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Economic Prospects for Central, East and Southeast Europe

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New Divide(s) in Europe?

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Executive summary

Introduction

The period ahead will be a trying one for the European Union and the countries closely connected with it. Since mid-2011 growth has slowed down and a mild recession or stagnation is being forecasted for 2012 with slow recovery in the medium run. The performance will differ across regions depending on their strengths and weaknesses. They will all, however, be constrained by the common EU economic policy framework which is emerging as a response to the crisis. Thus, new divides are opening up in the EU and in Europe in general. The main is between the industrialized and competitive 'North' and the indebted and mostly service-oriented 'South'. There is also an odd group of resources-rich countries in the Eastern Neighbourhood and fast developing Turkey with policy problems and advantages of their own. In this Forecast Report we cover Central European countries (including Poland, the Czech Republic, Slovakia, Hungary, and Slovenia), the GIPS (Greece, Italy, Portugal, and Spain; occasionally also Ireland), Southeast Europe (Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Montenegro, Romania, and Serbia), the Baltic states, Russia, Ukraine, Kazakhstan and Turkey.

The underlying driver of these 'new divides' is the build-up of external imbalances prior to the crisis within the EU and with the countries in Southeast Europe closely connected with the EU. The causes of this build-up are by now well known as is the inadequacy of the inherited institutional and policy framework of the EU and the eurozone in particular. In the course of policy responses to the crisis, the EU has been developing a new framework in which one of the main pillars is fiscal restraint now formalized in the fiscal compact. In addition, monetary policy has been relaxed and institutions have been set up to deal with the problem of stabilization support and debt resolution.

This policy framework deals mainly with stability while growth is expected to be spurred by structural reforms, i.e. by supply-side policies. The risk is that these policies for stability and growth may deliver a prolonged period of stagnation with high unemployment in countries and regions that need to deleverage and build up their tradable sectors. With exchange rate rigidity and fiscal austerity, it may take some time for these countries to recover. That will test Balkan economies and those in the GIPS group and in a different way some of those in Central Europe and in the Baltic.

Imbalances, debts, and prospects for investments

The analysis in both the overview piece and in the two special reports (one on foreign banks and deleveraging, the other on labour market and social developments) draws the following conclusions in the contexts of growth slowdown and the emerging policy framework:

- The most distinctive differentiating feature among the emerging European economies that the analysis singled out was the pre-crisis build-up of (structural) current account disequilibria, associated developments in external debt and the debt positions particularly in the private sector (households and corporations). The previous build-up of disequilibria and debt accounts for most of the differentiated impact of the crisis over the period 2008-2011.
- A sub-group of three Central European economies (Czech Republic, Poland and Slovakia) was found to have been scarcely affected by the debt build-up. The countries concerned showed little sign of competitiveness problems in their tradable sectors (which also includes Hungary), while the GIPS (Ireland's problems were debt-, not competitiveness-related) and most of the countries in Southeast Europe and the Baltic states developed unsustainable disequilibria in both of these respects.
- As to the prospects for 2012 and 2013, the situation is rather grim for emerging Europe. With growth slowing down significantly in the advanced parts of Europe, pursuit of an 'export-led' strategy (as pursued over the biennium 2010-2011) will prove problematic, while the greater reliance on domestic demand factors that the situation requires will also face severe problems. In a detailed analysis we evaluated the various aspects (fiscal, household and corporate) of the 'debt problem' in the various groups of countries:
    - First, the analysis addresses the differences in scope for fiscal policy from the standpoint of the sustainability conditions for public debt: (i) in the face of changed and differentiated growth prospects; (ii) interest rate perspectives (the latter in turn reflecting the financial markets' evaluation of sustainability issues); and (iii) the policy stances adopted by different governments.
    - Thereafter, the analysis assesses the likely recovery prospects of corporate investment activities and household consumption expenditures. For both items inherited debt levels and deleveraging processes, as well as income and sales prospects are seen to be major determinants (all of which, in turn, affect financing conditions). Country groups differ in those respects, just as they differed in the build-up of public debt in the course of the crisis.
- Important groups of economies, such as the GIPS countries and most of the countries of Southeast Europe, have come up against a vicious circle: high initial debt levels and dim growth prospects translate into greater doubts about sustainability and hence into higher interest rates that impose a constraint on investment and encourage corporate and household deleveraging (further compounded by the weak state of the banking system). This dampens consumption expenditures, and leads to cutbacks in employment (and wages), which, in

turn, lower household incomes and domestic sales prospects. The induced lower growth prospects, in turn, raise concerns over debt sustainability and the need to keep interest rates high.

- Prospects of offsetting factors such as a potential rise in competitiveness and hence export-led recovery are dim in the current context of low growth in the European economy as a whole. In a separate exercise, we show that in the latter respect the countries of Southeast Europe suffer further differentiating disadvantages as their main export markets are growing at even lower rates than those of the other economies in Europe.

Conclusion

The report thus points towards a sustained period in which the convergence processes which characterized the decade prior to the current financial and economic crisis will either not proceed or proceed at a much reduced pace. Deleveraging processes, difficult moves to deal with the high debt positions of the private sector, the weak banking system and the feedback effects on sovereign debt will characterize many of the low-income economies in Europe. The driving force of foreign direct investment and the build-up of cross-border production networks will also show weaker momentum compared to before the crisis. Adjustment processes to deal with the pre-crisis neglect of building-up a viable tradable sector and sufficient and modernizing export capacities will have to gain priority and the use of different sets of policy instruments (particularly in the areas of training, labour market, industrial and regional policies) will have to be strengthened.

Country summaries

In **Bulgaria**, GDP increased by 1.6% in 2011 but economic activity was weakening in the final months. While the export performance for the year as a whole was robust, sluggish domestic demand was a drag on economic growth. The process of macroeconomic rebalancing in 2011 was accompanied by a net outflow of financial resources. Short-term prospects have deteriorated and the economy is likely to stagnate in 2012.

Should the euro area continue to ‘muddle through’ and thus avoid deep recession in 2012, the **Czech** economy would escape recession as well. But its growth in 2012 will be depressed by the stubborn attempts to meet the fiscal targets, no matter what. A euro area recovery in 2013 and beyond would naturally (by way of stronger demand for imports) help speed up growth in the Czech Republic. In addition, the fiscal consolidation measures will by then become less intense (also because of the next regular parliamentary elections to be held in 2014). Good financial standing of the banking and corporate sectors, relatively low level of household debt, combined with competent policy of the Czech National Bank (determined to keep a very relaxed policy even in face of temporary hikes in inflation) should, by then, help accelerate growth – first of investments and then of private consumption and overall GDP.

After a year of strong economic activity, the recessionary developments in the eurozone also impair the growth prospects of the **Estonian** economy. Thus, the growth of investments will abate throughout 2012 while household demand will still support the trade cycle. Moreover, the latest protests and strikes in Estonia should give rise to stronger wage increases this year. In 2013 and 2014 a slight upswing of external demand should bring forth a revival of faster GDP growth.

The **Hungarian** economy will slide into recession this year due to the austerity measures required to reduce the fiscal deficit to below 3% of the GDP. Further, but smaller consolidation measures will be necessary in 2013 as well. An agreement with the IMF and the EU may help partially restore confidence in the government's economic policy; nevertheless, that would also mean the end of the 'unconventional' policy measures and probably a revision of some of the earlier introduced ones, such as the radical tax cuts. In the absence of an agreement with IMF and EU, the consequences may include a remarkable weakening of the exchange rate and serious difficulties in rolling over external debt.

The downturn of the European trade cycle leads to lowered growth prospects also for **Latvia** in 2012. The corporate and the household sector will continue to deleverage quite strongly, thus the growth in investments and household consumption will decline as well. Eager to join the eurozone in 2014, the Latvian government will most probably manage to reduce the budget deficit to below 3% in 2012. The greatest obstacle will however be to lower the consumer inflation rate to the Maastricht criterion. From 2013 onwards we expect external demand to trigger a revival in output growth.

In **Lithuania**, the slowdown of growth in exports and corporate investments that could be observed towards the end of 2011 will continue throughout 2012. In spite of parliamentary elections to be held in October 2012, the government reinforced austerity measures in order to reduce the budget deficit to below 4% of GDP. This will curb domestic demand throughout the year. Thus, the situation on the labour market will remain strained and outward migration especially of young people will continue. A revival of GDP growth to be expected in 2013 and 2014 should be backed by an external demand stimulus.

The general deterioration of conditions in the euro area (even in Germany) in the second half of 2011 has already affected the performance and prospects in most new member states. But so far **Poland** has kept its growth momentum. Growth in 2012 is likely to be satisfactory (though of course lower than in 2011) even if the euro area stagnates. The domestic economy is in no need for any meaningful deleveraging while fiscal and monetary policies will quite certainly not chase any overambitious goals. As in 2009 the Polish economy will benefit from its size, versatility and relative closedness. But the exchange rate volatility will continue to be a source of surprises which can be either pleasant or unpleasant.

In **Romania**, a bumper harvest boosted GDP by 2.5% in 2011, a one-time effect that is due to vanish in 2012. At best 1% growth can be expected, driven by private consumption. A major factor of the economic slowdown is the expected stop in credit expansion. The fiscal situation is not expected to deteriorate under the close control of the IMF. The elections in November may lead to a cohabitation of president and government from opposing political groupings, which may increase political uncertainty.

While **Slovakia** achieved a successful year 2011 – with a GDP growth of about 3.3% – main challenges lie ahead. Due to the ongoing European debt crisis and worsened outlook for its main trading partners Germany and the Czech Republic, we revised our growth forecasts downwards and expect GDP to grow by 1.5% this year. Net exports might remain the main driver of GDP provided that external demand does not weaken even further. After elections held on 10 March 2012 the next government will be dominated by the leftist Smer party led by Robert Fico. We expect weaker fiscal consolidation and thus slowly reviving private consumption.

Given fiscal consolidation and the expected growth slowdown in **Slovenia's** most important EU trading partners, GDP will decline by 1% in 2012. A rebound of economic activity is expected only in 2013 since public investment will need time to recover and deleveraging of the enterprise sector is still going on. Household consumption will depend on improvements on the labour market. Slovenia's economic recovery will largely hinge on the success or failure of the new government.

In **Croatia**, GDP growth will decline again in 2012 and should finally rebound only in 2013, provided external demand and competitiveness strengthen. The poor situation on the labour market will continue to be a major obstacle to a recovery in household consumption. The burdens associated with high foreign debt servicing and reducing the budget deficit including structural reforms will remain the most serious challenges for the new government. EU accession in 2013 may stimulate foreign investment flows.

Growth prospects in **Macedonia** are still somewhere around 2% this year with some acceleration next year and beyond. The main driver is private investment which should recover due to relatively low private debt. The main risk is the possible contagion effect from the Greek crisis. There are still slim prospects for the start of negotiations with the EU.

In **Montenegro**, growth prospects depend on the financial and fiscal stability, but are still not much above stagnation this year and slow recovery in the medium run. A start of negotiations with the EU would certainly contribute to overall stability.

The growth of **Turkey's** economy was close to 10% in the period 2010-2011. It may have decelerated recently, but it is not yet certain that this will lead to a more or less soft type of 'landing'; a swift resumption of growth is feasible. In 2011, thanks to high real growth and a rate of inflation between 5% and 10%, growing budget revenues offered a nice opportunity to increase expenditures and decrease the budget deficit at the same time. This 'pro-active' fiscal policy will continue. The central bank, too, supports GDP expansion by keeping the policy rate low. However, this job is a bit tricky. The rate of inflation should not climb over 10%, and the exchange rate should remain rather stable. The high deficit in the current account is a main source of vulnerability. In the case of no major adverse external shock, growth is likely to accelerate again in 2013-2014.

For **Albania**, we expect GDP growth of 2.2% in 2012 and a stronger increase to 2.6% in 2013 and 3.4% in 2014, the latter due to the election cycle and induced populist government spending. The assumption is that the government has no problems financing fiscal expansion, that heavy rainfall in early 2012 will bring the vital electricity production back to normal and that export growth will continue despite the eurozone crisis (also with the help of further increasing crude oil export production capacities); remittances will tend to stabilize or at least fall at a slower pace as further unemployment in Greece might rather hit the public sector, where Albanians are not employed. Obviously, the risks are on the downside, very much so.

The economy of **Bosnia and Herzegovina** will hardly grow substantially or may even shrink slightly in 2012. For the time being, there is nothing that would support expectations of a strong GDP decline. For the period after 2012 we can count with growth resumption, should external conditions allow for that. The main impetus needs to come from outside as a major home-made demand push is unlikely to happen. Prices will remain relatively stable, and no strong medium-term improvement on the labour market can be expected.

In **Serbia**, growth is grinding to a halt this year. Medium-term prospects depend in part on the outcome of the general elections in May and the presidential elections sometime this year. There is scope for significant economic policy changes and gradual recovery in the following couple of years. Improved relations with the EU – Serbia is now a candidate country hoping to start negotiating with the EU early next year – should prove helpful if sustained. The key issue is the huge drop in employment and possible social backlash.

Kazakhstan's economy exhibited outstanding real growth of 7.5% in 2011. We forecast that strong GDP growth of 5-6% in real terms will continue in 2012-2014. The oil sector will remain the backbone of the economy, accounting for the bulk of its exports and FDI. Investment growth is forecasted to speed up in 2012-2014 to about 8-10%, in particular owing to a number of state-financed investment projects. Banking sector vulnerabilities have been accumulating, with the share of non-performing bank loans reaching 21.7% and the BTA bank negotiating a second restructuring.

The **Russian** GDP grew by more than 4% in 2011 thanks to a robust recovery of fixed investment, construction and consumer expenditures. The contribution of net exports to GDP growth was sharply negative (despite a sizeable nominal increase in trade and current account surplus). wiiw reckons with unspectacular GDP growth during 2012-2014, assuming no abrupt policy changes or external shocks. Export revenues will grow rather slowly owing to stagnating volumes of exported oil and gas; import volumes are expected to grow at a faster rate as household consumption and investment will gradually pick up, both fuelled by the ongoing real currency appreciation. In the medium and long run, reforms and investments (including FDI) may be stimulated by WTO membership, while the attempted modernisation drive will hardly succeed any time soon. With some luck the annual CPI inflation may gradually drop to 5% and the budget deficit will remain balanced.

In **Ukraine**, booming private consumption and a bumper harvest contributed to an impressive 5% GDP growth in 2011. The budget situation improved markedly, and currency depreciation pressures were successfully counteracted. However, the recent monetary policy tightening coupled with weak external demand will likely dampen the growth prospects this year, possibly to below 4%, while dependence on external funding will remain a source of risk for financial stability. Following the 'Tymoshenko case', the association and free trade agreement with the EU have been put on hold and are unlikely to be signed before the end of 2012.

Keywords: Central and East European new EU member states, Southeast Europe, financial crisis, future EU member states, Balkans, former Soviet Union, Turkey, economic forecasts, employment, foreign trade, competitiveness, debt, deleveraging, exchange rates, flow of funds, inflation, monetary policy.

JEL classification: C33, C50, E20, E29, F34, G01, G18, O52, O57, P24, P27, P33, P52

Table I

Overview 2010-2011 and outlook 2012-2014

	GDP real change in % against previous year					**Consumer prices** change in % against previous year					**Unemployment, based on LFS** rate in %, annual average					**Current account** in % of GDP				
	2010	**2011**	**2012**	**2013**	**2014**	**2010**	**2011**	**2012**	**2013**	**2014**	**2010**	**2011**	**2012**	**2013**	**2014**	**2010**	**2011**	**2012**	**2013**	**2014**
			Forecast					**Forecast**					**Forecast**					**Forecast**		
Bulgaria	0.1	1.6	0	1.3	2.7	3.0	3.4	3	3	3	10.2	11.2	12	11	10	-1.3	1.9	1.2	0.0	-1.1
Czech Republic	2.7	1.8	0.5	2.5	3.5	1.2	2.2	3.2	2	2	7.3	6.8	7.0	7	6.5	-3.1	-2.1	-2.0	-2.0	-2.0
Estonia	2.2	7.5	1.9	4	5	2.7	5.1	3.3	3.8	4	16.9	12.5	11.5	10	9	3.6	3.1	0	-1.6	-2.5
Hungary	1.3	1.7	-1	2	3	4.7	3.9	5	3.5	3.1	11.2	10.9	11	10.5	10	1.1	2.0	2.2	1.7	1.0
Latvia	-0.3	5.3	2	3.3	3.5	-1.2	4.2	2.3	2.5	3.0	18.7	15.3	14	13	12	3.0	-0.8	-1.9	-2.5	-3.0
Lithuania	1.4	5.9	2.1	3.5	4	1.2	4.1	2.5	3	3.5	17.8	15.4	15	14	13	1.5	-1.7	-2.5	-2.9	-4.1
Poland	4.0	4.3	3	4.1	4.3	2.7	3.9	2.5	2.5	2	9.6	10	9	8.5	8	-4.7	-4.1	-4.0	-4.3	-4.2
Romania	-1.6	2.5	1	3	3	6.1	5.8	4	4	4	7.3	7.3	7.5	7	7	-4.4	-4.2	-4.6	-4.5	-4.9
Slovakia	4.2	3.3	1.5	3	4	0.7	4.1	2.5	3	3	14.4	13.4	13.5	13	12.5	-3.5	0.0	-0.7	-1.3	-1.8
Slovenia	1.4	0.4	-1	1.5	1.5	2.1	2.1	2	2	2	7.3	8	8.5	9	8.5	-0.8	-0.5	-0.5	-0.8	-1.0
NMS-10 [1]	**2.2**	**3.2**	**1.5**	**3.2**	**3.6**	**3.0**	**3.9**	**3.1**	**2.9**	**2.6**	**9.9**	**9.7**	**9.5**	**9.0**	**8.5**	**-3.0**	**-2.2**	**-2.4**	**-2.7**	**-3.0**
EA-17 [2]	*1.9*	*1.4*	*-0.3*	*1.3*	.	*1.6*	*2.7*	*2.1*	*1.6*	.	*10.1*	*10.1*	*10.1*	*10.0*	.	*0.2*	*-0.03*	.	.	.
EU-27 [2]	*2.0*	*1.5*	*0.0*	*1.5*	.	*2.1*	*3.1*	*2.3*	*1.8*	.	*9.7*	*9.6*	*9.8*	*9.6*	.	*-0.3*	*-0.2*	.	.	.
Croatia	-1.2	0.3	-1.2	1	2	1.1	2.3	2.5	2.4	2	11.8	13.7	14	14	13	-1.2	0	-0.6	-1.0	-1.2
Macedonia	1.8	3.5	2.3	3	3.5	1.6	3.9	3	3	3	32.0	31	31	31	31	-2.2	-5.5	-5.8	-4.8	-4.5
Montenegro	2.5	2	1	2	3	0.5	3.1	3	3	3	19.6	20	20	20	19	-24.6	-16.7	-20.6	-22.2	-21.1
Turkey	9.0	8.4	3.0	5.0	5.0	8.6	6.5	9.1	9.0	8.0	10.7	9.2	10.1	10.2	9.9	-6.5	-10.5	-9.1	-9.2	-9.0
Candidate countries [1]	**8.1**	**7.7**	**2.7**	**4.7**	**4.8**	**7.9**	**6.2**	**8.6**	**8.5**	**7.6**	**11.6**	**10.3**	**11.2**	**11.3**	**10.9**	**-6.1**	**-9.7**	**-8.5**	**-8.6**	**-8.5**
Albania	3.6	1.9	2.2	2.6	3.4	3.5	3.5	3	4	4	13.7	14	15	14	13	-11.8	-14.1	-13.1	-12.7	-12.9
Bosnia and Herzegovina	0.7	2.2	0.5	1.5	2.0	2.1	3.7	2	2	2	27.2	27.6	28	28	28	-6.1	-8.6	-8.4	-8.5	-9.5
Serbia	1.0	1.9	0	1	2	6.8	11.0	7	5	5	19.2	23.0	25	25	25	-7.2	-7.5	-9.0	-10.0	-9.5
Potential candidate countries [1]	**1.4**	**2.0**	**0.5**	**1.4**	**2.3**	**5.1**	**7.9**	**5.1**	**4.1**	**4.1**	**19.5**	**21.6**	**23.0**	**22.6**	**22.2**	**-7.7**	**-8.9**	**-9.6**	**-10.2**	**-10.2**
Kazakhstan	7.3	7.5	6	5	5.5	7.1	8.5	8	7	6	5.8	5.4	5.2	5	5	2.0	7.3	5.6	4.6	4.3
Russia	4.3	4.3	4.2	4.1	4.3	6.9	8.5	5	6	5	7.5	6.6	6.6	6.7	6.7	4.8	5.5	4.0	3.1	2.2
Ukraine	4.1	5.2	4	5	5	9.4	8.0	5	7	5	8.1	8	7.9	7.7	7.5	-2.2	-5.6	-5.7	-5.7	-5.5

Note: LFS: Labour Force Survey. NMS: The New EU Member States. EA: Euro area 17 countries.

1) wiiw estimate. - 2) Data for GDP and consumer prices in 2011-2012 revised by European Commission (Interim Forecast , February 2012). Current account data include transactions within the region.

Source: wiiw (March 2012), Eurostat. Forecasts by wiiw and European Commission (Interim Forecast February 2012, Autumn Report, November 2011) for EU and euro area.

Table II

Central and East European new EU member states (NMS-10): an overview of economic fundamentals, 2011

	Bulgaria	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	*NMS-10* [1)]	*EU-27* [2)]
GDP in EUR at exchange rates, EUR bn	38.95	155.96	16.20	100.76	19.82	30.62	371.31	135.17	70.80	36.30	*975.9*	*12649.0*
GDP in EUR at PPP, EUR bn	83.35	211.52	22.95	163.36	29.99	49.59	618.68	253.84	102.28	43.34	*1578.9*	*12649.0*
GDP in EUR at PPP, EU-27=100	0.7	1.7	0.2	1.3	0.2	0.4	4.9	2.0	0.8	0.3	*12.5*	*100.0*
GDP in EUR at PPP, per capita	11300	20100	17400	16400	14500	16200	16200	13300	18800	21100	*15900*	*25100*
GDP in EUR at PPP per capita, EU-27=100	45	80	69	65	58	65	65	53	75	84	*63*	*100*
GDP at constant prices, 1990=100	129.1	148.3	151.1	126.6	105.2	127.0	196.3 [3)]	133.6	168.5	157.4	*166.3*	*146.2*
GDP at constant prices, 2000=100	151.2	142.1	151.8	123.6	151.1	162.1	152.9	153.1	165.0	131.1	*148.4*	*118.1*
Industrial production real, 2000=100 [4)]	149.2	156.2	192.8	149.6	156.3	182.0	187.0	133.1	205.4	121.2	*166.3*	*105.7*
Population - thousands, average	7365	10540	1318	9960	2067	3054	38230	19043	5445	2050	*99071*	*502982*
Employed persons - LFS, thousands, average	2950	4905	609	3812	971	1371	16120	9200	2352	940	*43229*	*217300*
Unemployment rate - LFS, in %	11.2	6.8	12.5	10.9	15.3	15.4	10.0	7.3	13.4	8.0	*9.9*	*9.6*
General gov. revenues, EU-def., in % of GDP	35	39.8	39.3	52.0	37	32.8	40.3	34.0	33.1	45.0	*39.7*	*44.6*
General gov. expenditures, EU-def., in % of GDP	37	43.5	38.0	48.5	41	38.1	44.5	38.5	38.9	50.5	*43.1*	*49.3*
General gov. balance, EU-def., in % of GDP	-2	-3.7	1.3	3.5	-4	-5.3	-4.2	-4.5	-5.7	-5.5	*-3.4*	*-4.7*
Public debt, EU def., in % of GDP	17.1	40.5	5.5	80.3	43	37.5	53.7	32.0	43.5	45.0	*47.3*	*82.5*
Price level, EU-27=100 (PPP/exch. rate)	47	74	71	62	66	62	60	53	69	84	*62*	*100*
Compensation per employee, monthly, in EUR [5)]	472	1326	1177	1019	815	819	922	647	1169	2063	*932*	*2847*
Compensation per employee, monthly, EU-27=100	16.6	46.6	41.3	35.8	28.6	28.8	32.4	22.7	41.1	72.5	*32.7*	*100.0*
Exports of goods in % of GDP	51.6	64.4	74.6	78.7	43.4	65.9	37.2	33.3	80.5	57.0	*51.4* [6)]	*34.3* [6)]
Imports of goods in % of GDP	56.3	61.5	75.6	74.0	52.0	70.7	39.9	38.8	78.4	60.5	*52.7* [6)]	*30.6* [6)]
Exports of services in % of GDP	13.9	10.2	24.5	15.3	15.6	11.8	7.1	5.4	6.6	13.8	*9.3* [6)]	*10.5* [6)]
Imports of services in % of GDP	7.7	8.5	16.6	12.2	9.3	8.4	5.8	5.1	7.3	9.3	*7.5* [6)]	*7.8* [6)]
Current account in % of GDP	1.9	-2.1	3.1	2.0	-0.8	-1.7	-4.1	-4.2	0.0	-0.5	*-2.3* [6)]	*-0.2* [6)]
FDI stock per capita in EUR, 2010	4784	9228	9179	6693	3670	3174	3801	2447	6978	5254	*3239*	*9963*

NMS-10: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia. PPP: Purchasing power parity.
1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) 1989=100, which in the Polish case is the appropriate reference year. - 4) EU-27 working day adjusted. - 5) Gross wages plus indirect labour costs, according to national account concept. - 6) Data for NMS-10 and EU-27 include transactions within the region.

Source: wiiw, Eurostat, AMECO.

Table III

Southeast Europe and selected CIS countries: an overview of economic fundamentals, 2011

	Croatia	Macedonia	Montenegro	Turkey	Albania	Bosnia and Herzegovina	Serbia	Kazakhstan	Russia	Ukraine	*NMS-10* [1]	*EU-27* [2]
GDP in EUR at exchange rates, EUR bn	46.18	7.42	3.30	546.70	9.19	13.34	33.03	133.75	1330.29	118.47	*975.9*	*12649.0*
GDP in EUR at PPP, EUR bn	66.94	18.74	6.48	956.50	21.84	26.20	65.90	165.84	1913.10	265.03	*1578.9*	*12649.0*
GDP in EUR at PPP, EU-27=100	0.5	0.1	0.05	7.6	0.2	0.2	0.5	1.3	15.1	2.1	*12.5*	*100.0*
GDP in EUR at PPP, per capita	15100	9100	10500	12900	6800	6800	9100	10000	13400	5800	*15900*	*25100*
GDP in EUR at PPP per capita, EU-27=100	60	36	42	51	27	27	36	40	53	23	*63.3*	*100*
GDP at constant prices, 1990=100	111.8	120.4	.	230.3	200.7	.	.	165.3	112.1	69.2	*166.3*	*146.2*
GDP at constant prices, 2000=100	130.5	132.1	145.5	158.5	174.0	146.2	146.1	238.1	166.8	160.1	*148.4*	*118.1*
Industrial production real, 2000=100	121.2	103.8 [3]	80.9	159.5	239.2	197.0	106.8	213.3	155.4	165.8	*166.3*	*105.7*
Population - thousands, average	4435	2060	620	73950	3220	3843	7280	16558	142500	45700	*99071*	*502982*
Employed persons - LFS, thousands, average	1485	650	198	24000	1200	816	2253	8303	70732	20290	*43229*	*217300*
Unemployment rate - LFS, in %	13.7	31.0	20.0	9.2	14.0	27.6	23.0	5.4	6.6	8.0	*9.9*	*9.6*
General gov. revenues, nat. def., in % of GDP	36 [4]	30.0	41	33.5 [4]	25	44	39	19.7	35.5	30.3	*39.7* [4]	*44.6* [4]
General gov. expenditures, nat. def., in % of GDP	41 [4]	32.5	44	36.0 [4]	30	46.5	44	21.8	33.1	32.1	*43.1* [4]	*49.3* [4]
General gov. balance, nat. def., in % of GDP	-5 [4]	-2.5	-3	-2.5 [4]	-5	-2.5	-5	-2.1	2.5	-1.8	*-3.4* [4]	*-4.7* [4]
Public debt, nat. def., in % of GDP	43.9 [4]	35.0	44	42.5 [4]	60	39	45	16	9.2	36.0	*47.3* [4]	*82.5* [4]
Price level, EU-27=100 (PPP/exch. rate)	69	40	51	57	42	51	50	81	70	45	*62*	*100*
Average gross monthly wages, EUR at exchange rate	1043	501	722	591 [5]	292	649	512	440	576	237	*932* [6]	*2847* [6]
Average gross monthly wages, EU-27=100	36.6	17.6	25.4	20.8 [5]	10.3	22.8	18.0	15.5	20.2	8.3	*32.7* [6]	*100* [6]
Exports of goods in % of GDP	20.6	43.6	13.0	19.0	15.2	32.6	25.7	47.7	28.0	42.1	*51.4* [6]	*34.3* [6]
Imports of goods in % of GDP	32.3	66.7	53.0	31.1	38.1	59.9	42.4	22.6	17.4	50.5	*52.7* [6]	*30.6* [6]
Exports of services in % of GDP	18.9	11.2	26.1	5.3	18.5	7.1	8.9	2.4	2.9	11.7	*9.3* [6]	*10.5* [6]
Imports of services in % of GDP	5.3	9.6	10.3	2.8	17.4	3.3	8.9	5.6	4.9	8.9	*7.5* [6]	*7.8* [6]
Current account in % of GDP	0.0	-5.5	-16.7	-10.5	-14.1	-8.6	-7.5	7.3	5.5	-5.6	*-2.3* [6]	*-0.2* [6]
FDI stock per capita in EUR, 2010	5806	1629	6577	1843	961	1483	2169	3741	2609	954	*3239*	*9963*

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

1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) 2005=100. - 4) EU definition: expenditures and revenues according to ESA'95, excessive deficit procedure. - 5) Gross wages plus indirect labour costs, according to national account concept. - 6) Data for NMS-10 and EU-27 include transactions within the region.

Source: wiiw, Eurostat, AMECO.

Vladimir Gligorov and Michael Landesmann[1]

New Divide(s) in Europe?

1. The 2009-2012 crisis in Europe: an historical threshold?

Although global in character, the financial and economic crisis of 2009-2012 can be seen as having become an historical threshold event in the history of Europe's developments, in particular for the European Union (EU). In this report, we shall not comment on the handling of the eurozone crisis. The focus is on the implications that the crisis bears for the low-income economies of Europe comprising: the countries of Central, Eastern and Southeast Europe (CESEE), the GIPS countries (Greece, Italy, Portugal and Spain)[2] as well as Kazakhstan, Russia, Turkey and Ukraine.

