	115.6
Unit labour costs, PPP adj., Austria=100	23.8	21.0	21.0	22.6	22.8	22.9	23.2	23.4
Bosnia and Herzegovina								
Producer price index, 2000=100	.	.	.	.	.	.	.	.
Consumer price index, 2000=100	103.2	104.5	105.7	106.5	109.7	116.5	118.3	127.2
GDP deflator, 2000=100	103.6	108.6	110.5	113.1	116.7	123.4	130.7	140.3
Exchange rate (ER), NC/EUR	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96
ER, nominal, 2000=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2000=100	101.0	100.2	99.4	98.1	98.9	102.7	101.9	105.6
Real ER (PPI-based), 2000=100	.	.	.	.	.	.	.	
PPP, NC/EUR	0.819	0.838	0.850	0.850	0.857	0.878	0.889	0.952
Price level, EU-27 = 100	42	43	43	43	44	45	45	49
Average monthly gross wages, NC	598	660	717	748	798	869	939	1070
Average monthly gross wages, EUR (ER)	306	337	367	382	408	444	480	547
Average monthly gross wages, EUR (PPP)	730	787	843	880	931	990	1056	1124
GDP nominal, NC mn	11599.2	12829.4	13442.6	15786.0	16927.9	19121.1	21640.6	24400.0
Employed persons - LFS, th., average [5]	633.1	631.7	637.5	638.2	641.5	811.0	849.6	890.2
GDP per employed person, NC	18321	20311	21087	24735	26386	23577	25471	27408
GDP per empl. person, NC at 2000 pr.	17685	18699	19085	21864	22602	19111	19490	19530
Unit labour costs, NC, 2000=100	105.7	110.4	117.5	107.0	110.4	142.2	150.6	171.3
Unit labour costs, ER adj., 2000=100	105.7	110.4	117.5	107.0	110.4	142.2	150.6	171.3
Unit labour costs, PPP adj., Austria=100	31.19	31.97	33.35	30.98	31.46	39.53	41.18	45.56
Montenegro								
Producer price index, 2001=100	100.0	114.5	119.7	126.6	129.3	134.0	145.3	165.7
Consumer price index, 2001=100	100.0	116.0	123.8	126.8	129.7	133.5	139.2	149.5
GDP deflator, 2001=100	100.0	103.1	111.7	118.2	123.3	134.5	158.8	174.8
Real ER (CPI-based), 2001=100	100.0	113.6	118.9	119.2	119.4	120.3	122.5	126.9
Real ER (PPI-based), 2001=100	100.0	115.2	119.6	123.8	120.9	119.4	126.5	135.1
PPP, NC/EUR	0.37	0.37	0.40	0.41	0.42	0.41	0.44	0.48
Price level, EU-27 = 100	37	37	40	41	42	41	44	48
Average monthly gross wages, NC	176	251	271	303	326	377	497	609
Average monthly gross wages, EUR (PPP)	481	682	681	736	778	911	1139	1273
GDP nominal, NC mn	1295.1	1360.4	1510.1	1669.8	1815.0	2149.0	2807.9	3340.0
Employed persons - LFS, th., average	214.4	220.6	200	187.3	178.8	178.4	217.4	218.8
GDP per employed person, NC	6042	6167	7551	8913	10150	12048	12916	15263
GDP per empl. person, NC at 2000 pr.	5026	4978	5626	6272	6846	7451	6765	7265
Unit labour costs, NC, 2000=100	107.5	154.8	147.7	148.0	146.2	155.3	225.3	257.1
Unit labour costs, PPP adj., Austria=100	24.37	34.48	32.23	32.95	32.03	33.19	47.33	52.54

4) From 2002 according to census 2001. - 5) Until 2005 registered employees, from 2006 based on LFS.

(Table A/2 ctd.)

(Table A/2 ctd.)

