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Accelerating GDP Growth, Improved Prospects for European Integration

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Executive summary

The external conditions facing the transition economies slightly improved on balance during the year 2004. The eight new EU member states of Central and Eastern Europe (NMS-8) recorded higher GDP growth (5% on average) than in the previous year, largely thanks to expanding domestic demand – in particular of investment (Czech Republic, Hungary and Latvia) and of private consumption (Poland, Slovakia, Estonia and Lithuania). Growth accelerated also in Southeast Europe (except Croatia and Macedonia), as well as in Belarus and Ukraine (Russia's GDP grew by 7% again). The transition economies have thus been one of the most dynamic regions in the world. The NMS have been growing more than 2 percentage points faster than the 'old' EU-15. These countries not only add a certain dynamism to the European economy but put some pressure on the EU reform agenda as well. On the downside, the situation on the labour market remains precarious, robust economic growth notwithstanding. The average rate of unemployment in the NMS is nearly twice as high as in the EU-15 (mainly on account of Poland and Slovakia); in most of Southeast Europe it is even higher, with little prospect for marked improvements any time soon. The latter refers to industry in particular, which – despite a remarkable acceleration of output growth (10% on NMS average in 2004) – continues to shed labour. This implies impressive gains in labour productivity and, given the general wage restraint, in unit labour costs as well. The improving international costs competitiveness of NMS has recently been eroded by appreciating domestic currencies (Hungary, Poland and Slovakia).

After a temporary increase in 2004 (largely caused by tax adjustments prior to EU accession and rising energy prices), inflation resumed its downward trend, reaching low single digits in most NMS (except Slovakia) and in the remaining transition countries as well (except Romania, Serbia and Ukraine). Russian inflation has been stubbornly high, fuelled by large inflows of foreign currency, tariff hikes and galloping producer prices. The remaining inflation differential with respect to the eurozone, magnified by a natural appreciation tendency of NMS currencies (frequently stimulated by short-term capital inflows) may lead to competitiveness losses in the future. Given the ongoing productivity and quality improvements this danger is not imminent in most NMS yet. Still the exchange rate developments should be watched closely, not least in the period prior to EMU accession, which in several NMS will probably extend beyond 2010. The need to reduce excessive budget deficits represents another challenge facing several NMS in the coming years.

The outstanding feature of last year's economic developments was a boost in foreign trade (or of intra-EU dispatches and arrivals in the case of NMS). NMS exports jumped by more than 20% in current euro terms, somewhat faster than imports (+18%), yet their aggregate trade balance slightly deteriorated (in fact foreign trade contributed positively to GDP growth in Poland only). Nonetheless, the export sector of NMS is strengthening – not least thanks to sustained reforms and large FDI inflows in the past few years – and their integration in the European and world economy is increasing. Today, 86% of NMS exports and 72% of imports represent intra-EU trade. Given the high (and rising) export surpluses of Russia and Ukraine – in both cases swelled by rising world market commodity prices – the trade contribution to growth has been positive in these countries as well. After the takeover of EU external trade policies upon accession, especially intra-NMS trade

(preliminary estimates suggest an increase by 30% in 2004) and extra-EU trade are booming. Altogether, the NMS enjoy a surplus in trade transactions with the EU, an achievement attributable largely to the high and growing surpluses of the Czech Republic, Hungary and Slovakia (and to a lower deficit in Poland); the separate effect of trade with the EU on GDP growth was most likely positive. In Southeast Europe, trade integration is (with few exceptions such as Bulgaria) still rather low and many countries in the region suffer from huge trade and current account deficits which may not be sustainable (particularly in Bosnia and Herzegovina, and Serbia).

The EU accession of eight Central and East European countries on 1 May 2004 has brought few surprises and may generally be considered a success. The accession was well prepared and managed. The direct economic effects of accession on the NMS are difficult to identify: economic growth, especially of industry, had speeded up already before May 2004, a temporary increase of inflation was soon successfully contained and domestic currencies strengthened. Net transfers from the EU budget were negligible (less than 1% of NMS GDP), yet inflows of FDI picked up in 2004 again – albeit remaining below the peak of 2000-2002. The GDP growth outlook is fairly robust: barring major external shocks, the NMS are expected to grow by 4-5% annually in the coming years (the Baltic States will continue to enjoy even somewhat higher growth) thus maintaining their speed of nominal and real convergence to the 'old' EU. Inflation is converging to eurozone levels as well. The shadow side of this fairly upbeat forecast is the labour market where no substantial reduction of unemployment is expected. Estonia, Lithuania and Slovenia (all already participating in the ERM II) may adopt the euro in late 2006 or early 2007, with the remaining 'high-deficit' NMS following suit during 2008-2010.

Also the economic outlook for Southeast Europe is more encouraging now than in the recent past: GDP growth will accelerate in most countries (without recurring inflation), but unemployment will remain high. As far as the integration prospects of this region are concerned, Bulgaria and Romania will become EU members in 2007, followed by Croatia in 2008 and with Macedonia the next candidate. The coming two years will be crucial also for the remaining countries of the Western Balkans as a number of exceptionally difficult issues will have to be solved (in Bosnia and Herzegovina, Serbia, Montenegro and Kosovo). If everything goes well (and there are a lot of caveats) the whole region could be in the EU around 2015. However, by that time the issue of Turkey's EU membership will have to be finally decided and a possible application of Ukraine (as well as Moldova) for EU membership will have to be dealt with. In addition, the enlarged EU will simultaneously have to clarify its relations with Russia. These challenging developments will doubtlessly require a new (and this time much more radical) reform of the whole system of EU institutions.

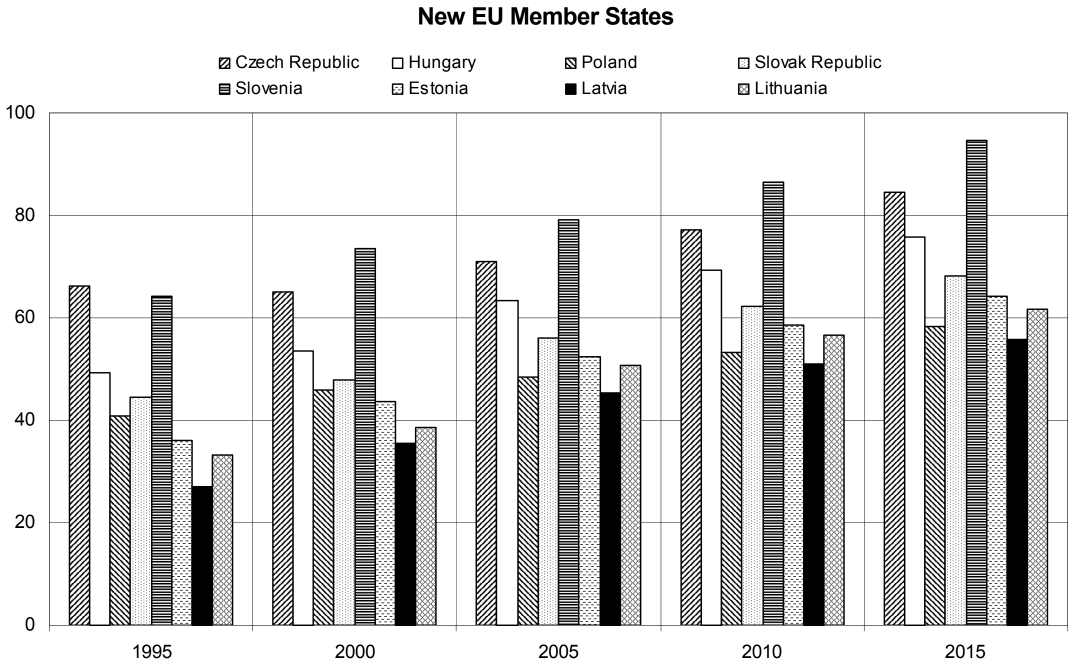
Keywords: *Central and East European new EU member states, Southeast Europe, Balkans, former Soviet Union, China, Turkey, GDP, industry, productivity, foreign trade, exchange rates, inflation, fiscal deficits, trade, ERM II*

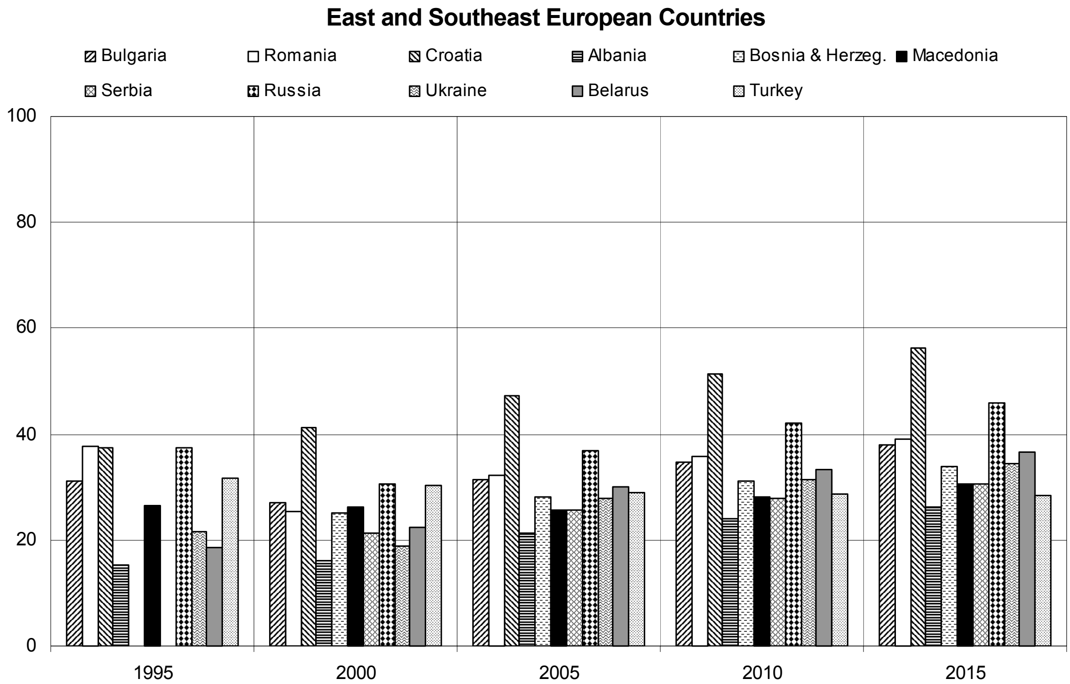
JEL classification: *O52, O57, P24, P27, P33, P52*

Figure I

Real per capita GDP in Central, East and Southeast European countries. 1995-2015,

European Union (25) average = 100





Projection assuming a 2 percentage points growth differential to the EU-15 after 2006.

Source: National statistics, Eurostat, wiiw estimates.

Table I

Overview developments 2003-2004 and outlook 2005-2006

	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			
	2003	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**
			forecast				**forecast**				**forecast**				**forecast**	
Czech Republic	3.7	3.8	3.9	4	0.1	2.8	1.8	2.2	7.8	8.3	8.7	9	-6.2	-5.4	-5.0	-4.9
Hungary	3.0	3.9	3.8	4.1	4.7	6.8	3.9	3.2	5.9	6.1	6.1	6.1	-9.0	-8.5	-7.9	-7.4
Poland	3.8	5.4	4.5	4.5	0.8	3.5	3	3	19.6	19.3	19	18	-2.2	-1.8	-2.5	-2.5
Slovak Republic	4.5	5.3	5.3	5.5	8.5	7.5	4	2.5	17.4	18.5	18	17	-0.8	-3.0	-4.4	-3.9
Slovenia	2.5	4.2	3.9	3.9	5.6	3.6	3	2.7	6.7	6.3	6	6	-0.4	-0.7	-0.5	-0.5
NMS-5 [2][3]	3.7	4.8	4.3	4.4	.	.	.	.	15.1	15.1	15.0	14.5	-4.1	-3.9	-4.1	-3.9
Estonia	5.1	6.2	6	5.7	1.3	3.0	2.8	2.5	10.0	10.0	9.5	9	-13.2	-15.1	-14.3	-13.4
Latvia	7.5	7.8	6	6.5	2.9	6.2	5.5	4.5	10.6	10.4	9.8	9.5	-8.2	-12.5	-12.7	-11.3
Lithuania	9.7	6.6	6.7	6.5	-1.2	1.2	1.5	1	12.4	11.4	11	10	-6.9	-8.3	-8.2	-7.3
NMS-8 [2][3]	4.0	4.9	4.5	4.5	.	.	.	.	14.7	14.6	14.5	14.0	-4.4	-4.5	-4.6	-4.3
EU-15 [3]	0.8	2.2	2.2	2.3	1.9	2.0	1.9	1.8	8.1	8.1	8.1	7.9	0.35	0.32	.	.
EU-25 [3]	1.1	2.4	2.4	2.5	2.0	2.1	2.1	1.9	9.1	9.1	9.1	8.8	0.14	0.10	.	.
Bulgaria	4.3	5.6	5	5	2.3	6.2	4	3	13.7	12.0	11	10	-8.6	-7.2	-6.1	-5.6
Croatia	4.3	3.7	3.5	3.5	1.8	2.1	2	2	14.3	13.8	13.5	13	-7.3	-6.1	-5.6	-5.3
Romania	4.9	7.8	5	5.5	15.3	11.9	9	7	7.0	7.5	8	8	-6.1	-7.7	-7.7	-7.4
Albania [4]	6.0	6.0	6.5	6.5	2.3	2.9	4	3	15.0	14.4	14	13.5	-6.7	-4.3	-6.0	-5.0
Bosnia and Herzegovina [4][5]	3.5	6	5	5	0.6	0.2	0.5	0.5	42.0	42	42	42	-30.2	-27.7	-24.3	-21.7
Macedonia [5]	3.4	2	4	4	2.4	0.9	2	2	36.7	37	35	35	-3.3	-7.1	-6.7	-6.5
Serbia and Montenegro [6]	2.5	8	5	5	9.4	10.8	10	10	15.2	15	15	15	.	.	.	.
Serbia	2.6	7	5	5	9.9	11.4	10	10	15.2	15	15	15	-10.2	-13.5	-15.0	-14.4
Montenegro	2.4	10	5	5	6.7	2.4	3	2	20.0	20	20	20	-7.3	-5.7	-5.0	-5.0
Turkey	5.8	8.0	6	6	25.3	10.6	7	5	10.5	10.5	10.8	11	-3.3	-5.2	.	.
Belarus [4]	7.0	11.0	8	6	28.0	18.1	14	12	3.1	1.9	2	2	-3.0	-3.5	-3.0	-2.5
Russia	7.3	7.1	5	5.5	13.6	11.0	11	10	8.6	8.2	8.5	9	8.2	10.0	7.2	6.0
Ukraine	9.4	12.0	9	7	5.2	9.0	10	8	9.1	8.0	7.5	7.5	5.8	11.3	9.5	6.0

Notes: NMS: the New EU Member States. - 1) LFS - Labour Force Survey, refers to ILO definition. - 2) wiiw estimate. - 3) Current account data include flows within the region. - 4) Unemployment rate by registration, end of period. - 5) Consumer price inflation measured by retail prices. - 6) Excluding Kosovo and Metohia.

Source: wiiw (February 2005); Eurostat; forecasts for EU-15: European Commission.

Table II **Central and East European new EU member states (NMS-8): an overview of economic fundamentals, 2004**

	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Slovak Republic	Slovenia	NMS-8 1)	EU-15	EU-25 2)
GDP in EUR at exchange rates, EUR bn	85.26	8.86	82.25	10.83	17.90	195.02	33.21	25.96	459.28	9720.11	10204.45
GDP in EUR at PPP, EUR bn	155.63	15.22	140.27	22.38	37.30	404.07	65.33	34.62	874.83	9306.40	10204.45
GDP in EUR at PPP, EU-25=100	1.5	0.1	1.4	0.2	0.4	4.0	0.6	0.3	8.6	91.2	100.0
GDP in EUR at PPP, per capita	15570	11280	13890	9670	10860	10580	12140	17350	12034	24251	22288
GDP in EUR at PPP per capita, EU-25=100	70	51	62	43	49	47	54	78	54	109	100
GDP at constant prices, 1990=100	114.8	116.0	124.1	85.8	94.5	141.9 3)	123.6	135.7	136.9	130.6	131.0
GDP at constant prices, 2000=100	112.1	127.4	115.0	133.2	132.8	112.0	119.5	113.3	114.5	105.9	106.2
Industrial production real, 1990=100	109.6	91.6	185.8	61.3	56.2	209.9 3)	117.6	100.4	154.8	119.8	121.4
Industrial production real, 2000=100	129.9	140.4	122.8	130.4	153.2	122.8	126.3	112.0	125.4	101.2	102.3
Population - thousands, average	10207	1349	10097	2314	3436	38183	5382	1997	72965	383759	457847
Employed persons - LFS, thousands, average	4707	595	3900	1020	1435	13707	2161	933	28458	161792 4)	190225 4)
Unemployment rate – LFS, in %	8.3	10.0	6.1	10.4	11.4	19.3	18.5	6.3	14.6	8.1	9.1
Public sector expenditures, EU-def., in % of GDP	46.7	38.7	48.7	36.0	35.7	51.2	40.1	47.5	47.6	48.0	48.0
Public sector revenues, EU-def., in % of GDP	42.4	39.3	43.3	34.0	33.2	45.6	34.6	45.3	42.8	45.3	45.1
Price level, EU-25=100 (PPP/exchange rate)	54	58	59	48	48	48	51	75	52	104	100
Compensation per employee,5) monthly, in EUR	818	644	958	420	500	755	609	1515	780	2900	2625
Compensation per employee, monthly, EU-25=100	31.1	24.5	36.5	16.0	19.1	28.8	23.2	57.7	29.7	110.5	100.0
Exports of goods in % of GDP	62.4	54.3	53.2	30.7	42.0	33.1	67.5	48.9	46.1 6)	27.9 6)	28.7 6)
Imports of goods in % of GDP	63.7	74.6	56.2	51.1	52.0	35.9	70.8	51.9	49.8 6)	26.8 6)	27.8 6)
Exports of services in % of GDP	9.1	25.5	9.0	13.2	10.8	5.3	8.7	10.7	8.0 6)	8.1 6)	8.1 6)
Imports of services in % of GDP	8.6	15.6	10.0	9.0	7.3	5.1	8.1	8.2	7.4 6)	7.7 6)	7.7 6)
Current account in % of GDP	-5.4	-15.1	-8.5	-12.5	-8.3	-1.8	-3.0	-0.7	-4.4 6)	0.3 6)	0.1 6)
FDI stock per capita in EUR	4120	4680	4660	1470	1340	1230	1950	2760	2280	.	.

NMS-8: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia. EU-15: EU up to 30 April 2004. EU-25: EU as of 1 May 2004. PPP: Purchasing power parity.

1) wiiw estimates. - 2) wiiw estimates, except: employed persons, budget and compensation per employee. - 3) 1989 = 100, which in the Polish case is the appropriate reference year. - 4) Employed persons aged 15-64, 2Q2004. - 5) Gross wages plus indirect labour costs, whole economy, national account concept. - 6) NMS-8, EU-15 and EU-25 data include flows within the region.

Source: wiiw, AMECO, Eurostat.

Table III

Southeast Europe: an overview of economic fundamentals, 2004

	Albania	Bosnia and Herzegovina	Bulgaria	Croatia	Macedonia	Romania	Serbia	NMS-8 [1)]	EU-15	EU-25 [2)]
GDP in EUR at exchange rates, EUR bn	6.55	6.65	19.56	27.66	4.25	57.14	17.78	459.28	9720.11	10204.45
GDP in EUR at PPP, EUR bn	14.61	17.04	53.13	46.19	11.40	151.39	42.01	874.83	9306.40	10204.45
GDP in EUR at PPP, EU-25=100	0.1	0.2	0.5	0.5	0.1	1.5	0.4	8.6	91.2	100.0
GDP in EUR at PPP, per capita	4570	6090	6830	10400	5620	6980	5600	12034	24251	22288
GDP in EUR at PPP per capita, EU-25=100	20	27	31	47	25	31	25	54	109	100
GDP at constant prices, 1990=100	144.0	413.3 [3)]	97.5	101.8	92.6	105.6	57.5	136.9	130.6	131.0
GDP at constant prices, 2000=100	126.6	120.9	120.3	118.8	101.6	125.5	119.3	114.5	105.9	106.2
Industrial production real, 1990=100	43.8	.	73.2	77.4	44.3	75.2	.	154.8	119.8	121.4
Industrial production real, 2000=100	115.4	130.5	138.0	120.6	83.9	122.7	105.8	125.4	101.2	102.3
Population - thousands, average	3200	3850	7780	4440	2030	21700	7500	72965	383759	457847
Employed persons - LFS, thousands, average	925 [4)]	634 [5)]	2923	1583	540	9180	3000 [6)]	28458	161792 [7)]	190225 [7)]
Unemployment rate – LFS, in %	14.4	42	12.0	13.8	37	7.5	15	14.6	8.1	9.1
Public sector expenditures, nat. def., in % of GDP	27.5	42.6 [8)]	39.7	49.5 [8)]	22.3 [8)]	31.9 [8)]	.	47.6	48.0	48.0
Public sector revenues, nat. def., in % of GDP	22.3	43.3 [8)]	41.5	44.9 [8)]	21.3 [8)]	29.8 [8)]	.	42.8	45.3	45.1
Price level, EU-25=100 (PPP/exchange rate)	45	39	37	60	37	38	42	52	104	100
Average gross monthly wages, EUR at exchange rate	188 [9)]	380	153	799	200	204	190 [10)]	780 [11)]	2900 [11)]	2625 [11)]
Average gross monthly wages, EUR at PPP	420 [9)]	974	415	1334	536	540	449 [10)]	1485 [11)]	2777 [11)]	2625 [11)]
Exports of goods in % of GDP	7.5	24.5	40.9	23.9	31.8	33.1	14.9	46.1 [12)]	27.9 [12)]	28.7 [12)]
Imports of goods in % of GDP	26.0	79.5	53.7	48.5	55.0	42.5	49.2	49.8 [12)]	26.8 [12)]	27.8 [12)]
Exports of services in % of GDP	11.7	10.3	17.1	27.8	7.2	5.1	6.1	8.0 [12)]	8.1 [12)]	8.1 [12)]
Imports of services in % of GDP	11.6	5.7	13.3	10.8	8.2	5.5	4.6	7.4 [12)]	7.7 [12)]	7.7 [12)]
Current account in % of GDP	-4.3	-27.7	-7.2	-6.1	-7.1	-7.7	-14.0	-4.4 [12)]	0.3 [12)]	0.1 [12)]
FDI stock per capita in EUR	440	390	740	2370	590	600	700	2280	.	.

NMS-8: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia. EU-15: EU up to 30 April 2004. EU-25: EU as of from 1 May 2004. PPP: Purchasing power parity - wiiw estimates for Albania, Bosnia and Herzegovina, Serbia.

1) wiiw estimates. - 2) wiiw estimates, except for: employed persons, budget and compensation per employee. - 3) 1995 = 100. - 4) Employment total. - 5) Employees, end of year 2003. - 6) Year 2002. - 7) Employed persons aged 15-64, 2Q2004. - 8) Year 2003; Croatia IMF-def. - 9) Public sector. - 10) Average net monthly wages, including various allowances. - 11) Gross wages plus indirect labour costs, whole economy, national account concept. - 12) NMS-8, EU-15 and EU-25 data include flows within the region.

Source: wiiw, AMECO, Eurostat.

Part A: The new EU member states

*Peter Havlik and Leon Podkaminer**

The new EU member states: faster GDP growth, booming foreign trade

External conditions: somewhat better in 2004, slightly worse in 2005 and 2006

The long-awaited recovery in the EU-15, which finally materialized in 2004, has not been really impressive: other OECD countries grew twice as fast. Nonetheless, compared with the mediocre GDP growth rates in 2002 and 2003 (1% and 0.8% respectively), the 2.2% growth recorded by the 'old' EU in 2004 is generally considered to have had positive impacts on the new EU member states (NMS). The fast growth prevailing in other transition countries (particularly in Russia, Ukraine and Romania) has also been conducive to growth acceleration in the NMS. Although NMS exports to these countries are relatively low, they have strongly expanded recently. The NMS add some dynamism to the European economy (GDP in the enlarged EU-25 increased by 2.4% in 2004), they put some urgency on the European reform agenda (such as concerning the Stability and Growth Pact and the Lisbon Strategy) and even set new accents to the EU's external policies (e.g. regarding Ukraine). It will be exciting to watch how much their voice will be heard in the formulation of the next EU Financial Perspective for 2007-2013 with its potentially very important implications for medium- and long-term growth in the NMS.

Among other factors affecting the NMS economies in the recent past, the substantial weakening of the US dollar against the euro has on the whole had a positive impact in 2004. Both exports and imports of the NMS are transacted primarily in euro (which generally has remained quite steady vs. their national currencies), but prices of their oil and natural gas imports are quoted in US dollars. The weakening of the US dollar thus helped to moderate the negative effects of high world market energy prices. Rising demand for other raw materials (steel in particular) – and the vigorous rise in their international prices observed in 2004 – may actually have been beneficial to several NMS which had managed to preserve sizeable steel sectors (Poland, Slovakia and the Czech Republic).

In 2005, economic growth in the EU-15 is likely to slow down slightly – especially if the euro remains strong vs. the US dollar. Domestic demand in Germany, which has been sluggish for many years, is unlikely to rebound very much. The German labour market reforms will have adverse effects on domestic demand, at least in the near future. But the external competitiveness of Germany vs. other EU countries must be expected to improve further. This way the internal weakness of the German economy will be externalized throughout the whole EU, and beyond. On that count the external conditions facing the NMS in 2005 (and possibly also 2006) will most probably be less favourable than in 2004. Also, growth is expected to slow down in most other transition countries (Russia, Ukraine, some Balkan countries), which will continue to be of some importance for NMS exports. Concluding, in so far as the external conditions contribute to their performance, one can expect a slightly dampening effect on growth in the NMS in 2005 with a possible modest rebound later on.

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* Research for this report was completed on 25 February 2005. The authors of the country reports provided valuable comments on the draft of this overview.

GDP growth in 2004 driven mainly by domestic demand

In the NMS-5 (the Czech Republic, Hungary, Poland, Slovakia and Slovenia) GDP growth was appreciably higher in 2004 – nearly 5% on average – than in the past several years. GDP growth in the three Baltic States accelerated slightly in 2004 as well (excepting Lithuania) and continued to be very high (see Table 1).

Table 1

Gross domestic product

real change in % against preceding year

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 1)	2005 forecast	2006 forecast	Index 1990=100 2004	Index 2000=100 2004
Czech Republic	5.9	4.2	-0.7	-1.1	1.2	3.9	2.6	1.5	3.7	3.8	3.9	4	114.8	112.1
Hungary	1.5	1.3	4.6	4.9	4.2	5.2	3.8	3.5	3.0	3.9	3.8	4.1	124.1	115.0
Poland	7.0	6.0	6.8	4.8	4.1	4.0	1.0	1.4	3.8	5.4	4.5	4.5	160.4	112.0
Slovak Republic	5.8	6.1	4.6	4.2	1.5	2.0	3.8	4.6	4.5	5.3	5.3	5.5	123.6	119.5
Slovenia	4.1	3.6	4.8	3.6	5.6	3.9	2.7	3.3	2.5	4.2	3.9	3.9	135.7	113.3
NMS-5 2)	5.7	4.8	4.7	3.5	3.4	4.0	2.1	2.1	3.7	4.8	4.3	4.4	140.2	113.1
Estonia	4.5	4.5	10.5	5.2	-0.1	7.8	6.4	7.2	5.1	6.2	6	5.7	116.0	127.4
Latvia	-0.8	3.8	8.3	4.7	3.3	6.9	8.0	6.4	7.5	7.8	6	6.5	85.8	133.2
Lithuania	3.3	4.7	7.0	7.3	-1.7	3.9	6.4	6.8	9.7	6.6	7	6.5	94.5	132.8
NMS-8 2)	5.4	4.7	5.0	3.7	3.2	4.1	2.4	2.4	4.0	4.9	4.5	4.5	136.9	114.5

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

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

Expanding gross fixed capital formation (investment for brevity) was one of the sources of GDP growth in all NMS (see Table 2). Everywhere (except Lithuania where investment growth has been high for a couple of years) investment growth accelerated, and its previous contraction in Slovakia and Poland came to an end in 2004. The contribution of rising investment expenditure to total effective expenditure (effective demand) – and hence to actual GDP growth recorded – depends not only on the magnitude of the rate of growth of investment. One also has to allow for the 'base', i.e. the investment's share in the GDP. Of course this applies to other components of the GDP, i.e. consumption, exports and imports as well. In particular a judgement on whether the foreign trade in goods and non-factor services (with changing real *volumes* of both exports and imports) has contributed positively to the rise in GDP may easily be wrong if one abstracts from the shares of exports and imports in the GDP. (It is also worth remembering that even if the trade balance measured at *current* prices – e.g. at current euro – improves strongly, the actual contribution of foreign trade to the *real* GDP growth may still be negative.)

Table 2

Gross fixed capital formation

real change in % against preceding year

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 [1)]	2005 forecast	2006 forecast	Index 1990=100 2004	Index 2000=100 2004
Czech Republic	19.8	7.6	-3.4	-1.1	-3.6	4.9	5.4	3.4	4.8	10	8	7	144.8	125.6
Hungary	-4.3	6.7	9.2	13.3	5.9	7.7	5.0	8.0	3.4	10	7	12	186.1	129.0
Poland	16.5	19.7	21.7	14.2	6.8	2.7	-8.8	-5.8	-0.5	5.1	7	.	209.8	89.8
Slovak Republic	0.6	29.1	15.0	11.0	-19.6	-7.2	13.9	-0.6	-1.5	4.0	7	10	94.7	116.0
Slovenia	16.8	11.3	13.5	9.9	21.0	0.6	4.1	3.1	6.3	6.9	6.5	6	234.5	121.9
Estonia	4.1	11.4	17.6	11.3	-15.5	14.3	13.0	17.2	5.4	7.0	6	5.5	.	149.4
Latvia	8.7	22.3	20.7	61.4	-6.8	10.2	11.4	13.0	10.9	15.0	9	8	85.5	160.6
Lithuania	.	15.2	24.5	21.8	-6.1	-9.0	13.5	11.1	14.0	14.0	15	12	.	163.9

Note: 1) Preliminary.

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

To gauge the actual importance of changes in individual GDP components for the GDP growth properly, one can calculate the *contributions* of those components to the overall GDP growth rates.[1] Table 3 reports these contributions to the recent GDP growth rates in NMS.

As can be seen, the sources of the recent growth are rather dissimilar across the individual countries. In the first three quarters of 2004, it was only total consumption (private and public combined) that contributed quite significantly to overall GDP growth in all NMS. However, even in this case there is an exception – the Czech Republic – where the contribution of consumption has been marginal. The contributions of gross fixed investment were quite significant generally, but not in Poland and Slovakia given their relatively weak investment growth. Perhaps surprisingly (considering last year's strong nominal export growth – see below), the contributions of foreign trade were negative everywhere (except Poland), but varied widely across countries (from fairly low absolute negative values in Slovenia and Slovakia, through moderate in Hungary, the Czech Republic and Estonia, to very high negative values in Latvia and Lithuania). In other words, foreign trade apparently *reduced real* GDP growth in the first three quarters of 2004 (and thus most probably in the whole year of 2004) in the NMS (except in Poland, where it added to growth relatively little). Or, equivalently, GDP growth in all NMS was driven by *domestic demand* everywhere (including Poland) in 2004.[2] Thus, the impression one may get from the data on NMS foreign trade (in goods),

1 The contribution of a GDP component to the GDP growth rate in a given period equals its GDP share in the previous period (at constant prices) times its real growth rate. If the original data on GDP, its structure and all growth rates involved are internally consistent, then the sum of the components' contributions must equal the overall GDP growth rate. This property allows the measurement of the contributions of foreign trade (in goods and services, which equals the contribution of exports minus the contribution of imports) or of changes in inventories (sometimes lumped together with the item called 'acquisition less disposals of non-financial valuables' and with statistical discrepancies). The contribution of changes in inventories (combined with other 'residuals') equals the GDP growth rate minus the contribution of total consumption minus contribution of total fixed investment minus the contribution of foreign trade.

2 This contrasts with developments in the eurozone (and especially in Germany) where domestic demand was much weaker in both 2003 and 2004 – see Table 3 and Eurostat News Release 6/2005, 12 January 2005.

measured in current euro (see below) – that foreign trade must have contributed to growth in 2004 – is probably not fully substantiated.

Table 3

Contributions (in percentage points) to the GDP growth rates in NMS and the eurozone

	2000	2001	2002	2003	1-3 Q 2003	1-3 Q 2004	2004
Czech Republic							
GDP growth rate (%)	**3.9**	**2.6**	**1.5**	**3.7**	**3.6**	**3.7**	**3.8**
Consumption	1.6	2.2	2.5	3.6	3.6	0.9	
Gross fixed investm.	1.5	1.6	1.1	1.5	1.4	3.1	
Trade balance	-1.1	-2.2	-2.7	-1.5	-1.3	-1.5	
Hungary							
GDP growth rate (%)	**5.2**	**3.8**	**3.5**	**3.0**	**2.8**	**4.1**	**3.9**
Consumption	3.2	4.1	6.3	5.6	6.0	2.2	
Gross fixed investm.	1.9	1.2	2.0	0.9	0.5	2.9	
Trade balance	0.5	2.1	-2.1	-2.6	-4.3	-1.2	
Poland							
GDP growth rate (%)	**4.0**	**1.0**	**1.4**	**3.8**	**3.5**	**5.9**	**5.4**
Consumption	2.0	1.4	2.2	2.0	1.8	2.9	
Gross fixed investm.	0.7	-2.2	-1.2	-0.1	-0.2	0.6	
Trade balance	1.0	2.7	0.6	1.2	1.0	0.7	
Slovenia							
GDP growth rate (%)	**3.9**	**2.7**	**3.3**	**2.5**	**2.4**	**4.5**	**4.2**
Consumption	0.7	2.0	0.5	2.0	1.8	2.2	
Gross fixed investm.	0.2	1.2	0.9	1.8	1.7	2.0	
Trade balance	2.4	1.8	1.0	-2.4	-2.4	-0.4	
Slovak Republic							
GDP growth rate (%)	**2.0**	**3.8**	**4.6**	**4.5**	**4.2**	**5.4**	**5.3**
Consumption	-0.1	3.5	3.8	0.4	-0.1	2.0	
Gross fixed investm.	-2.0	3.6	-0.3	-0.3	-0.3	0.8	
Trade balance	1.9	-3.7	0.0	6.4	5.2	-0.2	
Estonia							
GDP growth rate (%)	**7.8**	**6.4**	**7.2**	**5.1**	**4.8**	**6.2**	**6.2**
Consumption	5.2	4.0	7.1	4.5	4.4	4.3	
Gross fixed investm.	3.9	3.7	5.2	1.8	2.6	2.4	
Trade balance	-2.3	-2.5	-3.1	-6.2	-6.7	-1.8	
Latvia							
GDP growth rate (%)	**6.9**	**8.0**	**6.4**	**7.5**	**7.4**	**8.5**	**7.8**
Consumption	3.0	5.1	4.9	5.7	5.5	6.0	
Gross fixed investm.	2.6	3.0	3.5	3.1	2.8	4.7	
Trade balance	3.6	-4.3	-0.1	-5.1	-5.5	-5.1	
Lithuania							
GDP growth rate (%)	**3.9**	**6.4**	**6.8**	**9.7**	**9.1**	**6.7**	**6.6**
Consumption	4.7	2.4	4.2	8.6	7.8	7.9	
Gross fixed investm.	-2.7	3.5	3.1	4.0	4.1	4.2	
Trade balance	1.6	-1.5	-2.4	-4.4	-3.3	-10.6	
Eurozone							
GDP growth rate (%)	**3.5**	**1.6**	**0.9**	**0.5**	**0.4**	**2.0**	**2.0**
Consumption	2.1	1.5	1.0	0.8	1.0	1.0	
Gross fixed investm.	1.1	-0.1	-0.6	-0.1	-0.2	0.4	
Trade balance	0.5	0.7	0.6	-0.6	-0.6	0.4	

Source: Ameco, Eurostat, wiiw estimates.

The absence of convincing statistical evidence of strong impacts of the 'EU-15 business climate' on what happens to the contributions of foreign trade to overall GDP growth in the NMS does not imply that no such impacts exist. It can be argued – though not definitely proved – that, if growth in the EU-15 had been much lower in 2004, the foreign trade contributions to growth in the NMS would have been even lower than actually observed. By the same token also EU membership itself may have been good for trade (and thus for overall GDP growth) of the NMS (see section on foreign trade below). Nonetheless, it is still certain that the recent developments in the individual NMS follow quite separate paths. This is understandable because, despite several common features, there are many important differences. The individual NMS do not yet share the same problems, and do not conduct the same economic policies. Moreover, their emerging 'business cycles' are also far from synchronized. For that reason a deeper understanding of the macro performance of the individual NMS requires detailed country studies.

Without even trying to substitute such studies (brief country overviews are attached to this report) one can still use the contents of Table 3 to make a few observations regarding individual countries:

- The moderate GDP growth rates prevailing in the **Czech Republic** since 2000 have been associated with moderate (positive) contributions of both consumption and investment. The contribution of foreign trade in goods and services has been consistently negative – though moderate as well. The year 2004 conforms to that pattern. it is interesting that the higher positive contribution of investment in 2004 (reflecting the higher growth rate of investment) did not have much of an effect on the contribution of the trade balance. Apparently, higher investment did not require growing 'net transfers of resources from abroad'. Instead, there was a reduction in the contribution of consumption (signifying a much lower growth rate of consumption). This constellation of the contributions of investment, consumption and foreign trade has been quite typical of the Czech economy. There is a tendency for restricting the external imbalance – even if that results in relatively modest GDP growth and occasionally dampens growth of consumption. In the near future GDP is expected to grow moderately as well. Of course, consumption is unlikely to remain depressed permanently. Sooner or later its growth will accelerate. This is likely to be associated with a deceleration of investment growth, rather than with expanding external imbalances. In the longer run this need not matter much as far as the production potential (its fixed assets) of the Czech economy is concerned. The share of gross fixed capital formation has been very high, on average 27% of the GDP (at current prices) in the 2000s (and close to 30% in the 1990s). Thus production capacities have been expanding relative to the GDP. It is quite surprising that with such a high investment ratio one does not see much stronger GDP growth. (Or, one may wonder why the investment ratio in the Czech Republic is so high, given the relatively slow rise in the productivity of capital.)
- **Hungary's** recent growth has not been very impressive either and it appears rather volatile in terms of the changes in the composition of GDP growth. In particular there has been a tendency for wild swings in the contributions of foreign trade to GDP growth (e.g. from +2.1 p.p. in 2001 to -2.1 p.p. in 2002; or from -4.3 p.p. in the first three quarters of 2003 to -1.2 p.p. in 2004 – see Table 3). The decline in the foreign trade contribution since 2000 has been associated with a growing contribution of consumption. The strong expansion of consumption was achieved at the cost of unfavourable changes in foreign trade. Of course, part of that development must be attributed to the fairly generous fiscal and incomes policies conducted by the authorities over extended periods of time – and in due time requiring harsh budgetary and/or wage restrictions. The cycles consisting of prolonged consumption booms and growing external imbalance (2002-2003) followed by abrupt restrictions on consumption growth and an improved external balance (in 2004) were quite typical even under Hungary's 'planned economy' in the past. That cycle seems to have survived the transition to a market economy. The first such cycle in the 1990s ended with the implementation of the so-called 'Bokros programme' in 1994/95. Recently Hungary is experiencing a milder version of a broadly similar consolidation, which is putting an end to an extended period when consumption

expanded at the cost of growing external imbalance. So far the effects of the current consolidation efforts seem to be better than was the case with the austere 'Bokros programme'. Although the contribution of consumption to GDP growth has been radically reduced in 2004, it is still positive and significant. There has been no 'overkill' – the restrictions did not interfere with capital formation. Actually, growth of investment accelerated. Nonetheless the negative contribution of foreign trade to GDP growth was much reduced. As in the past, the Hungarian economy may now seem to be facing a period of calm, with relatively steady and broadly balanced growth. However, that period may come to end even before the next wave of populist sentiments prevails. As in several other NMS, the exchange rates have ceased to be controllable in Hungary. Thus, if the Hungarian currency chooses to unduly appreciate, the situation may deteriorate even without the return of lax fiscal/income policies.

- **Poland** went through a period of weak growth in the early 2000s. The contribution of investment to GDP growth was marginal already in 2000. In 2001-2002, the GDP virtually stagnated and there was a strong recession of investment, followed by stagnation in 2003. In 2001 and 2002 the GDP growth rates were reduced, on account of falling investment, by 2.2 and 1.2 p.p. respectively. The contributions of consumption were not impressive at all during the whole period 2000-2003. But foreign trade was contributing to GDP growth positively (and rather significantly) over the whole period, including the GDP recovery in 2003 and its further acceleration in 2004. Such an outcome can be attributed, at least partly, to the strong depreciation of the Polish currency in 2002-2003, extending to the first months of 2004. The strong appreciation of the currency in the second part of 2004 (and early 2005) is likely to result in imports rising faster than exports – and the foreign trade contribution to GDP growth turning negative. Unless this is accompanied by a strong rise in consumption and investment (which of course would further reduce the positive foreign trade contribution), the overall GDP growth rate will be reduced in 2005. Such a reduction is all the more probable as the high rise in inventories (in 2004) is unlikely to be repeated in 2005.
- Over the period 2000-2002, consumption, investment and foreign trade all contributed positively to **Slovenia's** (moderate) GDP growth rates. In actual fact the contribution of foreign trade was very significant (even decisive in 2000 and 2002). The least important was the contribution of investment – which reflected its weak dynamics (the share of investment in GDP has been relatively high). The acceleration of investment and consumption in 2003 turned out to be combined with a strong deterioration of the contribution of foreign trade to GDP growth (from +1 p.p. in 2002 to -2.4 p.p. in 2003). This turnaround seems rather astonishing (given the policy of sustained depreciation followed in Slovenia). Possibly, the low growth in the EU-15 registered in 2003 had a real impact on what happened to Slovenia's foreign trade. By the same token the strong improvement in the foreign trade contribution in the first three quarters of 2004 may reflect the much better business climate in the EU-15, as well as in the Balkans, which continue to be an important outlet for Slovenian exports. The conventional wisdom on the importance of growth in the EU-15 for the performance in the NMS may, after all, apply to Slovenia much more than to other NMS. This would imply that the slowdown of growth in the EU-15 expected in 2005 will be affecting Slovenian trade negatively and the contribution of foreign trade to GDP growth in 2005 may turn out to be even worse than in 2004.
- The consistently high GDP growth in **Slovakia** since 2001 appears to be combined with a rather strong volatility in the contributions of foreign trade and consumption. The swings in the contribution of consumption indicate that the authorities tend to be active in controlling public spending and wages, apparently trying to neutralize the swings in the contribution of foreign trade (which have been even more extreme). There are no good grounds to assume that in the future the authorities will be less successful in steering domestic demand (in response to foreign trade developments).
- In terms of growth, the three **Baltic States** have much in common. First, all of them are growing rather fast and the contributions of both consumption and gross fixed capital formation to the GDP growth rates are consistently high, or very high. Unlike in the NMS-5, there is little evidence that their huge external imbalances have forced major adjustments in consumption and investment, at least for the time being. Second, the contributions of foreign trade are persistently negative – and high, or even very high.

Apparently, financing the underlying external trade and current account deficits does not (yet) pose any problem. Third, the interpretation of the GDP data for the Baltic countries is not without problems. Those data suggest that in each of these countries there has been a systematic build-up of large inventories/net acquisitions of valuables sustained over a number of years.[3] That such a build-up actually takes place is hard to believe. More likely, some parts of the GDP growth reported for the Baltic countries represents 'statistical discrepancies' rather than real growth.

Industry gathers strength, growth accelerates again

In the past few years, the NMS industrial sector underwent sweeping restructuring which was facilitated by both sustained reform efforts and considerable inflows of foreign direct investments (FDI, see below). Production has been rapidly growing during the past decade while overall industrial employment has declined (or stagnated at best in some NMS such as Hungary), resulting in substantial productivity improvements. During the period 2000-2004, industrial output grew by 25% (Table 4), and labour productivity increased by more than 30% on average for all NMS, the fastest growth being recorded in the Baltic States (which started from a very low base). Industrial restructuring has been accompanied by large shifts in the sectoral structure within industry in the individual NMS; in particular, transport and electrical equipment in the NMS-5, wood products and furniture in the Baltic States (as well as textiles and clothing in the next entrants Bulgaria and Romania) emerged as new specialization patterns in the respective countries.

Table 4

Gross industrial production

real change in % against preceding year

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 1)	2005 forecast	2006 forecast	Index 1990=100 2004	Index 2000=100 2004
Czech Republic	8.7	2.0	4.5	1.6	-3.1	5.4	6.5	4.8	5.8	10.0	9	9	109.6	129.9
Hungary	4.6	3.4	11.1	12.5	10.4	18.1	3.6	2.8	6.4	8.4	7	10	185.8	122.8
Poland 2)	9.7	8.3	11.5	3.5	3.6	6.7	0.6	1.1	8.1	11.6	8	8	209.9	122.8
Slovak Republic	8.3	2.5	2.7	5.0	-2.6	8.4	7.6	6.7	5.3	4.5	5	7	117.6	126.3
Slovenia	2.0	1.0	1.0	3.7	-0.5	6.2	2.9	2.4	1.4	4.8	3.5	3	100.4	112.0
NMS-5 3)	8.3	5.1	8.6	4.6	2.4	8.3	3.2	2.8	6.8	9.8	7.6	8.2	162.1	124.3
Estonia	1.9	2.9	14.6	4.2	-3.4	14.6	8.9	8.2	9.8	8.5	7.5	7	91.6	140.4
Latvia	-3.7	5.5	13.8	3.1	-5.4	4.7	9.2	5.8	6.5	6.0	6	6	61.3	130.4
Lithuania	5.3	5.0	3.3	8.2	-11.2	2.2	16.0	3.1	16.1	10.3	10	9.5	56.2	153.2
NMS-8 3)	7.9	5.1	8.6	4.7	1.8	8.1	3.7	2.9	7.1	9.8	7.7	8.2	154.8	125.4

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

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

Growth of industrial production accelerated in 2004 again, to nearly 10% on average for all NMS, in most countries already prior to EU accession (Poland, Hungary and the Czech Republic recorded

3 Of course, occasionally one observes high increases in inventories in the NMS-5 too. But such increases precede (and often follow) decreases in inventories – and are not sustained over longer periods of time.

Table 5

Labour productivity in industry

change in % against preceding year

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 [1)]	Index 1990=100 2004	Index 2000=100 2004
Czech Republic [2)]	10.6	8.6	9.2	3.7	1.7	9.5	5.5	5.8	8.9	10.5 I-XI	176.7	134.3
Hungary [3)]	10.2	9.4	13.7	11.9	10.5	17.7	4.8	4.6	10.2	11.1 I-XI	313.7	134.2
Poland [4)]	6.3	9.1	11.2	4.7	11.8	13.6	4.6	6.6	9.4	13.1 I-XII	325.4	138.0
Slovak Republic	4.0	2.5	4.8	9.1	0.4	11.9	6.5	6.5	4.7	4.5 I-XI	154.3	124.1
Slovenia	6.3	9.2	4.4	5.4	3.1	8.4	3.5	5.6	3.6	5.6 I-XI	195.2	119.5
Estonia	8.4	5.8	15.4	2.2	4.2	17.6	15.3	10.3	.	.		
Latvia	.	.	.	.	.	.	.	.	.	.		
Lithuania	.	11.3	3.2	13.4	-6.6	5.5	19.3	.	.	.		

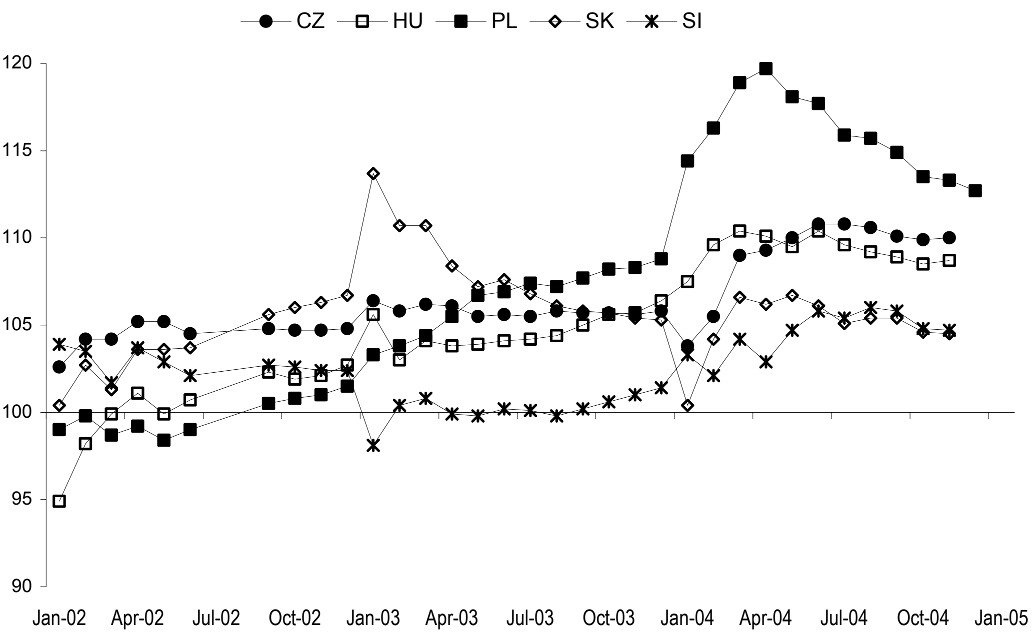
Notes: 1) Preliminary. - 2) Enterprises with 100 and more, from 1997 with 20 and more employees. From 2001 calculated with sales. - 3) Enterprises with more than 10, from 1999 more than 5 employees. - 4) For 2003 enterprises with more than 9 employees.

Source: wiiw Database incorporating national statistics.

Figure 1

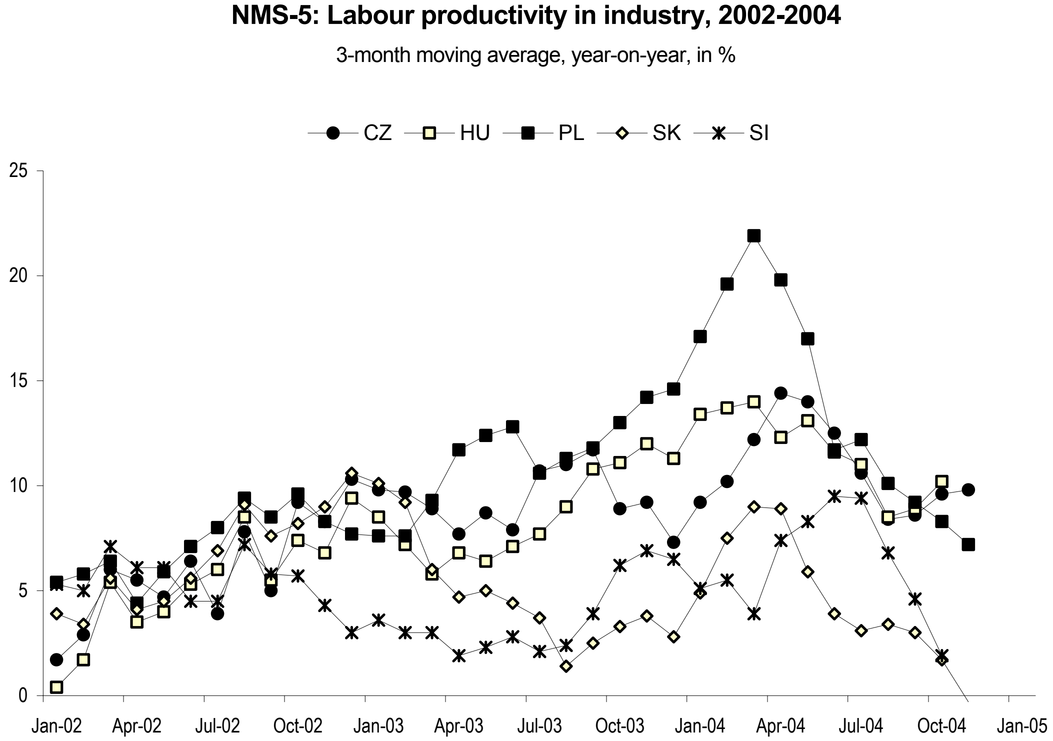
NMS-5: Gross industrial production, 2002-2004

annual growth, cumulated



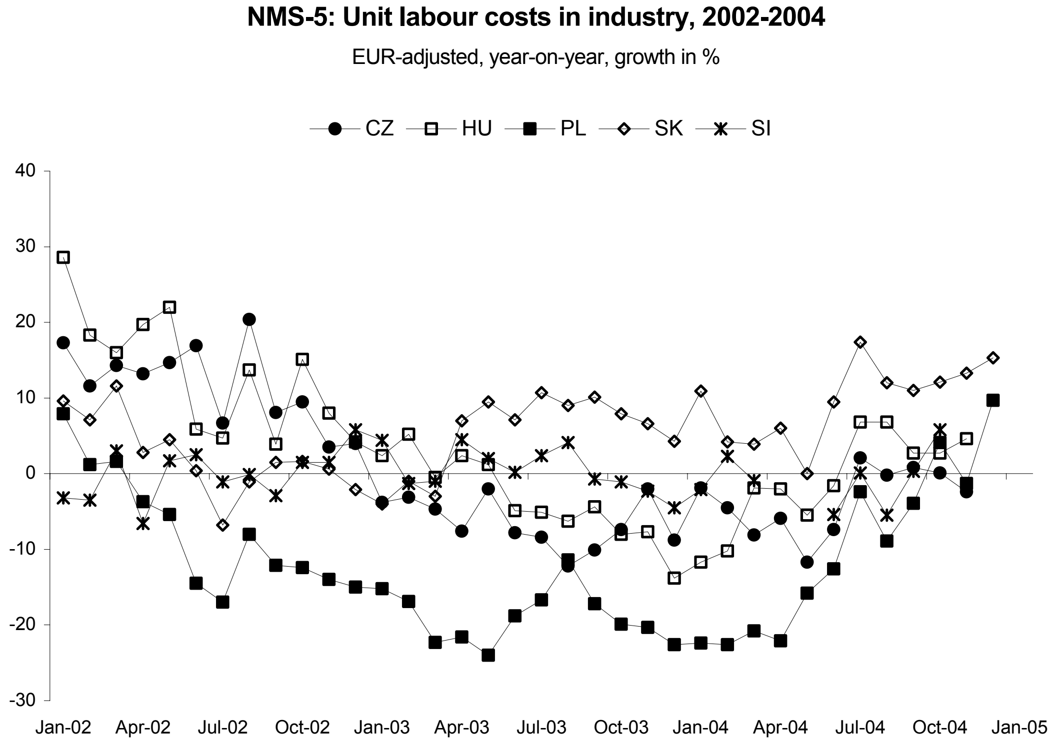
Source: wiiw Monthly Database incorporating national statistics.

Figure 2



Source: wiiw Monthly Database incorporating national statistics.

Figure 3



Source: wiiw Monthly Database incorporating national statistics.

the highest growth rates – see Figure 1). The below-mentioned trend of 'jobless growth' continued: disregarding the high growth of output, NMS industrial employment remained flat (and declined again in Poland, nearly 12% growth of output notwithstanding). Labour productivity thus increased strongly (by more than 10% for the year as a whole – see Table 5) and, given only modest growth of wages, unit labour costs declined. An improvement in international (labour) cost competitiveness could not be prevented even by sizeable currency appreciations (with the exception of Slovakia where unit labour costs measured in EUR increased by about 9% in 2004). In the course of the year 2004, the growth of labour productivity slowed down markedly and unit labour costs (exchange-rate adjusted) started to rise (Figures 2 and 3). With ongoing progress in restructuring and continuing inflows of FDI, the robust growth of industrial output is forecast to last, albeit at a slightly slower rate than in 2004, at least for the next two years. Given the fact that no major change in NMS employment policies and wage setting is expected in this period, a further strengthening of industrial competitiveness and rising attraction of investors to the region are likely. It seems that the only major risk that could jeopardize the competitive cost position of NMS industry would be an excessive appreciation of their currencies (see below).

Labour market situation remains precarious: 'jobless growth'

The overall economic performance of the NMS over the recent past has been characterized by fairly high growth of GDP and productivity (in both cases higher than in the 'old' EU, implying some catching-up) but little or no growth of employment (Figure 4). The productivity growth recorded in most NMS in the period after 1995 has been associated with some increases in employment in services and with considerable job losses in agriculture and industry (here with the exception of Hungary).[4] The overall development may thus be characterized as 'jobless growth'. In the context of the EU Lisbon Strategy, which aims at both improved competitiveness and high employment growth, the NMS thus face an even greater challenge than the EU-15. Focusing on both targets simultaneously (i.e. fast productivity growth and employment growth) may be conflicting. Taking into account that the NMS are confronted with a situation of low productivity levels and, at the same time, of high unemployment (on average nearly twice the EU-15 level), they need to foster both productivity and employment growth simultaneously. Seen from this angle, and taking into account the expected rates of economic growth and evolving economic structures, the prospects for rising employment (outside of the services sector) are not very encouraging for the NMS. Without a substantial acceleration of their economic growth and/or significant job creation in the services sector, the NMS seem to be condemned either to remain substantially less productive than EU-15 member states, or to face the challenge of even higher unemployment in the future.[5]

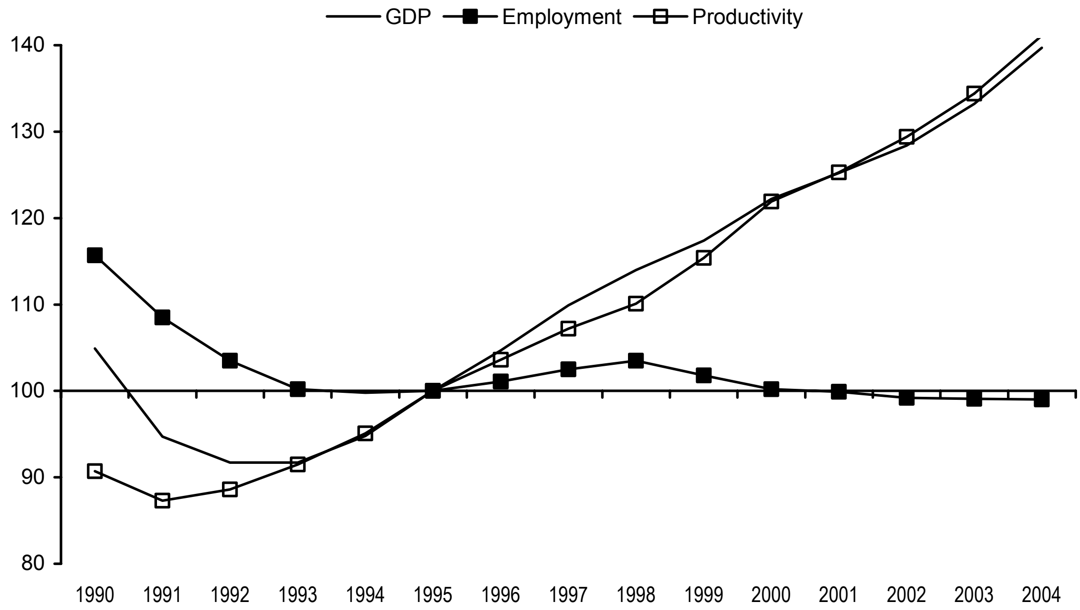
4 During the past couple of years, the only sectors where additional jobs were created in the NMS are trade, hotels and restaurants, real estate, public administration and other activities; for more details see M. Landesmann, H. Vidovic and T. Ward (2004), 'Economic Restructuring and Labour Market Developments in the New EU Member States', *wiiw Research Reports*, No. 312, December.