2010 and 2011 saw the European Union as a whole recovering from the deep recession it experienced in 2009 (only Poland and Albania registered positive growth in that year). However, the recovery was relatively muted, although Germany and a few other 'Northern' economies (such as Austria, Finland and Sweden) recorded reasonably high growth rates in both 2010 and 2011. Data for the final quarter of 2011 also show a severe growth slowdown and even contracting output. The European Commission's recent Interim February Forecast currently predicts – following a significant downward revision from its autumn forecast - negative growth (-0.3%) for the eurozone in 2012 (the IMF January 2012 forecast predicts -0.5%) and zero growth for the EU as a whole for the same year.

Major downward revisions were introduced for the GIPS countries. The 2012 forecast is -4.4% for Greece (previously -2.8%), Spain -1.0% (previously +0.7%), Italy -1.3% (previously +0.1%) and Portugal -3.3% (previously -3.0%). The crisis in the eurozone can thus be seen to have taken a heavy toll on the GIPS countries. In the present overview, we shall analyse the likely developments in the CESEE region in the context of events in the EU.

The adjustment processes initiated by the global financial and economic crisis proceeded along different lines in *different groups of mainly low-income economies in Europe.* The analysis of those processes will be the focus of the present overview; hence its title ***New Divide(s) in Europe***.

Prior to embarking on the analysis, we shall comment briefly on global developments.

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1 We want to thank Mario Holzner for research support and excellent coordination of the work on this overview and associated Special Reports. Our gratitude also goes to Monika Schwarzhappel, Beate Muck, Hana Ruskova, Barbara Swierczek, Alexandra Bykova, Renate Prasch and Galina Vasaros for very dedicated statistical support and to Peter Havlik, Sandor Richter, Gabor Hunya and Mario Holzner for comments on an earlier draft.

2 The GIPS countries as defined above are at times also referred to as Southern EU economies. In the analysis of the current economic and financial crisis, they are a prominent group of economies strongly affected by the current crisis; hence for comparative purposes, we have included them in our overview of CESEE developments. At various other times in the paper, we shall also refer to the GIIPS group of countries. In addition to the above economies, the latter group includes Ireland, as that country also suffered from severe external imbalances and debt build-up prior to the crisis. Ireland is thus of relevance to a comparative analysis of adjustment processes that took place in the course of the crisis. Ireland can, however, not be counted among the low-income economies of Europe.

2. External environment: global growth and inflation forecasts

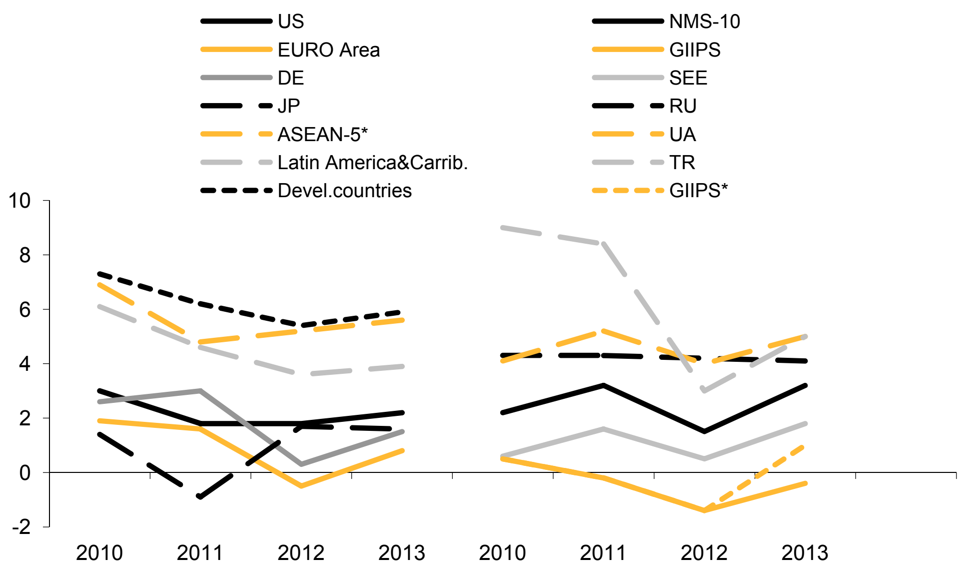
Current forecasts of global developments for 2012 and 2013 point to a slight slowdown in global output growth. The IMF January 2012 forecast predicts 3.3% for 2012, down from 3.8% in 2011, followed by a slight recovery rising to 3.9% in 2013.

As Figure 1 shows, the global situation is characterized by the following features: the outlook for the US economy in 2012 being better than previously expected and Japan experiencing recovery in the wake of the nuclear disaster. The ***major drop in growth in the advanced world expected for 2012 stems primarily from the eurozone***. Growth in both the emerging and developing countries will slow down as well. Whereas Asian resilience will prevail, growth in the other emerging regions in Latin America and the Middle East and North African region is expected to decelerate.

Figure 1

Development of GDP

change in % against preceding year



GIIPS: Greece, Italy, Ireland, Portugal, Spain, Forecast February 2012. GIIPS*: European Economic Forecast, Autumn 2011. ASEAN-5: Indonesia, Malaysia, Philippines, Thailand and Vietnam.

Source: IMF, World Economic Outlook, January 2012. European Commission, Interim Forecast, February, 2012. wiiw forecast.

Inflation pressures are expected to lessen on account of a slight fall in global output growth - and more particularly because commodity price inflation (including food and metals) that was a prominent feature of 2010 and the first half of 2011 is currently set on a stable path[3]. According to the recent IMF forecast, oil prices are expected to drop slightly (in our forecast, we assume a crude oil price of slightly

[3] This assessment implies no significant change in the policy stance globally with respect to inflation targets on the part of the principal monetary authorities.

below USD 100 for both 2012 and 2013 in line with the IMF forecast). Such forecasts, however, contain a major element of risk, given the volatile situation in the Middle East region.

3. EU policy framework

The EU policy stance is certainly a very important constraint on economic development in both the EU and eurozone member states, as well as in the Balkan countries whose economies are closely integrated with that of the EU. Given the manner in which EU policies have developed, the main characteristic is increasing pressure on fiscal consolidation supported by some monetary activism on the part of the European Central Bank (ECB). It is believed that fiscal commitment is essential to greater monetary support. This policy mix has been adopted following the sharp downturn in growth in mid-2011, which is currently expected to be followed by a mild recession in 2012, with somewhat faster growth in both 2013 and 2014.

Box 1

The evolving EU framework

Fiscal commitment in the EU has to be secured via the adoption of fiscal rules (similar to those in the Stability and Growth Pact (SGP)) on account of the fact that the EU budget is small and can only marginally serve stabilization purposes, while the eurozone has no budget at all. The new fiscal compact to be adopted in March of 2012 requires that all subscribing countries (25 out of 27 EU member states to date) put a cap on their primary structural fiscal deficits (the balance of revenues and expenditures, excluding interest payments) amounting to 0.5% of GDP or up to 1%, if the public debt to GDP ratio is lower than 60%. The cap on public debt is still binding, with the fiscal deficit (the balance of revenues and expenditures) limit remaining at 3% of GDP (both as in the SGP).

In broad terms, if real growth rate is 3% and a real interest rate is 2% and a debt to GDP ratio is 60%, the primary structural deficit needed to keep the debt level stable should be close to 0.5% of GDP. This can be seen from the simplified debt sustainability formula $(r-g)*d$ (with r real interest rate, g real growth rate, and d the debt to GDP ratio), which yields a primary deficit close to 0.5% of GDP with assumed growth and interests rates. In general $r-g$ should be around -1 for public debt to GDP ratio to be stabilized at 60% with the allowed structural deficit. Countries with higher levels of debt need to run significant primary surpluses, if they are to reach gradually the prescribed limit of 60% of GDP. Of course, lower growth and higher interest rates call for even higher primary surpluses. The debt to GDP target of 60% itself is not clearly justified.

The ECB has informally committed itself to maintaining a low policy rate (currently 1%) over a prolonged period of time, as well as implementing a massive programme of quantitative easing, currently based on three-year loans to banks. Those measures should ensure the banking system's liquidity and, it is hoped, boost their credit activities. That should go together with higher capital requirements aimed at securing the stability of the EU banking and financial system.

The new European Stability Mechanism (ESM) is scheduled to start in July 2012 – possibly with more money to hand than was initially intended. Funds are also being lent to the International Monetary Fund (IMF) for use in its programmes, most of which are being implemented in Europe. The aim of those programmes is to support liquidity and macroeconomic stability. In effect, the ESM should afford the EU a stabilization policy arm that can be used in conjunction with IMF funding and programmes.

In addition, the European Commission has issued its first review of internal and external imbalances. The scoreboard consists of a series of indicators that for the most part look at the development of stocks and flows of interest. Threshold values are cited for current account disequilibria, net international investment positions, real exchange rates, export market shares, unit labour costs, housing prices, credit growth, private sector debt, general government debt and unemployment rates (in addition to some other indicators). The threshold values should serve as early or late warning signals. They are based on historical values (some short-term, others long-term). Only rarely do they take into account the differentiation across groups of countries in the light of their different levels of development or other factors.

This mix of fiscal and monetary policy is geared towards stability, with growth being spurred, it is expected, by supply-side policies. The latter are considered especially important for countries with significant external imbalances, i.e. practically all the countries in Southern and Southeast Europe. From the microeconomic point of view, the policy mix implies deregulation and increased competition which, in turn, should have some positive effect on growth and employment. In macroeconomic terms, however, it also implies that improvement in the corporate balance sheets is to be secured, in part at least, by shedding labour and thus improving productivity. Improved growth performance should be the consequence of increased competitiveness, which, in turn, should lead to increased investment in exporting sectors.

It has been suggested that in terms of fiscal policy, the main structural support would be to increase indirect taxes (mainly VAT) and decrease direct taxes (mainly social contributions). The latter move is believed to support employment and increase labour effort, while the former is expected to realize revenues as well as reduce consumption, especially of imported goods. The overall effect should be a higher tax burden on income from labour and a lower burden on income from capital. The expectation is that the latter will attract investments and thus increase employment.

This policy framework is basically a strategy for transition or restructuring. It assumes that the crisis has not led to a decline in aggregate demand or, if it has, the EU and euro frameworks are such that they do not allow for a general boost in demand, although individual countries that may have the fiscal space for such moves can engage in one or the other type of fiscal stimulus. In the final analysis, it is really the accumulated imbalances that need to be corrected by supply-side oriented restructuring and an appropriate change in relative prices.

Perhaps the key imbalance as well as the relative price misalignment are reflected in the external deficits; they are possibly the consequence of the misalignment of real exchange rates between the countries of Southern and Southeast Europe and those of Central and Northern Europe. Those imbalances and a rigid nominal exchange rate regime of the euro monetary union suggest that one way of supporting growth is to increase both competitiveness and investments in the tradable sector. Increased competitiveness can be facilitated by appropriate incomes policy and greater competition in the product and labour markets, while increased investment can be secured from foreign investors or greater domestic savings. All the above presumes an end to the process of deleveraging and an improvement in corporate balance sheets.

The strategy is thus based on fiscal consolidation, with household savings and corporate investments increasing, as well as with a rebalancing of the tradable and non-tradable sectors. The risk is that the prerequisites for the strategy's success might not be met in which case stability, if achieved, will be coupled with stagnant or slow growing economies. It would also amount to a significant change in the growth model on which the common market and currency union are predicated. The original idea was that foreign investments would encourage converging growth, which would ultimately sustain the initially widening imbalances and eventually lead to their elimination. The new strategy, however, would require that the countries in Southern Europe shift towards adopting a mercantilist policy, i.e. aim to close the deficit on the external account and repay foreign debt. It is questionable whether a policy turnaround of that scope would support the existing or evolving overall institutional and policy framework in the EU, let alone being helped by the same.

Perhaps the most important observation is that this strategy of increased fiscal austerity and structural reforms does not categorize EU member and candidate states along the lines of a West-East divide, but more along a North-South divide. It is not a question of the old versus new member states or possibly both parties versus the candidate countries, but rather one of the industrialized North versus the non-competitive South. Moreover, it is not a split between developed and converging countries, but rather one between growing and diverging (or 'laggard') countries. The new EU and euro policy framework may well lead to a strengthening of this new divide.

4. External imbalances and a suggested grouping of Europe's low- and medium-income countries

The pre-crisis EMU framework encouraged large inflows of foreign investment from the more developed to the less developed countries, with external imbalances temporarily widening, then narrowing and eventually closing as income levels converged mainly on account of export growth. The outcome in Central Europe, or a part thereof, has been more or less as intended, but not in the countries of Southern Europe nor in the Baltic states. The financial crisis led to a dearth of foreign financial inflows and a sharp decline in foreign trade with exports as a rule recovering faster than imports in the aftermath. In that context, export recovery has proven stronger in some countries with lower pre-crisis trade deficits than in at least some of the countries with major trade imbalances.

These external imbalances led to an accumulation of foreign debts with clearly unsustainable growth dynamics. They have since started to climb at a slower rate and, in some cases, the foreign debt to GDP ratios have declined: indicative of the onset of a deleveraging process. This again is more evident in Central Europe and the Baltic states than in the countries of Southern Europe. Some countries in the Balkans do not have all that high a foreign debt exposure; the continuing additional accumulation, thus, does not suggest that it is unsustainable. However, high trade deficits and the uncertainties surrounding the future growth of exports of goods and services still point to a structural problem that may restrain the growth of those countries, given the somewhat unfavourable climate for foreign investments that is currently developing.

Box 2

Current account sustainability

Current account sustainability is basically about the development of foreign debt. Usually, the limit of sustainability tends to be marked by a sudden stop in the inflow of foreign funds (something that can also occur as a consequence of contagion). For a large number of countries in Southern Europe and the Baltic states, the development of the foreign debt proved unsustainable prior to the crisis and had led to slower growth or even recession before (and yet unrelated to) the financial crisis of 2008. Growing foreign debt is the consequence of high current account deficit. The latter can persist and increase over time if the interest rate on foreign liabilities is lower than the sum of the growth rate and the change in the exchange rate. For example, if the exchange rate is appreciating in real terms and the growth rate is high, interest rates on foreign liabilities will tend to be low and current account deficits will tend to increase and so push foreign debts up. Once interest rates increase because of the high foreign debt or due to contagion, the financing of the foreign debt will prove to be unsustainable and there will be a need for current account reversal. That may be supported by exchange rate devaluation or by internal devaluation, which is the downward adjustment of wages with growth slowdown and decreased employment.

A further reason for the time it takes to correct external imbalances lies in the distribution of foreign debts. The latter are mostly private sector debts and mostly on account of the crisis has the share of public foreign debts risen. When it comes to private debts, countries differ; some have high corporate foreign debt and others high household foreign debts. In the countries with relatively high corporate exposure to foreign debts, the corporate sector may have to be restructured: a process that may prove time-consuming. In any event, sustained acceleration of exports, even in those instances where it has occurred, cannot be expected, unless investments in the tradable sectors accelerate as well.

Grouping Europe's low- and medium-income countries

The discussion above serves as the backdrop to our having adopted a particular grouping of countries in the following analysis of economic developments in low- and medium-income countries. The grouping of countries is based on certain commonalities and related features, the most important of which date back to pre-crisis developments. Particular emphasis is placed on the build-up of external and internal disequilibria prior to the financial crisis, which then led to different adjustment pressures following the onset of that crisis. Other factors leading to different development patterns were different 'framework conditions', such as exchange-rate regimes, in which countries found themselves, and different policy responses in the respective settings.

Figure 2a shows developments in the current account and its components. Figure 2b presents the pre- and post-crisis developments in various debt segments: external debt, public and private debt and the various components of private debt (all expressed as a percentage of GDP). The information contained in Figures 2a and 2b provides the main background to differences across countries in the build-up of external disequilibria, as well as in the debt positions of the economies on entering the crisis, which proved to be the main challenges in the adjustment processes following its onset. The evidence contained in the two figures also provides the main ingredient in our adopting the country groupings in the following analysis.

Current account developments are taken first. The Central European economies (CE-5[4]) display a relatively positive performance in terms of their current account developments, which did not experience any substantial deterioration before the crisis. Furthermore, the trade accounts confirm the relative strength of those economies in terms of their export as against their import performance. A number of economies have been able to attain positive trade balances (Czech Republic and Slovakia) and others came close to balance. Given that evidence, it would thus seem that those economies encountered no competitiveness problems.[5]

Much more problematic were developments in the following groups of economies. All the Baltic economies as well as Romania and Bulgaria recorded strongly deteriorating current accounts before the crisis, which were predominantly associated with deteriorating trade balances. In part, those deteriorating trade balances reflected inordinately high growth rates in some of the economies prior to the crisis; however, there is clear evidence here of external balances ‘moving out of gear’.

If we compare the above economies with the GIIPS countries[6], we can see competitiveness problems that came particularly to the fore in two countries with persistently high current account deficits: Greece and Portugal. Competitive problems featured less prominently in Spain and Italy, while Ireland recorded persistently high export surpluses (the current account deficit reflecting a high level of profits earned by foreign-owned companies as evidenced by the income accounts).

The remaining countries in Southeast Europe (SE-6[7]) show very high trade deficits reflecting a very small export base upon which the economies can count. Current accounts displayed marked deterioration in the period prior to the crisis in two economies: Montenegro and Serbia. Most of the economies in the group rely on major transfers in the form of remittances from their nationals living and working abroad, thus partly offsetting the high trade deficit.

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4 CE-5: Czech Republic, Hungary, Poland, Slovakia and Slovenia.

5 Of course, the trade accounts per se are insufficient to reflect fully competitive strengths and weaknesses as they can, for example, become sharply positive or negative when GDP growth exceeds or falls short of that of the main trading partners.

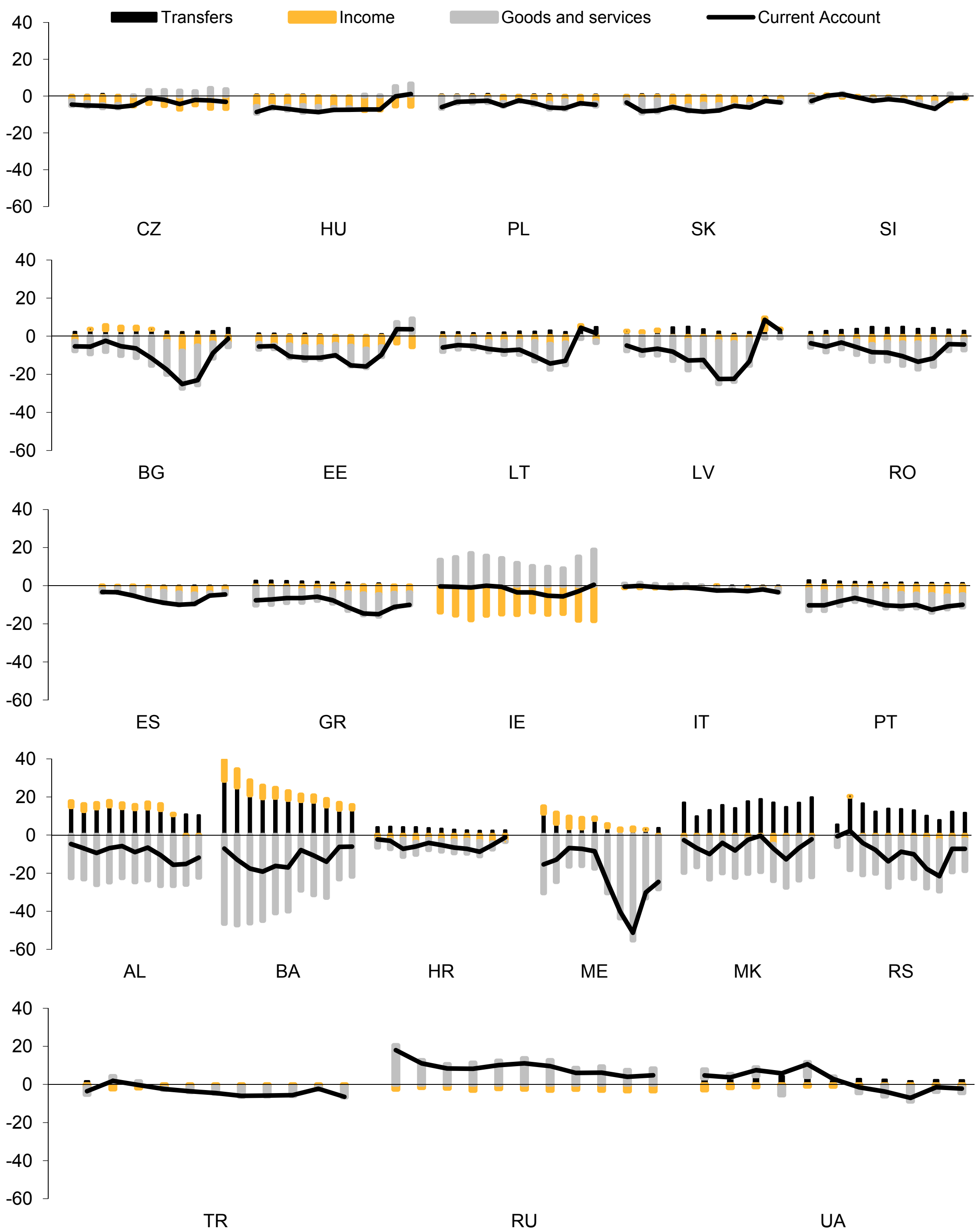
6 The GIIPS: Greece, Ireland, Italy, Portugal and Spain. See also footnote 1 above. While Ireland is not included in the range of low-income economies and therefore does not feature in other parts of our analysis (which refers to the GIPS without Ireland), it is included here and elsewhere as prior to the crisis, Ireland was also characterized by a build-up of very high external imbalances and high private sector debt growth.

7 SE-6: Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Serbia.

Figure 2a

Composition of the current account of the balance of payments, 2000-2010

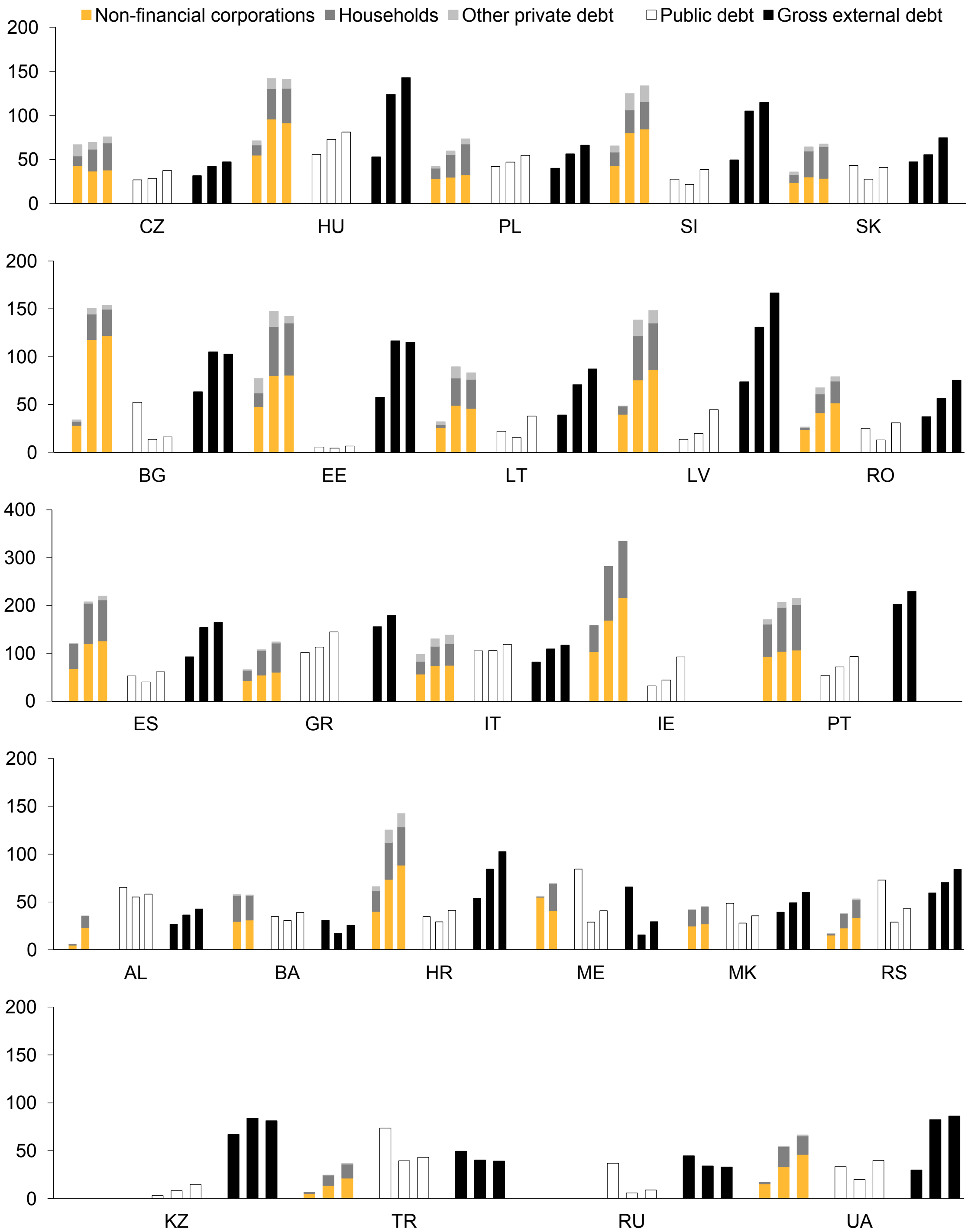
in % of GDP



Source: wiiw Database incorporating national and Eurostat statistics.

Figure 2b

Private and public debt in % of GDP, 2002, 2008 and 2010



IE: For a better readability other private debt and gross external debt is not shown (e.g. gross external debt 2010 would be 1105.1 % of GDP).

Source: Eurostat, IMF, wiiw own calculations.

As is well known, current account imbalances have to be financed and the capital inflows funding the same accumulate in the form of debt positions in different sectors of the economy. The accumulation of domestic and foreign debt positions is shown in Figure 2b. The information presented in the graphs shows further differences between and within country groupings.

Among the CE-5, relatively moderate or no increases are to be observed in the various debt positions of the Czech Republic and Poland, a somewhat higher increase of private debt in Slovakia (whereas public debt dropped as a percentage of GDP), and marked increases in private sector debt positions in Slovenia (mostly corporate debt) and Hungary. Furthermore, Hungary increased its public debt to 73 per cent of GDP in 2008, which is rather unique among the countries of central and Eastern Europe, followed by Poland whose public debt rose to 60 per cent of GDP in 2008.

The Baltic states as well as Bulgaria and Romania were characterized by a rapid development of private debt over the pre-crisis period, while public debt (as a percentage of GDP) was driven down, as it benefited from the high growth rates over that period and the associated tax revenue. Among the SE-6 countries, Croatia also displays a rapid rise in private sector debt, while Albania is characterized by a higher level of government debt, which, however, in common with most other economies, fell (as a percentage of GDP) in the period leading up to the crisis.

Summary

In the CESEE region prior to the crisis, one group of Central European economies (Czech Republic, Poland and Slovakia) encountered no evident problems related to the build-up of private and public debt. Many of the other CESEE economies in the group experienced a major build-up of their private sector debt positions, with only Hungary (and to a lesser extent, Poland) displaying a high public debt to GDP ratio.

The situation was not all that much different to that prevailing in the GIIPS countries before the crisis, with the important exceptions of Greece and Italy, both of which maintained public debt levels of over 100 per cent of GDP prior to 2009. The other GIIPS countries (including Greece, but not Italy) experienced extremely rapid growth in private sector debt: the (in)famous ‘credit bubble’ in those economies prior to the crisis.

Hence prior to the impact of the financial crisis, the starting point was the major imbalances in the external accounts in a large number of low- and medium-income economies in Europe (the GIIPS group without Ireland and Italy, and a large number of CESEE economies with a sub-group of CE-5 being the exception). This went along with the build-up of debt positions, which in many economies were largely characterized by the swift build-up of private sector debt to very high levels, with only a small sub-group of economies (Hungary, Greece, Italy) showing high public debt levels prior to the crisis.

As for the mix of other countries - *Kazakhstan, Russia, Turkey* and *Ukraine*, - covered in this overview, they constitute a rather heterogeneous set. Two of them are major energy exporters (Kazakhstan and Russia) that registered highly positive trade balances before and after the crisis. The Ukraine struggled with high current account deficits and the build-up of high external debt, in addition to going through a major banking crisis and an attack on its exchange rate in the wake of the crisis. Turkey, on the other hand, after undergoing a crisis of its own in the late 1990s, embarked on a very successful phase, in the course of which it built up a thriving and more diversified industrial and export sector and drove down its public and external debt prior to the crisis. Admittedly, Turkey goes through bouts of high current-account deficits with every sign of over-heating, as was more recently the case in 2010 and 2011. This makes it necessary to adopt an appropriate policy response in order to achieve re-equilibration (see the forecast for 2012).

5. The impact of the crisis: external accounts adjustment

The initial impact of the crisis can be observed in the graphs of Figure 2a (see also Table 1 with the foreign financial position), which show the current (and trade) account adjustments in the wake of the crisis. As can be seen, major adjustments in the current accounts were not called for in three CE-5 countries (Czech Republic, Poland and Slovakia) that *ab initio* had no external imbalances. On the other hand, adjustments were made in Slovenia and Hungary, both of which had experienced massive growth in private sector debt prior to the crisis and whose current accounts moved into balance or positive territory with the onset of the crisis (see Table 1 for detailed information). Much more dramatic were the developments in the Baltic states and Bulgaria (and to a lesser extent in Romania). They had experienced a marked deterioration in their current accounts (and private debt) prior to the crisis; following the onset of the crisis the notion of 'sudden stop' is an appropriate descriptor of the manner in which capital flows dried up or even went into reverse.

The SE-6 countries also adjusted their current accounts, albeit to a lesser extent, as they could still draw on very substantial transfers from their nationals living and working abroad. Interestingly enough, there were no reduced net capital inflows (as a percentage of GDP) in two GIIPS countries (Greece and Portugal), both of which recorded high current account deficits prior to the crisis, thus reflecting the supportive EU-IMF or EU agreements and support packages. In Ireland, which has a more robust tradable sector, GDP adjustment in the wake of the crisis led to a pronounced improvement in the current account.

In the following, we shall discuss in greater detail certain features of the adjustment processes that occurred in the wake of the financial and economic crisis, including both transitory features as well as the more permanent impact of the initial disequilibria on the patterns of recovery or lack thereof.

Figure 3 provides clear cross-country evidence, confirming that the extent of current account deficits prior to the crisis led to a major current account adjustment over the period 2008-2011. Furthermore, Figure 4a shows a similarly clear relationship between the other indicator of an extant disequilibrium prior to the crisis, the ratio of private sector debt to GDP, and the subsequent growth trajectories of the different economies. A similar relationship is shown in Figure 4b between the pre-crisis current account deficit and subsequent growth. We can conclude that, first, major current account adjustments took place that were determined by the previous extent of the disequilibria and, secondly, the extent of the previous build-up of private sector debt or pre-crisis current account disequilibria had a palpable negative impact on medium-term growth performance following the crisis.