	2001	2002	2003	2004	2005	2006	2007	2008 prelim.
Serbia								
Producer price index, 2000=100	187.7	204.2	213.6	233.1	266.1	301.5	319.3	358.9
Consumer price index, 2000=100	193.3	225.4	247.7	275.9	320.6	358.2	383.2	428.1
GDP deflator, 2000=100	223.3	270.8	298.7	351.4	418.2	453.0	511.8	568.4
Exchange rate (ER), NC/EUR	59.46	60.68	65.05	72.57	82.91	84.19	79.98	81.90
ER, nominal, 2000=100	113.1	115.5	123.8	138.1	157.8	160.2	152.2	155.9
Real ER (CPI-based), 2000=100	167.2	187.1	188.1	183.9	183.1	197.1	216.9	228.2
Real ER (PPI-based), 2000=100	164.0	175.8	170.5	163.0	155.9	165.9	180.5	185.7
PPP, NC/EUR	18.2	21.6	23.7	27.3	31.7	34.3	37.3	41.3
Price level, EU-27 = 100	31	36	36	38	38	41	47	50
Average monthly gross wages, NC	8691	13260	16612	20555	25514	31745	38744	45674
Average monthly gross wages, EUR (ER)	146	219	255	283	308	377	484	558
Average monthly gross wages, EUR (PPP)	476	614	700	754	804	925	1039	1106
GDP nominal, NC mn	762178	972901	1133027	1384253	1687832	1980237	2362850	2760700
Employed persons - LFS, th., average	3106	3000	2919	2931	2733	2631	2656	2805
GDP per employed person, NC	245421	324276	388211	472305	617482	752744	889716	984099
GDP per empl. person, NC at 2000 pr.	109892	119733	129954	134425	147664	166160	173833	173143
Unit labour costs, NC, 2000=100	258.6	362.1	417.9	499.9	564.9	624.6	728.6	862.4
Unit labour costs, ER adj., 2000=100	228.5	313.5	337.6	362.0	358.0	389.9	478.7	553.3
Unit labour costs, PPP adj., Austria=100	24.77	33.39	35.23	38.54	37.51	39.84	48.10	54.09
Russia								
Producer price index, 2000=100	119.1	133.0	153.8	190.7	230.2	258.7	295.1	358.3
Consumer price index, 2000=100	121.6	141.1	160.2	177.9	200.1	219.7	239.7	273.5
GDP deflator, 2000=100	116.5	134.7	153.5	184.4	219.8	253.9	289.1	344.5
Exchange rate (ER), NC/EUR	26.130	29.647	34.686	35.814	35.264	34.112	35.014	36.425
ER, nominal, 2000=100	100.4	113.9	133.3	137.6	135.5	131.1	134.5	139.9
Real ER (CPI-based), 2000=100	118.5	118.7	113.1	119.0	133.1	147.8	153.5	162.4
Real ER (PPI-based), 2000=100	117.2	116.1	114.0	133.9	157.0	174.0	188.7	206.4
PPP, NC/EUR	8.595	9.699	11.020	12.924	15.061	17.007	18.836	22.378
Price level, EU-27 = 100	33	33	32	36	43	50	54	61
Average monthly gross wages, NC	3240	4360	5499	6740	8555	10634	13593	17226
Average monthly gross wages, EUR (ER)	124	147	159	188	243	312	388	473
Average monthly gross wages, EUR (PPP)	377	450	499	521	568	625	722	770
GDP nominal, NC bn	8944	10831	13243	17048	21625	26904	33111	41668
Employed persons - LFS, th., average	65123	66659	66432	67275	68169	68855	70571	70965
GDP per employed person, NC	137334	162477	199350	253410	317232	390727	469196	587163
GDP per empl. person, NC at 2000 pr.	117901	120598	129841	137434	144315	153871	162298	170435
Unit labour costs, NC, 2000=100	138.8	182.6	213.8	247.6	299.3	349.0	422.9	510.4
Unit labour costs, ER adj., 2000=100	138.2	160.3	160.5	180.0	221.0	266.3	314.4	364.7
Unit labour costs, PPP adj., Austria=100	17.70	20.16	19.77	22.62	27.33	32.13	37.30	42.10
Ukraine								
Producer price index, 2000=100	108.7	112.0	120.5	145.2	169.4	185.7	221.9	300.6
Consumer price index, 2000=100	112.0	112.9	118.8	129.5	147.0	160.4	180.9	226.5
GDP deflator, 2000=100	109.9	115.6	124.9	143.8	179.1	205.6	252.3	325.7
Exchange rate (ER), NC/EUR	4.814	5.030	6.024	6.609	6.389	6.335	6.918	7.708
ER, nominal, 2000=100	95.7	100.0	119.8	131.4	127.0	126.0	137.6	153.3
Real ER (CPI-based), 2000=100	114.5	108.2	93.2	90.7	104.2	112.2	113.2	122.8
Real ER (PPI-based), 2000=100	112.3	111.3	99.3	106.7	123.2	129.9	138.7	158.1
PPP, NC/EUR	1.3133	1.3469	1.4506	1.6313	1.9861	2.2288	2.6386	3.4251
Price level, EU-27 = 100	27	27	24	25	31	35	38	44
Average monthly gross wages, NC	311	376	462	590	806	1041	1351	1806
Average monthly gross wages, EUR (ER)	65	75	77	89	126	164	195	234
Average monthly gross wages, EUR (PPP)	237	279	319	361	406	467	512	527
GDP nominal, NC mn	204190	225810	267344	345113	441452	544153	720731	949864
Employed persons - LFS, th., average	19971.5	20091.2	20163.3	20295.7	20680.0	20730.4	20904.7	20972.3
GDP per employed person, NC	10224	11239	13259	17004	21347	26249	34477	45291
GDP per empl. person, NC at 2000 pr.	9299	9725	10620	11827	11921	12769	13663	13905
Unit labour costs, NC, 2000=100	122.5	141.8	159.4	182.6	247.7	298.8	362.2	475.8
Unit labour costs, ER adj., 2000=100	128.0	141.7	133.1	138.9	195.0	237.2	263.3	310.4
Unit labour costs, PPP adj., Austria=100	18.93	20.59	18.94	20.18	27.86	33.06	36.08	41.39

(Table A/2 ctd.)

(Table A/2 ctd.)