5 Regression estimates covering a sample of all NMS-8 for the time period 1995-2003 show that the average *critical rate* of GDP growth which would prevent a further employment decline has been nearly 6% per year, which is much more than GDP growth actually achieved during that period – see P. Havlik (2005), 'Structural Change, Productivity and Employment in the New EU Member States', *wiiw Research Reports*, No. 313, January. Alternative estimates yield nearly the same discouraging results (a critical rate of GDP growth of more than 4%) – see P. Havlik and M. Landesmann (2004), 'Structural change, productivity and employment in the new EU member states', Chapter 1 in 'Economic Restructuring and Labour Markets in the Accession Countries', research project commissioned by EU DG Employment, Social Affairs and Equal Opportunities, Contract No. VC/2003/0367, December 2004.

Figure 4

GDP, employment and productivity in NMS-8

1995 = 100



Source: wiiw Database incorporating national statistics; wiiw estimates (weighted averages for NMS-8).

Table 6

Unemployment, LFS definition, annual averages

	in 1000 persons						rate in %				
	1999	**2000**	**2001**	**2002**	**2003**	**2004** 1)	**2002**	**2003**	**2004** 1)	**2005** forecast	**2006**
Czech Republic 2)	454	455	421	374	399	426	7.3	7.8	8.3	8.7	9
Hungary	285	264	234	239	245	253	5.8	5.9	6.1	6.1	6.1
Poland	2391	2785	3170	3431	3329	3280	19.9	19.6	19.3	19	18
Slovak Republic	417	485	508	487	459	489	18.5	17.4	18.5	18	17
Slovenia	73	68	63	62	65	63	6.4	6.7	6.3	6	6
NMS-5 3)	3620	4056	4396	4593	4496	4511	**15.3**	**15.1**	**15.1**	15.0	14.5
Estonia	81	90	83	67	66	66	10.3	10.0	10.0	9.5	9
Latvia	161	159	145	135	119	118	12.0	10.6	10.4	9.8	9.5
Lithuania	263	274	284	224	204	185	13.8	12.4	11.4	11	10
NMS-8 3)	4125	4579	4908	5019	4885	4880	**15.0**	**14.7**	**14.6**	14.5	14.0

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

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

The situation on the NMS labour market remained precarious in 2004 as well. Robust GDP growth notwithstanding (by nearly 5%, yet still less than the above-mentioned 'critical rate' of 6%), overall employment remained flat and the average rate of unemployment stayed close to 15% on NMS average (Table 6), nearly twice as high as in the EU-15 (8.1%). Extremely high unemployment persists in Poland (more than 19%) and in Slovakia (18.5%). In the Czech Republic, Hungary and Slovenia, unemployment rates are close to (or even below) the EU average. Given the above-mentioned low elasticity of employment to growth in the NMS, one cannot expect any marked improvement on the labour market in the medium (and possibly even in the long) run.[6]

Foreign trade expands, especially outside the 'old' EU

The year 2004 was exceptionally successful for NMS external trade. The accession to the EU and the related changes in the trade regime have apparently provided an additional stimulus for both exports and imports. After a rather unimpressive performance in 2003 (which was also associated with sluggish demand in the eurozone), NMS-8 exports jumped by more than 20% in 2004 (in current EUR terms), somewhat faster than imports (+18%), and the region's trade integration in the European and the world economy thus increased even further.[7] The two biggest exporters among the NMS, Poland and the Czech Republic, recorded the highest export growth (about 25% each) and their trade balances improved. On the other hand, exports from other NMS increased at a somewhat slower pace and their trade balances deteriorated (Table 7). Despite a minor deterioration of the aggregate trade balance (the summary NMS-8 trade deficit grew by EUR 0.5 billion, to EUR 27.3 billion in 2004), the more pronounced growth of exports over imports is still an achievement. It indicates a further strengthening of the NMS export sector which is all the more remarkable given the fact that import prices increased (especially of energy and metals, which represent an important part of imports), the import content of NMS exports is still rather high, and the NMS currencies appreciated.[8]

The first estimates of the regional composition of NMS trade and a tentative assessment of EU accession effects (based on preliminary data for the first 9 to 11 months of 2004)[9] indicate that, after EU accession, more than 80% of NMS exports (and nearly 70% of their imports) represent intra-EU trade (the Czech and Slovak Republics, due to their intensive mutual trade, have the highest shares of intra-EU exports – see Table 8). Due to this exceptionally high degree of trade integration and openness of the NMS economies (see also Table II above), developments in the EU (and in the eurozone in particular) have a significant impact on NMS. NMS exports to the EU-25 increased by 19% (imports by 17%), with the Czech Republic and Poland (as well as Lithuania) recording again the fastest growth. The overall trade surplus of the NMS-5 with the EU nearly doubled in 2004, reaching more than EUR 10 billion. As far as trade with the EU-15 is concerned – the main trading partner for all NMS – the growth of NMS exports exceeded 17% in 2004, twice as much as in 2003

6 See R. Stehrer (2004), 'Employment, education and occupational structures: future scenarios', in 'Economic Restructuring and Labour Markets in the Accession Countries', op. cit., Chapter 6 for more detailed analysis.

7 In terms of export growth, the NMS also outperformed the 'old' EU: according to Eurostat, Eurozone trade increased by some 8-9% in 2004. At the same time, Eurozone recorded a trade surplus of EUR 74 bn – see *Eurostat News Release* 24/2005, 22 February 2005.

8 The less pronounced growth of imports was facilitated by the depreciation of the US dollar with respect to the euro, which had a dampening effect on rising (USD-denominated) energy prices.

9 Due to EU accession, NMS foreign trade statistics underwent important methodological changes and data are not fully comparable over time. Since May 2004, data on NMS trade with the EU stem not from customs declarations but are estimated using the Intrastat system of dispatches and arrivals. However, not all countries use the same methodology and the comparisons with periods prior to EU accession have to be treated with extreme caution.

Table 7

Foreign trade of the new EU member states, EUR million

(based on customs statistics)

		1998	1999	2000	2001	2002	2003	2004 [1)]	2003	2004 [1)]
									change in %	
Czech	Exports	23068	24640	31483	37251	40726	43051	53119	5.7	23.4 [I-XI]
Republic	Imports	25287	26386	34876	40675	43025	45243	54142	5.2	19.7 [I-XI]
	Balance	-2219	-1746	-3393	-3424	-2298	-2192	-1024	.	.
Hungary [2)]	Exports	20477	23491	30545	34082	36523	38041	43859	4.2	15.3 [I-XI]
	Imports	22871	26288	34856	37654	39939	42189	48331	5.6	14.6 [I-XI]
	Balance	-2394	-2797	-4312	-3572	-3417	-4149	-4472	.	.
Poland	Exports	25145	25729	34383	40375	43400	47511	59434	9	25.1 [I-XI]
	Imports	41539	43151	53122	56223	58307	60288	71557	3	18.7 [I-XI]
	Balance	-16394	-17422	-18739	-15848	-14907	-12777	-12122	.	.
Slovakia	Exports	9541	9602	12880	14115	15270	19359	22528	26.8	16.4 [I-XI]
	Imports	11635	10628	13860	16488	17517	19924	23568	13.7	18.3 [I-XI]
	Balance	-2094	-1025	-980	-2372	-2247	-565	-1039	.	.
Slovenia	Exports	8052	8037	9505	10349	10966	11288	12465	2.9	10.4 [I-XI]
	Imports	8999	9482	10996	11345	11578	12242	13736	5.7	12.2 [I-XI]
	Balance	-947	-1445	-1491	-997	-612	-954	-1271	.	.
NMS-5	Exports	86283	91499	118795	136172	146885	159250	191405	8.4	20.2 [I-XI]
	Imports	110331	115935	147709	162385	170367	179886	211333	5.6	17.5 [I-XI]
	Balance	-24049	-24436	-28915	-26213	-23481	-20636	-19928	.	.
Estonia	Exports	2232	2238	3445	3698	3638	3995	4753	9.8	19.0 [I-XI]
	Imports	3499	3224	4615	4798	5079	5734	6997	12.9	22.0 [I-XI]
	Balance	-1266	-985	-1171	-1101	-1441	-1739	-2244	.	.
Latvia	Exports	1616	1617	2020	2233	2418	2560	3127	5.8	22.2 [I-XI]
	Imports	2844	2764	3453	3913	4287	4635	5561	8.1	20.0 [I-XI]
	Balance	-1228	-1147	-1433	-1680	-1868	-2076	-2434	.	.
Lithuania	Exports	2881	2579	3837	4775	5524	6158	7523	11.5	22.2
	Imports	4776	4333	5644	6762	7941	8526	10229	7.4	20.0
	Balance	-1895	-1754	-1807	-1987	-2416	-2368	-2706	.	.
NMS-8	Exports	93012	97933	128096	146877	158466	171963	206807	8.5	20.3
	Imports	121451	126255	161422	177858	187673	198781	234120	5.9	17.8
	Balance	-28439	-28322	-33326	-30980	-29207	-26818	-27312	.	.

Notes: 1) Preliminary. - 2) Including trade of firms with customs free legal status.
Source: wiiw Database incorporating national statistics.

(yet somewhat less than overall NMS exports). NMS exporters thus gained further market shares on the EU market and their products enjoy rising demand – despite continuously mediocre economic growth in the eurozone.[10] Notwithstanding an even stronger acceleration of import growth (imports from the EU-15 increased nearly 14% as compared with 4% in 2003), NMS enjoy a growing trade

10 There is some evidence that also agro-food exports to the EU, especially exports from the Czech Republic, Poland and Slovakia, rose faster than average in 2004 – see Z. Lukas (2005), 'New EU Member States: booming agro-food trade, Poland ahead', *The Vienna Institute Monthly Report*, No. 2, February.

surplus with the EU-15. This can be attributed mainly to the (rising) trade surpluses of the Czech Republic, Hungary and Slovakia, as well as to the declining trade deficit in Poland. Contrary to the findings regarding the real contribution of total trade (in goods and services) to GDP growth, the goods trade with the EU-15 thus might have had a growth-stimulating effect on these countries.

Table 8

Foreign trade of new EU member states with the EU-25, EUR million

(based on customs statistics)

		2000	2001	2002	2003	2004 [1]	2003	2004 [1]	2003	2004 [1]
							change in %		share of EU-25 in % of total	
Czech Republic	Exports	26765	31804	34477	37153	45703	7.8	23.0 I-XI	86.3	86.0
	Imports	25825	29858	31069	32303	39023	4.0	20.8 I-XI	71.4	72.1
	Balance	940	1946	3409	4850	6680	.	.	.	.
Hungary[2]	Exports	24832	27586	29885	30877	34808	3.3	12.7 I-X	81.2	79.4
	Imports	22637	24368	25444	26613	29033	4.6	9.1 I-X	63.1	60.1
	Balance	2195	3217	4441	4263	5775	.	.	.	.
Poland	Exports	27668	32415	34822	38383	47148	10.2	22.8 I-XI	80.8	79.3
	Imports	36462	38958	40591	41694	48755	2.7	16.9 I-XI	69.2	68.1
	Balance	-8795	-6543	-5769	-3312	-1607	.	.	.	.
Slovakia	Exports	11401	12593	13449	16375	19157	21.8	17.0 I-X	84.6	85.0
	Imports	9632	11769	12683	14681	17320	15.8	18.0 I-X	73.7	73.5
	Balance	1769	823	766	1694	1837	.	.	.	.
Slovenia[2]	Exports	6767	7858	7402	7551	8207	2.0	8.7 I-XI	66.9	65.8
	Imports	8347	9449	8840	9258	10853	4.7	17.2 I-XI	75.6	79.0
	Balance	-1580	-1591	-1438	-1706	-2646	.	.	.	.
NMS-5	Exports	97432	112254	120035	130339	155022	8.6	18.9	81.8	81.0
	Imports	102903	114402	118626	124550	144985	5.0	11.3	69.2	68.6
	Balance	-5471	-2148	1409	5789	10038	.	.	.	.
Estonia[2]	Exports	3033	3006	2974	3293	3817	10.7	15.9	82.4	80.3
	Imports	3249	3177	3485	3717	4989	6.7	34.2	64.8	71.3
	Balance	-216	-170	-511	-424	-1173	.	.	.	.
Latvia[2]	Exports	1631	1754	1879	2030	2409	8.0	18.7	79.3	77.1
	Imports	2555	2965	3310	3494	4175	5.5	19.5	75.4	75.1
	Balance	-924	-1210	-1431	-1464	-1765	.	.	.	.
Lithuania[2]	Exports	2863	3498	3822	3849	4800	0.7	24.6	62.5	63.8
	Imports	3534	4306	5258	5561	6260	5.8	12.6	65.2	61.2
	Balance	-670	-808	-1435	-1712	-1460	.	.	.	.
NMS-8	Exports	104959	120513	128711	139511	166048	8.4	19.0	81.1	80.3
	Imports	112241	124849	130679	137321	160409	5.1	16.8	69.1	68.5
	Balance	-7282	-4337	-1969	2190	5640	.	.	.	.

Notes: 1) Preliminary. - 2) After 2003 dispatches and arrivals according to Intrastat methodology.

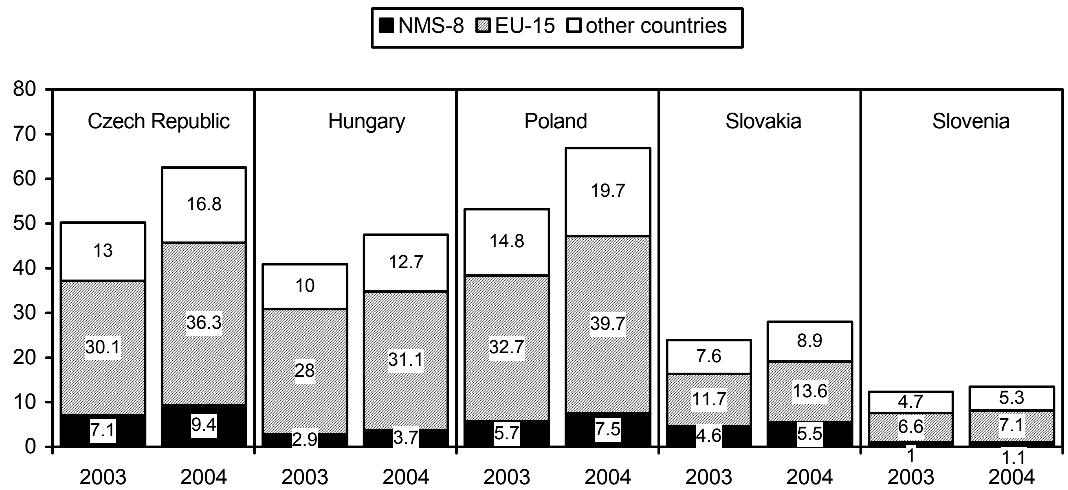
Source: wiiw Database incorporating national statistics.

The takeover of EU trade rules after accession brought about not only lower import tariffs for most NMS (the Baltic States were largely an exception), but resulted also in a complete removal of barriers in intra-NMS trade. Indeed, preliminary data suggest that these regime changes had the expected trade creation effects: NMS trade outside the ‘old’ EU (where tariffs had been largely scrapped already earlier), and in particular trade among the NMS themselves, recorded the most dynamic growth in 2004 (Table 9 and Figure 5). As far as extra-EU-25 trade is concerned, this is more or less in line with overall developments since EU trade with China, Russia, South Korea and Turkey (but not with the USA and Japan) boomed in 2004 as well. But intra-NMS exports and imports – which are now fully liberalized – shot up by about 30% in 2004 (Table 9). The Czech Republic and Poland report again the best export performance, both with respect to export growth rates and regarding the fact that they both have an export surplus in trade with other NMS.[11]

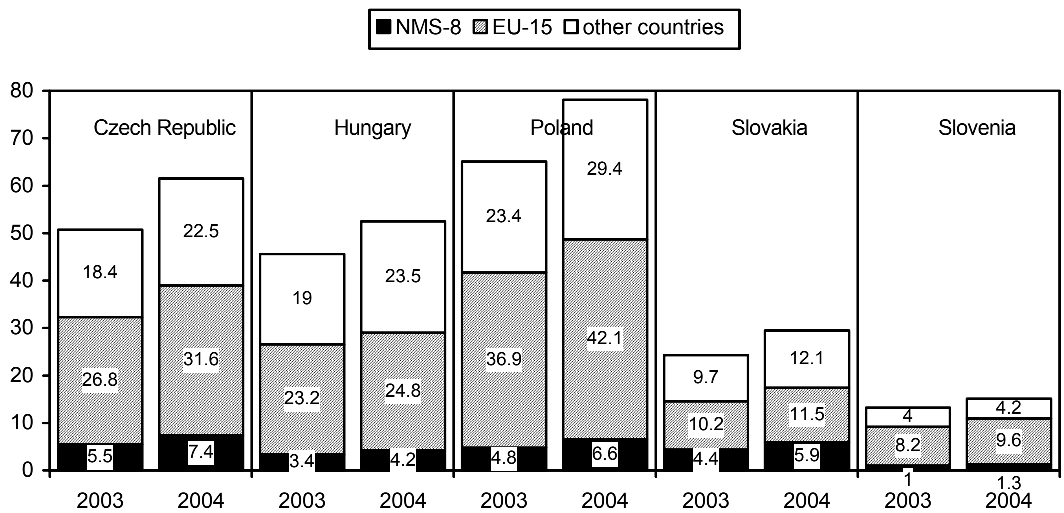
Figure 5

Foreign trade of selected new EU member states, 2003 and 2004, EUR billion

Exports by regions



Imports by regions



Source: wiiw estimates based national statistics.

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11 Extraordinary high growth rates of intra-NMS trade reported by Estonia and Latvia have to be treated with caution – especially since the change of the trade regime after EU accession should not have a too large effect in these countries.

Table 9

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

(based on customs statistics)

		2000	2001	2002	2003	2004 1)	2003	2004 1)	2003	2004 1)
							change in %		share of NMS-8 in % of EU-25	
Czech Republic	Exports	5177	6121	6620	7086	9364	7.1	32.1	19.1	20.5 I-XI
	Imports	4188	4719	5166	5498	7389	6.4	34.4	17.0	18.9 I-XI
	Balance	989	1403	1454	1588	1975	.	.	.	.
Hungary 2)	Exports	1892	2270	2444	2869	3691	17.4	28.7	9.3	10.6 I-X
	Imports	2283	2607	2977	3407	4202	14.4	23.3	12.8	14.5 I-X
	Balance	-391	-337	-533	-538	-511	.	.	.	.
Poland	Exports	3630	4473	5002	5711	7452	14.2	30.5	14.9	15.8 I-XI
	Imports	3968	4446	4619	4832	6621	4.6	37.0	11.6	13.6 I-XI
	Balance	-338	27	382	879	831	.	.	.	.
Slovakia	Exports	3799	4143	4202	4635	5527	10.3	19.3	28.3	28.9 I-X
	Imports	2857	3562	3869	4446	5861	14.9	31.8	30.3	33.8 I-X
	Balance	942	580	333	189	-334	.	.	.	.
Slovenia 2)	Exports	707	1427	893	956	1080	7.1	13.0	12.7	13.2 I-XI
	Imports	896	1775	969	1023	1279	5.6	25.0	11.1	11.8 I-XI
	Balance	-189	-347	-76	-67	-199	.	.	.	.
NMS-5	Exports	15205	18435	19161	21258	27114	10.9	27.5	16.3	17.5
	Imports	14191	17109	17600	19206	25353	9.1	32.0	15.4	17.5
	Balance	1013	1326	1561	2052	1761	.	.	.	.
Estonia 2)	Exports	398	438	501	561	845	12.1	50.6	17.0	22.2
	Imports	361	465	544	646	1025	18.6	58.8	17.4	20.6
	Balance	37	-27	-44	-84	-180	.	.	.	.
Latvia 2)	Exports	325	387	419	447	696	6.6	55.7	22.0	28.9
	Imports	744	908	1040	1132	1544	8.8	36.5	32.4	37.0
	Balance	-419	-521	-622	-685	-849	.	.	.	.
Lithuania 2)	Exports	934	1106	1082	1197	1532	10.6	28.0	31.1	31.9
	Imports	880	1065	1325	1453	1786	9.6	23.0	26.1	28.5
	Balance	55	41	-243	-256	-254	.	.	.	.
NMS-8	Exports	16862	20366	21163	23462	30187	10.9	28.7	16.8	18.2
	Imports	16176	19547	20511	22436	29709	9.4	32.4	16.3	18.5
	Balance	687	819	652	1026	478	.	.	.	.

Notes: 1) Preliminary. - 2) After 2003 dispatches and arrivals according to Intrastat methodology.

Source: wiiw Database incorporating national statistics.

Fiscal policies becoming more restrictive

The general government fiscal deficits have been low in the three Baltic States and in Slovenia (even with surpluses in Estonia since 2001). Deficits have been quite large in the remaining NMS (see Table 10). The former countries' ability to conduct 'sound' fiscal policies is of course commendable. However, the judgements on the fiscal prudence of these countries – and on the 'imprudence' of the remaining ones – ought to be qualified. Compared with other countries, the Baltic States (but also Slovenia) have much lower levels of public debt inherited from the past, and a correspondingly lower burden of interest payments. If the high-deficit NMS-5 had the Estonian levels of public debt (which is less than 5% of the GDP), their fiscal deficit to GDP ratios would be some 2-3 percentage points lower than recorded – thus below the magical 3% mark of the Stability and Growth Pact. Indeed, interest rates in the high-deficit countries are often very high, thus magnifying the interest payments.[12]

Table 10

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

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 [2)]	2005 forecast	2006 forecast
Czech Republic	-13.4	-3.1	-2.3	-5.0	-3.6	-3.7	-5.9	-6.7	-12.5	-4.3	-4.1	-3.8
Hungary	.	.	.	.	.	-3.0	-4.4	-9.1	-6.2	-5.3	-4.8	-4.4
Poland	-2.2	-3.6	-4.0	-2.1	-1.3	-0.7	-3.7	-3.6	-3.9	-5.5	-4.0	-3.1
Slovak Republic	-0.9	-7.4	-6.2	-3.7	-7.0	-12.3	-6.0	-5.7	-3.7	-5.5	-4.2	-3.5
Slovenia	.	.	.	.	.	-3.5	-2.7	-2.3	-2.0	-2.1	-2.1	-1.8
Estonia	0.4	-1.7	1.7	-0.3	-3.7	-0.6	0.3	1.3	3.1	0.5	0.2	0.1
Latvia	-2.0	-0.5	1.5	-0.6	-4.9	-2.7	-2.1	-2.7	-1.5	-2.0	-2.8	-2.9
Lithuania	-1.9	-3.6	-1.1	-3.0	-5.5	-2.5	-2.0	-1.5	-1.9	-2.6	-2.5	-1.9

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

Source: AMECO Database; wiiw forecasts.

Of course the EU fiscal policy guidelines in principle apply to all member countries, whether or not they inherited high public debt from the past or are already members of the eurozone.[13] The fiscal performance of the NMS is already monitored by the EU Commission and their convergence programmes are being regularly assessed. Hungary is the only NMS currently facing the 'excessive deficit procedure' since its fiscal consolidation programme is judged by the EU Commission as 'insufficient'. Meanwhile, excessive deficit procedures against the Czech Republic, Poland and Slovakia were all lifted by the decision of the EcoFin meeting on 18 January 2005. All high-deficit NMS are expected to mend their ways, gradually. The low-deficit countries: Slovenia, Estonia and Lithuania have already been 'rewarded': they have been admitted into the Exchange Rate Mechanism II almost immediately after EU accession. If they manage to keep fiscal discipline and their exchange rates stay in the prescribed corridor of +/- 15%, in two years' time (that is already late 2006 or early 2007) they will be able to give up their national monies and switch to the euro.

In actual fact the 2004 fiscal balances deteriorated somewhat in Poland and Slovakia. (The balances deteriorated – but remained low – also in Lithuania, Latvia and Slovenia; see Table 10). This should

[12] It is a separate question whether or not high governmental deficits contribute to high levels of interest rates. There are good grounds to believe that high deficits (and thus high borrowing needs) do not necessarily affect the interest rates. For example, high deficits in the Czech Republic have coexisted with low interest rates for many years. Conversely, very low deficits (as in Poland in 1999-2000) were associated with very high interest rates. Interest rates in the Baltic countries may be low not on account of relatively low deficits, but because their central banks have limited prerogatives (all of them have been on currency board regimes). In the remaining countries it is the independent central banks which effectively decide the levels of the interest rates.

[13] The relative importance of government deficit and debt is one of the issues presently discussed in the context of reforms of the Stability and Growth Pact.

not be interpreted as a sign of any deliberate and pronounced 'fiscal expansionism' of the government. The contributions of public consumption (i.e. consumption expenditure of the general government) to the GDP growth rates in the first three quarters of 2004 were minor and ranged between 0.3 and 0.4 percentage points in most NMS, except for the Czech Republic where this contribution was negative (-0.5 p.p.). For Hungary a rough estimate suggests that the contribution of public consumption may have been close to zero (or even negative). Estimates of the contributions of public gross fixed capital formation (public sector investment) to the GDP growth rates are currently unavailable. In any case these contributions must have been minimal (the shares of public investment in the GDP are very low in all NMS). Overall, the positive growth impulses of public consumption and investment must have been about zero, or even negative (in the Czech Republic and Hungary) – or positive (but close to zero) in other NMS (except Estonia and Lithuania). Besides, the ongoing cuts in social transfers observed in many NMS must have further reduced the aggregate-demand effects of public expenditure in 2004.

Certainly, the fiscal policy may have positive impacts on aggregate demand also via changes on the revenue side – via cuts in taxes and social contributions collected. Lower taxes collected imply higher disposable incomes of households and firms. Provided the disposable incomes increased through lower taxation are actually spent on purchases of domestic goods and services, the GDP would be rising as well. Derivation of proper estimates of the eventual impacts of the changes in the public sector (tax) revenues on the GDP growth rates is a demanding task. There are many conceptual problems – e.g. reflecting different theoretical opinions on the potential effects of changes in various taxes (indirect, personal, corporate etc). For example, it is often claimed that cuts in corporate income taxes imply higher capital formation, and thus higher aggregate demand. However, that claim is not generally accepted by the proponents of more realistic theories of business investment. There is less disagreement over the effects of rising indirect (consumption) tax rates. Rising indirect taxes tend to reduce consumption and GDP, *ceteris paribus*. Because in all NMS there is a tendency to increase indirect taxes (and at the same time to reduce the levels of corporate tax rates as well as the progression in the personal tax rates), the overall rise in the tax revenue increasingly represents the rise in the (consumption-reducing) indirect taxation. A rising *volume* of total taxation (computed by using the consumer price deflators) can therefore be considered a practical, if admittedly very rough, indicator to be used for assessing the *real* impacts of changing taxation on GDP growth. Preliminary calculations indicate that in no NMS did the impact of changing general government budget revenues have a positive impact on the aggregate demand (and the GDP) recorded in 2004. The revenues rose quite strongly in both nominal and real terms. Thus, everywhere the impact of rising tax revenues seems to have been negative, i.e. contractionary. The actual GDP recorded must have been lower, on account of rising taxation, than would be otherwise attainable. The least contractionary impact seems to have been the one in Slovakia (approximately 0.2 percentage points, despite the country's adoption of a 'flat tax' in that year), with much larger (negative) impacts in the remaining countries, especially in Estonia, Lithuania and Poland.

Concluding, the fiscal policies in the NMS were not really expansionary in 2004: the real impacts of rising general government expenditures were very small – most probably smaller than the real impacts of rising general government revenues.

Arguably, an expansionary fiscal policy would not do much good as far as the current account deficits in a number of countries are concerned (the Baltic countries, the Czech Republic and

Hungary). On the other hand, given the very high unemployment rates (particularly in Poland and Slovakia – see above) it might make sense to consider the merits of some limited and temporary fiscal expansion. Nevertheless, conscious changes in the attitudes regarding a more lax fiscal policy are very unlikely in the NMS, at least during the next 2-5 years, as they are striving to meet the deficit criterion of the Stability and Growth Pact and are thus constrained by their convergence programmes which are under surveillance of the EU Commission. It may be all the more important in this context that these countries prove capable of avoiding systematic mistakes in their monetary and exchange rate policies.

Inflation, monetary policy and the exchange rates

Inflation, both in consumer and in industrial producer prices, was generally low and falling in most NMS during 2003 (except Slovakia – see Tables 11a and 11b). But in 2004 the yearly inflation was

Table 11a

Consumer price inflation

change in % against preceding year

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 1)	2005 forecast	2006 forecast
Czech Republic	9.1	8.8	8.5	10.7	2.1	3.9	4.7	1.8	0.1	2.8	1.8	2.2
Hungary	28.2	23.6	18.3	14.3	10.0	9.8	9.2	5.3	4.7	6.8	3.9	3.2
Poland	27.8	19.9	14.9	11.8	7.3	10.1	5.5	1.9	0.8	3.5	3	3
Slovak Republic	9.9	5.8	6.1	6.7	10.6	12.0	7.1	3.3	8.5	7.5	4	2.5
Slovenia	13.5	9.9	8.4	7.9	6.1	8.9	8.4	7.5	5.6	3.6	3	2.7
Estonia	29.0	23.1	11.2	8.2	3.3	4.0	5.8	3.6	1.3	3.0	2.8	2.5
Latvia	25.0	17.6	8.4	4.7	2.4	2.6	2.5	1.9	2.9	6.2	5.5	4.5
Lithuania	39.6	24.6	8.9	5.1	0.8	1.0	1.3	0.3	-1.2	1.2	1.5	1

Note: 1) Preliminary.

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

Table 11b

Producer prices in industry

change in % against preceding year

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 1)	2005 forecast	2005 forecast
Czech Republic	7.6	4.7	4.9	4.9	1.0	4.9	2.8	-0.5	-0.3	5.7	4	2.5
Hungary	28.9	21.8	20.4	11.3	5.1	11.6	5.2	-1.8	2.4	3.5	.	.
Poland	25.4	12.4	12.2	7.3	5.7	7.8	1.6	1.0	2.6	7.0	4	4
Slovak Republic	9.0	4.2	4.5	3.3	4.3	10.8	6.5	2.1	8.3	3.4	3	2
Slovenia	12.8	6.8	6.1	6.0	2.1	7.6	8.9	5.1	2.5	3.1	3	.
Estonia	25.6	14.8	8.8	4.2	-1.2	4.9	4.4	0.4	0.2	2.9	2.5	2
Latvia	11.9	13.7	4.1	1.9	-4.0	0.6	1.7	1.0	3.2	8.6	6	5
Lithuania	28.3	16.5	6.0	-4.4	1.7	16.0	-3.0	-2.8	-0.5	5.0	3	2

Note: 1) Preliminary.

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

higher in many NMS. In part this was the result of fiscally motivated hikes in regulated prices and/or changes in indirect (VAT) taxes and excises (e.g. on tobacco) prior to EU accession (e.g. in Hungary and the Czech Republic; Slovakia did it partly already in 2003) in order to comply with EU regulations. Higher international prices of energy and other raw materials also added to inflation. Finally, the liberalization of trade in agro-food products pulled up the relatively very low domestic prices of some food items (e.g. sugar, some dairy products).

Overall, inflation in 2004 lost its momentum shortly after the EU accession. In the second half of the year inflation was falling very fast – and some signs of recurring deflation could be detected (see Figures 6a and 6b). This indicates that many price hikes of the first half of 2004 reflected overly optimistic demand expectations. (In so far as the price hikes reflected the fiscally motivated increases in indirect taxation, after a few months they proved deflationary.) Falling inflation in the second half of 2004 went hand in hand with some easing of the monetary policy in Hungary, Slovenia and Slovakia, despite the fact that the monetary policy in Hungary has remained very restrictive – see Figure 7. The responses of the Czech and the Polish central banks, which raised their interest rates just as inflation started to fall on its own, are more difficult to understand. The monetary authorities of the Baltic States apparently did not do anything about higher inflation – a consequence of their being on currency-board regimes and their reliance on fixed nominal exchange rates for the control of inflation.

The magnitudes of the increases in the interest rates of the Czech National Bank were more 'psychological' rather than intended to have any direct effect on inflation or on the 'real economy'. Besides, these rates have been lowered since. Increases in the Polish central bank's interest rates were more significant – and turned out to be hard to revoke.

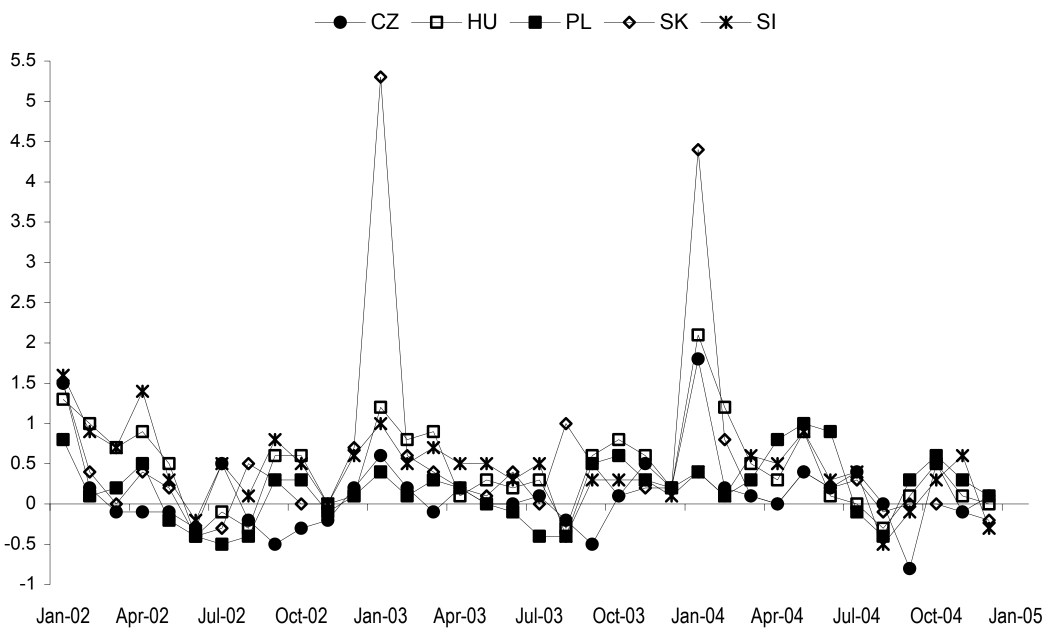
NMS exchange rates with respect to the euro have been fairly stable during the past few years. However, throughout much of the year 2004 the currencies of all NMS-5 countries (excepting Slovenia) were strengthening in nominal terms vs. the euro (Figure 8a). Generally, the strengthening of the national currencies might be explained by a relative 'oversupply' of foreign exchange on the domestic markets. However, the current accounts of all NMS are negative (in Hungary and the Baltic States highly negative – see Table 12). Moreover, inflows of FDI were rather moderate in 2004, at least compared to the period 2000-2002 – see Table 13 below.

The 'oversupply' of foreign exchange, which has been a material force behind the rising strength of NMS currencies, has taken the form of inflows of portfolio investment and/or foreign credits in 2004. It is easy to understand what has been motivating such inflows in the cases of Hungary and Poland. With high interest rate differentials (vs. the international markets) and the remarkable predictability ('consistency') of the monetary policies in these two countries, relatively large gains can be made in Hungary and Poland (at relatively low risk). Of course, the nominal appreciation (once set in motion, for whatever reason) is capable of initiating further, purely speculative inflows motivated by the expectation of continuing nominal appreciation. Despite the much lower official interest rates of the central banks, the fact that the currencies of Slovakia and the Czech Republic have been appreciating as well may also reflect the presence of some speculative expectations. Otherwise, the interest rates on credits charged by the domestic commercial banks and/or their lending practices may in fact have continued to be restrictive despite the relaxed official monetary policies.

Figure 6a

NMS-5: Change in consumer prices, 2002-2004

in %, month-on-month

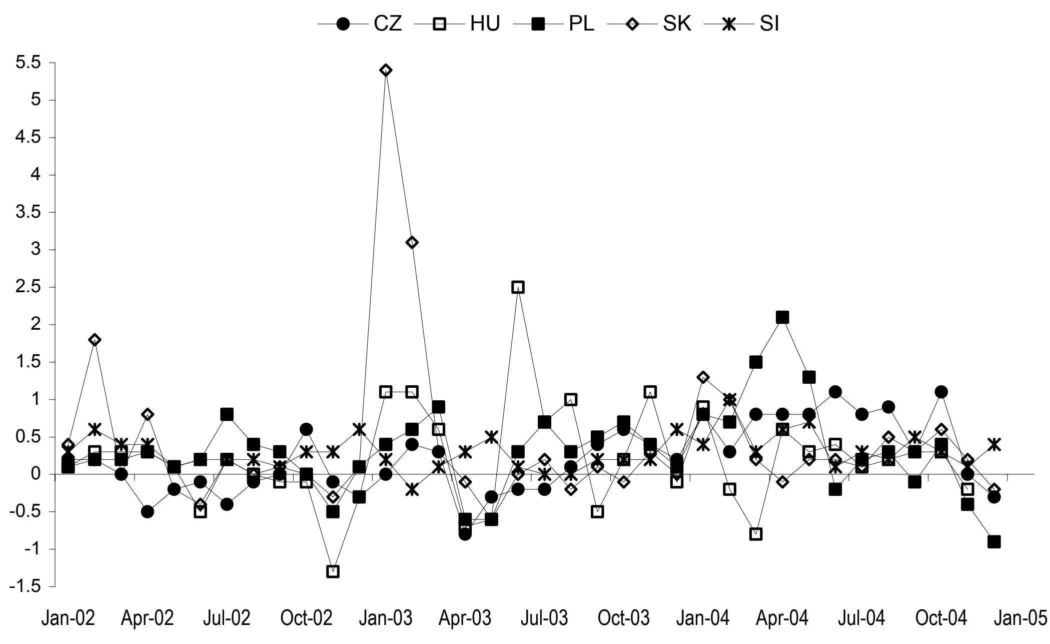


Source: wiiw Monthly Database incorporating national statistics.

Figure 6b

NMS-5: Change in producer prices, 2002-2004

in %, month-on-month

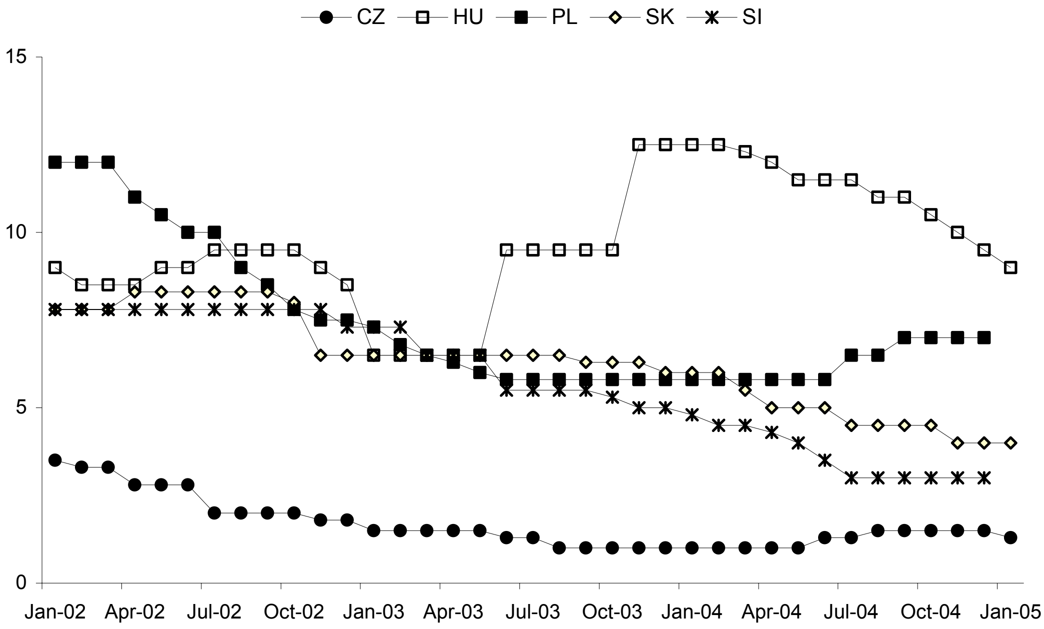


Source: wiiw Monthly Database incorporating national statistics.

Figure 7

NMS-5: Minimum interest rates, 2002-2004

nominal NB leading rate in % p.a.



Source: wiiw Monthly Database incorporating national statistics.

Table 12

Foreign financial position

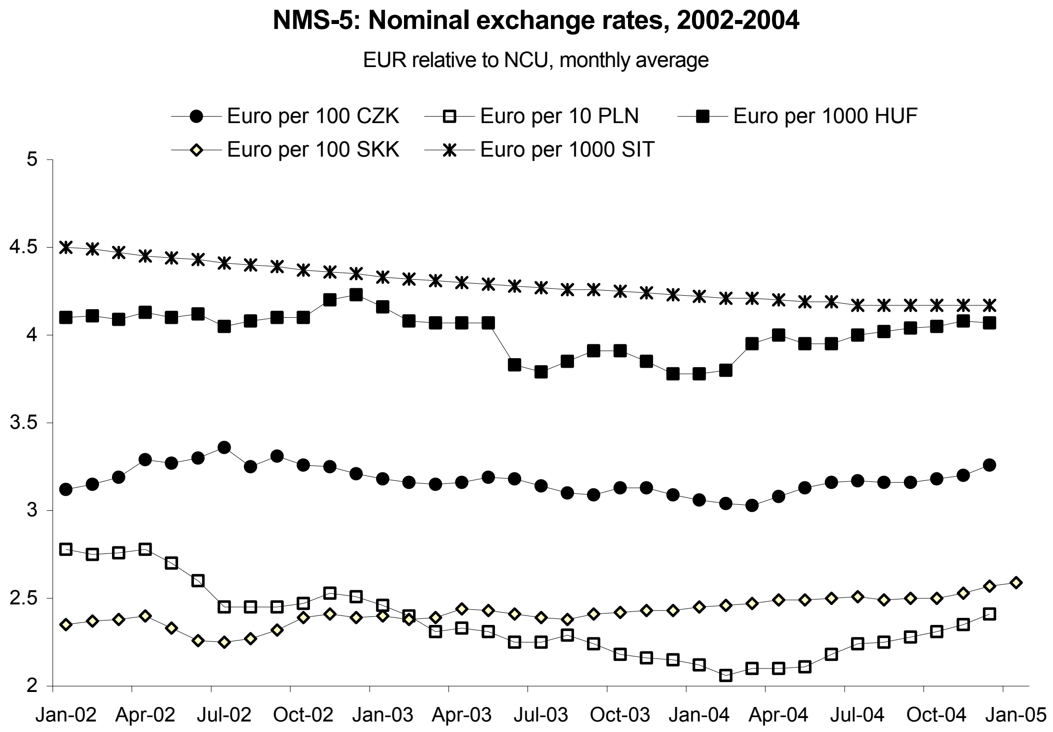
EUR billion, end of period

	Gross external Debt			Reserves of National Bank (excluding gold) [1)]			Current account				Current account (in % of GDP)			
	2002	2003	2004	2002	2003	2004	2003	2004	2005 forecast	2006 forecast	2003	2004	2005 forecast	2006 forecast
Czech Republic	25.7	27.6	29.9 IX	22.6	21.3	20.9	-4.9	-4.6	-4.8	-5.2	-6.2	-5.4	-5.0	-4.9
Hungary	38.6	46.5	52.7 IX	9.9	10.1	11.7	-6.6	-7.0	-7.0	-7.0	-9.0	-8.5	-7.9	-7.4
Poland	81.0	83.7	94.1 IX	27.4	26.0	25.9	-4.1	-3.5	-5.7	-6.0	-2.2	-1.8	-2.5	-2.5
Slovak Republic	12.7	14.7	16.2 X	8.8	9.7	11.0	-0.2	-1.0	-1.7	-1.7	-0.8	-3.0	-4.4	-3.9
Slovenia	11.5	13.3	15.4	6.7	6.8	6.5	-0.1	-0.2	-0.2	-0.2	-0.4	-0.7	-0.5	-0.5
Estonia	4.5	5.7	7.0	1.0	1.1	1.3	-1.1	-1.3	-1.4	-1.4	-13.2	-15.1	-14.3	-13.4
Latvia	6.9	7.5	10.0	1.2	1.1	2.6	-0.8	-1.4	-1.4	-1.4	-8.2	-12.5	-12.7	-11.3
Lithuania	5.9	6.9	8.3	2.3	2.7	3.0	-1.1	-1.5	-1.6	-1.5	-6.9	-8.3	-8.2	-7.3

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

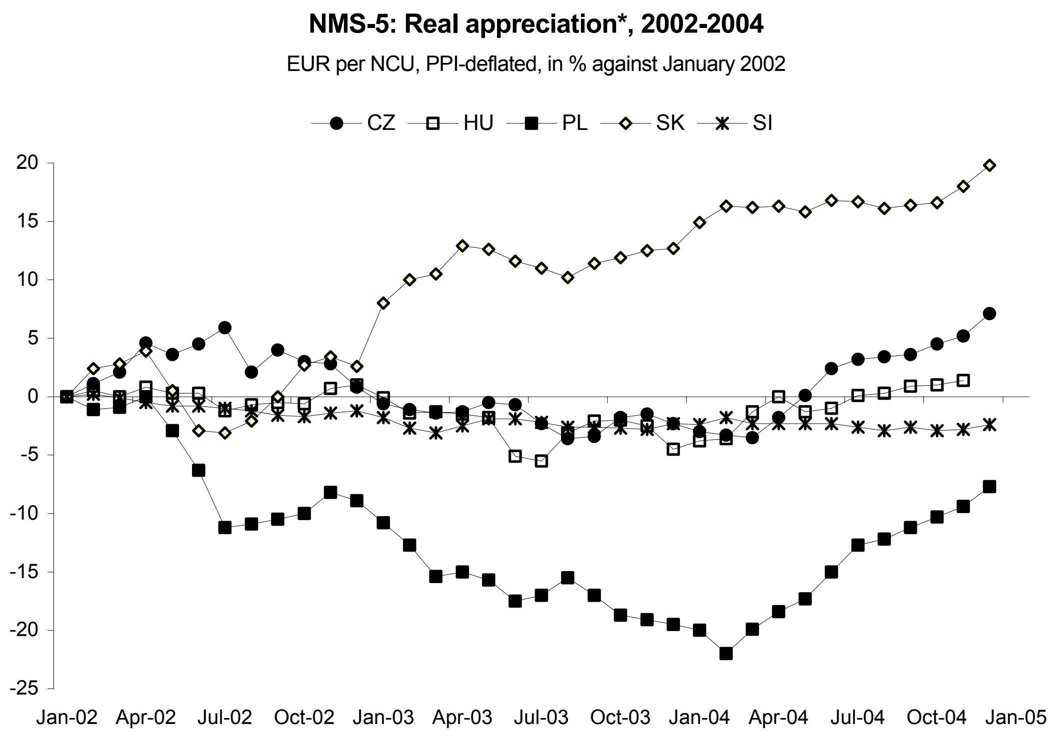
Source: wiiw Database incorporating national statistics; forecast: wiiw.

Figure 8a



Source: wiiw Monthly Database incorporating national statistics.

Figure 8b



* Increasing line indicates real appreciation

Source: wiiw Monthly Database incorporating national statistics.

One problem with high inflows of portfolio investment is that they tend to be inherently unstable – and essentially unpredictable. A reversal in the market sentiment (in this case of expectations of further appreciation) may trigger sudden outflows and abrupt devaluation, with the well-known negative effects for e.g. domestic banks and, ultimately, also for GDP growth. Of course, an early bursting of the bubble is perhaps the best possible outcome because it reduces the size of mismatches in the balance sheets of banks and firms which unduly accumulate over longer periods of time. But experience indicates that the self-sustaining nominal appreciation may go on even for years (as happened in Poland in the early 2000s, and more recently again in the Czech Republic, Hungary and Slovakia). While a certain degree of currency appreciation is plausible for NMS in the medium and long run (when backed by 'strong' fundamentals, e.g. productivity growth and not too large current account deficits), it will still be one of the key challenges of exchange rate policy prior to EMU accession to avoid 'excessive' appreciation and the possible subsequent currency crisis.

The risks and potential costs of the sudden outflows of portfolio investment with ensuing devaluation do not yet seem large in most NMS: compared with earlier periods of intensified nominal appreciation, the current one has not been long. Nonetheless, the continuing nominal appreciation can hardly be good for foreign trade. Arguably, the relatively low speeds of (real) appreciation in 2004 (in Hungary), and the relatively low levels of real exchange rates (in Poland and the Czech Republic) were conducive to the quite good trade performance in 2004 (e.g. lower trade deficits). No doubt the impressive recent gains in labour productivity in industry, and in unit labour costs generally, were also of importance since they could compensate the effects of real appreciation. The latter has been substantial during 2004 – especially in the Czech Republic, Poland and Slovakia – and potentially also dangerous (Figure 8b).

Nonetheless, the overall trade balances of the NMS were again negative in 2004, and in most cases actually worse than earlier on (see Table 7 above). And as already mentioned, the contribution of foreign trade to overall GDP growth was apparently also generally negative. Should the exchange rates of the NMS continue to appreciate, their overall trade performance may worsen even more visibly than in 2004, especially if the gains in labour productivity and unit labour costs turn out lower than in recent years. Under such conditions GDP growth is likely to slow down in 2005 – a possibility facing nearly all NMS, although Poland and Hungary appear most vulnerable in this respect.

FDI flows recover, profit repatriation increases[14]

Global FDI inflow in 2004 was more or less stagnating at the relatively low level of the previous year, approximately at one half of the year 2000.[15] FDI among developed countries fell in 2004, due to a further decline in mergers and acquisition and capital withdrawals from Germany. The main exception to the global trend was the FDI upswing in the USA and Great Britain. Developing countries booked all-time high FDI inflows, a development led by China. UNCTAD estimated a 33% increase for the transition countries due to higher FDI in NMS and also in Russia. This growth rate is calculated in current USD while our estimate in current EUR shows an increase of about 25% for the

[14] This section was drafted by Gábor Hunya, wiiw.

[15] UNCTAD reported a global FDI increase by 6% for 2004, measured in current (that is, weakened) USD – see http://www.unctad.org.

Table 13a

Foreign direct investment inflow

based on the balance of payments, EUR million

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Czech Republic	1982	1140	1152	3317	5933	5404	6296	9012	2289	3800	4000
Hungary	3696	2625	3681	2988	3106	2998	4391	3185	2018	3200	3500
Poland	2831	3592	4343	5676	6824	10334	6372	4371	3660	4400	4500
Slovak Republic	209	305	205	629	402	2089	1768	4397	636	800	2000
Slovenia	117	138	295	194	99	149	412	1750	299	400	200
NMS-5	8835	7800	9676	12805	16364	20974	19240	22716	8902	12600	14200
Estonia	156	120	236	511	284	425	603	307	797	700	800
Latvia	138	305	462	317	325	447	147	269	267	500	500
Lithuania	56	122	313	824	457	412	499	772	160	800	700
Baltic countries	350	547	1010	1653	1066	1284	1248	1347	1224	2000	2000
NMS-8	9185	8348	10686	14457	17430	22258	20488	24063	10125	14600	16200

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

Estonia: equity capital + reinvested earnings + loans.
Latvia: equity capital + reinvested earnings from 1996 + loans from 1996.
Lithuania: equity capital + reinvested earnings from 1995 + loans from 1997.

Source: National banks of respective countries according to balance of payments statistics. wiiw estimates for 2004 and 2005.

Table 13b

Foreign direct investment inward stock

based on international investment position (IIP), EUR million

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Czech Republic	5741	6910	8367	12255	17479	23323	30717	36884	37626	42000
Hungary	8817	10692	16296	17771	23161	24734	31375	36608	41977	47000
Poland	6121	9228	13205	19231	25947	36792	46686	46139	43827	47000
Slovak Republic	1013	1650	1888	2464	3174	5112	6327	8185	9504	10500
Slovenia	1376	1612	2000	2370	2675	3110	2952	3968	5070	5500
NMS-5	23068	30091	41757	54090	72435	93071	118057	131784	138004	152000
Estonia	574	665	1040	1561	2454	2843	3573	4035	5164	6300
Latvia	480	754	1140	1325	1782	2241	2648	2679	2634	3400
Lithuania	274	564	942	1384	2050	2509	3023	3818	3968	4600
Baltic countries	1328	1983	3123	4269	6285	7593	9244	10532	11765	14300
NMS-8	24396	32073	44879	58359	78720	100664	127301	142316	149769	166300

Remarks: Czech Republic: equity capital + reinvested earnings from 1997 + loans from 1997.
Hungary: equity capital + reinvested earnings from 1995 + loans from 1995.
Poland: equity capital + reinvested earnings + loans.
Slovak Republic: equity capital + reinvested earnings + loans.
Slovenia: equity capital + reinvested earnings + loans.

Estonia: equity capital + reinvested earnings + loans.
Latvia: equity capital + reinvested earnings + loans.
Lithuania: equity capital + reinvested earnings + loans from 1996.

Source: National banks of respective countries according to international investment position (IIP); wiiw estimates for 2004.

region as a whole. All sub-regions – NMS, accession countries (Bulgaria and Romania in particular), Western Balkans, and the CIS – were affected by this upswing. FDI growth seems to be lasting, it may even increase in 2005.

wiiw estimates FDI inflows to NMS-8 in 2004, based on 9-11 months balance of payments data, at about EUR 15 billion (after EUR 10 billion in the previous year – see Table 13). Despite the remarkable recovery, this amount still fell short of the EUR 24 billion record sum registered by NMS in 2002. The increasing FDI in new EU members as opposed to a falling trend in the 'old' EU may indicate some preference of investors seeking for new locations. FDI increased in all NMS with the only exception of Estonia. The leading FDI targets in terms of FDI inflow per capita in 2004 were, just as in the previous year, Estonia, the Czech Republic and Hungary. These are also the countries with the highest FDI stock per capita. Over the past 15 years, these three countries have received two times more FDI per capita than either Slovakia or Poland. A catching-up of the latter two countries can be expected in the near future.

An important feature of FDI in the more mature FDI host countries such as the Czech Republic and Hungary is the fact that it is growing more by way of reinvested profits rather than owing to new projects. Profit re-investment registered as FDI on the capital account has its current account counterpart as an outflow of foreign earnings.[16] Also the repatriated part of the FDI earnings is significant and shows the cost of such imported capital. In more recent FDI host countries such as Slovakia, Latvia and Lithuania, equity investments in new projects and privatization sales are still the dominant forms of FDI. In these countries, there are still relatively small amounts of profits reinvested or transferred abroad.

Services, including real estate development, retail trade and financial services, comprise about 60% of the FDI stocks in NMS. Investors in this sector are mainly attracted by the local market. A novelty of 2004 was the appearance of FDI in export-oriented services. Some important European service centres were transferred to the NMS, such as DHL to the Czech Republic and Avis to Hungary. Accounting services, the software industry and call centres are further examples of offshoring.

Manufacturing FDI in Central Europe is undergoing structural change due to increasing wages and declining transaction costs in the wake of EU accession. Labour-intensive production such as in the clothing and footwear industries is leaving. In other industries, such as food processing, there is increasing regional concentration. Meanwhile, the region's importance increases as a production site for EU-15 manufacturing companies. Examples for direct relocation of production lines from West to East are rare, but capacity expansions in the automotive industry and the household appliances production take place mostly in the NMS, and a scaling-down of production at the 'old' locations may follow soon.

Slovakia has become the chosen location of new automotive industry investment projects started by Volkswagen and recently followed by Hyundai (Kia) and PSA (Peugeot) as well as by Ford. The large pool of relatively cheap and skilled unemployed workforce, as well as the good image Slovakia has created by its business supporting reform policy (including tax reforms) made the country win the race ahead of its neighbours such as Hungary and Poland. These investments will stretch over 2005 and 2006. If the electricity network sale is finalized in 2005 as well, a jump of FDI in Slovakia

[16] The double booking of reinvestments may give an undue negative image of the size of the current account deficit.

can be expected (the respective deal with the Italian company Enel, worth EUR 840 million, was signed in February 2005).

There is a general tendency among NMS and accession countries to lower the statutory corporate income tax rate and increase promotion efforts to attract FDI. But as their labour costs and tax burden are lower compared to the more advanced EU member states, NMS would attract more medium-skilled and labour-intensive industrial capacities anyway. Thus competition can intensify only among the NMS. Countries with more similar cost levels can compete by lowering the marginal cost on investment and operation. The statutory corporate income tax is just one of those cost factors. In fact the amount of capital intending to move into the region may be high enough to benefit them all.

Companies located in NMS have also made a cautious start with expanding their operations abroad. Outward FDI has generally been on a steady increase over the past few years. Hungarian companies were the pioneers with unrepeatable high acquisitions in 2003. Outward investments in the range of EUR 3 million to 500 million in 2004 were made by companies based in Hungary, Slovenia, Poland and Estonia. It can be expected that the outward expansion of NMS firms will continue, targeting predominantly each other and Southeast European countries.[17]

Outlook: robust GDP growth, declining inflation, flat employment

As always, forecasting economic developments for the NMS is confronted with serious difficulties. Among the key external factors affecting current forecasts are developments in the EUR/USD exchange rate, changes in energy prices and, last but not least, the outlook for the eurozone. wiiw assumes that the US dollar will not depreciate further with regard to the euro (the exchange rate will remain roughly at 1.3 USD per EUR) and the oil price will stay at around USD 40 per barrel on average. Both assumptions imply no dramatic 'worsening' of the external environment of the NMS compared to the situation prevailing in 2004. As far as the eurozone economy is concerned, we assume that a certain weakening of growth observed in the last quarter of 2004 was only temporary and that growth will rebound soon, reaching somewhat more than 2% per year in both 2005 and 2006. Barring any larger external shock, GDP growth in the NMS-5 will slightly decelerate in 2005 (largely owing to a slowdown in Poland; the remaining NMS-4 will more or less maintain their last year's performance). On average, the NMS-5 will again grow about 2 percentage points faster that the 'old' EU-15, thus maintaining their 'standard' rate of catching-up. As for the Baltic States, they are expected to outperform the Central European NMS in terms of GDP growth again – at least in the coming two years. For the time being, they have been catching up faster (not least because they started from a lower development level) but there are some doubts whether they will be able to keep this pace of growth (more than 5-6% per year) in the medium and long run.