Table 1

Foreign financial position

in % of GDP

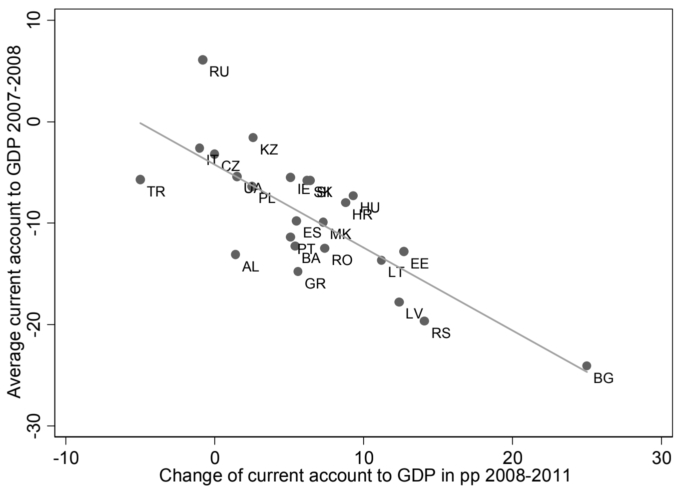
	Trade Balance (BOP)						Current account						Gross external debt				
	2007	**2008**	**2009**	**2010**	**2011** 1)	**2012** Forecast	**2007**	**2008**	**2009**	**2010**	**2011** 1)	**2012** Forecast	**2007**	**2008**	**2009**	**2010**	**2011** 1)
Bulgaria	-23.5	-24.3	-11.9	-7.7	-4.7	-5.2	-25.2	-23.1	-8.9	-1.3	1.9	1.2	94.3	105.1	108.3	102.8	91.0
Czech Republic	1.3	0.7	2.3	1.4	2.9	3.8	-4.3	-2.1	-2.4	-3.1	-2.1	-2.0	39.2	39.2	43.8	47.8	50.0
Estonia	-16.4	-13.0	-4.0	-1.8	-1.0	-1.8	-15.9	-9.7	3.7	3.6	3.1	0.0	108.3	116.8	124.7	115.2	96.6
Hungary	-0.7	-1.1	2.6	3.3	4.7	5.5	-7.3	-7.3	-0.2	1.1	2.0	2.2	104.6	117.0	149.8	141.7	137.9
Latvia	-24.0	-17.8	-7.1	-7.1	-8.6	-9.7	-22.4	-13.2	8.6	3.0	-0.8	-1.9	127.6	130.0	157.1	166.8	149.3
Lithuania	-14.9	-12.9	-3.2	-4.6	-4.8	-6.2	-14.4	-12.9	4.4	1.5	-1.7	-2.5	71.5	70.9	87.0	87.4	80.2
Poland	-4.4	-5.8	-1.7	-2.5	-2.8	-2.8	-6.2	-6.6	-3.9	-4.7	-4.1	-4.0	51.0	47.8	62.6	66.6	64.6
Romania	-14.3	-13.6	-5.8	-6.1	-5.5	-5.6	-13.4	-11.6	-4.2	-4.4	-4.2	-4.6	47.0	51.8	68.7	74.5	72.9
Slovakia	-1.2	-1.2	1.5	0.2	2.1	2.7	-5.3	-6.2	-2.6	-3.5	0.0	-0.7	55.0	57.8	72.1	74.8	77.7
Slovenia	-4.8	-7.1	-2.0	-3.4	-3.6	-1.9	-4.8	-6.9	-1.3	-0.8	-0.5	-0.5	100.6	105.2	114.1	114.9	114.2
Austria 2)	0.5	-0.2	-0.9	-1.1	-1.9	.	3.5	4.9	2.7	3.0	2.0	.	198.7	211.6	210.1	208.6	208.7
Germany 2)	8.2	7.3	5.7	6.4	6.0	.	7.5	6.3	5.6	5.7	4.8	.	143.2	148.8	149.8	157.6	163.5
Greece 2)	-18.6	-18.9	-13.3	-12.4	-12.9	.	-14.6	-14.9	-11.1	-10.1	-9.3	.	138.5	155.7	176.1	179.0	185.9
Ireland 2)	10.4	13.2	20.2	23.4	24.1	.	-5.3	-5.6	-2.9	0.5	-0.6	.	810.9	940.4	1030.8	1105.1	1071.0
Italy 2)	0.2	-0.1	0.1	-1.3	-1.5	.	-2.4	-2.9	-2.0	-3.5	-3.9	.	111.4	109.3	116.0	117.1	116.5
Portugal 2)	-11.3	-13.4	-10.6	-10.5	-8.5	.	-10.1	-12.6	-10.9	-10.0	-7.6	.	194.1	202.5	226.2	229.2	220.9
Spain 2)	-8.7	-7.9	-4.0	-4.5	-3.9	.	-10.0	-9.6	-5.2	-4.6	-4.1	.	148.5	153.7	167.8	164.4	164.9
Croatia	-21.7	-22.6	-16.2	-13.0	-11.7	-11.4	-7.2	-8.8	-5.2	-1.2	0.0	-0.6	77.7	83.3	95.8	101.3	100.7
Macedonia	-19.8	-26.2	-23.3	-21.3	-23.0	-26.2	-7.1	-12.8	-6.8	-2.2	-5.5	-5.8	47.6	49.2	56.4	59.9	64.7
Montenegro	-60.0	-68.1	-46.0	-40.8	-40.0	-42.9	-40.2	-51.3	-30.1	-24.6	-16.7	-20.6	17.2	15.6	23.5	29.4	30.3
Turkey	-7.1	-7.1	-4.0	-7.7	-12.1	-11.7	-5.8	-5.6	-2.3	-6.5	-10.5	-9.1	35.4	40.4	42.3	39.2	42.2
Albania	-26.9	-27.4	-26.4	-23.5	-22.8	-21.7	-10.5	-15.6	-15.2	-11.8	-14.1	-13.1	28.4	36.2	38.7	42.4	46.8
Bosnia and Herzegovina	-37.1	-38.1	-27.7	-25.8	-27.4	-29.2	-10.7	-14.0	-6.2	-6.1	-8.6	-8.4	18.1	17.1	21.8	25.6	25.5
Serbia	-24.8	-26.0	-17.7	-16.4	-16.7	-18.2	-17.7	-21.6	-7.2	-7.2	-7.5	-9.0	60.2	64.6	77.9	82.0	72.7
Kazakhstan	14.4	25.1	13.0	19.5	25.1	21.5	-7.9	4.7	-3.5	2.0	7.3	5.6	85.9	84.1	95.5	80.7	70.0
Russia	10.1	10.8	9.1	10.3	10.6	8.5	6.0	6.2	4.0	4.8	5.5	4.0	33.4	30.1	37.0	33.0	31.3
Ukraine	-7.4	-8.9	-3.7	-6.1	-8.4	-8.4	-3.7	-7.1	-1.5	-2.2	-5.6	-5.7	52.2	58.6	85.8	86.0	80.2

1) Preliminary and wiiw estimates. - 2) In 2011 data refer to 3 quarters 2011.

Source: wiiw Database incorporating national and Eurostat statistics, World dataBank - Quarterly External Debt Statistics. Forecasts by wiiw.

Figure 3

Current account adjustment 2008-2011



Source: wiiw Database incorporating national and Eurostat statistics, own calculations.

Figure 4a

Private sector debt and subsequent GDP growth trajectories 2008-2011

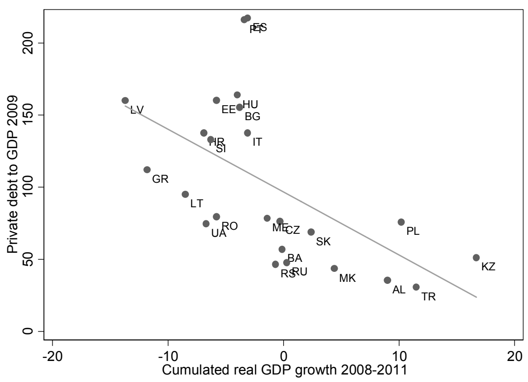
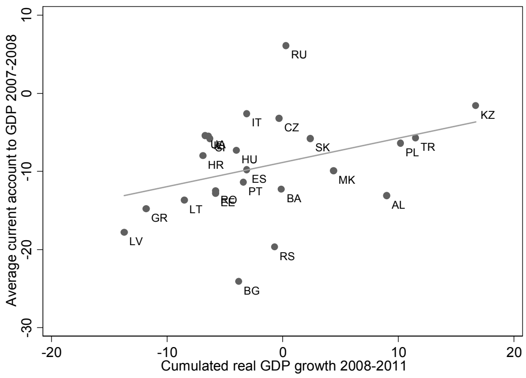


Figure 4b

Current account balance and subsequent GDP growth trajectories 2008-2011

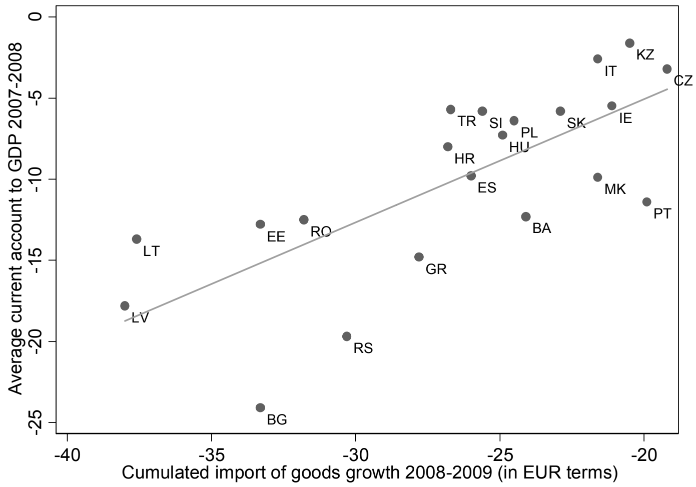


Source: wiiw Database incorporating national and Eurostat statistics, own calculations.

The respective roles of import and export growth in the adjustments of the current accounts deserve closer scrutiny. Figures 5a-5c show that in the short term (i.e. the year after the onset of the 2008-2009 crisis), it is almost exclusively the adjustment of imports which responds to the magnitude of the pre-crisis current account deficit (see the significant relationship in Figure 5a). Whereas in the short term no relationship obtains between export growth and the current account deficit, in the medium term exports make a significant contribution to current account adjustments as shown in Figure 5b. In that figure we can also see significant variances across countries in the role of exports in medium-term current account adjustments. For example, the Baltic countries and Bulgaria and Romania benefited from pronounced export growth over the period 2008-2011, while Greece, Portugal and Serbia, all of which displayed substantial current account deficits prior to the crisis, performed very poorly in terms of export growth. The degree of differentiation across economies is also apparent in Figure 5c, in which both export and import growth rates are plotted over the period 2008-2011, thus allowing us to distinguish between various groups of economies: (i) those in the top two quadrants which experienced relatively high medium-term export growth; (ii) those which experienced comparatively pronounced import contractions, but relatively weak or even negative export growth (this group comprises most of the GIPS countries, as well as many of the SE-6 countries); and (iii) those with more balanced export and import growth that had no need for external accounts adjustment (this group comprises the CE-5 countries without Slovenia, but also includes Italy).

Figure 5a

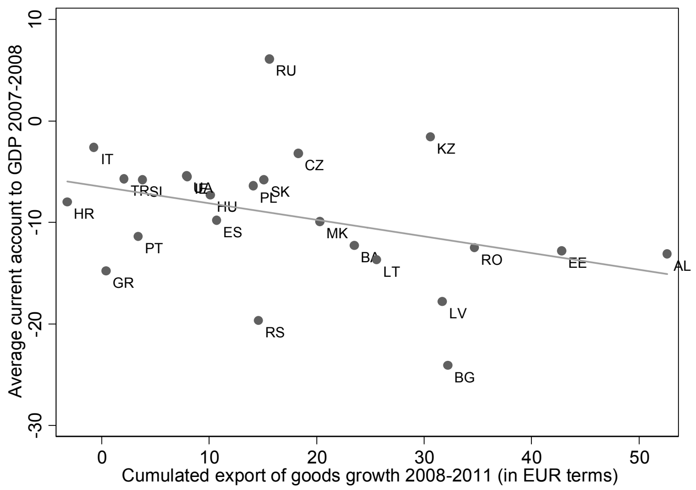
Current account balance and subsequent short run import development 2008-2009



Source: wiiw Database incorporating national and Eurostat statistics, own calculations.

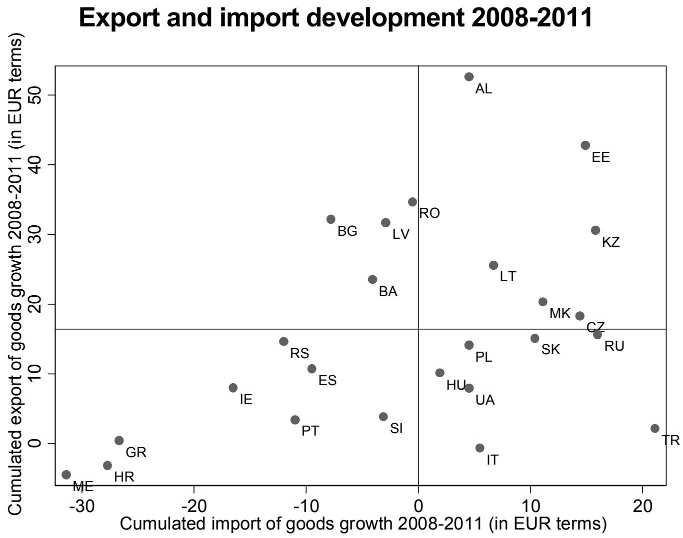
Figure 5b

Current account balance and subsequent medium term export development 2008-2011



Source: wiiw Database incorporating national and Eurostat statistics, own calculations.

Figure 5c



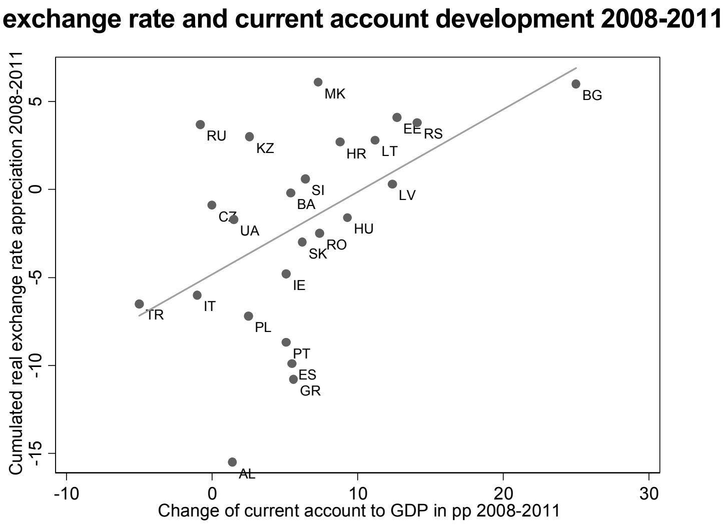
Source: wiiw Database incorporating national and Eurostat statistics, own calculations.

Box 3

Real exchange rates and current account adjustments

Starting from a position of serious current account imbalances in a wide range of countries, including both GIIPS and CESEE countries, one would expect real exchange rates to play an important role in re-equilibration processes. Below we show that – at least as far as the period 2008-2011 is concerned – real exchange rate developments had little or no impact or went in an unexpected direction. Subsequently we state a hypothesis concerning the reasons for the low effectiveness of real exchange rate movements in that phase.

Box Figure 1

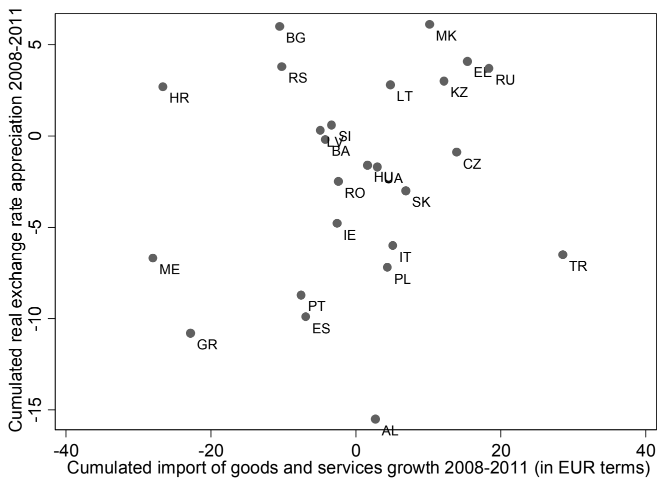


Source: wiiw Database incorporating national and Eurostat statistics, own calculations.

Box Figure 1 shows that if there was a relationship between real exchange-rate changes and current account changes over the period 2008-11 it went in the unexpected direction of countries with an appreciating real exchange rate improving their current accounts (the real exchange rate variable used here refers to nominal exchange-rate developments adjusted by relative producer price (PPI) changes between the country in question and the EU-27 as a whole). Furthermore, Box Figure 2 indicates that over the period 2008-2011, real exchange-rate depreciation did not have the desired negative impact on import developments (except for some of the GIPS economies), while Box Figure 3 shows that real exchange-rate appreciation was – again against expectations - associated with relatively higher export growth (all trade growth figures are in current price Euros).

Box Figure 2

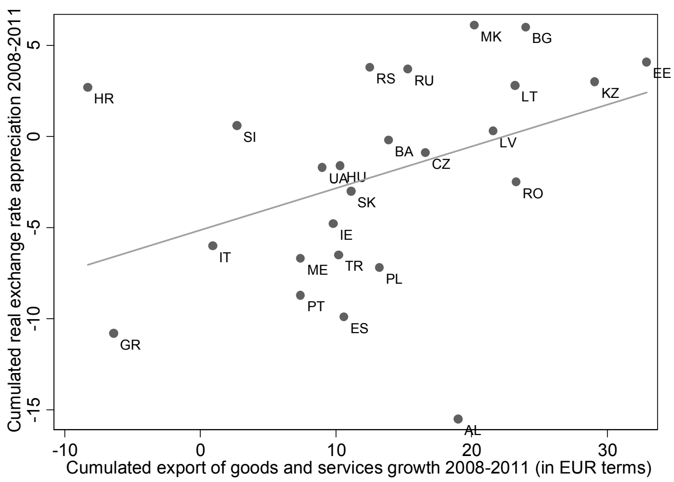
Real exchange rate and import development 2008-2011



Source: wiiw Database incorporating national and Eurostat statistics, own calculations.

Box Figure 3

Real exchange rate and export development 2008-2011



Source: wiiw Database incorporating national and Eurostat statistics, own calculations.

Putting the information provided in those figures together, we can conclude that over the period of current account adjustment (2008-2011), no evidence is to be found of real exchange-rate developments playing any kind of role (except in the GIPS countries on the import side, but not on the export side) in supporting current account adjustments in the expected direction which, as we showed earlier, were none the less an important feature of that phase. In fact, on the export side, the very opposite of what was to be expected occurred: the existence of a positive relationship between real exchange rate appreciation and export growth.

What is the explanation for this? Our hunch is that those countries, whose real exchange rate suffered major depreciation, also experienced a major decline in production activity induced by a 'sudden stop' phenomenon of capital inflows, financing constraints and a rise in capital costs. All of that combined to prevent those countries – at least over the period in question – from responding to the change in relative prices in the direction expected. This held true both for the import side (domestic producers could not take advantage of substitution for more expensive imports) and even more so for the export side.

Summary

It is quite apparent that the crisis brought about a need to correct strong external imbalances and strong private sector debt build-up prior to the crisis. We have shown that the extent of adjustment was directly related to the extent of the previous current account disequilibria and private sector debt build-up, and that those adjustments (and their severity) entailed clear medium-term costs in terms of GDP growth. Furthermore, patterns of adjustment across economies varied greatly, with some countries relying almost exclusively (even in the medium term) on import adjustments, while others were more successful in terms of export growth.

In the following section we analyse further features of GDP developments over the period 2008-2011 as a precursor to our analysis of the prospects for 2012-2014.

6. GDP developments and its components: what can recovery rely on?

GDP developments reflect many factors that will be discussed in more detail below. However, a first assessment of quarterly GDP developments in Figure 6[8] reveals a number of distinct country patterns:

(i) Those countries that (by the end of 2011) achieved or exceeded the pre-crisis level of real GDP. This group includes Poland and Slovakia from the CE-5 countries; Albania, Bosnia and Macedonia from the SE-6 countries, as well as Turkey and Russia.

(ii) Those countries that failed to return to the GDP level of 2008. This group includes Hungary and Slovenia from the CE-5 countries; all the Baltic states; Croatia, Montenegro, Serbia from the SE-6 countries; and all the GIIPS countries.

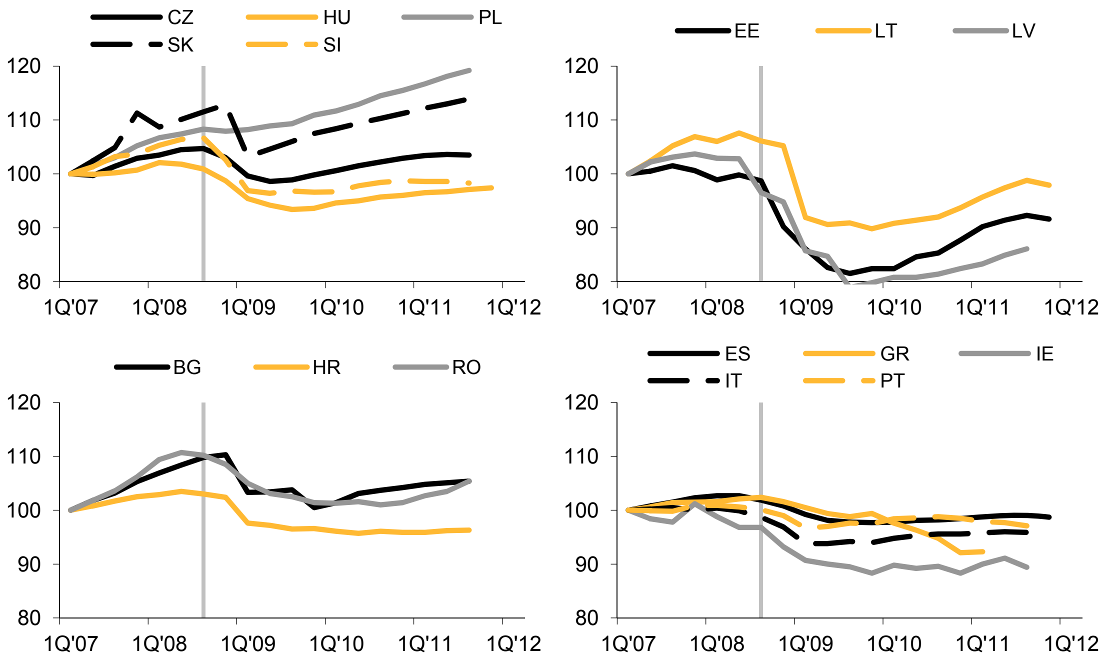
[8] For lack of availability of quarterly GDP data we cannot show the full set of countries referred to in the text. The assessment for some of the countries comes from half-yearly figures or estimates of full-year GDP developments.

(iii) Those countries that throughout 2011 continued to dip in terms of GDP growth. This group includes Greece, Portugal and Italy from the GIIPS countries. Moreover, both Croatia and Slovenia recorded close to zero growth in 2011 and evidence is building up of a further decline in GDP over the second half of 2011 in a number of economies.

Figure 6

Development of quarterly GDP

1 Q'07 = 100, seasonally and working day adjusted



Source: Eurostat.

A similar type of analysis can be performed using industrial production indicators (the higher frequency indicator kept most up-to-date across the range of economies (see Figure 7)). The situation in this context appears much more unfavourable than that of GDP. Once again, a number of distinct patterns can be identified:

(i) Those countries that (by the end of 2011) achieved the pre-crisis level of industrial production. The group includes only Poland, Slovakia and (marginally) the Czech Republic from the CE-5 countries, as well as Estonia, Lithuania, Romania, Russia and Turkey.

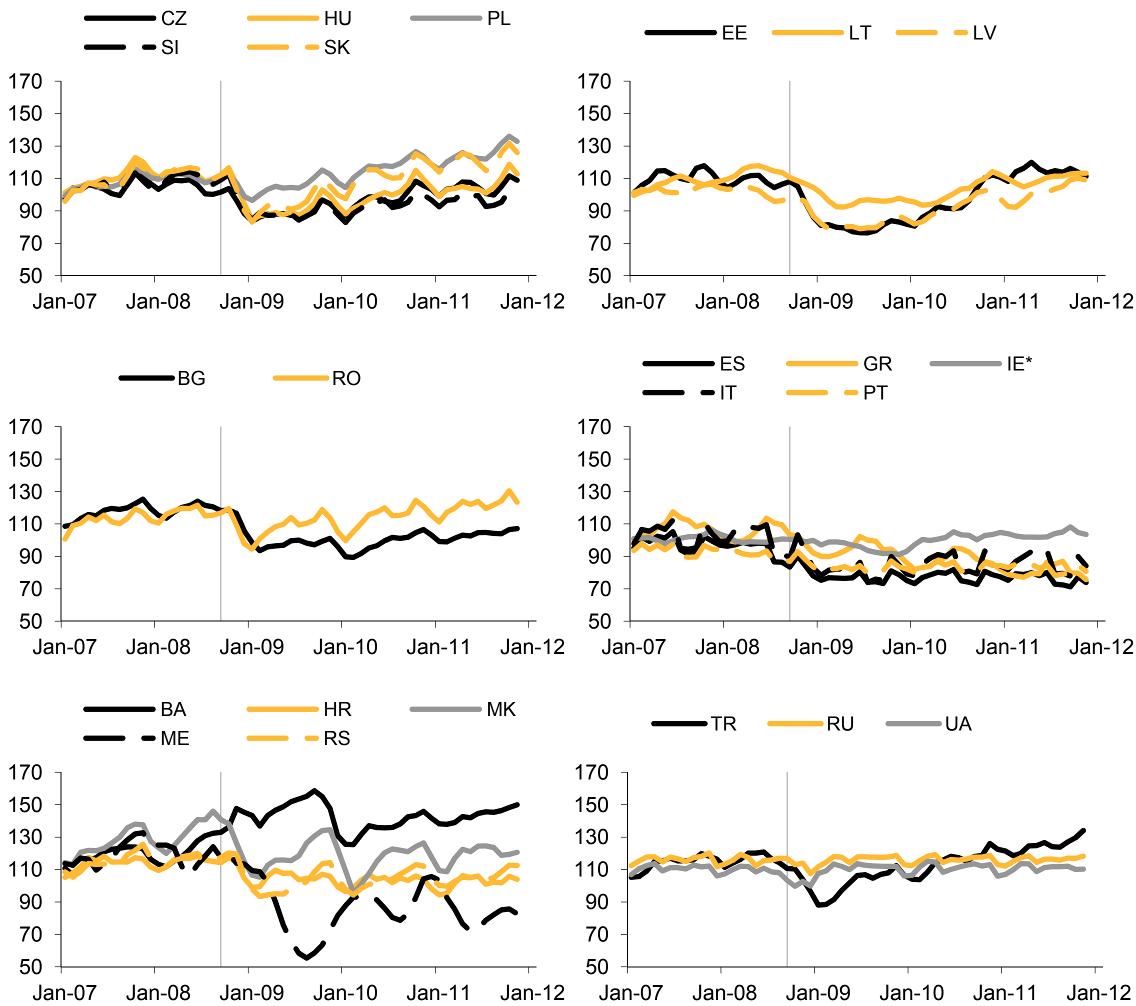
(ii) Those countries with yawning gaps between the pre-crisis (October 2008) and recent (October 2011) levels of industrial production. This group includes Croatia (-15%), Macedonia (-27%), Montenegro (-30%), Slovenia (-20%) and Serbia (-13%), as well as all the GIIPS countries: Spain (-18%), Greece (-30%), Ireland (-16%), Italy (-20%) and Portugal (-11%).

(iii) Those countries that throughout 2011 continued to drop in terms of industrial production. The group includes all the GIIPS countries, as well as Bulgaria, the Baltic states, Croatia, Macedonia, Romania, Serbia and Slovenia, as well as Russia and Ukraine (based on figures for the period December 2010 to December 2011).

Figure 7

Development of gross industrial production (real)

January 2007 = 100, 3-month moving average



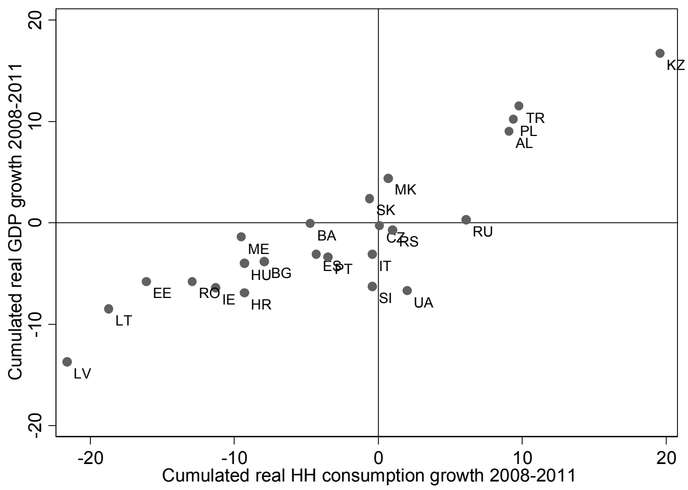
Remark: * IE seasonally adjusted.

Source: wiiw Monthly Database incorporating national and Eurostat statistics.

A further cardinal point we would like to make is the extent to which growth (or relief from GDP contraction) relied on exports over the period 2008-2011. Figures 8a-8b show in two scatter plots the relatively close relationship between consumption growth and GDP growth (something to be expected given the large share of final consumption in GDP) and between gross fixed capital formation and GDP growth. However, more important than the relationship between those variables is that most of the countries are to be found in the negative (south-western quadrant) of both graphs. This means that the levels of GDP, consumption and investment in 2011 were still below those in 2008. Furthermore, the collapse in investment levels was much more dramatic than the drop in GDP. The opposite is the case in Figure 8c which shows that exports was the one variable where most countries are to be found in the eastern quadrants: in brief, positive export growth. Hence, it can be stated that ***over the period 2008-2011***, ***the extent of growth or recovery hinged to a great extent on the growth of exports***. Furthermore, as emphasized above, countries varied in terms of the relative boost provided by export growth.