	2001	2002	2003	2004	2005	2006	2007	2008 prelim.
Austria								
Producer price index, 2000=100	101.5	101.1	102.7	107.7	110.0	113.2	117.8	125.4
Consumer price index, 2000=100	102.7	104.5	106.0	108.2	110.7	112.4	114.9	118.5
GDP deflator, 2000=100	101.9	103.2	104.5	106.2	108.4	110.4	112.7	115.4
Real ER (CPI-based), 2000=100	100.5	100.2	99.7	99.6	99.8	99.1	98.9	98.5
Real ER (PPI-based), 2000=100	100.3	100.5	101.5	104.1	101.6	99.8	101.4	101.1
PPP, NC/EUR	1.0680	1.0478	1.0465	1.0376	1.0583	1.0576	1.0559	1.0800
Price level, EU-27 = 100	107	105	105	104	106	106	106	108
Average monthly gross wages, EUR	2432	2482	2532	2579	2639	2723	2784	2868
Average monthly gross wages, EUR (PPP)	2277	2369	2420	2485	2494	2575	2637	2655
GDP nominal, NC mn	212499	218848	223302	232782	244453	257294	270837	282202
Employed persons - LFS, th., average [6)]	3711	3762	3794	3744	3824	3928	4028	4090
GDP per employed person, NC	57259	58172	58864	62175	63919	65498	67240	68998
GDP per empl. person, NC at 2000 pr.	56210	56363	56345	58542	58959	59336	59643	59773
Unit labour costs, NC, 2000=100	102.0	103.8	105.9	103.8	105.5	108.2	110.0	113.1
Unit labour costs, PPP adjusted	0.54	0.55	0.56	0.55	0.56	0.57	0.58	0.60

6) From 2004 new methodology.

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

PPP rates have been taken from Eurostat based on the benchmark results 2005. For Albania, Bosnia and Herzegovina, Montenegro and Serbia available data 2005-2007 have been extrapolated by wiiw with GDP deflators. Russia and Ukraine are estimated by wiiw using the OECD PPP benchmark results 2005 and extrapolation with GDP price deflators.

Real exchange rates: Increasing values mean real appreciation.