With pre-accession adjustment effects fading out, inflation is bound to decline again in the coming years, gradually converging with the eurozone. Inflation thus poses no problems as such, yet the remaining (small) inflation differential – together with a likelihood of further nominal appreciation of local currencies – implies some real appreciation and the corresponding loss of competitiveness. Under 'normal' circumstances this should be easily outweighed by the expected productivity and quality improvements induced by reforms and FDI (despite the lasting current account deficits in most NMS). However, any excessive (nominal) appreciation – perhaps fuelled by speculative capital

[17] Needless to say, the by far most important outward investor among the transition countries is Russia.

inflows in the wake of preparation for EMU accession – could lead to problems. Indeed, this seems to be one of the main risks which the NMS will face in the coming years.

As mentioned above, the situation on the labour market is not expected to improve much, despite the fairly robust GDP growth outlook. In fact, there is some ground to expect that employment rates might even deteriorate in the medium run, at least in some NMS (e.g. in Poland, as well as in the next EU entrant Romania).[18] A new start for the Lisbon Strategy, which focuses predominantly on growth and jobs, as recently announced by EU Commission President M. Barroso, is therefore especially urgent for the NMS.

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

With a growth rate of around 3.7% in 2004 and slightly accelerating in the coming years, the economy of the **Czech Republic** meets what one would expect from a medium-developed country. Gross fixed investment has become the main engine of growth. The trade balance is improving at current, but not at constant prices. EU accession speeded up trade expansion. Inflation remains low, a somewhat higher rate in 2004 was mainly the outcome of higher indirect taxation. In the same way as a few years ago, the currency shows an appreciation tendency against the euro, and it remains to be seen whether the Czech National Bank will again be able to slow or stop this development. On the political floor, bets on the survival of Prime Minister Gross and his centre-left government as a whole are en vogue at the time of writing.

In **Hungary**, the fiscal deficit will remain in the focus of attention. As no major budgetary reforms are in sight, while the Spring 2006 elections are all the more so, the deficit target for 2005 is fairly ambitious – a view shared by the EU Commission as well. Corrective measures will be required in the course of the year. The general outlook for 2005 is otherwise fairly good. Decelerating expansion of external (and an unchanged growth rate of domestic) demand will keep the GDP growth rate somewhat below 4%. Both exports and imports will expand at a slower pace than in 2004; transactions with NMS and Asian partners will gain in importance, as they did last year. The current account deficit will probably fall below 8% of the GDP (non-debt generating financing will again cover about half of the current account deficit). With a successful deceleration of inflation, further cautious steps towards a lower prime rate may take most of the poignancy of the economic policy struggles that dominated 2004. On an annual average, the forint is expected to weaken somewhat (250-253 HUF/EUR) compared to the last months of 2004, and the risk of a currency crisis appears smaller than it was during 2003-2004.

Parliamentary as well as presidential elections will be held in **Poland** in 2005, probably in autumn. The ruling liberal-left Social-Democrats, weakened by a number of corruption scandals (overblown by the generally hostile media) and by their own indecisiveness and opportunism, are likely to suffer heavy losses. But the likely victorious parties, currently competing with rather radical, if not fundamentalist proclamations, may find it difficult to form a working coalition. The strong economic growth in the first half of 2004 was due to rising consumption and positive trends in foreign trade. But

[18] See R. Stehrer (2004), ‘Employment, education and occupational structures: future scenarios’, Chapter 6 in ‘Economic Restructuring and Labour Markets in the Accession Countries’, research project commissioned by EU DG Employment, Social Affairs and Equal Opportunities, Contract No. VC/2003/0367, December 2004.

gross fixed investment has not yet really taken off, and unemployment has been stuck at very high levels. Unless the pronounced nominal strengthening of the zloty is corrected soon, GDP growth in 2005 will be slowing down again.

In **Slovakia**, a recovery of private demand and a strong investment expansion will drive GDP growth in both 2005 and 2006. In addition, on the supply side the economic expansion will be supported by gradually rising industrial output, particularly relating to FDI in car production. The bulk of price and tax adjustments is over, and thus the inflation rate will go down in the coming years. The government has confirmed its target to reduce the budget deficit to 3% in 2006 and to adopt the euro in 2009. However, as parliamentary elections are due in autumn 2006, pre-election populism will slow down the budgetary consolidation. The high unemployment rate will hardly change for the better. Nevertheless, there is hope that in the years to come foreign greenfield investment will, at least to some extent, also reach the poor eastern regions and eventually also create more new jobs. The current account deficit will rise in 2005, as profits earned by foreign-owned companies will be repatriated. In addition, the growth of exports may temporarily decelerate and that of imports accelerate, both in the context of expected further currency appreciation. In particular, the strengthening confidence in the success of the recent economic reforms and the high FDI inflows will fuel the demand for the Slovak koruna.

Backed by further export expansion and buoyant domestic demand, GDP growth of close to 4% will again be feasible in **Slovenia** in both 2005 and 2006. The fall in interest rates is also expected to boost domestic consumption. Inflation may drop to 3% this year and somewhat below that level in 2006. The central bank will adhere to its policy of a stable (real) exchange rate, allowing only minor fluctuations. The fiscal balance and the current account will not cause any serious problems in the years to come. The accession to the EMU could follow in 2007 at the latest.

Economic prospects for **Estonia** are fairly good – despite a certain slowdown in GDP growth in the incoming years. The economy in neighbouring Finland, where the bulk of tourists to Estonia are coming from, is growing more rapidly than the eurozone on average. Tourism from Russia seems to develop dynamically as well. Estonia is benefiting from its reputation as a tourist destination with a very good price-quality relationship. Given its budget surplus and low public debt, Estonia may join the eurozone by the end of 2006 or early 2007.

In **Latvia**, the domestic currency was pegged to the euro on 1 January 2005; this will be followed by participation in the ERM II early next year. According to the current plans, the adoption of the euro is envisaged for 1 January 2008. To counteract signs of overheating, the Latvian government is likely to tighten its fiscal policy soon. The Bank of Latvia is expected to raise its refinancing rate. No strong inflationary pressure seems to come from the labour market. Despite high economic growth (more than 6% per year), the employment situation is improving only slowly.

Lithuania's convergence programme aims at a further reduction of its already low fiscal deficits over the next years, targeting a deficit of only 1.5% of GDP in 2007. The country should not encounter any difficulties in fulfilling the requirements of ERM II and may join the eurozone by 2007 at the latest. As rising transfers from Brussels will be fuelling public investment, and exports are likely to develop favourably, GDP will probably grow by more than 6% in both 2005 and 2006. As a result of lower increases in household consumption, import growth as well as the current account deficit are likely to decline somewhat in the coming years.

Country reports

Josef Pöschl

Czech Republic: revised data present a picture of sound development

The Czech Republic's statistical office is eagerly engaged in revising its methodology and data sets, driven by the objective of implementing the EU methodology. This leads to frequent revisions, even several years back. As the latest revised data for national accounts suggest, GDP growth had come close to 4% in 2000, but shrank in the two subsequent years, to 1.5% in 2002. A recovery, up to 3.7%, followed in 2003. A result quite similar to the one reported for 2003 can be expected for 2004; in 2005 and 2006 growth could slightly accelerate.

Meanwhile, a strong expansion of gross fixed investment acts as the main engine of growth. Money from Brussels, aimed at upgrading the country's infrastructure, has an accelerating effect, together with the companies' efforts to meet EU standards or to increase competitiveness. Private consumption, on the other hand, expands on a slow track, no matter that average wages (gross, monthly) are increasing year-on-year by about 7% in nominal and close to 4% in real terms and overall employment has remained nearly constant. Changes in indirect taxation, introduced in the context of EU accession, have adversely affected private consumption. Enlarged savings to finance investment in housing have played a similar role. Stimulated by the announcement of new regulations starting from the beginning of 2005, mortgage loans and borrowing from building societies increased by 47% and 33% respectively, so that at the end of 2004, relative to the GDP, mortgage loans added up to about 6%; loans from building societies totalled 4% whereas deposits in these societies almost doubled against 2003, climbing to 13% of GDP. The banking sector is in good shape and eager to expand lending to private households, which is good business without big risk. Commercial banks hold relatively high deposits with the Czech National Bank (CNB), but are cautious with respect to lending to non-financial enterprises, at least to those not governed by transnational companies. It is still difficult to recover loans that have become non-performing; the legal procedures are dragging and complicated. A new attempt to reform bankruptcy procedures is likely to become, once again, delayed indefinitely. With more banks lending to non-financial enterprises, last years' overall growth performance may have been better. This underlines the importance of legal reforms.

At present, the most dynamic element in the Czech economy is foreign trade. In euro terms, the export of goods increased nearly 25% in 2004, and imports rose close to 20%. In trade with the EU-25 countries, the Czech Republic may have reached a surplus of close to EUR 2 billion in 2004 – in particular with Germany (over 1 billion), Slovakia, Austria and Belgium. The product group generating the highest surplus was machinery and transport equipment (close to EUR 2 billion). EU accession had a significant positive impact on foreign trade: In the last months prior to accession, i.e. from January to April 2004, exports in CZK terms had increased by 16.3% and imports by 15.8%, whereas thereafter, from May to November 2004, the growth rates were 28.6% and 23.0% respectively. Not surprisingly, the removal of all kinds of tariff and non-tariff barriers caused a boom in trade with unprocessed agricultural products as well as food.

Export prices rose by about 1.5% year-on-year in 2004, import prices by some 3.5%. At constant prices in CZK terms, exports of goods rose by 22%, imports by 15% in 2004, year-on-year. The 9% nominal appreciation against the US dollar helped to keep the rise in import prices within limits, as on the import side the dollar plays an important role (particularly in energy imports). On the other hand, the destination of exports is predominantly to the eurozone (86% of exports went to the EU-25 in 2004). Although in the course of the year 2004 an appreciation tendency vis-à-vis the euro became visible, the average nominal exchange rate against the euro was nearly identical in 2003 and 2004. In other words, Czech exporters profited from some real depreciation: in euro terms, Czech export prices rose less than the eurozone's consumer prices. The background was a growth of industrial labour productivity in excess of the increase in nominal wages (over 11% versus 7%) and a corresponding decline in unit labour costs.

In spite of improving foreign trade in goods – in 2004, export revenues covered nearly 100% of import expenditures – and a lasting surplus in services trade, the deficit on the current account has remained high, reflecting high and rising profits earned by foreign investors. Total income outflows, mainly related to previous foreign direct investment inflows, amounted to EUR 6.8 billion or 8% of GDP in 2003, and to approximately 8% of GDP in 2004. Income inflows were much lower and did not grow much (in both years they made up about 2.9% of GDP). Part of the profits earned by foreigners remained in the country and figured as capital inflow in the balance of payments. All in all, the CNB's international reserves fell from EUR 21.3 billion at the end of 2003 to 20.9 billion a year later, whereas the country's gross external debt increased from EUR 27.6 billion to 29.9 billion.

For financial investors, the ongoing gradual nominal appreciation strengthens the attractiveness of the Czech currency. A similar tendency had emerged in the first half of 1999; the exchange rate fell from peak values of over CZK 38 per euro to below 29 on 10 July 2002. The Czech National Bank had responded with a set of instruments, among them a reduction of repo and discount rates to levels that were low even compared to the eurozone. The CNB kept them that low up to the moment when in 2004 increases in VAT rates and in energy prices fuelled inflation. Inflation had been 0.5% in 2003, but jumped to 2.8% in 2004. When confronted with the renewed ongoing appreciation tendency, on 27 January 2005 the CNB surprised the markets by reducing interest rates once again, down to 2.25% (2 weeks repo rate), 1.25% (discount rate) and 3.25% (Lombard rate). It has to be seen as an indicator of the CNB's willingness to keep the exchange rate above 30 CZK per euro for the time being. This policy was successful in the past, and this time again it is likely that the CNB will be able to decelerate nominal appreciation. On paper, the CNB's policy is inflation targeting and nothing else, but most of the time, inflation has remained below the targeted band. In 2005, this may easily happen again, with an inflation rate remaining below that of the eurozone.

With regard to inflation, interest rates and the exchange rate, the Czech economy gives the impression of being fit for the introduction of the euro. The main obstacle is the high deficit of the public sector. Figures related to government deficit differ depending on the measurement method, but in terms of the EU-relevant methodology (ESA 1995) the deficit fell from 12.6% of GDP in 2003 to between 4% and 4.5% in 2004. This unexpectedly good performance resulted from higher revenues thanks to relatively high GDP growth, slightly higher inflation and a higher average VAT rate. Budgetary pre-election populism – parliamentary elections are due in 2006 – may prevent the deficit from reaching the Maastricht limit of 3% of GDP already in 2006.

Table CZ

Czech Republic: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 [1)]	2005 forecast	2006 forecast
Population, th pers., mid-year [2)]	10294.9	10282.8	10272.5	10224.2	10200.8	10201.7	10207.0	.	.
Gross domestic product, CZK bn, nom. [3)]	1962.5	2041.4	2150.1	2315.3	2414.7	2550.8	2720	2880	3050
annual change in % (real) [3)]	-1.1	1.2	3.9	2.6	1.5	3.7	3.8	3.9	4
GDP/capita (EUR at exchange rate)	5271	5383	5878	6644	7683	7852	8350	.	.
GDP/capita (EUR at PPP - wiiw)	11840	12170	12810	13530	14320	14690	15570	.	.
Gross industrial production									
annual change in % (real)	1.6	-3.1	5.4	6.5	4.8	5.8	10.0	9	9
Gross agricultural production									
annual change in % (real)	0.7	0.6	-4.5	2.5	-4.4	-7.6	.	.	.
Construction industry									
annual change in % (real)	-7.0	-6.5	5.3	9.6	2.5	8.9	10.4 I-XI	.	.
Consumption of households, CZK bn, nom. [3)]	998.3	1046.3	1108.8	1179.4	1220.6	1283.1	.	.	.
annual change in % (real) [3)]	-1.5	2.2	2.9	2.8	2.7	4.9	2.7	3.2	3.3
Gross fixed capital form., CZK bn, nom. [3)]	554.6	550.6	594.9	638.6	643.3	678.0	.	.	.
annual change in % (real) [3)]	-1.1	-3.6	4.9	5.4	3.4	4.8	10	8	7
LFS - employed persons, th, avg. [4)]	4865.7	4764.1	4731.6	4750.2	4764.9	4733.2	4706.7	.	.
annual change in %	-1.4	-2.1	-0.7	0.4	0.8	-0.7	-0.6	.	.
LFS - employed pers. in industry, th, avg. [4)]	1519.9	1468.7	1429.4	1470.6	1463.1	1424.7	1408.1 I-IX	.	.
annual change in %	-2.0	-3.4	-2.7	2.9	-0.1	-2.6	-1.4 I-IX	.	.
LFS - unemployed, th pers., average	335.7	454.1	454.5	421.0	374.1	399.1	425.9	.	.
LFS - unemployment rate in %, average [4)]	6.5	8.7	8.8	8.1	7.3	7.8	8.3	8.7	9
Reg. unemployment rate in %, end of period	7.5	9.4	8.8	8.9	9.8	10.3	9.5	10	10
Average gross monthly wages, CZK [5)]	11801	12797	13614	14793	15866	16920	17418 I-IX	.	.
annual change in % (real, gross)	-1.4	6.2	2.4	3.8	5.4	6.5	3.9 I-IX	.	.
Consumer prices, % p.a.	10.7	2.1	3.9	4.7	1.8	0.1	2.8	1.8	2.2
Producer prices in industry, % p.a.	4.9	1.0	4.9	2.8	-0.5	-0.3	5.7	4	2.5
General governm. budget, EU-def., % GDP [6)]									
Revenues	38.8	39.2	38.5	39.1	40.2	41.9	42.4	.	.
Expenditures	43.7	42.8	42.1	45.0	46.8	54.5	46.7	.	.
Deficit (-) / surplus (+)	-5.0	-3.6	-3.7	-5.9	-6.7	-12.5	-4.3	-4.1	-3.8
Public debt, EU-def., in % of GDP [6)]	15.0	16.0	18.2	25.3	28.8	37.8	37.8	39.4	40.6
Discount rate, % p.a., end of period	7.5	5.0	5.0	3.8	1.8	1.0	1.5	.	.
Current account, EUR mn	-1120	-1372	-2945	-3652	-4426	-4937	-4600	-4800	-5200
Current account in % of GDP	-2.1	-2.5	-4.9	-5.4	-5.6	-6.2	-5.4	-5.0	-4.9
Gross reserves of NB incl. gold, EUR mn	10756	12771	14159	16400	22614	21341	20885	.	.
Gross external debt, EUR mn	20757	22765	23285	25368	25738	27599	29882 IX	.	.
FDI inflow, EUR mn	3317	5933	5404	6296	9012	2289	3800 [7)]	.	.
FDI outflow, EUR mn	114	84	47	185	219	206	200 [7)]	.	.
Exports of goods, BOP, EUR mn	23068	24640	31483	37251	40711	43079	53200	62200	69000
annual growth rate in %	16.4	6.8	27.8	18.3	9.3	5.8	23.5	17	11
Imports of goods, BOP, EUR mn	25391	26424	34876	40675	43026	45258	54300	62200	68500
annual growth rate in %	5.2	4.1	32.0	16.6	5.8	5.2	20.0	15	10
Exports of services, BOP, EUR mn	6822	6612	7436	7913	7501	6882	7800	8900	10200
annual growth rate in %	7.5	-3.1	12.5	6.4	-5.2	-8.3	13.3	14	15
Imports of services, BOP, EUR mn	5109	5486	5904	6211	6792	6466	7300	8500	10000
annual growth rate in %	6.8	7.4	7.6	5.2	9.4	-4.8	12.9	16	18
Average exchange rate CZK/USD	32.27	34.60	38.59	38.04	32.74	28.23	25.70	.	.
Average exchange rate CZK/EUR (ECU)	36.16	36.88	35.61	34.08	30.81	31.84	31.90	30.2	29
Purchasing power parity CZK/USD, wiiw	13.97	14.26	14.36	14.60	14.27	14.51	14.58	.	.
Purchasing power parity CZK/EUR, wiiw	16.10	16.31	16.34	16.74	16.53	17.02	17.12	.	.

Notes: 1) Preliminary. - 2) From 2001 based on census March 2001. - 3) According to ESA 95. - 4) From 2002 weighted according to census 2001. - 5) Enterprises with more than 20 employees, including part of the Ministry of Defence and the Ministry of the Interior. - 6) According to ESA'95, excessive deficit procedure. – 7) wiiw estimate.

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

The clear merit of the ruling centre-left government is having guided the country to EU membership. In the economic sphere, the government has not made many mistakes so far, nor was it an assiduous reformer. Of course, introducing some kind of flat tax has now become a much-debated topic in Prague as well. Another lasting topic is reforming the pension system: this is not an urgent problem in the Czech case but, like everywhere else, politicians feel urged to care about long-term perspectives – which is a rare approach in many other fields. Reform alternatives in the healthcare system are also a topic, and the sector may face trouble after a EU-wide liberalization of labour markets. In any case, the Czech Republic is one of the lucky countries where political debates and even turmoil are not likely to disturb economic progress substantially. Things are a bit different on the political floor. Prime Minister Gross and the coalition government as a whole are in a wobbly position. Quite possibly, within a few months' time, i.e. long before the next regular election year (2006), the Civic Democratic Party (ODS), the leading opposition party, may come to power. Large parts of this party share the EU scepticism of President Klaus, and it may become interesting to see the ODS-led government's handling of the ratification of the EU constitutional treaty.

Sándor Richter

Hungary: healthy growth, sick budget and current account

The Hungarian GDP expanded by about 4% in 2004. The growth path differed significantly, to the better, from the one followed between mid-2001 and mid-2003. Excessive household consumption growth of the earlier years was curbed to 2.7-3% in 2004. A sharp upturn took place in investments; exports increased at a rapid pace. FDI inflow recovered, with the second highest annual inflow since transition began. Industry increased its output by about 8%, with much higher growth rates in engineering. After a transitional hike caused by changes in taxation upon accession to the EU, year-on-year inflation fell to 5.5% by December, a better record than expected by the market or the central bank. The bad news of 2004: all the above-outlined positive developments notwithstanding, the current account remained deeply in the red (8-9% of GDP) and the financing of the deficit took the form of a considerable increase in foreign debt (partly in forint-denominated securities). Failures in the fiscal area remained a sore spot; the budget deficit target for 2004 had to be revised upwards no less than three times within one year (from 3.8% to 4.6% and finally to 5-5.3% of GDP).

The state of the economy has been interpreted differently by the government and the central bank, respectively. In the central bank's view the 2004 growth path is unsustainable. It urges the government to introduce measures more resolute than those already taken to cut the budget deficit, pointing to the danger of recurrent inflation due to a possible sharp devaluation of the forint in case foreign financial investors should become reluctant to buy Hungarian government securities. The practical consequence of the central bank's evaluation has been to keep the prime rate high ever since the weakening of the forint in late 2003. Although that rate has been reduced, in small steps, by 425 basis points to 8.25% by the end of February 2005, it still remains the highest prime rate in the EU. The result is a strong forint, HUF 243 per EUR, in early 2005, close to the strong edge (HUF 240) of the intervention band. A further consequence of the strong forint and high interest rates is the rapid increase in lending in foreign currencies, both to the enterprise sector and to households, at substantially lower interest rates than with forint credits. Thus an increasing segment of the economy has become exposed to the risk of a possible devaluation.

The government is of the opinion that the current exchange rate of the forint is too strong, causing damage to import-competing firms and hindering the export activities of those small and medium-sized enterprises which rely primarily on domestic inputs in their production. (Hungary's export growth was slower than that of other new EU Member States in the region.) The government is convinced that lower inflation can be achieved and maintained at a lower prime rate and a weaker forint, which in turn would help to attain a more dynamic, export-driven growth that would also generate more budget revenues and support the consolidation of the budget. The high interest rates themselves increase the budget deficit due to the higher debt service burden.

Hungary has declared its intention to introduce the euro in 2010. However, the EU is not satisfied with the implementation of the Hungarian convergence programme. In January 2005 the ECOFIN decided to carry on the excessive deficit procedure against Hungary (while it was lifted in the case of all other new Member States) for the reason that the Hungarian government has been unable to observe its own fiscal deficit target. It is not so much the extent of the deficit that is at stake – in 2004 the fiscal deficit was lower (at about 5.2% of GDP) than in 2002 (9.3%) and in 2003 (6.2%). The real issue here is the shaken confidence in the Hungarian government's readiness to set realistic deficit targets and observe them.

Concerning the budget deficit, the EU has provided not only criticism but also some help recently. Eurostat agreed that payments to the private pension funds will not be included in the budget deficit. Calculated according to the new methodology, Hungary's 2004 fiscal deficit would only amount to about 4.5% of the GDP, and the original 2005 target deficit of 4.7% drops to 3.8%. Though the new methodology is no remedy to chronic fiscal problems, it may help to attain the 3% deficit/GDP ratio required by the Stability and Growth Pact earlier or with less pain than by the old methodology. The government, too, proved innovative concerning virtual deficit reduction. This year a substantial part of public investment (predominantly the expensive highway construction) will be implemented in a quasi-fiscal scheme. This solution helps to decrease public expenditures in the short run. With no major budgetary reforms in sight, but elections due in Spring 2006, the deficit target for 2005 is, despite all tricks, fairly ambitious. Observing it may require corrective measures in the course of the year.

Apart from the troublesome fiscal position the general outlook for 2005 is good. A decelerating expansion of external demand and an unchanged growth rate of domestic demand will keep the GDP growth rate at slightly below 4%. Both exports and imports will rise at a slower pace than in 2004; transactions with the new EU Member States and with the rapidly growing (mainly Asian) non-EU partners will, as in the past year, gain in importance. The extent of the current account deficit will remains at around EUR 7 billion (as in 2004), but its ratio to the GDP will probably fall below 8%. Non-debt generating financing will cover, as in 2004, about half of the current account deficit. With the successful deceleration of inflation, further cautious steps towards a lower prime rate may take most of the poignancy of the economic policy struggles which dominated 2004. On an annual average the forint will be slightly weaker (250-253 HUF/EUR) than in the last months of 2004. The risk of a currency crisis is substantially smaller than it was in 2003-2004.

Table HU

Hungary: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 [1)]	2005	2006
								forecast	
Population, th pers., end of period	10253.4	10221.6	10200.3	10174.9	10142.4	10116.7	10097 [XI]	10065	10040
Gross domestic product, HUF bn, nom.	10087.4	11393.5	13150.8	14849.8	16740.4	18568.3	20700	22300	24000
annual change in % (real)	4.9	4.2	5.2	3.8	3.5	3.0	3.9	3.8	4.1
GDP/capita (EUR at exchange rate)	4077	4402	4953	5679	6782	7231	8150	.	.
GDP/capita (EUR at PPP - wiiw)	9120	9730	10550	11550	12400	12930	13890	.	.
Gross industrial production									
annual change in % (real)	12.5	10.4	18.1	3.6	2.8	6.4	8.4	7	10
Gross agricultural production									
annual change in % (real)	0.7	0.4	-6.5	15.8	-4.1	-4.5	.	.	.
Construction industry									
annual change in % (real)	15.3	9.0	7.9	7.7	17.5	2.2	6.8	.	.
Consumption of households, HUF bn, nom.	4994.2	5826.6	6689.2	7680.4	8767.2	9904.7	.	.	.
annual change in % (real)	4.8	5.4	4.4	5.7	10.3	8.1	2.9	3	3.3
Gross fixed capital form., HUF bn, nom.	2384.6	2724.5	3179.8	3493.0	3916.9	4141.3	.	.	.
annual change in % (real)	13.3	5.9	7.7	5.0	8.0	3.4	10	7	12
LFS - employed persons, th, avg. [2)]	3674.7	3809.3	3856.2	3868.3	3870.6	3921.9	3900.4	.	.
annual change in % [2)]	1.8	0.6	1.2	0.3	0.1	1.3	-0.5	.	.
Reg. employees in industry, th pers., avg. [3)]	795.9	834.0	844.8	833.9	817.9	801.8	785.3	.	.
annual change in %	1.6	0.8	1.3	-1.3	-1.9	-2.0	-2.1	.	.
LFS - unemployed, th pers., average	313.0	285.3	263.7	234.1	238.8	244.5	252.9	.	.
LFS - unemployment rate in %, average	7.8	7.0	6.4	5.7	5.8	5.9	6.1	6.1	6.1
Reg. unemployment rate in %, end of period	9.5	9.3	8.6	8.0	8.0	8.3	8.7 [XI]	8.5	8.5
Average gross monthly wages, HUF [3)]	67764	77187	87645	103553	122482	137193	145675	.	.
annual change in % (real, net)	3.6	2.5	1.5	6.4	13.6	9.2	-1.1	.	.
Consumer prices, % p.a.	14.3	10.0	9.8	9.2	5.3	4.7	6.8	3.9	3.2
Producer prices in industry, % p.a.	11.3	5.1	11.6	5.2	-1.8	2.4	3.5	.	.
General governm.budget, EU-def., % GDP [4)]									
Revenues	.	.	44.6	44.3	43.4	43.6	43.3	.	.
Expenditures	.	.	47.6	48.7	52.6	49.7	48.7	.	.
Deficit (-) / surplus (+) [5)]	.	.	-3.0	-4.4	-9.2	-6.2	-5.3	-4.8	-4.4
Public debt, EU-def., in % of GDP [4)5)]	61.6	60.9	55.4	53.5	57.2	59.1	59.7	.	.
Refinancing rate, % p.a., end of period	17.0	14.5	11.0	9.8	8.5	12.5	9.5	8	6.5
Current account, EUR mn	-3026.1	-3531.4	-4380.0	-3612.5	-4973.7	-6575.5	-7000	-7000	-7000
Current account in % of GDP	-7.2	-7.8	-8.7	-6.2	-7.2	-9.0	-8.5	-7.9	-7.4
Reserves total, excl. gold, EUR mn	7976.8	10845.3	12038.4	12163.7	9887.4	10108.3	11669.8	.	.
Gross external debt, EUR mn	23657.1	29230.9	32571.5	37387.0	38559.3	46504.4	52699.4 [IX]	.	.
FDI inflow, EUR mn	2988.1	3106.4	2998.4	4390.7	3185.1	2018.0	3200 [6)]	.	.
FDI outflow, EUR mn	245.2	234.7	664.4	398.5	295.7	1456.5	500 [6)]	.	.
Exports of goods, BOP, EUR mn	21056.7	24058.8	31277.5	34697.1	36820.7	38376.9	43750	48100	54400
annual growth rate in %	23.3	14.3	30.0	10.9	6.1	4.2	14	10	13
Imports of goods, BOP, EUR mn	22742.1	26102.4	34457.1	37192.8	39024.1	41274.5	46230	50400	55900
annual growth rate in %	24.6	14.8	32.0	7.9	4.9	5.8	12	9	11
Exports of services, BOP, EUR mn	4810.9	4910.2	6114.2	7434.5	7342.3	7082.0	7430	.	.
annual growth rate in %	-6.5	2.1	24.5	21.6	-1.2	-3.5	5	.	.
Imports of services, BOP, EUR mn	3735.5	4093.9	4907.4	5809.1	6799.9	7611.2	8220	.	.
annual growth rate in %	4.2	9.6	19.9	18.4	17.1	11.9	8	.	.
Average exchange rate HUF/USD	214.45	237.31	282.27	286.54	258.00	224.44	202.63	.	.
Average exchange rate HUF/EUR (ECU)	240.98	252.80	260.04	256.68	242.97	253.51	251.68	252	253
Purchasing power parity HUF/USD, wiiw	92.83	99.96	107.34	110.10	114.72	120.86	127.15	.	.
Purchasing power parity HUF/EUR, wiiw	107.78	114.35	122.11	126.21	132.87	141.78	147.57	.	.

Notes: 1) Preliminary. - 2) From 1999 according to census 2001. - 3) Enterprises with more than 5 employees. - 4) According to ESA'95, excessive deficit procedure. - 5) Without taking into consideration the payments to public pension funds. – 6) wiiw estimate.

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

Leon Podkaminer

Poland: the return of the strong zloty

Poland's yearly indicators for 2004 are looking quite favourable. GDP grew by 5.4%: more than domestic demand, which increased by 4.9%, with private consumption rising by 3.2% only and gross fixed investment by 5.1%. Foreign trade (goods and non-factor services) added to the overall GDP growth, contributing approximately 0.4 percentage points to the GDP growth rate. Total gross value-added rose by 5% (in industry it was up 9.7%, in construction it fell however, already for the fourth year running). But there was a massive rise in inventories which accounted for about 1.8 percentage points of the overall GDP growth rate. In addition, GDP growth has been slowing down throughout 2004: from 6.9% in the first quarter to about 4.1% in the fourth. The second half of 2004 (and its final months in particular) seems to have brought qualitatively new developments. Quite unexpectedly private consumption, which had kept rising by 3.5-3.9% earlier in the year, grew by approximately only 1.5% in the fourth quarter. The slowdown in the growth of private (and overall) consumption was not compensated by the acceleration in growth of gross fixed investment (from 3.7% in the first three quarters to over 7% in the fourth). In addition, the positive contribution of foreign trade was reduced in the fourth quarter (from about 0.66 percentage points in the first three quarters to 0.4 p.p. in the whole year of 2004). Some signs of a 'structural break' can also been seen in data on industry. Industrial sales, which in the first half of 2004 were about 17.6% higher (in real terms) than in the same period of 2003, rose less dynamically in the second half of 2004. (Overall industrial sales rose by about 11.6% in 2004.) The growth slowdown does not seem to be an 'effect of accession', at least directly. Indirectly, the accession may have played a role through higher inflation which eroded the purchasing power of wages and pensions, thus weakening the rise of consumer demand. (A tighter monetary policy is another indirect effect of accession.)

Whether or not the 'structural break' had some impacts on profits is not yet known. According to available data on the first three quarters of 2004, the non-financial corporate sector made very high profits (amounting to PLN 57.9 billion, up from 24.6 billion in first three quarters of 2003). In the entire year of 2003 gross profits reached PLN 30.2 billion. Net profits grew even faster (also on account of lower corporate tax rates): from PLN 15.1 billion in the first three quarters of 2003 to 46.4 billion in the same period of 2004. Net profitability (the ratio of net profit to revenue) rose from 2% to 5.1%. Profits improved in all major branches and sectors. Exporting firms continued to outperform other firms on profitability. All in all, even if profits and profitability declined somewhat in the last quarter of 2004, the financial standing of the corporate sector must be considered very good. The same applies to commercial banks, whose net profits also rose very strongly, from PLN 2.3 billion in 2003 to 7.3 billion in 2004. The banks' strong profits were accompanied by an improving quality of banks' assets. Within 2004 the share of 'problematic' assets in banks' credit portfolios fell from 21.2% to 14.8%.

The manifold expansion of corporate profits happened to coincide with a very slow (3.3%) rise in that sector's nominal wage bill. In real terms the average gross wage in that sector rose by 0.6%. In manufacturing the average gross wage rose by 0.9% in real terms, while labour productivity increased by 13.1% – resulting in unit labour costs falling by close to 19%. The stagnation of wages is easily explained by the very high, persistent unemployment and the ensuing weakness of the Trade Unions.

The high profits earned by the corporate sector and the still relatively low levels of investment are consistent with the falling volume of the sector's credit liabilities. On aggregate the corporate sector does not need to borrow. To the contrary, the sector's deposits with commercial banks are rising very fast. In contrast, the volume of households' deposits have been stagnant while their credit liabilities are expanding quite strongly.

The outstanding performance of foreign trade has followed from two developments: the ongoing decline in unit labour costs (strong rise in labour productivity combined with weak increases in wages) and the weak (nominal) exchange rate vs. the euro. On average the PLN/EUR exchange rate was 11% higher (i.e. weaker) in the first half of 2004 than in the same period of 2003. However, the zloty, which had been weakening since the first half of 2002 – together with falling National Bank (NBP) interest rates and amid quite low inflows of both FDI and portfolio investment – has been strengthening since February 2004. By September the zloty had appreciated by close to 11% in nominal terms. In the fourth quarter the zloty strengthened by another 5.6%. Further gains were recorded in early 2005. The strengthening of the zloty can be seen as reflecting the rapid rise in inflows of portfolio capital and the expectations (correct so far) of relatively high interest rates and of the zloty strengthening even further. Indeed, in the first nine months of 2004 there was a massive inflow (equivalent to EUR 6.8 billion) of portfolio investment targeting government debt securities. This is over twice the level recorded in the whole year of 2003. Capital inflows and the strengthening of the zloty may be intimately linked to the correctly anticipated moves of the National Bank of Poland: NBP interest rates were raised twice in 2004, in July and August.

The rising NBP interest rates followed from concerns over inflation, which suddenly accelerated in April, May and June, bringing the 12-month CPI from 1.7% in March to 4.6% in July and August. Despite being sudden, the inflationary acceleration had been generally expected. It reflected higher prices of imported energy carriers and the well anticipated price hikes in the wake of EU accession. Producer prices in coal mining, petroleum processing and metallurgy also accelerated (in March, April and May), partly in response to world market developments. The Spring inflationary acceleration was in fact transient. It is no small irony that the NBP tightened its policy precisely when consumer prices began to *fall* on their own (in July and August). As it turned out the CPI rose cumulatively by less than 1% over the second half of 2004 (and the index of industrial producer prices by less than 0.5%). Despite this the NBP drags its feet on the interest rates, referring to all kinds of imaginable risks to price stability: a build-up of inflationary expectations, pressures for high wages, lax fiscal policy etc. This certainly serves the goal of NBP's 'reputation building'. Otherwise, under the current conditions, none of these risks seems even remotely real. The real problem is the interest rates being too high, the zloty being too strong, and the portfolio inflows currently taking advantage of that constellation of exchange and interest rates.

High interest rates are unlikely to be conducive to higher fixed investment in the corporate sector. And they are likely to discourage investment in small and medium-size firms. Higher communal and public investment (and also investment in smaller firms) is more likely to be stimulated by the forthcoming EU transfers. But the return of a strong zloty is very likely to prove harmful to the export and import-competing sectors. Of course the actual foreign trade performance need not deteriorate immediately. It may take time to adapt to the new realities, with the zloty much stronger than

Table PL

Poland: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 [1]	2005	2006
								forecast	
Population, th pers., end of period [2]	38667	38654	38644	38633	38219	38191	38175	.	.
Gross domestic product, PLN mn, nom.	589361	652517	723886	760595	781112	814922	884200	951700	1024300
annual change in % (real)	4.8	4.1	4.0	1.0	1.4	3.8	5.4	4.5	4.5
GDP/capita (EUR at exchange rate)	3885	3994	4670	5366	5299	4851	5110	.	.
GDP/capita (EUR at PPP - WIIW)	7940	8450	9050	9290	9660	9830	10580	.	.
Gross industrial production (sales)									
annual change in % (real)	3.5	3.6	6.7	0.6	1.1	8.1	11.6	8	8
Gross agricultural production									
annual change in % (real)	5.9	-5.2	-5.6	5.8	-1.9	-0.8	7.6	.	.
Construction output total									
annual change in % (real)	12.4	6.2	1.0	-6.4	-0.3	0.9	.	.	.
Consumption of households, PLN mn, nom.	363074	406517	455405	486504	510817	530033	422774 [I-IX]	.	.
annual change in % (real)	4.8	5.2	2.8	2.1	3.3	3.1	3.2	3	.
Gross fixed capital form., PLN mn, nom.	139205	156690	170430	157209	148338	148962	97014 [I-IX]	.	.
annual change in % (real)	14.2	6.8	2.7	-8.8	-5.8	-0.5	5.1	7	.
LFS - employed persons, th, avg. [3]	15354.0	14757.0	14526.0	14207.0	13782.0	13616.8	13707.0 [I-IX]	.	.
annual change in %	1.2	-3.9	-1.6	-2.2	-3.0	.	0.9 [I-IX]	.	.
Reg. employees in industry, th pers., avg.	3378.7	3138.4	2955.0	2820.6	2670.5	2656.9	2399.4 [5]	.	.
annual change in %	-1.6	-7.1	-5.8	-4.5	-5.3	-0.5	-0.4 [5]	.	.
LFS - unemployed, th pers., average [3]	1816.0	2391.0	2785.0	3170.0	3431.0	3328.5	3280.0 [I-IX]		
LFS - unemployment rate in %, average [3]	10.6	13.9	16.1	18.2	19.9	19.6	19.3	19	18
Reg. unemployment rate in %, end of period [3]	10.4	13.1	15.1	17.5	20.0	20.0	19.1	18	.
Average gross monthly wages, PLN [4]	1232.7	1697.1	1893.7	2045.1	2097.8	2185.0	2289.6	.	.
annual change in % (real, gross)	4.5	4.7	1.0	2.5	0.7	3.4	1.5	.	.
Consumer prices, % p.a.	11.8	7.3	10.1	5.5	1.9	0.8	3.5	3	3
Producer prices in industry, % p.a.	7.3	5.7	7.8	1.6	1.0	2.6	7.0	4	4
General governm. budget, EU-def., % GDP [6]									
Revenues	44.5	44.9	42.5	43.8	43.9	43.7	45.6	.	.
Expenditures	46.6	47.0	44.2	47.7	48.1	47.6	51.2	.	.
Deficit (-) / surplus (+)	-2.1	-1.3	-0.7	-3.7	-3.6	-3.9	-5.5	-4	-3.1
Public debt, EU-def., % of GDP [6]	39.1	40.1	36.8	36.7	41.1	45.4	47.7	50.3	.
Discount rate of NB % p.a., end of period	18.2	19.0	21.5	14.0	7.5	5.8	7.0	.	.
Current account, EUR mn	-6154	-11719	-10789	-6004	-5402	-4109	-3500	-5700	-6000
Current account in % of GDP	-4.1	-7.6	-6.0	-2.9	-2.7	-2.2	-2	-2.5	-2.5
Gross reserves of NB excl. gold, EUR mn	23396	26224	28555	29031	27367	26000	25904	.	.
Gross external debt, EUR mn	50668	65121	74671	81461	81046	83705	94130 [IX]	.	.
FDI inflow, EUR mn	5676	6824	10334	6372	4371	3660	4400 [7]	.	.
FDI outflow, EUR mn	282	29	18	-97	228	173	300 [7]	.	.
Exports of goods, BOP, EUR mn	28951	28215	39022	46537	49338	53836	64600	69800	75400
annual growth rate in %	6.5	-2.5	38.3	19.3	6.0	9.1	20	8	8
Imports of goods, BOP, EUR mn	40397	42361	52349	55094	57039	58913	70100	76400	84000
annual growth rate in %	12.6	4.9	23.6	5.2	3.5	3.3	19	9	10
Exports of services, BOP, EUR mn	9666	7850	11320	10914	10545	9850	10400	10700	11000
annual growth rate in %	22.5	-18.8	44.2	-3.6	-3.4	-6.6	6	3	3
Imports of services, BOP, EUR mn	5907	6553	9773	10021	9690	9408	9900	10000	10100
annual growth rate in %	16.2	10.9	49.1	2.5	-3.3	-2.9	5	1	1
Average exchange rate PLN/USD	3.49	3.97	4.35	4.09	4.08	3.89	3.65	.	.
Average exchange rate PLN/EUR (ECU)	3.92	4.23	4.01	3.67	3.86	4.40	4.53	4.2	4.2
Purchasing power parity PLN/USD, WIIW	1.65	1.75	1.82	1.85	1.83	1.85	1.83	.	.
Purchasing power parity PLN/EUR, WIIW	1.92	2.00	2.07	2.12	2.11	2.17	2.19	.	.

Notes: 1) Preliminary. - 2) From 2002 according to census May 2002. - 3) From 2003 according to census May 2002. - 4) From 1999 including mandatory premium for social security. - 5) Enterprises with more than 9 employees. - 6) According to ESA'95, excessive deficit procedure. – 7) wiiw estimate.

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

generally expected not long ago.[19] Nonetheless, even if the volumes of exports continue to rise, profits earned on them, expressed in domestic currency, may be contracting. In addition, the build-up of inventories will eventually be coming to an end. Under these conditions even a quite strong rise in fixed investment may be incapable of generating an overall growth acceleration.

The actions taken by the NBP in Summer 2004 were provoked by the price hikes partly related to Poland's accession to the EU. Otherwise, the accession has done some good – especially to the country's numerous farmers. Farmers have been benefiting not only from sizeable direct payments and other forms of support. Under fully liberalized trade in food and farm products, Poland's agro-food exports to the EU-25 expanded strongly (by more than 30%), pulling up some domestic prices. For the first time in several years prices of farm products rose faster than prices of agricultural production inputs. Farmers, until recently the staunchest opponents of Poland's EU membership, emerge as its clear beneficiaries. Other positive impulses of EU membership are yet to materialize. For the time being one cannot reliably detect or measure e.g. the effects of various non-farm transfer programmes. Also, it is hard to relate the recent FDI inflows to EU membership: quantitatively they do not seem to be any higher than on average in the past several years.

Parliamentary as well as presidential elections will be held in 2005, probably in autumn. The ruling liberal-left Social-Democrats, weakened by a number of corruption scandals (overblown by the generally hostile media) and by their own indecisiveness and opportunism, will probably suffer heavy losses. But the likely victorious parties, currently competing with rather radical, if not fundamentalist proclamations, may find it difficult to form a working coalition.

Zdenek Lukas

Slovakia: good news, especially for the business community

The former main driving force of economic expansion, exports, has been losing momentum. Nevertheless, the GDP grew by above 5% in 2004. Both overall consumption and gross fixed capital formation increased by nearly 4%, accompanied by rising inventories. On the supply side, the GDP expansion in 2004 followed mainly from an increase in gross value added in industry and construction (both up some 10%). Gross industrial production grew by about 4.5%, whereas industrial employment rose only marginally. Industrial labour productivity increased by around 4.5%, less than average industrial gross monthly wages (up about 10%). In other words, unit labour costs in industry are likely to have increased by around 5% in SKK terms and by some 9% in euro terms. The former major contributor to industrial growth, carmaker VW Bratislava, expanded its production by only 1% in 2004; its major output expansion had taken place already in 2003 (+32%). Nevertheless, the rise in industrial output was mainly attributable to machinery and equipment as well as electrical and optical equipment, which both expanded by about 15%.

[19] According to a poll conducted among a large sample of firms in September 2004, it was generally expected that at the end of 2004 the PLN/EUR rate would be about 4.41 and the PLN/USD rate 3.67. The actual rates were 4.08 and 2.99 respectively. Clearly, the firms' expectations were wrong. In September the firms generally believed that exports would cease to be profitable at a PLN/EUR rate of 4.1. Moreover, already the rate of 4.24 was considered harmful for domestic import-competing firms. See NBP's web page at www.nbp.pl/publikacje/koniunktura.

It was real appreciation (by more than 5% on annual average) which, possibly among other factors, slowed down export expansion and accelerated import growth. The competitiveness of Slovak tradable goods continues to rely on wage rates, which in euro terms are relatively low: gross monthly wages averaged some EUR 380 in 2004 compared to 346 in 2003. The National Bank of Slovakia (NBS) is fighting appreciation by lowering interest rates, but has so far not been able to stop it.

A number of factors fuel the demand for the Slovak currency: strengthening confidence in the success of the recent economic reforms, the continuation of high FDI inflows and interest rates still above those in the euro zone together with the expectation of further appreciation. On 2 February this year the Slovak koruna reached a new historical high of 38.1 SKK per EUR, which represented a year-on-year nominal appreciation by 7%.

In recent years, Slovakia has gained a reputation as a reform pioneer. Because of comprehensive tax reforms and favourable macroeconomic developments, in December 2004 Standard & Poor's upgraded Slovakia's rating from BBB+ to A-, the same rank as that of the Czech Republic and Hungary and better than Poland's. The 19% tax rate on corporate profits and all types of personal income, introduced at the beginning of 2004, was supposed in particular to attract more foreign direct investors as well as to contribute positively to a reduction of the budget deficit. Yet it appears that the deficit climbed from 3.7% of GDP in 2003 to 5.5% in 2004. However, this result is bloated by the fact that in late 2004 the Slovak government had to pay the Czech bank Československá Obchodní Banka AS (CSOB) around EUR 620 million, or about 1.9% of the Slovak GDP, as a result of a court decision. It represents principal and interest from an unpaid loan that the CSOB provided to a Slovak agency set up in 1993 to assume the bank's bad debts.

If this extraordinary payment is left out, the deficit – calculated in accordance with the EU methodology (ESA 95) in per cent of GDP – was slightly lower than in 2003, mainly supported by higher GDP growth in 2004. The government confirmed its target to reduce the budget deficit to 3% in 2006 and to adopt the euro in 2009. The budget for 2005 projects a deficit of 3.8% of GDP. However, pre-election populism (parliamentary elections are due in autumn 2006) will slow down the budgetary consolidation. Higher indirect taxation starting from the beginning of 2004 and the ongoing price deregulation have resulted in relatively high inflation (7.5%). Fears that EU accession would accelerate inflation significantly have proved as not justified. Retail prices remained virtually unchanged after 1 May. The number of retailers is increasing, and competition among them exerts a downward pressure on prices. Besides, because consumers' purchasing power is only modestly rising, there is little scope for prices to go up.

The tax reform was accompanied by a radical reform of the pension and healthcare systems and of the provision of basic social benefits for long-term jobless, starting from the beginning of 2004. The latter contains a ceiling for transfer payments to families, which rises degressively with the number of children. It implied de facto a serious income squeeze for many Roma families and has resulted in social unrest in the eastern parts of the country in February 2004. Most of the about 300,000 Roma live in slums (mainly in Eastern Slovakia); they are trapped in a vicious circle of low education and poor job opportunities.

Most provisions of the reforms in the pension and healthcare systems have taken effect at the beginning of 2005. The pension reform contains a gradual increase in the statutory retirement age and introduces a privately managed second pillar of the pension system. The new pension scheme is mandatory for new entrants to the labour market, whereas currently employed workers can voluntarily join it. The reform of the healthcare system is based on obligatory and voluntary insurance. It is expected to result in a reduction of the financial burden for the state, greater financial transparency in the healthcare institutions, and an improvement in healthcare quality. The latter, however, may in fact materialize only for those patients who can afford voluntary insurance. The actual effects of the healthcare reform will soon become visible, whereas the impact of the pension reform will show only in the long run. In December 2004, the new regulatory framework for bankruptcies was approved. The crucial target is to accelerate bankruptcy procedures, strengthen creditors' rights and increase the proportion of claims that creditors can recover.

Following 1.8% growth in 2003, according to Labour Force Survey (LFS) data, employment stagnated in 2004 despite the relatively robust expansion of the economy. Compared to 2003, the unemployment rate (LFS) rose by 1.1 percentage points in 2004 and reached 18.5% on an annual average. FDI has so far not eased the tension on the labour market. FDI inflows had dropped to EUR 0.6 billion in 2003, but climbed to an estimated EUR 0.8 billion in 2004. The greatest number of investors has targeted the car and electro-technical industries as well as services. The increased is supposed to be closely related to Slovakia's accession to the EU, the low corporate tax rate, the rising number of industrial parks and the improved business climate. A further hike is expected in the coming years on account of two new car factories (PSA Peugeot-Citroen and KIA-Hyundai), both located in Slovakia's richer western region: the investments planned total some EUR 1.5 billion, and the projected car production amounts to over 500,000 units annually, implying the creation of almost 10 thousands new jobs by 2006. Whereas the core of FDI remains concentrated in the West of the country, the German automobile gear box manufacturer Getrag Ford has announced a plan to invest some EUR 300 million in the poorer region in the East (industrial park Kechnec close to Košice) where unemployment is high – and the link to the Hungarian highway system is close. The company intends to start producing new-technology transmissions in 2007, and including local sub-contractors the project should create over 2000 new jobs. Another two, already agreed, smaller projects with a total FDI volume of over EUR 40 million within five years are related to the car industry as well. In addition, Korea's electronics producer Nuritech Global will expand its FDI activities in Southern Slovakia. As for the years to come, the Slovak Investment and Trade Development Agency (SARIO) announced to mainly support FDI projects in the pharmaceuticals, IT and R&D sectors as well as in call centres.

Driven by a recovery of private demand and by strong investment expansion, GDP growth will remain high, about 5.3%, in 2005 and increase to around 5.5% in 2006. In addition, on the supply side the economic expansion will be supported by gradually rising industrial output, particularly relating to FDI in car production. The bulk of price and tax adjustments is over, and thus the inflation rate will go down to some 4% this year and to below 3% in 2006. The high unemployment rate will hardly change for the better this year. Nevertheless, there is hope that in the years to come foreign greenfield investment will, at least to some extent, also reach the poor eastern regions and gradually create more new jobs there. (The situation of the Roma, however, will remain unaffected by the new FDI projects.) The country's infrastructure is unbalanced and links between the eastern and western parts of the country are underdeveloped. In 2005 FDI inflows may reach EUR 1.5 billion, with the bulk flowing into job-creating greenfield investment. The current account deficit will rise in 2005, as profits earned by foreign-owned companies will progressively enlarge the deficit. In addition, the growth of exports may temporarily decelerate and that of imports accelerate, both in the context of further appreciation of the Slovak koruna.

Table SK

Slovak Republic: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 [1)]	2005 forecast	2006 forecast
Population, th pers., mid-year	5390.7	5395.3	5400.7	5379.8	5378.6	5378.8	5382.2	.	.
Gross domestic product, SKK bn, nom.	781.4	844.1	934.1	1009.8	1098.7	1201.2	1330	1460	1600
annual change in % (real)	4.2	1.5	2.0	3.8	4.6	4.5	5.3	5.3	5.5
GDP/capita (EUR at exchange rate)	3661	3546	4061	4334	4784	5382	6170	.	.
GDP/capita (EUR at PPP - wiiw)	8440	8740	9460	10050	10880	11180	12140	.	.
Gross industrial production									
annual change in % (real)	5.0	-2.6	8.4	7.6	6.7	5.3	4.5	5	7
Gross agricultural production									
annual change in % (real)	-6.0	-2.5	-12.3	9.9	1.5	-4.5	.	.	.
Construction industry									
annual change in % (real)	-3.5	-25.8	-0.4	0.8	4.1	6.0	4.2 I-XI	.	.
Consumption of households, SKK bn, nom.	424.1	473.0	519.6	577.5	624.5	667.5	.	.	.
annual change in % (real)	6.0	2.7	-0.9	4.9	5.5	-0.8	3.5	5	6
Gross fixed capital form., SKK bn, nom.	281.8	249.8	242.3	291.0	303.5	308.4	.	.	.
annual change in % (real)	11.0	-19.6	-7.2	13.9	-0.6	-1.5	4.0	7	10
LFS - employed persons, th, avg.	2198.6	2132.1	2101.7	2123.7	2127.0	2164.6	2160.5 I-IX	.	.
annual change in %	-0.3	-3.0	-1.4	1.0	0.2	1.8	-0.1 I-IX	.	.
LFS - employed pers. in industry, th, avg.	662.5	630.3	615.3	628.8	640.9	634.1	638.9 I-IX	.	.
annual change in %	-0.5	-4.9	-2.4	2.2	1.9	-1.1	0.7 I-IX	.	.
LFS - unemployed, th pers., average	317.1	416.8	485.2	508.0	486.9	459.2	489.3 I-IX	.	.
LFS - unemployment rate in %, average	12.5	16.2	18.6	19.2	18.5	17.4	18.5	18	17
Reg. unemployment rate in %, end of period	15.6	19.2	17.9	18.6	17.5	15.6	13.1	13	13
Average gross monthly wages, SKK	10003	10728	11430	12365	13511	14365	15105 I-IX	.	.
annual change in % (real, gross)	1.7	-2.8	-4.5	0.8	5.8	-2.0	1.7 I-IX	.	.
Consumer prices, % p.a.	6.7	10.6	12.0	7.1	3.3	8.5	7.5	4	2.5
Producer prices in industry, % p.a.	3.3	4.3	10.8	6.5	2.1	8.3	3.4	3	2
General governm.budget, EU-def., % GDP [2)]									
Revenues	57.1	49.8	47.6	45.5	45.2	35.4	34.6	.	.
Expenditures	60.7	56.8	59.8	51.5	50.8	39.2	40.1	.	.
Deficit (-) / surplus (+)	-3.7	-7.0	-12.3	-6.0	-5.7	-3.7	-5.5	-4.2	-3.5
Public debt in % of GDP [2)]	34.0	47.2	49.9	48.7	43.3	42.8	44.5	47	48
Discount rate, % p.a., end of period	8.8	8.8	8.8	8.8	6.5	6.0	4.0	.	.
Current account, EUR mn	-1764	-920	-761	-1950	-2043	-244	-1000	-1700	-1700
Current account in % of GDP	-8.9	-4.8	-3.5	-8.4	-7.9	-0.8	-3.0	-4.4	-3.9
Gross reserves of NB incl. gold, EUR mn [3)]	2493	3410	4391	4748	8824	9717	10954	.	.
Gross external debt, EUR mn [4)]	10146	10470	11637	12516	12655	14654	16242 X	.	.
FDI inflow, EUR mn	629	402	2089	1768	4397	636	800 [5)]	.	.
FDI outflow, EUR mn	130	-348	23	39	5	20	-110 [5)]	.	.
Exports of goods, BOP, EUR mn	9540	9603	12879	14115	15270	19359	22400	25800	30200
annual growth rate in %	30.7	0.7	34.1	9.6	8.2	26.8	16	15	17
Imports of goods, BOP, EUR mn	11634	10628	13860	16488	17517	19924	23500	27500	31700
annual growth rate in %	27.6	-8.6	30.4	19.0	6.2	13.7	18	17	15
Exports of services, BOP, EUR mn	2168	1937	2436	2779	2958	2912	2900	.	.
annual growth rate in %	6.7	-10.7	25.8	14.1	6.4	-1.5	0	.	.
Imports of services, BOP, EUR mn	2025	1732	1961	2244	2474	2703	2700	.	.
annual growth rate in %	9.2	-14.5	13.2	14.5	10.3	9.2	0	.	.
Average exchange rate SKK/USD	35.24	41.42	46.20	48.35	45.34	36.77	32.26	.	.
Average exchange rate SKK/EUR (ECU)	39.60	44.12	42.59	43.31	42.70	41.49	40.05	38	37
Purchasing power parity SKK/USD, wiiw	14.80	15.65	16.06	16.29	16.21	17.02	17.21	.	.
Purchasing power parity SKK/EUR, wiiw	17.19	17.90	18.28	18.67	18.77	19.97	20.36	.	.

Notes: 1) Preliminary. - 2) According to ESA'95, excessive deficit procedure. - 3) From January 2002 new valuation of gold. - 4) Up to 2002 wiiw calculated from USD, from 2003 original data in EUR. – 5) wiiw estimate.

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

Hermine Vidovic

Slovenia: smooth EU entry

Backed both by rising domestic demand and a recovery of external demand, GDP grew by about 4% in 2004, more than initially expected by the Slovenian authorities. Within domestic demand, private consumption growth gained momentum from quarter to quarter boosted by increasing credits to private households. Fixed capital formation grew at a slightly higher rate than in 2003 with investment activities directed to the construction sector lately.

Industrial production growth recorded the most favourable result since 2000 and was up by about 4.5% in 2004: capital goods and intermediate goods production increased by 8% and 7% respectively, while the production of consumer goods stagnated. Output of manufacturing mirrored the average industrial production growth. Within manufacturing, outstanding results were reported for electrical and optical equipment, transport equipment and chemicals. In contrast, output declines of nearly 10% were registered in the manufacturing of food and beverages, textiles and textile products as well as leather and leather products. The production of the country's textile industry has been on the decline since the early 1990s. According to the Slovenian Chamber of Commerce, the number of textile workers fell to 23 thousand in 2003, from nearly 41 thousand in 1993. Layoffs and bankruptcies continued in 2004. Similar tendencies are observed in the leather industry. As for food processing, Slovenian experts' fears that EU accession might create serious problems for the sector (first of all for meat processing, but also for dairy products and wine) seem to have been confirmed by the output decline by almost 10%, coupled with falling exports (exports of beverages even fell by one third) and rising imports. In the past, Slovenia's food production had enjoyed a high level of protection, with virtually no competition from abroad. But along with the country's accession to the EU, customs barriers were lifted and the favourable bilateral free trade agreements with the successor states of the former Yugoslavia cancelled; the latter had accounted for about two thirds of Slovenia's food exports. However, apart from exports of the food industry, deliveries to the region of the former Yugoslavia expanded significantly.

Available information on developments in employment differs substantially. Based on labour force survey data, employment grew remarkably in 2004, after only moderate increases or even slight declines in the years before. The estimated 4% rise was resulting from an increase of part-time workers and unpaid family members as well as workers in agriculture. (After two successive years of either heavy rains or drought, 2004 was a 'normal' year in agriculture.) Registration and national accounts data, however, point to a stagnation of employment. At the same time unemployment fell slightly based both on survey and registration data, but structural problems remained, such as low employment levels of older workers and the high share of long-term unemployed.