Figure 8a

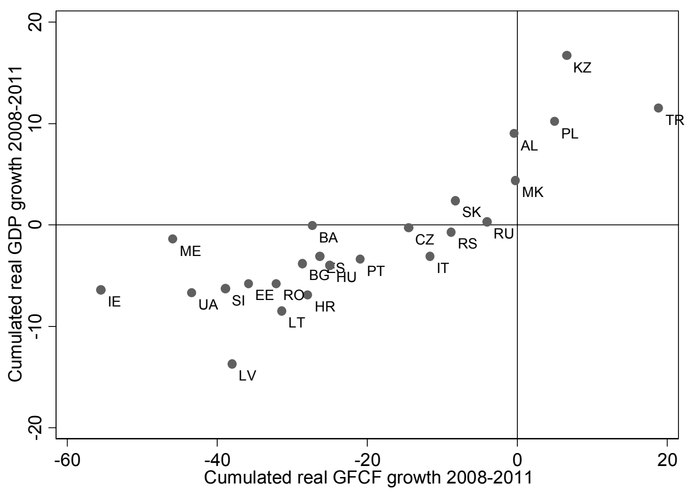
GDP and household consumption growth 2008-2011



Source: wiiw Database incorporating national and Eurostat statistics, own calculations.

Figure 8b

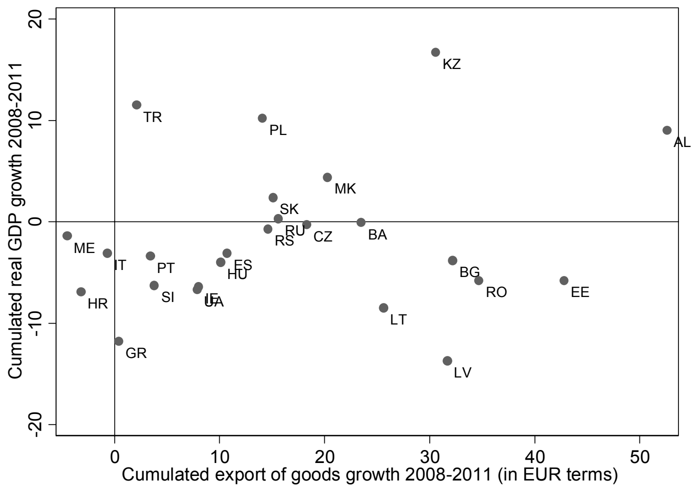
GDP and gross fixed capital formation growth 2008-2011



Source: wiiw Database incorporating national and Eurostat statistics, own calculations.

Figure 8c

GDP and export growth 2008-2011



Source: wiiw Database incorporating national and Eurostat statistics, own calculations.

Summary

- The 2008-2012 economic crisis bears all the familiar hallmarks of crises that are linked to the financial, debt-related and structural aspects of current accounts crises; they have lasting level effects and recovery can be very protracted;
- In the medium term, the level of impact is higher in those countries where the build-up of imbalances (current accounts and debt – mostly private) was much more pronounced before the crisis;
- The level effects are more pronounced in industrial production than in GDP; hence, it looks as though production capacities in the tradable sectors are hardest hit, especially in countries that started out from weak positions in the first place;
- Export-led growth was an important feature of the recovery period 2010-2011, yet significant inter-country differences persisted. A few countries with severe pre-crisis imbalances (Romania, Bulgaria and the Baltic states) enjoyed improved export growth over that period (some of these benefited from a commodity boom on global markets), while other structurally weak economies (other SE-6 countries and the GIPS countries) fared badly in that respect.

7. Predicting cyclical patterns for 2012 to 2014

In the following section, the focus is on our forecasts of GDP developments in the CESEE region (wiiw does not draw up its own GIIPS country forecasts) for the period 2012-2014. Those forecasts and our estimates with respect to the likely contribution to GDP growth of the different components of demand (broken down by household final consumption, government final consumption, gross fixed capital formation and trade balance) are depicted in Table 2.

Table 2

Contributions to the GDP growth rates

in percentage points [1)]

	2007	2008	2009	2010	2011	2012	2013 Forecast	2014
Czech Republic								
GDP growth rate (%)	**5.7**	**3.1**	**-4.7**	**2.7**	**1.8**	**0.5**	**2.5**	**3.5**
Household final consumption	1.9	1.4	-0.2	0.3	-0.2	-0.2	0.7	1.2
Government final consumption	0.1	0.2	0.7	0.1	-0.5	-0.4	0.2	0.1
Gross fixed capital formation	3.4	1.1	-3.1	0.0	-0.1	0.1	0.9	1.4
Trade balance	-0.5	1.0	0.7	0.8	2.8	1.2	0.6	0.8
Estonia								
GDP growth rate (%)	**7.5**	**-3.6**	**-14.3**	**2.2**	**7.5**	**1.9**	**4.0**	**5.0**
Household final consumption	4.9	-3.5	-8.4	-0.9	2.0	1.0	1.1	1.4
Government final consumption	1.2	0.9	-0.3	-0.2	0.6	0.2	0.1	0.2
Gross fixed capital formation	3.3	-5.5	-12.0	-1.9	3.8	1.3	1.5	2.0
Trade balance	-2.8	5.7	11.1	2.9	0.9	-0.6	1.2	1.2
Hungary								
GDP growth rate (%)	**0.2**	**0.9**	**-6.8**	**1.3**	**1.7**	**-1.0**	**2.0**	**2.9**
Household final consumption	0.5	-0.3	-3.4	-1.1	0.0	-0.8	0.0	1.0
Government final consumption	-1.6	0.2	-0.1	-0.5	0.0	-1.2	-0.4	-0.4
Gross fixed capital formation	0.8	0.7	-2.4	-2.0	-0.8	-0.2	0.3	0.5
Trade balance	1.6	0.3	3.7	1.7	1.9	1.1	2.0	1.8
Latvia								
GDP growth rate (%)	**9.6**	**-3.3**	**-17.8**	**0.0**	**5.3**	**2.0**	**3.3**	**3.5**
Household final consumption	9.9	-3.9	-13.7	0.3	2.7	1.5	1.8	2.1
Government final consumption	1.0	0.0	-1.8	-2.1	0.4	0.2	0.1	0.1
Gross fixed capital formation	2.6	-4.5	-11.4	-2.8	4.0	1.3	1.8	1.9
Trade balance	-6.2	8.5	13.1	-0.2	-3.3	-1.3	-0.7	-1.2
Lithuania								
GDP growth rate (%)	**9.8**	**2.9**	**-14.8**	**1.4**	**5.9**	**2.1**	**3.5**	**4.0**
Household final consumption	7.5	2.7	-11.3	-3.2	3.7	1.6	1.9	2.6
Government final consumption	0.2	0.0	-0.2	-0.7	0.0	0.1	0.1	0.2
Gross fixed capital formation	5.5	-1.4	-10.3	0.2	2.7	0.9	1.3	1.8
Trade balance	-5.4	-0.8	13.1	0.2	-0.6	-0.5	0.0	-0.7
Poland								
GDP growth rate (%)	**6.8**	**5.2**	**1.6**	**4.0**	**4.3**	**3.0**	**4.1**	**4.3**
Household final consumption	3.0	3.5	1.2	2.0	1.9	1.3	2.3	2.6
Government final consumption	0.7	1.3	0.4	0.8	-0.2	0.0	0.2	0.2
Gross fixed capital formation	3.5	2.1	-0.3	0.0	1.8	0.7	1.3	1.5
Trade balance	-2.0	-0.7	2.8	-0.8	0.4	0.3	-0.4	-0.3
Slovakia								
GDP growth rate (%)	**10.5**	**5.9**	**-4.9**	**4.2**	**3.3**	**1.5**	**3.0**	**4.0**
Household final consumption	3.8	3.3	0.1	-0.5	0.0	0.3	0.8	1.3
Government final consumption	0.0	1.2	1.1	0.3	-0.8	-0.2	-0.2	0.2
Gross fixed capital formation	2.4	0.3	-4.9	2.6	1.0	0.6	0.7	0.9
Trade balance	4.0	0.0	2.0	0.2	4.3	1.0	1.5	1.5
Slovenia								
GDP growth rate (%)	**6.9**	**3.6**	**-8.0**	**1.4**	**0.4**	**-1.0**	**1.5**	**1.5**
Household final consumption	3.1	2.0	-0.1	-0.4	0.0	-0.3	-0.2	0.2
Government final consumption	0.1	1.1	0.5	0.3	0.0	-0.1	0.0	0.1
Gross fixed capital formation	3.5	2.2	-6.7	-2.0	-2.5	-0.9	0.0	0.7
Trade balance	-2.0	-0.6	2.2	1.3	1.3	0.2	1.2	0.6

Note: Similar contributions are calculated for the GIIPS countries in Annex Table 1 - 1) Contributions of changes in inventories are not shown.

(Table 2 ctd.)

Table 2 (ctd.)

	2007	2008	2009	2010	2011	2012	2013 Forecast	2014
Bulgaria								
GDP growth rate (%)	**6.4**	**6.2**	**-5.5**	**0.1**	**1.6**	**0.0**	**1.3**	**2.6**
Household final consumption	6.4	2.3	-5.0	-0.8	0.9	0.6	0.9	1.3
Government final consumption	0.0	-0.2	-1.0	-0.2	0.0	0.1	0.2	0.2
Gross fixed capital formation	3.2	6.3	-5.8	-4.8	-1.7	0.0	0.9	1.4
Trade balance	-3.9	-1.6	9.8	5.9	2.5	-0.7	-0.7	-0.2
Romania								
GDP growth rate (%)	**6.3**	**7.4**	**-6.6**	**-1.6**	**2.5**	**1.0**	**3.0**	**3.0**
Household final consumption	8.5	6.4	-6.9	-0.2	0.6	0.6	1.2	1.8
Government final consumption	0.0	1.1	0.5	-0.8	-0.5	-0.2	0.2	0.3
Gross fixed capital formation	8.0	4.9	-9.1	-0.5	0.7	0.7	1.2	1.5
Trade balance	-10.8	-1.5	7.0	-0.1	-0.3	-0.3	0.0	-1.0
Croatia								
GDP growth rate (%)	**5.1**	**2.2**	**-6.0**	**-1.2**	**0.3**	**-1.2**	**1.0**	**2.0**
Household final consumption	3.7	0.5	-4.9	-0.5	0.1	-0.1	0.3	0.6
Government final consumption	1.0	0.4	0.0	-0.2	0.0	0.0	0.0	0.1
Gross fixed capital formation	1.9	2.2	-3.3	-2.9	-1.6	-0.6	0.3	0.6
Trade balance	-1.6	-0.7	3.0	2.8	1.5	-0.4	0.2	0.6
Macedonia								
GDP growth rate (%)	**6.1**	**5.0**	**-0.9**	**1.8**	**3.5**	**2.3**	**3.0**	**3.5**
Household final consumption	6.4	5.9	-3.7	1.2	3.1	1.5	1.5	1.5
Government final consumption	-0.1	1.8	0.1	0.1	0.0	0.0	0.0	0.2
Gross fixed capital formation	2.9	1.1	-1.6	-0.2	1.9	0.8	0.8	0.8
Trade balance	-5.0	-3.7	2.6	2.7	-4.3	-0.9	0.0	0.1
Turkey								
GDP growth rate (%)	**4.7**	**0.7**	**-4.8**	**9.0**	**8.4**	**3.0**	**5.0**	**5.0**
Household final consumption	3.9	-0.2	-1.6	4.8	6.4	2.8	2.9	3.5
Government final consumption	0.8	0.2	1.0	0.3	0.3	0.0	0.0	0.0
Gross fixed capital formation	0.7	-1.4	-3.8	5.0	4.5	-0.5	2.2	2.3
Trade balance	-1.1	1.8	2.6	-4.4	-3.2	-0.1	-0.4	-1.0
Albania								
GDP growth rate (%)	**5.9**	**7.5**	**3.3**	**3.6**	**1.9**	**2.2**	**2.6**	**3.4**
Household final consumption	8.1	5.4	2.4	2.2	2.4	2.4	3.2	4.1
Government final consumption	0.0	0.0	0.7	0.5	0.3	0.3	0.7	0.4
Gross fixed capital formation	2.1	3.7	1.6	-2.7	0.7	0.3	1.3	2.0
Trade balance	-4.7	-0.1	-0.5	3.4	-1.4	-0.9	-2.6	-3.1
Bosnia and Herzegovina								
GDP growth rate (%)	**6.1**	**5.6**	**-2.9**	**0.7**	**2.2**	**0.5**	**1.5**	**2.0**
Household final consumption	5.1	4.9	-3.1	-0.8	0.2	0.0	0.7	0.7
Government final consumption	0.4	0.6	0.1	0.4	0.1	0.0	0.0	0.0
Gross fixed capital formation	6.1	4.0	-6.1	-2.4	1.0	0.4	0.8	1.0
Trade balance	-3.6	-2.9	9.1	3.2	1.3	-0.3	-0.2	0.2
Russia								
GDP growth rate (%)	**8.5**	**5.2**	**-7.8**	**4.3**	**4.3**	**4.2**	**4.1**	**4.3**
Household final consumption	7.3	5.4	-2.6	2.5	3.4	3.0	2.8	2.8
Government final consumption	0.4	0.6	-0.1	-0.3	0.4	0.8	0.8	0.9
Gross fixed capital formation	4.1	2.2	-3.2	1.2	1.3	1.3	1.4	1.2
Trade balance	-4.1	-3.4	5.9	-2.0	-4.8	-2.9	-2.3	-1.9
Ukraine								
GDP growth rate (%)	**7.9**	**2.3**	**-14.8**	**4.1**	**5.2**	**4.0**	**5.0**	**5.0**
Household final consumption	10.6	8.4	-9.7	4.3	7.8	4.2	5.0	4.3
Government final consumption	0.3	0.0	-0.5	0.6	-0.9	0.0	0.1	0.1
Gross fixed capital formation	5.9	-0.3	-16.1	2.0	3.7	1.5	1.8	1.8
Trade balance	-9.3	-6.9	12.3	-2.4	-5.5	-1.7	-1.8	-1.2

Source: wiiw estimates incorporating national and Eurostat statistics.

In general, we predict much lower GDP growth for 2012 than for 2011 (on average, a decline in growth of: 1.7 pp for the NMS; 1.5 pp for the SE-6; 1.3 pp for the GIIPS countries; 5.4 pp for Turkey; 1.2 pp for Ukraine, 0.1 pp for Russia and 1.5 pp for Kazakhstan). The basic picture is one of diminished expectations with regard to the contribution of net trade balances to GDP growth on account of the greatly reduced growth forecast for the EU as a whole (EU-27 growth forecast by the European Commission for 2012 of 0% as against 1.5% in 2011).

Given this deteriorating external environment, we shall evaluate whether and to which extent domestic demand components might take on the role of compensating or reinforcing factors:

In that respect we shall discuss developments in

- Household consumption in relation to the inherited debt problem and tight financing conditions, as well as employment and wage developments;
- Investment activity in relation to demand forecasts, capacity utilization and, once again, the debt position and financing conditions faced by the corporate sector;
- Fiscal policy in the light of the 'fiscal space' available in different economies and the policy choices made in relation to the same.

We start with an overview of GDP forecasts and the breakdown of the contributions to GDP growth in 2012 and 2013 presented in Table 2, which draw on the estimates of the wiiw country experts (see also the individual country reports in this Forecast Report):

Table 3a

Contributions to GDP growth (2009-2013) in 17 CESEE countries

		2009	2010	2011	2012	2013
Household final consumption	+	3	8	13	12	15
	-	14	9	4	5	2
Government final consumption	+	9	9	6	6	10
	-	8	8	11	11	7
Gross fixed capital formation	+	1	5	12	12	16
	-	16	12	5	5	1
Trade balance	+	16	11	9	5	6
	-	1	6	8	12	11

Note: A figure in a + row indicates the number of countries that had a positive contribution. A figure in a - row indicates the number of countries that had a negative or stagnant contribution.

Source: wiiw estimates incorporating national and Eurostat statistics.

A summary of the information contained in Table 2 is to be found in Tables 3a and 3b showing the general shifts expected in our forecasts with regard to the contributions of the different components of demand (household final consumption; government final consumption, gross fixed capital formation and the trade balance) to the greatly reduced overall growth forecast for 2012 and the period of presumed recovery (starting in 2013).

Table 3b

Average unweighted growth rates of real GDP and components forecasts

		2011	2012	2013
Czech and Slovak Republics and Poland	Real GDP	**3.1**	**1.7**	**3.2**
	Household consumption	0.9	0.7	2.3
	Gross fixed capital formation	4.3	2.2	4.3
Hungary and Slovenia	Real GDP	**1.1**	**-1.0**	**1.8**
	Household consumption	0.0	-1.0	-0.2
	Gross fixed capital formation	-8.2	-3.0	1.0
Baltic countries	Real GDP	**6.2**	**2.0**	**3.6**
	Household consumption	4.8	2.3	2.7
	Gross fixed capital formation	18.8	5.7	7.3
Bulgaria and Romania	Real GDP	**2.1**	**0.5**	**2.2**
	Household consumption	1.2	1.0	1.8
	Gross fixed capital formation	-2.0	1.5	4.5
Western Balkan countries	Real GDP	**2.0**	**0.8**	**1.9**
	Household consumption	1.7	1.1	1.9
	Gross fixed capital formation	0.9	1.5	3.6

Source: wiiw estimates incorporating national and Eurostat statistics.

The main thrust of the developments expected is that growth in the CESEE region will not be able to rely on a boost from net exports in a significantly larger number of countries. In fact, the number of countries, in which changes in the net trade balance contribute negatively to overall GDP growth, has been rising steadily: up from 1 in 2009 to 6 in 2010, 8 in 2011 and then 12 in 2012, remaining at 11 (out of 17) in 2013.

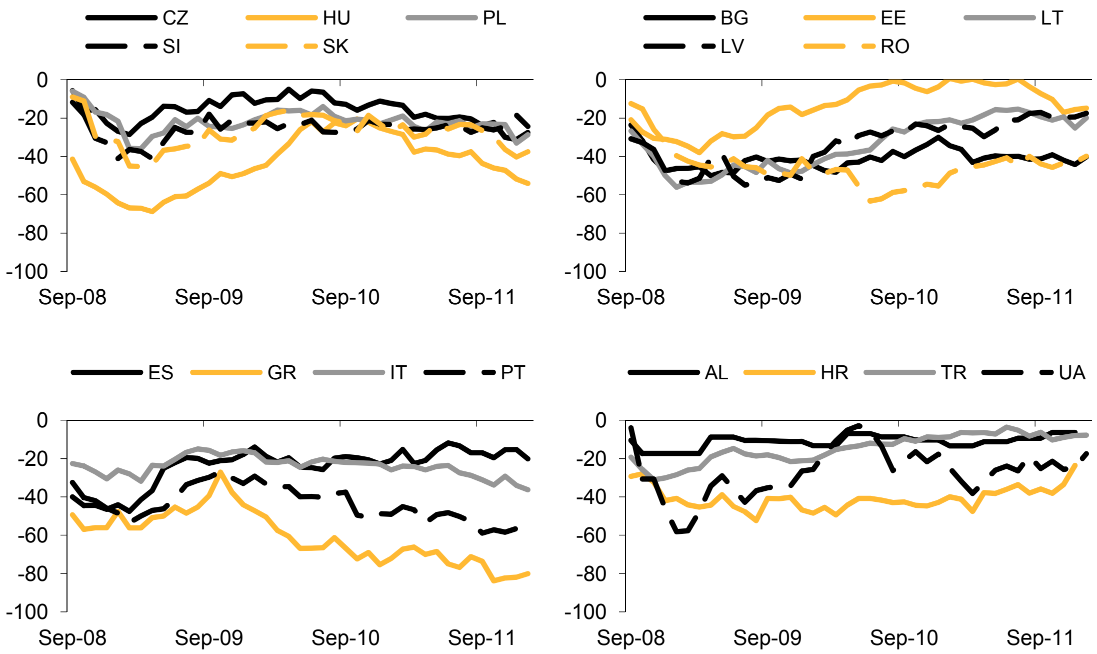
If positive growth is forecast for GDP as a whole over the period 2012-2013 for almost all CESEE countries (with the exception of Croatia, Hungary and Slovenia), this automatically means that despite growth being at a much lower level in 2012 than 2011 other components of demand, i.e. those of domestic demand, must be contributing positively to GDP growth. The main message from Table 3 is that since the majority of CESEE economies are pursuing fiscally conservative policies, we do not expect positive contributions to come from government spending. In fact, the number of countries, in which the government's fiscal stance continues to contribute negatively to GDP growth (within a simple accounting framework[9]), stands at 11 in 2012 as in 2011. In only 6 countries are the government's fiscal policies expected to contribute positively to growth (see section 8 below for an in-depth discussion of fiscal policy).

[9] The contributions of the different components of the national accounts to GDP growth are derived from the simple accounting identity: GDP = C + I + G + X – M. Changes in GDP are then constrained additively by the changes in the various components whereby these components are weighted by their respective base year value shares in GDP. In this way the various 'contributions to GDP growth' are calculated by final household consumption, government consumption, investment, and net trade balance. This simple growth accounting exercise thus treats the various GDP components simply in an additive manner and hence does not allow for any complex relationships between these.

Figure 9a

Consumer confidence indicator

balance of positive over negative survey results



Remark: * AL: quarterly data.
Source: Eurostat, national statistics.

Household consumption and investment activity are thus left as the two demand factors remaining that have to account for overall positive, but reduced economic growth. This is borne out in Table 3a; it shows the relatively high proportion of countries that rely on those two domestic demand components as a factor contributing positively to economic growth in the coming years. However, we predict a severe slowdown of growth in these two domestic demand components in 2012 (Table 3b).

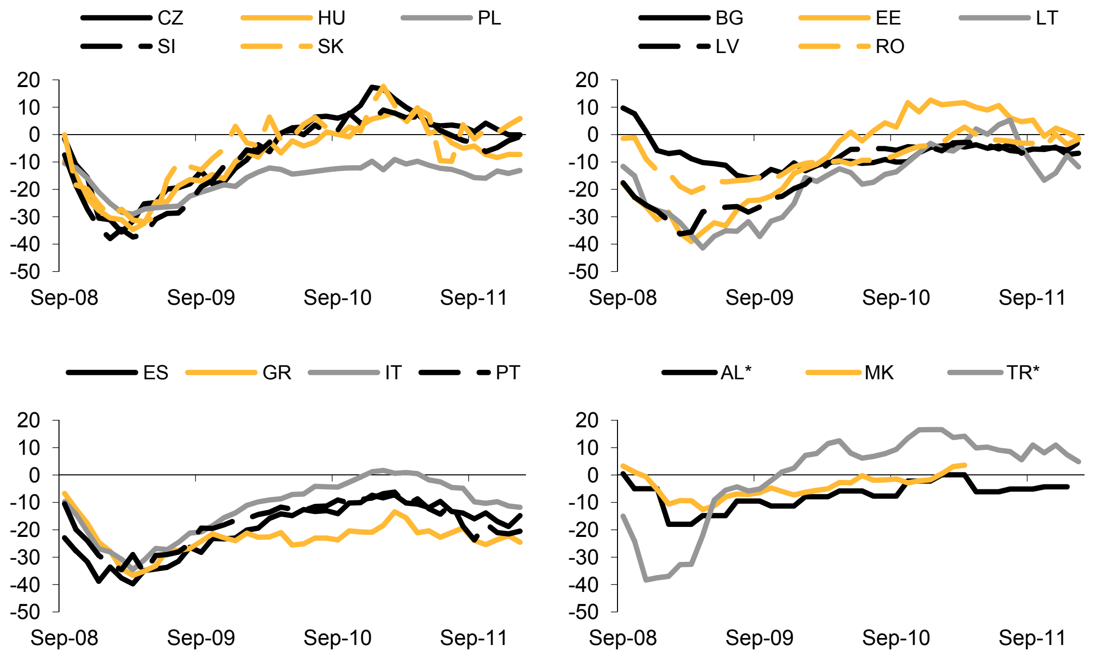
An assessment of probable developments related to household consumption and investment is complex. We shall wait for a fuller discussion of the factors determining the likely developments of those domestic demand factors after discussing the issue of debt and financing conditions below. The current deleveraging processes taking place in households, enterprises and banks play an important role in evaluating the potential growth prospects of both household spending and firms' investments. Furthermore, the situation with regard to labour market developments (employment and wages) has a significant impact on household incomes and hence demand (see Special Topic on 'Labour market developments in the CESEE region during and after the crisis').

At this juncture, the recent findings of the European Commission's Surveys on Consumer Confidence and Industry Confidence Indicators are presented (Figures 9a and 9b). As lead indicators, confidence indicators are relevant as pointers to the plans that both households and firms have regarding consumption and investment expenditures in the coming year. The bulk of the surveys' findings suggest a ***deteriorating climate*** with respect to consumer confidence over the past year. The two exceptions are Romania and Latvia[10], where, however, data for the last quarter show a visible flattening in the level of consumer confidence. The decline in industry confidence was even more uniform throughout 2011.

Figure 9b

Industrial confidence indicator

balance of positive over negative survey results



Remark: * AL: quarterly data. TR: real sector.
Source: Eurostat, national statistics.

A series of factors, such as the expected slow-down of growth in the EU as a whole, has contributed to the growing lack of confidence. Another important factor is the lingering debt issue, to which we now turn, starting with the fiscal aspects.

Summary

Given the negative contributions to overall economic growth predicted for 2012 coming from net trade balances and from fiscal policy in a large number of countries, as well as a significant deceleration of household consumption spending and of corporate investments, this all adds up to very low growth forecasts of GDP growth in 2012. The resumption of growth predicted for 2013 and 2014 is simply based on assuming a cyclical recovery (also in the Eurozone) but the timing of this is uncertain and the low growth period may well last longer than that.

[10] Croatia as well in respect of the last quarter in 2011, most likely reflecting the successful referendum leading to a completion of the EU accession process in July 2012.

8. Fiscal policy stance

Fiscal consolidation is the key policy adjustment tool in both the EU and most of Europe (see also the discussion in section 3 above). In some countries, it is seen as inevitable on account of the unsustainable growth of public debt; in other countries, it is seen as a means to promote private investments. Once again, the countries in Southern Europe fall more into the first category, while those in Central Europe fall more into the second category. The Baltic countries constitute a quite distinct category of their own, while Hungary is more of a fiscally constrained country, as is Slovenia to an ever increasing degree.

Table 4

Public finance overview

	Fiscal balance in % of GDP								Public debt in % of GDP							
	2007	2008	2009	2010	2011 1)	2012	2013 Forecast	2014	2007	2008	2009	2010	2011 1)	2012	2013 Forecast	2014
Bulgaria	1.2	1.7	-4.3	-3.1	-2.0	-1.8	-1.5	-1.5	17.2	13.7	14.6	16.3	17.1	18	19	20
Czech Republic	-0.7	-2.2	-5.8	-4.8	-3.7	-4.0	-3.5	-3.0	27.9	28.7	34.4	37.6	40.5	44	46	46
Estonia	2.4	-2.9	-2.0	0.3	1.3	-2.0	0.5	0.5	3.7	4.5	7.2	6.7	5.5	7	6	5
Hungary	-5.1	-3.7	-4.5	-4.3	3.5	-3	-3	-3	67.0	72.9	79.7	81.3	80.3	81	80	79
Latvia	-0.4	-4.2	-9.6	-8.2	-4.0	-2.8	-2.5	-2.0	9.0	19.8	36.7	44.7	43	42	41	40
Lithuania	-1.0	-3.3	-9.5	-7.1	-5.3	-3.3	-2.8	-2.5	16.8	15.5	29.4	38.0	37.5	37	36	34
Poland	-1.9	-3.7	-7.3	-7.8	-4.2	-3.5	-3.1	-3.0	45.0	47.1	50.9	54.9	53.7	54	54	54
Romania	-2.9	-5.7	-9.0	-6.8	-4.5	-4	-3	-3	12.8	13.4	23.6	31.0	32	34	34	34
Slovakia	-1.8	-2.1	-8.0	-7.7	-5.7	-5.0	-4.7	-4.4	29.6	27.8	35.5	41.0	43.5	46.8	48.6	49.7
Slovenia	0.0	-1.9	-6.1	-5.8	-5.5	-5.0	-4.5	-4	23.1	21.9	35.3	38.8	45	49	52	55
Austria	-1.0	-1.0	-4.1	-4.4	-3.4	-3.1	-2.9	.	60.2	63.8	69.5	71.8	72.2	73.3	73.7	.
Germany	0.2	-0.1	-3.2	-4.3	-1.3	-1.0	-0.7	.	65.2	66.7	74.4	83.2	81.7	81.2	79.9	.
Greece	-6.8	-9.9	-15.8	-10.8	-8.9	-7.0	-6.8	.	107.4	113.0	129.3	144.9	162.8	198.3	198.5	.
Ireland	0.1	-7.3	-14.2	-31.3	-10.3	-8.6	-7.8	.	24.8	44.2	65.2	92.5	108.1	117.5	121.1	.
Italy	-1.6	-2.7	-5.4	-4.5	-4.0	-2.3	-1.2	.	103.1	105.8	115.5	118.4	120.5	120.5	118.7	.
Portugal	-3.2	-3.7	-10.2	-9.8	-5.8	-4.5	-3.2	.	68.3	71.6	83.0	93.3	101.6	111.0	112.1	.
Spain	1.9	-4.5	-11.2	-9.3	-6.6	-5.9	-5.3	.	36.2	40.1	53.8	61.0	69.6	73.8	78.0	.
EA-17	-0.7	-2.1	-6.4	-6.2	.	-3.4	-3.0	.	66.3	70.1	79.8	85.3	88.0	90.4	90.9	.
EU-27	-0.9	-2.4	-6.9	-6.6	-4.7	-3.9	-3.2	.	59.0	62.5	74.7	80.1	82.5	84.9	84.9	.
Croatia	-2.4	-1.4	-4.1	-4.9	-5	-4	-4	-4	32.9	29.2	35.1	41.3	43.9	48	52	55
Macedonia	0.6	-0.9	-2.7	-2.5	-2.5	-1	-1	-1	32.3	27.9	31.7	35.6	35	34	33	32
Montenegro	6.7	1.7	-3.6	-3.0	-3	-1	-1	-1	27.5	29.0	38.2	40.9	44	44	42	41
Turkey	-1.1	-2.2	-6.7	-3.5	-2.5	-3.3	-2.4	-2.5	39.4	39.5	45.5	43.2	42.5	41	38	36
Albania	-3.5	-5.5	-7.0	-3.1	-5	-5	-8	-6	53.9	55.2	59.7	58.2	60	62	66	67
Bosnia and Herzegovina	1.2	-2.2	-4.5	-2.5	-2.5	-3.0	-2.5	-2.5	29.7	30.7	35.3	38.9	39.0	41	42	43
Serbia	-2.0	-2.6	-4.5	-4.6	-5	-5	-4	-4	30.9	29.2	34.8	42.9	45	48	49	49
Kazakhstan	-1.7	-2.1	-2.9	-2.4	-2.1	-2.5	-1.5	-1.0	7.1	8.3	12.2	14.7	16	16	16	15
Russia	6.0	4.9	-6.3	-3.5	2.5	0	0	0	6.7	5.7	8.3	8.6	9.2	8	7	7
Ukraine	-1.1	-1.5	-4.1	-6.0	-1.8	-3	-3	-2.5	12.3	20.0	34.8	39.9	36	34	33	32

1) Preliminary and wiiw estimates.