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

Table A3

Indicators of macro-competitiveness, 2001-2008

annual changes in %

	2001	2002	2003	2004	2005	2006	2007	2008 prelim.	2004-08 average
Czech Republic									
GDP deflator	4.9	2.8	0.9	4.6	-0.4	1.0	3.6	1.8	2.1
Exchange rate (ER), EUR/NC	4.5	10.6	-3.3	-0.1	7.1	5.1	2.1	11.3	5.0
Real ER (CPI-based)	6.9	9.9	-5.2	0.2	6.5	5.0	2.6	14.1	5.6
Real ER (PPI-based)	5.6	8.2	-3.8	2.5	3.9	0.4	2.2	4.3	2.6
Average gross wages, NC	8.7	7.3	6.6	6.6	5.3	6.5	7.3	8.5	6.8
Average gross wages, real (PPI based)	6.3	10.2	6.5	1.6	3.8	6.3	4.6	8.5	4.9
Average gross wages, real (CPI based)	4.0	5.7	6.7	4.0	3.6	4.3	4.2	2.1	3.6
Average gross wages, EUR (ER)	13.5	18.6	3.1	6.5	12.7	11.9	9.5	20.8	12.2
Employed persons (LFS) [1]	0.4	0.8	-0.7	-0.6	1.2	1.3	1.9	1.6	1.1
GDP per empl. person, NC at 2000 prices	2.0	1.1	4.3	5.0	5.1	5.3	4.0	1.5	4.2
Unit labour costs, NC at 2000 prices	6.5	6.0	2.2	1.6	0.2	1.1	3.2	6.9	2.6
Unit labour costs, ER (EUR) adjusted	11.3	17.3	-1.1	1.4	7.3	6.2	5.3	19.0	7.7
Hungary									
GDP deflator	8.3	7.8	5.8	4.5	2.3	3.9	5.9	3.4	4.0
Exchange rate (ER), EUR/NC	1.3	5.6	-4.2	0.8	1.5	-6.1	5.1	-0.1	0.2
Real ER (CPI-based)	8.2	8.9	-1.6	5.4	2.8	-4.5	10.9	2.2	3.2
Real ER (PPI-based)	5.3	4.3	-2.5	2.0	1.6	-4.6	4.6	-1.1	0.4
Average gross wages, NC	18.2	18.3	12.0	6.1	8.8	8.2	8.0	7.5	7.7
Average gross wages, real (PPI based)	12.4	20.4	9.3	2.5	4.0	1.6	5.9	1.8	3.1
Average gross wages, real (CPI based)	8.3	12.4	7.0	-0.7	5.1	4.0	0.0	1.4	2.0
Average gross wages, EUR (ER)	19.7	24.9	7.3	6.9	10.4	1.6	13.5	7.5	7.9
Employed persons (LFS)	0.3	0.1	1.3	-0.5	0.0	0.7	-0.1	-1.2	-0.2
GDP per empl. person, NC at 2000 prices	3.8	4.4	2.9	5.2	3.8	3.3	1.3	1.7	3.1
Unit labour costs, NC at 2000 prices	13.8	13.3	8.9	0.8	4.8	4.8	6.6	5.7	4.5
Unit labour costs, ER (EUR) adjusted	15.3	19.7	4.3	1.6	6.3	-1.6	12.1	5.6	4.7
Poland									
GDP deflator	3.5	2.2	0.4	4.1	2.6	1.5	3.9	3.1	3.0
Exchange rate (ER), EUR/NC	9.2	-4.8	-12.3	-2.8	12.5	3.3	3.0	7.7	4.6
Real ER (CPI-based)	12.4	-4.9	-13.4	-1.4	12.5	2.4	3.2	8.3	4.9
Real ER (PPI-based)	9.8	-3.2	-10.6	1.8	8.4	0.7	2.8	3.6	3.4
Average gross wages, NC	8.0	2.6	4.2	4.0	3.8	4.9	8.6	10.0	6.3
Average gross wages, real (PPI based)	6.1	1.5	1.5	-2.8	3.1	2.6	6.2	7.2	3.2