Since the entry of the Slovenian tolar into the ERM II as of end of June 2004, the exchange rate has remained close to the central band. The disinflation process has continued, however, inflation is still higher than required by the Maastricht criterion. Consumer price increases averaged 3.6% in 2004, by two percentage points less than a year earlier. Real wage increases remained within the limits set in the Convergence Programme 2004-2007, according to which wage growth should lag behind labour productivity growth by at least one percentage point.

Table SI

Slovenia: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 [1)]	2005	2006
								forecast	
Population, th pers., mid-year	1982.6	1985.6	1990.3	1992.0	1995.7	1996.8	1997.0	.	.
Gross domestic product, SIT bn, nom.	3464.9	3874.7	4252.3	4761.8	5314.5	5747.2	6200	6600	7100
annual change in % (real)	3.6	5.6	3.9	2.7	3.3	2.5	4.2	3.9	3.9
GDP/capita (EUR at exchange rate)	9383	10078	10421	11006	11771	12316	13000	.	.
GDP/capita (EUR at PPP - wiiw)	12700	13690	14460	15290	15940	16400	17350	.	.
Gross industrial production									
annual change in % (real)	3.7	-0.5	6.2	2.9	2.4	1.4	4.8	3.5	3
Gross agricultural production									
annual change in % (real)	2.2	-1.3	2.4	.	.	.	.	.	.
Construction output, in effect. working time									
annual change in % (real) [2)]	1.7	10.2	-1.2	-2.1	-3.4	-1.7	3.9 [I-XI]	.	.
Consumption of households, SIT bn, nom.	1944.5	2185.1	2373.6	2621.8	2830.4	3053.9	2410.9 [I-IX]	.	.
annual change in % (real)	3.0	5.9	0.3	2.3	0.2	2.8	3.6	3.5	3
Gross fixed capital form., SIT bn, nom.	823.2	1019.5	1066.8	1164.4	1239.2	1373.3	1127.5 [I-IX]	.	.
annual change in % (real)	9.9	21.0	0.6	4.1	3.1	6.3	6.9	6.5	6
LFS - employed persons, th, avg.	901	886	901	916	910	897	933 [3)]	.	.
annual change in %	-0.6	-1.7	1.7	1.7	-0.7	-1.4	4 [3)]	.	.
Reg. employees in industry, th pers., avg.	246.2	242.8	241.6	243.5	246.1	242.2	239.8 [I-IX]	.	.
annual change in %	-0.9	-1.4	-0.5	0.8	1.1	-1.6	-1.0 [I-IX]	.	.
LFS - unemployed, th pers., average	77.0	73.0	68.0	63.0	62.0	64.8	63	.	.
LFS - unemployment rate in %, average	7.9	7.6	7.0	6.4	6.4	6.7	6.3	6	6
Reg. unemployment rate in %, end of period	14.6	13.0	12.0	11.8	11.3	11.0	10.4	10	9.5
Average gross monthly wages, SIT	158069	173245	191669	214561	235436	253200	267571	.	.
annual change in % (real, net)	1.5	3.0	1.4	3.1	2.1	1.8	2.1	.	.
Consumer prices, % p.a.	7.9	6.1	8.9	8.4	7.5	5.6	3.6	3	2.7
Producer prices in industry, % p.a.	6.0	2.1	7.6	8.9	5.1	2.5	3.1	3	.
General governm.budget, EU-def., % GDP [4)]									
Revenues	.	.	44.7	45.1	45.7	46.2	45.3	.	.
Expenditures	.	.	48.2	47.9	48.1	48.2	47.5	.	.
Deficit (-) / surplus (+), % GDP	.	.	-3.5	-2.8	-2.3	-2.0	-2.1	-2.1	-1.8
Public debt in % of GDP [3)]	.	25.1	27.4	28.1	29.5	29.4	30.9	30.7	30.9
Discount rate % p.a., end of period [5)]	10.0	8.0	10.0	7.8	7.3	5.0	3.3	.	.
Current account, EUR mn	-107.9	-664.2	-583.0	38.0	335.4	-91.2	-179.1	-150	-150
Current account in % of GDP	-0.6	-3.3	-2.8	0.2	1.4	-0.4	-0.7	-0.5	-0.5
Gross reserves of NB excl. gold, EUR mn	3104.5	3159.2	3435.8	4907.5	6701.5	6798.1	6456.8	.	.
Gross external debt, EUR mn	6459	8012	9490	10403	11455	13305	15355	.	.
FDI inflow, EUR mn	194.3	99.2	149.1	412.4	1750.4	298.8	419.9	.	.
FDI outflow, EUR mn	-4.9	44.7	71.7	161.2	168.1	413.7	368.1	.	.
Exports of goods, BOP, EUR mn	8088.3	8103.2	9574.2	10454.3	11081.6	11414.0	12700.1	13700	14400
annual growth rate in %	8.7	0.2	18.2	9.2	6.0	3.0	11.3	8	5
Imports of goods, BOP, EUR mn	8796.5	9267.3	10801.2	11138.7	11351.0	11959.8	13475.1	14500	15400
annual growth rate in %	8.3	5.4	16.6	3.1	1.9	5.4	12.7	8	6
Exports of services, BOP, EUR mn	1804.2	1763.5	2051.5	2177.6	2440.0	2468.6	2790.0	.	.
annual growth rate in %	-0.3	-2.3	16.3	6.1	12.0	1.2	13.0	.	.
Imports of services, BOP, EUR mn	1357.3	1434.0	1562.3	1642.1	1823.5	1930.3	2120.8	.	.
annual growth rate in %	8.7	5.7	8.9	5.1	11.0	5.9	9.9	.	.
Average exchange rate SIT/USD	166.13	181.77	222.68	242.75	240.24	207.11	192.38	.	.
Average exchange rate SIT/EUR (ECU)	186.27	193.63	205.03	217.19	226.22	233.70	238.86	239	240
Purchasing power parity SIT/USD, wiiw	119.40	124.66	130.38	137.35	147.93	152.75	159.05	.	.
Purchasing power parity SIT/EUR, wiiw	137.57	142.60	147.72	156.30	167.10	175.46	179.08	.	.

Notes: 1) Preliminary. - 2) From 2004 construction put in place; units with at least 20 employees. - 3) wiiw estimate; registration data show a growth of 0.6% only. - 4) According to ESA'95, excessive deficit procedure. - 5) From 2001 main refinancing rate.

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

Against the advice of the newly established Strategic Council for Economic Development, a new tax legislation – which had been subject to protracted discussions in the former government – became effective from January 2005. The main goal of the reform is a reduction of labour-related taxes; accordingly more than 60% of taxable persons will have to pay a lower average effective tax rate. The Council had argued that implementing the new legislation could endanger the meeting of the nominal convergence criteria for introducing the euro, cause a certain loss of the anticipated 2005 budget revenues and would provide an inconsistent and non-transparent legislative framework. As a consequence the government appointed an expert group to draft a new comprehensive tax reform aimed at a simplification of the tax legislation. The 2004 general government closed with an estimated 2.1% deficit to GDP – a result higher than anticipated and mainly due to the inclusion of two extra-budgetary funds (Capital Fund KAD and the Slovene Restitution Fund SOD) in the general government, lower VAT revenues than anticipated and less withdrawals from EU funds than originally expected. Based on the revised revenue forecasts the government will present a supplementary budget for 2005 which should be adopted in March. According to preliminary calculations the deficits should be 2.1% of GDP in 2005 and 1.8% in 2006.

Fears that exports might suffer from the (stable) exchange rate have not materialized. Both exports and imports developed dynamically in 2004, expanding by 11% and 13% respectively. As in the recent past, exports to non-EU Member States (particularly to the successors of the former Yugoslavia and to Russia) showed above-average increases (by close to 17%), while deliveries to the EU rose by 12%. The higher trade deficit has to a large part been offset by a rising surplus in services trade, and the current account ended up slightly negative (-0.7% of GDP) in 2004. EU entry has not triggered any substantial rise in FDI inflows. As for Slovenian investments abroad, they were slightly lower than a year earlier and mainly targeting the successor states of the former Yugoslavia, but also some of the 'old' EU Member States such as Austria and the Netherlands.

The parliamentary elections held in October 2004 brought about major changes in Slovenia's political landscape. The Slovenian Democratic Party gained a clear victory over the Liberal Democratic Party (LDS) which had been the main political power for more than ten years. Slovenia's new centre-right government came into office on 3 December. It is based on a coalition of the Slovenian Democratic Party (SDS), New Slovenia (NSi), Slovenian Peoples Party (SLS) and DeSUS, the pensioners' party, and controls 49 of the 90 seats in parliament. It is headed by Janez Janša, who was already defence minister in the coalition DEMOS at the beginning of the 1990s. As far as economic goals are concerned, the new government committed itself (as did the outgoing) to introducing the euro in 2007. More generally it is aiming at the reduction of state involvement in the economy, the promotion of entrepreneurship and FDI and easier business conditions for SMEs. Regarding the privatization of state-owned banks, the government intends to find strategic partners which will support entrepreneurship in the country.

On 1 February 2005 the Slovenian parliament ratified the EU constitutional treaty, backed by a vast majority of its members. In general, the provisions of the constitution are seen as 'very favourable for Slovenia'.

Prospects for the years to come are encouraging. Supported by export expansion and buoyant domestic demand, GDP growth of close to 4% will be feasible in both 2005 and 2006. Inflation may drop to 3% this year and somewhat below that level in 2006. wiiw expects the central bank to adhere to its policy of a stable exchange rate, allowing only minor fluctuations. The fiscal balance and the current account will not cause any serious problems in the years to come.

*Tauno Tiusanen**

Estonia: amid export boom, current account problems remain

The Estonian economy has registered annual real growth rates of over 6% on average since 2000. The preliminary figure for 2004 shows a healthy 6.2% GDP increase. Gross fixed capital formation increased by 7% in 2004, following a strong investment boom with average annual growth figures exceeding 10% in the five preceding years.

Exports experienced a vigorous boost of over 18% in 2004. Imports expanded even more rapidly, by over 19%. The current account deficit hit a new record high of EUR 1.3 billion, which is almost 15% of the GDP, an increase from 13.2% in 2003. At the same time, net inflows of FDI clearly decelerated.

In its fiscal policy, Estonia applies an interesting trick: corporate income tax is zero for reinvested profits. Dividends are taxed with a 26% rate. This dual system, which has caused amazement in the high-taxed Scandinavian countries, has obviously contributed to the strong investment boom in Estonia. Estonian fiscal policy seems to be permanently prudent. The general government budget ran annual surpluses in 2001-2004. Thus, public sector debt is being kept well under control, and amounts to less than 5% of GDP.

Private consumption increased by 6% in real terms in 2004, even though average gross monthly wages rose only by less than 4%, after an 8% boost in 2003. Amid strong economic growth, the unemployment rate remained at a rather high level of about 10% in 2002-2004. This fact obviously explains the rather modest increase in the average pay in 2004. CPI inflation accelerated from 1.3% in 2003 to 3% in 2004. Thus, there is no indication of an overheating of the booming Estonian economy.

In the early post-Soviet period, Estonia established a currency board system and pegged its currency (the Estonian kroon, EEK) first to the German mark and then to the euro with a fixed exchange rate of EEK/EUR 15.65. In June 2004 Estonia joined the ERM II; the official fixed exchange rate became the central rate in the managed floating system of the ERM II. In this context it is worth noting that Estonia's fiscal policy in the entire transitional period has been extremely prudent. Thus, fulfilling the main requirements of the monetary union (balanced budget with no excess public sector debt burden) has posed no problems.

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Table EE

Estonia: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 1)	2005	2006
								forecast	
Population, th pers., mid-year	1386.2	1375.7	1369.5	1364.1	1358.6	1353.8	1349.3	.	.
Gross domestic product, EEK mn, nom.	78341.2	81639.7	92717.1	104337.7	116869.0	125832.1	138700	151100	163700
annual change in % (real)	5.2	-0.1	7.8	6.4	7.2	5.1	6.2	6	5.7
GDP/capita (EUR at exchange rate)	3581	3793	4327	4888	5498	5940	6570	.	.
GDP/capita (EUR at PPP - wiiw)	7410	7640	8600	9180	9890	10380	11280	.	.
Gross industrial production 2)									
annual change in % (real)	4.2	-3.4	14.6	8.9	8.2	9.8	8.5	7.5	7
Gross agricultural production									
annual change in % (real)	-3.6	-10.4	8.2	-9.7	.	.	.	.	.
Construction industry 2)									
annual change in % (real)	.	-13.4	14.8	4.6	25.2	10.6	.	.	.
Consumption of households, EEK mn, nom.	44361.6	45832.9	51036.5	57351.9	65135.3	69201.7	.	.	.
annual change in % (real)	5.2	-2.7	8.5	5.9	9.9	5.4	6.0	.	.
Gross fixed capital form., EEK mn, nom.	23365.6	20238.6	23769.4	28134.3	33554.7	35749.7	.	.	.
annual change in % (real)	14.0	-15.6	14.3	13.0	17.2	5.4	7.0	6	5.5
LFS - employed persons, th, avg. 3)	606.5	579.3	572.5	577.7	585.5	594.3	595	.	.
annual change in % 3)	-1.7	-4.5	-1.2	0.9	1.4	1.5	0.1	.	.
LFS - employed pers. in industry, th, avg. 3)	156.5	147.2	151.1	151.3	144.4	150.0	160	.	.
annual change in % 3)	-2.3	-5.9	2.6	0.1	-4.6	3.9	6.7	.	.
LFS - unemployed, th pers., average 3)	66.1	80.5	89.9	83.1	67.2	66.2	66.3	.	.
LFS - unemployment rate in %, average 3)	9.8	12.2	13.6	12.6	10.3	10.0	10.0	9.5	9
Reg. unemployment rate in %, end of period	4.0	5.2	5.9	6.1	5.4	4.9	3.9	3.5	3.3
Average gross monthly wages, EEK	4125	4440	4907	5510	6144	6723	7150	.	.
annual change in % (real, gross)	.	6.9	6.3	6.1	7.6	8.0	3.8	.	.
Consumer prices, % p.a.	8.2	3.3	4.0	5.8	3.6	1.3	3.0	2.8	2.5
Producer prices in industry, % p.a.	4.2	-1.2	4.9	4.4	0.4	0.2	2.9	2.5	2
General governm. budget, EU-def., % GDP 4)									
Revenues	38.9	38.8	37.7	37.2	38.0	38.9	39.3	39.6	39.0
Expenditures	39.2	42.6	38.2	36.8	36.6	35.7	38.7	39.4	38.9
Deficit (-) / surplus (+)	-0.3	-3.7	-0.6	0.3	1.3	3.1	0.5	0.2	0.1
Public debt in % of GDP 4)	.	.	4.7	4.4	5.3	5.3	4.8	4.4	4.2
Money market rate, % p.a., end of period 5)	.	4.4	5.8	3.7	3.4	2.6	2.4	.	.
Current account, EUR mn	-428	-231	-326	-376	-759	-1059	-1337	-1380	-1400
Current account in % of GDP	-8.6	-4.4	-5.5	-5.6	-10.2	-13.2	-15.1	-14.3	-13.4
Total reserves minus gold, EUR mn	695	850	990	927	964	1089	1300		
Gross external debt, EUR mn	2505	2864	3233	3707	4490	5658	7000	.	.
FDI inflow, EUR mn	609	284	425	603	307	797	713	.	.
FDI outflow, EUR mn	131	79	67	226	140	130	291	.	.
Exports of goods, BOP, EUR mn	.	2364	3601	3749	3728	4061	4813	5280	5760
annual growth rate in %	.	.	52.3	4.1	-0.6	8.9	18.5	10	9
Imports of goods, BOP, EUR mn	.	3138	4441	4630	4878	5457	6611	7150	7790
annual growth rate in %	.	.	41.5	4.3	5.4	11.9	21.1	10	9
Exports of services, BOP, EUR mn	.	1403	1629	1845	1807	1969	2259	.	.
annual growth rate in %	.	.	16.1	13.3	-2.0	9.0	14.7	.	.
Imports of services, BOP, EUR mn	.	870	1017	1195	1189	1218	1380	.	.
annual growth rate in %	.	.	16.9	17.5	-0.5	2.5	13.3	.	.
Average exchange rate EEK/USD	14.06	14.69	16.98	17.48	16.61	13.86	12.59	.	.
Average exchange rate EEK/EUR (ECU)	15.78	15.65	15.65	15.65	15.65	15.65	15.65	15.65	15.65
Purchasing power parity EEK/USD, wiiw	6.62	6.79	6.95	7.32	7.70	7.80	8.09	.	.
Purchasing power parity EEK/EUR, wiiw	7.62	7.77	7.87	8.34	8.70	8.96	9.11	.	.

Notes: 1) Preliminary. - 2) Enterprises with 20 employees and more. - 3) Persons aged 15-74. - 4) According to ESA 95, excessive deficit procedure. - 5) TALIBOR 1 month interbank rate.

Source: wiiw Database incorporating national statistics; AMECO Database; forecasts by wiiw and European Commission.

A political scandal erupted in Estonia in 2004, when it became known that some sensitive documents had leaked from the foreign ministry. There were even calls for dissolving the parliament. However, the issue has been settled by sacking Foreign Minister Kristina Ojuland, who was one of the most popular ministers of the current Estonian government. The centre-right coalition of Prime Minister Juhan Parts will remain in office. The investment-friendly fiscal policy will be continued (for instance, the corporate income tax rate will be cut by 2% in 2005, to 24%).

Economic prospects for **Estonia** are fairly good. The economy in neighbouring Finland, where the bulk of tourists to Estonia are coming from, is growing more rapidly than the eurozone on average. Tourism from Russia seems to develop dynamically as well. Estonia is benefiting from its reputation as a tourist destination with a very good price-quality relationship. Given its budget surplus and low public debt, Estonia may join the eurozone by the end of 2006.

*Jari Jumpponen**

Latvia: economic dynamism with signs of overheating**

In 2004 Latvia joined the EU as well as NATO. The decision to phase out Russian-language high schools in September 2004 resulted in strong protests by Russian speakers. Relations with Russia are not quite relaxed, also on the score of the still unsigned border agreement.

Latvia's GDP grew by 7.8% in real terms in 2004, after 7.5% in 2003. The sectors recording the fastest growth were construction (12% output growth), manufacturing and transport and communications.

Growth in gross fixed capital formation accelerated to 15% in 2004, after average annual growth rates of about 10% during the preceding five years. Private consumption has developed dynamically as well. Both investment and consumption have benefited from very low interest rates, which lately have even been slightly negative in real terms: borrowing has been expanding very rapidly.

At the turn of the century, Russia started to construct new harbour capacities on the shores of the Baltic Sea (in the Gulf of Finland, close to St. Petersburg). The declared aim of that project was to bypass Latvian territory, with its Soviet-era transit routes for oil and other exports. Recently however some transit traffic business via Latvia has been resuming. Russian oil products transport via the transit pipeline increased by 22% in 2004 and cargo transport by rail rose as well. Cargo routes via Latvia offer a rational alternative, as ports in Latvia are ice-free in winter, unlike in the Gulf of Finland.

In the early 2000s inflation had been under control. But in 2004 yearly consumer price inflation roughly doubled, from about 3% in 2003 to over 6%, resulting also from rising excise taxes prior to EU accession and increasing oil prices. The exchange rate of the Latvian lats (LVL) depreciated nominally by 4% against the euro during the year 2004.

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** Sebastian Leitner (wiiw) contributed significantly to the final version of the paper.

Table LV

Latvia: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 [1]	2005	2006
								forecast	
Population, th pers., mid-year [2]	2410.0	2390.5	2373.0	2355.0	2338.6	2325.3	2313.6	.	.
Gross domestic product, LVL mn, nom.	3902.9	4224.2	4685.7	5168.3	5691.1	6322.5	7270	7920	8600
annual change in % (real)	4.7	3.3	6.9	8.0	6.4	7.5	7.8	6	6.5
GDP/capita (EUR at exchange rate)	2449	2833	3526	3900	4177	4216	4680	.	.
GDP/capita (EUR at PPP - wiiw)	5960	6340	7010	7660	8250	8760	9670	.	.
Gross industrial production [2]									
annual change in % (real)	3.1	-5.4	4.7	9.2	5.8	6.5	6.0	6	5.5
Gross agricultural production									
annual change in % (real)	-7.9	-10.6	4.1	6.7	4.0	0.5	.	.	.
Construction industry [2]									
annual change in % (real)	.	7.8	8.0	6.0	10.8	13.7	12	.	.
Consumption of households, LVL mn, nom.		2683.8	2953.5	3251.4	3566.7	3985.5	.	.	.
annual change in % (real)		4.3	6.3	7.3	7.4	8.6	9.0	.	.
Gross fixed capital form., LVL mn, nom.	979.4	980.0	1151.5	1297.4	1370.6	1527.8	.	.	.
annual change in % (real)	61.4	-6.8	10.2	11.4	13.0	10.9	15.0	9	8
LFS - employed persons, th, avg. [3]	986.1	968.5	941.1	962.1	989.0	1006.9	1020	.	.
annual change in % [3]	-0.4	-1.8	-2.8	2.2	2.8	1.8	1.3	.	.
LFS - employed pers. in industry, th, avg. [3]	208.2	193.1	193.0	186.3	193.1	197.6	194	.	.
annual change in % [3]	1.9	-7.3	-0.1	-3.5	3.7	2.3	-1.9	.	.
LFS - unemployed, th pers., average [3]	162.0	161.0	159.0	145.0	134.5	119.2	118	.	.
LFS - unemployment rate in %, average [3]	14.2	14.2	14.5	13.1	12.0	10.6	10.4	9.8	9.5
Reg. unemployment rate in %, end of period	9.2	9.1	7.8	7.7	8.5	8.6	8.5	8	7.5
Average gross monthly wages, LVL	133	141	150	159	173	192	210	.	.
annual change in % (real, gross)	5.3	2.9	3.0	3.5	6.0	7.8	2.4	.	.
Consumer prices, % p.a.	4.7	2.4	2.6	2.5	1.9	2.9	6.2	5.5	4.5
Producer prices in industry, % p.a.	1.9	-4.0	0.6	1.7	1.0	3.2	8.6	6	5
General government budget, EU-def., % GDP [4]									
Revenues	40.6	37.3964	35.1	34.4	33.1	34.5	34.0	35.3	34.8
Expenditures	41.2	42.2	37.8	36.5	35.7	36.0	36.0	38.1	37.7
Deficit (-) / surplus (+)	-0.6	-4.9	-2.7	-2.1	-2.7	-1.5	-2.0	-2.8	-2.9
Public debt in % of GDP [4]	.	.	12.9	14.9	14.1	14.4	14.6	15.4	16.6
Discount rate, % p.a., end of period	.	4.0	3.5	3.5	3.0	3.0	4.0	.	.
Current account, EUR mn	-575	-609	-388	-700	-653	-807	-1356	-1430	-1380
Current account in % of GDP	-9.7	-9.0	-4.6	-7.6	-6.7	-8.2	-12.5	-12.7	-11.3
Total reserves minus gold, EUR mn	619	832	915	1307	1209	1150	2601	.	.
Gross external debt, EUR mn	2635	3791	5011	6345	6865	7505	9950	.	.
FDI inflow, EUR mn	317	326	447	147	269	266	530	.	.
FDI outflow, EUR mn	49	16	13	21	4	32	85	.	.
Exports of goods, BOP, EUR mn	1795	1772	2252	2502	2700	2809	3322	3800	4250
annual growth rate in %	.	-1.3	27.1	11.1	7.9	4.1	18.2	15	12
Imports of goods, BOP, EUR mn	2800	2735	3382	3992	4269	4584	5540	6050	6530
annual growth rate in %	.	-2.3	23.7	18.0	6.9	7.4	20.9	10	8
Exports of services, BOP, EUR mn	989	961	1270	1318	1319	1342	1432	.	.
annual growth rate in %	.	-2.9	32.2	3.8	0.1	1.7	6.7	.	.
Imports of services, BOP, EUR mn	718	646	754	750	749	831	976	.	.
annual growth rate in %	.	-10.1	16.7	-0.5	-0.1	10.9	17.5	.	.
Average exchange rate LVL/USD	0.59	0.58	0.61	0.63	0.62	0.57	0.54	.	.
Average exchange rate LVL/EUR (ECU)	0.66	0.62	0.56	0.56	0.58	0.64	0.67	0.70	0.70
Purchasing power parity LVL/USD, wiiw	0.24	0.24	0.25	0.25	0.26	0.27	0.29	.	.
Purchasing power parity LVL/EUR, wiiw	0.27	0.28	0.28	0.29	0.29	0.31	0.32	.	.

Notes: 1) Preliminary. - 2) Enterprises with 50 employees and more. - 3) From 2002 persons aged 15-74, up to 2002 persons aged 15 and over. - 4) According to ESA 95, excessive deficit procedure.

Source: wiiw Database incorporating national statistics; AMECO Database; forecasts by wiiw and European Commission.

Import growth was exceptionally strong in 2004, especially because of expectations of rising prices after EU membership. Compared to the previous year, imports of goods expanded by 20%. Machinery and equipment and raw materials (oil in particular) were the most important import items. Also export activities experienced robust annual growth of 17.5%, dominated by wood and wood products (making up a third of the country's exports). Metals benefited from the global market price rise, overtaking textiles as Latvia's second most important export item. Germany, the UK and Sweden remained the most important export destinations, accounting together for 40% of Latvian exports in 2004.

Even though exports experienced a strong growth acceleration, the current account deficit widened significantly to as much as 12.9% in 2004. The FDI inflow is not nearly able to cover that deficit. Foreign direct investment reached EUR 530 million, a third of which in the form of reinvested earnings. The amount of outward FDI increased as well, amounting to some EUR 85 million.

The pegging of the lats to the euro – the first most significant monetary adjustment following Latvia's accession to the EU – was effected on 1 January 2005; it will be followed by Latvia's participation in the Exchange Rate Mechanism II (ERM II). According to the current plans, the euro will be adopted on 1 January 2008.

Latvia has not been as prudent as Estonia in its fiscal policy. Nonetheless, in the past five years, budget deficits have been rather modest, never exceeding the Maastricht limit of 3% of GDP. The public sector debt is less than 15% of GDP. However, the potential risks of overheating and widening current account deficits represent a challenge to Latvia's fiscal policy. To counteract signs of overheating, the Latvian government is likely to tighten its fiscal policy in 2005. The Bank of Latvia is expected to raise its refinancing rate.

Despite high economic growth, the employment situation is improving only slowly. The overall unemployment rate was 10.4% in 2004, ranging from 4% (in the capital of Riga) to nearly 30% (in the eastern rural regions).

Jatta Kinnunen and Sebastian Leitner*

Lithuania: strong growth with modest inflationary pressures

The Lithuanian political scene witnessed remarkable events in 2004: President Rolandas Paksas was removed from office in April, ending a five-month political battle that paralysed the country – and tested the resilience of Lithuanian democracy. Mr. Paksas was accused of having dubious links with international criminal organizations. He was replaced by Valdas Adamkus, who had already acted as Lithuania's head of state from 1998 to 2003. The parliamentary elections held in October brought about another change: Lithuania's Labour Party, led by Russian-born millionaire Viktor Uspaskich, came out victorious after campaigning on a populist platform and promising to boost social welfare, raise living standards and lower taxes.

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Lithuania was more severely hit by the Russian rouble crisis of 1998 than the other Baltic States, Estonia and Latvia. In the post-crisis period, a phenomenal economic recovery took place. In this period inflation was very modest (even negative in 2003, when GDP grew close to 10%).

It is worth mentioning that the fluctuations in world market prices of oil have had only a minor impact on the Lithuanian energy sector, which relies heavily on the country's Ignalina nuclear power station. Lithuania's EU-membership treaty stipulates that this Chernobyl-type power station be dismantled after an interim period. One of the two units of Ignalina has been decommissioned recently. According to President Adamkus, Lithuania should build a third unit that would supply the whole country with energy.

The period of vigorous economic growth has had a positive impact on the labour market. The unemployment rate dropped from 13.8% in 2002 to 11.4% in 2004. The services sector has been providing most of the new jobs.

Average gross monthly wage fell in real terms in 2000-2001, but have recovered since 2002. In 2004 the average real wage rose by 6.9%. However, growth in real wages in the previous three years lagged behind the GDP growth.

It is hardly surprising that the unusually strong demand expansion has been associated with a growing current account deficit (to 8.6% of the GDP in 2004). Rising imports from other EU countries reflect both the expansion of domestic consumption and the real appreciation of the national currency, the Lithuanian litas, LTL (especially vis-à-vis the currencies of other NMS). However, the deficit is lower than in other Baltic States. Oil products are the main trading commodity accounting for one fourth of total exports and one fifth of total imports. The remarkable rise in production of the Mazeiku Nafta oil refinery (which was reconstructed in 2003) as well as the high oil prices contributed to growing export revenues.

In 2004, FDI inflows exceeded EUR 700 million. The largest foreign investor was the Indonesian-based textile group Indorama Synthetics, with investments of nearly EUR 100 million. Besides, in January 2005 a 34% stake in Lithuania's natural gas company Lietuvos Dujos was sold to Russian Gazprom. After this acquisition, Gazprom is increasingly becoming an owner of natural gas utilities in the Baltic region, holding a 25% stake in Latvia's Latvian Gaze and a 37% stake in Estonia's Eesti Gaas (along with other major foreign shareholders, Germany's Ruhrgas and Finland's Fortum). It is expected that Gazprom's growing influence in the Baltics could serve as a staging ground for higher exports to the countries of the European Union. As there are no big Lithuanian companies on the privatization list, future FDI inflows will depend on greenfield projects. Naturally, it is possible that the 'post-Ignalina' restructuring of Lithuania's energy system will bring in direct investors from abroad.

In the early period of Lithuania's transition, a currency board system pegging the national currency against the US dollar was established. In 2002, the litas pegging was changed from dollar to euro. In June 2004, Lithuania joined the ERM II, with a LTL/EUR exchange rate of 3.45.

Lithuania's public sector debt is only about 22% of GDP. The general government deficit rose to 2.6% of GDP in 2004. As the government aims at reducing this figure gradually, to 1.5% by 2007, Lithuania will conveniently meet the Maastricht criteria.

Table LT

Lithuania: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 [1]	2005	2006
								forecast	
Population, th pers., mid-year [2]	3549.3	3524.2	3499.5	3481.3	3469.1	3454.2	3435.8	.	.
Gross domestic product, LTL mn, nom.	44377.4	43359.4	45525.9	48378.7	51643.0	56179.0	61801.0	67100	72200
annual change in % (real)	7.3	-1.7	3.9	6.4	6.8	9.7	6.6	7	6.5
GDP/capita (EUR at exchange rate)	2783	2881	3517	3876	4302	4710	5210	.	.
GDP/capita (EUR at PPP - wiiw)	6900	6980	7610	8340	8980	9780	10860	.	.
Gross industrial production [2]									
annual change in % (real)	8.2	-11.2	2.2	16.0	3.1	16.1	10.3	10	9.5
Gross agricultural production									
annual change in % (real)	-5.2	-14.5	5.4	-5.4	8.0	8.9	2.0	.	.
Construction industry [3]									
annual change in % (real)	15.9	-10.5	-17.8	7.5	21.8	26.8	4.9	.	.
Consumption of households, LTL mn, nom.	27344.8	28315.5	29530.6	31352.6	33096.4	36283.3	.	.	.
annual change in % (real)	.	3.2	6.4	4.0	5.8	12.5	10	.	.
Gross fixed capital form., LTL bn, nom.	10723.1	9614.2	8565.3	9784.6	10549.2	12024.1	.	.	.
annual change in % (real)	21.8	-6.1	-9.0	13.5	11.1	14.0	14.0	15	12
LFS - employed persons, th, avg. [4]	1597.6	1598.4	1397.8	1351.8	1405.9	1438.0	1435	.	.
annual change in %	1.7	0.1	-12.6	-3.3	4.0	2.3	-0.2	.	.
LFS - employed pers. in industry, th, avg. [4]	339.4	330.3	290.8	281.1	293.3	297.5	297	.	.
annual change in %	0.1	-2.7	-12.0	-3.3	4.3	1.4	-0.2	.	.
LFS - unemployed, th pers., average [4]	244.9	263.3	273.7	284.0	224.4	203.9	185	.	.
LFS - unemployment rate in %, average [4]	13.3	14.1	16.4	17.4	13.8	12.4	11.4	11	10
Reg. unemployment rate in %, end of period	6.9	10.0	12.6	12.9	10.9	7.7	6.5	6.3	6
Average gross monthly wages, LTL	930	987	971	982	1014	1073	1158	.	.
annual change in % (real, gross)	12.8	4.8	-5.1	-0.3	3.8	9.3	6.9	.	.
Consumer prices, % p.a.	5.1	0.8	1.0	1.3	0.3	-1.2	1.2	1.5	1
Producer prices in industry, % p.a.	-4.4	1.7	16.0	-3.0	-2.8	-0.5	5.0	3	2
General goverm.budget, EU-def., % GDP [5]									
Revenues	37.4	37.3	35.8	33.0	32.8	32.3	33.2	33.7	33.2
Expenditures	40.3	42.8	38.3	35.0	34.2	34.1	35.7	36.2	35.1
Deficit (-) / surplus (+)	-3.0	-5.5	-2.5	-2.0	-1.5	-1.9	-2.6	-2.5	-1.9
Public debt in % of GDP [5]	.	.	23.8	22.9	22.4	21.4	21.1	21.7	21.3
Money market rate, % p.a., end of period [6]	.	15.9	7.5	4.5	3.3	2.4	2.3	.	.
Current account, EUR mn	-1156	-1118	-730	-639	-772	-1116	-1483	-1590	-1520
Current account in % of GDP	-11.7	-11.0	-5.9	-4.7	-5.2	-6.9	-8.3	-8.2	-7.3
Total reserves minus gold, EUR mn	1200	1187	1410	1835	2253	2697	3000	.	.
Gross external debt, EUR mn	3203	4499	5221	5974	5945	6905	8300	.	.
FDI inflow, EUR mn		457	412	499	772	160	812	.	.
FDI outflow, EUR mn		8	4	8	18	34	63	.	.
Exports of goods, BOP, EUR mn	3527	2951	4395	5461	6363	6773	7512	7980	8860
annual growth rate in %	.	-16.3	48.9	24.3	16.5	6.4	10.9	8	11
Imports of goods, BOP, EUR mn	4879	4275	5603	6697	7770	8262	9309	10060	10870
annual growth rate in %	.	-12.4	31.1	19.5	16.0	6.3	12.7	9	8
Exports of services, BOP, EUR mn	987	1026	1149	1293	1560	1661	1935	.	.
annual growth rate in %	.	3.9	12.0	12.5	20.7	6.5	16.5	.	.
Imports of services, BOP, EUR mn	773	739	735	783	986	1114	1304	.	.
annual growth rate in %	.	-4.4	-0.5	6.5	25.9	13.0	17.0	.	.
Average exchange rate LTL/USD	4.00	4.00	4.00	4.00	3.67	3.06	2.78	.	.
Average exchange rate LTL/EUR (ECU)	4.49	4.27	3.70	3.58	3.46	3.45	3.45	3.45	3.45
Purchasing power parity LTL/USD, wiiw	1.57	1.54	1.51	1.46	1.47	1.45	1.47	.	.
Purchasing power parity LTL/EUR, wiiw	1.81	1.76	1.71	1.67	1.66	1.66	1.66	.	.

Notes: 1) Preliminary. - 2) Sales of industrial production. - 3) Enterprises with more than 20 employees. - 4) From 2002 persons aged 15-74, up to 2002 persons aged 15 and over. - 5) According to ESA 95, excessive deficit procedure. - 6) VILIBOR 1 month interbank rate.

Source: wiiw Database incorporating national statistics; AMECO Database; forecasts by wiiw and European Commission.

With rising transfers from Brussels fuelling public investment and exports likely to develop favourably, GDP will probably grow by 7% in 2005. As a result of lower increases in household consumption, import growth as well as the current account deficit are likely to decline in the year 2006.

Part B: EU candidate countries and countries aspiring to EU membership

Vladimir Gligorov

Southeast Europe: crucial years ahead

Introduction

Growth turned out to be even better than expected in Southeast Europe (SEE) in 2004. Prospects, over the medium term, are also good. Industrial production should continue to grow as well as services. Investments are rising and so is consumption, the latter boosted additionally by increased bank lending. Trade and current account deficits remain the main worry as they imply in some cases unsustainable foreign debt accumulation. Macroeconomic policy continues to support stability: fiscal adjustment is on the way in most countries while monetary policy continues to be passive given that the region is mostly on fixed exchange rates. Institutional transformation is uneven as is the speed of EU integration. In the institutional and political sense, this year and the next should prove to be decisive for the whole region.

Growth and macroeconomic stability

Growth of GDP and of industrial production accelerated in 2004. Practically all the sectors posted good growth figures. Industrial production continued to expand, in some cases quite fast, except in Macedonia where it was in deep recession for the better part of last year. Agricultural production grew faster than expected throughout the region (and recovered exceptionally strongly in Serbia) due to very favourable weather conditions. Construction continued to be a highly dynamic sector in many parts of SEE, e.g., in Serbia and especially in Albania. Services in general and tourism in particular continued to grow. Also, financial services kept on growing at quite high rates as banks continue to expand their businesses throughout the region.

Table 1

Gross domestic product

real change in % against preceding year

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 [1)]	2005 forecast	2006 forecast	Index 1990=100 2004	Index 2000=100 2004
Albania	8.9	9.1	-10.2	12.7	10.1	7.3	7.6	4.7	6.0	6	6.5	6.5	144	126.6
Bosn. & Herz.	50.0	86.0	37.0	15.6	10.0	5.5	4.5	5.5	3.5	6	5	5	.	120.9
Bulgaria	2.9	-9.4	-5.6	4.0	2.3	5.4	4.1	4.9	4.3	5.6	5	5	97.5	120.3
Croatia	6.8	5.9	6.8	2.5	-0.9	2.9	4.4	5.2	4.3	3.7	3.5	3.5	101.8	118.8
Macedonia	-1.1	1.2	1.4	3.4	4.3	4.5	-4.5	0.9	3.4	2	4	4	92.6	101.6
Romania	7.1	3.9	-6.1	-4.8	-1.2	2.1	5.7	5.0	4.9	7.8	5	5.5	105.6	125.5
Serb. & Mont. [2)]	6.1	5.9	7.4	2.5	-18.0	5.2	5.3	3.8	2.0	7	5	5	57.5	119.3

Notes: 1) Preliminary. - 2) Up to 1998 Gross Material Product.

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

Table 2

Gross industrial production

real change in % against preceding year

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 1)	2005	2006	Index 1990=100 2004	Index 2000=100 2004
											forecast			
Albania 2)	6.0	13.6	-25.8	26.1	34.2	0.5	7.1	1.8	2.7	3.1	4	5	43.8	115.4
Bosnia and Herzegovina 3)	.	.	.	23.6	8.0	7.9	4.9	5.7	5.1	12	10	10	.	130.5
Bulgaria	4.5	5.1	-18.4	-8.5	-8.0	8.3	1.5	6.5	8.3	17.8	12	10	73.2	138.0
Croatia	0.3	3.1	6.8	3.7	-1.4	1.7	6.0	5.4	4.1	3.7	3.5	3.5	77.4	120.6
Macedonia	-10.7	3.2	1.6	4.5	-2.6	3.0	-3.1	-5.3	4.7	-12.7	3	5	44.3	83.9
Romania	9.4	6.3	-7.2	-13.8	-2.4	7.1	8.3	4.3	3.1	5.3	5	5	75.2	122.7
Serbia and Montenegro	3.8	7.6	9.5	3.6	-23.1	11.1	0.0	1.7	-2.7	8	5	5	47.0	106.8

Notes: 1) Preliminary. - 2) According to gross value added. - 3) wiiw estimates based on weighted averages for the two entities (Federation BH and Republika Srpska).

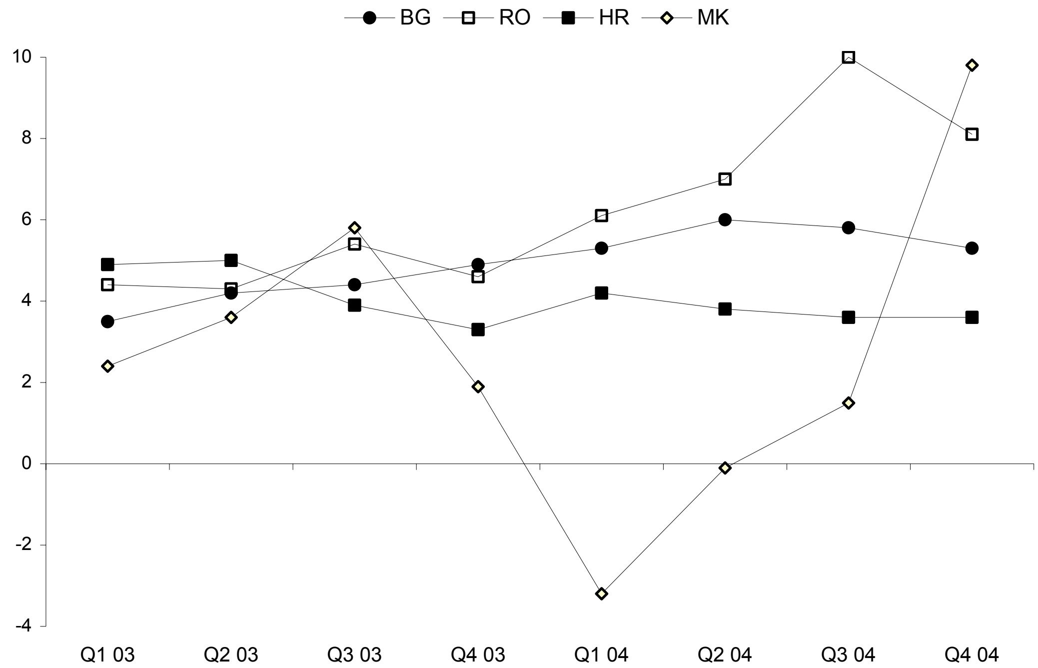
Source: wiiw Database incorporating national statistics, forecast: wiiw.

Quarterly growth of GDP, for the countries for which data are available, shows perhaps some deceleration in line with the expectation that future growth, though still quite fast, will slow down a bit. Similarly, industrial production, as can be seen from the monthly data, may not accelerate as the whole process of re-industrialization is only just starting in Southeast Europe.

Figure 1

Quarterly GDP, 2003-2004

real change in % against preceding year

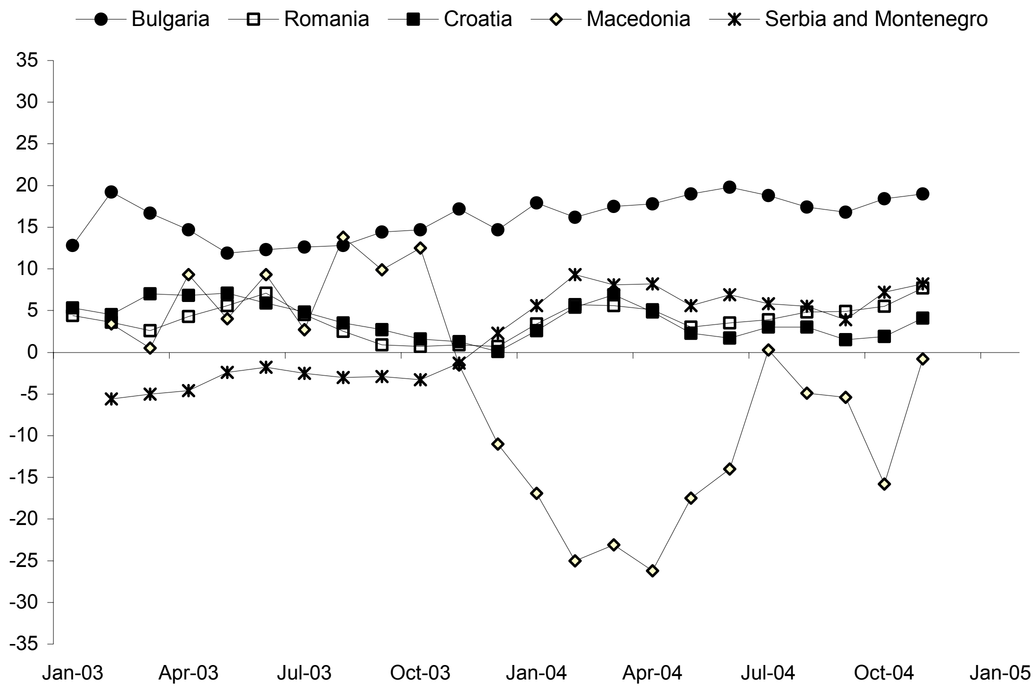


Source: wiiw Monthly Database incorporating national statistics.

Figure 2

Gross industrial production in SEE

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

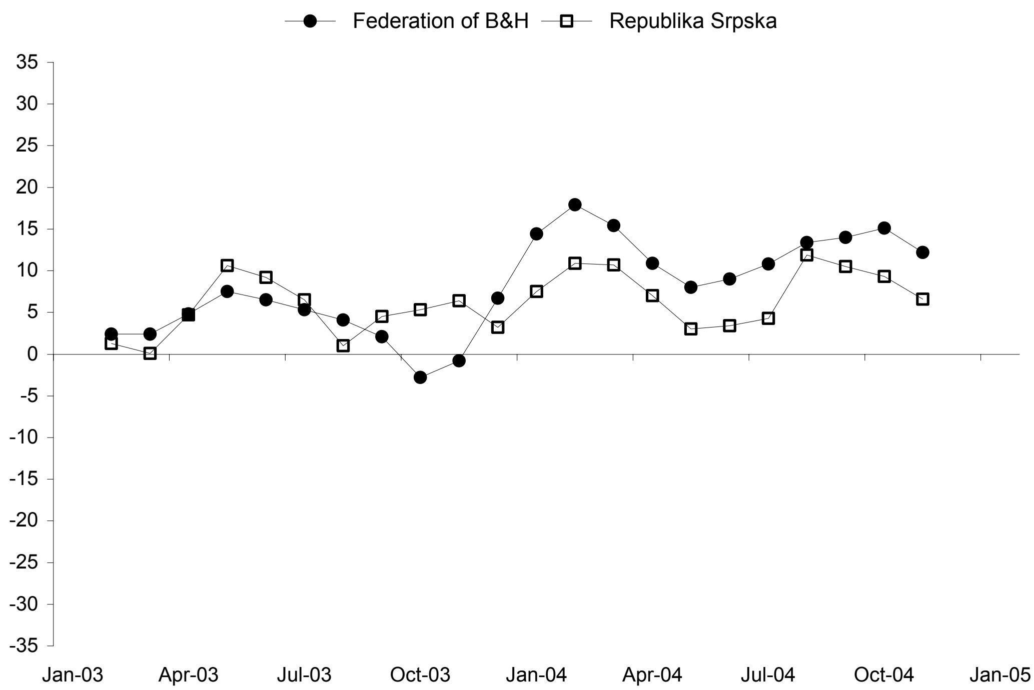


Source: wiiw Monthly Database incorporating national statistics.

Figure 3

Gross industrial production in Bosnia and Herzegovina

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



Source: wiiw Monthly Database incorporating national statistics.

On the demand side, private consumption was the driving force of growth. This is partly the consequence of the rise in wages, but is also due to sharply increased lending to the households in almost the whole region. Investments have also been growing, domestic as well as foreign. The picture is not so clear-cut as there are countries that have had to restrain (public) investments (such as Croatia and Serbia) or have received less foreign direct investments than in the previous years (e.g., again Croatia and Serbia). Still, the investment climate is improving overall. Gross fixed capital formation contributed to the GDP growth. Finally, exports have continued to expand, in some cases exceptionally fast, though net exports contributed negatively to the GDP growth.

Table 3

Contributions to the GDP growth rates by individual GDP components, 2000-2004

	2000	2001	2002	2003	2004 prelim.	2000	2001	2002	2003	1-3Q2004 prelim.
			Bulgaria					Croatia		
Final consumption expenditure	4.7	4.1	3.2	5.6	5.4	2.1	1.1	4.1	2.5	2.2
Household final consumption	3.3	3.9	2.7	4.7	4.5	2.5	2.7	4.5	2.5	2.3
Government final consumption	1.4	0.2	0.5	0.9	0.9	-0.4	-1.6	-0.4	-0.1	0.0
Gross capital formation	2.5	4.1	1.1	3.9	5.1	-2.4	4.8	5.4	3.3	1.7
Gross fixed capital formation	2.6	4.3	1.9	3.1	3.7	-0.9	1.5	2.7	4.0	1.5
Change in inventories	-0.1	-0.2	-0.8	0.8	1.4	-1.5	3.2	2.7	-0.7	0.2
Balance of goods and NFS	-3.3	-5.1	0.5	-7.1	-5.1	3.2	-1.4	-4.2	-1.5	-0.1
Exports of goods and NFS	.	.	.	.	.	5.1	3.7	0.6	4.6	2.6
Imports of goods and NFS	.	.	.	.	.	1.9	5.1	4.8	6.2	2.8
Stat. Discrepancy	*1.5*	*1.0*	*0.1*	*1.9*	*-0.4*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
GDP growth rate, real in %	**5.4**	**4.1**	**4.9**	**4.3**	**5.6**	**2.9**	**4.4**	**5.2**	**4.3**	**3.9**

	2000	2001	2002	2003	2004 prelim.
			Romania		
Final consumption expenditure	1.2	5.6	2.2	6.1	6.7
Household final consumption	-0.4	5.2	3.5	5.3	6.3
Government final consumption	1.6	0.4	-1.3	0.8	0.4
Gross capital formation	2.7	3.4	2.0	2.3	2.2
Gross fixed capital formation	1.2	2.3	1.8	2.3	2.2
Change in inventories	1.5	1.1	0.2	0.0	0.0
Balance of goods and NFS	-3.8	-5.2	0.6	-5.3	-2.1
Exports of goods and NFS	.	.	.	.	.
Imports of goods and NFS	.	.	.	.	.
Stat. Discrepancy	*2.0*	*1.9*	*0.2*	*1.8*	*1.0*
GDP growth rate, real in %	**2.1**	**5.7**	**5.0**	**4.9**	**7.8**

Source: wiiw Annual Database incorporating national statistics; AMECO.

Table 4

Gross fixed capital formation

real change in % against preceding year

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 1)	2005 forecast	2006 forecast	Index 1990=100 2004	Index 2000=100 2004
Bulgaria	16.1	-21.2	-20.9	35.2	20.8	15.4	23.3	8.5	13.8	12.4 I-IX	.	.	144.7	171.1
Croatia	.	37.6	26.4	2.5	-3.9	-3.8	7.1	12.0	16.8	5.5 I-IX	5	4	35.0	147.8
Macedonia	10.2	6.5	-4.3	-2.6	-1.4	-1.5	-8.6	17.6	.	.	.	.		
Romania	6.9	5.7	1.7	-5.7	-4.8	5.5	10.2	8.2	9.2	13	10	8	158.8	147.1
Serbia & Montenegro 2)	-3.7	-5.7	0.8	-2.2	-29.7	13.3	-4.1	.	.	.	.	.		

Notes: 1) Preliminary. - 2) Gross fixed investment.

Source: wiiw Database incorporating national statistics.

Inflation is still quite low in the region as a whole. In Romania, a country that has had problems with inflation in the past, it has continued to go down. In Serbia, the other country where inflation is still a problem, there has been a reversal: inflation has started to accelerate again, though still not in a worrisome manner (though the monthly inflation rates of 2.7% in December of 2004 and January of 2005 are alarming). In some cases, e.g., Romania, producer prices have been rising faster than consumer prices due to increased demand and in some cases in accordance with the revival of industrial production. Also, some of the price rises have been the consequence of tax changes or reforms as in the case of the introduction of the VAT in Serbia. Still, the region as a whole has continued to enjoy price stability or price stabilization as in Romania, with Serbia being an important exception.

Table 5

Consumer price inflation

change in % against preceding year

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 1)	2005 Forecast	2006 Forecast
Albania	7.8	12.7	33.2	20.9	0.4	0.1	3.1	5.2	2.3	2.9	4	3
Bosnia and Herzegovina 2)	.	.	.	13.3	3.7	4.8	3.1	0.4	0.6	0.2	0.5	0.5
Bulgaria	62.1	121.6	1058.4	18.7	2.6	10.3	7.4	5.8	2.3	6.2	4	4
Croatia 3)	2.0	3.5	3.6	5.7	4.2	6.2	4.9	1.7	1.8	2.1	2	2
Macedonia 2)	15.9	3.0	4.4	0.8	-1.1	10.6	5.2	1.4	2.4	0.9	2	2
Romania	32.3	38.8	154.8	59.1	45.8	45.7	34.5	22.5	15.3	11.9	9	7
Serbia & Montenegro	78.6	91.5	21.6	29.9	44.9	86.0	88.9	16.5	9.4	10.8	10	10

Notes: 1) Preliminary. - 2) Retail prices. - 3) Up to 2001 retail prices.

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

Table 6

Producer prices in industry

change in % against preceding year

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 1)	2005 forecast	2006 forecast
Albania 2)	.	.	.	.	2.8	6.5	-7.2	5.1	1.8	.	.	.
Bulgaria	53.4	130.0	971.1	18.7	2.8	17.5	3.8	1.2	4.9	5.9	.	.
Croatia	0.7	1.4	2.3	-1.2	2.6	9.7	3.6	-0.4	1.9	3.5	2	.
Macedonia	4.7	-0.3	4.2	4.0	-0.1	10.7	2.0	-0.9	-0.3	0.9	2	3
Romania	35.1	49.9	152.7	33.2	44.5	53.4	38.1	23.0	19.5	18.6	.	.
Serbia & Montenegro	57.7	90.2	19.5	25.5	44.2	106.0	85.1	8.7	4.6	9	10	10

Notes: 1) Preliminary. - 2) In manufacturing industry.

Source: wiiw Database incorporating national statistics.

Employment and productivity

SEE is characterized by low employment and, for the most part, by high unemployment. There is a lot of diversity, however. Romania continues to report low unemployment rates. In some countries employment has started to grow and unemployment rates have been falling (e.g., Bulgaria). In other countries, growth has yet to start adding new employment, and unemployment levels continue to be quite high. Productivity in industry is rising in most countries, except in Macedonia. With the exception of Bulgaria, however, it is still hard to assess the overall situation in the labour market. Restructuring of the public sector is high on the agenda of a number of countries, so a further decline in employment can be expected. The growing private sector, however, should be absorbing more labour so the overall effect on employment is difficult to determine.

Table 7

Unemployment, LFS definition, annual averages

	in 1000 persons					rate in %			
	2000	2001	2002	2003	2004 1)	2003	2004 1)	2005 forecast	2006 forecast
Albania 2)	215	181	172	164	156	15.0	14.4	14	13.5
Bosnia & Herzegovina 2)	421	422	442	460	.	42.0	42.0	42	42
Bulgaria	567	664	592	449	400	13.7	12.0	11	10
Croatia	298	277	266	256	253	14.3	13.8	13.5	13
Macedonia	262	263	263	316	.	36.7	37	35	35
Romania 3)	821	750	845	692	800	7.0	7.5	8	8
Serbia & Montenegro	481	490	517	562	.	15.2	15	15	15

Notes: 1) Preliminary. - 2) Unemployment by registration, end of period. - 3) From 2002 new methodology in accordance to EU definitions.

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

Table 8

Labour productivity in industry

change in % against preceding year

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 [1]	Index 1990=100 2004	Index 2000=100 2004
Bulgaria [2]	7.4	7.0	-16.0	-4.4	2.2	18.2	2.1	5.2	4.7	18.5	159.5	133.3
Croatia [3]	6.6	11.3	11.9	8.7	3.9	4.3	9.6	9.6	7.7	5.7	192.3	136.7
Macedonia [4]	1.2	29.8	8.3	14.8	6.2	5.0	-0.2	1.4	10.8	-11.1 I-XI	118.1	99.7
Romania [3]	13.7	7.5	-1.8	-7.4	11.3	13.8	6.8	4.8	11.2	11.2 I-XI	179.4	138.4
Serbia & Montenegro [4]	8.3	9.6	12.3	6.3	-19.1	16.4	3.1	12.1	12.2	.	.	.

Notes: 1) Preliminary. - 2) Up to 1996 public sector only. - 3) Enterprises with more than 20 employees (for Romania from 1999). - 4) Excluding small enterprises.

Source: wiiw Database incorporating national statistics.

Productivity can be expected to continue to grow quite strongly. The restructuring of the privatized sector is still in early stages in a number of countries. The new private sector is yet, in all probability, rather small to fully compensate for the loss of employment in the declining public sector. This may prove to be a problem for those countries where unemployment is exceptionally high. Though social sustainability may not be a pressing issue in the region, the persistently depressed labour market is probably still the main economic problem in the bulk of the region.

Foreign trade and current account

SEE runs high trade and current account deficits. Though exports have been rising in the past couple of years, and in a number of cases especially in 2004, imports have been growing too. Even in those instances where exports were increasing faster than imports last year, such as in Croatia, the trade deficit continued to widen. Exports from SEE increased both to the EU-15 and EU-25 as well as to NMS.

The growth of services helped keep the current account deficits below the trade deficits, well below in some cases (e.g., Croatia and Montenegro). Transfers, public and private (remittances in particular) play an increasingly important role in the region as a whole, but the data are still not very reliable. However, income balances are negative in most countries (Bosnia and Herzegovina and Albania are exceptions) and increasingly so in some of them (e.g., Croatia). Thus, overall external sustainability is an open issue.

The financing of the external balances, which still contains contributions of aid and transfers, slows down the growth of foreign debt in a number of countries. The high growth rates also help the sustainability of foreign debt. It is, however, useful to look at the implications of the high current account deficits for the sustainability of the foreign debt. If it is assumed that the current account deficit is equal to additional foreign borrowing (or to the increase in foreign liabilities), then the ratio of

Table 9

Trade of Southeast European countries with the EU-15, EUR million

(based on customs statistics)

		1998	1999	2000	2001	2002	2003	2004 [1]	2003	2004 [1]
									change in %	
Bulgaria [2]	Exports	1905	1942	2684	3129	3376	3770	4338	11.7	15.1
	Imports	2010	2486	3119	4011	4229	4767	5597	12.7	17.4
	Balance	-105	-544	-435	-882	-852	-997	-1259	.	
Croatia [3]	Exports	1927	1960	2619	2821	2746	2993	4117	9.0	37.5 [I-XI]
	Imports	4440	4136	4756	5844	6321	7092	9323	12.2	31.5 [I-XI]
	Balance	-2513	-2175	-2137	-3023	-3575	-4099	-5206	.	
Macedonia	Exports	516	506	612	632	603	659	688	9.2	4.3 [I-XI]
	Imports	620	677	866	803	947	889	1044	-6.1	17.4 [I-XI]
	Balance	-104	-172	-254	-171	-344	-231	-357	.	
Romania	Exports	4760	5236	7195	8623	9864	10571	12315	7.2	16.5 [I-XI]
	Imports	6068	6027	8046	9975	11033	12223	14459	10.8	18.3 [I-XI]
	Balance	-1307	-791	-851	-1352	-1169	-1652	-2144	.	
Serbia & Montenegro [4]	Exports	965	504	700	897	981	974	.	-0.7	.
	Imports	1847	1276	1610	2214	2833	3011	.	6.3	.
	Balance	-882	-772	-910	-1317	-1852	-2037	.	.	.