Source: wiiw Database incorporating national and Eurostat statistics. Forecasts by wiiw and European Commission (Economic Forecast, Autumn 2011) for GR, IE, IT, PT, ES, EA-17 and EU-27.

There is no clear correlation between the level of public debt or fiscal deficits and the sustainability of that debt and deficits. By and large, unlike the GIIPS countries, the debt to GDP ratios of the countries in Southeast Europe are no higher than those of their Central European counterparts. In that respect, the Baltic states bear a greater similarity to the countries in Southern Europe (see Table 4). Moreover, as a rule the projected fiscal deficits are no higher in Southeast Europe than in Central Europe or the Baltic states (except for Estonia). None the less, the countries in Central Europe tend to secure lower yields on their public debts than the countries in Southern Europe. Furthermore, it does not seem as if access to a national central bank makes all that much of a difference. In most European countries, with the exception of Russia, Ukraine and Turkey, the manoeuvring space for independent monetary policy is rather limited.

Box 4

Public debt and fiscal rules

The sustainability of public debts is all about the expected long-term growth in the public debt to GDP ratio in the light of the long-term or potential growth rate and the interest rates to be paid. Once the desired public debt to GDP ratio and the assumed growth and interest rates have been set, the primary fiscal deficit, and hence the fiscal deficit proper, are determined. Clearly, the development of public debt can become unsustainable because of a permanent growth slowdown or a permanent increase in the interest rate. Unsustainability can also be due to permanently higher fiscal deficits, attributable perhaps to a permanent increase in the structural fiscal deficit. The latter may be the consequence of lower public revenues, for example, on account of opposition to rising taxes or the lack of political support for reducing public expenditures. If public debt developments prove unsustainable, it implies default which, in turn, will lead to a hike in interest rates and theoretically to an immediate default.

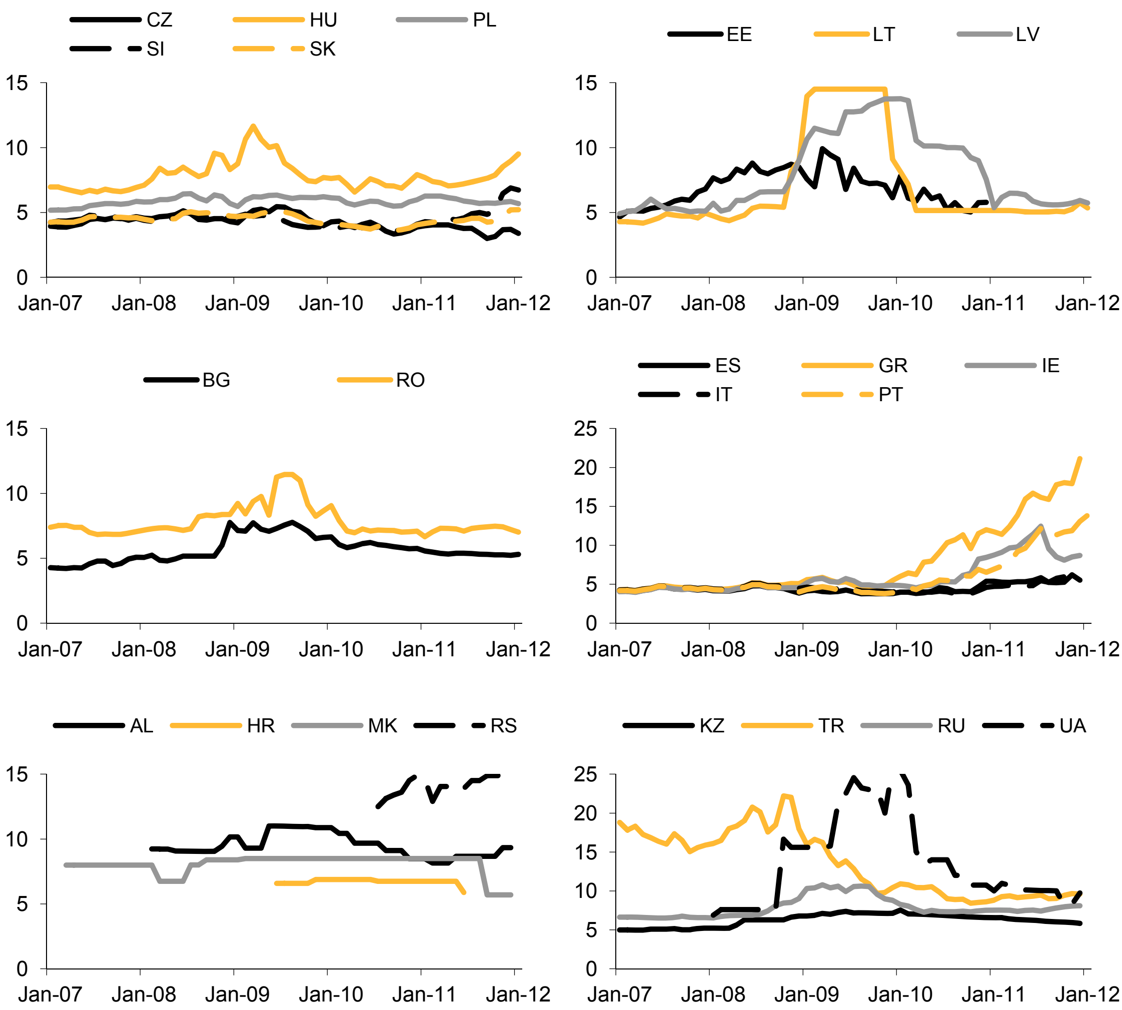
One way of ensuring the sustainability of public debt is to subscribe to a fiscal rule that does just that. One such rule is the EU fiscal compact which should become a legal or even a constitutional commitment. For their part, countries outside the EU have adopted a variety of rules with the same intent. The first difference is to be fund in the choice of the ceiling set for public debt, which is usually 40 or 45 per cent of GDP (in the SGP 60 per cent). Then, it is a matter of determining the fiscal deficit, which, in some cases, is either a variant of the golden rule (balanced budget on current expenditures) or a ceiling of 1 or 2% of GDP. It might also be a fiscal deficit that makes the public debt to GDP ceiling sustainable in a countercyclical manner, possibly leaving some fiscal space in which to manoeuvre, such as a somewhat lower public debt to GDP ratio that allows for something more than cyclical adverse shocks. The actual strength of commitment to those rules is a separate issue. The examples of Hungary and Serbia, not to mention the SGP, are not really encouraging.

One can thus ask where the differentiating factors lie. One factor is the willingness to pay or commitment to honouring public liabilities; the other is the level of public debt and the sustainability of external balances. The development of fiscal deficits is one commitment device, though not necessarily convincing of itself. The other is improvement in the external balances and the decline of foreign debt. Should both those conditions not be met or expected to be met, yields on public bonds tend to remain high and public debt embarks on an unsustainable upward trend.

Figure 10

Yields on government bonds

maturity 10 years, % p.a.



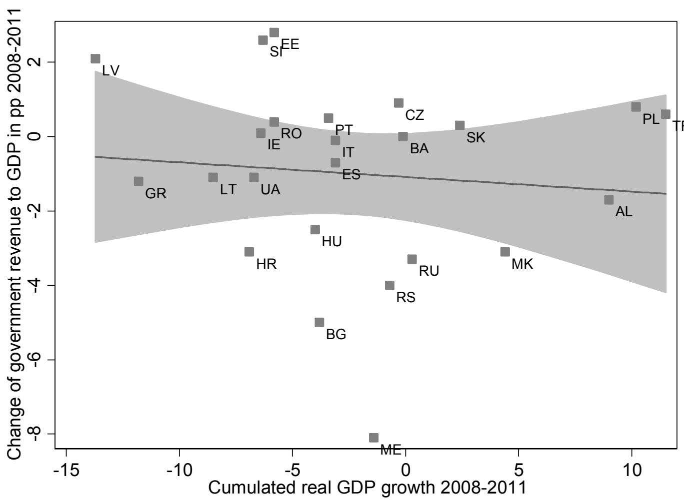
Source: International Finance Statistics (IMF), Eurostat, National Banks and National Ministries of Finance.

Countries that face yields of 6 - 7% on their new public borrowing are confronted with the prospect of unsustainable public debts. As a rule, the countries in Southeast Europe are facing yields on 10-year government bonds that are about 2 percentage points above those in Central Europe (see Figure 10). At the moment, most inherited implicit or effective interest rates tend to be rather low. However, new public bonds carry very high interest rates and their gradual refinancing thus leads to a volume of public debt that cannot be repaid. Even rather low initial levels of public debt will tend to lead to explosive debt developments, if the interest rate is well above the growth rate of the economy. Of course, that all depends on the commitment to repay the debt, a stance that is communicated via the policies of fiscal consolidation, i.e. via the reduction of the fiscal deficit and an ability to run a fiscal surplus. Clearly, if a country can run primary fiscal surpluses that offset the difference between the high interest rate on public borrowing and low growth rate of the economy, the public debt to GDP ratio will tend to stay constant and decline with the recovery of growth. The problem of that approach to fiscal sustainability is that growth may suffer on account of fiscal austerity, while the commitment to pay back public debts may thus lack credibility and ultimately disappear. In the case of the countries with IMF and EU programmes, that commitment is part of the agreement; it is underwritten by the financial support that was negotiated. In those cases, however, it is hard to separate the effect of the commitment from that of the financial support.

The fiscal adjustments to date have been partly automatic and only marginally the outcome of consistent fiscal policies. One quite common consequence of negative or slow growth has been a decline in revenues – theoretically with an elasticity of 1. If so, the change in public revenues to GDP ratio should not be, and indeed has not been, all that susceptible to GDP growth, although some outliers among the groups displaying a marked decline in revenues tilt the scatter plot slightly downwards (see Figure 11). Overall, however, revenues as a share of GDP have held up rather well. In Figure 11, it can be seen that revenues as a percentage of GDP have remained relatively constant in Central Europe (except for Hungary), yet have declined in certain countries in Southeast Europe. Estonia and Latvia have increased their ratios of public revenues to GDP, while those same ratios have remained constant in the GIIPS countries, with the exception of Greece. These variations in public revenue to GDP ratios are most probably due to policy interventions (for example, tax-relief or fiscal sustainability policies).

Figure 11

Change of general government revenues and GDP growth 2008-2011

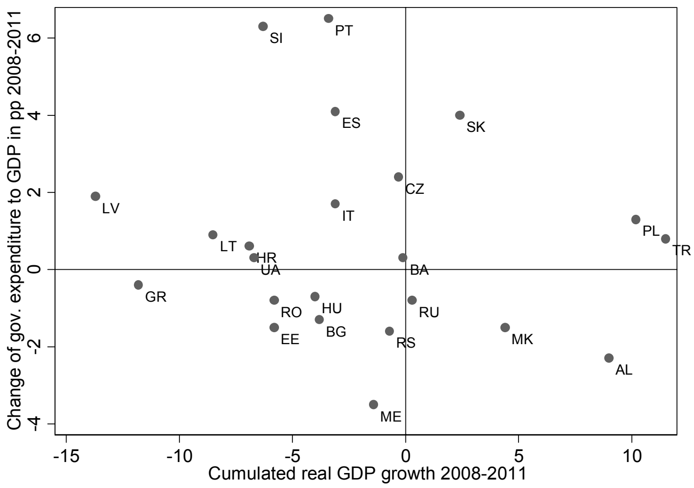


Note: Shaded area shows the 95% confidence bands for conditional means. Hungarian figures corrected for one-time effect.
Source: wiiw Database incorporating national and Eurostat statistics, own calculations.

Expenditures, however, have shown some sensitivity with respect to growth (see Figure 12) owing to the workings of the automatic stabilizers. Recessions or growth slowdowns have been accompanied by some resilience in public expenditure to GDP ratios. However, full working of the automatic stabilisers should have put most of the countries with negative growth rates in the northwest quadrant of Figure 12 rather than in the southwest quadrant or around the zero line. With exception of GIPS countries and Slovenia, and on the other side Poland and to an extent Slovakia, most other countries have not really pursued much of a countercyclical fiscal policy.

Figure 12

Change of general government expenditures and GDP growth 2008-2011



Source: wiiw Database incorporating national and Eurostat statistics, own calculations.

Looking across the various groups of countries, no clear connection seems to exist between the initial or evolving level of public debt and the attempts at fiscal austerity since public expenditures tend to decline more in countries with relatively low initial debt to GDP ratios. The latter group consists mostly of countries facing high refinancing costs that also enjoy no access to significant EU support or have decided not to request support of the IMF. The one group includes countries in the Balkans (Bulgaria, Romania, Montenegro) with relatively low, though often increasing, public debt to GDP ratios. The other group includes the Baltic countries, some countries in Central Europe (such as Slovenia, Poland and Slovakia), as well as those eurozone member states in the South in receipt of EU and IMF financial support, except Greece.

Depending on the policy mix adopted, almost every country will have to introduce measures that increase revenues and lower expenditures. It is expected that this will ensue over a longer period of time, so fiscal support for growth should hardly be forthcoming in a prolonged period of fiscal consolidation. The recovery of the countries that will have to introduce more stringent fiscal austerity measures, many of them in Southern Europe, will have long-term negative effects on their growth performance, should it not be matched by a speedy recovery of their investments and exporting capacities.

Table 5

Government revenue and expenditure

in % of GDP

	Czech Republic		Estonia		Hungary		Latvia		Lithuania		Poland		Slovakia		Slovenia	
	2008	2010	2008	2010	2008	2010	2008	2010	2008	2010	2008	2010	2008	2010	2008	2010
Total revenue	38.9	39.3	36.5	40.9	45.5	45.2	34.9	36.1	33.9	33.8	39.5	37.5	32.8	32.3	42.4	44.3
Taxes	18.6	18.2	19.8	20.7	26.3	25.4	20.7	18.7	20.7	16.5	22.8	20.6	16.9	15.5	23.0	22.6
. Indirect taxes	10.6	11.2	11.9	13.9	15.6	16.9	10.9	11.3	11.4	11.8	14.2	13.6	10.4	10.1	14.0	14.3
. Direct taxes	8.0	7.0	7.8	6.8	10.6	8.0	9.8	7.4	9.3	4.7	8.6	6.9	6.5	5.4	8.9	8.2
. Capital taxes	<0.1	<0.1	-	-	<0.1	0.5	<0.1	<0.1	<0.1	<0.1	<0.1	<0.1	<0.1	<0.1	<0.1	<0.1
Social contributions	15.6	15.3	11.7	13.3	13.8	12.1	8.7	8.6	9.3	10.7	11.3	11.1	12.2	12.5	14.3	15.5
Other items	4.8	5.8	5.0	6.9	5.4	7.6	5.5	8.8	3.9	6.6	5.4	5.9	3.7	4.3	5.1	6.2
Total expenditure	41.1	44.1	39.5	40.6	49.2	49.5	39.1	44.4	37.2	40.9	43.2	45.4	34.9	40.0	44.2	50.1
Intermediate consumption	5.9	6.2	7.0	7.5	7.2	7.8	6.9	6.4	5.7	6.4	6.2	6.2	4.5	4.9	6.0	6.8
Compensation of employees	7.3	7.6	11.2	11.9	11.6	10.9	12.1	10.2	10.7	11.1	10.0	10.1	6.8	7.7	11.0	12.7
Interest	1.0	1.4	0.2	0.1	4.1	4.2	0.6	1.4	0.7	1.8	2.2	2.7	1.2	1.3	1.1	1.6
Subsidies	1.6	1.9	1.0	1.1	1.1	1.1	1.2	0.8	0.7	0.5	0.6	0.5	1.7	1.4	1.6	2.2
Social benefits	17.5	19.7	12.1	14.9	18.6	18.5	9.0	13.6	12.7	14.9	16.1	17.0	16.1	19.4	16.6	19.5
Capital investments	3.5	3.3	5.2	2.4	2.7	3.3	4.8	4.4	5.0	4.5	4.6	5.7	1.7	2.6	4.5	4.3
of which, GFCF	*4.6*	*4.4*	*5.2*	*3.9*	*2.9*	*3.4*	*4.9*	*3.7*	*4.9*	*4.6*	*4.6*	*5.6*	*2.0*	*2.6*	*4.4*	*4.3*
Other items	4.2	4.1	2.8	2.7	3.8	3.7	4.6	7.6	1.8	1.7	3.5	3.2	2.9	2.7	3.3	2.9

	Austria		Germany		Greece		Ireland		Italy		Portugal		Spain	
	2008	2010	2008	2010	2008	2010	2008	2010	2008	2010	2008	2010	2008	2010
Total revenue	48.3	48.1	44.0	43.6	40.7	39.5	35.5	35.5	45.9	45.8	41.1	41.6	37.0	36.3
Taxes	28.1	27.2	23.3	22.3	20.7	19.8	24.0	22.1	28.9	28.7	23.8	22.2	21.0	20.2
. Indirect taxes	14.1	14.5	10.9	11.1	12.4	12.0	12.3	11.4	13.7	13.9	14.1	13.3	9.8	10.3
. Direct taxes	14.0	12.7	12.2	11.0	8.0	7.7	11.5	10.5	15.2	14.5	9.7	8.9	10.7	9.5
. Capital taxes	<0.1	<0.1	0.2	0.2	0.3	0.1	0.2	0.2	<0.1	0.2	<0.1	<0.1	0.4	0.4
Social contributions	15.9	16.3	16.5	16.9	13.2	13.1	6.8	7.5	13.7	13.7	11.9	12.2	13.2	13.3
Other items	4.2	4.6	4.1	4.4	6.7	6.6	4.6	5.9	3.3	3.4	5.4	7.1	2.9	2.7
Total expenditure	49.3	52.5	44.0	47.9	50.6	50.2	42.8	66.8	48.6	50.3	44.8	51.3	41.5	45.6
Intermediate consumption	4.5	4.5	4.3	4.8	6.4	6.1	5.8	6.0	5.4	5.8	4.4	5.0	5.5	5.6
Compensation of employees	9.2	9.7	7.4	7.9	12.0	12.1	11.2	11.8	10.8	11.1	12.0	12.2	10.9	11.9
Interest	2.7	2.6	2.8	2.5	5.1	5.8	1.4	3.1	5.1	4.4	3.1	3.0	1.6	1.9
Subsidies	3.5	3.5	1.0	1.1	<0.1	<0.1	0.5	0.5	1.0	1.1	0.7	0.7	1.1	1.2
Social benefits	23.6	25.4	23.9	25.5	19.6	20.8	14.2	18.0	20.3	22.1	19.3	21.9	15.2	18.3
Capital investments	1.1	1.0	1.5	1.4	3.8	2.9	5.4	3.7	2.2	2.1	2.0	3.7	4.2	3.9
of which, GFCF	*1.1*	*1.0*	*1.6*	*1.6*	*3.7*	*2.8*	*5.2*	*3.8*	*2.2*	*2.1*	*2.9*	*3.6*	*4.0*	*3.8*
Other items	4.8	5.8	3.2	4.6	3.6	2.5	4.3	23.6	3.8	3.7	3.3	4.8	3.0	2.8

	Bulgaria		Romania		Croatia		Macedonia		Montenegro		Turkey		Albania		Bosnia and Herzegovina		Serbia	
	2008	2010	2008	2010	2008	2010	2008	2011	2008	2010	2008	2011	2008	2010	2008	2010	2008	2010
Total revenue	40.0	34.9	33.6	34.0	39.1	37.0	33.1	30.0	49.1	40.9	32.0	32.6	26.7	26.6	44.0	44.2	43.0	41.0
Taxes	24.1	20.1	18.4	18.3	23.1	21.4	18.6	17.1	29.6	24.3	19.0	18.9	19.9	19.3	24.0	22.9	25.8	24.6
. Indirect taxes	17.4	14.9	11.7	12.1	16.6	16.5	14.4	14.2	21.9	19.4	11.6	13.6	15.6	15.2	20.4	19.7	19.2	18.8
. Direct taxes	6.1	4.9	6.7	6.2	6.2	4.7	4.2	2.9	7.7	4.9	7.4	5.3	4.1	3.9	3.1	2.9	6.6	5.7
. Capital taxes	0.5	0.2	-	-	0.4	0.3	.	.	.	.	.	.	0.1	0.2	0.5	0.4	.	.
Social contributions	7.8	7.1	10.1	9.6	11.8	11.6	9.3	8.7	11.0	11.1	6.3	5.0	4.4	4.4	14.4	15.5	11.7	10.8
Other items	8.1	7.8	5.1	6.0	4.2	4.0	5.2	4.2	8.4	5.5	6.7	8.7	2.5	3.0	5.6	5.7	5.4	5.6
Total expenditure	38.3	38.1	39.3	40.9	39.9	41.3	34.1	32.5	47.5	43.9	34.2	35.0	32.3	29.7	46.2	46.7	45.6	45.5
Intermediate consumption	7.2	6.2	7.2	6.5	4.8	4.6	4.6	3.1	4.7	4.2	4.6	9.3	2.6	2.8	9.9	10.5	7.7	7.6
Compensation of employees	9.2	9.3	10.5	9.8	9.7	10.5	5.1	5.1	11.0	9.8	8.0	6.3	6.1	5.4	12.2	12.9	11.0	10.3
Interest	0.9	0.6	0.7	1.6	1.5	2.0	0.6	0.8	0.7	1.0	5.0	4.8	2.9	3.4	0.5	0.5	0.6	1.1
Subsidies	1.1	1.3	0.8	0.6	2.4	2.4	.	.	0.6	1.3	0.7	0.9	0.2	0.3	1.8	1.9	2.9	2.6
Social benefits	11.6	14.3	11.0	13.8	15.4	17.2	18.9	19.8	11.3	13.7	10.0	6.4	7.0	8.7	15.9	15.3	18.7	19.4
Capital investments	5.3	4.8	6.7	5.9	2.3	1.5	3.3	3.1	8.1	5.3	3.4	2.8	8.6	5.5	3.2	.	4.0	3.5
of which, GFCF	*5.6*	*4.8*	*6.6*	*5.8*	.	.	.	.	.	.	.	.	.	.	.	.	.	.
Other items	3.0	1.6	2.4	2.8	3.8	3.2	1.6	0.8	11.0	8.6	2.5	4.5	4.8	3.6	2.7	.	0.7	1.0

GFCF: Gross fixed capital formation. All EU countries and Turkey refer to ESA'95 definition.

Sources: Eurostat, Government Finance Statistics (IMF), National Ministries of Finance, National Banks.

Tax reform, an ingredient common to most fiscal adjustment programmes, increases reliance on indirect taxes and reduces the burden of direct taxes. As was to be observed over the past few years, VAT has proved to be a reliable source of revenue, even though its share in tax receipts has, for the most part, declined (see Table 5). However, the decline in revenues from direct taxes, in particular taxes on corporate profits and dividends, has been even more marked. Social contributions have, by and large, held up and are an important source of revenues almost everywhere. Supply-side tax reform, which is often proposed and in some cases adopted, aims at increasing VAT rates and decreasing the rate of social contributions. Other proposals include increasing the progressivity of direct taxes and imposing more tax on property. The expectation is that increased indirect tax rates will yield more revenue, while lower rates of social contributions will reduce the tax burden on entrepreneurs. The added advantage is that lower consumption should limit import growth, while increased investments should be geared towards exports, since domestic consumption is not expected to recover swiftly. Given the experience to date, lower contributions will hardly be offset by higher VAT rate and not much can be expected of the change in income tax rates. In fact, if it fails to boost investments, employment, growth and, thereby, public revenue, fiscal reform will lead to higher deficits.

Summary

The key observation is that the fiscal stance adopted has been rather restrictive, except in some countries with EU and IMF programmes. This will be followed by even more fiscal austerity measures, as it proves increasingly costly to finance fiscal deficits and refinance public debts.

9. Private sector debts

Significant differences are to be seen between countries with high and growing private debts and those with lower or stable debts, although by and large some decline in private debts was noted in 2011. Other significant variations are attributable to the different borrowing costs for corporations and households. Those differences suggest that not all countries can expect to shift seamlessly to investment-led growth. Indeed, some of the countries may face significant problems in terms of corporate debt sustainability or, put differently, in terms of corporate sector solvency.

Box 5

Private debt sustainability

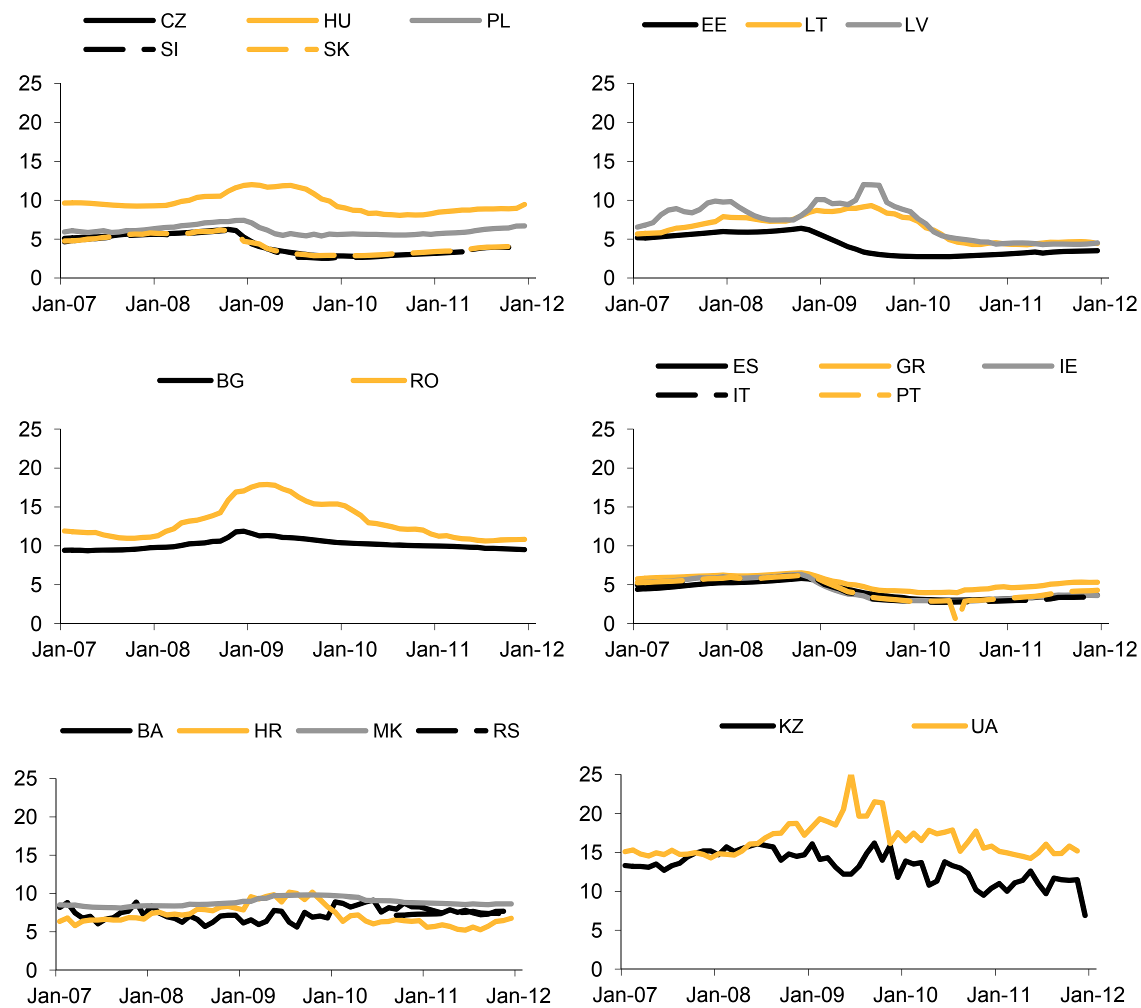
The formula used to assess public debt sustainability (see Box 1) can be used to assess private debt with an appropriate adjustment for interest rates and income growth. Thus, if interest rates on household borrowing are significantly higher than their income growth, private debt will only be sustainable, provided households are genuinely willing to reduce consumption. If household incomes are stagnant and interest rates high, debt defaults will increase even if household consumption declines.

Similarly, in the case of corporations, high interest rates will either require high sales or lead to disinvestment and shedding of labour. The accumulation of high corporate debt is the consequence of a period of low interest rates - and possibly higher inflation than in the eurozone. In any case, high interest rates with low growth of sales due to low or negative growth will lead to increased problems with corporate insolvency.

Figure 13

Interest rates - loans to non-financial corporations domestic currency, amount outstanding

maturity over 5 years, % p.a.



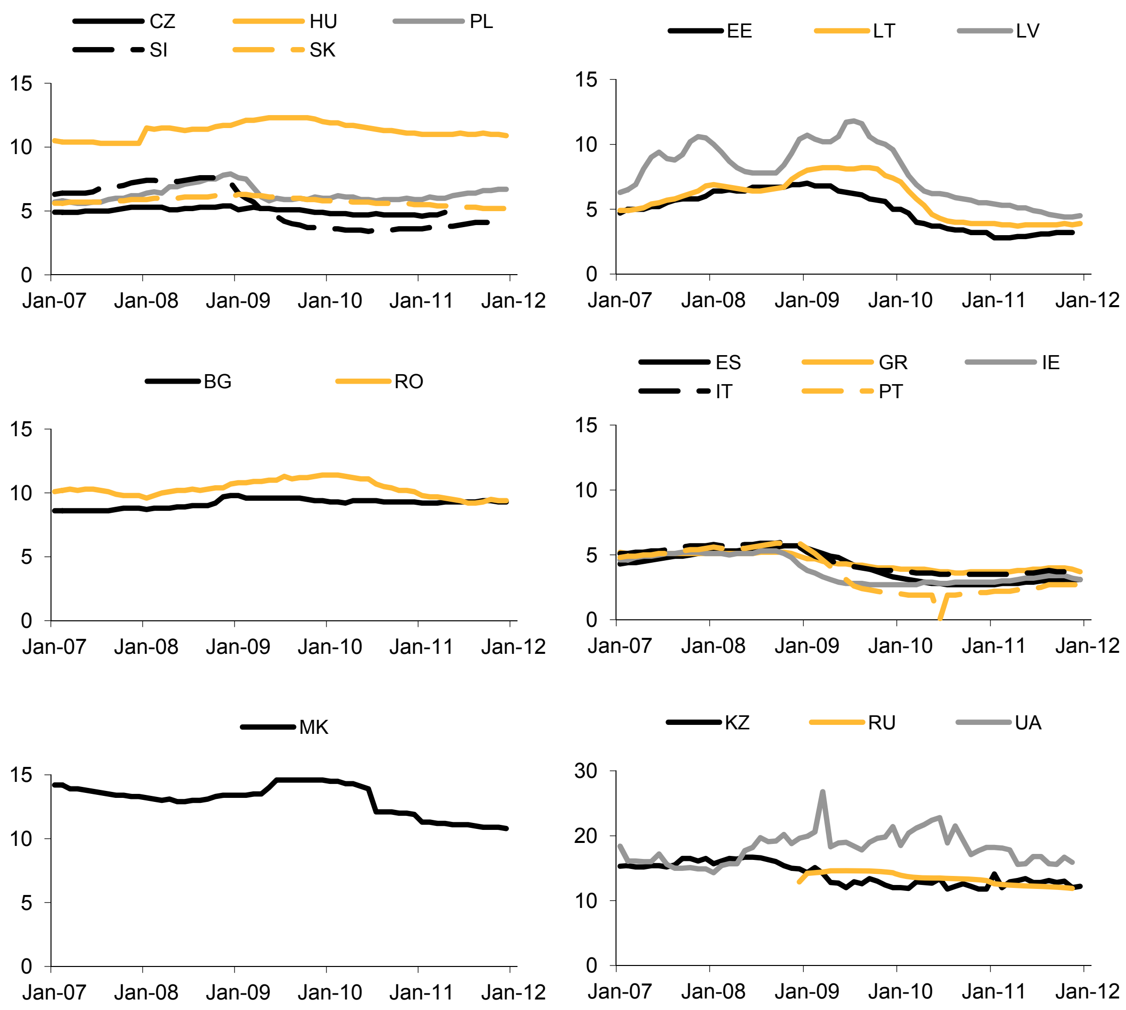
Source: Eurostat, National bank statistics.