Average gross wages, real (CPI based)	2.6	0.6	3.4	0.4	1.7	3.6	5.9	5.5	3.4
Average gross wages, EUR (ER)	17.9	-2.3	-8.7	1.1	16.8	8.3	11.9	18.5	11.2
Employed persons (LFS) [2]	-2.2	-3.0	0.6	1.3	2.3	3.4	4.4	3.7	3.0
GDP per empl. person, NC at 2000 prices	3.5	4.6	3.3	3.9	1.3	2.7	2.2	1.2	2.3
Unit labour costs, NC at 2000 prices	4.4	-1.9	0.9	0.1	2.5	2.1	6.3	8.6	3.9
Unit labour costs, ER (EUR) adjusted	13.9	-6.6	-11.6	-2.7	15.4	5.5	9.5	17.0	8.7
Slovak Republic									
GDP deflator	5.0	3.9	5.3	5.8	2.4	3.0	1.1	2.9	3.0
Exchange rate (ER), EUR/NC	-1.6	1.4	2.9	3.7	3.7	3.7	10.2	8.0	5.8
Real ER (CPI-based)	3.2	2.8	9.4	9.1	4.3	5.8	9.7	8.3	7.4
Real ER (PPI-based)	3.6	4.1	10.8	4.0	4.5	4.5	6.3	4.1	4.7
Average gross wages, NC	8.2	9.3	6.3	10.2	9.2	8.6	7.4	8.1	8.7
Average gross wages, real (PPI based)	1.6	7.0	-1.8	7.3	3.6	2.8	8.7	5.2	5.5
Average gross wages, real (CPI based)	1.0	5.6	-1.9	2.5	6.2	4.2	5.4	4.0	4.4
Average gross wages, EUR (ER)	6.4	10.8	9.4	14.2	13.2	12.6	18.4	16.8	15.0
Employed persons (LFS)	1.0	0.2	1.8	0.3	2.1	3.9	2.4	3.2	2.4
GDP per empl. person, NC at 2000 prices	2.3	4.6	2.9	4.9	4.4	4.4	7.9	3.0	4.9
Unit labour costs, NC at 2000 prices	5.7	4.5	3.3	5.0	4.6	4.1	-0.4	4.9	3.6
Unit labour costs, ER (EUR) adjusted	4.0	6.0	6.3	8.8	8.4	7.9	9.8	13.4	9.6
Slovenia									
GDP deflator	8.7	7.6	5.6	3.3	1.6	2.0	4.2	4.0	3.0
Exchange rate (ER), EUR/NC	-5.6	-4.0	-3.2	-2.2	-0.3	0.0	0.0	0.0	-0.5
Real ER (CPI-based)	0.3	1.1	0.3	-0.7	0.0	0.3	1.3	1.8	0.5
Real ER (PPI-based)	0.0	0.2	-2.6	-1.8	-2.9	-2.4	1.6	-2.7	-1.7
Average gross wages, NC	11.9	9.7	7.5	5.7	3.6	4.8	5.9	8.3	5.7
Average gross wages, real (PPI based)	4.5	5.8	6.2	3.0	1.7	2.4	1.8	4.3	2.6
Average gross wages, real (CPI based)	3.1	2.1	1.8	2.0	1.1	2.2	2.1	2.6	2.0
Average gross wages, EUR (ER)	5.7	5.3	4.1	3.4	3.3	4.8	5.9	8.3	5.1
Employed persons (LFS)	1.7	-0.7	-1.4	5.1	0.7	1.3	2.5	1.1	2.1
GDP per empl. person, NC at 2000 prices	1.1	4.7	4.3	-0.7	3.6	4.6	4.1	2.4	2.8
Unit labour costs, NC at 2000 prices	10.7	4.8	3.1	6.5	0.0	0.2	1.7	5.7	2.8
Unit labour costs, ER (EUR) adjusted	4.5	0.6	-0.2	4.2	-0.3	0.2	1.7	5.7	2.3

1) From 2002 according to census 2001. - 2) From 2003 according to census 2002.

(Table A/3 ctd.)

Table A3 (ctd.)