Notes: 1) Preliminary. - 2) From 1999 according to new methodology. - 3) From 2000 according to new methodology. - 4) From 1999 excluding Kosovo and Metohia.

Source: wiiw Database incorporating national statistics.

Table 10

Trade of Southeast European countries with the EU-25, EUR million

(based on customs statistics)

		2000	2001	2002	2003	2004 [1]	2003	2004 [1]	2003	2004
							change in %		share of EU (25) trade in % of total	
Bulgaria [2]	Exports	2855	3323	3595	4010	4661	11.6	16.2	60.1	58.3
	Imports	3497	4447	4679	5319	6284	13.7	18.1	55.3	54.1
	Balance	-642	-1124	-1084	-1309	-1624	.	.	.	.
Croatia [3]	Exports	3338	3520	3407	3696	4120	8.5	11.5 [I-XI]	67.6	63.9
	Imports	6020	7330	8080	9028	9310	11.7	3.1 [I-XI]	72.0	69.8
	Balance	-2682	-3810	-4673	-5332	-5190	.		.	.
Macedonia	Exports	672	668	635	687	750	8.3	9	57.0	56.4
	Imports	1103	994	1157	1084	1140	-6.3	5	53.3	48.3
	Balance	-431	-327	-523	-397	-390	.	.	.	.
Romania	Exports	7816	9310	10609	11498	13740	8.4	19.5 [I-XI]	73.6	72.8
	Imports	9238	11525	12720	14250	16906	12.0	18.6 [I-XI]	67.2	65.0
	Balance	-1422	-2216	-2111	-2752	-3166	.		.	.

Notes: 1) Preliminary. - 2) From 1999 according to new methodology. - 3) From 2000 according to new methodology.

Source: wiiw Database incorporating national statistics.

Table 11

Trade of Southeast European countries with the new EU member states, EUR million

(based on customs statistics)

		2000	2001	2002	2003	2004 1)	2003	2004 1)	2003	2004 1)
							change in %		share of NMS-8 trade in % of EU (25)	
Bulgaria 2)	Exports	171	194	218	241	323	10.2	34.2	6.0	6.9
	Imports	378	436	451	552	688	22.6	24.6	10.4	10.9
	Balance	-207	-242	-232	-312	-365	.	.	.	.
Croatia 3)	Exports	719	699	661	703	3	6.3	-99.6	19.0	0.1 I-XI
	Imports	1264	1486	1759	1935	-13	10.1	-100.7	21.4	-0.1 I-XI
	Balance	-544	-787	-1098	-1233	16	.	.	.	.
Macedonia	Exports	60	35	31	28	62	-8.8	120.7	4.1	8.3
	Imports	237	191	210	195	96	-7.4	-50.8	18.0	8.4
	Balance	-177	-156	-179	-166	-33	.	.	.	.
Romania	Exports	621	687	745	927	1425	24.5	53.7	8.1	10.4 I-XI
	Imports	1192	1550	1687	2028	2447	20.2	20.7	14.2	14.5 I-XI
	Balance	-571	-864	-942	-1711	-382	.	.	.	.

Notes: 1) Preliminary. - 2) From 1999 according to new methodology. - 3) From 2000 according to new methodology.

Source: wiiw Database incorporating national statistics.

Table 12

Foreign financial position

EUR billion, end of period

	Gross external debt 1)			Reserves of National Bank (excluding gold) 2)			Current account 3) EUR billion				Current account 3) in % of GDP			
	2002	2003	2004	2002	2003	2004	2003	2004	2005 forecast	2006 forecast	2003	2004	2005 forecast	2006 forecast
Albania	1.1	1.1	.	0.8	0.8	1.0 XI	-0.4	-0.3	-0.5	-0.4	-6.7	-4.3	-6.0	-5.0
Bosnia & Herzegovina	2.2	2.1	2.1 IX	1.3	1.4	1.7 IX	-1.9	-1.8	-1.7	-1.6	-30.2	-27.7	-24.3	-21.7
Bulgaria	10.8	10.7	12.4	4.2	5.0	6.4	-1.5	-1.4	-1.3	-1.3	-8.6	-7.2	-6.1	-5.6
Croatia	14.8	18.8	22.2	5.7	6.6	6.4	-1.9	-1.7	-1.6	-1.6	-7.3	-6.1	-5.6	-5.3
Macedonia	1.5	1.4	1.4	0.7	0.8	0.6 XI	-0.1	-0.3	-0.3	-0.3	-3.3	-7.1	-6.7	-6.5
Romania	14.7	15.7	17.5 XI	5.9	6.4	10.7	-3.1	-4.4	-5.5	-6.0	-6.1	-7.7	-7.7	-7.4
Serbia & Montenegro	11.4	10.9	10.2 XI	2.1	2.7	3.0	-1.7	-2.4	-2.5	-2.5	-11.7	-15.5	-17.3	-16.6

Notes: 1) General government foreign debt for BiH; Macedonia and Romania medium- and long-term; for Serbia & Montenegro 2004 Serbia only. - 2) Albania: including gold; refer to total foreign assets of Bank of Albania. - 3) For Serbia & Montenegro Serbia only.

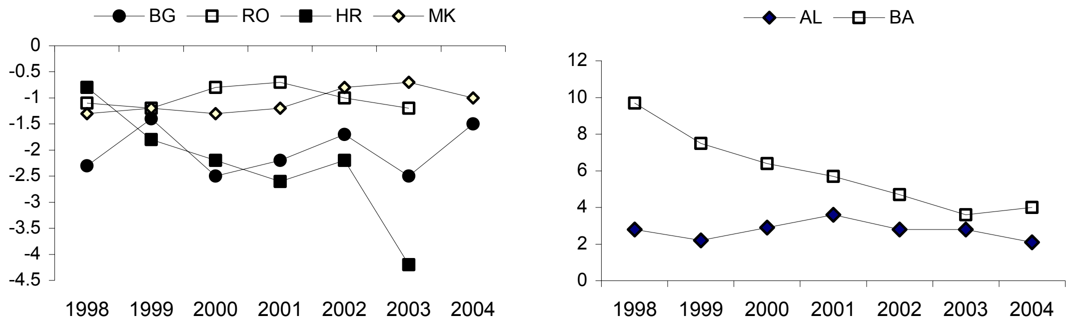
Source: wiiw Database incorporating national statistics; forecast: wiiw.

the current account to GDP and the nominal GDP growth should give the level of foreign debt at which there will be no further increase in the debt to GDP ratio.[20] A calculation of that sort gives a diverse picture of SEE countries.

Figure 4

Income balance

In % of GDP



Source: wiiw Annual Database incorporating national statistics.

Some countries can stabilize their foreign debt to GDP ratio only at an unsustainably high level – unsustainable in the sense that it cannot be expected that foreign creditors would be ready to continue to finance it. Thus, Bosnia and Herzegovina would stabilize its foreign debt to GDP ratio at close to 400%, if it continues to have the same current account and growth record as it has had in the past four years or so. The actual debt has not risen in this period because current account deficits have been financed from non-debt and non-liability creating sources, i.e., aid and donations as well as transfers, but those cannot be expected to be there in the same amount in the future.

Macedonia is a different case as it has a moderate debt to GDP ratio now and its current account deficit is not as high as in several other countries, but it has managed to grow only very slowly and thus faces an unsustainable level of foreign debt if it continues to develop in a similar manner. Croatia is yet another case because its current account deficit is lower than its additional borrowing. If the measure of the current account were to be correct, its foreign debt to GDP ratio would stabilize at around 70%, but if its level of foreign borrowing is considered, then it is looking at a debt to GDP ratio of around 150% as the level at which it would stabilize. Albania, on the other hand, has traditionally had a high current account deficit, but has been growing quite fast so that its level of debt at those rates stabilizes at a level below 50%. Similarly, Bulgaria and Romania do not have to worry too much about their external balances if they continue to grow as they have been growing in the past four or so years. Finally, Serbia is looking at a high level of debt if its external balances do not improve even if it continues to grow as fast as in the past few years – which is rather unlikely.

[20] If the current account deficit equals the capital account surplus net of the change in reserves, that is equals net new foreign borrowing (or liabilities), then the debt to GDP ratio, d, will not change at the ratio of the current account or net new foreign borrowing, b (here measured in euro), and the nominal growth rate of GDP, g. That is, d = b/g.

Table 13

Sustainable foreign debt

	average annual euro nominal growth rate in % 2004/2000	Current account In % of GDP 2000-2004	Curr. account/GDP nom. growth rate GDP
Albania	13.1	-5.8	45 %
Bosnia and Herzegovina	6.6	-26.2	394 %
Bulgaria	9.3	-6.9	74 %
Croatia	8.5	-5.8	68 %
Macedonia	2.2	-5.8	260 %
Romania	9.1	-5.2	57 %
Serbia and Montenegro	9.2	-10.7	116 %

Fiscal adjustment

SEE countries have also had problems with their fiscal deficits. Indeed, those have been under scrutiny by the International Financial Institutions and by the foreign investors. In the past few years, the region has managed a remarkable fiscal adjustment. Most countries have reduced their general budget deficits, in some cases quite significantly. Thus, Albania, a country that used to have a fiscal deficit of more than 10% of GDP, managed to bring it down significantly in the past few years. Macedonia's fiscal adjustment was perhaps the most severe one as its fiscal deficit went down from 6% of GDP in 2002 to just below 2% in 2003 and in 2004. Bosnia and Herzegovina has a relatively moderate fiscal deficit, though the true picture of its public sector may not be available. Finally, Serbia managed to bring down its budget deficit to just below 2% in 2004, though the initial intention was to run a higher deficit in order to stimulate the economy. Romania managed a remarkable fiscal adjustment in the past few years with the general budget deficits going down to 1% of GDP in 2004. Bulgaria, and also Kosovo, ran budget surpluses in 2004 and 2003 respectively. In Croatia, however, the fiscal deficit is still high, though fiscal adjustment has been one of the main policy aims in the past couple of years.

This fiscal adjustment is remarkable, but that does not mean that further public sector restructuring may not be needed. Some countries in SEE can be characterized as having small states in terms of their public expenditures. Albania's public spending is below 30% of its GDP and its public revenues are just above 20% of GDP; Romania's public revenues and expenditures are around 30% while Macedonia's public expenditures are now well below 40% of GDP. On the other hand, Croatia, Serbia, Montenegro (though there are some doubts about its figures) and Bosnia and Herzegovina have much larger public sectors and have been rather unsuccessful in lowering the share of public expenditures in their GDPs. Further fiscal adjustment in these countries will have to be combined with public sector reform, that is, with the restructuring of public expenditures in order to bring their overall levels down.

Table 14

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

Revenues

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 [2)]
Albania	23.9	16.4	18.3	24.9	26.0	24.6	23.9	22.8	22.4	22.3
Bosnia and Herzegovina	.	.	.	.	57.7	53.8	49.7	44.1	43.3	.
Bulgaria	37.3	32.9	31.8	39.7	40.7	41.4	39.8	38.7	40.9	41.5
Croatia	.	.	47.7	51.1	48.4	46.2	44.7	45.2	44.9	.
Macedonia [3)]	37.9	36.5	.	40.1	42.1	43.9	34.4	34.9	33.2	.
Romania	.	29.9	30.3	31.7	32.8	31.2	30.1	29.6	29.8	.
Serbia and Montenegro	.	.	43.4	41.0	41.4	35.0	41.0	53.6	52.6	.

Expenditure

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 [2)]
Albania	34.3	27.8	31.3	34.3	34.9	32.1	30.5	28.4	27.0	27.5
Bosnia and Herzegovina	.	.	.	.	65.5	60.7	53.1	44.2	42.6	.
Bulgaria	42.9	43.3	34.8	38.4	40.6	42.0	40.7	39.4	40.9	39.7
Croatia	.	.	50.1	54.6	56.6	52.7	51.5	50.0	49.5	.
Macedonia [4)]	39.0	36.9	.	40.7	41.1	41.5	40.8	40.5	34.8	.
Romania	.	33.8	33.9	35.3	34.7	35.2	33.3	32.1	31.9	.
Serbia and Montenegro	.	.	50.6	47.2	.	35.9	42.4	58.1	56.8	.

Deficit (-) / surplus (+)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 [2)]	2005 forecast	2006 forecast
Albania	-10.4	-11.4	-13.0	-9.5	-9.0	-7.5	-6.9	-6.0	-4.6	-5.2	-7	-5
Bosnia and Herzegovina	.	.	.	.	-7.8	-7.0	-3.3	-0.2	0.8	.	.	.
Bulgaria	-5.6	-10.4	-3.1	1.3	0.2	-0.6	-0.9	-0.7	0.0	1.7	.	.
Croatia	.	.	-2.3	-3.5	-8.2	-6.5	-6.8	-4.8	-6.3	.	.	.
Macedonia [3)]	-1.0	-0.4	.	-0.5	0.9	2.3	-6.3	-5.6	-1.6	-1.9	.	.
Romania	.	-3.8	-3.5	-3.6	-1.9	-4.0	-3.2	-2.5	-2.0	-1.0	-1.5	-1.5
Serbia and Montenegro	.	.	-7.2	-6.3	.	-0.9	-1.4	-4.5	-4.2	-1.7	.	.

Notes: 1) National definition, for Croatia IFM definition. - 2) Preliminary. - 3) From 2001 excluding privatization incomes. - 4) From 2001 excluding financing items.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Low monetization and the exchange rate

In the past couple of years there has been a sharp increase in banks' lending activities in practically the whole region. Credits to households have often increased faster than those to businesses, but usually from rather low levels. These lending activities have been supported by rising deposits, especially after the euro conversion. Still, the region as a whole continues to exhibit low monetization and also quite high currency substitution. In most countries the monetary aggregates are about half of those that can be found in the New Member States (NMS). For instance, Romania has a very low monetary base and even the broad money figure is significantly lower than in the other countries in the region (except for Serbia). In a number of countries there is quite a difference between the amount of deposits in domestic currency and in foreign currencies. Looking just at the monetary aggregates and their slow upward movements, at least in domestic currencies, it is clear that monetary policy plays a rather limited role.

Table 15

Money supply, end of period

		National currency unit, billion							in % of GDP						
		1998	1999	2000	2001	2002	2003	2004 1)	1998	1999	2000	2001	2002	2003	2004
Albania															
	GDP	412	474	531	610	678	745	835	100	100	100	100	100	100	100
	Currency outside banks	.	.	.	.	.	.	.	.	.	.	.	.	.	.
	M1, Narrow money	84	103	124	143	153	145	157	20.3	21.7	23.4	23.4	22.5	19.4	18.8
	Broad money	240	293	328	394	417	448	495	58.1	61.7	61.8	64.6	61.5	60.2	59.3
Bosnia and Herzegovina															
	GDP	7.6	9.0	10.1	11.0	11.7	12.3	13.0	100	100	100	100	100	100	100
	Currency outside banks	0.1	0.2	0.5	0.7	1.7	1.7	1.6	1.5	1.8	5.1	5.9	14.4	14.2	12.3
	M1, Narrow money	0.3	0.3	1.1	1.4	2.7	3.0	3.1	3.3	3.4	10.9	12.8	23.1	24.5	23.9
	Broad money 2)	1.2	1.5	2.2	2.5	4.7	5.1	5.5	15.6	17.2	21.5	22.5	40.1	41.4	42.3
Bulgaria															
	GDP	22	24	27	30	32	34	38	100	100	100	100	100	100	100
	Currency outside banks3)	1.7	2.0	2.4	3.1	3.3	3.9	4.6	7.8	8.2	8.9	10.4	10.3	11.3	12.1
	M1, Narrow money	3.7	4.0	4.8	6.0	6.7	8.0	10.3	16.5	17.0	17.9	20.3	20.7	23.3	26.9
	Broad money	6.6	7.5	9.9	12.4	13.9	16.6	20.4	29.6	31.7	36.8	41.7	42.9	48.1	53.3
Croatia															
	GDP	138	142	153	166	179	193	207	100	100	100	100	100	100	100
	Currency outside banks	5.7	6.0	6.6	8.5	9.7	10.6	11.0	4.2	4.2	4.4	5.1	5.4	5.5	5.3
	M1, Narrow money	13.5	13.9	18.0	23.7	30.9	33.9	34.6	9.8	9.8	11.8	14.3	17.2	17.6	16.7
	Broad money	57.3	56.7	73.1	106.1	116.1	128.9	139.9	41.7	40.0	47.9	64.0	64.7	66.8	67.5
Macedonia															
	GDP	195	209	236	234	244	253	261	100	100	100	100	100	100	100
	Currency outside banks	7.1	8.2	9.5	14.1	14.1	14.2	14.2	3.7	3.9	4.0	6.0	5.8	5.6	5.4
	M1, Narrow money	15.2	19.7	22.4	25.3	26.4	27.3	27.6	7.8	9.4	9.5	10.8	10.8	10.8	10.6
	Broad money	27.2	35.1	43.7	71.6	65.0	76.7	93.9	14.0	16.8	18.5	30.6	26.6	30.2	36.0
Romania															
	GDP	371194	545730	803773	1167687	1512617	1890778	2316000	100	100	100	100	100	100	100
	Currency outside banks	11525	17372	25742	35636	45578	57978	75366.8	3.1	3.2	3.2	3.1	3.0	3.1	3.3
	M1, Narrow money	22110	29669	46331	64309	88305	113260	153601.1	6.0	5.4	5.8	5.5	5.8	6.0	6.6
	Broad money 2)	92530	134123	185060	270512	373713	460741	645332.2	24.9	24.6	23.0	23.2	24.7	24.4	27.9
Serbia and Montenegro	GDP	150	192	396	782	946	1056	1252	100	100	100	100	100	100	100
	Currency outside banks	5.1	6.7	10.9	25.3	43.7	43.0	45.1	3.4	3.5	2.8	3.2	4.6	4.1	3.6
	M1, Narrow money	10.8	14.8	27.1	58.2	93.8	105.2	119.2	7.2	7.7	6.8	7.4	9.9	10.0	9.5
	Broad money5)	62.4	24.9	65.3	125.4	191.5	244.9	323.6	41.6	13.0	16.5	16.0	20.2	23.2	25.8

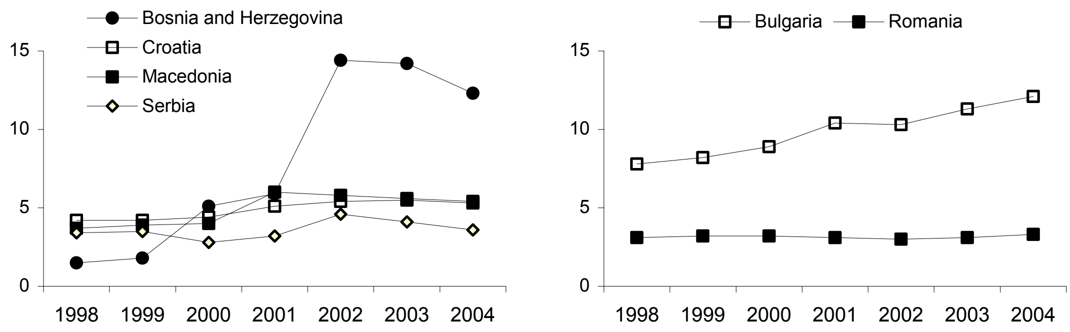
Notes: 1) Preliminary. - 2) Intermediate money M2 (M1+Quasi money). - 3) Currency in circulation. - 4) Excluding frozen foreign currency savings deposits of households.

Source: wiiw Database incorporating national statistics.

Figure 5

Currency outside banks

In % of GDP

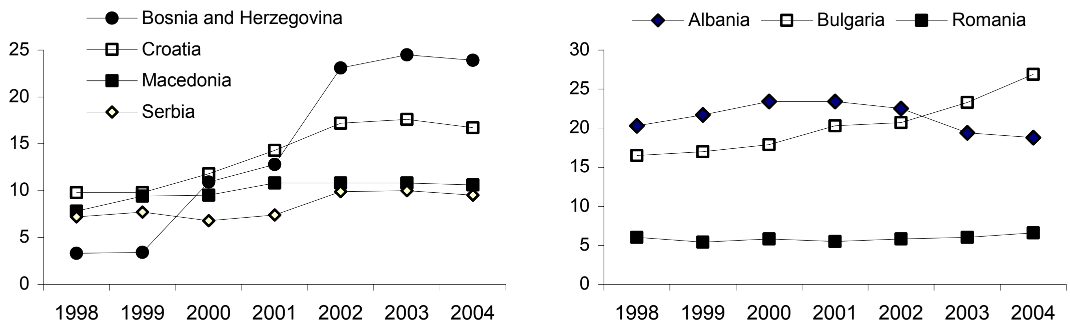


Source: wiiw Annual Database incorporating national statistics.

Figure 6

M1, Narrow money

In % of GDP

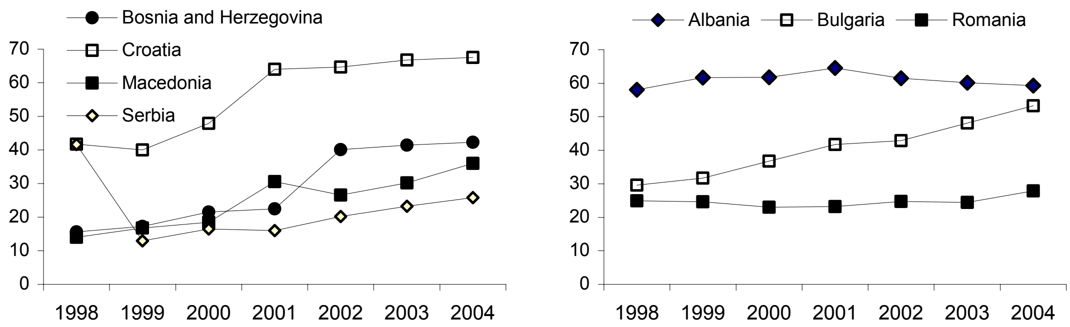


Source: wiiw Annual Database incorporating national statistics.

Figure 7

Broad money

In % of GDP



Source: wiiw Annual Database incorporating national statistics.

This is additionally supported by the exchange rate regimes that exist in the region. Though in the past more flexible exchange rate regimes could be found in Romania, Serbia and Albania, the region has almost invariably moved towards fixed exchange rate regimes, and very rigid ones indeed. Kosovo and Montenegro use the euro, Bosnia and Herzegovina and Bulgaria have currency boards based on the euro, Macedonia has a hard euro peg while Croatia manages a euro peg with quite small flexibility. Romania and Albania have moved to more fixed exchange rate regimes in recent years too. That leaves only Serbia, which has moved away from the fixed peg with the euro to an unannounced crawling peg. It is not altogether clear whether that more flexible exchange rate regime will persist in Serbia in view of the rekindled inflation. In any case, in the region as a whole, fixed exchange rates are more or less a rule.

The choice of a rather rigid exchange rate regime requires also a rather prudent fiscal policy, which probably explains the recent concerted effort at fiscal adjustment. That policy mix does not support the development of the money market and also tends not to support the confidence in the domestic currency. That has consequences for the level of monetization and for the high level of currency substitution.

It also has consequences for monetary policy, or rather for the instruments that monetary authorities can use. In principle, fixed pegs go with quite passive monetary policies. As for the currency boards, the central banks should actually have no monetary policy at all. In practice, this is hardly ever the case. An interesting example is Montenegro, which is using the euro, but its central bank maintains quite high reserve requirements for the commercial banks. Similarly, countries with currency boards or with more or less hard fixed pegs tend to influence the amount of money in the economy through the reserve requirements. Thus, Bulgaria and Croatia (and also Serbia) tried to influence the credit activity of the commercial banks by raising the reserve requirements last year as did Romania quite recently. Other countries tend to do the same in case they feel that either inflation is getting out of hand or that the exchange rate is becoming vulnerable.

Policy mix and growth

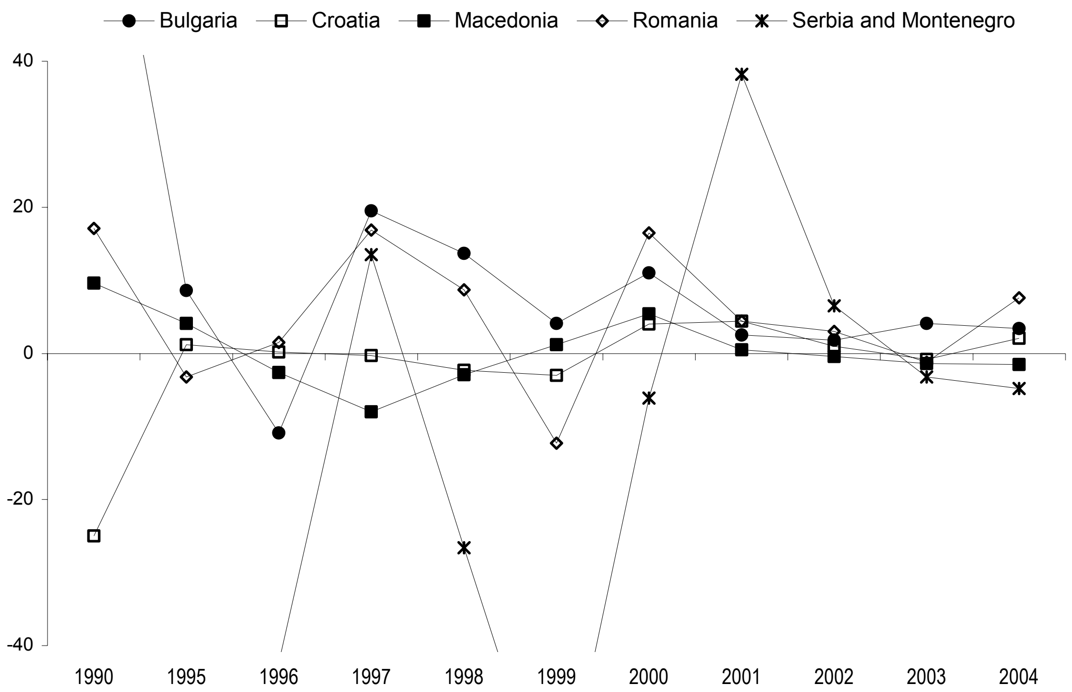
The policy mix pursued by the SEE economic authorities to stabilise prices is characterized by initially restrictive and then rather passive monetary policy and restrictive fiscal stances, that is, by rather tight control of aggregate demand. At times, this policy mix has led to low growth or even to recessions. Thus, the low growth in Macedonia over the years and the negative growth for the most of the last year is a consequence of the very tight control of both public and private expenditures. It is arguable that in a number of other cases that policy mix has led to lower growth and especially to slow recovery of industrial production. In the past few years, the growth of private credit as well as the better performance of the new private sector have been able to push growth upwards even though economic policy has remained mostly restrictive. This can be expected to continue to be the case in a number of countries, while in a few this policy mix has clearly become a constraint on growth (e.g., in Macedonia).

As external balances are the main worry, income policy is quite important if the exchange rate is used as an anchor for price stability or stabilization. Indeed, over the years real exchange rates of local currencies have appreciated together with the mostly upward movement of wages. Both seem to have been covered by higher growth rates and the increases in productivity and have not led to a significant erosion of competitiveness. This is true for countries with relatively low wages such as Romania, Bulgaria and Albania. In the other countries real exchange rate appreciation and growth of wages are certainly a cause of persisting high current account deficits. Probably the most distorted wage levels can be found in countries and territories that have been recipients of significant foreign aid and concessionary lending.

Figure 8

Real appreciation*

EUR per NCU, PPI-deflated, in %



* Increasing line indicates real appreciation

Up to 2000 Serbia had multiple exchange rates. Up to 1998 official exchange rate, 1999 and 2000 black market exchange rate.

Source: wiiw Annual Database incorporating national statistics.

Table 16

Real exchange rates in NCU per EUR (PPI-deflated)

annual change in %

	1990	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Bulgaria	78.0	8.6	-10.9	19.5	13.7	4.1	11.0	2.5	1.8	4.1	3.4
Croatia	-25.0	1.2	0.2	-0.3	-2.3	-3.0	4.0	4.4	1.0	-0.8	2.1
Macedonia	9.6	4.1	-2.6	-8.0	-2.9	1.2	5.4	0.5	-0.4	-1.4	-1.5
Romania	17.1	-3.2	1.5	16.9	8.7	-12.3	16.5	4.4	3.0	-1.2	7.6
Serbia and Montenegro[1)]	.	.	-42.3	13.5	-26.6	-65.7	-6.1	38.2	6.5	-3.2	-4.8

Notes: Minus sign indicates real depreciation. NCU: National currency units. PPI: Producer price index. - 1) Up to 2000 Serbia had multiple exchange rate. Up to 1998 official exchange rate, 1999-2000 marker exchange rate.

Source: wiiw Annual Database incorporating national statistics.

(Table 16 ctd.)

Table 16 (ctd.)

Real net wages

annual change in %

	1990	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Bulgaria 1)	5.3	-5.5	-17.1	-16.6	20.7	6.9	1.3	-0.5	1.5	3.7	3.3
Croatia	-16.2	40.2	7.2	12.3	6.0	10.1	3.4	1.6	3.1	3.8	3.8 I-XI
Macedonia	-19.4	-4.3	0.5	0.2	3.8	3.6	-0.3	-1.9	5.0	3.6	4.2 I-XI
Romania	5.6	12.0	9.3	-22.6	3.4	-3.8	4.6	4.9	2.2	8.8	9.5
Serbia and Montenegro 2)	-21.9	16.1	1.0	21.2	2.0	-15.0	6.5	13.3	24.7	15.2	11.5 I-XI

Notes: 1) Real gross wages. - 2) 2004 Serbia only.

Source: wiiw Annual Database incorporating national statistics.

Table 17

Nominal exchange rates per EUR, 2003-2004

growth rate year-on-year[1)]

	I Q 2003	II Q 2003	III Q 2003	IV Q 2003	I Q 2004	II Q 2004	III Q 2004	IV Q 2004
Bulgaria	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Croatia	101.6	102.3	102.0	102.5	101.6	102.3	102.0	102.5
Macedonia	100.6	100.5	100.4	100.4	100.6	100.5	100.4	100.4
Romania	125.7	122.1	115.1	118.8	113.9	108.7	109.6	100.4

Note: 1) Quarterly data are averages of monthly rates.

Source: wiiw Monthly Database incorporating national statistics.

Real exchange rates per EUR, PPI-based, 2003-2004

growth rate year-on-year[1)]

	I Q 2003	II Q 2003	III Q 2003	IV Q 2003	I Q 2004	II Q 2004	III Q 2004	IV Q 2004
Bulgaria	-5.6	-3.5	-3.2	-3.6	-1.0	-4.1	-4.3	-1.3
Croatia	0.9	1.5	1.3	2.8	-1.2	-3.5	-3.7	-2.7
Macedonia	1.1	2.9	2.4	2.2	2.4	-0.8	-3.7	-8.6
Romania	4.0	1.2	-1.2	-0.4	-4.1	-9.1	-7.0	-12.7

Note: 1) Minus means real appreciation.

Source: wiiw Monthly Database incorporating national statistics.

Real exchange rates per EUR, CPI-based, 2003-2004

growth rate year-on-year[1)]

	I Q 2003	II Q 2003	III Q 2003	IV Q 2003	I Q 2004	II Q 2004	III Q 2004	IV Q 2004
Bulgaria	2.8	1.0	-1.3	-3.2	-4.0	-4.4	-3.7	-1.7
Croatia	3.9	3.3	2.4	3.8	-1.7	-2.1	-0.4	-2.1
Macedonia	1.3	1.2	-0.6	-0.4	0.0	0.9	2.1	2.6
Romania	9.4	6.9	2.9	6.0	0.7	-2.0	-0.1	-6.8

Note: 1) Minus means real appreciation.

Source: wiiw Monthly Database incorporating national statistics.

Investments and financial integration

FDI in the EU candidate countries Bulgaria and Romania continued to grow in 2004, reacting to the improving business climate. It went hand in hand with accelerating economic growth. Romania attracted record amounts due to successful privatizations in oil refining and energy distribution. Also wage-intensive production segments of the automotive and consumer goods sectors continue to move here and also to Bulgaria. Austria was a major investor in both countries, in Romania through the oil company OMV, in Bulgaria through Telecom Austria. The real estate and retail sectors of both countries witnessed an upswing of FDI. The trend is set to continue as EU accession draws near and there are more privatization projects in the pipeline.

Table 18

Foreign direct investment inflow

based on the balance of payments, EUR million

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Albania	53.6	71.1	41.9	40.2	38.6	154.8	231.4	151.3	157.4	400	400
Bosnia and Herzegovina	.	.	.	60	166	159	133	282	338	400	500
Bulgaria	70	87	446	478	775	1103	903	980	1254	1500	1500
Croatia	88	408	471	831	1377	1181	1740	1193	1748	800	1000
Macedonia	7	9	27	114	31	189	493	83	84	100	200
Romania	324	210	1077	1763	964	1147	1294	1212	1946	4100	4000
Serbia and Montenegro	.	.	653	101	105	55	186	502	1197	700	1000
Southeastern Europe	543	785	2716	3387	3456	3989	4981	4403	6724	8000	8600
NMS-8	9185	8348	10686	14457	17430	22258	20488	24063	10125	14500	16200

Remarks: Albania: equity capital.
Bosnia and Herzegovina: equity capital.
Bulgaria: equity capital + reinvested earnings from 1997 + loans from 1997.
Croatia: equity capital + reinvested earnings from 1997 + loans from 1997.
Macedonia: equity capital.
Romania: equity capital + reinvested earnings from 2003 + loans from 1998.
Serbia and Montenegro: FDI net (inflow minus outflow); from 2003 Serbia only.

Sources: National banks of respective countries according to balance of payments statistics. wiiw estimates for 2004 and 2005.

In the Western Balkans the FDI inflows were lower in 2004. They are still significantly lower in per capita terms than in the NMS and the candidate countries Romania and Bulgaria. Romania alone attracted more than the five Western Balkan countries together. Croatia is the most attractive target but in 2004 it performed below the level of the previous two years when important privatization projects had taken place. The upswing of FDI in Serbia and Montenegro (in 2003 and as expected in 2005), Bosnia and Herzegovina and Albania is mainly due to privatization deals.

Export-oriented manufacturing FDI is still rare in the Western Balkans. The area has some disadvantage compared to Romania and Bulgaria due to higher wages and a less attractive investment environment. An improvement of the institutional framework, communication facilities and skills would be needed to compensate.

Table 19

Foreign direct investment inward stock

based on international investment position (IIP), EUR million

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Albania	172	244	285	326	364	519	750	902	1059	1400
Bosnia and Herzegovina	.	.	.	60	225	384	517	799	1136	1500
Bulgaria	273	360	806	1363	2392	2426	3129	3530	4024	5700
Croatia	274	696	1266	1622	2568	3821	5336	6443	8100	10500
Macedonia	28	37	63	177	208	397	890	973	1057	1200
Romania	642	885	2128	3783	5447	6966	8656	8656	10445	13000
Serbia and Montenegro	.	.	653	754	859	914	1100	1602	2799	2500
Southeastern Europe	1389	2220	5202	8084	12062	15427	20379	22904	28620	35800
NMS-8	24396	32073	44879	58359	78720	100664	127301	142316	149769	166300

Remarks: Albania: equity capital.

Bosnia and Herzegovina: equity capital.

Bulgaria: equity capital + reinvested earnings from 1997 + loans from 1997.

Croatia: equity capital + reinvested earnings from 1997 + loans from 1997.

Macedonia: equity capital.

Romania: equity capital + loans from 1994.

Serbia and Montenegro: FDI net; from 2003 Serbia only.

Source: National banks of respective countries according to international investment position (IIP). Cumulated EUR inflows for Albania, Bosnia and Herzegovina, Bulgaria till 1997, Croatia till 1997, Macedonia, Serbia and Montenegro; wiiw estimates for 2004.

Table 20

Standard & Poor's Sovereign Ratings

S&P Foreign Currency Sovereign Credit Rating, Long Term, 3 February 2005

	1999	2000	2001	2002	2003	2004
Bosnia and Herzegovina [1)]	.	.	.	.	.	*B3*
Bulgaria	B	B+	BB-	BB	BB+	BBB-
Croatia	BBB-	BBB-	BBB-	BBB-	BBB-	BBB- / BBB
Macedonia	.	.	.	.	.	BB
Montenegro	.	.	.	.	.	BB
Romania	B-	B-	B- / B	B+	BB- / BB	BB+
Serbia	.	.	.	.	.	B+
Czech Republic	A-	A-	A-	A-	A-	A-
Hungary	BBB	BBB+ / A-	A-	A-	A-	A-
Poland	BBB	BBB+	BBB+	BBB+	BBB+	BBB+
Slovakia	BB+	BB+	BBB-	BBB	BBB	BBB+ / A-
Slovenia	A	A	A	A	A+	AA-
Russia	.	B-	B / B+	B+ / BB- / BB	BB	BB+
Ukraine	.	.	B	B	B	B+

Note: Standard&Poor's rating definition: AAA is better than AA; AA is better than A; "+" and "-" are the respective modifiers. - 1) The 2004 rating for Bosnia and Herzegovina is done by Moody's; the modifier 3 is comparable to a S&P "-".

Investments can be expected to pick up in the future also because the region is increasing its financial integration. All of the countries in the region have a credit rating now. Though these are not investment grades in most cases, they indicate that the region is getting on the investment map. It is also clear that, apart from economic performance, it is the expectation of the progress in EU integration that improves a country's investment rating. This is evident from the improved rating for Bulgaria, Romania and Croatia, but may also explain the rather good starting point of the new entrants on the rating scales. A number of countries in the region still do not have access to the international financial markets, though this should change even in the short run.

EU integration

The next couple of years will prove to be crucial for the EU integration of the whole region. It can be assumed that the EU will want to have a clear picture of where all the SEE countries are on their path to EU integration by the beginning of 2007. Then, Bulgaria and Romania will join the EU, and the date of Croatia's accession should be reasonably clear. It would be optimal if by that time Macedonia were to start its negotiations with the EU and all the other SEE countries had concluded their Stabilization and Association Agreements with the EU. Then, all the countries in the region might become members by 2015.

Table 21

SEE EU accession forecast

	SAA[1)]	**Negotiations**	**EU**	**euro**
Bulgaria	1995 (EEA)	1999	2007	2009
Romania	1995 (EEA)	1999	2007	2012
Croatia	2005	2005	2009	2011
Macedonia	2004	2006-2007	2012-2013	2015
Albania	2007	2009	by 2015	by 2017
Bosnia and Herzegovina	2007	2009	by 2015	by 2017
Serbia	2007	2009	by 2015	by 2017
Montenegro	2007	2009	by 2015	by 2017
Kosovo	2007	2009[2)]	after 2015	by 2017

Notes: 1) In some cases SAA can be expected to be ratified and in others only signed by the date in the table. Kosovo will in all probability have something that resembles an SAA. - 2) Kosovo's negotiations may be somewhat non-standard.

In order for that to happen, a number of outstanding political and indeed constitutional issues would have to be solved by the beginning of 2007. The final status of Kosovo would have to be decided, as well as the fate of the state union of Serbia and Montenegro, and the constitutional strengthening of Bosnia and Herzegovina would have to be achieved. There is no doubt that these decisions cannot but test the political will of the countries involved and of the region as a whole. They may also have economic consequences, though the current improvement in the economic fortunes of the region will be helpful and may even prove to be politically stabilizing.

Conclusion: *SEE should continue to grow at rather high levels in the medium term. Macroeconomic stability should also be sustained in the same period. Some improvements in the formation and implementation of economic policy can also be expected. The main risks are still institutional and political. If those are managed well, the integration of SEE into the EU should proceed as expected.*

Country reports

Anton Mihailov

Bulgaria: a year of solid growth

2004 was another year of sound economic performance in Bulgaria, combining robust growth with a stable macroeconomic environment. GDP is expected to have increased by some 5.5%, or even more, for the year as a whole, more than 1 percentage point above the rate in 2003. Manufacturing output surged, an upshot of several years of active restructuring. But in absolute terms, it was the service sector that made the most significant contribution to the growth of aggregate output, with a number of key industries (telecommunications, financial services and especially tourism) posting solid gains in 2004. A relatively good harvest contributed to an upturn in agricultural output.

In contrast to recent developments in other Central and Eastern European economies, the ongoing recovery in Bulgaria has been accompanied by relatively strong net job creation, especially in 2003 and 2004. This positive outcome partly reflects the fact that the restructuring effort had contributed to a significant reduction in the previously existing employment slack. The absence of slack facilitates the transmission of labour demand associated with output growth into net job creation. But the active labour market policies introduced in 2003 have also had a positive effect on employment. The unemployment rate remains relatively high (the average rate for 2004 as a whole was 12% according to labour force surveys) but this is mostly due to regional disparities. In large cities (especially the capital Sofia) there are already signs of labour shortages, especially as regards qualified labour.

The average annual rate of consumer price inflation rose somewhat (to 6.2%) in 2004, but this was mostly due to statistical carryover effects originating in the final months of 2003. The cumulative (January to December) change of CPI in 2004 was 4%, lower than the change in the corresponding period of 2003 (5.6%).

In current euro terms merchandise exports (BOP definition) increased by some 20% in 2004 underpinned by vibrant external demand and facilitated by the coming on stream of new, export-oriented manufacturing capacity. Merchandise imports also rose significantly (by more than 18% in 2004), partly reflecting the ongoing recovery in fixed investment but also strong import demand generated by the export-oriented industries. Robust exports and a strong outturn in the tourism industry contributed to a certain reduction in the current account deficit in the second half of 2004. At some 7% of GDP for the year as a whole the deficit still remains high; nevertheless, being fully covered by FDI inflows, it does not seem to pose immediate dangers for macroeconomic stability.

Domestic credit continued to expand at a brisk pace throughout the year. At the end of December 2004 the stock of outstanding credit to the non-government sector was almost 50% higher than a year earlier. Its fastest growing component was credit to households, which grew by some 75% during the same period. While providing a solid impetus to domestic economic activity, the credit boom became an issue of policy concern due to worries that it had fuelled a widening of the current account deficit at the beginning of the year. However, a series of policy measures (such as the withdrawal of government funds from commercial banks, increases in the mandatory reserves of commercial banks and tightening of the provisioning requirements on various types of credit) failed to put effective brakes on the growth of credit.

The credit boom sparked fears of overheating, an issue recently raised by the IMF. However, judging by several key macroeconomic indicators, both on the demand and on the supply side, these fears appear to be unsubstantiated, at least for the time being. Despite the healthy recovery in consumer demand (partly fuelled by borrowing), there are no signs of excessive growth in private consumption. In fact, during the first three quarters of 2004 private consumption increased by just 4.4% year on year, lagging behind GDP, which increased by 5.7% compared to the same period of 2003. Nor are there signs of acceleration in inflation: on the contrary, inflation has been on the decline through 2004. Despite the recovery, average capacity utilization in manufacturing still remains low (it was 63% at the end of December 2004) and cannot be a source of inflationary pressure. The recently emerging bottlenecks in some segments of the labour market are minor and their macroeconomic impact is negligible.

The fiscal outturn in 2004 proved to be much better than expected. According to preliminary data, the level of consolidated general government revenues in 2004 was by 10.4% higher than envisaged in the budget. This allowed the government to increase public expenditure (by 3.8% above those budgeted) and nevertheless achieve a healthy 1.7% surplus in the consolidated financial balance for 2004. However, the reported fiscal outturn excludes BGN 340 million set aside in December with the intention to establish a public investment company (a policy move likely targeting the upcoming parliamentary elections in June 2005); if the allocated funds are counted as expenditure for the year, the surplus in the general government financial balance comes to 0.8% of GDP. The swelling fiscal reserve allowed the government to implement, in January 2005, a second Brady buy-back (after a similar operation in July 2004), redeeming USD 937.5 million worth of Interest Arrears Bonds (IABs) maturing in 2011. This amounts to a reduction of public debt by the equivalent of 3.7% of GDP.

Fiscal policy issues came high on the agenda in a series of discussions with the IMF in the final months of 2004. The negotiations were difficult as the Fund, fearful of pre-election loosening, kept a rigid stance on a number of issues (the very idea of establishing a public investment company being one of them). Ironically, despite an excellent macroeconomic performance, Bulgaria’s relations with the IMF came near the freezing point at the beginning of 2005. The main stumbling block turned out to be a seemingly minor policy issue: by how much could the government afford to raise the regulated minimum monthly wage in the country? The Fund insisted on restraint in incomes policy, one of the few remaining policy instruments under the currency board arrangement, in fears of negative repercussions for the current account deficit. However, the government had pledged a 25% rise in minimum wages in 2005 (from BGN 120 to BGN 150), another blatant pre-election move. In the event, the two sides failed to agree on a mutually acceptable solution and in January the government went ahead with the planned wage increase. As the IMF remained opposed to this measure until the very last moment, the future of the current precautionary agreement looks uncertain.

Table BG

Bulgaria: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 [1]	2005 forecast	2006 forecast
Population, th pers., end of period [2]	8230.4	8190.9	8149.5	7891.1	7845.8	7801.3	.	.	.
Gross domestic product, BGN mn, nom.	22421.1	23790.4	26752.8	29709.2	32335.1	34410.2	38250.0	41900	45700
annual change in % (real)	4.0	2.3	5.4	4.1	4.9	4.3	5.6	5	5
GDP/capita (EUR at exchange rate)	1377	1481	1674	1920	2101	2249	2510	.	.
GDP/capita (EUR at PPP - wiiw)	4650	4890	5330	5850	6100	6340	6830	.	.
Gross industrial production									
annual change in % (real) [3]	-8.5	-8.0	8.3	1.5	6.5	8.3	17.8	12	10
Gross agricultural production									
annual change in % (real)	-1.5	2.7	-9.1	-0.1	4.2	-1.4	.	.	.
Construction output total									
annual change in % (real)	-0.2	8.8	8.0	15.0	1.9	-17.2	.	.	.
Actual final consump.of househ., BGN mn, nom.	.	453.3	634.6	917.2	1151.4	1451.2	20750.2 I-IX	.	.
annual change in % (real)	.	-1.1	0.2	6.8	3.1	7.1	4.4 I-IX	.	.
Gross fixed capital form., BGN mn, nom.	2919.8	3600.5	4206.0	5415.2	5908.5	6733.1	5416.9 I-IX	.	.
annual change in % (real)	35.2	20.8	15.4	23.3	8.5	13.8	12.4 I-IX	.	.
LFS - employed persons, th, avg.	3034.8	2875.3	2794.7	2698.8	2739.6	2834.8	2922.5	.	.
annual change in %	-0.8	-5.3	-2.8	-3.4	1.5	3.5	3.1	.	.
Reg. employees in industry, th pers., avg.	802.5	722.5	662.0	658.4	666.8	689.5	685.1	.	.
annual change in %	-4.3	-10.0	-8.4	-0.5	1.3	3.4	-0.6	.	.
LFS - unemployed, th pers,, average	497.5	534.0	566.8	663.9	592.4	448.7	399.7	370	350
LFS - unemployment rate in %, average	14.1	15.7	16.9	19.7	17.8	13.7	12.0	11	10
Reg. unemployment rate in %, end of period	12.2	16.0	17.9	17.3	16.3	13.5	12.2	11	10
Average gross monthly wages, BGN	183.3	201.0	224.5	240.0	257.6	273.3	299.0	.	.
annual change in % (real, gross)	20.7	6.9	1.3	-0.5	1.5	3.7	3.3	.	.
Consumer prices, % p.a.	18.7	2.6	10.3	7.4	5.8	2.3	6.2	4	4
Producer prices in industry, % p.a.	18.7	2.8	17.5	3.8	1.2	4.9	5.9	.	.
General governm. budget, nat. def., % GDP									
Revenues	39.7	40.7	41.4	39.8	38.7	40.9	41.5	.	.
Expenditures	38.4	40.6	42.0	40.7	39.4	40.9	39.7	.	.
Deficit (-) / surplus (+), % GDP	1.3	0.2	-0.6	-0.9	-0.7	0.0	1.7	.	.
Public debt in % of GDP	79.6	79.3	73.6	66.2	53.2	46.2	39.1 XI	33	28
Base rate of NB % p.a., end of period	5.2	4.5	4.7	4.7	3.4	2.9	2.4	.	.
Current account, EUR mn	-28.5	-586.9	-761.4	-1101.7	-925.5	-1505.2	-1400	-1300	-1300
Current account in % of GDP	-0.3	-4.8	-5.6	-7.3	-5.6	-8.6	-7.2	-6.1	-5.6
Gross reserves of NB excl. gold, EUR mn [5]	2290.9	2878.7	3390.6	3734.0	4247.1	4981.0	6443.0	.	.
Gross external debt, EUR mn [6]	9295.0	10863.9	12038.5	12046.0	10768.6	10681.1	12376.0	.	.
FDI inflow, EUR mn	478.0	775.0	1103.3	903.4	980.0	1253.9	1500 [7]	1500	1200
FDI outflow, EUR mn	0.1	16.3	3.5	10.8	28.9	19.2	200 [7]	.	
Exports of goods, BOP, EUR mn	3746.9	3733.7	5253.1	5714.2	6062.9	6668.2	8000.0	9200	10300
annual growth rate in %	-11.9	-0.4	40.7	8.8	6.1	10.0	20.0	15	12
Imports of goods, BOP, EUR mn	4075.3	4741.4	6533.0	7492.6	7754.7	8867.8	10500.0	11750	13000
annual growth rate in %	2.7	16.3	37.8	14.7	3.5	14.4	18.4	12	11
Exports of services, BOP, EUR mn	1602.7	1686.2	2366.2	2384.8	2478.9	2790.8	3350.0	3750	4100
annual growth rate in %	-17.7	5.2	40.3	0.8	3.9	12.6	20.0	12	9
Imports of services, BOP, EUR mn	1249.4	1380.6	1818.6	1930.3	1992.9	2267.6	2600.0	2900	3200
annual growth rate in %	4.1	10.5	31.7	6.1	3.2	13.8	14.7	12	10
Average exchange rate BGN/USD	1.760	1.838	2.124	2.185	2.077	1.733	1.575	.	.
Average exchange rate BGN/EUR (ECU)	1.972	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956
Purchasing power parity BGN/USD, wiiw	0.507	0.518	0.543	0.564	0.597	0.604	0.639	.	.
Purchasing power parity BGN/EUR, wiiw	0.584	0.592	0.615	0.642	0.674	0.694	0.720	.	.

Notes: 1) Preliminary. - 2) From 2001 according to census March 2001. - 3) Other methodology than quarterly data. - 4) According to ESA'95, excessive deficit procedure. - 5) Converted from the national currency to EUR at the official exchange rate. - 6) Up to 2001 converted from USD to NCU, and from NCU to EUR at the official exchange rates. – 7) wiiw estimate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

On the positive side, the latest signals coming from Brussels have been generally favourable and the widely shared expectation is that the Accession Treaty will be signed in the coming months, opening the way for full EU membership in 2007. Furthermore, the authorities recently unveiled the ambitious target to join EMU by 2009 (implying the adoption of the ERM-2 immediately after accession to the EU in 2007). Nevertheless, the EU has played it safe, including (similarly to the case of Romania) 'safeguard clauses' to the Bulgarian Accession Treaty, which should act as another straitjacket for the government in implementing its commitments related to EU accession.

Despite the row with the IMF, the outlook for the Bulgarian economy in 2005 remains positive. Investment-driven restructuring is underway in full swing, providing an impetus for solid economic performance. However, compared to 2004, the pace of aggregate output growth may slow down somewhat, reflecting a certain worsening in the external conditions. The improvement in the labour market is set to continue while there are no signs of rising inflationary pressures. Some fiscal loosening cannot be excluded (as the upcoming parliamentary elections lay their print on the current policy agenda) but nevertheless macroeconomic fundamentals will remain generally sound. The goal of EU membership in 2007 – shared by all political parties – precludes major deviations from the current policy course after the 2005 elections. Thus, given the healthy state of the economy, it can be expected that robust economic performance, including further improvements in labour markets, will continue in 2006 as well.

Gábor Hunya

Romania: can new government continue expansionist policy?

Economic growth reached a new record in 2004, close to 8%. It was supported by the expansion of household demand and of fixed investments, while public demand shrank and the foreign balance deteriorated. An exceptionally good harvest explains about 1.5 percentage points of the growth. The economy shows signs of overheating due to pre-election wage rises and credit expansion to the population. While growth may continue at a rate of about 5% in 2005, risks are present both in the fiscal and monetary spheres. Managing these risks is a primary challenge for the new government.

The social-liberal government, in office since December last year, enjoys a comfortable majority in both houses of parliament, but the four-party coalition may prove fragile, and President Basescu may also cause tensions with his frequent interference in daily politics. While the former government was associated with the old nomenklatura and trade union interests, the new government is mainly supported by the business class and urban people. No wonder that the first reform package provided tax relief to businesses and to high-income people.

Personal incomes and corporate profits are taxed with a flat rate of 16% in 2005. Low-income people receive a compensation for their higher tax rate, while high-income persons will definitely pay less than previously. Tax revenue losses for the budget are estimated at 1% of GDP. This will be partly compensated by increasing the turnover-based tax on micro-enterprises and postponing the planned reduction of social security contributions. An increase in excise taxes and of the VAT rate is suggested by the IMF but opposed by the government. While the government wants to keep the budget deficit at the 2004 level of 1.2% of GDP, the IMF insists on cutting it to half in order to correct the overheating. After meeting the IMF delegation in early February, the government agreed to raise taxes on interests, stock exchange gains and real estate transactions as well as to increase excise duties, but it defended the VAT rate. A rectified budget will be finalized by April.

The debate over the budget deficit boils down to the expected rate of disinflation. With the end-year CPI having declined to 9.3% (from 14.1% in December 2003), the central bank (BNR) was able to meet its 2004 target. This result was helped by three earlier unexpected developments: booming domestic food production kept prices down; the Romanian leu (ROL) started to appreciate and caused a decline in prices of some imported goods, and of euro-priced services; and the government postponed gas and electricity tariff rises to after the elections. When increasing the end-2005 inflation target from 6% to 7% in October last year, the BNR included already the postponed tariff hikes. However, also this target is in danger due to the demand effects of tax cuts.

The nominal appreciation of the leu since the last quarter of 2004 has been a novelty for Romania. Improving credit ratings and high interest rates have attracted foreign portfolio investors, and also significantly more foreign exchange came into the country through FDI and remittances, all increasing the demand for the local currency. The BNR declared to stop intervening on the currency market last year but interfered several times in January 2005 to stop appreciation. It also intends to introduce direct inflation targeting in June 2005 and to further liberalize capital account transactions, allowing short-term ROL deposits for foreigners. To discourage short-term capital inflows and a further strengthening of the leu, the BNR has repeatedly cut the prime-rate (most recently to 15.75% on 14 February). Still it is likely that speculative capital will flow in at an accelerating pace after the liberalization in April. A nominally stable exchange rate through 2005 would help disinflation without hurting exports but as of February, all signs point to further appreciation. One can expect that direct inflation targeting will not be applied in the strict sense and the BNR will keep an eye on the exchange rate.

Exports expanded significantly in 2004, by about 21% in current euro terms. Despite some upgrading of the export structure, Romania is still highly specialized in labour-intensive low-tech products whose competitiveness is very sensitive to exchange rate developments. Wages have grown ahead of GDP for the second consecutive year and euro wages increased even more rapidly, draining the profits of manufacturing sector exporters and curtailing future export expansion. Imports rose by some 23% in 2004. The widening trade deficit was partially mitigated by remittances of Romanians working abroad. Still the current account deficit deteriorated to about 7.7% of GDP.[21] In this respect, the policy target was missed by a wide margin, and the authorities seem to lack the tools to forestall a further current account deterioration.

In 2005 and 2006 the Romanian economy will grow less rapidly than last year (at an annual rate of 5-5.5%), partly due to lower agricultural production, partly to less vigorous foreign demand. Wage expansion will be more moderate than last year and the nominal appreciation of the leu will come to an end. The correction of the expansionist policy will proceed moderately and inflation will remain somewhat above the level targeted by the government and the BNR.

[21] The National Bank of Romania started to include re-invested earnings of foreigners into the current account and increased FDI in the capital account by the same amount. The new methodology applies for the balance of payments of 2003 and 2004.