Differentiation arises according to the level of private debt, its distribution between households and corporations, as well as variations in the share of foreign debt (see Figure 2b above). Arguably, the countries of Central Europe tend to have stable and low levels of private debt, both household and corporate debt, irrespective of whether it has been incurred in foreign currency or not (Slovenia and Hungary, however, are exceptions). Both the countries of Southeast Europe and the GIPS countries tended to have rising private debts, with the less developed countries incurring more corporate than household debt, while the proportion of foreign debts tends to be large as well. Overall, in the countries of Central and Southeast Europe, corporate debts to GDP ratios tend to be about twice as high as household debts in terms of percentage of GDP. This is an indication, albeit indirect, that the corporate sector may be burdened with significant debt obligations.

Figure 14

Interest rates - loans to households for mortgage in domestic currency amount outstanding

maturity over 5 years, % p.a.



Note: KZ, RU: refers to all currencies. UA: Interest rates for new business.

Source: Eurostat, National bank statistics.

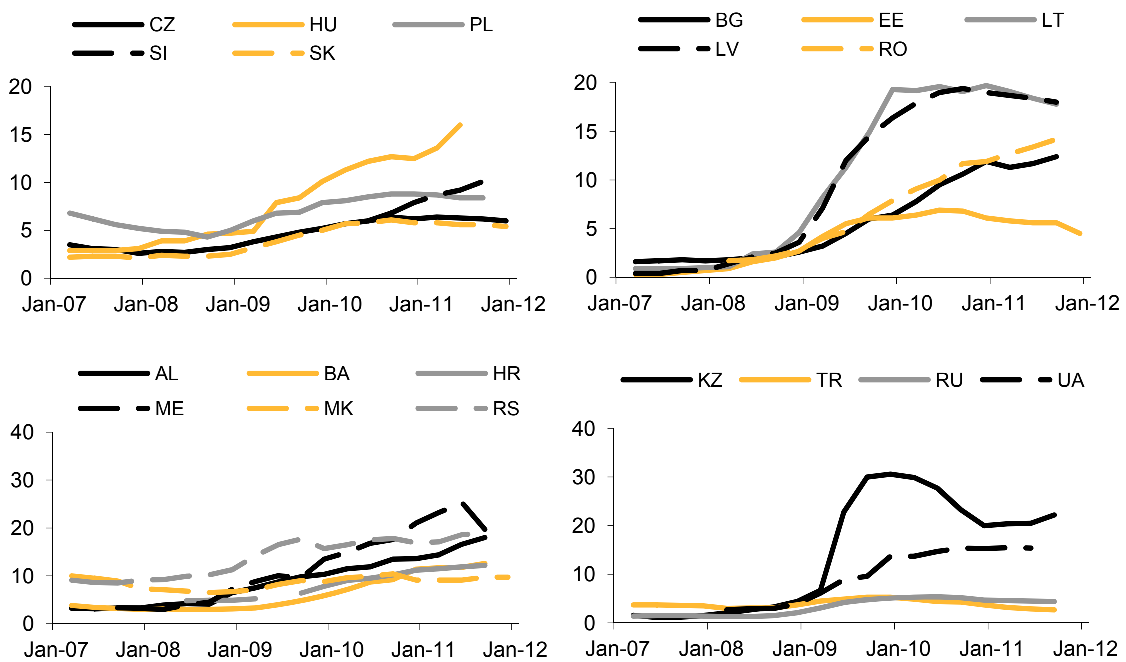
The countries also differ in terms of the interest rates they pay to service their debts, new and old alike. Clearly, an indebted corporate sector confronted with high interest rates will have to consider options ranging from liquidation to restructuring, as well as reacting to a possible increase in the number of new entrants. The latter development can be encouraged by introducing reforms in the product and labour markets, whereas the former two processes may weigh heavily on the economy as they take time and may call for government support that may not necessarily be forthcoming, given the policy of fiscal consolidation.

The level of private debt is not decisive where its sustainability is concerned, although in some cases it may be indicative of the reasons for interest rates tending to be rather high or on the increase. Borrowing costs and sales prospects are certainly the major factors governing companies' futures and thus investments. In that respect, most of the countries in Southern Europe, in particular those in the Balkans are encountering strong counterforces as they seek to speed up corporate investments and thus economic expansion. With the exception of Hungary and Poland, the countries in Central Europe have low corporate borrowing costs, while those in Southeast Europe have to bear significantly higher interest rates (see Figure 13).

Figure 15

Non-performing loans

in % of total



Note: Non-performing loans defined as credits more than 90 days overdue. EE: loans more than 60 days overdue.

Source: National Bank of respective country.

In a number of countries, household debt is high and may have accumulated in foreign currencies, some in Swiss francs. Furthermore, interest rates differ significantly between the countries in Central and Southeast Europe. In Southeast Europe, the interest rates on mortgages are 2 or more percentage points higher than in Central Europe (except Hungary), and much higher than the interest rates in the GIPS countries (see Figure 14). As households are pressed to deleverage, their level of consumption drops, thus paving the way to lower aggregate demand. Households are not as likely to default as corporations. Consequently, the data on non-performing loans, which are increasing across the board, can be taken as an indication of the sorry state of corporate solvency (see Figure 15). With adverse growth prospects, those problems can only get worse.

Summary

Overall, the debt hangover is more of a problem in countries with higher corporate debt than in those with household debt. An additional aggravating factor is greater exposure to cross-border corporate debt, which tends to be appreciable in countries with relatively high interest rates. By and large, it seems that the corporate debt problem takes on greater importance in countries that prior to the crisis enjoyed a boom in the construction sector that at present is still struggling. In fact, only a few countries can point to a revival of construction activity which, in those particular cases, is probably due to public investment. In all likelihood, the main effect of the financial crisis is that it saps private investment owing to the problems associated with settling liquidity and solvency problems in the corporate sector. See also the Special section on 'European banking crisis and spillover effects in CESEE' in this report.

10. Investment and consumption

The debt build-up, high interest costs and the deleveraging process have taken a heavy toll on investment while the decline in household consumption has been modest (see Table 6). This holds true for practically all of the countries reviewed. Some exceptions are to be found in Central Europe where investments have increased (Poland and Slovakia) or have not dipped as sharply as in other countries in Southern and Southeast Europe. Investments in Russia, Ukraine, Kazakhstan and Turkey are, for the most part, increasing.

A similar development is to be observed in foreign investments, direct and otherwise (see Table 7). Foreign investments and cross-border deleveraging by the banks have slowed down perceptibly (See the Special Topic on 'The European banking crisis and spillover effects in the countries of CESEE'). This, in part, reflects the fact that the corporate sector is burdened with debt that cannot be serviced, given the current state of the economy in most European countries.

In addition, the state of the banking sector in both the EU and most other countries is such that it does not support the rapid growth of credit. In fact, a few years after the onset of the crisis, credit growth still remains anaemic. To the extent that it relies on foreign credit, the prospects are not positive due to the stricter rules on capital requirements in the EU and globally. Thus, the prospect in countries with strong presence of foreign banks is that those will tend to decrease their cross-border exposure. (There is more on that in the Special Topic below.)The Vienna Initiative 2 is an agreement to slow down that process. Still, banks will increasingly depend on their domestic increase in deposits to finance their investments.

The question thus arises as to the consequences over the coming few years, given the prevailing policy framework in Europe. Household consumption cannot be expected to grow strongly owing to (at best) stagnant wages and the significant decrease in employment in a number of countries (see Figure 18 in the Special section on ‘Labour market developments in the CESEE region’). This shedding of labour is part and parcel of the corporate sector’s restructuring strategy, which will take a while to unfold. In the medium term, the slow, if any, recovery of investments and stagnant consumption will translate into comparatively low rates of recovery.

Table 6

Consumption and investment

real change in % against preceding year

	Household final consumption								Gross fixed capital formation							
	2007	2008	2009	2010	2011 1)	2012	2013	2014	2007	2008	2009	2010	2011 1)	2012	2013	2014
							Forecast								Forecast	
Bulgaria	9.1	3.4	-7.6	-1.3	1.4	1	1.5	2	11.8	21.9	-17.6	-16.5	-7.0	0	4	6
Czech Republic	4.1	3.0	-0.5	0.6	-0.4	-0.5	1.5	2.5	13.3	4.1	-11.5	0.2	-0.3	0.5	4	6
Estonia	8.8	-6.4	-16.1	-1.7	4.1	2	2.2	3	9.3	-15.1	-37.8	-9.1	20	6	7	9
Hungary	1.0	-0.5	-6.4	-2.1	0	-1.5	0	2	3.8	2.9	-11.0	-9.7	-4.5	-1	2	3
Latvia	14.6	-5.8	-22.8	0.6	4.4	3	3	3.5	7.9	-13.7	-37.4	-12.2	21	6	8	8
Lithuania	11.3	4.2	-17.4	-5.0	5.8	2.5	3	4	21.8	-5.2	-39.5	1.0	15.5	5	7	9
Poland	4.9	5.7	2.1	3.2	3.1	2.2	4	4.5	17.5	9.7	-1.3	-0.1	8.7	3.5	6	7
Romania	12.0	9.0	-10.4	-0.4	1	1	2	3	30.3	15.6	-28.1	-2.1	3	3	5	6
Slovakia	7.0	6.0	0.1	-0.8	0	0.5	1.5	2.5	9.0	1.0	-19.7	12.4	4.5	2.5	3	4
Slovenia	6.0	3.9	-0.2	-0.6	0	-0.5	-0.3	0.4	13.3	7.8	-23.3	-8.3	-12	-5	0	4
NMS-10	6.6	4.7	-3.4	0.8	1.8	1.1	2.5	3.4	16.6	8.2	-13.5	-1.9	4.3	2.3	4.8	6.1
Austria	0.9	0.8	-0.3	2.2	0.6	1.0	1.4	.	3.6	0.7	-8.3	0.1	4.7	0.7	3.0	.
Germany	-0.2	0.6	-0.1	0.6	1.5	1.1	1.1	.	4.7	1.7	-11.4	5.5	6.4	2.7	4.6	.
Greece	3.7	4.0	-1.3	-3.6	-6.2	-4.3	-0.9	.	5.4	-6.7	-15.2	-15.0	-15.9	-3.6	6.3	.
Ireland	6.3	-1.4	-7.2	-0.9	-2.4	-1.1	0.5	.	2.3	-10.1	-28.8	-25.1	-10.5	0.6	4.2	.
Italy	1.1	-0.8	-1.6	1.0	0.7	0.1	0.4	.	1.8	-3.7	-11.7	2.4	0.1	-1.2	1.2	.
Portugal	2.5	1.3	-2.3	2.1	-4.2	-5.9	-0.4	.	2.6	-0.3	-8.6	-4.1	-11.6	-9.4	1.5	.
Spain	3.5	-0.6	-4.3	0.8	0.7	0.9	1.1	.	4.5	-4.7	-16.6	-6.3	-5.4	-0.3	1.3	.
EA-17	1.7	0.4	-1.2	0.9	0.5	0.4	1.0	.	4.7	-1.1	-12.0	-0.6	2.0	0.5	2.9	.
EU-27	2.2	0.3	-1.8	1	0.4	0.4	1.1	.	5.9	-0.9	-12.4	-0.2	1.9	0.8	3.0	.
Croatia	6.3	0.8	-8.5	-0.9	0.2	-0.2	0.5	1	7.1	8.2	-11.8	-11.3	-7.0	-3	1.5	3
Macedonia	8.1	7.4	-4.7	1.6	4	2	2	2	17.1	5.4	-8.3	-1.0	10.0	4	4	4
Montenegro	.	12.1	-12.9	2.0	2	2	3	3	.	27.3	-30.1	-18.5	-5.0	2	5	5
Turkey	5.5	-0.3	-2.3	6.7	9	4	4	5	3.1	-6.2	-19.0	29.9	22.0	-2	10	10
Candidate countries	.	0.1	-2.8	6.1	8.3	3.7	3.7	4.7	.	-4.1	-18.1	25.8	19.9	-1.9	9.4	9.5
Albania	10.7	6.7	3.0	2.8	3	3	4	5	5.5	9.5	5.0	-7.0	2.0	1	4	6
Bosnia and Herzegovina	5.9	6.0	-3.9	-1.0	0.2	0	1	1	28.2	16.1	-22.4	-11.1	5.4	2	4	5
Serbia	6	6	-2	2	1	0	1	1	12	8	-5	-4	0	3	3	3
Potential candidate countries	6.8	6.1	-1.5	1.4	1.2	0.6	1.6	1.8	14.2	10.4	-6.1	-6.4	1.7	2.2	3.5	4.2
Kazakhstan	10.9	6.3	0.7	10.0	8.0	5	4	4	17.3	1.0	-0.8	3.8	3.5	8	9	10
Russia	14.3	10.6	-5.1	5.1	6.4	5.5	5	5	21.0	10.6	-14.4	5.8	6.0	6	6	5
Ukraine	17.2	13.1	-14.9	7.0	12	6	7	6	23.9	-1.2	-50.5	4.9	9.0	7	8	8

1) Preliminary and wiiw estimates.

Source: wiiw Database incorporating national and Eurostat statistics. Forecasts by wiiw and European Commission (Economic Forecast, Autumn 2011) for GR, IE, IT, PT, ES, EA-17 and EU-27.

Whether there is any likelihood of investments increasing is a further issue. The assumption is that to date investments have declined for reasons of both supply and demand, but recovery should be spurred by adjustments in production and borrowing costs. Borrowing costs are a constraint in many countries in Southeast Europe, albeit to a lesser extent in the countries of Central Europe. Problems associated with production costs are to be addressed by lowering taxes on labour, reducing wages and downsizing. However, given the depressed state of demand in the wake of stagnant private consumption and declining public expenditures, any marked increase in investments will depend on the revival of external demand. In the countries of Central Europe, external demand may be spurred by the recovery of the German economy and indirectly by global demand. In the countries of Southeast Europe, the corporate sector faces balance-sheet problems, high financing costs and rising non-performing loans, investment-driven recovery is thus 'a long shot'.

Figure 16a

Corporate debt and subsequent gross fixed capital formation growth 2008-2011

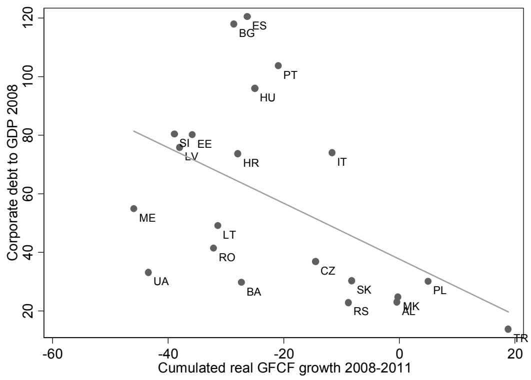
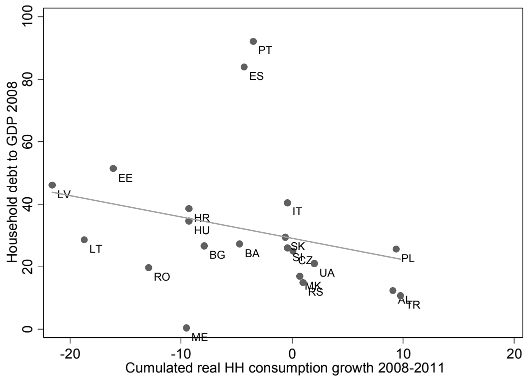


Figure 16b

Household debt and subsequent household consumption growth 2008-2011



Source: wiiw Database incorporating national and Eurostat statistics, own calculations.

Figure 16c

Corporate debt and subsequent gross fixed capital formation growth forecast 2012

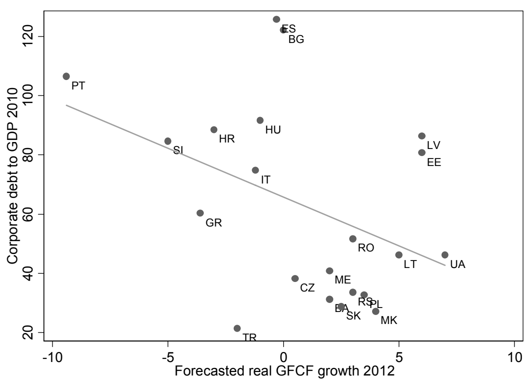
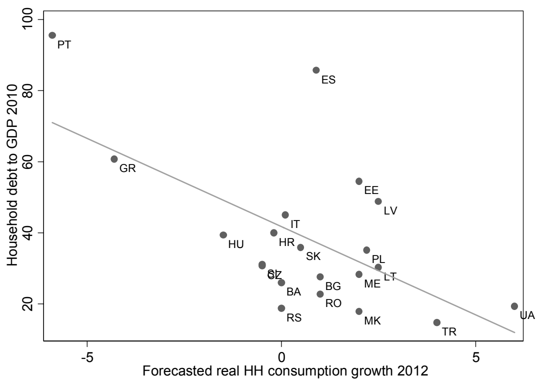


Figure 16d

Household debt and subsequent household consumption growth forecast 2012



Source: wiiw Database incorporating national and Eurostat statistics, own calculations.

Table 7

Balance of Payments: selected positions

EUR mn

	Financial account						FDI, net						Other capital investment net [1]						Change in official reserves					
					1-3'Q						1-3'Q						1-3'Q						1-3'Q	
	2007	2008	2009	2010	2010	2011	2007	2008	2009	2010	2010	2011	2007	2008	2009	2010	2010	2011	2007	2008	2009	2010	2010	2011
Bulgaria	10513	10789	1813	210	-84	-1540	8838	6206	2505	1585	892	435	4583	5258	-1342	-1760	-1425	-2078	-2908	-674	650	384	449	103
Czech Republic	3958	2193	3236	5697	3965	4387	6480	1503	1397	3822	4761	2235	-1931	2284	4088	3540	1555	988	-591	-1594	-2249	-1665	-2351	1164
Estonia	2350	1233	-936	-816	-487	-589	708	423	209	1062	657	1416	1732	1314	-1142	-2710	-1619	-1989	-90	-504	-3	832	475	-16
Hungary	6537	9020	-626	-1639	-1442	-1157	217	2721	-180	421	-522	-1293	6467	14007	5130	952	1789	5143	-147	-7708	-5576	-3012	-2709	-5007
Latvia	4468	3083	-2191	-981	-951	-128	1434	702	113	268	109	835	3751	1933	-1377	-531	-194	-985	-717	448	-927	-718	-866	22
Lithuania	3678	3600	-2089	-1151	-682	-474	1036	1111	-110	508	330	695	3495	1704	-2042	-1137	-723	-751	-853	785	63	-522	-289	-418
Poland	18245	28373	15920	17030	10839	12253	13222	7064	6008	2551	2674	4522	14399	18868	20327	25976	22903	12053	-9376	2441	-10415	-11497	-14738	-4322
Romania	16781	17662	5584	5481	4846	4160	7074	9315	3551	2238	2443	1123	14137	8264	3253	6731	6049	4669	-4430	83	-1220	-3488	-3646	-1632
Slovakia	2425	6031	2627	-551	-415	2185	2195	2947	-655	85	-35	242	3033	2148	2715	-635	-382	1943	-2803	936	567	-1	2	0
Slovenia	1972	2630	163	310	360	-299	-210	346	-643	334	-1	544	2042	2263	639	-43	331	-897	140	21	167	19	30	54
Austria	-11503	-14966	-9942	-2622	-2342	-5101	-5481	-15425	-506	-3444	-25	-4826	-4165	-133	-11810	1917	-1460	491	-1857	592	2374	-1095	-857	-766
Germany	-210150	-160195	-145427	-140300	-90254	-102919	-66057	-49784	-29207	-45923	-44920	-19833	-143140	-108403	-119420	-92763	-44226	-80616	-953	-2008	3200	-1614	-1108	-2470
Greece	27570	29914	24396	21323	16379	15060	-2284	1423	273	-458	-445	-1602	30176	28520	24229	21684	16694	16756	-322	-29	-106	97	130	-94
Ireland	12050	16133	-886	12390	8431	8266	2602	-24167	-473	6439	-1758	18179	9460	.	.	.	.	.	-12	.	.	.	.	.
Italy	26212	31393	37338	86752	56364	43603	-36953	-53143	-867	-17720	-8123	-25434	64689	90110	38125	105506	65344	69621	-1524	-5574	80	-1034	-857	-584
Portugal	14454	19140	17487	15732	11746	8881	-1775	1312	1360	7421	7095	-2025	15516	17907	16047	9308	5826	10056	713	-79	80	-997	-1175	850
Spain	101005	100221	54640	44562	39849	37783	-53180	1552	-432	2226	-4543	-5796	154350	99314	56635	43150	44954	45805	-165	-645	-1563	-814	-562	-2226
Croatia	4409	5758	3388	1230	494	720	3435	3246	1492	393	703	1027	1696	2181	2793	920	407	360	-722	330	-896	-84	-616	-667
Macedonia	457	898	410	118	1	210	507	409	137	158	104	181	45	414	350	22	-47	148	-95	75	-77	-62	-56	-119
Montenegro	1055	1326	526	371	82	8	568	582	1067	552	413	266	638	589	-456	-164	-258	-306	-151	155	-85	-17	-73	48
Turkey	26693	24266	6036	32489	21641	34756	14670	11511	4976	5878	3342	6689	18098	11550	925	36384	24885	31900	-6075	1205	135	-9773	-6586	-3833
Albania	532	1322	958	638	367	561	464	610	668	823	578	430	234	902	260	-6	-158	109	-166	-190	29	-178	-53	22
Bosnia and Herzegovina	997	1555	556	545	347	633	1499	673	176	142	88	233	135	677	335	517	275	353	-637	206	46	-114	-16	46
Serbia	5175	7133	2207	2032	1782	1737	1821	1824	1372	860	595	1147	4097	3622	3198	243	185	1927	-742	1687	-2364	929	1001	-1337
Kazakhstan	8225	-385	3904	-10252	-10044	-9	5817	8914	7231	2152	4820	5418	197	-7812	-1561	-8838	-11546	-2878	2212	-1487	-1766	-3566	-3319	-2549.4
Russia	-39597	-63286	-25182	-47216	-41716	-46896	6690	13243	-5154	-6998	-5513	-5434	62521	-103089	-17599	-12370	-1453	-26392	-108809	26560	-2429	-27848	-34750	-15069
Ukraine	4165	8355	569	5923	178	3815	6729	6767	3336	4339	2726	3796	3992	2326	-6821	7958	3832	73	-6555	-738	4053	-6374	-6380	-55

1) Includes portfolio investment, other investment and financial derivatives.

Source: wiiw Database incorporating national and Eurostat statistics.

Summary

The EU economic policy stance, which the countries in Southeast Europe also follow to a large extent, depends on the revival of external demand. Household consumption will only grow slowly, if at all, and public consumption is set to decline. Private investment will have hard time picking up, if credit remains low and external demand subdued. If the expectation is that structural reforms will spur investments and exports, it may take some time before that actually happens, further to which it could well lead to an ever-widening divide between the various European regions.

Box 6

Differential growth of external markets

This box adds an additional piece of information regarding the impact that the external environment exerts upon growth performance in different countries. Box Table 1 shows the GDP growth rates calculated for the external markets with which different CESEE country groups (CE-5, Baltics, Bulgaria and Romania, SE-6, Russia and Ukraine) were linked through exports of goods over the period 2005-2011. The GDP growth figures have been calculated on the basis of individual countries' export structure to different export markets; these have provided the weights for the different countries' exposure to different markets and have been used to arrive at aggregate GDP growth in the respective 'composite' export market. They thus reflect the export market orientation of different economies. In order to save space, figures are only presented for groups of countries rather than individual countries.

Box Table 1

Trade weighted GDP growth in %

	2005	2006	2007	2008	2009	2010	2011
CE-5	2.4	3.7	3.6	1.6	-3.6	2.4	2.2
Baltics	4.4	5.9	5.8	1.4	-6.6	3.4	3.8
BG+RO	3.3	4.5	4.1	1.8	-3.8	2.9	2.5
SEE-6	2.9	4.2	4.1	2.0	-4.0	2.0	1.8
RU+UA	5.0	6.1	6.0	3.2	-2.4	4.3	3.7

Source: wiiw Database incorporating national and Eurostat statistics, own calculations.

It can be seen that in the pre-crisis period 2005-2007 the Baltic states, as well as Russia and the Ukraine, benefited from higher growth of their (trade-weighted) export markets, while the CE-5 faced relatively lower growth in their (composite) export market. The interesting feature is that as compared to the pre-crisis period, the SE-6 as well as Bulgaria and Romania switched from an orientation towards a relatively high-growth export region to a relatively low-growth export region in the post-crisis period. This reflects the impact of the new, low-growth scenario in Southeast Europe (including the crises in Greece and Italy) and the much reduced export stimulus it provides for each other's exports.

11. Political economy issues

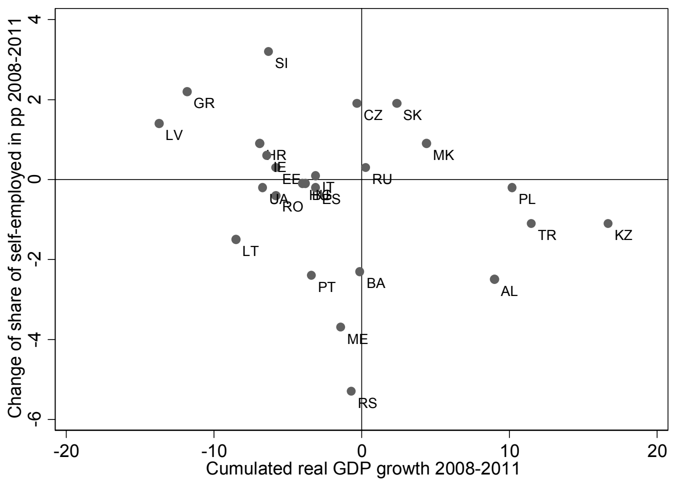
The policy mix adopted suggests a major role for labour market adjustments. Indeed, in the countries of Southern Europe, employment effects have been quite strong. Given that in most cases, employment rates, even in good times, tended to be low before the current crisis, this policy of internal devaluation, partly through labour lay-offs, is going to have significant social consequences. This is not to say that the policy of fiscal consolidation and thus of the redistribution of the burden of the crisis, will not have social effects in better performing countries as well. Furthermore, in an integrated Europe, distributional problems between countries come to a head that are hard to control.

In the past, some of the adverse labour market developments were countered by growth in informal employment. This time round, however, this has not been the case in a number of countries owing to the fact that the determining factor is a decline in aggregate demand, not structural readjustment. By and large, the share of self-employed in total employment tends to decline in Southern Europe, in particular in the Balkans (see Figure 17). This is not the case in Greece, Slovenia and a few other countries, and only marginally so in Croatia. With certain exceptions, informal employment would thus not seem to provide much of a safety valve in the current crisis.

This type of depressed labour market tends to have two social and political consequences. One is that in countries with stronger trade unions, it may prove difficult to implement an austerity policy in defiance of social resistance. However, in countries that are less organized along social lines, nationalist protection and disintegration policies may prove more influential. In both cases, structural adjustment policies relating to product and labour markets may prove unavailing.

Figure 17

Change of share of self-employed and GDP growth 2008-2011



Source: wiiw Database incorporating national and Eurostat statistics, own calculations.

The other effect is in the erosion of democracy. This can take on a number of forms that are all too familiar and well known from the history of democratic governments and their collapse both in

Europe and elsewhere. This may well compound the problem in the EU context, given the additional issue of national sovereignty and the perception that decisions are being imposed from without.

Both of these social and political developments may lead to repudiation of the EU and eurozone policy mix. For instance, they may lead to defaults and adverse political developments. In all likelihood, a prolonged period of stagnation or low growth will lead to significant social and political changes in the divergent countries and, in turn, to instability in the EU and the eurozone.

12. Summary and conclusions

The present overview analysed developments in the CESEE region in relation to; (i) recent developments in the EU, particularly the Union's evolving policy framework; and (ii) a broad spectrum of lower- and medium-income economies in Europe in a comprehensive comparative perspective encompassing both the CESEE and GIIPS countries.

That comprehensive comparative perspective was chosen so as to focus the analysis on the theme of *New Divide(s) in Europe*. The analysis attempted to examine the impact of the financial and economic crisis over the period 2008-2012 on divergent developments in the EU and the broader European region, which might not be solely short-term in nature.

This stands in sharp contrast to the perspective widely subscribed to in the mid-1990s. From that time on, the conventional wisdom was that Europe displayed clear signs of 'convergence' at the inter-country level, with low-income economies growing at a faster rate than rich economies. Broadly convincing evidence was found of narrowing inter-country income gaps.

The impact of the financial and economic crisis, not only in its narrow economic dimension but also in its broad political and social dimension, as well as in the ways in which European policy frameworks are currently evolving, has since cast some doubt on the *European integration model of convergence*. The convergence model was based on the enormous potential that transition and integration would provide to low-income and transition economies and the benefit they would gain from technology transfer, as well as organizational, institutional and behavioural emulation. If all that were properly applied, those economies would also benefit from a net inflow of capital and enjoy funding at relatively cheap rates.