	2001	2002	2003	2004	2005	2006	2007	2008 prelim.	2004-08 average
Bulgaria									
GDP deflator	6.7	4.4	1.7	5.2	3.7	8.5	7.9	11.3	7.3
Exchange rate (ER), EUR/NC	0.2	-0.1	0.0	-0.2	-0.1	0.0	0.0	0.0	-0.1
Real ER (CPI-based)	5.3	3.6	0.4	3.7	3.7	5.1	5.1	8.0	5.1
Real ER (PPI-based)	2.8	1.7	4.3	3.4	3.0	6.9	5.8	3.6	4.6
Average gross wages, NC	6.9	7.3	6.1	7.0	10.7	11.3	19.7	21.6	13.9
Average gross wages, real (PPI based)	3.0	6.1	1.1	0.9	2.6	-0.7	10.4	10.0	4.5
Average gross wages, real (CPI based)	-0.4	1.4	3.7	0.8	4.4	3.6	11.3	8.7	5.7
Average gross wages, EUR (ER)	7.1	7.3	6.1	6.8	10.6	11.3	19.7	21.6	13.8
Employed persons (LFS)	-3.4	1.5	3.5	3.1	2.0	4.3	4.6	3.3	3.5
GDP per empl. person, NC at 2000 prices	7.8	2.9	1.6	3.4	4.2	1.9	1.5	2.6	2.7
Unit labour costs, NC at 2000 prices	-0.8	4.3	4.5	3.5	6.2	9.2	18.0	18.5	10.9
Unit labour costs, ER (EUR) adjusted	-0.6	4.2	4.5	3.3	6.1	9.2	18.0	18.5	10.8
Romania									
GDP deflator	37.8	22.6	23.4	15.5	12.2	10.6	12.7	14.0	13.0
Exchange rate (ER), EUR/NC	-23.4	-16.8	-16.7	-7.3	11.9	2.7	5.8	-9.4	0.4
Real ER (CPI-based)	0.8	-0.2	-5.9	1.5	19.4	7.1	8.4	-5.7	5.9
Real ER (PPI-based)	4.6	2.9	-1.1	8.0	18.2	9.3	11.6	-1.6	8.9
Average gross wages, NC	48.6	26.1	24.8	23.3	18.3	18.4	21.8	24.8	21.3
Average gross wages, real (PPI based)	7.6	2.5	4.4	3.5	7.1	6.1	12.7	7.8	7.4
Average gross wages, real (CPI based)	10.5	2.9	8.2	10.2	8.4	11.1	16.1	15.6	12.2
Average gross wages, EUR (ER)	13.8	4.8	3.9	14.3	32.3	21.6	28.9	13.1	21.8
Employed persons (LFS)	-0.6	.	-0.1	-0.7	-0.5	1.9	0.7	0.2	0.3
GDP per empl. person, NC at 2000 prices	6.4	.	5.4	9.3	4.6	5.8	5.5	6.9	6.4
Unit labour costs, NC at 2000 prices	39.7	.	18.4	12.8	13.0	11.9	15.4	16.7	14.0
Unit labour costs, ER (EUR) adjusted	7.0	.	-1.4	4.6	26.5	14.9	22.1	5.8	14.4
Estonia									
GDP deflator	5.3	4.0	4.6	3.3	5.2	7.1	9.6	7.7	6.6
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	3.4	1.5	-0.6	0.9	1.9	2.2	4.3	6.7	3.2
Real ER (PPI-based)	3.2	1.0	-0.4	0.6	-2.3	-0.3	5.7	0.4	0.8
Average gross wages, NC	12.3	11.5	9.4	8.4	10.8	16.5	20.5	13.1	13.8
Average gross wages, real (PPI based)	7.5	11.1	9.2	5.4	8.5	11.5	11.3	5.5	8.4
Average gross wages, real (CPI based)	6.3	7.6	7.9	5.2	6.4	11.6	12.9	2.2	7.6
Average gross wages, EUR (ER)	12.3	11.5	9.4	8.4	10.8	16.5	20.5	13.1	13.8
Employed persons (LFS)	0.9	1.4	1.5	0.2	2.0	6.4	1.4	0.2	2.0
GDP per empl. person, NC at 2000 prices	6.7	6.4	5.6	7.2	7.0	3.7	4.9	-3.8	3.7
Unit labour costs, NC at 2000 prices	5.3	4.8	3.6	1.1	3.5	12.4	14.9	17.5	9.7
Unit labour costs, ER (EUR) adjusted	5.3	4.8	3.6	1.1	3.5	12.4	14.9	17.5	9.7
Latvia									
GDP deflator	1.7	3.6	3.5	7.1	10.1	10.0	20.2	15.2	12.4
Exchange rate (ER), EUR/NC	-0.2	-3.6	-9.3	-3.7	-4.5	0.0	-0.6	-0.4	-1.8
Real ER (CPI-based)	0.2	-3.7	-8.4	0.1	0.0	4.3	6.9	10.8	4.3
Real ER (PPI-based)	0.4	-2.2	-7.0	2.3	-1.5	5.3	12.7	4.1	4.5
Average gross wages, NC	6.3	8.8	11.3	9.6	16.5	23.0	31.5	20.5	20.0
Average gross wages, real (PPI based)	4.5	7.8	7.8	0.9	8.1	11.5	13.2	8.0	8.3
Average gross wages, real (CPI based)	3.7	6.7	8.1	3.2	9.0	15.5	19.5	4.5	10.1
Average gross wages, EUR (ER)	6.2	4.9	0.9	5.5	11.3	23.0	30.8	20.0	17.8
Employed persons (LFS)	2.2	2.8	1.8	1.1	1.6	5.2	2.8	0.6	2.2
GDP per empl. person, NC at 2000 prices	5.7	3.5	5.3	7.5	9.0	6.6	7.0	-5.2	4.8
Unit labour costs, NC at 2000 prices	0.6	5.1	5.6	2.0	6.9	15.4	22.9	27.0	14.5
Unit labour costs, ER (EUR) adjusted	0.4	1.3	-4.2	-1.8	2.2	15.4	22.2	26.6	12.4
Lithuania									
GDP deflator	-0.4	0.2	-0.8	2.5	6.7	6.5	8.8	10.3	6.9
Exchange rate (ER), EUR/NC	3.2	3.6	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	2.5	1.8	-2.8	-1.0	0.5	1.6	3.4	7.2	2.3
Real ER (PPI-based)	-1.1	1.2	-0.9	3.7	6.6	2.4	4.4	10.8	5.5
Average gross wages, NC	1.2	3.2	5.8	7.2	11.0	17.2	20.5	20.6	15.2
Average gross wages, real (PPI based)	4.3	6.2	6.3	1.1	-0.4	9.1	12.7	2.0	4.8
Average gross wages, real (CPI based)	-0.4	2.9	6.9	5.9	8.2	12.9	13.9	8.6	9.9
Average gross wages, EUR (ER)	4.4	6.9	6.0	7.1	11.0	17.2	20.5	20.6	15.2
Employed persons (LFS)	-3.3	4.0	2.3	-0.1	2.6	1.7	2.3	-0.9	1.1
GDP per empl. person, NC at 2000 prices	10.4	2.7	7.8	7.5	5.0	6.1	6.4	4.0	5.8
Unit labour costs, NC at 2000 prices	-8.3	0.5	-1.9	-0.3	5.8	10.4	13.3	16.0	8.9
Unit labour costs, ER (EUR) adjusted	-5.5	4.0	-1.7	-0.3	5.8	10.4	13.3	16.0	8.9