Table RO

Romania: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 1)	2005 forecast	2006 forecast
Population, th pers., mid-year	22502.8	22458.0	22435.2	22408.4	21794.8	21733.6	21700	.	.
Gross domestic product, ROL bn, nom.	371194	545730	803773	1167687	1512617	1890778	2316000	2700000	3100000
annual change in % (real)	-4.8	-1.2	2.1	5.7	5.0	4.9	7.8	5	5.5
GDP/capita (EUR at exchange rate)	1651	1491	1795	2002	2221	2316	2630	.	.
GDP/capita (EUR at PPP - wiiw)	4670	4760	5010	5460	6060	6320	6980	.	.
Gross industrial production									
annual change in % (real)	-13.8	-2.4	7.1	8.3	4.3	3.1	5.3	5	5
Gross agricultural production									
annual change in % (real)	-7.5	4.0	-14.8	22.7	-3.5	3.6	.	.	.
Construction output total									
annual change in % (real)	-0.5	-0.2	2.8	9.0	10.0	6.5	8.5 I-IX	.	.
Actual final consump.of househ., ROL bn, nom.	.	453308	634590	917186	1151356	1451166	.	.	.
annual change in % (real)	.	-1.1	0.2	6.8	3.1	7.1	9	.	.
Gross fixed capital formation, ROL bn, nom.	68112	96630	151947	241154	322383	425917	.	.	.
annual change in % (real)	-5.7	-4.8	5.5	10.2	8.2	9.2	13	10	8
LFS - employed persons, th, avg. 2)	10844.9	10775.6	10763.8	10696.9	9234.3	9222.5	9077.0 I-VI	.	.
annual change in %	-1.9	-0.6	-0.1	-0.6	-13.7	-0.1	-0.5 I-VI	.	.
Reg. employees in industry, th pers., avg.	2272.0	1991.0	1873.0	1901.0	1891.0	1855.0	.	.	.
annual change in %	-7.0	-12.4	-5.9	1.5	-0.5	-1.9	-1.8 I-XI	.	.
LFS - unemployed, th pers., average 2)	732.4	789.9	821.2	750.0	845.3	692.0	800	.	.
LFS - unemployment rate in %, average 2)	6.3	6.8	7.1	6.6	8.4	7.0	7.5	8	8
Reg. unemployment rate in %, end of period	10.4	11.8	10.5	8.8	8.4	7.4	6.2	.	.
Average gross monthly wages, ROL	1357132	1957731	2876645	4282622	5452097	6741152	8261492	.	.
annual change in % (real, net)	3.4	-3.8	4.6	4.9	2.2	8.8	9.5	.	.
Consumer prices, % p.a.	59.1	45.8	45.7	34.5	22.5	15.3	11.9	9	7
Producer prices in industry, % p.a.	33.2	44.5	53.4	38.1	23.0	19.5	18.6	.	.
General governm. budget, nat. def., % GDP									
Revenues	31.7	32.8	31.2	30.1	29.6	29.8	.	.	.
Expenditures	35.3	34.7	35.2	33.3	32.1	31.9	.	.	.
Deficit (-) / surplus (+)	-3.6	-1.9	-4.0	-3.2	-2.5	-2.0	-1.0	-1.5	-1.5
Public debt, EU-def., % of GDP 3)	18.0	24.0	23.9	23.2	23.3	21.8	21.8	.	.
Discount rate, % p.a., end of period 4)	35.0	35.0	35.0	35.0	20.4	20.4	18.0	.	.
Current account, EUR mn	-2575	-1355	-1494	-2488	-1623	-3060	-4402	-5500	-6000
Current account in % of GDP	-6.9	-4.0	-3.7	-5.5	-3.4	-6.1	-7.7	-7.7	-7.4
Gross reserves of NB excl. gold, EUR mn	1177.3	1520.0	2654.8	4445.3	5876.8	6373.6	10711.5	.	.
Gross external debt, EUR mn 5)	8054.3	8756.4	11113.4	13507.1	14691.0	15683.0	17547.0	.	.
FDI inflow, EUR mn	1763	964	1147	1294	1212	1946	4098	.	.
FDI outflow, EUR mn	-8	15	-14	-18	18	36	56	.	.
Exports of goods, BOP, EUR mn	7400	7977	11273	12722	14675	15614	18935	20800	22900
annual growth rate in %	-0.9	7.8	41.3	12.9	15.4	6.4	21.3	10	10
Imports of goods, BOP, EUR mn	9718	9164	13140	16045	17427	19569	24258	27200	30000
annual growth rate in %	5.4	-5.7	43.4	22.1	8.6	12.3	24.0	12	10
Exports of services, BOP, EUR mn	1089	1287	1910	2273	2468	2671	2903	3100	3300
annual growth rate in %	-19.3	18.2	48.4	19.0	8.6	8.2	8.7	7	6
Imports of services, BOP, EUR mn	1619	1657	2170	2402	2463	2609	3116	3400	3600
annual growth rate in %	-4.0	2.3	31.0	10.7	2.5	5.9	19.4	9	6
Average exchange rate ROL/USD	8875.6	15332.9	21692.7	29060.9	33055.5	33200.1	32636.6	.	.
Average exchange rate ROL/EUR (ECU)	9989.3	16295.6	19955.8	26026.9	31255.3	37555.9	40532.1	38000	38000
Purchasing power parity ROL/USD, wiiw	3067.8	4465.4	6316.4	8383.3	10141.4	11992.4	13586.8	.	.
Purchasing power parity ROL/EUR, wiiw	3534.8	5107.9	7156.5	9539.7	11455.9	13775.4	15297.8	.	.

Notes: 1) Preliminary. - 2) From 2002 break in methodology and according to census March 2002. - 3) According to ESA 95, excessive deficit procedure. - 4) From February 2002 reference rate of NB. - 5) Medium- and long-term.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

The two years preceding Romania's accession to the EU in 2007 will require costly structural reforms. The privatization of utility companies and banks will be carried on. Confidence has increased that the new government will fight corruption more efficiently than the previous one. The country will enjoy upgraded assistance from the European Commission to meet the accession criteria but in case of non-alignment, the date of accession may be postponed. A delay by one year may not be a tragedy and allow for adjustments in the unprepared part of the Romanian economy.

Hermine Vidovic

Croatia: stubborn external imbalances

During 2004 Croatia's growth lost momentum from quarter to quarter, and the GDP was finally up by less than 4% for the year as a whole. The deceleration went hand in hand with a slowdown of (public) investment growth, which in turn resulted in a remarkable slowdown of construction activities. On the other hand, the weakening of domestic demand could be partly offset by rising external demand. After a 5.4% increase in the first quarter of the year industrial production growth slowed down to 3.7% in 2004 as a whole. Within manufacturing, reporting slightly higher than average growth, the most favourable results were achieved in 'other transport equipment' (ships), machinery and equipment, chemicals and chemical products, manufacturing of wood and wood products and publishing and printing. Labour-intensive industries such as textiles and manufacturing of wearing apparel, but also office machinery, computers, television and communication equipment, suffered all severe output declines.

Foreign trade performed dynamically in 2004, with overall exports expanding by nearly 18% (based on customs statistics expressed in euro terms) whereas imports increased only moderately, by 6%. These developments resulted in a lowering of the foreign trade deficit. Exports to and imports from the EU reported below-average growth rates, while trade with the successors of Yugoslavia, particularly Bosnia and Herzegovina and Serbia and Montenegro, speeded up significantly. A breakdown by individual industrial segments shows a strong export expansion of ships and radio, television and communication equipment. The slowdown of import growth is partially attributed to the decline in car imports after years of strong increases. FDI data available for the first three quarters of 2004 indicate a considerable decline of inward FDI compared with a year earlier. The current account closed with an estimated EUR 1.7 billion deficit or more than 6% of the expected GDP.

Foreign debt continued to grow, but at a lower rate than in 2003. By the end of December 2004 it stood at EUR 22.2 billion (81% of the GDP) as against EUR 18.8 billion in December 2003. The increase resulted mainly from banks' and state borrowing, followed by other sectors (such as enterprises and the population). The banks' share in the foreign debt is, for the first time, the highest (33.7%), whereas the state accounts for 32.9% and enterprises for 25.9% of total foreign debt. Croatia's debt service burden is expected to increase significantly in the years to come. According to the most recent projections of the Croatian National Bank, in 2005 the debt service will amount to USD 4.5 billion, of which USD 3.6 billion in principal and USD 900 million in interest payments. The bulk will be due in the first and third quarters of the year.

Table HR

Croatia: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 [1)]	2005	2006
								forecast	
Population, th pers., mid-year [2)]	4501	4554	4437	4437	4443	4442	.	.	.
Gross domestic product, HRK mn, nom.	137604	141579	152519	165640	179390	193067	207300	218900	231200
annual change in % (real)	2.5	-0.9	2.9	4.4	5.2	4.3	3.7	3.5	3.5
GDP/capita (EUR at exchange rate)	4284	4102	4502	4998	5451	5747	6225	.	.
GDP/capita (EUR at PPP - wiiw)	7470	7450	8110	8640	9300	9720	10270	.	.
Gross industrial production [3)]									
annual change in % (real)	3.7	-1.4	1.7	6.0	5.4	4.1	3.7	3.5	3.5
Gross agricultural production									
annual change in % (real)	10.2	-3.5	-10.0	8.5	7.7	-15.9	.	.	.
Construction industry, hours worked [3)]									
annual change in % (real)	0.7	-7.7	-9.1	3.6	12.8	22.8	2.6 [I-XI]	.	.
Consumption of households, HRK mn, nom.	81067	81546	89637	98054	107427	113396	87455 [I-IX]	.	.
annual change in % (real)	-0.6	-2.9	4.2	4.5	7.6	4.1	3.9 [I-IX]	3	3
Gross fixed capital form., HRK mn, nom.	32066	33025	33281	36984	44114	53168	43701 [I-IX]	.	.
annual change in % (real)	2.5	-3.9	-3.8	7.1	12.0	16.8	5.5 [I-IX]	5	4
LFS - employed persons, th, avg.	1544	1492	1553	1469	1528	1537	1583 [I-VI]	.	.
annual change in %	-3.1	-3.4	4.1	-5.4	4.0	0.6	3.0 [I-VI]	.	.
Reg. employees in industry, th pers., avg.	308.9	299.5	291.9	287.2	281.0	282.6	276.6 [I-XI]	.	.
annual change in %	-3.4	-3.0	-2.5	-1.6	-2.2	0.6	-2.2 [I-XI]	.	.
LFS - unemployed, th pers., average	199.0	234.0	298.0	277.0	266.0	256.0	253	.	.
LFS - unemployment rate in %, average	11.4	13.6	16.1	15.9	14.8	14.3	13.8	13.5	13
Reg. unemployment rate in %, end of period	18.1	20.4	22.3	23.1	21.3	19.1	18.7	18	17.5
Average gross monthly wages, HRK	4131	4551	4869	5061	5366	5623	5971 [I-XI]	.	.
annual change in % (real, net)	6.0	10.1	3.4	1.6	3.1	3.8	3.8 [I-XI]	.	.
Consumer prices, % p.a. [4)]	5.7	4.2	6.2	4.9	1.7	1.8	2.1	2	2
Producer prices in industry, % p.a.	-1.2	2.6	9.7	3.6	-0.4	1.9	3.5	2	.
General governm.budget, IMF-def., % GDP									
Revenues	51.1	48.4	46.2	44.7	45.2	44.9	.	.	.
Expenditures	54.6	56.6	52.7	51.5	50.0	49.5	.	.	.
Deficit (-) / surplus (+), % GDP	-3.5	-8.2	-6.5	-6.8	-4.8	-6.3	.	-4	.
Public debt in % of GDP		.	51.1	51.6	51.6	52.7	53	54	55
Discount rate % p.a., end of period	5.9	7.9	5.9	5.9	4.5	4.5	4.5	.	.
Current account, EUR mn [5)]	-1295	-1311	-499	-809	-2066	-1853	-1700	-1600	-1600
Current account in % of GDP	-6.7	-7.0	-2.5	-3.6	-8.5	-7.3	-6.1	-5.6	-5.3
Gross reserves of NB excl. gold, EUR mn	2400.2	3012.6	3783.2	5333.6	5651.3	6554.1	6436.2	.	.
Gross external debt, EUR mn	8254.3	9937.2	11865.2	12827.6	14795.3	18841.5	22207.4	.	.
FDI inflow, EUR mn [5)]	831	1377	1181	1740	1193	1748	800 [6)]	.	.
FDI outflow, EUR mn [5)]	87	44	4	173	566	82	100 [6)]	.	.
Exports of goods, BOP, EUR mn [5)]	4084	4124	4951	5313	5312	5589	6600	7100	7500
annual growth rate in %	14.8	1.0	20.1	7.3	0.0	5.2	18.1	8	6
Imports of goods, BOP, EUR mn [5)]	7713	7219	8424	9892	11309	12596	13400	14100	14800
annual growth rate in %	-7.3	-6.4	16.7	17.4	14.3	11.4	6.4	5	5
Exports of services, BOP, EUR mn [5)]	3534	3494	4440	5444	5911	7639	7700	.	.
annual growth rate in %	-0.2	-1.1	27.1	22.6	8.6	29.2	0.8	.	.
Imports of services, BOP, EUR mn [5)]	1683	1969	1982	2175	2562	2640	3000	.	.
annual growth rate in %	-3.9	17.0	0.7	9.8	17.8	3.1	13.6	.	.
Average exchange rate HRK/USD	6.36	7.11	8.28	8.34	7.86	6.70	6.04	.	.
Average exchange rate HRK/EUR (ECU)	7.14	7.58	7.63	7.47	7.41	7.56	7.50	7.6	7.6
Purchasing power parity HRK/USD, wiiw	3.55	3.65	3.74	3.80	3.85	3.89	3.99	.	.
Purchasing power parity HRK/EUR, wiiw	4.09	4.18	4.24	4.32	4.34	4.47	4.49	.	.

Notes: 1) Preliminary. - 2) From 2000 according to census March 2001. - 3) Enterprises with more than 20 employees. - 4) Up to 2001 retail prices, % p.a. - 5) wiiw calculated from USD. – 6) wiiw estimate.

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

Reducing the fiscal deficit has been one of the primary tasks of the old and new Croatian governments. In 2003 alone the deficit of the consolidated general government amounted to 6.3% of GDP. The target rate for 2004 was set at 4.5%, but it is more than questionable whether this goal could be achieved. In accordance with the targets agreed upon with the IMF in August last year, the Croatian parliament passed the 2005 budget bill in November 2004. The budget is aiming at a further reduction of the consolidated general government deficit to 3.7% in 2005; in the following two years the deficit is envisaged to fall to 3.3% (2006) and finally to 2.9% of the GDP (2007). The 2005 budget is based on a projected 2.5% inflation rate and 4.4% GDP growth; the latter is quite optimistic compared to available forecasts (from various research institutes and the EU) that range from 3.5% to 4%.

Depending on the respective data source, labour market developments show a diverging picture. According to registration data, employment remained stagnant in 2004, while unemployment fell below 19%. A decrease in unemployment (below 14%) is also confirmed by labour force survey data for the first half of the year. The same data set points to a 3% increase in employment as compared to the first half of 2003. Data obtained from the Croatian Pension Insurance Institute (CPII) also indicate a (less pronounced) rise in employment, based on the number of insured persons.

EU membership negotiations are scheduled to start on 17 March – provided that the country continues to cooperate with the International Criminal Tribunal for the Former Yugoslavia (ICTY) in particular concerning the fugitive general A. Gotovina. Only recently has EU Enlargement Commissioner Olli Rehn put additional pressure on Croatia to give up the general, by stating that otherwise he could not recommend the start of accession negotiations.

Contrary to earlier announcements by Croatian officials that the country may join the EU already in 2007, the current wording is that Croatia aims to conclude accession talks by that date. The president of the European Commission stated recently that he 'hopes Croatia will become an EU member in November 2009'. Accession talks with Croatia will be conducted in the framework of 35 chapters (not 31 as during the previous enlargement round) as some policy areas will be split. The Stabilization and Association Agreement (SAA) signed between the EU and Croatia in 2001 came into force on 1 February 2005. Croatia's first pre-accession programme was adopted by the government by the end of November, focusing *inter alia* on reforms of public financing (reduction of the fiscal deficit, improvement of fiscal transparency etc.) and on structural reforms, relating to privatization, agricultural policy or the social security and health care systems.

On 16 January 2005 Croatia's incumbent president Stipe Mesić was re-elected for a new five-year mandate; in the second round of the elections he won 66% of the vote against 34% for his competitor Jadranka Kosor from the ruling Croatian Democratic Union (HDZ).

Assuming a further decline in domestic demand due to the cuts in public investments, wiiw expects a slowdown of Croatia's GDP growth to some 3.5% in both 2005 and 2006. Thus, the situation on the labour market will not change significantly: employment will grow only moderately or even stagnate, whereas the number of unemployed will decrease only slightly. Despite some rise in inflation in 2004, the National Bank will adhere to its policy of stable prices and exchange rates. The current account deficits will remain at high levels and diminish only slightly over the next two years.

Vladimir Gligorov

Macedonia: from stability to growth

Growth returned to Macedonia in the second half of 2004. Industrial production recovered somewhat in the last months of the year, though not enough to overcome the deep recession experienced during much of 2004. GDP was reported to have grown by more than 2%, though that implies quite high growth in the last quarter of 2004 as growth was negative in the first three quarters. These uncertainties about the developments in the real sector cannot be resolved satisfactorily at this time.

Foreign trade increased in 2004, and the trade and current account deficits widened. That also suggests that the economy did expand somewhat last year. Also, foreign direct investments came in at about EUR 100 million, which is not too low by historical standards. It is certainly lower than the country would need and the expectations are that there will be much more FDI this year and the next.

Last year's foreign trade figures show an increase in imports from Serbia. The recent change in the Serbian exchange rate policy, from a fixed peg to an unannounced crawling peg, may prove to be a problem for Macedonia, which is on a very hard peg with the euro. The free trade agreement between the two countries translated every depreciation in Serbia into a competitive disadvantage in Macedonia. As wages are already significantly higher in Macedonia than in Serbia, the pressure on the trade account may prove to be significant.

Employment in industry continued to decline, which is not surprising given the sharp drop in industrial production in 2004. Indeed, productivity in industry was negative because the loss of employment was much smaller than the decline of production. Unemployment, however, remained at approximately the same level, at around 37%. Even if industrial production continues to grow, which can be expected, it will take quite some time for this level of unemployment to start to go down decisively. In the meantime, public employment cannot grow; in fact it can be expected to decrease because of the planned reforms and restructurings in the public sector.

Probably the main disturbing element is the fiscal policy. A major fiscal adjustment has been underway in the past few years and the fiscal deficit was brought down to below 2% of GDP at the end of 2004 (from around 6% in 2002). Most of this fiscal adjustment took place in 2003 and that partly explains the recession in the first half of 2004. Fiscal austerity was deemed necessary in order to support the stability of the exchange rate and to maintain the very low inflation rate. In the first half of 2004 there was deflation again; inflation for the whole year was below 1%.

This fiscal adjustment was supported by a restrictive monetary policy. The spread between the lending and the borrowing rates are traditionally quite high. The central bank did not hesitate to increase the interest rates additionally at the end of 2004 fearing that the foreign exchange market could be destabilized. Central bank reserves declined and, though they are at a level sufficient to sustain possible shocks in the foreign exchange market, the central bank is fearful of an exchange rate crisis. Thus, the economy was treated to fiscal austerity and monetary tightening exactly when it was in recession.

Table MK

Macedonia: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 [1)]	2005	2006
								forecast	
Population, th pers., mid-year	2007.5	2017.1	2026.4	2034.9	2020.2	2027.0	.	.	.
Gross domestic product, MKD mn, nom.	194979	209010	236389	233841	243970	253454	260800	276700	288000
annual change in % (real)	3.4	4.3	4.5	-4.5	0.9	3.4	2	4	4
GDP/capita (EUR at exchange rate)	1590	1709	1921	1887	1981	2041	2095	.	.
GDP/capita (EUR at PPP – wiiw)	4550	4830	5170	5000	5210	5400	5620	.	.
Gross industrial production									
annual change in % (real) [2)]	4.5	-2.6	3.0	-3.1	-5.3	4.7	-12.7	3	5
Gross agricultural production									
annual change in % (real)	4.3	1.0	1.0	-10.2	-2.3	1.8	.	.	.
Construction output, value added									
annual change in % (real)	7.7	10.4	-1.1	-14.4	0.6	4.1	.	.	.
Consumption of households, MKD mn, nom.	141078	145693	175965	163788	188179	.	.	.	.
annual change in % (real)	3.3	3.6	11.2	-11.7	12.5	.	.	.	.
Gross fixed capital form., MKD mn, nom.	33982	34710	38332	34716	40448	42110	.	.	.
annual change in % (real)	-2.6	-1.4	-1.5	-8.6	17.6	.	.	.	.
LFS – employed persons, th. avg.	539.8	545.2	549.8	599.3	561.3	545.1	.	.	.
annual change in %	5.4	1.0	0.8	9.0	-6.3	-2.9	.	.	.
Reg. employees in industry, th pers., avg. [3)]	113.6	119.8	114.4	122.5	110.9	106.7	101.8 I-X	.	.
annual change in % [3)]	-3.4	5.5	-4.5	-4.8	-9.5	-3.8	-5.6 I-X	.	.
LFS – unemployed, th pers., average	284.1	261.5	261.7	263.2	263.5	315.9	.	.	.
LFS – unemployment rate in %, average	34.5	32.4	32.2	30.5	31.9	36.7	37	35	35
Reg. unemployment rate in %, end of period	.	.	.	.	.	.		.	.
Average net monthly wages, MKD	9394	9664	10193	10552	11279	11824	12272 I-XI	.	.
annual change in % (real, net)	3.8	3.6	-0.3	-1.9	5.0	3.6	4.2 I-XI	.	.
Retail prices, % p.a.	0.8	-1.1	10.6	5.2	1.4	2.4	0.9	2	2
Producer prices in industry, % p.a.	4.0	-0.1	10.7	2.0	-0.9	-0.3	0.9	2	3
Central governm. budget, nat.def., % GDP									
Revenues	21.9	24.2	26.7	22.6	23.8	21.3	.	.	.
Expenditures	21.9	23.8	24.4	28.0	26.8	22.3	.	.	.
Deficit (-) / surplus (+), % GDP	0.0	0.3	2.3	-5.5	-3.0	-1.0	.	.	.
Public debt in % of GDP		.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	8.9	8.9	7.9	10.7	10.7	6.5	6.5	.	.
Current account, EUR mn [4) 5)]	-240.5	-30.4	-78.5	-272.1	-379.9	-135.0	-300	-300	-300
Current account in % of GDP	-7.5	-0.9	-2.0	-7.1	-9.5	-3.3	-7.1	-7	-6
Gross reserves of NB, excl. gold, EUR mn [5)]	260.5	428.0	461.5	845.5	692.8	786.9	646.1 XI	.	.
Gross external debt, EUR mn [5) 6)]	1190.3	1431.9	1545.2	1638.3	1486.3	1417.0	1439.0	.	.
FDI inflow, EUR mn [5)]	113.9	30.7	189.4	493.2	82.6	83.8	100 [7)]	.	.
FDI outflow, EUR mn [5)]	0.0	0.3	-0.7	1.0	0.1	0.3	0 [7)]	.	.
Exports of goods, BOP, EUR mn [5)]	1152	1117	1433	1291	1181	1205	1350	1400	1400
annual growth rate in %	5.0	-3.0	28.3	-9.9	-8.5	2.0	12.1	4	0
Imports of goods, BOP, EUR mn [5)]	1611	1582	2182	1879	2035	1959	2338	2400	2450
annual growth rate in %	11.9	-1.8	37.9	-13.9	8.3	-3.7	19.3	3	2
Exports of services, BOP, EUR mn [5)]	133	256	344	273	269	289	305	.	.
annual growth rate in %	8.7	92.4	34.2	-20.5	-1.5	7.4	5.6	.	.
Imports of services, BOP, EUR mn [5)]	186	217	291	295	292	291	347	.	.
annual growth rate in %	-23.8	16.3	34.1	1.3	-0.9	-0.3	19.0	.	.
Average exchange rate MKD/USD	54.45	56.90	65.89	68.04	64.74	54.30	49.41	.	.
Average exchange rate MKD/EUR (ECU)	61.07	60.62	60.73	60.91	60.98	61.26	61.34	62	62
Purchasing power parity MKD/USD, wiiw	18.07	18.32	19.40	19.63	20.00	19.76	19.55	.	.
Purchasing power parity MKD/EUR, wiiw	21.36	21.46	22.57	22.97	23.18	23.15	22.88	.	.

Notes: 1) Preliminary. - 2) Excluding small enterprises. - 3) From 2001 according to NACE. - 4) Including grants. - 5) Converted from USD to EUR. - 6) Medium- and long-term. – 7) wiiw estimate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

The fiscal austerity over the years has led to Macedonia having a smaller state than most other transition economies. Its public expenditures are now well below 40% of GDP, which is low for a transition country of that size. The savings have been mostly on investments, but public services have suffered too. The social and political implications have been considerable, including a close encounter with a violent conflict that just stopped short of growing into a fully fledged civil war.

In 2004 Macedonia applied for membership in the EU. The EU has started the process of assessment of the application and will probably come up with an opinion by the end of this year. It is expected that the opinion will be positive, though conditions will be attached that will have to be fulfilled in order for negotiations to start. That may happen already in 2006 or at the beginning of 2007 at the latest.

A positive attitude of the EU towards Macedonia is crucial for the country to sustain its political and economic stability. A number of outstanding issues in the region, especially that of the political status of Kosovo, will have to be resolved in the next couple of years, and that may influence developments in Macedonia as well. Even if there were no other ones, It would be for that reason alone that a positive and engaged approach on the part of the EU would be crucial.

Vladimir Gligorov

Serbia and Montenegro: growing apart

It is increasingly difficult to discuss the state union of Serbia and Montenegro as if it were one country. Montenegro uses the euro, has its own foreign trade regime, is fiscally sovereign, and the same is true for Serbia. This fact has now been recognized by the European Union, which has decided to apply a two-track approach to the integration of Serbia and Montenegro with the EU. Also, the WTO has decided to accept separate applications from Serbia and Montenegro, so that they will be members of that international organizations as two separate economic areas.

It is awkward to talk about Serbia and Montenegro as one country also because the statistics are not really integrated. The federal statistical office attempts to put the figures together, but those are increasingly less than reliable. The IMF also tries to integrate the balance of payments of the state union and also its general government budget, but that is increasingly irrelevant because the policy assessments and recommendations are important for the states rather than for the union. In this brief comment, Serbia and Montenegro will be discussed separately and the attached table will only contain data for Serbia. In future publications an additional table on Montenegro will appear.[22]

Serbia ended the year with a reported growth rate of GDP of around 7%. The main contributions came from a recovery of both industrial and agricultural production. In the year before, agriculture had suffered a large drop, so last year, due to excellent weather conditions also, agricultural production grew by more than 20%. Industrial production recovered too, growing by about 7%. Overall, this was the first post-transition year in which production rebounded sharply.

[22] The difference between data for Serbia and for Serbia and Montenegro is quite small because Montenegro contributes around 7% to the latter. For that reason also it will be useful to have separate data for Montenegro.

Table Serbia

Serbia: Selected Economic Indicators *)

	2000	2001	2002	2003	2004 1)	2005	2006
						forecast	
Population, th pers., mid-year 2)	7747	7727	7504	7500	7500	.	.
Gross domestic product, CSD mn, nom.	355168	708100	919200	1088800	1298000	1499000	1731000
annual change in % (real)	.	5.5	4.0	3.0	7	5	5
GDP/capita (EUR at exchange rate) 3)	872	1542	2015	2225	2370	.	.
GDP/capita (EUR at PPP - wiiw)	4190	4510	4950	5130	5600		
Gross industrial production 4)							
annual change in % (real)	11	0.1	1.7	-3	7.1	5	5
Gross agricultural production							
annual change in % (real)	-14	18.1	-2.5	-5.7	.	.	.
Construction, hours of work actually done							
annual change in %	.	-13.8	-7.4	10.9	.	.	.
Gross fixed investment, CSD mn, nom.	50047.3	66764.6	.	.	.	.	.
annual change in % (real)	13.3	-4.1	.	.	.	.	.
LFS - employed persons, th, Oct.	3093.7	3105.6	3000.2	.	.	.	.
annual change in %	.	0.4	-3.4	.	.	.	.
Reg. employees in industry, th pers., avg.	.	705	648	605	561 I-XI	.	.
annual change in %	.	.	-8.1	-6.6	-7.4 I-XI	.	.
LFS - unemployed, th pers., average	425.6	432.7	459.6	.	.	.	.
LFS - unemployment rate in %, average	12.1	12.2	13.3	15.2	15	15	15
Reg. unemployment rate in %,end of period 5)	.	.	30.5	31.9	32.1 XI	32	32
Average net monthly wages, CSD 6)	2389	5375	9208	11500	13820 I-XI	.	.
annual change in % (real, net)	6.0	16.5	29.9	13.6	11.5 I-XI	.	.
Consumer prices, % p.a.	79.6	93.3	16.6	9.9	11.4	10	10
Producer prices in industry, % p.a.	102.6	87.7	8.8	4.6	9.1	10	10
General governm. budget, nat.def., % GDP							
Revenues	.	.	.	.	.	.	.
Expenditures	.	.	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	.	.	.	.	.	.	.
Public debt in % of GDP	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	26.3	16.4	9.5	9.0	8.5	.	.
Current account, EUR mn 7)	.	.	-1514	-1697	-2400	-2500	-2500
Current account in % of GDP	.	.	-10.0	-10.2	-13.5	-15.0	-14.4
Gross reserves of NB, excl. gold, EUR mn	.	1138.6	2076.8	2728.2	3008.0	.	.
Gross external debt, EUR mn	11659	12609	10768	10858	10217 XI	.	.
FDI net, EUR mn 7)	.	.	502	1197	629 I-XI		
Exports of goods, BOP, EUR mn 7)	.	.	2191	2180	2660	2900	3200
annual growth rate in %	.	.	.	-0.5	22	10	10
Imports of goods, BOP, EUR mn 7)	.	.	5928	6446	8750	9600	10600
annual growth rate in %	.	.	.	8.7	36	10	10
Exports of services, BOP, EUR mn 7)	.	.	886	886	1048 I-XI	.	.
annual growth rate in %	.	.	.	0.0	33.0 I-XI	.	.
Imports of services, BOP, EUR mn 7)	.	.	604	632	781 I-XI	.	.
annual growth rate in %	.	.	.	4.6	42.0 I-XI	.	.
Average exchange rate CSD/USD	16.69	66.84	64.19	57.44	58.59	.	.
Average exchange rate CSD/EUR (ECU)	15.30	59.44	60.79	65.26	73.00	90	100
Purchasing power parity CSD/USD, wiiw	9.7	17.9	21.9	24.6	26.9	.	.
Purchasing power parity CSD/EUR, wiiw	11.0	20.3	24.8	28.3	30.9	.	.

**) Note:* Excluding Kosovo and Metohia.

1) Preliminary. - 2) From 2002 according to census data. Year 2003 and 2004 wiiw estimates. - 3) In 2000 wiiw estimate with black market rate. - 4) Excluding private enterprises. - 5) In % of unemployed plus employment. - 6) From 2002 including various allowances. - 7) Converted from USD.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Recorded employment rose slightly as well, though it is not clear what has actually happened on the labour market. The differences between the registered and the LFS employment and unemployment rates are such that it is hard to say anything decisive about labour market developments. It is, however, possible that the growth of unemployment has been interrupted by the new private sector posting very fast growth while the public sector (state- and socially owned, which in Serbia contributes as much as 60% of GDP) did not decline further. If that is true, then the delayed transition in the public sector and the post-transition growth in the private sector may have led to the stop in the growth of unemployment and have resulted in the growth of employment. This process however is expected to change this year as well as in the next couple of years because of the government's intention to restructure the public sector. The private sector may not grow fast enough to compensate for the loss in public employment.

Four other main developments have characterized 2004 and will have significant impacts on the next few years.

The first is the fiscal uncertainty. The initial expansionary budget was substituted by a more austere one in the second half of 2004. This fiscal uncertainty contributed to the variability in the growth rates and in inflation over the year. Second, inflationary expectations were created by rather non-transparent fiscal and monetary policies and the year ended on the note of rather significant acceleration of inflation. After steadily increasing over the year, the monthly inflation rate reached 2.7% in December 2004 and January 2005. Third, imports outpaced exports and only about a third of the former were covered by the later. The current account deficit came in at a record level, which raised the issue of the sustainability of foreign debt once more (the debt was just rescheduled last year). Fourth, privatization was slowed down and overall foreign direct investments fell short of what was expected in 2004.

At the beginning of 2005, there is considerable uncertainty about the future direction of economic policy. Foreign investments will increase, because privatization has been resumed. On 1 January, the VAT was introduced. That may have been responsible for some of the pick-up in inflation. Though it is expected that the fiscal deficit will not present the same problems as last year, further fiscal expansion is quite possible given that the government is not very popular and has to buy the support of the public. Unlike last year, when it was clear that the central bank would let the dinar depreciate in an orderly manner, this year it is not evident what the monetary policy will be. Already some tightening of the reserve requirements has been implemented, but there is pressure from the government to go back to a fixed exchange rate in order to bring inflation down. Finally, it has been suggested to keep wages in the public sector under strict control, but that has proved to be difficult in the past.

With all that uncertainty, it can still be expected that the Serbian economy will continue to grow in the medium term. The risk is that reducing the trade deficit will require a sharp reduction in consumption, and that may sap growth. Another risk is the need to fix the exchange rate again in order to control inflation, and that would require an even more austere fiscal and monetary policy in order to keep the external balance under some kind of control. Still, the most likely scenario is that privatization will be speeded up so that the financing of the deficit will not present a problem and a somewhat higher inflation rate will be tolerated in order to support growth. Beyond the medium term, this policy may lead to a sharp adjustment in the external balances.

In Montenegro, 2004 was also a relatively good year. Inflation was kept under control and fiscal adjustment was implemented without too many problems. After some time, both GDP and industrial production posted solid growths. Services expanded as well, in particular tourism. Last year there was also more foreign investment than in the previous years. Similar developments can be expected in the medium term.

The EU should come out with a feasibility study for Serbia's and Montenegro's Stabilization and Association Agreement at the beginning of spring of 2005. If it were positive – and that very much depends on Serbia's cooperation with the ICTY in the Hague – then negotiations could start with the intention to have the Agreement in place by the beginning of 2007 at the latest. This development may also be influenced by the intensified discussion on the independence of Kosovo. Even without that, early elections are possible, which may postpone some of the political processes and also introduce changes in the economic policy.

Josef Pöschl

Bosnia and Herzegovina: politics still hamper economic development

At present, the political atmosphere is chilly in Bosnia and Herzegovina (BiH). The leaders of Republika Srpska consider the entity's far-reaching autonomy endangered: Representatives of the international community, including the current High Representative Paddy Ashdown, want more power to be given to the central government. From time to time this causes annoyance. The idea of building up a country-wide police, army, tax authority, social security administration, electricity grid management, telecommunications system or even statistical office and putting such bodies under one central command has always provoked fierce opposition, in an open or hidden way. Though not all citizens are opposed to the implementation or strengthening of central institutions, they could not achieve or sustain a majority in the various parliaments of the country. Among the successes one can list the creation of a central bank for the whole country immediately after the war, as foreseen in the Dayton agreement, and, a few years later, the introduction of the convertible mark (BAM) as the countrywide legal tender. Another encouraging step was a single Indirect Tax Authority (ITA), which started its work in January 2005 as a preparatory step for the introduction of a countrywide value-added tax system. The ITA has started collecting indirect taxes – which are not yet value-added taxes – and distributes revenues to BiH institutions. After meeting claims of institutions at the state level, the residual goes to the Federation (65.7%), the Republika Srpska (30.5%) and the Brčko District (3.8%). The new system, to be completed by the VAT introduction on 1 September 2005 or 1 January 2006, will make it much easier for BiH manufacturers to sell their products countrywide. Slowly, BiH is thus becoming a uniform economic space, something which has been torpedoed for a decade.

Difficulties with more cohesion are not only (hu)man-made. The Neretva valley, with Mostar as its urban centre and Neum as its costal area, opens towards the Adriatic Sea and has an economic focus differing from the rest of the country. Three regional centres to the north, Bihać, Banja Luka and Tuzla are, from an infrastructure point of view, linked to the plain adjacent to the Sava river, where the Balkans' most important traffic lines, the motor- and railway between Belgrade and Zagreb, are located, both of them directly linked to the EU. From these three centres, driving a car or truck south to Sarajevo or Mostar requires more time and effort than going to, say, Zagreb. Post-war Sarajevo's economic basis has been its function as a capital where all representatives of the international community and of some transnational companies settled and opened their offices. They have hardly enough time to visit the more remote parts of the country, including even Banja Luka. A motorway, under construction now, will link Banja Luka to Croatia's motorway, not to Sarajevo. The precondition for more cohesion within BiH would be the modernization of traffic lines between the country's regional centres, something that would require considerable investment.

A major problem with present structures is that the constitution, which has evolved from the Washington (March 1994) and the Dayton (December 1995) Agreements, foresees an amount of state institutions that would hardly be affordable even for a rich country. They employ a large number of persons and the public institutions' aggregate wage bill, together with social security expenditures, absorb most of the funds the state authorities are able to collect or to get transferred. The social security system pays small average amounts to a large number of persons: pensioners, disabled persons and unemployed. Public institutions are the country's most important employer, but are lacking efficiency. As the number of institutions is larger than the number of tasks to be fulfilled, an overlapping of competences is frequent, and their activities are often based on incompatible rules.

Several large companies had dominated the pre-war economy. They were integrated in larger production chains, and some of them had expanded their activities worldwide. After 1995, the necessary preconditions for their recovery were lacking and they continued as walking dead. A few of them did better than the rest, such as the aluminium producer in Mostar, now a company with private owners. Recently hope for a recovery and massive expansion of the steel factory in Zenica has spread thanks to the involvement of a global player, LNM, as direct investor. Logistics will require an upgrading of transport ways, as large amounts of input will have to be imported and most of the output will have to be shipped abroad. This very large project is likely to stimulate a wider range of business activities and further foreign investment. A number of other foreign companies, most of them from the wider neighbourhood, have recently signalled interest in the purchase of a majority share in the petrol distributor Energopetrol.

In several sectors of the economy, a large number of small and medium-size enterprises are active. Metallurgy, including the production of car components, has been a traditional stronghold of the BiH economy, and a lot of activity is going on in this field. The same is true for wood processing, textiles and clothing, food production and construction. In all these sectors, foreign direct investors are present to some extent. FDI stocks totalled, thanks to an inflow of close to EUR 0.4 billion in 2004, EUR 1.4 billion at the end of the year, most of it concentrated in metallurgy and banking.

The fixed exchange rate – approximately 2 BAM per EUR in the context of a currency board arrangement – has proved very helpful. It allowed to overcome the population's initial deep distrust with the banking sector, and inflation, measured by the retail price index, is stable. However, the average gross monthly wage rate is relatively high: it was more than EUR 380 in 2004, and thus higher than in Bulgaria (EUR 149), Romania (EUR 204) and even Slovakia (EUR 377). The overall price level is probably not much lower than in Slovakia and thus much above Bulgarian and Romanian levels. In other words, being competitive is difficult for BiH producers of tradable goods. Statistics indicate that exports cover only about one third of imports, and there is no sign that in the

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 [1]	2005 forecast	2006 forecast
Population, th pers., mid-year	3654.0	3725.0	3781.0	3798.0	3828.0	3832.0	.	.	.
Gross domestic product, BAM mn, nom.	7559	8990	10050	10960	11650	12255	13000	13700	14400
annual change in % (real)	15.6	10.0	5.5	4.5	5.5	3.5	6	5	5
GDP/capita (EUR at exchange rate)	1049	1234	1359	1475	1556	1635	1730	.	.
GDP including NOE, BAM mn, nom. [2]	.	12802	14160	15410	16170	16887	17900	.	.
GDP/capita, incl. NOE (EUR at PPP - wiiw)	.	4660	4940	5230	5520	5670	6090	.	.
Gross industrial production									
annual change in % (real) [3]	23.6	8.0	7.9	4.9	5.7	5.1	12	10	10
Employees total, th pers., end of period	651.3	630.9	640.6	625.6	637.7	634.0	.	.	.
annual change in %	.	-3.1	1.5	-2.3	1.9	-0.6	.	.	.
Reg. unemployed, th pers., end of period	398.5	409.3	421.2	422.2	441.9	459.6	.	.	.
Reg. unemployment rate in %, end of period	38.0	39.3	39.7	40.3	40.9	42.0	42	42	42
Average gross monthly wages, BAM	454	503	541	652	661	716	747 I-IX	.	.
annual change in % (real, net) [4]	.	9.7	4.0	14.8	-0.6	7.3	.	.	.
Retail prices, % p.a.	13.3	3.7	4.8	3.1	0.4	0.6	0.2 I-IX	0.5	0.5
General government budget, in % of GDP									
Revenues	.	57.7	53.8	49.7	44.1	43.3	.	.	.
Expenditures	.	65.5	60.7	53.1	44.2	42.6	.	.	.
Deficit (-) / surplus (+), % GDP	.	-7.8	-7.0	-3.3	-0.2	0.8	.	.	.
Public debt in % of GDP	.	.	58.8	48.2	42.2	34.0	.	.	.
Current account, EUR mn	-644.6	-966.3	-1050.0	-1273.3	-1695.3	-1895.3	-1838.0	-1700	-1600
Current account in % of GDP	-16.8	-21.0	-20.4	-22.7	-28.5	-30.2	-27.7	-24.3	-21.7
Gross reserves of CB excl. gold, EUR mn [5]	144.7	442.6	522.2	1378.7	1260.0	1421.7	1743.5 IX	.	.
Gross external debt, EUR mn [5][6]	.	1914.7	2073.6	2260.6	2193.8	2054.2	2083.6 IX	.	.
FDI net inflow, EUR mn	59.6	165.9	158.6	132.8	281.8	337.6	400 [7]	.	.
Exports of goods, BOP, EUR mn [5]	592.4	780.7	1226.3	1268.1	1168.5	1303.0	1629.0	2000	2400
annual growth rate in %	.	31.8	57.1	3.4	-7.9	11.5	25.0	23	20
Imports of goods, BOP, EUR mn [5]	3372.5	3875.3	4226.7	4576.4	4692.2	4974.1	5284.6	5600	5900
annual growth rate in %	.	14.9	9.1	8.3	2.5	6.0	6.2	6	5
Exports of services, BOP, EUR mn [5]	394.9	416.9	462.6	528.4	528.8	588.4	685.2	.	.
annual growth rate in %	.	5.6	11.0	14.2	0.1	11.3	16.5	.	.
Imports of services, BOP, EUR mn [5]	246.3	272.6	307.5	318.5	339.5	366.5	379.7	.	.
annual growth rate in %	.	10.7	12.8	3.6	6.6	8.0	3.6	.	.
Average exchange rate BAM/USD	1.761	1.834	2.119	2.186	2.077	1.734	1.575	.	.
Average exchange rate BAM/EUR (ECU)	1.972	1.956	1.956	1.956	1.956	1.956	1.956	1.96	1.96
Purchasing power parity BAM/USD, wiiw [8]	.	0.646	0.669	0.682	0.677	0.677	0.664	.	.
Purchasing power parity BAM/EUR, wiiw [8]	.	0.738	0.758	0.776	0.765	0.777	0.763	.	.

Notes: BAM: ISO code for the convertible mark in Bosnia and Herzegovina. - 1) Preliminary. - 2) GDP figures including the Non-Observed Economy (NOE) are based on IMF estimates. - 3) wiiw estimates based on weighted averages for the two entities (Federation BH and Republika Srpska). - 4) wiiw calculation. - 5) Converted from the national currency to EUR at the official exchange rate. - 6) General government foreign debt. - 7) wiiw estimate. - 8) Rough estimates based on World Bank and wiiw; price level presumably higher.

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

nearer future this ratio will increase substantially. It would, however, not be justified to blame the wage level alone for this fact. The EU has granted favourable conditions for imports from BiH, but enterprises are not in a position to make much use of it. One of the reasons for that is the lack of a state agency that after its accreditation by the EU would make sure that exports meet EU standards. In its feasibility study from November 2003 the European Commission listed a number of improvements to be achieved before negotiations on a Stabilization and Association Agreement (SAA) can start. Progress is slow despite popular support for quick and comprehensive EU integration.

Another crucial barrier for more international competitiveness of BiH enterprises is the lack of funds to be invested in new equipment and sometimes even production material. The profits earned by BiH manufacturers are not sufficient to finance larger investment projects, and long-term credits, as required for the purchase of new equipment, are costly if accessible at all. Commercial banks are hesitant to grant such loans, not matter that they have collected a relatively large amount of deposits, which they prefer to lend to households or invest abroad. Only with fair bankruptcy procedures becoming the rule and with well-functioning real estate markets might banks start regarding loans to the manufacturing sector as a business with bearable risk.

During the next few years, the GDP will continue to grow by some 5% p.a. Industrial production will go on rising at a higher rate, fuelled by rather strong export growth. Over time, export-oriented enterprises may gain strength also in terms of political influence. Overcoming obsolete institutional and political structures will then become much easier. Inflation is likely to re-emerge temporarily in the context of the VAT introduction. Unemployment can be assumed to remain stable, disregarding the fact that nobody knows its genuine extent since reliable measurement practices are so far non-existent.

Mario Holzner

Albania: SAA 2005? EU 2014?

In 2004 Albania remained on the previous year's high average growth path of 6%. At the same time the country has recorded low inflation and falling unemployment rates. Still, with a real GDP per capita at PPP significantly below EUR 5000, it is one of the poorest countries in Europe, pressing for EU integration and longing for better living conditions.

Recently, at a visit to France, Albanian Prime Minister Fatos Nano expressed his hope that the country will be able to conclude the Stabilization and Association Agreement (SAA) with the EU in 2005 and targeted the year 2014 as the desired date for full EU membership. However, EU Enlargement Commissioner Olli Rehn has dampened the optimism by indicating that, although the SAA negotiations with Albania are continuing, progress will depend on the parliamentary elections (due before July 2005) and the pace of reforms. He also emphasized his concern about the political climate in Albania being currently not conducive to reform.

Table AL

Albania: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 1)	2005	2006
								forecast	
Population, th pers., end of period 2)	3373.4	3401.2	3418.1	3112.4	3145.4	3190	.	.	.
Gross domestic product, ALL mn, nom.	412326	474291	530906	610426	677684	744974	835448	940000	1050000
annual change in % (real)	12.7	10.1	7.3	7.6	4.7	6.0	6.0	6.5	6.5
GDP/capita (EUR at exchange rate)	726	953	1174	1539	1636	1710	2046	.	.
GDP/capita (EUR at PPP - wiiw)	2380	2790	3180	3860	4080	4270	4570	.	.
Gross industrial production									
annual change in % (real) 3)	26.1	34.2	0.5	7.1	1.8	2.7	3.1	4	5
Gross agricultural production									
annual change in % (real) 3)	4.8	0.4	4.5	2.2	2.1	3.0	3.0	3.5	3.5
Construction output total									
annual change in % (real) 3)	18.0	17.8	37.2	49.3	8.7	11.3	10.6	11	10
Consumption of households, ALL mn, nom.	346775	334801	350038	359016	363864	.	.	.	.
Consumption of households, in % of GDP	84.1	70.6	65.9	58.8	53.7	.	.	.	.
Gross fixed capital form., ALL mn, nom.	58184	81633	112958	151327	145920	.	.	.	.
Gross fixed capital form., in % of GDP	14.1	17.2	21.3	24.8	21.5	.	.	.	.
Employment total, th pers., end of period	1085.1	1065.1	1068.2	920.6	920.1	926.2	924.5	.	.
annual change in %	-2.0	-1.8	0.3	-13.8	0.0	0.7	-0.2	.	.
Reg. unemployed, th pers., end of period	235.0	240.0	215.0	181.0	172.0	164.0	155.5	.	.
Reg. unemployment rate in %, end of period	17.8	18.2	16.8	16.4	15.8	15.0	14.4	14	13.5
Average gross monthly wages, ALL 4)	11509	12708	14963	17218	19659	21325	24000	.	.
annual change in % (real, gross) 4)	-0.2	9.9	17.7	11.6	8.1	6.0	9.4	.	.
Consumer prices, % p.a.	20.9	0.4	0.1	3.1	5.2	2.3	2.9	4	3
Producer prices in manufacturing industry, % p.a.	.	2.8	6.5	-7.2	5.1	1.8	.	.	.
Consolidated budget, nat.def., % GDP									
Revenues	24.9	26.0	24.6	23.9	22.8	22.4	22.3	.	.
Expenditures	34.3	34.9	32.1	30.5	28.4	27.0	27.5	.	.
Deficit (-) / surplus (+), % GDP	-9.5	-9.0	-7.5	-6.9	-6.0	-4.6	-5.2	-7	-5
Public debt in % of GDP	35.1	36.3	41.0	39.4	38.5	37.7	.	.	.
Interest rate, % p.a., end of year 5)	16.6	9.5	6.9	6.9	8.0	5.5	4.7	.	.
Current account, EUR mn 6)	-58.0	-124.5	-176.8	-243.3	-445.6	-360.4	-279.0	-450	-420
Current account in % of GDP	-2.4	-3.9	-4.4	-5.1	-8.7	-6.7	-4.3	-6	-5
Gross reserves of BoA incl. gold, EUR mn 6)7)	385.5	518.2	691.5	863.5	813.0	812.7	991.5 XI	.	.
Gross external debt, EUR mn 6)	604.0	1103.0	1262.0	1356.0	1124.0	1117.0	.	.	.
FDI net inflow, EUR mn 6)	40	39	155	232	143	158	400 8)	.	.
Exports of goods, BOP, EUR mn 6)	185.7	257.7	276.8	340.2	349.6	396.3	490.0	550	600
annual growth rate in %	32.7	38.8	7.4	22.9	2.8	13.4	23.6	12	9
Imports of goods, BOP, EUR mn 6)	724.7	878.7	1166.8	1487.1	1572.8	1580.5	1704.0	1950	2020
annual growth rate in %	18.5	21.3	32.8	27.5	5.8	0.5	7.8	14	4
Exports of services, BOP, EUR mn 6)	77.3	249.8	485.7	595.9	619.4	637.8	766.0	850	950
annual growth rate in %	29.3	223.2	94.4	22.7	3.9	3.0	20.1	11	12
Imports of services, BOP, EUR mn 6)	119.3	155.0	466.1	496.1	625.0	711.1	762.0	900	950
annual growth rate in %	33.6	29.9	200.7	6.4	26.0	13.8	7.2	18	6
Average exchange rate ALL/USD	150.6	137.7	143.7	143.5	140.2	121.9	102.8	.	.
Average exchange rate ALL/EUR (ECU)	168.7	147.0	132.6	128.5	132.4	137.5	127.6	125	126
Purchasing power parity ALL/USD, wiiw	44.7	43.8	43.2	45.0	47.1	48.0	49.8	.	.
Purchasing power parity ALL/EUR, wiiw	51.5	50.1	48.9	51.3	53.2	55.1	57.2	.	.

Notes: ALL: ISO code for the Albanian lek. - 1) Preliminary. - 2) Until 2000: population estimates; 2001: census data; thereafter: projection. - 3) According to gross value-added. - 4) Public sector only. - 5) 3-month deposit rate. - 6) wiiw calculated from USD. - 7) Refer to total foreign assets of Bank of Albania. - 8) wiiw estmate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

This latter points not only to the embittered atmosphere between the ruling Socialist Party and the opposition but also to the long-lasting political infight within the Socialist Party. In this context it is indicative that Prime Minister Nano publicly criticized the work of two members of his cabinet at the end of January 2005: he blamed his Minister of Education for the lack of transparency in tenders organized by the ministry, and he assessed his Labour Minister to have failed to achieve any positive results. Thus, doubts about the time schedule for Albania's EU integration steps as put forward by the Prime Minister seem justified.

Nevertheless, Albania has reason to be pleased with its continued high economic growth. In 2004 the Albanian economy appears to have managed a precision landing at a 6.0% GDP growth rate, as was the case in 2003. On the one hand this might point to the deplorable state of the national accounts statistics, which are still in their fledgling stages. On the other hand it is widely observable that the Albanian economy is in fact booming. Here the construction sector is in the forefront. Huge and growing inflows of remittances from Albanian expatriates (at about 12% of GDP in 2004) boost e.g. gross fixed capital formation through private housebuilding. Furthermore agriculture did better than expected because of favourable weather conditions in 2004. However, inflation remained below 3% in 2004, also due to a lower than expected budget deficit. At the same time the current account deficit is expected to shrink (based on the first nine months' balance of payments data for 2004) below EUR 300 million (less than 5% of GDP) facilitated by double-digit export growth rates.

Growth prospects for 2005 and 2006 appear to be even more encouraging. Real GDP growth in both years is forecast at 6% to 7%. Other things being equal, one may expect an increasing budget deficit in the run-up to the 2005 parliamentary elections to act as a growth momentum in 2005. This could drive inflation to the upper bound of the 2-4% inflation range targeted by the Albanian Central Bank and put additional pressure on the current account deficit.

In 2006 we may expect a switchback to fiscal prudence and easing inflation. Given an economic recovery in the eurozone, which is Albania's most important export market, increased foreign demand may be a stimulus for domestic GDP growth. Also, increased international economic presence in Albania might yield first results in enhanced productivity.

After the takeover of the main Albanian bank by the Austrian RZB in 2004, further substantial FDI inflows can be expected for 2005. Albania is privatizing its oil processing and trading company ARMO. Reportedly the list of potential bidders includes Croatia's INA, Italy's ENI, Greece's Motor Oil and a consortium of Samsung and the South Korean state oil corporation. The privatization revenue for ARMO is expected to reach USD 58 million. Similarly the privatization of the Albanian fixed telephony company Albtelekom is expected for 2005.

Overall, the short- and long-run prospects for the Albanian economy appear to be very favourable. However, political risk is the main threat to the medium-term development. Fair and democratic parliamentary elections in 2005 will be decisive.

Josef Pöschl

Turkey: soft landing appreciated

In past decades, Turkey's economic development suffered from periodical crises, in particular after the liberalization of capital flows in 1989. Now, the crucial question is whether the crisis of 2001, the most recent and most severe one, was a turning point to the better, thanks to less vulnerability of the economy.

Still before 2001, the government had adopted a programme of fiscal consolidation. This programme gained absolute priority after 2001. Primary surpluses are high enough to bring the debt/GDP ratio down. In 2004, the high debt service burden generated a sharp contrast between a primary surplus of 5.1% of GDP and an overall deficit of 7%. The debt to GDP ratio was 74% at the end of 2004, but may reach Maastricht-standard by 2007.

In 2004, the performance of the real sector was characterized by GDP growth of at least 8% and industrial output growth of around 10%. Given that last December the EU decided to start accession negotiations on 3 October 2005, the year 2004 proved to be successful for Turkey. Consumer price inflation, year-on-year, was 9.3% at year-end and 10.6% on average. This was a new phenomenon after decades of two- and sometimes even three-digit annual inflation rates. 1 January 2005 appeared to be a well-chosen starting point for the New Turkish lira (YTL), with 1 unit worth 1 million units of the previous lira. IMF representatives have repeatedly expressed satisfaction about Turkey's economic progress; the latter seems to demonstrate that sticking to the Fund's conditionality is instrumental for stabilizing the internal and external value of money, and that it is at the same time also compatible with high GDP growth.

The sector of government-managed enterprises has entered a process of transformation. The state has privatized some of these enterprises, or parts of them; others have started a partnership with domestic or foreign private enterprises; and even the management style in some of the still completely state-administered enterprises has changed. Already before 2001, the government had laid the foundations for a reform of the banking sector. While this had come too late to prevent the sector from becoming the starting point of the crisis, a comprehensive reform gained high priority thereafter. Now, the country has an independent banking supervision, and the government's costly consolidation measures contributed substantially to the consolidation of the banking industry. The latter is still heavily dependent on the government's debt servicing ability – but this fact is not a matter of much concern at present.

Not only has the erosion of the internal value of the Turkish money decelerated, nominal depreciation has also come to an end for the time being. In January 2005 the lira showed an appreciation tendency against the euro, certainly not under the influence of recent foreign trade data. Exports of goods continue to exceed imports by far, and the surplus in services offsets only part of this deficit. The current account deficit may have climbed slightly over 5% of GDP in 2004. However, GDP-related figures are just in the pipeline for revision; the State Institute for Statistics has started adopting the EU methodology of national accounts calculation, and the outcome will be a marked upward shift in GDP.

Table TR

Republic of Turkey: Selected Economic Indicators

Variables	1998	1999	2000	2001	2002	2003	2004 [1]	2005	2006
								forecast	
Population, th pers., mid-year [2]	65145	66304	67469	68618	69757	70885	72003	72003	73109
Gross domestic product, YTL mn, nom.	52225	77415	124583	178412	277574	359763	429730	487400	542500
annual change in % (real)	3.1	-4.7	7.4	-7.5	7.9	5.8	8.0	6	6
GDP/capita (EUR at exchange rate)	2660	2577	3171	2348	2776	3004	3369	.	.
GDP/capita (EUR at PPP)	5.820	5.573	6.260	5.570	5.949	6.254	.		
Gross industrial production									
annual change in % (real)	2.0	-5.0	6.0	-7.5	9.4	7.8	9.8	8	8
Gross agricultural production									
annual change in % (real)	8.4	-5.0	3.9	-6.5	6.9	-2.5	.	.	.
Construction industry									
annual change in % (real)	2.5	-9.4	0.2	-10.6	-6.1	-10.3	.	.	.
Consumption of households, YTL mn, nom.	36123	55928	89098	128513	184420	239586			
annual change in % (real)	0.6	-2.6	6.2	-9	2.1	6.6	8.3	7	7
Gross fixed capital form., YTL mn, nom. [3]	12839	16931	27848	32409	46043	55618			
annual change in % (real)	-3.9	-15.7	16.9	-31.5	-1.1	10.0	35.0	25	15
LFS - employed persons, th, avg. [4]	20872	21413	20557	20492	21463	21291	.	.	.
LFS - employed pers. in agricult. th, avg. [4]	8461	8872	7176	8105	7623	7390	.	.	.
LFS - employed pers. in industry th, avg. [5]	3638	3580	3731	3767	3913	3821	.	.	.
LFS - employed pers. in services th, avg.	8772	8962	9650	9647	9926	10080	.	.	.
LFS - unemployed, th pers. average [6]	1527	1774	1449	1905	2473	2497	.	.	.
LFS - unemployment rate in %, average	6.8	7.6	6.6	8.5	10.4	10.5	10.5	10.8	11
Reg. unemployment rate in %, average	2.1	2.1	3.3	3.2	1.9	2.5	.	.	.
Average nom. wages (YTL/Hour)	0.52	0.95	1.48	1.95	2.68	3.30	.	.	.
annual change in % (real)	0.5	11.0	0.8	-14.6	-5.4	-1.8	.	.	.
Consumer prices, % p.a.	84.6	64.9	54.9	54.4	45.0	25.3	10.6	7	5
Wholesale prices in manufacturing, % p.a.	66.7	57.2	56.1	66.7	48.3	23.8	11.1	.	.
Government budget, % GDP									
Central government revenues	22.4	24.3	26.7	29.0	27.5	27.9	.	.	.
Central government expenditures	29.8	36.2	37.4	45.1	41.6	38.9	.	.	.
General governm. deficit (-) / surplus (+) [7]	-9.6	-15.7	-11.9	-16.2	-12.6	-8.6	-7.0	.	.
Public debt in % of GDP	42.2	52.7	53.8	100.4	88.8	83.3	.	.	.
Discount rate % p.a., end of period	67.0	60.0	60.0	60.0	55.0	43.0	.	.	.
Current account, EUR mn	1751	-1267	-10670	3798	-1603	-7120	-12530	-14000	-17000
Current account in % of GDP	1.0	-0.7	-4.9	2.3	0.0	-3.3	-5.2	.	.
Gross reserves of CB, EUR mn	17404	21849	24095	21050	28233	29781	.	.	.
Gross external debt, EUR mn	85090	97121	129107	127620	138031	130263	.	.	.
FDI inflow, EUR mn	841	766	1855	3684	621	367	.	.	.
FDI outflow, EUR mn	11	28	788	25	5	7	.	.	.
Exports total, fob, EUR mn	27060	27189	33385	38484	42203	45365	53630	61700	71000
annual change in %	-4.5	0.5	22.8	15.3	9.7	7.5	18.2	15	15
Imports total, fob, EUR mn	38094	36040	55673	42495	49557	57777	72860	84000	96000
annual change in %	-5.4	-5.4	54.5	-23.7	16.6	16.6	26.1	15	14
Exports of services, BOP, EUR mn	20903	15837	22130	17961	15570	16855	19400	.	.
annual growth rate in %	19.0	-24.2	39.7	-18.8	-13.3	8.3	15.1	.	.
Imports of services, BOP, EUR mn	8984	8779	9776	7731	7271	7548	9050	.	.
annual growth rate in %	13.1	-2.3	11.4	-20.9	-6.0	3.8	19.9	.	.
Average exchange rate YTL/USD	0.2616	0.4211	0.6252	1.2284	1.5095	1.4967	1.4253	.	.
Average exchange rate YTL/EUR (ECU)	0.2964	0.4468	0.5753	1.0963	1.4332	1.6894	1.7714	.	.
Purchasing power parity YTL/USD, wiiw	0.1241	0.1917	0.2744	0.4301	0.6183	0.7451	0.7126	.	.
Purchasing power parity YTL/EUR, wiiw	0.1378	0.2095	0.2950	0.4668	0.6689	0.8116	0.8857	.	.