Following the impact of the crisis, the differentiating features of the pre-crisis catching-up and integration processes have been subject to more critical scrutiny. Some of those features (such as the characteristics of capital inflows and the availability of cheap finance), it has transpired, are highly problematic. Furthermore, analysis of development processes prior and following the outbreak of the crisis leads, on the one hand, to a closer consideration of segmentation processes with regard to the performance and prospects of different groups of 'emerging economies' in Europe. On the other hand, they also raise the question whether the crisis marks a watershed with regard to prospects of a continuing 'convergence' process for the integrating lower-income European economies' as a group or for sub-sets thereof - at least over the medium term (5-7 years).

In a nutshell, the analysis in both this overview and the other special articles (one on foreign banks and deleveraging, the other on labour market and social developments) draws the following conclusions:

- Within the context of the global economy, Europe's economic prospects over the coming two years are the most daunting. Despite the crisis having started in the United States, its negative impact will be most lasting and pronounced in Europe;
- The EU is continuously developing its policy framework in response to the crisis. This has had an impact on both policy formulation and current developments in the various groups of low- and medium-income economies in Europe.
- The most distinctive differentiating feature among the emerging European economies that the analysis singled out was the pre-crisis build-up of (structural) current account disequilibria, associated developments in external debt and the debt positions particularly in the private sector (households and corporations).
- A sub-group of three Central European economies (Czech Republic, Poland and Slovakia) was found to have been scarcely affected by the debt build-up. The countries concerned showed little sign of competitiveness problems in their tradable sectors (which also includes Hungary), while the GIPS (Ireland's problems were debt-, not competitiveness-related) and most of the countries in Southeast Europe and the Baltic states developed unsustainable disequilibria on both those fronts.
- The previous build-up of disequilibria and debt accounts for most of the differentiated impact when the crisis hit. This held particularly true for developments over the period 2008-2011.
- As to the prospects for 2012 and 2013, the situation is rather grim for emerging Europe. With growth slowing down significantly in the advanced parts of Europe, pursuit of an 'export-led' strategy (as pursued over the biennium 2010 - 2011) will prove problematic, while the greater reliance on domestic demand factors that the situation demands will also face severe problems. In a detailed analysis we evaluated the various aspects (fiscal, household and corporate) of the 'debt problem' in the various groups of countries:
    - First, the analysis addressed the differences in scope for fiscal policy from the standpoint of the sustainability conditions for public debt: (i) in the face of changed and differentiated growth prospects; (ii) interest rate perspectives (the latter in turn reflecting the financial markets' evaluation of sustainability issues); and (iii) the policy stances adopted by different governments.
    - Thereafter, the analysis assessed the likely recovery prospects of corporate investment activities and household consumption expenditures. For both items inherited debt levels and deleveraging processes, as well as income and sales prospects are seen to be major determinants (all of which, in turn, affect financing conditions). Country groups differ in those respects, just as they differed in the build-up of public debt in the course of the crisis.
- Important groups of economies, such as the GIPS countries and most of the countries of Southeast Europe, have come up against a vicious circle: high initial debt levels and dim growth prospects translate into greater doubts about sustainability and hence into higher in-

terest rates that impose a constraint on investment and encourage corporate and household deleveraging (further compounded by the weak state of the banking system). This dampens consumption expenditures, and leads to cutbacks in employment (and wages), which, in turn, lower household incomes and domestic sales prospects. The induced lower growth prospects, in turn, raise concerns over debt sustainability and the need to keep interest rates high.

- Prospects of offsetting factors such as a potential rise in competitiveness and hence export-led recovery are dim in the current context of low growth in the European economy as a whole. In a separate exercise, we showed that in the latter respect the countries of Southeast Europe suffer further differentiating disadvantages as their main export markets are growing at even lower rates than those of the other economies in Europe.

The report thus points towards a sustained period in which the convergence processes which characterised the decade prior to the current financial and economic crisis will either not proceed or proceed at a much reduced pace. Deleveraging processes, difficult moves to deal with the high debt positions of the private sector, the weak banking system and the feedback effects on sovereign debt will characterise many of the lower-income economies in Europe. The driving force of foreign direct investment and the build-up of cross-border production networks will also show weaker momentum compared to before the crisis. Adjustment processes to deal with the pre-crisis neglect of building-up a viable tradable sector and sufficient and modernising export capacities will have to gain priority and the use of different sets of policy instruments (particularly in the areas of training, labour market, industrial and regional policies) will have to be strengthened.

Annex

Annex Table 1

Contributions to the GDP growth rates in the GIIPS countries

in percentage points [1)]

	2007	2008	2009	2010	2011		2012		2013	
							Forecast			
Greece										
GDP growth rate (%)	**3.0**	**-0.2**	**-3.3**	**-3.5**	**-5.5**	(-6.8)	**-2.8**	(-4.4)	**0.7**	(-0.9)
Household final consumption	2.6	2.9	-1.1	-2.7	-4.4		-3.1		-0.6	
Government final consumption	1.3	-0.4	0.8	-1.4	-1.7		-1.7		-1.3	
Gross fixed capital formation	1.3	-1.6	-3.4	-2.9	-2.7		-0.5		1.0	
Trade balance	-3.3	-0.5	3.0	3.1	2.8		2.5		1.5	
Ireland										
GDP growth rate (%)	**5.2**	**-3.0**	**-7.0**	**-0.4**	**1.1**	(0.9)	**1.1**	(0.5)	**2.3**	(1.7)
Household final consumption	2.9	-0.6	-3.5	-0.4	-1.1		-0.5		0.2	
Government final consumption	1.1	0.2	-0.6	-0.6	-0.7		-0.2		-0.4	
Gross fixed capital formation	0.6	-2.7	-6.8	-4.2	-1.2		0.1		0.4	
Trade balance	1.2	1.2	3.2	3.5	3.1		1.8		2.0	
Italy										
GDP growth rate (%)	**1.7**	**-1.2**	**-5.1**	**1.5**	**0.5**	(0.2)	**0.1**	(-1.3)	**0.7**	(-0.7)
Household final consumption	0.6	-0.5	-0.9	0.6	0.4		0.1		0.2	
Government final consumption	0.2	0.1	0.2	-0.1	0.0		-0.1		0.0	
Gross fixed capital formation	0.4	-0.8	-2.4	0.5	0.0		-0.2		0.2	
Trade balance	0.3	0.1	-1.1	-0.4	0.5		0.5		0.3	
Portugal										
GDP growth rate (%)	**2.4**	**0.0**	**-2.9**	**1.4**	**-1.9**	(-1.5)	**-3.0**	(-3.3)	**1.1**	(0.8)
Household final consumption	1.5	0.8	-1.5	1.4	-2.7		-3.7		-0.2	
Government final consumption	0.1	0.1	0.9	0.2	-0.7		-1.4		-0.8	
Gross fixed capital formation	0.6	-0.1	-1.9	-0.9	-2.3		-1.7		0.3	
Trade balance	0.1	-1.0	0.6	0.5	3.8		3.3		1.8	
Spain										
GDP growth rate (%)	**3.5**	**0.9**	**-3.7**	**-0.1**	**0.7**	(0.7)	**0.7**	(-0.1)	**1.4**	(-0.3)
Household final consumption	2.0	-0.3	-2.4	0.4	0.4		0.5		0.6	
Government final consumption	1.0	1.1	0.7	0.0	-0.2		-0.6		0.1	
Gross fixed capital formation	1.4	-1.5	-4.8	-1.6	-1.2		-0.1		0.3	
Trade balance	-0.9	1.5	2.7	0.9	1.8		0.7		0.4	

1) Contributions of changes in inventories are not shown.

Source: The data refers to the Autumn 2011 Forecasts by European Commision, which has been substantial revised downward in the February 2012 Forecast (see EC, 2012). The 2011-2012 figures in brackets are from the February 2012 Forecast and 2013 wiiw adjusted figures.

Sebastian Leitner and Hermine Vidovic

Labour market developments in the CESEE region during and after the crisis

Employment

The incidence of job reductions during the crisis and the recovery thereafter differed substantially across the CESEE region and individual countries. In the Baltic States, which were hit hardest by job reductions during the crisis, employment increased by 3.5% between the third quarter of 2010 and the third quarter of 2011, while in the entire NMS employment stagnated.[11] In the Western Balkan countries, employment continued to drop, by 1.6% on aggregate, but grew remarkably (7%) in Turkey. In Russia and Kazakhstan employment continued to increase, yet remained stagnant in Ukraine. Despite the recovery in economic growth in 2011, employment levels in most NMS, except Poland, are still below or far below those in the pre-crisis period. Employment patterns of the main economic sectors followed very different growth trajectories between the third quarters of 2010 and 2011. Throughout the NMS region, Turkey and Russia, the rise in employment resulted from an increase in industrial and services sector jobs, albeit to varying degrees. It is interesting to note that following two decades of de-agrarianization, in four out of seven NMS countries reporting employment growth, the generation of new jobs was partly due to employment in agriculture having risen. For example, in Hungary more than half and in Latvia over one third of the new jobs were created in (subsistence) agriculture. In Croatia, which also reported a continued decline in overall employment, job growth was mostly concentrated in agriculture. A marked increase in agricultural employment was also to be observed in Turkey; that trend is mainly due to workers laid-off in industry and services returning to rural areas as unpaid family workers.[12] This might also hold partly true for the other countries, over and above a palpable rise in agricultural production (Hungary).

Employment rates

Before the crisis, employment rates had been on the increase in most countries, thus providing for progress towards the Lisbon targets (i.e. 70% employment rate). Following the (dramatic) drop during 2008-2009, employment rates started growing again in almost all countries over the period 2010-2011 (Figure 18). Improvements were most pronounced in the three Baltic countries, which had been hit hardest by the slump in employment during the crisis. Conversely, in almost all Western Balkan countries (except Macedonia), Bulgaria, Romania and Slovenia employment rates continued to decline in 2011, with Ukraine also reporting a slight decrease. In 2011, the employment rate in Serbia dropped by 8.5 percentage points compared to 2008 – decreasing to only 45.5%. In Croatia, Latvia, Bulgaria and Slovenia, however, employment rates were also 5pp below the pre-crisis level. Only in three countries - Turkey, Macedonia and Kazakhstan – did employment rates in 2011 exceed the 2008 level. With regard to gender, men have borne the brunt of the cutback in employment

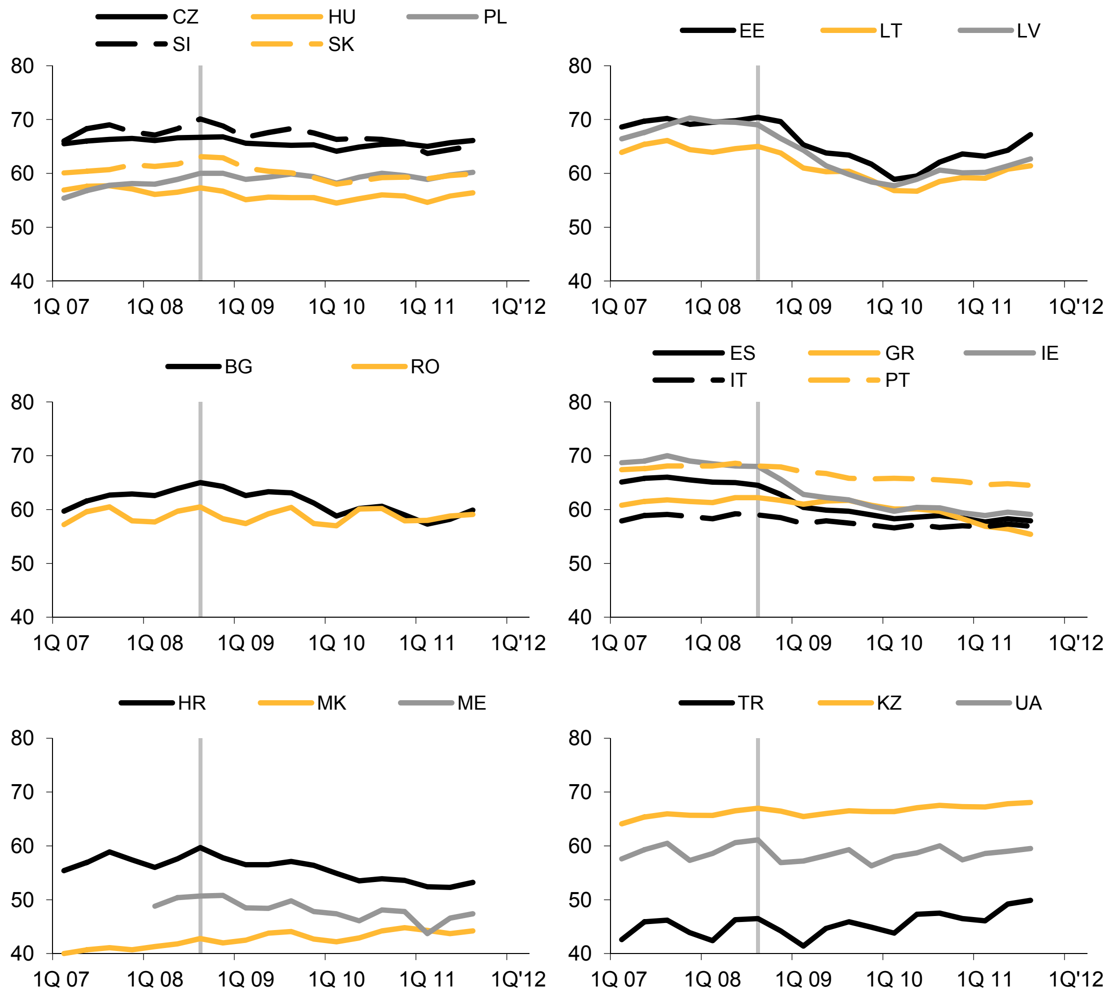
[11] Of the ten NMS, employment continued to fall in Bulgaria, Romania and Slovenia.

[12] For further details see H. Ercan et al. (2010), Crisis and Turkey: Impact Analysis of Crisis Response Measures, ILO, Ankara.

rates during the crisis; they are still worse off than women, although they enjoyed significantly stronger recovery over the 2010/2011 period. Consequently, since the beginning of the crisis, the gap between male and female employment rates has decreased.

Figure 18

Employment rates total (15-64, LFS)



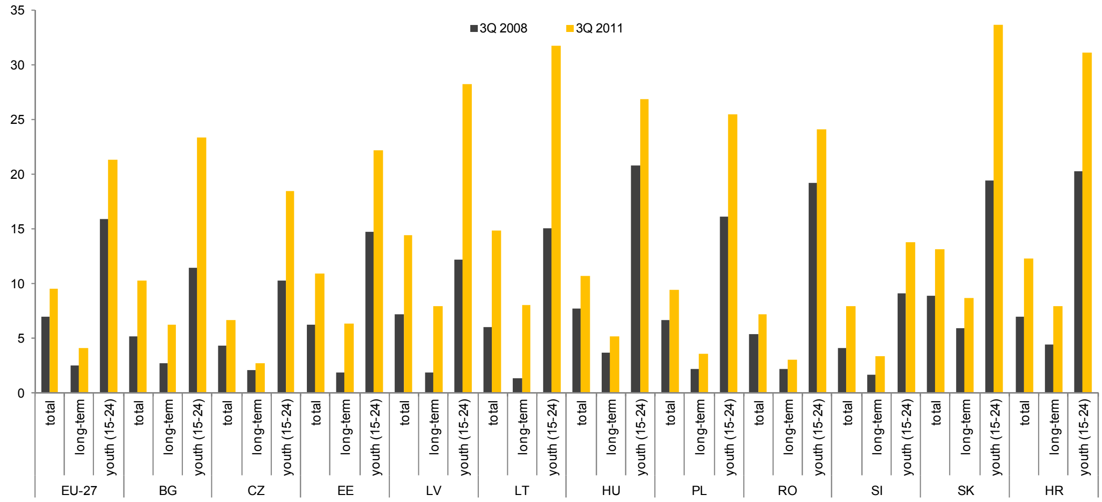
Source: Eurostat, national statistics.

The fact that the crisis hit males more than females was mostly due to the differences in the sectors that were immediately affected by the crisis (e.g. construction and other male- dominated industrial branches). There is every possibility that, once those branches have recovered from the present particularly severe crisis, the impact could be that the male-female balance between men and women might progressively revert to the traditional pattern, with women being more adversely affected by cyclical fluctuations than men.

Figure 19

Unemployment rates for total and young population (15-24) and long-term unemployment rate (unemployment ≥ 12 months),

3rd quarter 2008, 3rd quarter 2011



Source: Eurostat.

Young people hit hard

The economic crisis hit young people exceptionally hard in the European Union. The unemployment rate for those aged 15 to 24 leapt from 16% in the 3rd quarter of 2008 in the EU-27 to 23% in the same quarter of the subsequent year. For two years now, the situation on the labour market has not become easier for young people. Indeed, in the NMS-10, where the unemployment rate already stood at 16% in 2008, it has continued to increase, reaching 25% in the third quarter 2011. Only in Slovenia and the Czech Republic was the rate below 20%; in Latvia, Lithuania, Poland and the Slovak Republic it stood at about 30%. In most of the Western Balkan countries, the current situation is (almost traditionally) exceptionally disappointing: the youth unemployment rates range between about 35% in Croatia and Montenegro, 50% in Serbia and 60% in Bosnia and Herzegovina. In Russia the youth unemployment rate had already started to decline from the beginning of 2010 onwards, while in Ukraine it continued to increase throughout 2011. In both countries it amounts to almost 20%, while in Kazakhstan it is even lower than the total unemployment rate and amounted to only 4% in the fourth quarter of 2011.

Since the group of 15 to 24 year-olds includes numerous pupils and students, unemployment rates can only partially describe the extent of the youngsters' exclusion. Thus, only recently did the European Commission start to adjudge the exclusion of young people by following NEET rates (share of persons 'Not in employment, education and training') for those aged 15 to 24 years. The situation varied appreciably across the NMS countries in 2010, the year for which the most recent data are available. In Slovenia with 7% and the Czech Republic with about 9%, the situation is better compared to most EU-15 countries. In Bulgaria, however, close to 22% of the persons aged 15 to 24 years do not go to school or an institute of further education, nor are they employed. Macedonia reports a rate of 26% and Turkey 32%. On account of the economic crisis, the NEET rate for the EU-27 increased from 11% in 2008 to 13% in 2010.

Long-term unemployment

The marked rise in unemployment during the financial crisis has turned somewhat belatedly into burgeoning long-term unemployment (unemployed for more than one year). The long-term unemployment rate (long-term unemployed in % of active population) surged in all countries, the Baltic States in particular, up until the second quarter of 2011; it moderated somewhat thereafter in line with the overall unemployment rate. The long-term unemployment rate is still below the EU-27 average in the Czech Republic, Poland, Romania, Slovenia and Turkey, but it has reached the remarkable height of 8-9% in Croatia, Slovakia, Latvia and Lithuania.

In the NMS, the share of long-term unemployed in total unemployment increased to about 46% (EU-27: 43%) in the third quarter of 2011; however, the incidence of long-term unemployment differs across countries. With the exception of Hungary, Slovenia and Slovakia the portion of long-term unemployed continued to grow in all NMS in 2011, ranging between 40% in the Czech Republic and 66% in Slovakia. Compared with the pre-crisis period, notable rises in long-term unemployed were registered in the three Baltic countries (up by 28-32 pp) and to a lesser extent in Bulgaria and Poland. In the Western Balkan countries, the share of long-term unemployment has dropped somewhat compared to the pre-crisis period, but the levels remain high: at about 80% in Macedonia, Montenegro and Bosnia and Herzegovina, as well as slightly over 70% in Serbia. Conversely, in Russia and Ukraine long-term unemployment has been declining over the past couple of years, whereas it has remained stagnant in Kazakhstan.

A further increase in overall unemployment might intensify the growth of long-tem unemployment and bear serious social implications, such as the high risk of increasing poverty and associated social failure. Long-term unemployment may lead to a degradation of skills and thus decrease employability, ultimately leading to discouragement and exit from the labour market, as has already been the case in the Western Balkan countries.[13]

Adjusted labour market policies

The recession resulted in (partly) dramatic increases in the number of registered unemployed in most countries, thus exerting growing pressure on their welfare systems. As a consequence almost all NMS and Western Balkan countries have taken measures to adjust their unemployment benefit systems. Some countries such as Latvia, Romania and Slovenia have extended the duration of unemployment benefit entitlements or the amount of benefit paid. Conversely, in the Czech Republic and Serbia, the duration of benefit entitlement has been reduced; Lithuania has reduced the amount of benefits paid as a temporary measure until the end of 2011, and in Croatia the relatively generous

[13] See European Commission, EU Employment and Social Situation, Quarterly Review, December 2011, p. 15.

unemployment benefit system at the beginning of the crisis has undergone numerous modifications owing to growing budgetary constraints. In Serbia entitlement criteria and placement rates have also become more exacting. In Hungary and Turkey, unemployment benefit systems have not been used as a tool to address the economic crisis.[14] It has to be noted, however, that in both the NMS and the Western Balkan countries, only a relatively small share of the jobless is entitled to unemployment benefits as compared to the EU-15 (for example, in Austria or the Netherlands that share accounts for about 70%). Thus, the effects of changes in the unemployment compensation system may be considered limited.

With regard to active labour market policies (ALMPs), the CESEE countries tend to have (much) lower levels of expenditures than the EU-15 countries. As for the NMS, survey results show that all public employment services changed their ALMPs in response to the crisis, by introducing new or adapting old measures that affected a range of interventions, training in particular. Bulgaria, the Czech Republic, Estonia, Latvia, Slovenia and Poland introduced new training measures that were aimed at the employed and those working short-term - or those at risk of unemployment. In Slovenia current measures were also modified.

Demographic puzzle

Most of the European countries conducted a population census in 2011 or are going to finalise it in the course of 2012. Thus, it is appropriate to take a look at the demographic changes in the NMS over the past decades. Whereas in the EU-15 the population increased by 5.8%, over the period 2000–2011, in the NMS-10 according to preliminary figures, it declined by 5%. While in Latvia, Lithuania, Bulgaria and Romania the decline ranged between 10% and 15%, in Poland, Hungary and Estonia the decrease amounted to less than 4%. On the other hand in Slovenia, the Czech Republic and Slovakia, however, the population actually increased. The average population decrease in the NMS-10 almost doubled over the past decade compared to the period 1989-2000. About half of the reduction from 2000 to 2011 is due to net emigration from the region, while the other half stems from a natural decrease in the population, with birth rates consistently lower than death rates. In the Western Balkan countries, the population figure remained almost stable and increased by about 10% in Turkey, while in Russia it declined by some 3% and in the Ukraine by 7%. If we look at the disaggregated changes by age group, the demographic changes look still more dramatic. Whereas in the EU-15 the population aged 0 to 14 decreased by about 1%, in the NMS-10 it shrank by almost 25% over the period 2000-2011. In the Western Balkan countries, the shrinkage was slightly lower. This development will cause dependency rates to increase in the future, thus giving rise to greater financial constraints on the welfare system, especially in terms of public and private pensions. In the short to medium term, emigration and the related reduction of the young segment in the population is expected to lead once again to labour shortages for skilled jobs, as soon as economic activity regains momentum in the CESEE region.

[14] European Employment Observatory (2011), Adapting unemployment benefit systems to the economic cycle, 2011.

Migration

Apart from young people, migrant workers were also hit hard by the economic crisis. Employment rates in this group of the population fell in almost all EU countries more pronouncedly compared to native-born citizens. In the EU-15 the unemployment rate of non-native citizens climbed from 12% in the third quarter of 2008 to more than 16% in the same period of 2009, remaining at that level until the end of 2011. However, the situation is different for various groups of NMS citizens working in EU-15 countries. On average, the unemployment rate for NMS-8[15] migrants and native citizens is the same (8.8% in the third quarter 2011), while for NMS-2[16] migrants it amounts to 19.5%. Although the labour market situation worsened in the EU-15, migration from the NMS to the EU-15 increased during the crisis. The stock of migrant workers in total EU-15 employment both from NMS-8 and NMS-2 increased by about 20% from the third quarter in 2008 to the same quarter in 2011. Only in some of the hardest hit EU-15 countries, i.e. Spain, Portugal and Ireland (but not Greece) did employment of NMS foreigners decline, while in traditional host countries for Eastern European migrants (United Kingdom, Germany, Italy and Austria) the total number of NMS migrant workers and their share in total employment continued to rise.

Given the rather grim economic outlook for the NMS, labour market recovery will be slow. Only the Baltic States and Poland may expect a drop in unemployment in 2012,while labour markets in the other countries may only enjoy a slight improvement, if at all, from 2013 onwards. In the Western Balkan countries labour markets will remain weak throughout the forecast period, while labour markets will continue to improve in Kazakhstan and Ukraine, yet stagnate in Russia.

[15] NMS-8: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia.

[16] NMS-2: Bulgaria and Romania.

Olga Pindyuk and Mario Holzner

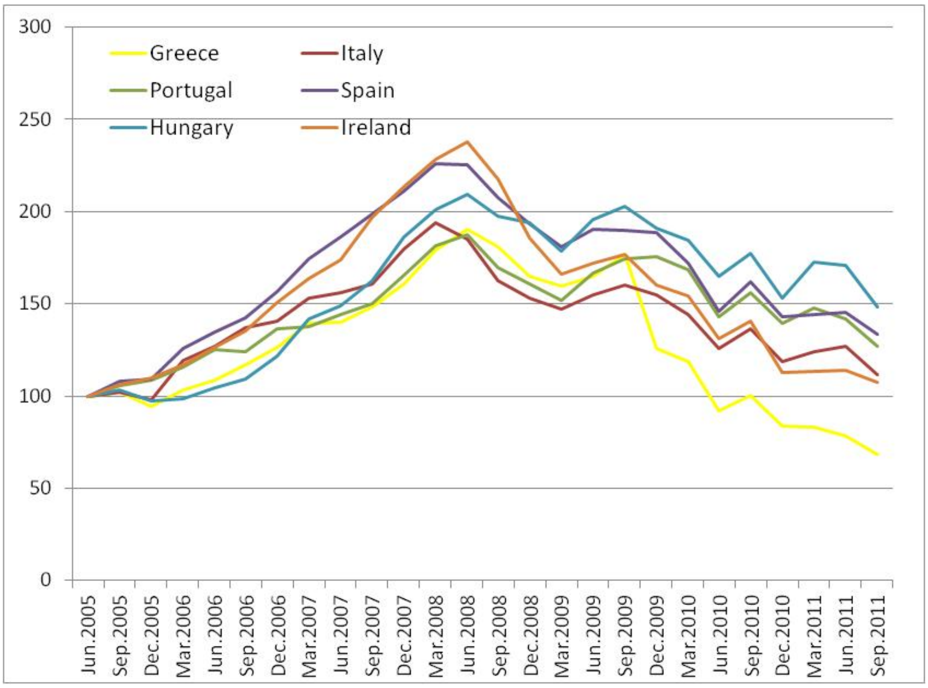
The European banking crisis and spillover effects in the countries of CESEE

Banking crisis in the CESEE countries: main trends

The deleveraging process of the European banking sector since the outburst of the crisis in late 2008 has been quite substantial. The banking centres are still reducing their lending to the European periphery. Bank of International Settlements (BIS) data have been used to analyse the extent of deleveraging in Europe. The data are derived from the consolidated banking statistics on an ultimate risk basis (the country of ultimate risk is defined as the country in which the guarantor of a financial claim resides and/or the country in which the head office of a legally dependent branch is located). The period covered in our analysis is June 2005 - September 2011. The data are reported in USD.

Figure 20

Indices of European banks' foreign bank claims on an ultimate risk basis, Mar. 2005=100



Source: BIS

Greece, Ireland, Italy, Portugal and Spain (GIIPS) have turned out to be the countries most affected by the credit contractions in Europe, while the CESEE countries have been hit relatively less. Figure 20 compares the indices of foreign claims[17] on banks in the GIIPS countries and Hungary, the latter

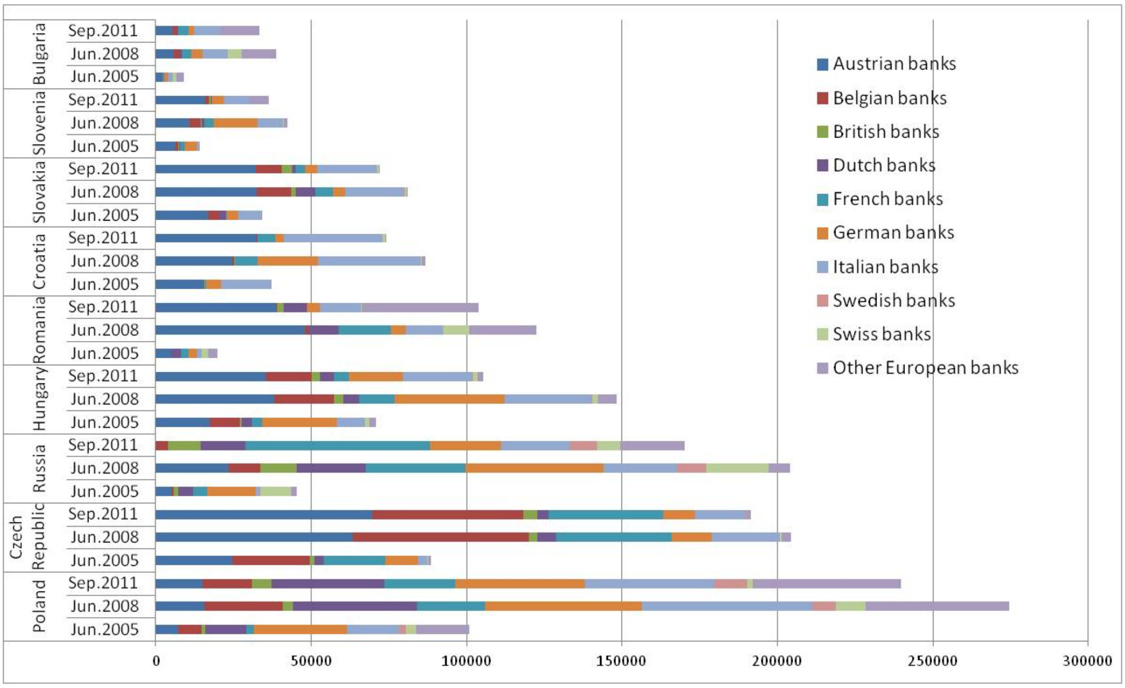
[17] Foreign claims include cross-border claims and local claims of foreign affiliates in both foreign and local currency.

being one of the most troublesome countries in Central and Eastern Europe. After peaking in most European countries in June 2008, foreign bank claims started to plummet in all six countries. However, of that group of countries, Hungary experienced the mildest decline: a drop of 29% in September 2011 as compared to June 2008 (which was also partly caused by more than 10% devaluation of the HUF at the end of 2008). The most striking dynamic was recorded in Greece and Portugal, where European banks reduced their claims on those countries by 64% and 55%, respectively, with the stock of banking claims in Greece falling below the 2005 level.