(Table A/3 ctd.)

Table A3 (ctd.)

	2001	2002	2003	2004	2005	2006	2007	2008 prelim.	2004-08 average
Croatia									
GDP deflator	4.0	3.5	3.8	3.8	3.3	3.4	4.0	6.3	4.2
Exchange rate (ER), EUR/NC	2.2	0.8	-2.1	0.9	1.3	1.1	-0.2	1.6	0.9
Real ER (CPI-based)	4.9	0.5	-2.2	0.9	2.4	2.0	0.3	4.0	1.9
Real ER (PPI-based)	4.7	1.0	-0.8	2.1	-0.2	-0.8	0.7	3.2	1.0
Average gross wages, NC	3.9	6.0	4.8	6.4	4.4	6.2	6.2	7.1	6.1
Average gross wages, real (PPI based)	0.3	6.5	2.8	2.8	1.4	3.2	2.7	-1.2	1.8
Average gross wages, real (CPI based)	-0.9	4.3	2.9	4.3	1.0	2.9	3.2	0.9	2.5
Average gross wages, EUR (ER)	6.3	6.9	2.6	7.4	5.7	7.3	6.0	8.7	7.0
Employed persons (LFS)	-5.4	4.0	0.6	1.7	0.7	0.8	1.8	1.3	1.3
GDP per empl. person, NC at 2000 prices	9.7	1.3	4.4	2.5	3.5	3.8	3.6	1.1	2.9
Unit labour costs, NC at 2000 prices	-5.3	4.6	0.4	3.9	0.9	2.2	2.5	5.9	3.1
Unit labour costs, ER (EUR) adjusted	-3.2	5.5	-1.7	4.8	2.2	3.3	2.3	7.6	4.0
Macedonia									
GDP deflator	3.6	3.4	0.3	1.3	3.8	4.3	7.5	7.1	4.8
Exchange rate (ER), EUR/NC	-0.3	-0.1	-0.5	-0.1	0.1	0.2	0.0	-0.1	0.0
Real ER (CPI-based)	2.9	-0.4	-1.2	-2.6	-1.6	1.2	-0.1	4.3	0.2
Real ER (PPI-based)	0.5	-0.4	-1.4	-1.4	-1.2	2.5	0.0	3.2	0.6
Average gross wages, NC	-0.4	6.4	4.9	4.1	2.7	8.0	4.8	8.7	5.6
Average gross wages, real (PPI based)	-2.4	7.3	5.2	3.2	-0.5	0.7	2.2	-1.5	0.8
Average gross wages, real (CPI based)	-5.6	4.5	3.6	4.5	2.2	4.6	2.4	0.3	2.8
Average gross wages, EUR (ER)	-0.7	6.3	4.4	4.0	2.8	8.2	4.8	8.5	5.6
Employed persons (LFS)	9.0	-6.3	-2.9	-4.1	4.3	4.6	3.5	3.2	2.2
GDP per empl. person, NC at 2000 prices	-12.4	7.7	5.8	8.5	-0.2	-0.6	2.5	1.8	2.4
Unit labour costs, NC at 2000 prices	13.7	-1.3	-0.9	-4.1	2.8	8.6	2.2	6.8	3.2
Unit labour costs, ER (EUR) adjusted	13.3	-1.4	-1.4	-4.2	2.9	8.8	2.2	6.6	3.2
Albania									
GDP deflator	3.3	2.4	5.4	2.3	2.7	3.7	3.9	3.6	3.2
Exchange rate (ER), EUR/NC	3.2	-2.9	-3.7	7.7	2.8	0.9	-0.4	0.7	2.3
Real ER (CPI-based)	4.1	0.0	-3.3	8.5	3.0	1.1	0.1	0.4	2.6
Real ER (PPI-based)	-5.4	-3.9	4.0	18.2	3.2	-3.0	0.5	0.5	3.6
Average gross wages, NC	11.0	11.6	12.0	2.8	5.0	7.5	8.1	8.9	6.4
Average gross wages, real (PPI based)	19.6	13.3	3.0	-8.4	0.1	6.7	4.5	2.2	0.9
Average gross wages, real (CPI based)	7.6	6.1	9.4	-0.1	2.6	5.0	5.0	5.3	3.6
Average gross wages, EUR (ER)	14.5	8.3	7.8	10.7	8.0	8.5	7.6	9.6	8.9
Registered employment, total [3)	-0.1	-0.1	0.3	0.6	0.3	0.2	1.8	2.1	1.0
GDP per empl. person, NC at 2000 prices	8.0	4.3	5.4	5.1	5.4	5.3	4.3	5.8	5.2
Unit labour costs, NC at 2000 prices	2.7	7.0	6.2	-2.2	-0.3	2.1	3.6	2.9	1.2
Unit labour costs, ER (EUR) adjusted	6.0	3.9	2.2	5.4	2.5	3.0	3.2	3.6	3.5
Bosnia and Herzegovina									
GDP deflator	3.6	4.8	1.7	2.4	3.2	5.7	5.9	7.4	4.9
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	1.0	-0.8	-0.8	-1.3	0.8	3.9	-0.8	3.7	1.2
Real ER (PPI-based)	.	.	.	.	.	.	.	.	.
Average gross wages, NC	10.9	10.4	8.6	4.3	6.7	8.9	8.1	14.0	8.3
Average gross wages, real (PPI based)	.	.	.	.	.	.	.	.	.
Average gross wages, real (CPI based)	7.5	9.0	7.5	3.5	3.6	2.5	6.5	6.0	4.4
Average gross wages, EUR (ER)	10.9	10.4	8.6	4.3	6.7	8.9	8.1	14.0	8.3
Employed persons (LFS) [4)	-0.4	-0.2	0.9	0.1	0.5	1.1	4.8	4.8	2.2
GDP per empl. person, NC at 2000 prices	4.9	5.7	2.1	14.6	3.4	5.7	2.0	0.2	5.0
Unit labour costs, NC at 2000 prices	5.7	4.4	6.4	-8.9	3.2	3.0	6.0	13.7	3.1
Unit labour costs, ER (EUR) adjusted	5.7	4.4	6.4	-8.9	3.2	3.0	6.0	13.7	3.1
Montenegro									
GDP deflator	20.2	3.1	8.3	5.9	4.3	9.1	18.1	10.0	9.4
Real ER (CPI-based)	19.1	13.6	4.7	0.3	0.1	0.8	1.8	3.6	1.3
Real ER (PPI-based)	.	15.2	3.8	3.5	-2.4	-1.2	5.9	6.8	2.5
Average gross wages, NC	16.8	42.6	7.8	11.7	7.8	15.6	31.7	22.5	17.6
Average gross wages, real (PPI based)	.	24.5	3.2	5.6	5.6	11.6	21.4	7.5	10.2
Average gross wages, real (CPI based)	-4.1	23.0	1.1	9.1	5.4	12.2	26.4	14.1	13.2
Employed persons (LFS)	-6.9	2.9	-9.3	-6.3	-4.5	-0.3	21.9	0.7	1.8
GDP per empl. person, NC	30.6	2.1	22.4	18.0	13.9	18.7	7.2	18.2	15.1
GDP per empl. person, NC at 2000 prices	8.6	-1.0	13.0	11.5	9.1	8.8	-9.2	7.4	5.2
Unit labour costs, NC at 2000 prices	7.5	44.0	-4.6	0.2	-1.2	6.2	45.1	14.1	11.7
Unit labour costs, ER (EUR) adjusted	7.5	44.0	-4.6	0.2	-1.2	6.2	45.1	14.1	11.7

3) From 2002 according to census 2001. - 4) Until 2006 based on registered employees.

(Table A/3 ctd.)

Table A3 (ctd.)