Notes: 1) Preliminary. - 2) 2004 to 2006 SIS projections. - 3) Private and public. - 4) For years prior to 2000 estimates based on biannual data. - 5) Mining and Quarrying, Manufacturing, Electricity, Gas and Water. - 6) Civilian Labour Force: unemployed; for years prior to 2000 estimates based on biannual data . - 7) Based on the Public Sector Borrowing Requirement (PSBR) methodology including local public administration, social security and enterprises under public administration.-

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

The exchange rate is not primarily determined by current account flows. Given that confidence in the soundness of the Turkish economy is increasing, in the future high nominal interest rates will have the potential of generating massive capital inflow pushing the exchange rate towards appreciation. The result would be a development unsustainable in the longer run: nominal appreciation coupled with a widening deficit on the current account, the latter constituting a sign of shrinking competitiveness of Turkish producers of tradable goods and services. This is one point of vulnerability.

Another set of influences has also the potential of increasing, at least in the longer run, the economy's vulnerability. The present government has a strong prime minister and a comfortable absolute majority in the parliament. Its achievements are most impressive in economic and political terms. However, to be become fit for EU accession, the country needs to have reform-determined governments with a solid parliamentary backing for a decade or so. Meeting the reform requirements and at the same time upholding popularity will not always be an easy task.

To win the elections scheduled for 2007, the current government will try to keep its popularity as high as it is. However, to consolidate its economic success, the government has to continue with its reform programme, no matter that part of that programme will have painful consequences for its voters. To give a few examples from the economic sphere:

(1) Last years' high GDP growth was accompanied by a corresponding rise in labour productivity, but did not create jobs; unemployment may rise further, especially in the case of privatization of several large state-owned companies.

(2) The agricultural reform package contains not only the transition to a new support system, but also cuts in the total amount of support. The sector's output shows a slightly falling trend, and the rural population articulates signs of disappointment.

(3) In spite of the population's low average age and low average life expectancy, the pension system generates high deficits, which have to be covered by the government; so a reform of the pension system is on the agenda.

(4) The tax system needs a comprehensive reform. At present, government revenues stem predominantly from indirect taxation and direct taxation of employees. The degree of tax evasion, combined with corruption, is immense.

These are sensitive issues, and reform initiatives can easily trigger a popularity loss without provoking a solid victory of an opposition party. The outcome would be weak governments such as Turkey had in the past. To maintain its popularity, the current government will most probably schedule reforms in a way that postpones painful consequences to the post-election period. Temptations to fuel popularity through more generosity will be there, but it will be possible to maintain a relatively high degree of budgetary discipline, should growth remain high, as seems likely.

In other words, Turkey is on the way towards fulfilling the Maastricht criteria; the main risks in the macroeconomic sphere are (1) weak governments in the future, which would prove incapable of maintaining budgetary discipline and (2) a central bank unable or unwilling to control nominal appreciation. Nevertheless, the Turkish economy is in better shape than several years ago, and the economy's vulnerability has diminished.

In both 2005 and 2006, GDP growth will reach around 6% and thus be somewhat weaker than in 2004. The fear of overheating has vanished. It had been triggered by year-on-year growth of 13.1% in the second quarter of 2004, which, however, originated from special conditions speeding up purchases of durable consumer goods. Both employment and real wages will continue to stagnate and thus again not contribute to consumption growth. Inflation will come down to about 7% in 2005 and to about 5% in 2006. In 2004, the main source of inflation was an increase in prices of non-tradables. Foreign trade will continue to expand faster than GDP, turning Turkey finally into a more open economy. Still, the volume of exports is below that of Poland's, a country whose economy is of similar size. Foreign direct investment inflows may rise, depending on the realization of larger privatization projects.

Part C: Russia, Belarus and Ukraine; China

Peter Havlik

Russian Federation: GDP growth slows down, reform stalemate

For the Russian economy 2004 was another year of robust growth. The GDP increased by about 7% according to preliminary official figures, slightly less than in 2003 (7.3%) yet still more than expected.[23] However, economic growth decelerated markedly in the closing months of the year and the final results might have to be revised downwards. The slowdown was recorded in industry, construction as well as agriculture, while output growth of services (particularly trade, telecommunications and transport) accelerated. On the demand side, it was mainly investment and private consumption that boomed. Exceptionally high world market prices of Russia's main export commodities (particularly of energy carriers and metals) represented once again the key growth stimulus. The export surplus increased markedly, reaching more than 13% of GDP (in 2003: 11% of GDP), and also the current account surplus (EUR 47 billion) exceeded 10% of GDP. The Stabilization Fund, which accumulates part of the windfall profits from energy exports and is to be used mainly for debt repayment, reached more than RUR 500 billion (around USD 20 billion) by the end of 2004. With lasting strong export (and therefore also state budget) revenues, economic growth may have become broader-based and therefore apparently also more sustainable, yet the reliance on resource-intensive sectors and structural distortions have increased. Reforms have stalled as well (with the exception of housing and social benefits reforms – see below) and the investment climate has been poisoned by the handling of the Yukos affair. A series of terrorist attacks in Russia, culminating in the tragic school siege in Beslan, was used by President Putin as a pretext for curtailing regional decision making powers.

Due to the combined effects of high foreign exchange inflows, expanding money supply, robust economic growth, and price hikes in food and services, the pace of disinflation has diminished. Consumer price inflation has been gradually declining for a couple of years - a process facilitated by the appreciating rouble (especially with respect to the US dollar). Nevertheless, the CPI increased on average by around 11% in 2004 and the official inflation target of less than 10% was missed once again. Even more disturbing is the fact that producer price inflation has been accelerating during the past two years: it reached nearly 25% in 2004, mainly as a result of surging energy and metals producer prices. Given the envisaged further adjustments of administered prices, e.g. of electricity and gas, it is quite likely that permanently growing producer prices will eventually translate into higher consumer price inflation as well. A rapid disinflation is therefore highly unlikely – not least due to rapidly rising unit labour costs.

Despite the general deterioration of the investment climate in Russia, investment continued to increase in 2004, by more than 10%, in particular in export-oriented and export-related sectors of the economy such as energy, metals and transportation. Robust investment demand stimulated growth of construction, not least also in housing. Apart from the growing export surplus, private consumption and real household incomes continue to boom; employment has been growing as well and unemployment has declined. With the government consolidated budget in a sizeable surplus and

[23] This can be partly explained by the revision of industrial output growth which amounted, according to the latest figure, to 7.3% in 2004 (compared to 6.1% previously published).

foreign exchange reserves exceeding USD 120 billion as of end-2004, the Russian economy is now in its best shape since the beginning of transition. Nevertheless, the official target – to double the GDP by 2010 – proclaimed by President Putin in his inaugural speech after the April elections is not realistic, though prospects for relatively high economic growth (around 5% per year) in the medium term are fairly good – barring a (rather unlikely) collapse of oil prices or a (perhaps more probable) major devaluation of US dollar, which would have a similar effect on Russian terms of trade.

In 2004, goods exports were up by more than 20% (+35% in USD terms) compared to a year earlier, largely thanks to higher energy revenues (revenues from crude oil exports grew by nearly 70%). Imports of goods increased by 13% (+25% in USD terms), with machinery and transport equipment (in particular passenger cars) imports rising faster than average. The foreign trade surplus (USD 87 billion) was significantly higher than a year earlier, as was the current account surplus (USD 58 billion – more than 10% of GDP). Despite the prevailing expectation of lasting high world market prices of energy and metals (and moderately growing Russian production and exports), the growth in export revenues will most likely decelerate due to the bottoming-out of energy prices (and to export capacity constraints) while imports, fuelled by robust domestic demand and the ongoing real appreciation of the rouble, will continue to grow faster. Though the trade and current account surpluses will remain large, the contribution of net exports to GDP growth will gradually diminish.

Apart from net exports, the main pillar of growth during the past couple of years has been private consumption, with investments gradually gaining importance as well. However, the share of investments in GDP is still quite low (about 20% of GDP) and their growth is expected to slow down. In particular, we do not expect any marked upturn in FDI (during 2004, FDI inflows declined whereas the net outflow of FDI from Russia continued) as the investment climate – especially for foreigners – will stay rough. Yet the situation of most Russian companies, in particular those which are engaged in export activities, is quite comfortable (except Yukos, which is facing liquidation after its main asset Yuganskneftegas was sold to a subsidiary of Gazprom), and they can easily finance investments from own resources (or credits – as was the case in Gazprom's recent acquisition of Yukos assets).

Despite the recent predominantly positive economic indicators, a sustainable long-term development is still uncertain considering the lagging reform progress, insufficient transparency of legal regulations and, last but not least, structural imbalances in the economy, which is excessively dependent on the fluctuating world market commodity prices. In line with most observers and even the official government forecasts, wiiw expects that Russia's GDP growth will slow down to some 5% in both 2005 and 2006. There is a broad consensus – both in- and outside Russia – that the current rate of economic growth is unsustainable unless the pace of structural, institutional, legal and banking sector reforms (and especially their implementation) increases substantially. After the lacklustre implementation of public sector administration and tax reforms, the latest example was the botched attempt at social benefits reform. The 'monetization' and streamlining of social benefits introduced at the beginning of 2005 and directly affecting more than 35 million Russian citizens, was poorly implemented as well. It lacked sufficient funding in particular at the regional level and had to be watered down after widespread popular protests. After President Putin's intervention, pensions will be increased in March 2005 while the fate of several reform-oriented ministers – G. Gref, A. Kudrin and M. Zurabov (responsible for the economy, finances and social affairs, respectively) – is uncertain.

Table RU

Russia: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 [1)]	2005	2006
								forecast	
Population, th pers., end of period [2)]	146328	145559	144819	143954	144964	144168	143400	14300	142500
Gross domestic product, RUB bn, nom.	2629.6	4823.2	7305.6	8943.6	10817.5	13201.1	16778.8	20300	24000
annual change in % (real)	-5.3	6.4	10.0	5.1	4.7	7.3	7.1	5	5.5
GDP/capita (EUR at exchange rate)	1618	1256	1928	2365	2536	2643	3258	.	.
GDP/capita (EUR at PPP - wiiw)	5000	5460	6030	6480	7000	7520	8270	.	.
Gross industrial production									
annual change in % (real)	-5.2	11.0	11.9	4.9	3.7	7.0	7.3	5.5	4
Gross agricultural production									
annual change in % (real)	-13.2	4.1	7.7	7.5	1.5	1.5	1.6	.	.
Construction output total									
annual change in % (real)	-5.0	6.0	17.0	9.9	2.7	14.4	10.1	.	.
Consumption of households, RUB bn, nom.	1462.3	2526.2	3295.2	4318.1	5408.4	6559.9	8010.7	.	.
annual change in % (real)	-3.4	-2.9	7.3	9.5	8.5	7.5	11.3	9	8
Gross fixed capital form., RUB bn, nom.	424.7	693.9	1232.0	1689.3	1938.8	2407.6	3002.1	.	
annual change in % (real)	-12.4	6.4	18.1	10.2	2.8	12.8	10.8	8	8
LFS - employed persons, th, avg.	58437	62475	64255	64400	66071	65800	67383	.	.
annual change in %	-2.6	6.9	2.8	0.2	2.6	-0.4	2.4	.	.
Reg. employment in industry, th pers., avg.	14162	14297	14543	14692	14534	14143	.	.	.
annual change in %	-5.0	1.0	1.7	1.0	-1.1	-2.7	.	.	.
LFS - unemployed, th pers., average	8902.0	9323.0	7515.0	6416.0	5712.0	6231.0	5856.0	.	.
LFS - unemployment rate in %, average	13.5	13.0	10.5	9.1	8.0	8.6	8.2	8.5	9
Reg. unemployment rate in %, end of period	2.7	1.7	1.4	1.6	2.1	2.3	2.6	.	.
Average gross monthly wages, RUB	1051.5	1522.6	2223.4	3240.4	4360.3	5498.5	6828.0	.	.
annual change in % (real, gross)	-13.3	-22.0	20.9	19.9	16.2	11.0	10.8	.	.
Consumer prices, % p.a.	27.6	85.7	20.8	21.6	16.0	13.6	11.0	11	10
Producer prices in industry, % p.a.	7.1	58.9	46.6	19.1	11.8	15.6	24.4	20	15
General governm. budget, nat.def., % GDP									
Revenues	26.1	25.2	28.7	30.0	32.5	31.4	32.0	.	.
Expenditures	32.0	26.1	26.8	27.1	31.6	30.0	26.0	.	.
Deficit (-) / surplus (+), % GDP	-5.9	-0.9	1.9	3.0	0.9	1.3	6.0	.	.
Public debt, nat. def., in % of GDP [3)]	142.7	94.2	57.1	44.1	36.9	28.7	.	.	.
Refinancing rate of NB % p.a., end of per.	60	55	25	25	21	16	13	.	.
Current account, EUR mn [4)]	192	23100	50619	37885	30789	31334	46865	42000	40000
Current account in % of GDP	0.1	12.6	18.0	11.1	8.4	8.2	10.0	7.2	6
Gross reserves of NB, excl. gold, EUR mn	6650	8387	26139	37026	42290	58531	88663	.	.
Gross external debt, EUR mn	160089	176298	172903	169530	147067	148536	155951 [IX]	.	.
FDI inflow, EUR mn [4)]	2424	3105	2933	3069	3660	7042	5300 [5)]	.	.
FDI outflow, EUR mn [4)]	1114	2071	3433	2828	3736	8607	7000 [5)]	.	.
Exports of goods, BOP, EUR mn [4)]	65327	70898	113510	113744	113468	120282	147530	150000	155000
annual growth rate in %	-15.0	8.5	60.1	0.2	-0.2	6.0	22.6	2	3
Imports of goods, BOP, EUR mn [4)]	50910	37102	48483	60022	64470	67314	76337	84000	92000
annual growth rate in %	-20.0	-27.1	30.7	23.8	7.4	4.4	13.4	10	10
Exports of services, BOP, EUR mn [4)]	10857	8509	10337	12773	14393	14361	16346	18000	20000
annual growth rate in %	-12.8	-21.6	21.5	23.6	12.7	-0.2	13.8	10	11
Imports of services, BOP, EUR mn [4)]	14441	12529	17540	22967	24848	24000	27620	32000	36000
annual growth rate in %	-18.5	-13.2	40.0	30.9	8.2	-3.4	15.1	16	13
Average exchange rate RUB/USD	9.71	24.62	28.13	29.17	31.35	30.57	28.84	28	29
Average exchange rate RUB/EUR (ECU)	11.06	26.24	26.03	26.13	29.65	34.55	35.81	35	36
Purchasing power parity RUB/USD, wiiw	3.26	5.54	7.16	8.15	9.27	10.37	12.06	13	14
Purchasing power parity RUB/EUR, wiiw	3.58	6.04	8.33	9.53	10.74	12.14	14.11	14	15

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

Source: wiiw Database incorporating national statistics; wiiw forecasts.

In view of recent events which seem to diminish the role of government reformers while that of *siloviki* from Mr. Putin's apparatus is increasing, an acceleration of liberal reforms is unlikely. On the contrary, a tendency towards increasing state intervention in the economy (especially in strategic sectors such as energy) and to exert more influence on decision making at the regional level (President Putin's proposal to appoint regional governors adopted by the Duma after the tragedy in Beslan) is becoming more apparent. While a stronger state, in the sense of better law enforcement and institution building, would certainly be welcome, the real outcome of the government's attempts at direct involvement in the economy will hardly yield positive results.

Perhaps as a side effect of rising economic strength, Russia's assertiveness has increased and its external relations with nearly all partners subsequently deteriorated. The EU has been increasingly concerned with a revival of authoritarian tendencies in Russia (Chechnya, press freedom violations, growing state influence in the economy, etc.). In the negotiations prior to EU enlargement, Russia had attempted to create some obstacles before agreeing to extend the coverage of the Partnership and Co-operation Agreement to the new EU Members from Central and Eastern Europe. An agreement was finally reached in May 2004, not only on travel modalities to the Russian exclave Kaliningrad, but also regarding an increased quota on steel imports from Russia. The EU had also expressed its support for Russian WTO accession in exchange for the Russian promise to gradually raise domestic prices for electricity and natural gas (WTO membership is still at least two years ahead). Russia had also ratified the Kyoto protocol yet it made hardly any concessions regarding improved market access of foreigners to the domestic services sector. EU-Russian relations cooled down again before the presidential elections in Ukraine, with each side openly supporting opposing candidates. Even before, Russian relations with Georgia also deteriorated, and the plans for a Union with Belarus have apparently been put on ice as well (here the blame lies mainly with Belarus' President Lukashenko). Russian relations with the USA focus on the fight against terrorism mainly (a WTO deal has not yet been reached, with financial services and intellectual property rights being the main stumbling issues), though Mr. Putin has been one of the few European politicians to openly support President Bush's re-election. The only silver lining may have been a (still fragile) warming of relations with China, after the last controversies over the Russian-Chinese border (as well as deals on energy deliveries and WTO accession) have been finally settled, and with Japan, where negotiations over the Kurile Islands (for Japan: Northern Territories) are slowly progressing.

Vasily Astrov

Belarus: private consumption drives growth acceleration

Preliminary figures suggest that economic growth increased from 7% in 2003 to 11% last year. Industrial production (+15.6% in gross terms) was the main engine of growth, with machinery (+22.3%) and fuels (+18.8%) ranking among the top-performing branches. Thus, after nine consecutive years of economic growth, the GDP in 2004 was 14.5% above the 1990 level. Although initially growth was primarily due to the rising utilization of idle production capacities (following the deep recession in the first half of the 1990s), more recently there has been a surge in fixed capital investment (by 20.8% in 2003 and another 20.2% last year) – an encouraging development in terms of growth sustainability. Simultaneously, the disinflation path has continued: consumer prices rose by 18.1% on average – ten percentage points less than the year before, while the end-year inflation stood at just 14.4%. The registered unemployment rate dropped from 3.1% to 1.9%, although these figures may be a poor reflection of the real situation due to the low incentives to register as unemployed, and the wide incidence of unpaid leave and involuntary part-time employment.

The quarterly GDP figures give evidence of a continuous growth acceleration starting from the second quarter of 2003 and reflecting a strong pick-up in private consumption growth, which increased from 7.4% in 2003 to 15% in the third quarter of 2004 on a year-on-year basis. The booming private consumption is not surprising against the background of rapidly rising wages (the latter grew by 17% in real terms and reached USD 200 per month by the end of the year) and explains why Belarus proved resilient to the slight deceleration of growth in Russia – its by far biggest trading partner. Indeed, according to customs statistics, in 2004 net exports declined, with imports growing faster than exports (by 42% and 38% in dollar terms, respectively, with mineral fuels accounting for a large part of the increase on both sides). Thus, the trade deficit expanded from USD 1.5 billion in 2003 to USD 2.6 billion last year. However, given the forceful economic growth and the real appreciation of the Belarusian rouble, the deterioration of the current account should not be dramatic: a deficit between 3% and 4% of GDP can be expected for 2004, after a 3% deficit in 2003. Besides, the balance-of-payments data are to be treated with caution, since the 'errors and omissions' item is often large, presumably reflecting unrecorded 'shuttle trade' and unregistered capital movements.

Recently there has been a piece of good news for exporters, as the EU has raised its textile imports quotas allocated to Belarus (along with some other countries). However, the average use of the EU textiles quotas by Belarus stood at only 78.3% in 2004, and export prospects for 2005 may be complicated by rising competition from other non-EU suppliers. More generally, the robust growth in Russia and the recovering domestic consumer confidence should make possible a continuation of the currently observed high growth in the country. Disinflation is likely to continue as well – a process which will be facilitated by lower inflationary expectations. Also, the monetary policy guidelines for 2005 envisage *inter alia* using the Russian rouble as a nominal anchor by setting a 2.4% devaluation limit for the domestic currency within the framework of a 'crawling-peg' arrangement.

The popular referendum held in October 2004 gave an 88% approval to the constitutional amendments permitting the president to remain in office any number of terms. The next presidential elections are due in 2006, and there is little doubt that the incumbent President Alexander Lukashenko will be elected for his 'third' term (his first term was extended by two years as a result of another referendum held in 1996). The political opposition in the country remains weak, and any spillover of the recent political instability from neighbouring Ukraine is highly unlikely, at least in the short and medium term. In fact, the authoritarian rule of Mr. Lukashenko may even harden somewhat in response to the Ukrainian events.

The stable political outlook and the likely continuation of the perceived pro-Russian policies of President Lukashenko do not automatically mean that the planned re-unification with Russia will proceed smoothly. The adoption of the Russian rouble as a means of payment has been postponed repeatedly, and there is evidence of diminishing public support in Belarus in favour of such a move. Recently, there have been new tensions in bilateral relations, triggered by the switch to the 'country of destination' principle of VAT taxation in trade among the countries of the Common Economic Space (Belarus, Russia, Ukraine and Kazakhstan) starting from January 2005. In particular, the Belarusian side has complained that the price of goods imported from Russia failed to reflect the

Table BY

Belarus: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 [1)]	2005 forecast	2006 forecast
Population, th pers., end of period	10045	10019	9990	9951	9899	9849	9800	.	.
Gross domestic product, BYR bn, nom. [2)]	702	3026	9134	17173	26138	36565	49445	.	.
annual change in % (real)	8.4	3.4	5.8	4.7	5.0	7.0	11.0	8	6
GDP/capita (EUR at exchange rate)	1428	1022	1235	1354	1545	1578	1874	.	.
GDP/capita (EUR at PPP - wiiw)	3820	4060	4430	4740	5130	5550	6320	.	.
Gross industrial production									
annual change in % (real)	12.4	10.3	7.8	5.9	4.5	7.1	15.6	.	.
Gross agricultural production									
annual change in % (real)	-0.7	-8.3	9.3	1.8	0.7	6.8	12.9	.	.
Consumption of households, BYR bn, nom. [2)]	388	1597	4566	9082	14142	18226	.	.	.
annual change in % (real)	20.6	4.5	6.3	23.6	8.9	0.7	.	.	.
Gross fixed investment, BYR bn, nom. [2)]	159	624	1809	3049	4485	7131	10244	.	.
annual change in % (real)	25.0	-8.0	2.0	-3.0	6.0	20.8	20.2	.	.
Reg. employment total, th pers., average	4417	4442	4441	4417	4381	4339	.	.	.
annual change in %	1.1	0.6	0.0	-0.5	-0.8	-1.0	.	.	.
Reg. employment in industry, th pers., avg.	1221	1231	1227	1212	1170	1159	.	.	.
annual change in %	1.4	0.8	-0.3	-1.2	-3.5	-0.9	.	.	.
Reg. unemployed, th pers., end of period	105.9	95.4	95.8	102.9	130.5	136.1	85.1	.	.
Reg. unemployment rate in %, end of period	2.3	2.1	2.1	2.3	3.0	3.1	1.9	2	2
Average gross monthly wages, BYR [2)]	4640	19580	58920	123020	189200	253500	350200	.	.
annual change in % (real, gross)	18.2	7.1	11.9	29.7	7.5	4.7	17.0	.	.
Consumer prices, % p.a.	73	294	169	61	43	28	18.1	14	12
Producer prices in industry, % p.a.	72	356	186	72	40	38	24.2	.	.
General government budget, nat.def., % GDP									
Revenues	34.1	34.9	34.8	33.5	33.0	33.4	44.9 I-XI	.	.
Expenditures	35.5	37.8	35.4	35.1	33.2	35.0	43.2 I-XI	.	.
Deficit (-) / surplus (+)	-1.4	-2.9	-0.6	-1.6	-0.2	-1.6	1.8 I-XI	.	.
Public debt in % of GDP	.	14.7	12.8	9.1	7.1	7.1	.	.	.
Refinancing rate of NB % p.a., end of period	48	120	80	48	38	28	17	.	.
Current account, EUR mn	-908	-182	-366	-440	-329	-466	-650	.	.
Current account in % of GDP	-6.3	-1.8	-3.0	-3.3	-2.1	-3.0	-3.5	-3	-2.5
Gross reserves of NB, incl. gold, EUR mn	291	303	383	408	456	395	482	.	.
Gross external debt, EUR mn	2031	2215	2281	2777	2925	2705	3055 IX	.	.
FDI inflow, EUR mn	181.4	416.2	128.6	107.0	261.5	151.9	100 [3)]	.	.
FDI outflow, EUR mn	2.1	0.7	0.2	0.3	-218.2	1.3	0 [3)]	.	.
Exports of goods, EUR mn [4)]	6312	5539	7929	8319	8489	8811	11054	.	.
annual growth rate in %	-2.0	-12.3	43.1	4.9	2.0	3.8	25.5	.	.
Imports of goods, EUR mn [4)]	7633	6256	9357	9251	9622	10173	13136	.	.
annual growth rate in %	-0.4	-18.0	49.6	-1.1	4.0	5.7	29.1	.	.
Average exchange rate BYR/USD [2)]	43.6	276.7	800.0	1420.0	1804.0	2075.0	2160.0	.	.
Average exchange rate BYR/EUR (ECU) [2)]	48.8	295.1	739.2	1271.9	1704.6	2346.6	2685.5	.	.
Purchasing power parity BYR/USD, wiiw [2)]	16.5	67.7	189.0	331.4	473.3	608.5	726.8	.	.
Purchasing power parity BYR/EUR, wiiw [2)]	18.2	74.3	206.0	363.4	513.9	667.9	796.9	.	.

Notes: BYR: ISO code for the Belarusian rouble. - 1) Preliminary. - 2) In denominated roubles. – 3) wiiw estimate. - 4) Data refer to customs statistics.

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

abolition of indirect taxation on the Russian side. For instance, the contract signed in December set the price of natural gas imported to Belarus in 2005 at nearly USD 47 per th cm – the same as last year (although the latter is not really surprising, since the pricing of energy carriers in intra-CIS trade tends to be politically motivated). In response, the Belarusian government has elaborated a programme aimed at a gradual reduction of the country's dependence on Russian gas by encouraging the use of own energy sources such as peat, water, and wind. Meanwhile, if the 'country of destination' regime of VAT taxation were implemented properly, the Belarusian public finances would benefit, given the country's big deficit in trade with Russia.

Vasily Astrov

Ukraine: in a new political setting

The outcome of the second round of the presidential elections held on 21 November 2004, declaring the incumbent prime-minister Viktor Yanukovich the winner, was widely believed to be rigged and led to large-scale popular protests. Under the pressure, Ukraine's Supreme Court cancelled the election result and ordered a repeated vote for 26 December, which was fairly easily (with 52%) won by Mr. Yanukovich's contender, the right-wing opposition leader Viktor Yushchenko. Although there are certain doubts as to the legal aspects of the 'third round' of the elections, it may have represented the best possible way out of the political stalemate, avoiding both greater violence and a territorial break-up of the country, at least so far. However, the perceived pro-western and anti-Russian stance of the newly elected president depresses his support in the mostly Russian-speaking and generally wealthier eastern and southern regions of the country. Mr. Yushchenko will need a lot of political skills to bridge these regional divisions, as well as to balance the country's external policies between Russia and the EU.

Meanwhile, the presidential powers of Mr. Yushchenko will soon be diluted by constitutional amendments which will enter into force between September 2005 and January 2006 (depending on the adoption of amendments to the legislation on local governments, which is also part of the constitutional package). These amendments, aiming at turning Ukraine from a presidential-parliamentary into a parliamentary-presidential republic, were passed in December 2004 as a concession to the forces supporting the outgoing president Leonid Kuchma, in exchange for alterations to the law on presidential elections, making it more difficult to manipulate the voting in the 'third round'. After the constitutional amendments have taken effect, the government will be formed by a majority coalition in the parliament, although the president will retain his right to propose the ministers of defence and foreign affairs. The next parliamentary elections (which for the first time will be held on an entirely proportional basis) are due only in March 2006. However, even the present parliament will hardly pose any big problems for Mr. Yushchenko, because many of its members who used to form the pro-Kuchma 'centrist' coalition majority prior to the crisis have switched sides in the meantime.

The concern over the outcome of the political crisis after the second round of elections led to a run on Ukraine's currency at the end of last year. The volume of hryvnia deposits in banks dropped by 4.8% in November and by another 2.9% in December, while deposits denominated in hard currencies (dollar and euro) went up. The banks responded by raising interest rates offered on hryvnia deposits by 2-4 percentage points and lowering them on hard currency deposits. In addition, the National Bank intervened heavily in the foreign exchange market (its forex reserves contracted by about EUR 1 billion in the last two months of 2004 alone) and resorted to a number of other measures, including a moratorium on premature withdrawal of term deposits, a ban on the net expansion of credit portfolios of commercial banks, and stabilization credits extended to some of them. By January 2005, the financial turmoil seemed to be largely over. On 10 January, the National Bank revoked the moratorium on premature withdrawal of term deposits, forex reserves are on the rise again, and some of the banks have expressed interest in paying back the stabilization credits ahead of schedule. Also, the National Bank has abolished its regulation from October according to which the exchange rate could not deviate from the officially set one by more than 2%. There is good reason to believe that the present interest rate spread between hryvnia and dollar deposits, reaching up to 6-7 percentage points, is not sustainable, given the stable outlook for the nominal exchange rate of the hryvnia.

The impact of the banking crisis on real economy has been minimal, with real GDP growing by 12% in 2004 (as compared to 9.6% in 2003). Driven by the booming exports of steel and machinery and the persistently high inflows of remittances, the current account surplus probably reached some 11% of GDP. However, gross industrial output increased ‘only’ by 12.5%, representing a marked slowdown in comparison to 2003 (15.8%). There is evidence that some branches operate on the verge of their capacity, so that the high aggregate demand increasingly translates into higher inflation rather than into higher production volumes. Also, inflation was fed by the rising gasoline price and the low supply of certain agricultural products (such as meat). As a result, the 2004 consumer price inflation reached 9% on average and 12.3% on the end-year basis, and the surge in industrial producer prices (20.4% and 24.1%, respectively) turned out to be even higher. To ease the inflationary pressure, the National Bank gradually raised the refinancing rate from 7% to 9% p.a., but given the small size of the banking sector, it is no big surprise that the real impact of this measure has so far been limited.

Although the current inflation rates may not necessarily represent an imminent threat to economic growth, the IMF in its most recent statement has named taming inflation a key priority for the new government and the National Bank. The prescribed instruments are standard and include a more restrictive monetary and fiscal policy. In the area of monetary policy, the IMF is *inter alia* advocating direct inflation targeting in place of the *de facto* dollar peg pursued so far. The nominal peg to a currency which has considerably declined in real terms against the currencies of Ukraine’s main trading partners – Russia and the EU – has maintained Ukraine’s competitiveness over the past few years and has also undoubtedly had a strong expansionary impact. Adopting a more flexible exchange rate regime would almost certainly result in a nominal appreciation of the hryvnia and (hopefully) a lower demand-pull inflation, although growth could suffer as well.

Last year’s fiscal policy, too, was much more lax than in previous years. After four years of a nearly balanced budget, the consolidated government recorded a 3.3% budget deficit in 2004, driven by the election-motivated increase in social spending in autumn, and despite the record-high revenues from privatization. The latter reached UAH 9.5 billion (nearly 3% of GDP), largely due to the controversial sale of a 93% stake in Ukraine’s biggest plant, and the country’s biggest exporter, *Krivorizhstal*. For 2005, privatization revenues are targeted at UAH 4.9 billion, but they may be higher in view of the upcoming re-nationalisation of *Krivorizhstal*, already announced by the new authorities, and its likely

Table UA

Ukraine: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003	2004 [1]	2005	2006
								forecast	
Population, th pers., end of period [2]	50105.6	49710.8	49291.2	48457.1	48003.5	47622.4	47280.8	47000	46800
Gross domestic product, UAH mn, nom.	102593	130442	170070	204190	225810	264165	322500	386700	446900
annual change in % (real)	-1.9	-0.2	5.9	9.2	5.2	9.4	12.0	9	7
GDP/capita (EUR at exchange rate)	737	595	683	872	931	917	1030	.	.
GDP/capita (EUR at PPP - wiiw)	3310	3400	3740	4230	4600	5110	5830	.	.
Gross industrial production									
annual change in % (real)	-1.0	4.0	13.2	14.3	7.0	15.8	12.5	12	10
Gross agricultural production									
annual change in % (real)	-9.6	-6.9	9.8	10.2	1.2	-10.2	19.1	.	.
Construction output total									
annual change in % (real)	2.7	-8.0	9.1	16.7	-0.7	23.1	21.8 [I-XI]	.	.
Consumption of households, UAH mn, nom.	58323	71310	92406	112260	124560	144954		.	.
annual change in % (real)	2.0	-1.9	2.5	9.6	9.5	12.4		.	.
Gross fixed investment, UAH mn, nom.	13958	17552	23629	32573	37178	51011	42116.0 [I-IX]	.	.
annual change in % (real)	6.1	0.4	14.4	20.8	8.9	31.3	34.5 [I-IX]	25	20
LFS - employed persons, th, avg. [3]	22998.4	20048.2	20419.8	20238.1	20400.7	20163.3	20369.1 [I-IX]	.	.
annual change in % [4]	-3.2	-12.8	1.9	-0.9	0.8	0.8	.	.	.
Reg. employees in industry, th pers., avg. [5]	4142.0	3932.0	3445.0	3811.0	3578.1	3415.6	.	.	.
annual change in %	-3.1	-5.1	-12.4	-6.2	-6.1	-4.5	.	.	.
LFS - unemployed, th pers., average	2937.1	2698.8	2707.6	2516.9	2301.0	2008.0	1732.9 [I-IX]	.	
LFS - unemployment rate in %, average	11.3	11.9	11.7	11.1	10.1	9.1	8.0	7.5	7.5
Reg. unemployment rate in %, end of period	3.7	4.3	4.2	3.7	3.8	3.6	3.6	3.5	3.5
Average gross monthly wages, UAH [5]	153.0	177.5	230.1	311.1	376.4	462.3	589.6	.	.
annual change in % (real, gross)	-3.2	-5.4	1.1	20.7	20.0	16.7	17.0	.	.
Consumer prices, % p.a.	10.6	22.7	28.2	12.0	0.8	5.2	9.0	10	8
Producer prices in industry, % p.a.	13.2	31.1	20.9	8.6	3.1	7.8	20.4	10	7
General governm. budget, nat. def., % GDP									
Revenues	28.2	25.2	28.9	26.9	27.4	28.5	28.1	.	.
Expenditures	30.4	26.7	28.3	27.2	26.7	28.6	31.4	.	.
Deficit (-) / surplus (+), % GDP	-2.2	-1.5	0.6	-0.3	0.7	-0.2	-3.3	.	.
Public debt in % of GDP	48.1	61.0	45.3	36.5	33.5	29.4	26.5	.	.
Refinancing rate of NB % p.a., end of period	60.0	45.0	27.0	12.5	7.0	7.0	9.0	.	.
Current account, EUR mn [6]	-1147	1559	1602	1565	3360	2559	5500	5500	4000
Current account in % of GDP	-3.1	5.2	4.7	3.7	7.5	5.8	11.3	9.5	6
Gross reserves of NB excl. gold, EUR mn [6)7]	650	1042	1453	3353	4088	5386	6838	.	.
Gross external debt, EUR mn [6)8]	10420	13456	12759	13785	12247	19055	23491 [IX]	.	.
FDI inflow, EUR mn [6]	658	466	644	884	734	1261	1500 [9]	.	.
FDI outflow, EUR mn [6]	-4	7	1	26	-5	12	0 [9]	.	.
Exports of goods, BOP, EUR mn [6]	12124	12400	17008	19074	19770	21013	27100	30000	33000
annual growth rate in %	-10.8	2.3	37.2	12.1	3.6	6.3	29	11	10
Imports of goods, BOP, EUR mn [6]	14411	12170	16165	18853	19018	21251	24500	27000	31000
annual growth rate in %	-16.6	-15.6	32.8	16.6	0.9	11.7	15	10	15
Exports of services, BOP, EUR mn [6]	3471	3637	4111	4459	4958	4615	4500	4500	4500
annual growth rate in %	-20.2	4.8	13.0	8.5	11.2	-6.9	-2	0	0
Imports of services, BOP, EUR mn [6]	2252	2155	3433	3995	3743	3237	3000	3000	3000
annual growth rate in %	12.7	-4.3	59.3	16.4	-6.3	-13.5	-7	0	0
Average exchange rate UAH/USD	2.450	4.130	5.440	5.372	5.327	5.333	5.319	5.3	5.3
Average exchange rate UAH/EUR (ECU)	2.768	4.393	5.029	4.814	5.030	6.024	6.609	6.7	6.7
Purchasing power parity UAH/USD, wiiw	0.561	0.705	0.849	0.912	0.944	0.993	1.071	.	.
Purchasing power parity UAH/EUR, wiiw	0.617	0.768	0.919	0.992	1.018	1.082	1.165	.	.

Notes: 1) Preliminary. - 2) In 2001 according to census 5 Dec. 2001. - 3) From 2003 revised data according to census 2001. - 4) In 2003 unrevised data. - 5) Excluding small enterprises. - 6) Converted from USD to NCU, and from NCU to EUR at the official exchange rates. - 7) Useable. - 8) Up to 2002 long-term debt only, - 9) wiiw estimate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

subsequent re-privatization. The move is to be seen as part of the fight of the new power elite against the financial-industrial groups, which benefited the most under the previous regime, and thus resembles somewhat the 'Yukos case' in Russia. Simultaneously, the new authorities appear to stick to the policy of the late Yanukovich government of increased social spending, probably reflecting the growing awareness within the ruling elite that Ukraine should have more of a welfare state than it used to have up to now. Indeed, the present share of consolidated government expenditures in GDP of 31% is low not only by European, but even by US standards.

Given the good prospects of both domestic and foreign demand, the country's economic performance is likely to remain robust. A slight deceleration of growth is possible, but the external position will remain strong. However, inflation will be stubbornly high, fuelled by the planned hikes in regulated prices, spillovers from the recently soaring producer prices, and – last but not least – the possibly further rising price of imported energy.

The recent political changes in Ukraine may bring certain benefits to the country already in the near future. In particular, the European Union seems to be finally ready to grant Ukraine the official status of a market economy, and the USA will probably enact the long-awaited abolition of the so-called 'Jackson-Vanik amendment', which has been in place since 1974 and still applies to some of the successor states of the former Soviet Union. Both moves should reduce the incidence of anti-dumping measures applied to some important Ukrainian export items, such as metals, chemicals, and textiles in the European and the US markets. The negotiations on WTO membership are reportedly progressing well, with 30 (out of 42) bilateral protocols signed by now, and Ukraine hopes to join the WTO already by the end of the year (although the protocols with the United States and China have not been signed yet). However, despite Mr. Yushchenko's eager advances towards Brussels, the EU reaction has been rather lukewarm, and the prospects of Ukraine's EU membership remain as hazy as before.

Waltraut Urban

China: maintaining stable and fast economic development

In 2004, the Chinese GDP rose by 9.5%, slightly faster than in 2003 (9.1%). This is the highest growth rate since the Asian economic and financial crisis in 1997/1998. Thus neither a 'hard landing', as feared by some economists, nor the Chinese government's proclaimed goal to return to a more sustainable growth path has materialized. However, certain structural changes to be observed point in the right direction: the very fast expansion of fixed asset investment and of output in some sectors of the economy has cooled down, private consumption has picked up and growth in agriculture and services, lagging significantly behind the industrial development for the past several years, has accelerated. Foreign trade and direct investment remained strong throughout the year 2004.

Measured in quarterly figures, the GDP growth rate gradually slowed down from the first quarter (9.6%) to the third quarter (9.1%) in response to the various measures implemented by the Chinese authorities to prevent an overheating of the economy, but rebounded again in the forth quarter (9.5%). This was however due to a much better than expected development of agricultural output, accelerating growth in the services sector and a rising trade surplus, while investment and industrial production continued to cool down. For the year 2005, a certain deceleration of overall economic growth is expected, probably reaching 8.2%, because of the continuously restrictive economic policy of the Chinese government and the predicted slowing down of the world economy. In 2006, a slight acceleration of growth to 8.5% may take place.

The very rapid expansion of the Chinese economy at the beginning of 2004 was driven by investment in fixed assets, surging 43% year-on-year in the first quarter of 2004 and raising fears of overheating and a build-up of overcapacities. To guard against a boom/bust cycle, the Chinese authorities began to restrict loans and to limit operating licences in these sectors. They also followed a tighter monetary policy: the bank reserve requirement ratio was raised from 7% to 7.5% in April 2004, and in October the central bank raised the target interest rate by 0.25 percentage points. Although the effect of these measures was partly undermined by soaring profits, the growth rate of fixed investment declined to about 29% for the first half and to 25.8% for the whole year of 2004 – which is still very high by international standards but below that in 2003 (26.7%). For 2005, we may expect investment growth to slow down further, as government policy will remain restrictive and overcapacities have already become a constraint on growth in certain important sectors, such as in the motor vehicle industry and probably in the steel industry as well. As investment in fixed assets currently takes a share of about 50% in the Chinese GDP, i.e. much more than in most economies of the world, the impact of this sector's development on overall GDP growth is substantial.

While investment lost momentum throughout 2004, the growth of private consumption remained strong and probably even accelerated during the last few months of the year. Data on aggregate private consumption are not available yet but retail sales of consumer goods (in real terms) as a proxy for private consumption expanded by 10.2% year-on-year during the first 11 months of 2004 (compared to 9.2% in the whole year 2003), with an increase of 11% and 12% in October and November respectively. Rising urban and, in particular, rural incomes stand behind this development: in China around 60% of the population are still living in rural areas, and in 2004, for the first time in many years, rural incomes rose faster than urban incomes. Urban per capita incomes reached 785 yuan (plus 7%) and rural per capita incomes came up to 234 yuan (plus 11.4%) during the first nine months of the year. Rural incomes were supported by a tax reform (the 'tax for fee') on the one hand and rising prices for many agricultural goods on the other. In the last quarter, a bumper crop helped further to raise rural incomes. The latter effect may taper off in 2005, but government support for farmers will continue. As a result, we may expect rural incomes and thus private consumption to remain strong in 2005 but to rise less than last year.

Rising prices in agriculture were the main factor behind consumer price inflation, which reached 3.9% in 2004, after 1.2% the year before. However, price hikes reached their peak already by the middle of the year; in the last two months of 2004, consumer prices were up less than 3% compared to the previous year. For 2005, we thus expect inflation to stay around 3%, barring any dramatic events such as a natural disaster or a strong increase in oil prices.

Supported by the favourable development of the world economy, particularly in Asia and the USA, exports were an important driving force of the Chinese economy. They reached USD 593.4 billion and, with an average growth rate of 35% throughout the year, they expanded at a similar pace as in 2003. However, in the first six months of the year, imports increased much faster than exports (42.3%) because of a surge in the demand for investment goods and inputs for production on the one hand and rapidly rising raw material prices (crude oil, ferrous and non-ferrous metals) on the other, resulting in a (moderate) trade deficit. Yet in the second half of the year, growth of imports decelerated in line with a slowing-down of investment and industrial production, and the trade balance turned positive again. Over the whole year imports came up to USD 561.3 billion and the trade surplus reached a new record high of USD 32 billion, partly compensating for the deceleration of investment. In terms of trade volume, China has now overtaken Japan as a world trading power and ranks third after Germany and the USA. Taking into account the predicted slowing-down of the world economy[24] in 2005, we may expect overall Chinese exports to develop less dynamically than the year before. But a certain expansive effect will come from the phasing-out of the 'Agreement of textiles and clothing' (ATC) as of end-2004, leading to an abolishment of all quotas in textiles and clothing trade among members of the World Trade Organization (WTO). China is a very competitive producer of textiles and clothing on the world market and T&C take an important share in Chinese merchandise exports (around 15%). The existing import quotas, of the USA and the EU in particular, were considered a severe constraint on the further expansion of exports in this field. However, the major importers have become alert of Chinese textiles flooding their markets and have threatened to use WTO safeguard clauses to protect their T&C industries, which may finally result in new quotas. To prevent such steps, China has imposed (moderate) export taxes on certain textiles and clothing products as of the beginning of 2005 and has signalled its readiness to accept voluntary export restrictions, in order to secure a smooth and predictable development of Chinese T&C exports. Notably, the Chinese government has also introduced export taxes on aluminium, coal and some other metals the production of which is very energy-intensive and domestic demand is high. Import growth will remain strong, due to further tariff reductions and the lifting of quotas (for instance for automobiles), in line with China's WTO commitments. All in all, we may expect the trade surplus and its contribution to growth to diminish in 2005.

Foreign direct investment, as an important source of technology and a major supplier of exports, reached a record size of USD 60.6 billion in 2004 and China is again the second most important recipient of FDI world-wide. The bulk of investment comes from Asian countries, with Hong Kong and the Caribbean tax havens taking a special role: together they account for about half of the total inflow of investment. FDI inflows from the USA and Europe reached approximately the same size and had a share of about 7% each. The continuous strong growth of contracted investment (33.4%) points to a further strong inflow of FDI in 2005; the observed trend towards accelerated investment in the services industries relative to manufacturing may continue as a consequence of the further opening-up of this sector as stipulated in China's WTO treaty.

China's foreign reserves rose to USD 609.9 billion, an increase of USD 210 billion against 2003, due to the high trade surplus (no current account data are available yet) and the strong inflow of FDI, but also fuelled by financial inflows, partly on the expectation of a yuan revaluation.

On the supply side, the industrial sector remained the fastest growing sector of the economy, expanding at a rate of 11%; yet the lead was less prominent than in 2003 and growth decelerated slightly throughout the year. However, growth declined significantly e.g. in the motor vehicle industry, where the number of vehicles produced increased by just 14% in 2004 as compared to 34% in 2003.

[24] According to the International Monetary Fund (MF), the growth of world output is expected to decline from 5% in 2004 to 4.3% in 2005 and the growth of world trade is expected to fall from 8.8% to 7.2%. (IMF; World Economic Outlook, September 2004, Table 1.1; see www.imf.org).

Table CN

China: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004 [1)]	2005 forecast	2006 forecast
Population, mn pers., end of period	1259.1	1265.8 [2)]	1277.3	1286.0	1292.0	.	.	.
Gross domestic product, CNY bn, nom.	8191.1	8940.4	9593.3	10239.8	11669.4	13650	15460	17393
annual change in % (real)	7.1	8.0	7.3	8.0	9.1	9.5	8.2	8.5
GDP/capita (USD at exchange rate)	785.7	853.0	907.1	960.5	1091.1	.	.	.
GDP/capita (USD at PPP - wiiw)	3717.5	4082.6	4444.3	4818.3	5344.4	.	.	.
Industrial value added								
annual change in % (real)	8.8	9.9	8.9	9.9	12.5	11.0	.	.
Agricultural value added								
annual change in % (real)	2.8	2.4	2.5	2.9	2.5	6.0	.	.
Construction output, CNY bn [3)]	1115.2	1249.7	1536.1	1852.7	2308.3	.	.	.
annual change in % (nominal)	10.8	12.1	22.9	20.6	24.6	.	.	.
Retail trade turnover, CNY bn	3113.4	3415.3	3759.5	4191.1	4572.5	5400	.	.
annual change in % (real)	10.1	11.1	10.9	10.6	9.2	10.5	.	.
Total investment in fixed assets, CNY bn	2985.5	3291.8	3689.8	4283.9	5427.6	7000	.	.
annual change in % (nominal)	5.1	10.3	12.1	16.1	26.7	25.8	.	.
Employment total, mn pers., end of period	713.9	720.9	730.3	737.4	744.3	.	.	.
annual change in %	0.9	1.0	1.3	1.0	0.9	.	.	.
Staff and workers, mn pers., end of period [4)]	117.7	112.6	107.9	105.6	104.6	104.5 I-IX	.	.
annual change in %	-4.6	-4.3	-4.2	-2.2	-0.9	-0.1 I-IX	.	.
Unemployment rate (urban) in %, end of per.[5)]	3.1	3.1	3.6	4.0	4.5	4.2 I-IX	4.5	4.5
Average gross annual wages, CNY [6)]	8346	9371	10870	12422	14040	14453 I-IX	.	.
annual change in % (real) [7)]	13.1	11.1	15.2	15.5	12.0	10.4 I-IX	.	.
Retail prices, % p.a.	-3.0	-1.5	-0.8	-1.8	-0.1	2.8	.	.
Consumer prices, % p.a.	-1.4	0.4	0.7	-0.8	1.2	3.9	3	2
General government budget, nat.def., % GDP								
Revenues	14.0	15.0	17.1	18.5	18.6	.	.	.
Expenditures	16.1	17.8	19.6	21.5	21.1	.	.	.
Deficit (-) / surplus (+), % GDP	-2.1	-2.8	-2.6	-3.1	-2.5	.	.	.
Refinancing rate of NB % p.a., end of per. [7)]	3.2	3.2	3.2	2.7	2.7	3.0	.	.
Current account, USD bn	15.7	20.5	17.4	35.4	45.9	.	.	.
Current account in % of GDP	1.6	1.9	1.5	2.9	3.3	.	2.2	2
Gross reserves of NB excl. gold, USD bn	154.7	165.6	212.2	286.4	403.3	609.9	.	.
Gross external debt, USD bn	151.8	145.7	170.1	171.7	194.0	223.0 I-IX	.	.
FDI inflow, USD bn	40.3	40.7	46.9	52.8	53.3	60.6	60	.
FDI outflow, USD bn	1.8	0.9	6.9	2.5	1.8	1.8 I-XI	2.5	.
Exports of goods total, USD bn [8)]	194.9	249.2	266.2	325.6	438.4	593.4	.	.
annual change in %	6.1	27.8	6.8	22.3	34.6	35.4	.	.
Imports of goods total, USD bn [8)]	165.8	225.1	243.6	295.3	412.8	561.3	.	.
annual change in %	18.2	35.8	8.2	21.2	39.9	36.0	.	.
Trade balance of goods, USD bn [8)]	29.1	24.1	22.5	30.3	25.5	32.0	.	.
Average exchange rate CNY/USD	8.28	8.28	8.28	8.28	8.28	8.28	8.28	.
Average exchange rate CNY/EUR	8.89	7.65	7.35	7.75	9.37	11.28	.	.
Purchasing power parity CNY/USD, wiiw [9)]	1.75	1.73	1.69	1.69	1.69	.	.	.
Purchasing power parity CNY/EUR, wiiw	1.91	1.86	1.83	1.83	1.84	.	.	.

Notes: CNY: ISO code for the Chinese yuan. - 1) Preliminary. - 2) Census results from 1 Nov. 2000. - 3) Enterprises with independent accounting systems. - 4) Refer to persons who work in state-owned enterprises, urban collectives and foreign invested enterprises. - 5) Ratio of registered urban unemployed in per cent of urban employed and unemployed. - 6) Average gross annual wages of staff and workers. - 7) Overnight rate. - 8) According to customs statistics. - 9) Purchasing power parity, ICP-method; see Ren Ruoen, *The Vienna Institute Monthly Report* 1996/2.

Source: China Statistical Yearbook; International Financial Statistics; China Monthly Statistics; China Daily; Asian Development Bank (ADB, ARIC Indicators); World Investment Report 2003 (UNCTAD).

Both the primary sector and the tertiary sector expanded significantly faster than the year before. The acceleration of growth was particularly outstanding in agriculture, which dominates the primary sector, reaching an increase of 6% year-on-year after only 2.5% in 2003. This was mainly due to a bumper autumn harvest (the autumn harvest typically makes up about 70% of total agricultural output) pushing up production growth in the fourth quarter. Total grain output in 2004 reached 470 million tons, 9% up from 2003 and reversing the downward trend in grain production prevailing for several years; output of many other agricultural products increased strongly as well. However, as grain consumption rose significantly too, China remained an important net importer. Apart from favourable weather conditions, the good development of the agricultural sector results from various policy measures to support agriculture and raise farmer's incomes.

Growth in the services sector also picked up as against 2003, and remained fairly stable throughout the year. The value-added of the sector was up 8% year-on-year. Growth was strong in both sales and the transport sector.[25] So far, the services sector in China has been relatively underdeveloped as is typical of socialist economies. Acceleration of growth in the services sector may thus be interpreted as a sign of restructuring in the direction of a market economy and has also to be seen in the light of the stepwise opening-up of this sector in line with China's commitments to WTO.

With restrictive policy measures remaining in place, investment in fixed assets is expected to cool down further in 2005 and 2006. Consumption will remain strong but may grow slightly less due to farmers' incomes not reaching a similar income hike as last year. Export growth and the trade surplus – and thus the current account as well – will be smaller assuming a slowdown of the world economy. On the supply side, industrial production in some sectors may continue to lose momentum (e.g. vehicles), but growth may accelerate in others (e.g. textiles and clothing); overall growth of the sector is expected to decelerate. Agriculture, further supported by various policy measures, may continue its positive development although to a lesser degree. The services sector may continue to expand, also thanks to foreign direct investment. Inflation will be lower as imbalances between supply and demand are becoming less. Altogether, we expect GDP growth to decline to about 8.2% in 2005 and to rebound slightly in 2006 along with the world economy, probably reaching 8.5%.

[25] *BOFIT Weekly* No. 4, 28 January 2005, Bank of Finland, Institute for Economies in Transition (BOFIT).

Appendix

Selected Indicators of Competitiveness

Table A/1

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

	1991	1995	1999	2000	2001	2002	2003	2004	2005	2006	2007	2010	2015
									projection assuming 4% p.a. GDP growth and zero population growth p.a.				
Czech Republic	9191	10041	12172	12810	13530	14319	14690	15565	16141	16738	17408	19581	23824
Hungary	7310	7480	9732	10547	11549	12402	12929	13892	14420	15012	15612	17561	21366
Poland	4480	6210	8454	9048	9290	9664	9826	10582	11059	11556	12019	13519	16448
Slovak Republic	6959	6782	8740	9464	10052	10882	11183	12138	12781	13484	14024	15775	19193
Slovenia	9421	9768	13685	14464	15294	15936	16404	17346	18022	18725	19474	21906	26652
Estonia	6387	5458	7636	8601	9177	9890	10378	11279	11956	12697	13205	14854	18072
Latvia	8618	4103	6341	7007	7658	8251	8756	9674	10332	11024	11465	12896	15690
Lithuania	7459	5037	6980	7610	8340	8977	9783	10857	11552	12234	12723	14312	17413
Cyprus	10889	13114	15750	17028	18272	17679	17663	18493	19232	20002	20802	23399	28468
Malta	8754	11134	14371	15525	15347	15729	16041	16452	17110	17795	18506	20817	25327
Bulgaria	5138	4749	4894	5325	5846	6099	6341	6830	7171	7530	7831	8809	10717
Romania	5252	5718	4757	5006	5462	6058	6315	6977	7360	7765	8076	9084	11052
Croatia	5954	5682	7445	8111	8638	9295	9720	10403	10767	11144	11589	13037	15861
Albania	1456	2313	2792	3184	3857	4075	4267	4566	4863	5179	5387	6059	7372
Bosnia & Herzeg.	.	.	4655	4940	5228	5523	5670	6094	6398	6718	6987	7859	9562
Macedonia	4103	4031	4828	5169	5003	5211	5401	5615	5840	6073	6316	7105	8644
Serbia	.	.	.	4186	4508	4948	5130	5604	5828	6061	6304	7091	8627
Russia	8042	5677	5462	6027	6484	7000	7522	8270	8684	9161	9528	10718	13040
Ukraine	5758	3268	3403	3739	4228	4603	5108	5832	6357	6802	7074	7957	9681
Belarus	.	2817	4060	4432	4740	5125	5545	6316	6821	7230	7519	8458	10291
									projection assuming 2% p.a. GDP growth and zero population growth p.a.				
Germany	17203	18187	20995	22127	22520	23012	23101	23967	24447	24935	25434	26991	29800
Greece	10781	10990	13298	14317	15092	16462	17281	18270	18636	19008	19389	20575	22717
Spain	12470	13331	17017	18113	18893	20026	20897	21744	22179	22623	23075	24488	27036
Austria	18450	19678	23507	25255	25459	25988	26118	27041	27581	28133	28696	30452	33621
Portugal	10488	11139	14302	15272	15787	16249	15889	16317	16643	16976	17316	18376	20288
Turkey	4466	4587	5484	5991	5350	5626	5916	6449	6578	6710	6844	7263	8019
USA	21193	23371	29008	30679	31189	32211	32912	35489	36199	36923	37661	39966	44126
EU-15 average	15740	16844	20320	21639	22419	23172	23321	24251	24736	25230	25735	27310	30153
EU-25 average	14127	15193	18487	19706	20445	21180	21365	22288	22769	23261	23764	25337	28194

European Union (25) average = 100

	1991	1995	1999	2000	2001	2002	2003	2004	2005	2006	2007	2010	2015
Czech Republic	65	66	66	65	66	68	69	70	71	72	73	77	84
Hungary	52	49	53	54	56	59	61	62	63	65	66	69	76
Poland	32	41	46	46	45	46	46	47	49	50	51	53	58
Slovak Republic	49	45	47	48	49	51	52	54	56	58	59	62	68
Slovenia	67	64	74	73	75	75	77	78	79	80	82	86	95
Estonia	45	36	41	44	45	47	49	51	53	55	56	59	64
Latvia	61	27	34	36	37	39	41	43	45	47	48	51	56
Lithuania	53	33	38	39	41	42	46	49	51	53	54	56	62
Cyprus	77	86	85	86	89	83	83	83	84	86	88	92	101
Malta	62	73	78	79	75	74	75	74	75	76	78	82	90
Bulgaria	36	31	26	27	29	29	30	31	31	32	33	35	38
Romania	37	38	26	25	27	29	30	31	32	33	34	36	39
Croatia	42	37	40	41	42	44	45	47	47	48	49	51	56
Albania	10	15	15	16	19	19	20	20	21	22	23	24	26
Bosnia & Herzeg.	.	.	25	25	26	26	27	27	28	29	29	31	34
Macedonia	29	27	26	26	24	25	25	25	26	26	27	28	31
Serbia	.	.	.	21	22	23	24	25	26	26	27	28	31
Russia	57	37	30	31	32	33	35	37	38	39	40	42	46
Ukraine	41	22	18	19	21	22	24	26	28	29	30	31	34
Belarus	.	19	22	22	23	24	26	28	30	31	32	33	36
Germany	122	120	114	112	110	109	108	108	107	107	107	107	106
Greece	76	72	72	73	74	78	81	82	82	82	82	81	81
Spain	88	88	92	92	92	95	98	98	97	97	97	97	96
Austria	131	130	127	128	125	123	122	121	121	121	121	120	119
Portugal	74	73	77	78	77	77	74	73	73	73	73	73	72
Turkey	32	30	30	30	26	27	28	29	29	29	29	29	28
USA	150	154	157	156	153	152	154	159	159	159	158	158	157
EU-15 average	111	111	110	110	110	109	109	109	109	108	108	108	107
EU-25 average	100	100	100	100	100	100	100	100	100	100	100	100	100

Sources: National statistics, Eurostat, wiiw estimates.