	2001	2002	2003	2004	2005	2006	2007	2008 prelim.	2004-08 average
Serbia									
GDP deflator	123.3	21.3	10.3	17.6	19.0	8.3	13.0	11.0	13.7
Exchange rate (ER), NC/EUR	-11.6	-2.0	-6.7	-10.4	-12.5	-1.5	5.3	-2.3	-4.5
Real ER (CPI-based)	67.2	11.9	0.6	-2.2	-0.4	7.6	10.0	5.2	3.9
Real ER (PPI-based)	64.0	7.2	-3.0	-4.4	-4.4	6.4	8.8	2.9	1.7
Average gross wages, NC	128.8	52.6	25.3	23.7	24.1	24.4	22.0	17.9	22.4
Average gross wages, real (PPI based)	21.9	40.2	19.8	13.4	8.7	9.8	15.2	4.9	10.4
Average gross wages, real (CPI based)	18.4	30.9	14.0	11.1	6.8	11.4	14.1	5.5	9.7
Average gross wages, EUR (ER)	102.2	49.5	16.9	10.9	8.6	22.5	28.5	15.1	16.9
Employed persons (LFS)	0.4	-3.4	-2.7	0.4	-6.7	-3.8	1.0	5.6	-0.8
GDP per empl. person, NC at 2000 prices	-11.5	9.0	8.5	3.4	9.8	12.5	4.6	-0.4	5.9
Unit labour costs, NC at 2000 prices	158.6	40.0	15.4	19.6	13.0	10.6	16.7	18.4	15.6
Unit labour costs, ER (EUR) adjusted	128.5	37.2	7.7	7.2	-1.1	8.9	22.8	15.6	10.4
Russia									
GDP deflator	16.5	15.7	14.0	20.1	19.2	15.5	13.8	19.2	17.5
Exchange rate (ER), NC/EUR	-0.4	-11.9	-14.5	-3.1	1.6	3.4	-2.6	-3.9	-1.0
Real ER (CPI-based)	18.5	0.2	-4.8	5.3	11.8	11.1	3.8	5.8	7.5
Real ER (PPI-based)	17.2	-0.9	-1.8	17.4	17.2	10.8	8.5	9.4	12.6
Average gross wages, NC	45.7	34.6	26.1	22.6	26.9	24.3	27.8	26.7	25.7
Average gross wages, real (PPI based)	22.4	20.4	9.1	-1.2	5.2	10.6	12.1	4.4	6.1
Average gross wages, real (CPI based)	19.9	16.0	11.0	10.4	12.8	13.2	17.2	11.1	12.9
Average gross wages, EUR (ER)	45.2	18.6	7.8	18.7	28.9	28.5	24.5	21.8	24.4
Employed persons (LFS)	0.1	2.4	-0.3	1.3	1.3	1.0	2.5	0.6	1.3
GDP per empl. person, NC at 2000 prices	5.0	2.3	7.7	5.8	5.0	6.6	5.5	5.0	5.6
Unit labour costs, NC at 2000 prices	38.8	31.6	17.1	15.8	20.9	16.6	21.2	20.7	19.0
Unit labour costs, ER (EUR) adjusted	38.2	15.9	0.1	12.2	22.8	20.5	18.1	16.0	17.8
Ukraine									
GDP deflator	9.9	5.1	8.0	15.2	24.6	14.8	22.8	29.1	21.1
Exchange rate (ER), NC/EUR	4.5	-4.3	-16.5	-8.9	3.5	0.8	-8.4	-10.3	-4.8
Real ER (CPI-based)	14.5	-5.5	-13.8	-2.7	14.9	7.7	0.9	8.4	5.7
Real ER (PPI-based)	12.3	-0.9	-10.7	7.4	15.5	5.4	6.8	14.0	9.7
Average gross wages, NC	35.2	21.0	22.8	27.6	36.7	29.2	29.7	33.7	31.3
Average gross wages, real (PPI based)	24.4	17.5	14.1	5.9	17.2	17.9	8.6	-1.3	9.4
Average gross wages, real (CPI based)	20.7	20.0	16.7	17.0	20.5	18.4	15.0	6.8	15.4
Average gross wages, EUR (ER)	41.2	15.8	2.5	16.3	41.4	30.3	18.8	20.0	25.0
Employed persons (LFS)	-1.0	0.6	0.4	0.7	1.9	0.2	0.8	0.3	0.8
GDP per empl. person, NC at 2000 prices	10.3	4.6	9.2	11.4	0.8	7.1	7.0	1.8	5.5
Unit labour costs, NC at 2000 prices	22.5	15.7	12.5	14.5	35.7	20.6	21.2	31.4	24.4
Unit labour costs, ER (EUR) adjusted	28.0	10.7	-6.1	4.4	40.3	21.6	11.0	17.9	18.5
Austria									
GDP deflator	1.9	1.3	1.2	1.7	2.1	1.8	2.1	2.4	2.0
Real ER (CPI-based)	0.5	-0.3	-0.5	0.0	0.1	-0.7	-0.2	-0.4	-0.2
Real ER (PPI-based)	0.3	0.2	1.0	2.6	-2.4	-1.8	1.6	-0.3	-0.1
Average gross wages, NC	1.8	2.1	2.0	1.8	2.3	3.2	2.2	3.0	2.5
Average gross wages, real (PPI based)	0.3	2.5	0.4	-2.9	0.2	0.3	-1.8	-3.2	-1.5
Average gross wages, real (CPI based)	-0.9	0.3	0.6	-0.3	0.0	1.6	0.0	-0.2	0.3
Employed persons (LFS) 5)	0.7	1.4	0.8	0.4	2.1	2.7	2.5	1.5	1.9
GDP per empl. person, NC at 2000 prices	-0.2	0.3	0.0	2.1	0.7	0.6	0.5	0.2	0.8
Unit labour costs, NC at 2000 prices	2.0	1.8	2.0	-0.3	1.6	2.5	1.7	2.8	1.7
Unit labour costs, ER (EUR) adjusted	2.0	1.8	2.0	-0.3	1.6	2.5	1.7	2.8	1.7

5) From 2004 new methodology.

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

Sources: National statistics and wiiw estimates.

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Internet Homepage: www.wiiw.ac.at
Nachdruck nur auszugsweise und mit genauer Quellenangabe gestattet.
P.b.b. Verlagspostamt 1060 Wien