Table A/2

Indicators of macro-competitiveness, 1996-2004

EUR-based, annual averages

	1996	1997	1998	1999	2000	2001	2002	2003	2004 prelim.
Czech Republic									
Producer price index, 2000=100	85.7	90.0	94.4	95.3	100.0	102.8	102.3	102.0	107.8
Consumer price index, 2000=100	78.5	85.1	94.3	96.2	100.0	104.7	106.6	106.7	109.7
GDP deflator, 2000=100	79.7	86.3	95.9	98.6	100.0	104.9	107.8	109.8	112.7
Exchange rate (ER), CZK/EUR	34.01	35.80	36.16	36.88	35.61	34.08	30.81	31.84	31.90
ER nominal, 2000=100	95.5	100.5	101.6	103.6	100.0	95.7	86.5	89.4	89.6
Real ER (CPI-based), 2000=100	114.5	113.0	104.5	105.6	100.0	93.4	84.7	89.2	88.8
Real ER (PPI-based), 2000=100	106.6	107.9	103.1	103.7	100.0	94.7	85.9	90.4	88.1
PPP, CZK/EUR	13.99	14.76	16.10	16.31	16.34	16.74	16.53	17.02	17.12
Price level, EU(25) = 100	41	41	45	44	46	49	54	53	54
Average monthly gross wages, CZK	9825	10802	11801	12797	13614	14793	15866	16920	18050
Average monthly gross wages, EUR (ER)	289	302	326	347	382	434	515	531	566
Average monthly gross wages, EUR (PPP)	702	732	733	785	833	884	960	994	1054
GDP nominal, bn CZK	1660.6	1785.1	1962.5	2041.4	2150.1	2315.3	2414.7	2550.8	2720
Employed persons - LFS, th., average	4972.0	4936.5	4865.7	4764.1	4731.6	4750.2	4764.9	4733.2	4706.7
GDP per employed person, CZK	334000	361619	403330	428487	454404	487402	506762	538913	577900
GDP per empl. person, CZK at 1999 pr.	413490	413380	414638	428487	448143	458220	463438	484122	505512
Unit labour costs, 2000=100	78.2	86.0	93.7	98.3	100.0	106.3	112.7	115.0	117.5
Unit labour costs, ER adj., 2000=100	81.9	85.6	92.3	94.9	100.0	111.0	130.2	128.7	131.2
Unit labour costs, PPP adj., Austria=100	25.46	27.71	30.18	30.61	32.25	35.41	41.14	39.55	39.89
Hungary									
Producer price index, 2000=100	63.6	76.6	85.3	89.6	100.0	105.2	103.3	105.8	109.5
Consumer price index, 2000=100	61.2	72.4	82.8	91.1	100.0	109.2	115.0	120.4	128.6
GDP deflator, 2000=100	63.0	74.6	84.0	91.1	100.0	108.6	118.3	127.4	136.6
Exchange rate (ER), HUF/EUR	191.15	210.93	240.98	252.80	260.04	256.68	242.97	253.51	251.68
ER, nominal 2000=100	73.5	81.1	92.7	97.2	100.0	98.7	93.4	97.5	96.8
Real ER (CPI-based), 2000=100	113.0	107.2	108.5	104.8	100.0	92.4	84.8	86.2	81.8
Real ER (PPI-based), 2000=100	110.6	102.2	104.1	103.6	100.0	95.5	91.8	95.0	93.6
PPP, HUF/EUR	84.43	97.42	107.78	114.35	122.11	126.21	132.87	141.78	147.57
Price level, EU(25) = 100	44	46	45	45	47	49	55	56	59
Average monthly gross wages, HUF	46837	57270	67764	77187	87645	103553	122482	137193	145675
Average monthly gross wages, EUR (ER)	245	272	281	305	337	403	504	541	579
Average monthly gross wages, EUR (PPP)	555	588	629	675	718	820	922	968	987
GDP nominal, bn HUF	6893.9	8540.7	10087.4	11393.5	13150.8	14849.8	16740.4	18568.3	20700
Employed persons - LFS, th., average	3605.1	3610.3	3674.7	3809.3	3856.2	3868.3	3870.6	3921.9	3900.4
GDP per employed person, HUF	1912273	2365640	2745104	2990969	3410291	3838846	4325020	4734509	5307148
GDP per empl. person, HUF at 1999 pr.	2765169	2888463	2976353	2990969	3107678	3222322	3332642	3387590	3539175
Unit labour costs, 2000=100	60.1	70.3	80.7	91.5	100.0	113.9	130.3	143.6	145.9
Unit labour costs, ER adj., 2000=100	81.7	86.7	87.1	94.1	100.0	115.4	139.5	147.3	150.8
Unit labour costs, PPP adj., Austria=100	22.63	25.02	25.40	27.05	28.75	32.82	39.27	40.36	40.87
Poland									
Producer price index, 2000=100	72.9	81.8	87.8	92.8	100.0	101.6	102.6	105.3	112.7
Consumer price index, 2000=100	65.9	75.7	84.6	90.8	100.0	105.5	107.5	108.4	112.2
GDP deflator, 2000=100	69.4	79.0	88.1	93.7	100.0	104.0	105.4	105.9	109.0
Exchange rate (ER), PLN/EUR	3.377	3.706	3.923	4.227	4.011	3.669	3.856	4.398	4.534
ER, nominal, 2000=100	84.2	92.4	97.8	105.4	100.0	91.5	96.1	109.6	113.0
Real ER (CPI-based), 2000=100	120.3	116.8	112.0	113.9	100.0	88.6	93.3	107.7	109.5
Real ER (PPI-based), 2000=100	110.5	109.0	106.7	108.5	100.0	91.6	95.1	107.3	106.3
PPP, PLZ/EUR	1.579	1.751	1.919	1.997	2.070	2.119	2.114	2.171	2.188
Price level, EU(25) = 100	47	47	49	47	52	58	55	49	48
Average monthly gross wages, PLN *)	874	1066	1233	1697	1894	2045	2098	2185	2439
Average monthly gross wages, EUR (ER)	259	288	314	401	472	557	544	497	538
Average monthly gross wages, EUR (PPP)	554	609	642	850	915	965	992	1006	1114
GDP nominal, bn PLN	414.4	504.1	589.4	652.5	723.9	760.6	781.1	814.9	884.2
Employment total - reg., th., average	15020.6	15438.7	15800.4	15373.5	15017.5	14923.6	14589.9	14486.9	14490
GDP per employed person, PLN	27590	32654	37300	42444	48203	50966	53538	56252	61021
GDP per empl. person, PLN at 1999 pr.	37283	38741	39672	42444	45189	45927	47634	49795	52494
Unit labour costs, 2000=100	56.0	65.6	74.1	95.4	100.0	106.3	105.1	104.7	110.9
Unit labour costs, ER adj., 2000=100	66.5	71.1	75.8	90.5	100.0	116.2	109.3	95.5	98.1
Unit labour costs, PPP adj., Austria=100	30.97	34.51	37.19	43.77	48.36	55.56	51.78	44.02	44.71

*) Poland: Methodological change in 1999 (broader wage coverage).

(Table A/2 ctd.)

Table A/2 (ctd.)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 prelim.
Slovak Republic									
Producer price index, 2000=100	80.2	83.8	86.5	90.2	100.0	106.5	108.7	117.8	121.8
Consumer price index, 2000=100	71.3	75.7	80.7	89.3	100.0	107.1	110.6	120.0	129.0
GDP deflator, 2000=100	77.1	82.3	86.5	92.2	100.0	104.2	108.4	113.5	119.2
Exchange rate (ER), SKK/EUR	38.40	38.01	39.60	44.12	42.59	43.31	42.70	41.49	40.05
ER, nominal, 2000=100	90.2	89.2	93.0	103.6	100.0	101.7	100.3	97.4	94.0
Real ER (CPI-based), 2000=100	119.0	112.9	111.7	113.9	100.0	97.0	94.6	86.4	79.2
Real ER (PPI-based), 2000=100	107.6	102.8	102.9	109.6	100.0	97.1	93.6	85.2	81.8
PPP, SKK/EUR	16.00	16.63	17.19	17.90	18.28	18.67	18.77	19.97	20.36
Price level, EU(25) = 100	42	44	43	41	43	43	44	48	51
Average monthly gross wages, SKK	8154	9226	10003	10728	11430	12365	13511	14365	14366
Average monthly gross wages, EUR (ER)	212	243	253	243	268	286	316	346	359
Average monthly gross wages, EUR (PPP)	510	555	582	599	625	662	720	719	706
GDP nominal, bn SKK	638.4	712.7	781.4	844.1	934.1	1009.8	1098.7	1201.2	1330.0
Employed persons, - LFS, th., average	2224.9	2205.9	2198.6	2132.1	2101.7	2123.7	2127.0	2164.6	2160
GDP per employed person, SKK	286956	323079	355425	395905	444440	475509	516529	554927	615741
GDP per empl. person, SKK at 1999 pr.	343027	361950	378496	395905	409615	420561	439297	450768	475890
Unit labour costs, 2000=100	85.2	91.3	94.7	97.1	100.0	105.4	110.2	114.2	108.2
Unit labour costs, ER adj., 2000=100	94.5	102.4	101.9	93.7	100.0	103.6	109.9	117.2	115.0
Unit labour costs, PPP adj., Austria=100	24.75	27.94	28.09	25.48	27.18	27.85	29.27	30.37	29.49
Slovenia									
Producer price index, 2000=100	80.9	85.9	91.0	92.9	100.0	108.9	114.5	117.3	120.9
Consumer price index, 2000=100	74.0	80.2	86.5	91.8	100.0	108.4	116.5	123.1	127.5
GDP deflator, 2000=100	76.3	83.1	89.4	94.7	100.0	109.1	117.8	124.2	128.6
Exchange rate (ER), SIT/EUR	169.51	180.40	186.27	193.63	205.03	217.19	226.22	233.70	238.86
ER, nominal, 2000=100	82.7	88.0	90.8	94.4	100.0	105.9	110.3	114.0	116.5
Real ER (CPI-based), 2000=100	105.2	105.0	101.8	100.9	100.0	99.9	98.8	98.6	99.3
Real ER (PPI-based), 2000=100	97.7	98.9	95.6	97.0	100.0	99.0	97.9	100.1	102.0
PPP, SIT/EUR	122.86	130.20	137.57	142.60	147.72	156.30	167.10	175.46	179.08
Price level, EU(25) = 100	72	72	74	74	72	72	74	75	75
Average monthly gross wages, SIT	129125	144251	158069	173245	191669	214561	235436	253200	267571
Average monthly gross wages, EUR (ER)	762	800	849	895	935	988	1041	1083	1120
Average monthly gross wages, EUR (PPP)	1051	1108	1149	1215	1298	1373	1409	1443	1494
GDP nominal, bn SIT	2728.2	3110.1	3464.9	3874.7	4252.3	4761.8	5314.5	5747.2	6200.0
Employment total - reg., th., average	741.7	743.4	745.2	758.5	768.2	779.0	783.5	777.2	781.9
GDP per employed person, SIT	3678186	4183408	4649803	5108573	5535629	6112406	6783026	7394262	7929296
GDP per empl. person, SIT at 1999 pr.	4561427	4767509	4925982	5108573	5240102	5305488	5450747	5633410	5836746
Unit labour costs, 2000=100	77.4	82.7	87.7	92.7	100.0	110.6	118.1	122.9	125.3
Unit labour costs, ER adj., 2000=100	93.6	94.0	96.6	98.2	100.0	104.4	107.0	107.8	107.6
Unit labour costs, PPP adj., Austria=100	53.19	55.67	57.76	57.88	58.96	60.87	61.81	60.59	59.81
Estonia									
Producer price index, 2000=100	85.1	92.6	96.5	95.3	100.0	104.4	104.8	105.0	108.1
Consumer price index, 2000=100	77.4	86.0	93.1	96.2	100.0	105.8	109.6	111.0	114.4
GDP deflator, 2000=100	75.6	83.5	91.0	94.9	100.0	105.8	110.5	113.1	117.4
Exchange rate (ER), EEK/EUR	15.074	15.670	15.783	15.647	15.647	15.647	15.647	15.647	15.647
ER, nominal, 2000=100	96.3	100.1	100.9	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2000=100	117.2	111.4	105.1	102.1	100.0	96.6	95.2	95.9	95.0
Real ER (PPI-based), 2000=100	108.3	104.4	100.1	100.2	100.0	97.4	96.9	98.1	98.0
PPP, EEK/EUR	6.610	7.114	7.623	7.772	7.872	8.335	8.698	8.956	9.114
Price level, EU(25) = 100	44	45	48	50	50	53	56	57	58
Average monthly gross wages, EEK	2985	3573	4125	4440	4907	5510	6144	6723	7150
Average monthly gross wages, EUR (ER)	198	228	261	284	314	352	393	430	457
Average monthly gross wages, EUR (PPP)	452	502	541	571	623	661	706	751	785
GDP nominal, bn EEK	56.0	68.3	78.3	81.6	92.7	104.3	116.9	125.8	138.7
Employed persons - LFS, th., average	619.3	617.2	606.5	579.3	572.5	577.7	585.5	594.3	595
GDP per employed person, EEK	90371	110706	129169	140928	161951	180609	199605	211732	233109
GDP per empl. person, EEK at 1999 pr.	113458	125825	134713	140928	153732	162089	171516	177669	188462
Unit labour costs, 2000=100	82.4	89.0	95.9	98.7	100.0	106.5	112.2	118.5	118.9
Unit labour costs, ER adj., 2000=100	85.6	88.8	95.1	98.7	100.0	106.5	112.2	118.5	118.9
Unit labour costs, PPP adj., Austria=100	30.30	32.79	35.46	36.27	36.75	38.71	40.39	41.53	41.18

(Table A/2 ctd.)

Table A/2 (ctd.)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 prelim.
Latvia									
Producer price index, 2000=100	97.6	101.6	103.5	99.4	100.0	101.7	102.7	106.0	115.1
Consumer price index, 2000=100	83.9	90.9	95.2	97.5	100.0	102.5	104.4	107.5	114.1
GDP deflator, 2000=100	82.2	87.9	92.0	96.4	100.0	102.1	105.6	109.2	116.5
Exchange rate (ER), LVL/EUR	0.6900	0.6574	0.6614	0.6237	0.5600	0.5627	0.5826	0.6449	0.6711
ER, nominal, 2000=100	123.2	117.4	118.1	111.4	100.0	100.5	104.0	115.2	119.8
Real ER (CPI-based), 2000=100	138.3	123.6	120.3	112.1	100.0	100.2	103.9	114.0	114.1
Real ER (PPI-based), 2000=100	120.8	111.5	109.3	107.0	100.0	100.5	102.8	112.0	110.3
PPP, LVL/EUR	0.2540	0.2646	0.2718	0.2787	0.2818	0.2866	0.2949	0.3105	0.3248
Price level, EU(25) = 100	37	40	41	45	50	51	51	48	48
Average monthly gross wages, LVL	99	120	133	141	150	159	173	192	210
Average monthly gross wages, EUR (ER)	143	183	202	226	267	283	297	298	313
Average monthly gross wages, EUR (PPP)	389	454	490	506	531	555	587	620	646
GDP nominal, bn LVL	3.076	3.563	3.903	4.224	4.686	5.168	5.691	6.322	7.270
Employed persons - LFS, th., average	948.7	990.2	986.1	968.5	941.1	962.1	989.0	1006.9	1020
GDP per employed person, LVL	3242	3598	3958	4362	4979	5372	5754	6279	7127
GDP per empl. person, LVL at 1999 pr.	3802	3944	4147	4362	4798	5069	5249	5540	5894
Unit labour costs, 2000=100	83.3	97.7	103.1	103.7	100.0	100.6	105.8	111.5	114.3
Unit labour costs, ER adj., 2000=100	67.6	83.2	87.3	93.1	100.0	100.2	101.6	96.8	95.4
Unit labour costs, PPP adj., Austria=100	23.43	30.03	31.84	33.47	35.95	35.61	35.79	33.17	32.33
Lithuania									
Producer price index, 2000=100	83.6	88.7	84.8	86.2	100.0	97.0	94.3	93.8	98.5
Consumer price index, 2000=100	85.8	93.5	98.2	99.0	100.0	101.3	101.6	100.4	101.6
GDP deflator, 2000=100	83.2	94.8	99.6	99.0	100.0	99.9	99.9	99.1	102.2
Exchange rate (ER), LTL/EUR	5.0118	4.5272	4.4924	4.2712	3.6990	3.5849	3.4605	3.4528	3.4528
ER, nominal, 2000=100	135.5	122.4	121.4	115.5	100.0	96.9	93.6	93.3	93.3
Real ER (CPI-based), 2000=100	148.6	125.4	119.9	114.4	100.0	97.8	96.1	99.0	99.8
Real ER (PPI-based), 2000=100	155.0	133.2	137.2	127.9	100.0	101.6	100.7	102.5	100.4
PPP, LTL/EUR	1.5829	1.7568	1.8127	1.7628	1.7096	1.6663	1.6582	1.6626	1.6567
Price level, EU(25) = 100	32	39	40	41	46	46	48	48	48
Average monthly gross wages, LTL	618	778	930	987	971	982	1014	1073	1158
Average monthly gross wages, EUR (ER)	123	172	207	231	262	274	293	311	335
Average monthly gross wages, EUR (PPP)	391	443	513	560	568	590	611	645	699
GDP nominal, bn LTL	32.3	39.4	44.4	43.4	45.5	48.4	51.6	56.2	61.8
Employed persons - LFS, th., average	1620.4	1570.7	1597.6	1598.4	1397.8	1351.8	1405.9	1438.0	1435
GDP per employed person, LTL	19927	25070	27778	27127	32570	35788	36733	39067	43067
GDP per empl. person, LTL at 1999 pr.	23711	26176	27608	27127	32235	35458	36399	39036	41699
Unit labour costs, 2000=100	86.6	98.7	111.8	120.9	100.0	92.0	92.5	91.2	92.2
Unit labour costs, ER adj., 2000=100	63.9	80.6	92.1	104.7	100.0	94.9	98.9	97.7	98.8
Unit labour costs, PPP adj., Austria=100	20.48	26.94	31.07	34.81	33.27	31.23	32.21	30.99	30.98
Bulgaria									
Producer price index, 2000=100	6.5	69.7	82.8	85.1	100.0	103.8	105.0	110.1	116.6
Consumer price index, 2000=100	6.4	74.5	88.4	90.7	100.0	107.4	113.6	116.2	123.4
GDP deflator, 2000=100	7.0	73.1	90.4	93.7	100.0	106.7	110.7	113.0	118.9
Exchange rate (ER), BGN/EUR	0.2204	1.8958	1.9723	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2000=100	11.3	96.9	100.8	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2000=100	165.0	124.6	110.6	108.3	100.0	95.2	91.9	91.6	88.1
Real ER (PPI-based), 2000=100	165.7	134.2	116.7	112.2	100.0	98.0	96.7	93.6	90.8
PPP, BGN/EUR	0.0471	0.4800	0.5837	0.5921	0.6149	0.6423	0.6738	0.6937	0.7199
Price level, EU(25) = 100	21	25	30	30	31	33	34	35	37
Average monthly gross wages, BGN	13	128	183	201	225	240	258	273	299
Average monthly gross wages, EUR (ER)	60	67	93	103	115	123	132	140	153
Average monthly gross wages, EUR (PPP)	281	266	314	339	365	374	382	394	415
GDP nominal, bn BGN	1.8	17.4	22.4	23.8	26.8	29.7	32.3	34.4	38.3
Employment total - reg., th.,average	3285.9	3157.4	3152.6	3087.8	2980.1	2968.1	2978.6	3020.7	3115
GDP per employed person, BGN	536	5521	7112	7705	8977	10010	10856	11392	12279
GDP per empl. person, BGN at 1999 pr.	7210	7082	7375	7705	8413	8792	9190	9452	9679
Unit labour costs, 2000=100	6.9	67.7	93.1	97.8	100.0	102.3	105.0	108.4	115.8
Unit labour costs, ER adj., 2000=100	61.1	69.8	92.3	97.8	100.0	102.3	105.0	108.4	115.8
Unit labour costs, PPP adj., Austria=100	11.03	13.13	17.54	18.30	18.72	18.94	19.26	19.34	20.44

(Table A/2 ctd.)

Table A/2 (ctd.)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 prelim.
Romania									
Producer price index, 2000=100	13.4	33.9	45.1	65.2	100.0	138.1	169.9	203.0	241.6
Consumer price index, 2000=100	11.6	29.6	47.1	68.6	100.0	134.5	164.8	190.0	212.6
GDP deflator, 2000=100	12.3	30.4	46.9	69.3	100.0	137.4	169.6	202.1	229.6
Exchange rate (ER), ROL/EUR	3862.9	8090.9	9989.3	16295.6	19955.8	26026.9	31255.3	37555.9	40532.1
ER, nominal, 2000=100	19.4	40.5	50.1	81.7	100.0	130.4	156.6	188.2	203.1
Real ER (CPI-based), 2000=100	156.9	131.1	103.1	116.7	100.0	99.1	99.2	105.4	103.8
Real ER (PPI-based), 2000=100	138.2	115.5	106.3	119.6	100.0	96.1	93.6	95.5	89.1
PPP, ROL/EUR	788.6	1875.2	3534.8	5107.9	7156.5	9539.7	11455.9	13775.4	15297.8
Price level, EU(25) = 100	20	23	35	31	36	37	37	37	38
Average monthly grross wages, ROL	426610	846450	1357132	1957731	2876645	4282622	5452097	6741152	8261492
Average monthly gross wages, EUR (ER)	110	105	136	120	144	165	174	179	204
Average monthly gross wages, EUR (PPP)	541	451	384	383	402	449	476	489	540
GDP nominal, bn ROL	108920	252926	371194	545730	803773	1167687	1512617	1890778	2316000
Employed persons - LFS, th., average *)	10935.5	11050.0	10844.9	10775.6	10763.8	10696.9	9234.3	9222.5	9180
GDP per employed person, th. ROL	9960.2	22889.2	34227.5	50645.0	74673.7	109161.3	163804.2	205018.0	252287.6
GDP per empl. person, th. ROL at 1999 pr.	56113.1	52139.0	50578.0	50645.0	51768.9	55061.3	66971.0	70343.4	76180.7
Unit labour costs, 2000=100	13.7	29.2	48.3	69.6	100.0	140.0	146.5	172.5	195.2
Unit labour costs, ER adj., 2000=100	70.7	72.1	96.5	85.2	100.0	107.3	93.5	91.6	96.1
Unit labour costs, PPP adj., Austria=100	22.46	23.86	32.26	28.08	32.97	34.99	30.20	28.80	29.87
Croatia									
Producer price index, 2000=100	87.9	89.9	88.8	91.2	100.0	103.6	103.2	105.1	108.8
Consumer price index, 2000=100	82.5	85.5	90.4	94.2	100.0	104.9	107.2	108.8	111.1
GDP deflator, 2000=100	79.0	84.9	92.0	95.5	100.0	104.0	107.1	110.5	114.4
Exchange rate (ER), HRK/EUR	6.8047	6.9597	7.1366	7.5796	7.6350	7.4690	7.4068	7.5634	7.4959
ER, nominal, 2000=100	89.1	91.2	93.5	99.3	100.0	97.8	97.0	99.1	98.2
Real ER (CPI-based), 2000=100	101.7	102.1	100.3	103.5	100.0	95.3	94.4	96.9	96.0
Real ER (PPI-based), 2000=100	97.0	97.8	100.8	104.0	100.0	96.1	95.5	97.1	95.6
PPP, HRK/EUR	3.7391	3.8585	4.0924	4.1759	4.2379	4.3219	4.3440	4.4715	4.4882
Price level, EU(25) = 100	55	55	57	55	56	58	59	59	60
Average monthly gross wages, HRK	3243	3668	4131	4551	4869	5061	5366	5623	5990
Average monthly gross wages, EUR (ER)	477	527	579	600	638	678	724	743	799
Average monthly gross wages, EUR (PPP)	867	951	1009	1090	1149	1171	1235	1258	1335
GDP nominal, bn HRK	108.0	123.8	137.6	141.6	152.5	165.6	179.4	193.1	207.3
Employment total - reg., th., average	1329.5	1310.9	1384.8	1364.5	1341.0	1348.3	1359.0	1392.5	1391.1
GDP per employed person, HRK	81219	94447	99364	103759	113739	122850	132000	138646	149016
GDP per empl. person, HRK at 1999 pr.	98160	106322	103163	103759	108647	112817	117741	119846	124454
Unit labour costs, 2000=100	73.7	77.0	89.4	97.9	100.0	100.1	101.7	104.7	107.4
Unit labour costs, ER adj., 2000=100	82.7	84.5	95.6	98.6	100.0	102.3	104.8	105.7	109.4
Unit labour costs, PPP adj., Austria=100	45.29	48.18	55.10	56.00	56.81	57.49	58.33	57.23	58.60
Macedonia									
Producer price index, 2000=100	83.4	86.9	90.4	90.3	100.0	102.0	101.1	100.8	101.7
Consumer price index, 2000=100	92.9	95.3	95.2	94.5	100.0	105.5	107.4	108.7	108.2
GDP deflator, 1990=100	43692.4	45183.5	45800.5	47072.7	50948.2	52787.9	54581.7	54852.8	55346.4
Exchange rate (ER), MKD/EUR	50.08	56.20	61.07	60.62	60.73	60.91	60.98	61.26	61.34
ER, nominal, 2000=100	82.5	92.5	100.6	99.8	100.0	100.3	100.4	100.9	101.0
Real ER (CPI-based), 2000=100	83.6	93.0	102.4	103.6	100.0	97.2	97.6	98.8	101.4
Real ER (PPI-based), 2000=100	94.6	102.7	106.5	105.5	100.0	100.0	100.9	103.2	105.2
PPP, MKD/EUR	21.28	21.43	21.36	21.46	22.57	22.97	23.18	23.15	22.88
Price level, EU(25) = 100	42	38	35	35	37	38	38	38	37
Average monthly net wages, MKD	8817	9063	9394	9664	10193	10552	11279	11824	12285
Average monthly net wages, EUR (ER)	176	161	154	159	168	173	185	193	200
Average monthly net wages, EUR (PPP)	414	423	440	450	452	459	487	511	537
GDP nominal, bn MKD	176.4	186.0	195.0	209.0	236.4	233.8	244.0	253.5	260.8
Employed persons - LFS, th., average	537.6	512.3	539.8	545.2	549.8	599.3	561.3	545.1	540
GDP per employed person, MKD	328212	363103	361231	383348	429919	390185	434620	464961	482963
GDP per empl. person, MKD at 1999 pr.	353604	378285	371265	383348	397216	347941	374828	399013	410764
Unit labour costs, 2000=100	97.2	93.4	98.6	98.2	100.0	118.2	117.3	115.5	116.5
Unit labour costs, ER adj., 2000=100	117.8	100.9	98.1	98.4	100.0	117.8	116.8	114.5	115.4
Unit labour costs, PPP adj., Austria=100	23.87	21.30	20.91	20.68	21.02	24.49	24.04	22.93	22.87

*) Romania: Methodological break in 2001/2002.

(Table A/2 ctd.)

Table A/2 (ctd.)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 prelim.
Russia									
Producer price index, 2000=100	34.9	40.1	42.9	68.2	100.0	119.1	133.0	153.8	191.3
Consumer price index, 2000=100	30.4	34.9	44.6	82.8	100.0	121.6	141.1	160.2	177.9
GDP deflator, 2000=100	30.9	35.5	42.1	72.6	100.0	116.5	134.6	153.0	181.6
Exchange rate (ER), RUB/EUR	6.632	6.541	11.063	26.239	26.029	26.130	29.647	34.548	35.814
ER, nominal, 2000=100	25.5	25.1	42.5	100.8	100.0	100.4	113.9	132.7	137.6
Real ER (CPI-based), 2000=100	78.8	68.9	92.5	119.5	100.0	84.4	84.3	88.2	84.1
Real ER (PPI-based), 2000=100	70.0	60.5	94.8	141.1	100.0	85.8	86.9	88.9	76.2
PPP, RUB/EUR	2.395	3.072	3.581	6.035	8.328	9.529	10.740	12.140	14.110
Price level, EU(25) = 100	36	47	32	23	32	36	36	35	39
Average monthly gross wages, RUB	790.2	950.2	1051.5	1522.6	2223.4	3240.4	4360.3	5498.5	6828.0
Average monthly gross wages, EUR (ER)	119	145	95	58	85	124	147	159	191
Average monthly gross wages, EUR (PPP)	330	309	294	252	267	340	406	453	484
GDP nominal, bn RUB	2007.8	2342.5	2629.6	4823.2	7305.6	8943.6	10817.5	13201.1	16778.8
Employment total - reg., th., average	65950	64693	63812	63963	64327	64710	65359	65666	67240
GDP per employed person, RUB	30445	36210	41209	75406	113570	138211	165508	201034	249536
GDP per empl. person, RUB at 1999 pr.	71580	73993	71038	75406	82477	86170	89322	95395	99782
Unit labour costs, 2000=100	41.0	47.6	54.9	74.9	100.0	139.5	181.1	213.8	253.8
Unit labour costs, ER adj., 2000=100	160.7	189.6	129.2	74.3	100.0	139.0	159.0	161.1	184.5
Unit labour costs, PPP adj., Austria=100	22.44	27.58	18.99	10.76	14.49	19.91	22.56	22.24	25.20
Ukraine									
Producer price index, 2000=100	51.7	55.7	63.1	82.7	100.0	108.6	112.0	120.7	145.3
Consumer price index, 2000=100	49.6	57.5	63.6	78.0	100.0	112.0	112.9	118.8	129.5
GDP deflator, 2000=100	48.2	57.0	63.8	81.2	100.0	109.9	115.6	123.6	134.7
Exchange rate (ER), UAH/EUR	2.322	2.113	2.768	4.393	5.029	4.814	5.030	6.024	6.609
ER, nominal, 2000=100	46.2	42.0	55.0	87.4	100.0	95.7	100.0	119.8	131.4
Real ER (CPI-based), 2000=100	87.6	70.0	83.9	109.9	100.0	87.3	92.4	107.4	110.3
Real ER (PPI-based), 2000=100	85.4	72.8	83.5	100.8	100.0	89.7	90.7	102.3	95.8
PPP, UAH/EUR	0.5201	0.5600	0.6170	0.7680	0.9188	0.9923	1.0177	1.0817	1.1654
Price level, EU(25) = 100	22	27	22	17	18	21	20	18	18
Average monthly gross wages, UAH	126.0	143.0	153.0	177.5	230.1	311.1	376.4	462.3	589.6
Average monthly gross wages, EUR (ER)	54	68	55	40	46	65	75	77	89
Average monthly gross wages, EUR (PPP)	242	255	248	231	250	313	370	427	506
GDP nominal, bn UAH	81.5	93.4	102.6	130.4	170.1	204.2	225.8	264.2	322.5
Employment total - reg., th., average	23231.8	22597.6	22348.7	21823.7	21268.5	21015.5	21378.6	21448.7	22000
GDP per employed person, UAH	3509	4132	4591	5977	7996	9716	10562	12316	14659
GDP per empl. person, UAH at 1999 pr.	5909	5891	5846	5977	6495	7179	7424	8095	8840
Unit labour costs, 2000=100	60.2	68.5	73.9	83.8	100.0	122.3	143.1	161.2	188.3
Unit labour costs, ER adj., 2000=100	130.4	163.1	134.2	96.0	100.0	127.8	143.1	134.5	143.2
Unit labour costs, PPP adj., Austria=100	15.75	20.54	17.08	12.03	12.54	15.85	17.57	16.08	16.94
Austria									
Producer price index, 2000=100	97.0	97.4	96.9	96.2	100.0	101.5	101.1	102.7	107.7
Consumer price index, 2000=100	95.0	96.2	97.1	97.7	100.0	102.7	104.5	106.0	108.2
GDP deflator, 2000=100	96.6	97.4	97.9	98.6	100.0	102.1	103.4	105.5	107.1
Exchange rate (ER), ATS-EUR/EUR	0.9636	1.0017	1.0089	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000
PPP, ATS-EUR/EUR	1.1015	1.0881	1.0892	1.0646	1.0397	1.0543	1.0560	1.0692	1.0814
Price level, EU(25) = 100	114	109	108	106	104	105	106	107	108
Average monthly gross wages, EUR-ATS	2157	2180	2245	2296	2355	2389	2438	2499	2558
Average monthly gross wages, EUR (ER)	2239	2177	2225	2296	2355	2389	2438	2499	2558
Average monthly gross wages, EUR (PPP)	1958	2004	2061	2157	2265	2266	2308	2337	2366
GDP nominal, bn EUR-ATS	178.0	182.5	190.6	197.1	206.7	212.5	218.3	224.1	232.0
Employment total - reg., th., average	3415.4	3424.5	3446.6	3478.8	3506.5	3522.5	3532.9	3565.5	3586.9
GDP per employed person, EUR-ATS	52131	53289	55309	56647	58939	60330	61800	62861	64673
GDP per empl. person, EUR-ATS at 1999 pr.	53235	53939	55695	56647	58122	58292	58914	58764	59524
Unit labour costs, 2000=100	100.0	99.7	99.5	100.0	100.0	101.1	102.1	104.9	106.1
Unit labour costs, ER adj., 2000=100	103.8	99.6	98.6	100.0	100.0	101.1	102.1	104.9	106.1
Unit labour costs, PPP adjusted	0.54	0.52	0.51	0.52	0.52	0.52	0.53	0.54	0.55

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

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

For new EU member states and candidate countries PPPs are taken from Eurostat. For the rest of the countries PPPs have been estimated by wiiw using the OECD benchmark PPPs for 2002 and extrapolated with GDP price deflators.

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

Table A/3

Indicators of macro-competitiveness, 1996-2004

annual changes in %

	1996	1997	1998	1999	2000	2001	2002	2003	2004 prelim.	1996-04 average
Czech Republic										
GDP deflator	8.7	8.3	11.2	2.8	1.4	4.9	2.8	1.8	2.7	4.9
Exchange rate (ER), CZK/EUR	-0.9	5.3	1.0	2.0	-3.4	-4.3	-9.6	3.3	0.2	-0.8
Real ER (CPI-based)	-6.7	-1.3	-7.6	1.1	-5.3	-6.6	-9.3	5.3	-0.5	-3.5
Real ER (PPI-based)	-4.9	1.2	-4.4	0.7	-3.6	-5.3	-9.3	5.2	-2.6	-2.6
Average gross wages, CZK	18.3	9.9	9.2	8.4	6.4	8.7	7.3	6.6	6.7	9.0
Average gross wages, real (PPI based)	13.0	4.8	4.1	7.4	1.4	5.7	7.8	7.0	0.9	5.7
Average gross wages, real (CPI based)	8.7	1.3	-1.3	6.2	2.4	3.8	5.4	6.5	3.8	4.0
Average gross wages, EUR (ER)	19.3	4.4	8.2	6.3	10.2	13.5	18.6	3.2	6.5	9.9
Employment total	0.2	-0.7	-1.4	-2.1	-0.7	0.4	0.3	-0.7	-0.6	-0.6
GDP per empl. person, CZK at 1999 pr.	10.4	0.0	0.3	3.3	4.6	2.2	1.1	4.5	4.4	3.4
Unit labour costs, CZK at 1999 prices	7.1	10.0	8.9	4.9	1.7	6.3	6.0	2.1	2.2	5.4
Unit labour costs, ER (EUR) adjusted	8.1	4.5	7.8	2.9	5.4	11.0	17.3	-1.2	2.0	6.3
Hungary										
GDP deflator	21.2	18.4	12.6	8.4	9.7	8.6	8.9	7.7	7.3	11.3
Exchange rate (ER), HUF/EUR	17.5	10.3	14.2	4.9	2.9	-1.3	-5.3	4.3	-0.7	5.0
Real ER (CPI-based)	-2.6	-5.1	1.2	-3.5	-4.5	-7.6	-8.2	1.6	-5.1	-3.8
Real ER (PPI-based)	-3.1	-7.6	1.9	-0.5	-3.5	-4.5	-3.8	3.4	-1.4	-2.2
Average gross wages, HUF	20.4	22.3	18.3	13.9	13.5	18.2	18.3	12.0	6.2	15.8
Average gross wages, real (PPI based)	-1.1	1.6	6.3	8.4	1.7	12.3	20.4	9.4	2.6	6.7
Average gross wages, real (CPI based)	-2.6	3.3	3.5	3.5	3.4	8.2	12.3	7.0	-0.6	4.2
Average gross wages, EUR (ER)	2.5	10.8	3.6	8.6	10.4	19.7	25.0	7.4	7.0	10.3
Employment total	-0.5	0.1	1.8	3.7	1.2	0.3	0.1	1.3	-0.5	0.8
GDP per empl. person, HUF at 1999 pr.	2.7	4.5	3.0	0.5	3.9	3.7	3.4	1.6	4.5	3.1
Unit labour costs, HUF at 1999 prices	17.2	17.1	14.8	13.3	9.3	13.9	14.4	10.2	1.6	12.3
Unit labour costs, ER (EUR) adjusted	-0.3	6.1	0.5	8.0	6.2	15.4	20.8	5.6	2.4	7.0
Poland										
GDP deflator	18.6	13.9	11.5	6.4	6.7	4.0	1.3	0.5	2.9	7.2
Exchange rate (ER), PLN/EUR	7.7	9.7	5.9	7.7	-5.1	-8.5	5.1	14.1	3.1	4.2
Real ER (CPI-based)	-8.0	-2.9	-4.1	1.6	-12.2	-11.4	5.3	15.4	1.7	-1.9
Real ER (PPI-based)	-3.7	-1.4	-2.1	1.6	-7.8	-8.4	3.9	12.8	-0.9	-0.9
Average gross wages, PLN *)	26.5	21.9	15.7	10.6	11.6	8.0	2.6	4.2	11.6	12.3
Average gross wages, real (PPI based)	12.6	8.6	7.8	30.3	3.5	6.3	1.6	1.5	4.3	8.2
Average gross wages, real (CPI based)	5.5	6.1	3.5	28.3	1.3	2.4	0.7	3.3	7.8	6.3
Average gross wages, EUR (ER)	17.4	11.1	9.2	27.8	17.6	18.1	-2.4	-8.7	8.3	10.4
Employment total	1.9	2.8	2.3	-2.7	-2.3	-0.6	-2.2	-0.7	0.0	-0.2
GDP per empl. person, PLN at 1999 pr.	4.0	3.9	2.4	7.0	6.5	1.6	3.7	4.5	5.4	4.3
Unit labour costs, PLN at 1999 prices	21.7	17.3	12.9	28.7	4.8	6.3	-1.1	-0.4	5.9	10.3
Unit labour costs, ER (EUR) adjusted	12.9	6.9	6.7	19.4	10.5	16.2	-5.9	-12.6	2.7	5.8
Slovak Republic										
GDP deflator	4.3	6.7	5.2	6.5	8.5	4.2	4.0	4.7	5.1	5.5
Exchange rate (ER), SKK/EUR	-0.1	-1.0	4.2	11.4	-3.5	1.7	-1.4	-2.8	-3.5	0.5
Real ER (CPI-based)	-3.3	-5.1	-1.1	2.0	-12.2	-3.0	-2.6	-8.7	-8.3	-4.8
Real ER (PPI-based)	-3.7	-4.5	0.1	6.5	-8.8	-2.9	-3.6	-8.9	-4.0	-3.4
Average gross wages, SKK	13.3	13.1	8.4	7.2	6.5	8.2	9.3	6.3	0.0	8.0
Average gross wages, real (PPI based)	8.8	8.3	5.0	2.8	-3.8	1.6	7.0	-1.8	-3.3	2.6
Average gross wages, real (CPI based)	7.1	6.6	1.6	-3.0	-4.9	1.0	5.8	-2.0	-7.0	0.5
Average gross wages, EUR (ER)	13.5	14.3	4.1	-3.7	10.4	6.4	10.8	9.4	3.6	7.5
Employment total	3.6	-0.9	-0.3	-3.0	-1.4	1.0	0.2	1.8	-0.2	0.1
GDP per empl. person, SKK at 1999 pr.	2.5	5.5	4.6	4.6	3.5	2.7	4.5	2.6	5.6	4.0
Unit labour costs, SKK at 1999 prices	10.6	7.2	3.7	2.5	3.0	5.4	4.6	3.6	-5.3	3.8
Unit labour costs, ER (EUR) adjusted	10.8	8.3	-0.5	-8.0	6.7	3.6	6.1	6.6	-1.9	3.4
Slovenia										
GDP deflator	10.9	8.8	7.6	5.9	5.6	9.1	8.0	5.5	3.5	7.2
Exchange rate (ER), SIT/EUR	10.7	6.4	3.3	4.0	5.9	5.9	4.2	3.3	2.2	5.1
Real ER (CPI-based)	3.2	-0.2	-3.1	-0.8	-0.9	-0.1	-1.1	-0.2	0.7	-0.3
Real ER (PPI-based)	4.1	1.2	-3.3	1.5	3.1	-1.0	-1.1	2.3	1.9	0.9
Average gross wages, SIT	15.3	11.7	9.6	9.6	10.6	11.9	9.7	7.5	5.7	10.2
Average gross wages, real (PPI based)	8.0	5.3	3.4	7.3	2.8	2.8	4.4	4.9	2.5	4.6
Average gross wages, real (CPI based)	4.9	3.1	1.6	3.3	1.6	3.3	2.1	1.8	2.0	2.6
Average gross wages, EUR (ER)	4.1	5.0	6.1	5.4	4.5	5.7	5.3	4.1	3.4	4.8
Employment total	-0.5	0.2	0.2	1.8	1.3	1.4	0.6	-0.8	0.6	0.5
GDP per empl. person, SIT at 1999 pr.	11.2	4.5	3.3	3.7	2.6	1.2	2.7	3.4	3.6	4.0
Unit labour costs, SIT at 1999 prices	3.7	6.9	6.1	5.7	7.9	10.6	6.8	4.1	2.0	5.9
Unit labour costs, ER (EUR) adjusted	-6.4	0.4	2.7	1.7	1.9	4.4	2.5	0.7	-0.2	0.8

*) Poland: Methodological change in 1999 (broader wage coverage). Growth in 1999 comparable according to new methodology.

(Table A/3 ctd.)

Table A/3 (ctd.)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 prelim.	1996-04 average
Estonia										
GDP deflator	24.3	10.5	9.0	4.3	5.3	5.8	4.4	2.4	3.8	7.6
Exchange rate (ER), EEK/EUR	1.7	4.0	0.7	-0.9	0.0	0.0	0.0	0.0	0.0	0.6
Real ER (CPI-based)	-15.4	-4.9	-5.7	-2.9	-2.0	-3.4	-1.4	0.7	-0.9	-4.1
Real ER (PPI-based)	-11.0	-3.6	-4.1	0.0	-0.2	-2.6	-0.6	1.3	-0.1	-2.4
Average gross wages, EEK	25.7	19.7	15.4	7.6	10.5	12.3	11.5	9.4	6.4	13.0
Average gross wages, real (PPI based)	9.5	10.0	10.8	8.9	5.4	7.6	11.1	9.2	3.4	8.4
Average gross wages, real (CPI based)	2.1	7.6	6.7	4.2	6.3	6.1	7.6	8.0	3.3	5.8
Average gross wages, EUR (ER)	23.6	15.1	14.6	8.6	10.5	12.3	11.5	9.4	6.4	12.3
Employment total	-2.2	-0.3	-1.7	-4.5	-1.2	0.9	1.4	1.5	0.1	-0.7
GDP per empl. person, EEK at 1999 pr.	6.9	10.9	7.1	4.6	9.1	5.4	5.8	3.6	6.1	6.6
Unit labour costs, EEK at 1999 prices	17.6	7.9	7.8	2.9	1.3	6.5	5.4	5.6	0.3	6.0
Unit labour costs, ER (EUR) adjusted	15.6	3.8	7.1	3.8	1.3	6.5	5.4	5.6	0.3	5.4
Latvia										
GDP deflator	14.9	7.0	4.6	4.8	3.8	2.1	3.4	3.4	6.7	5.6
Exchange rate (ER), LVL/EUR	1.2	-4.7	0.6	-5.7	-10.2	0.5	3.5	10.7	4.1	-0.2
Real ER (CPI-based)	-11.9	-10.6	-2.7	-6.8	-10.8	0.2	3.7	9.7	0.0	-3.5
Real ER (PPI-based)	-10.6	-7.7	-2.0	-2.1	-6.5	0.5	2.3	8.9	-1.5	-2.2
Average gross wages, LVL	10.3	21.6	11.1	5.8	6.1	6.3	8.8	11.3	9.1	9.9
Average gross wages, real (PPI based)	-3.0	16.8	9.0	10.2	5.4	4.6	7.7	7.8	0.5	6.4
Average gross wages, real (CPI based)	-6.2	12.2	6.1	3.3	3.4	3.7	6.8	8.1	2.7	4.3
Average gross wages, EUR (ER)	9.0	27.6	10.4	12.2	18.1	5.8	5.1	0.5	4.8	10.1
Employment total	-1.9	4.4	-0.4	-1.8	-2.8	2.2	2.8	1.8	1.3	0.6
GDP per empl. person, LVL at 1999 pr.	17.1	3.7	5.2	5.2	10.0	5.7	3.6	5.5	6.4	6.9
Unit labour costs, LVL at 1999 prices	-5.8	17.2	5.6	0.6	-3.6	0.6	5.1	5.4	2.6	2.9
Unit labour costs, ER (EUR) adjusted	-6.9	23.0	5.0	6.7	7.4	0.2	1.5	-4.8	-1.5	3.1
Lithuania										
GDP deflator	20.6	14.0	5.1	-0.6	1.0	-0.1	0.0	-0.8	3.2	4.5
Exchange rate (ER), LTL/EUR	-3.1	-9.7	-0.8	-4.9	-13.4	-3.1	-3.5	-0.2	0.0	-4.4
Real ER (CPI-based)	-20.4	-15.6	-4.4	-4.5	-12.6	-2.2	-1.7	3.0	0.9	-6.7
Real ER (PPI-based)	-16.4	-14.1	3.0	-6.8	-21.8	1.6	-0.9	1.8	-2.1	-6.6
Average gross wages, LTL	28.6	25.9	19.5	6.2	-1.7	1.2	3.2	5.8	7.9	10.3
Average gross wages, real (PPI based)	10.3	18.7	25.0	4.4	-15.2	4.3	6.2	6.3	2.8	6.4
Average gross wages, real (CPI based)	3.2	15.6	13.7	5.4	-2.7	-0.1	2.9	7.1	6.7	5.6
Average gross wages, EUR (ER)	32.7	39.3	20.4	11.7	13.5	4.4	6.9	6.0	7.9	15.3
Employment total	-0.7	-3.1	1.7	0.1	-12.6	-3.3	4.0	2.3	-0.2	-1.4
GDP per empl. person, LTL at 1999 pr.	8.8	10.4	5.5	-1.7	18.8	10.0	2.7	7.2	6.8	7.5
Unit labour costs, LTL at 1999 prices	18.2	14.0	13.3	8.1	-17.3	-8.0	0.5	-1.4	1.0	2.6
Unit labour costs, ER (EUR) adjusted	21.9	26.2	14.2	13.7	-4.5	-5.1	4.2	-1.1	1.0	7.3
Bulgaria										
GDP deflator	120.9	948.6	23.7	3.7	6.7	6.7	3.8	2.0	5.3	49.7
Exchange rate (ER), BGN/EUR	153.8	760.2	4.0	-0.8	0.0	0.0	0.0	0.0	0.0	41.4
Real ER (CPI-based)	17.3	-24.5	-11.2	-2.2	-7.6	-4.8	-3.5	-0.3	-3.8	-5.1
Real ER (PPI-based)	10.9	-19.0	-13.0	-3.8	-10.9	-2.0	-1.4	-3.2	-2.9	-5.4
Average gross wages, BGN	74.4	865.6	43.3	9.7	11.7	6.9	7.3	6.1	9.4	50.4
Average gross wages, real (PPI based)	-24.2	-9.9	20.7	6.7	-5.0	3.0	6.1	1.1	3.3	-0.5
Average gross wages, real (CPI based)	-21.3	-16.6	20.7	6.9	1.2	-0.4	1.4	3.7	3.1	-0.9
Average gross wages, EUR (ER)	-31.3	12.3	37.7	10.6	11.7	6.9	7.3	6.1	9.4	6.4
Employment total	0.1	-3.9	-0.2	-2.1	-3.5	-0.4	0.4	1.4	3.1	-0.6
GDP per empl. person, BGN at 1999 pr.	-9.5	-1.8	4.1	4.5	9.2	4.5	4.5	2.8	2.4	2.2
Unit labour costs, BGN at 1999 prices	92.8	882.9	37.6	5.0	2.3	2.3	2.7	3.2	6.8	47.2
Unit labour costs, ER (EUR) adjusted	-24.1	14.3	32.2	5.9	2.3	2.3	2.7	3.2	6.8	4.1
Romania										
GDP deflator	45.3	147.3	54.2	47.8	44.2	37.4	23.4	19.2	13.6	44.3
Exchange rate (ER), ROL/EUR	46.9	109.5	23.5	63.1	22.5	30.4	20.1	20.2	7.9	35.5
Real ER (CPI-based)	8.4	-16.4	-21.4	13.2	-14.3	-0.9	0.1	6.3	-1.5	-3.6
Real ER (PPI-based)	-1.5	-16.4	-8.0	12.5	-16.4	-3.9	-2.6	2.1	-6.8	-4.9
Average gross wages, ROL	51.7	98.4	60.3	44.3	46.9	48.9	27.3	23.6	22.6	45.6
Average gross wages, real (PPI based)	1.2	-21.5	20.4	-0.2	-4.2	7.8	3.5	3.5	3.0	0.9
Average gross wages, real (CPI based)	9.3	-22.1	0.8	-1.1	0.9	10.7	3.9	7.2	9.5	1.6
Average gross wages, EUR (ER)	3.2	-5.3	29.9	-11.6	20.0	14.1	6.0	2.9	13.6	7.4
Employment total *)	-1.9	1.0	-1.9	-0.6	-0.1	-0.6	.	-0.1	-0.5	-0.6
GDP per empl. person, ROL at 1999 pr.	6.0	-7.1	-3.0	0.1	2.2	6.4	21.6	5.0	8.3	4.1
Unit labour costs, ROL at 1999 prices	43.1	113.5	65.3	44.1	43.7	40.0	4.7	17.7	13.2	39.8
Unit labour costs, ER (EUR) adjusted	-2.6	1.9	33.9	-11.7	17.4	7.3	-12.8	-2.0	4.9	3.2

*) Romania: In 2002 no comparable growth rate available due to methodological break.

(Table A/3 ctd.)

Table A/3 (ctd.)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 prelim.	1996-04 average
Croatia										
GDP deflator	3.6	7.4	8.4	3.8	4.7	4.0	3.0	3.2	3.5	4.6
Exchange rate (ER), HRK/EUR	0.7	2.3	2.5	6.2	0.7	-2.2	-0.8	2.1	-0.9	1.2
Real ER (CPI-based)	-0.4	0.4	-1.7	3.1	-3.3	-4.7	-0.9	2.6	-0.9	-0.7
Real ER (PPI-based)	-0.2	0.8	3.0	3.2	-3.8	-3.9	-0.6	1.7	-1.6	-0.2
Average gross wages, HRK	12.3	13.1	12.6	10.2	7.0	3.9	6.0	4.8	6.5	8.4
Average gross wages, real (PPI based)	10.8	10.6	14.0	7.4	-2.5	0.3	6.5	2.8	2.9	5.7
Average gross wages, real (CPI based)	8.5	9.2	6.5	5.7	0.7	-0.9	3.7	3.2	4.3	4.5
Average gross wages, EUR (ER)	11.6	10.6	9.8	3.7	6.2	6.3	6.9	2.6	7.5	7.2
Employment total	-6.2	-1.4	5.6	-1.5	-1.7	0.5	0.8	2.5	-0.1	-0.2
GDP per empl. person, HRK at 1999 pr.	12.9	8.3	-3.0	0.6	4.7	3.8	4.4	1.8	3.8	4.1
Unit labour costs, HRK at 1999 prices	-0.5	4.4	16.1	9.5	2.2	0.1	1.6	2.9	2.6	4.2
Unit labour costs, ER (EUR) adjusted	-1.2	2.1	13.2	3.1	1.4	2.3	2.4	0.8	3.5	3.0
Macedonia										
GDP deflator	2.9	3.4	1.4	2.8	8.2	3.6	3.4	0.5	0.9	3.0
Exchange rate (ER), MKD/EUR	1.9	12.2	8.7	-0.7	0.2	0.3	0.1	0.5	0.1	2.5
Real ER (CPI-based)	2.0	11.2	10.2	1.2	-3.5	-2.8	0.4	1.3	2.6	2.4
Real ER (PPI-based)	2.6	8.6	3.7	-0.9	-5.2	0.0	0.8	2.3	2.0	1.5
Average net wages, MKD	2.8	2.8	3.7	2.9	5.5	3.5	6.9	4.8	3.9	4.1
Average net wages, real (PPI based)	3.1	-1.4	-0.3	3.0	-4.7	1.5	7.9	5.1	3.0	1.8
Average net wages, real (CPI based)	0.5	0.2	3.8	3.6	-0.3	-1.9	5.0	3.6	4.3	2.1
Average net wages, EUR (ER)	0.9	-8.4	-4.6	3.6	5.3	3.2	6.8	4.3	3.8	1.5
Employment total	.	-4.7	5.4	1.0	0.8	9.0	-6.3	-2.9	-0.9	0.1
GDP per empl. person, MKD at 1999 pr.	.	7.0	-1.9	3.3	3.6	-12.4	7.7	6.5	2.9	1.9
Unit labour costs, MKD at 1999 prices	.	-3.9	5.6	-0.4	1.8	18.2	-0.8	-1.5	0.9	2.3
Unit labour costs, ER (EUR) adjusted	.	-14.4	-2.8	0.4	1.6	17.8	-0.9	-2.0	0.8	-0.3
Russia										
GDP deflator	45.8	15.1	18.5	72.4	37.7	16.5	15.5	13.7	18.7	27.0
Exchange rate (ER), RUB/EUR	12.6	-1.4	69.1	137.2	-0.8	0.4	13.5	16.5	3.7	22.2
Real ER (CPI-based)	-22.0	-12.6	34.3	29.3	-16.3	-15.6	-0.1	4.6	-4.6	-2.0
Real ER (PPI-based)	-25.0	-13.5	56.7	48.8	-29.1	-14.2	1.3	2.3	-14.3	-2.2
Average gross wages, RUB	67.3	20.2	10.7	44.8	46.0	45.7	34.6	26.1	24.2	34.6
Average gross wages, real (PPI based)	10.9	4.6	3.3	-8.9	-0.4	22.4	20.4	9.1	-0.2	6.4
Average gross wages, real (CPI based)	13.2	4.7	-13.3	-22.0	20.9	19.9	16.0	11.0	11.9	5.9
Average gross wages, EUR (ER)	48.6	21.9	-34.6	-38.9	47.2	45.2	18.6	8.2	19.8	10.1
Employment total	-0.7	-1.9	-1.4	0.2	0.6	0.6	1.0	0.5	2.4	0.1
GDP per empl. person, RUB at 1999 pr.	-2.9	3.4	-4.0	6.1	9.4	4.5	3.7	6.8	4.6	3.4
Unit labour costs, RUB at 1999 prices	72.3	16.3	15.3	36.4	33.5	39.5	29.8	18.1	18.7	30.1
Unit labour costs, ER (EUR) adjusted	53.1	18.0	-31.9	-42.5	34.6	39.0	14.4	1.3	14.5	6.5
Ukraine										
GDP deflator	66.2	18.1	12.0	27.4	23.1	9.9	5.1	6.9	9.0	18.6
Exchange rate (ER), UAH/EUR	20.4	-9.0	31.0	58.7	14.5	-4.3	4.5	19.8	9.7	14.7
Real ER (CPI-based)	-31.6	-20.1	20.0	30.9	-9.0	-12.7	5.8	16.1	2.7	-1.6
Real ER (PPI-based)	-20.5	-14.8	14.8	20.7	-0.8	-10.3	1.2	12.8	-6.3	-1.3
Average gross wages, UAH	72.6	13.5	7.0	16.0	29.6	35.2	21.0	22.8	27.6	26.1
Average gross wages, real (PPI based)	13.5	5.4	-5.5	-11.5	7.2	24.5	17.4	13.9	5.9	7.3
Average gross wages, real (CPI based)	-4.2	-2.1	-3.3	-5.4	1.1	20.7	20.0	16.7	17.0	6.2
Average gross wages, EUR (ER)	43.3	24.7	-18.3	-26.9	13.3	41.2	15.8	2.5	16.3	10.0
Employment total	-2.1	-2.7	-1.1	-2.3	-2.5	-1.2	1.7	0.3	2.6	-0.8
GDP per empl. person, UAH at 1999 pr.	-8.1	-0.3	-0.8	2.2	8.7	10.5	3.4	9.0	9.2	3.6
Unit labour costs, UAH at 1999 prices	87.8	13.8	7.8	13.5	19.3	22.3	17.0	12.6	16.8	21.7
Unit labour costs, ER (EUR) adjusted	55.9	25.1	-17.7	-28.5	4.2	27.8	12.0	-6.0	6.5	6.2
Austria										
GDP deflator	1.3	0.9	0.5	0.7	1.4	2.1	1.4	2.0	1.6	1.3
Exchange rate (ER), ATS-EUR/EUR	1.7	4.0	0.7	-0.9	0.0	0.0	0.0	0.0	0.0	0.6
Real ER (CPI-based)	2.2	4.4	1.1	-0.3	-0.5	-0.5	0.3	0.6	0.0	0.8
Real ER (PPI-based)	2.2	4.4	0.5	-0.4	0.7	0.2	0.2	-0.1	-2.0	0.6
Average gross wages, ATS-EUR	0.8	1.1	3.0	2.3	2.6	1.4	2.1	2.5	2.4	2.0
Average gross wages, real (PPI based)	0.8	0.7	3.5	3.1	-1.4	-0.1	2.5	0.9	-2.4	0.8
Average gross wages, real (CPI based)	-1.1	-0.2	2.0	1.7	0.2	-1.3	0.2	1.1	0.3	0.3
Average gross wages, EUR (ER)	-0.9	-2.8	2.2	3.2	2.6	1.4	2.1	2.5	2.4	1.4
Employment total	-0.7	0.3	0.6	0.9	0.8	0.5	0.3	0.9	0.6	0.5
GDP per empl. person, ATS-EUR at 1999 pr.	2.7	1.3	3.3	1.7	2.6	0.3	1.1	-0.3	1.3	1.6
Unit labour costs, ATS-EUR at 1999 prices	-1.9	-0.2	-0.3	0.6	0.0	1.1	1.0	2.8	1.1	0.4
Unit labour costs, ER (EUR) adjusted	-3.6	-4.0	-1.0	1.5	0.0	1.1	1.0	2.8	1.1	-0.2

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

Sources: National statistics and wiiw estimates.

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