In the three figures below (Figures 21-23), we take a closer look at the activities of foreign banks in the CESEE countries. Figure 21 and 22 show the structure and dynamics of the consolidated foreign claims of European banks in the region. Poland, the Czech Republic and Russia display the highest levels of foreign claims in their banking sectors. The lowest levels of foreign bank claims are in the countries of the Western Balkans, Baltic States and Ukraine.

Figure 21

Consolidated foreign claims on banks in CESEE countries, USD million



Source: BIS

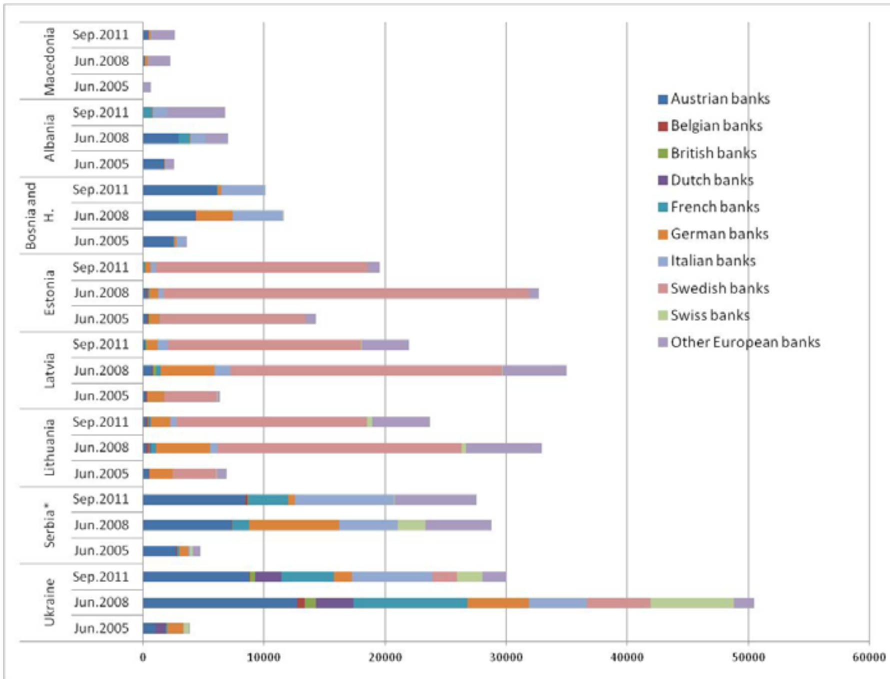
The Austrian, Italian and German banks account for significant shares of foreign bank claims in most countries of the region, with the exception of the Baltic States and some Western Balkan countries. None the less, the CESEE countries are characterized by quite different geographic structures of consolidated foreign bank claims. For example, German and Italian banks dominate the Polish banking sector, while in the Czech Republic the Austrian and Belgian banks play the biggest role.

Russia's banking sector has been using resources drawn primarily from French and German banks, while the banking sectors in the Baltic States are centred on Swedish banks.

Over the period June 2008 – September 2011, the CESEE countries experienced a decline in the foreign bank claims: on average by 17%. Deleveraging occurred in all the countries of the region, albeit at varying speeds. The most marked decline in foreign bank claims - in the range of 28%-40% - occurred in Ukraine, Baltic States and Hungary. At the same time, other countries experienced only a minor decline in their foreign bank claims – ranging from -4% in Serbia and -6% in the Czech Republic to -15% in Romania and -17% in Russia.

Figure 22

Consolidated foreign claims on banks in other CESEE countries, USD million



Source: BIS

If we look at the structure of the consolidated foreign claims broken down by lending banks, the Austrian banks stand out as those most exposed to the region, followed by the Italian and French banks. Together the banking groups in those three countries account for 53% of all foreign bank claims on the CESEE countries. Whereas German banks used to rank third in terms of foreign claims in the region, they rapidly reduced their exposure so that by September 2011 their share had dropped to 10%: 6 p.p. lower than in June 2008. British and Swiss banks are the least exposed in the region.

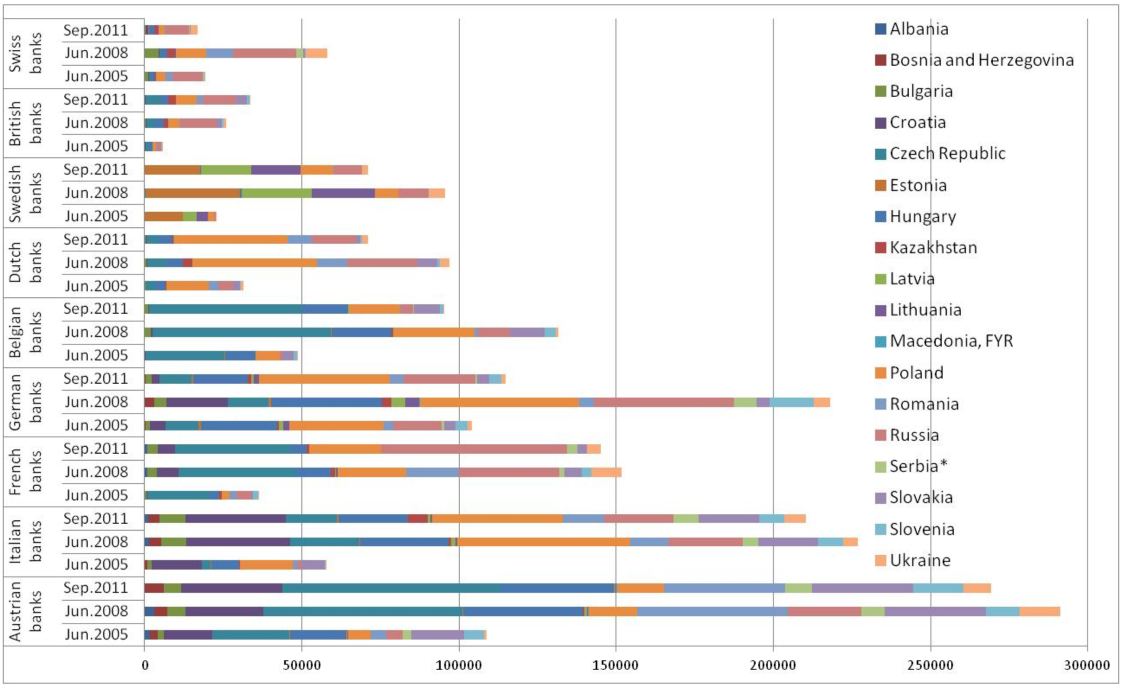
It appears that the European banks tend to concentrate their activities in but a few CESEE countries – the shares of three major countries of destination for foreign bank claims account for 46% in Italy, 54% in Austria, and as much as 82% in France and the Netherlands, and 84% in Belgium. Poland, Russia and Hungary account for significant shares of the foreign claims portfolios in most of the European banks.

Over the period June 2008 – September 2011, all European banks, apart from the British banks, reduced their exposure to the CESEE region. Over the same period, British banks bucked the trend and increased their foreign claims on the region by 30%. Swiss and German banks have been swiftest in withdrawing from the region; they decreased their claims by 71% and 47%, respectively. The Austrian, Italian and French banks, however, decreased their exposure to CESEE countries only slightly – by less than 10%.

It is interesting that the European banks, even those whose foreign claim structures are similar, have targeted different countries to run on. Only the German banks decreased their foreign claims on all the countries of the region, and Hungary and Latvia were the only countries to suffer a decrease in foreign claims by banks from all European countries. For example, while the Swiss banks drastically decreased their exposure to Poland and Russia (by 82% and 63%, respectively), the British banks increased their position in Poland by 93% and the French banks increased their foreign claims on Russia by 86%.

Figure 23

Consolidated foreign claims of European banks, USD million



Source: BIS

In summary, although the banking sectors in the CESEE countries have suffered some deleveraging, it has been on average only quite small-scale, except in Hungary. That was possible due to the small decline in foreign bank claims on the part of the major creditor countries in the region – Austria, Italy and France. However, if all the lending countries were to follow the example of the German and Swiss banks, the region would undergo a much more severe crisis.

Another important observation is that during the crisis the European banks have behaved in many different ways. Dissimilarities in their decisions on changes of exposure to the CESEE countries might be attributed to the banks' subjective perceptions of risk (rather than those based on objective indicators) and the varying performance of individual banks in a given CESEE country.

Spillover through banking centres in Europe

Besides the general reduction of credit to emerging markets for reasons of a change in risk awareness, it is widely assumed that those banks that were deeply involved in countries overly hit by the crisis have found it necessary to reduce their exposure to other emerging markets as well on account of unexpected losses in the former countries. This spillover effect is also termed 'common lender effect'.

Following the methodology of Van Rijckeghem and Weder (2003)[18], we wish to distinguish between those two effects for: (i) a set of European emerging markets from the so called GIIPS group; (ii) the ten EU new member states (NMS); and (iii) six Western Balkan Countries (WBCs). One dimension of the panel data is by European creditor countries - not by time. The creditor countries[19] in question are Austria, Belgium, France, Germany, the Netherlands, Sweden, Switzerland and the United Kingdom. The general public perceives Greece and Hungary as the two countries, whose economies triggered negative spillover effects throughout the region. Those two countries have been excluded from the panel. They act as 'ground-zero-countries' with the potential to cause spillover effects via banking centres that are heavily involved in their economies.
The estimated panel data model has the following structure:

$$\Delta Exposure_{ci} = Exposure_{ci} + Exposure_{c0} + Macro_i + Trade_i + \varepsilon_{ci},$$

where $\Delta Exposure_{ci}$ is the change in the lending of the creditor country's banking sector *c* to the Emerging Europe country *i* over the period September 2008 - September 2011 as a share of the pre-crisis (June 2008) overall exposure to emerging Europe. $Exposure_{ci}$ represents the pre-crisis share of creditor country's claims on the respective emerging Europe country in overall exposure to emerging Europe. The common lender variables are defined as $Exposure_{c0}$. They correspond to the pre-crisis share of the creditor country's claims on Greece and Hungary respectively in overall exposure to emerging Europe. A set of $Macro_i$ control variables consists of the current account and government balance shares in GDP for the year 2007, as well as a real effective exchange rate appreciation rate calculated as a percentage change between the averages of the respective indices in

18 Van Rijckeghem; C. and Weder, B. (2003), "Spillover through banking centres: a panel data analysis of bank flows", *Journal of International Money and Finance*, Vol. 22, No. 4, pp. 483-509.

19 The GIIPS countries were not included in the set of creditor countries as they are already included in the other dimension of the panel, in the group of emerging Europe countries. For the remaining EU or EFTA countries, no creditor data vis-à-vis emerging Europe were forthcoming from BIS.

the period 2004-2006 and the year 2007. A fixed exchange rate country dummy variable has also been included. Finally $Trade_i$ stands for the 2007 export shares of the respective Emerging Europe country to Greece and Hungary respectively in order to check for possible trade-based contagion effects. The data on exposure stem from the BIS database on consolidated claims on an ultimate risk basis. The Macro control variables are taken from the Eurostat and wiiw databases and the trade data from the UN Comtrade database.

The results of the robustly estimated random effects model are summarised in Table 8. Two specifications were estimated: one on the full sample and the other on the sub-sample of NMS and WBCs only. In the first specification, we find a large negative and significant result for the major deleveraging process throughout Europe's periphery. For every additional percentage point of pre-crisis relative exposure of the creditor countries' banking sector to the respective Emerging Europe country, more than a quarter of a percentage point left those countries in the period September 2008 - September 2011, indicating a general wake-up call in line with a revised risk assessment of the region.

Interestingly enough, there is no common lender effect visible among those creditor countries' banks that prior to the crisis were heavily involved in Greece (such as France and Switzerland). There is a common lender effect in the case of Hungary (predominantly Austria but also Belgium), at a significance level of ten per cent. However, this effect is positive, which would indicate that Hungary is not a ground-zero country. For each additional percentage point of creditor countries' pre-crisis exposure to Hungary, economies from emerging Europe received 0.11 percentage points more lending in the period September 2008 – September 2011. This is most likely the positive effect of the European Bank Coordination "Vienna" Initiative (EBCI) that was launched in January 2009 to ensure that parent bank groups maintained their exposure and recapitalise their subsidiaries in the NMS and the WBCs.

Of the macro control variables, only the coefficient of the current account variable is insignificant; the others are at a significance level of ten per cent. The coefficients of government balance, real effective exchange rate appreciation and the fixed exchange rate regime dummy are significant and negative. Since September 2008 those countries that in their pre-crisis boom period had government surpluses (e.g. Spain or Ireland) or low deficits have experienced an additional outflow of funds. This shows that pre-crisis fiscal deficits are not necessarily correlated with subsequent financial outflows. However, those countries that lost competitiveness before the crisis as evidenced by the marked appreciation of their real effective exchange rate were hit by stronger deleveraging on the part of the banking centres. Similarly, those countries with a fixed exchange rate regime were perceived by the markets to be less flexible - and hence a riskier proposition.

Finally, financial contagion did not occur via the trade channel. The pre-crisis trade share with Greece was insignificant and the share with Hungary even positive. Other things being equal, Hungary's main neighbouring trading partners experienced an increase in inflows from the creditor countries throughout the crisis period. This probably relates to the financial markets' conviction that the economies of Central Europe that are closely tied to the German automobile cluster have better prospects of weathering the crisis than other emerging European economies.

Table 8

Spillover model

Dependent variable: Crisis changes in creditor countries' bank exposure to emerging Europe

Sample:	GIIPS, NMS, WBCs	NMS, WBCs
Pre-crisis period explanatory variables:		
Constant	-0.22	0.30
	(0.307)	(0.222)
Relative exposure to emerging market	-0.28	-0.16
	(0.000)***	(0.022)**
Creditor's Greece exposure	0.00	-0.01
	(0.741)	(0.008)***
Creditor's Hungary exposure	0.11	0.11
	(0.060)*	(0.000)***
Current account balance share in GDP	-0.01	0.02
	(0.643)	(0.070)*
Government balance share in GDP	-0.12	0.01
	(0.064)*	(0.913)
Real effective exchange rate appreciation	-0.03	-0.03
	(0.071)*	(0.203)
Fixed exchange rate regime dummy	-0.64	-0.27
	(0.060)*	(0.286)
Export share to Greece	-0.01	-0.01
	(0.347)	(0.363)
Export share to Hungary	0.13	0.06
	(0.004)***	(0.202)
Overall R^2	0.717	0.408
Observations	146	114
Creditor countries	8	8

In the specification of the sub-sample of NMS and WBCs, we find only four coefficients that remain significant. The own-country general deleveraging effect is still significant, but appreciably smaller. The Hungarian common lender effect is also significant and still positive, presumably related to the Vienna Initiative effect for the most part via Austrian banks. However, at present the Greek common lender effect is also significant. The coefficient displays negative traits. For each creditor’s euro of claims on Greece before the crisis, their exposure to NMS and WBCs economies during the crisis was reduced by one cent. This probably relates to the fact that Greek banks are not operating in the GIIPS region, but in a number of WBCs and the NMS. Hence, once again other things being equal, common lenders regarded parts of this region as a riskier proposition. However, the negative spillover is minuscule. Furthermore, we also find the coefficient of the current account balance share in GDP to be both significant and positive. Countries that had a low level of current account deficits before the crisis (mostly on account of higher competitiveness) experienced fewer outflows during the crisis than those countries with huge deficits. However, this effect is also rather limited. If anything, the exercise points to the general deleveraging trend in the European periphery, as well as the positive impact of the Vienna Initiative. Regulators and other institutions agreed on the 13th of March 2012 to coordinate efforts in a new Vienna Initiative 2.0 according to a number of basic principles for home-host authority coordination. However, no concrete actions have been decided as yet. On the contrary, the Austrian Central Bank plans to introduce new funding rules for Austrian banks and their business activities in Eastern Europe. From January 2013 onwards, loan-to-deposit ratios should not exceed 110 percent for new loans. It is still unclear whether the new rules will be accepted by the European Commission or whether they will have a further deleveraging effect, if enforced.

Table BG

Bulgaria: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 [1]	2012	2013 Forecast	2014
Population, th pers., average [2]	7699.0	7659.8	7623.4	7585.1	7534.3	7364.6	7330	7300	7270
Gross domestic product, BGN mn, nom.	51783.1	60184.6	69295.0	68321.6	70474.3	76170	78500	81900	86600
annual change in % (real)	6.5	6.4	6.2	-5.5	0.1	1.6	0	1.3	2.7
GDP/capita (EUR at exchange rate)	3400	4000	4600	4600	4800	5300	.	.	.
GDP/capita (EUR at PPP)	9000	10000	10900	10300	10700	11300	.	.	.
Consumption of households, BGN mn, nom.	34761.9	41300.8	45765.7	42942.1	42844.4	45150	.	.	.
annual change in % (real)	8.7	9.1	3.4	-7.6	-1.3	1.4	1	1.5	2
Gross fixed capital form., BGN mn, nom.	14297.5	17263.9	23282.6	19724.3	16546.4	16000	.	.	.
annual change in % (real)	13.1	11.8	21.9	-17.6	-16.5	-7	0	4	6
Gross industrial production [3]									
annual change in % (real)	6.0	9.6	0.6	-17.4	1.1	4.9	3	5	6
Gross agricultural production (EAA)									
annual change in % (real)	-0.1	-21.0	33.0	-1.6	-5.1	-2.1	.	.	.
Construction industry [4]									
annual change in % (real)	23.9	27.9	12.6	-14.5	-17.9	-12.8	.	.	.
Employed persons - LFS, th, average	3110.0	3252.6	3360.7	3253.6	3052.8	2949.6	2930	2960	3000
annual change in %	4.3	4.6	3.3	-3.2	-6.2	-3.4	-0.7	1.0	1.4
Unemployed persons - LFS, th, average	305.7	240.2	199.7	238.0	348.1	372.3	.	.	.
Unemployment rate - LFS, in %, average	9.0	6.9	5.6	6.8	10.2	11.2	12	11	10
Reg. unemployment rate, in %, end of period [2]	9.1	6.9	6.3	9.1	9.2	10.4	.	.	.
Average gross monthly wages, BGN	360.3	430.6	544.8	609.1	647.4	706.5	.	.	.
annual change in % (real, gross)	3.8	10.3	12.6	8.8	3.8	4.7	.	.	.
Consumer prices (HICP), % p.a.	7.4	7.6	12.0	2.5	3.0	3.4	3	3	3
Producer prices in industry, % p.a.	12.0	7.7	10.9	-6.5	8.6	9.4	.	.	.
General governm.budget, EU-def., % GDP									
Revenues	36.2	40.9	40.0	36.3	34.9	35	.	.	.
Expenditures	34.4	39.8	38.3	40.7	38.1	37	.	.	.
Net lending (+) / net borrowing (-)	1.9	1.2	1.7	-4.3	-3.1	-2	-1.8	-1.5	-1.5
Public debt, EU-def., in % of GDP	21.6	17.2	13.7	14.6	16.3	17.1	18	19	20
Central bank policy rate, % p.a., end of period [5]	3.26	4.58	5.77	0.55	0.18	0.22	.	.	.
Current account, EUR mn	-4648	-7755	-8183	-3116	-476	744	500	0	-500
Current account in % of GDP	-17.6	-25.2	-23.1	-8.9	-1.3	1.9	1.2	0.0	-1.1
Exports of goods, BOP, EUR mn	12012	13512	15204	11699	15561	20097	21400	22800	24800
annual growth rate in %	26.9	12.5	12.5	-23.1	33.0	29.1	6	7	9
Imports of goods, BOP, EUR mn	17574	20757	23802	15873	18325	21942	23500	25500	28000
annual growth rate in %	26.7	18.1	14.7	-33.3	15.4	19.7	7	9	10
Exports of services, BOP, EUR mn	4187	4760	5355	4916	5164	5395	5600	5900	6300
annual growth rate in %	17.5	13.7	12.5	-8.2	5.0	4.5	4	5	7
Imports of services, BOP, EUR mn	3264	3587	4046	3617	3149	2994	3150	3350	3700
annual growth rate in %	18.9	9.9	12.8	-10.6	-12.9	-4.9	5	6	10
FDI inflow, EUR mn	6222	9052	6728	2437	1779	1064	1000	1300	1500
FDI outflow, EUR mn	141	206	522	-68	193	125	.	.	.
Gross reserves of NB excl. gold, EUR mn	8309	11216	11928	11943	11612	11788	.	.	.
Gross external debt, EUR mn	20691	29017	37246	37816	37042	35431	.	.	.
Gross external debt in % of GDP	78.1	94.3	105.1	108.3	102.8	91.0	.	.	.
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.956	1.956	1.956
Purchasing power parity BGN/EUR	0.7456	0.7839	0.8355	0.8712	0.8729	0.9138	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary and wiiw estimates. - 2) From 2011 according to census February 2011. - 3) Enterprises with 10 and more employees. - 4) All enterprises in public sector, private enterprises with 5 and more employees. - 5) Base interest rate. This is a reference rate based on the average interbank LEONIA rate of previous month (Bulgaria has a currency board).

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

Anton Mihailov

Bulgaria:
Heading for a downturn?

According to flash estimates, Bulgaria's GDP grew by 1.6% for 2011 as a whole which was below the earlier expectations. There were visible signs that economic activity was losing pace in the second half of the year both on the supply and on the demand side. While export growth remained in the positive territory, there was a notable slowdown in the second semester. Concomitantly, the pace of manufacturing also decelerated, investment activity continued to decline while private consumption grew only marginally throughout the year.

Overall, against the backdrop or a general economic sluggishness in much of Europe, Bulgaria's export performance in 2011 was quite impressive: according to preliminary data, exports of goods and services in current prices rose by 30.7% for the year as a whole while exports to the EU grew by 33.3%. As to destinations other than the EU, exports to Turkey, Macedonia, Ukraine, Georgia, China, India and Egypt also rose significantly in 2011. Total non-EU exports grew by 24.4%. The structure of Bulgaria's exports is still dominated by minerals and fuels; however, manufactured products including machinery and equipment have been steadily growing in recent years and continued to do so in 2011. Much of the export growth however was recorded in the first half of the year when in some cases monthly exports were growing at a pace of 50% and more year on year. But exports to all destinations were losing steam in the second semester.

The sharp and continuing reduction in the merchandise trade deficit after 2009 was the main factor behind the reversal in the current account balance which turned positive in 2011, after a decade in the red, and alarming proportions in the years prior to the crisis. Ultimately, this outflow of financial resources reflects amortization of external debt by the corporate sector and repayments of foreign funds borrowed by the banks, which is a complete reversal of the flows that prevailed before the crisis. The outflow of funds mirrors both weak domestic demand and a persistent squeeze in new foreign borrowing. Ultimately, the nominal stock of Bulgaria's gross foreign debt dropped both in 2010 and in 2011. As a share of GDP, gross foreign debt fell below the 100% mark in 2011.

So far the Bulgarian banking system has not experienced severe external shocks related to the financial and euro debt crisis. Quite the opposite – and quite ironically – part of the capital flight that has been accompanying the Greek crisis has reportedly been directed to Bulgaria. Apparently, these inflows have contributed to the recent persistent growth of deposits in the Bulgarian banking system which is otherwise difficult to explain in the current weak economic environment. Thus the total stock of deposits in the banking system in December 2011 grew by EUR 1.8 billion (or 11%) over December 2010.

The growth of the deposit base – which is increasingly becoming the main source of financial resources for Bulgarian banks in view of the draining of external resources – was probably one of the factors that contributed to some revival in credit activity in the second half of 2011, after more than two years of credit squeeze. The state of the banks' credit portfolios continued to deteriorate in 2011, with the share of substandard loans reaching 17.4% in December, an increase by 3.2 percentage points from the same month of the previous year. The deterioration was most pronounced as regards mortgage loans whereas there was almost no further increase in the share of bad corporate loans in the second half of the year. Mirroring that, the increase in new bank credit in this period was entirely directed to the corporate sector (the stock of outstanding credit to the corporate sector increased by 4.2% between June and December).

Nominal interest rates were generally on the decline in 2011: thus the annual average long-term interest rate for convergence assessment purposes dropped from 6.0% in 2010 to 5.4% in 2011; the average interest on short-term credit in domestic currency fell from 11.2% to 10.9% and that on new short-term corporate credit fell from 10.2% to 9.6%. Viewed against the producer price index, the real interest rate on new short-term corporate credit in 2011 was close to 0%.

The sluggish economic performance has done little to ease the situation in the labour market and in 2011 employment continued to decline for the third year in a row. More than 400 thousand jobs (some 12% of total employment) have been lost since the start of the crisis. In 2011, the rate of unemployment peaked above 10% (both by registrations and by LFS) for the first time since 2005. While the rate of unemployment in Bulgaria is not among the highest in the EU, some of the underlying long-term and structural factors are worrying. Thus among the EU member countries, Bulgaria has the highest share of young people who are either out of job or out of study or vocational training. Average wages continued to grow in 2011 both in nominal and in real terms but as noted above, this was largely due to job cuts so overall there was no loss in competitiveness in terms of economy-wide unit labour costs.

On paper, public finances in Bulgaria are in a better shape than those in many EU countries but this has come at a very high price. Regrettably, since the start of the crisis, policy has done next to nothing to counter any of the negative economic trends outlined above. The lack of a pro-active stance coupled with excessive fiscal austerity featured also in 2011. One indication of the overall inefficiency of fiscal policy is the fact that the modest recovery in 2011 did not bring about a rise in consolidated public revenue as a share in GDP.

Probably the most damaging development in recent years (which will also have severe long-term implications) has been the continuous curtailing of public investment. Thus public investment expenditure from national sources in 2011 was a mere 44% (in nominal terms) of the spending in 2008. As a share in GDP, national public investment expenditure dropped from 5.4% in 2008 to 2.2%. Public investment financed from EU funds in 2011 was roughly at the same level as in 2010 but was 23% below those planned in the 2011 budget.

The present policy stance seems to be cemented also in the 2012 budget. Moreover, the macroeconomic framework under which the budget was adopted and which envisages 2.9% GDP growth in 2012 already seems outdated and unduly optimistic. It is therefore very likely that actual public revenues in 2012 will fall below the planned figures and major adjustments in spending will be needed. The government's track record suggests that among the most likely candidates for slashing will be the planned expenditure on public investment.

The recent trends suggest a significant slowdown in the Bulgarian economy and there are no solid arguments for optimism for the year 2012. Much will depend on whether the EU as a whole will manage to arrest the downturn but, given the recent downgrading of most forecasts, the likelihood of a turnaround in Europe as a whole is not very high.

In the present circumstances and in the absence of a more pro-active domestic policy, there are no visible growth drivers in the Bulgarian economy in the short term: the short-lived phase of export-led growth seems to be coming to an end while domestic demand, which was sluggish anyway, seems to be weakening further. Exports to non-EU countries may be less affected in the short run but probably this will not be sufficient to generate an economy-wide pull effect. Unless there is a reversal in these factors, the Bulgarian economy is likely to stagnate in 2012, bringing about further deterioration in the labour market situation. The net outflow of financial resources is likely to continue in 2012; coupled with weak domestic demand, this should keep the current account balance slightly positive or close to zero. The ongoing increase in substandard loans in the banking system is one of the worrying recent developments. While the situation still seems to be under control, it calls for careful monitoring of future developments.

Even if the external conditions start improving in 2012, no miracles can be expected in the outlook for 2013 and 2014. The net outflow of financial resources seems to have become a lasting trend related to the overall process of financial and macroeconomic rebalancing in Europe and is likely to continue in the following years. Even if EU demand for Bulgarian exports rebounds in 2013 and 2014, its potential role as a pull factor will be relatively limited due to constraining domestic supply factors. In an optimistic scenario, one can also expect a recovery in investor and consumer confidence. However, even if this materializes, it is likely to be a gradual process without a significant effect on domestic economic activity.

Table CZ

Czech Republic: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 1)	2012	2013 Forecast	2014
Population, th pers., average	10269	10334	10424	10487	10520	10540	10580	10610	10640
Gross domestic product, CZK bn, nom.	3352.6	3662.6	3848.4	3739.2	3775.2	3835	3930	4060	4260
annual change in % (real)	7.0	5.7	3.1	-4.7	2.7	1.8	0.5	2.5	3.5
GDP/capita (EUR at exchange rate)	11500	12800	14800	13500	14200	14800	.	.	.
GDP/capita (EUR at PPP)	18900	20700	20200	19300	19400	20100	.	.	.
Consumption of households, CZK bn, nom.	1604.5	1719.7	1856.7	1852.5	1871.8	1860	.	.	.
annual change in % (real)	4.3	4.1	3.0	-0.5	0.6	-0.4	-0.5	1.5	2.5
Gross fixed capital form., CZK bn, nom.	860.2	989.6	1031.2	927.5	923.0	920	.	.	.
annual change in % (real)	5.8	13.3	4.1	-11.5	0.2	-0.3	0.5	4	6
Gross industrial production									
annual change in % (real)	8.3	10.6	-1.9	-13.6	10.3	6.9	4	8	8
Gross agricultural production (EAA)									
annual change in % (real)	-4.2	3.1	6.8	-3.6	-7.0	7.1	.	.	.
Construction industry									
annual change in % (real)	6.1	7.0	-0.2	-0.8	-7.1	-3.1	-3	2	3
Employed persons - LFS, th, average	4828.1	4922.0	5002.5	4934.3	4885.2	4904.9	4910	4930	4950
annual change in %	1.3	1.9	1.6	-1.4	-1.0	0.4	0.2	0.5	0.5
Unemployed persons - LFS, th, average	371.7	276.6	229.8	352.2	383.5	353.6	.	.	.
Unemployment rate - LFS, in %, average	7.2	5.3	4.4	6.7	7.3	6.8	7.0	7	6.5
Reg. unemployment rate, in %, end of period	7.7	6.0	6.0	9.2	9.6	8.6	.	.	.
Average gross monthly wages, CZK 2)	19546	20957	22592	23344	23797	24420	.	.	.
annual change in % (real, gross)	4.0	4.3	1.4	2.3	0.4	0.4	0.5	1	2
Consumer prices (HICP), % p.a.	2.1	2.9	6.3	0.6	1.2	2.2	3.2	2	2
Producer prices in industry, % p.a.	0.1	2.6	0.4	-1.5	0.1	3.7	.	.	.
General governm. budget, EU-def., % GDP									
Revenues	39.6	40.3	38.9	39.1	39.3	39.8	.	.	.
Expenditures	42.0	41.0	41.1	44.9	44.1	43.5	.	.	.
Net lending (+) / net borrowing (-)	-2.4	-0.7	-2.2	-5.8	-4.8	-3.7	-4.0	-3.5	-3.0
Public debt, EU-def., in % of GDP	28.3	27.9	28.7	34.4	37.6	40.5	44	46	46
Central bank policy rate, % p.a., end of period 3)	2.50	3.50	2.25	1.00	0.75	0.75	0.75	1.0	1.5
Current account, EUR mn	-2391	-5671	-3297	-3428	-4664	-3269	-3200	-3300	-3500
Current account in % of GDP	-2.0	-4.3	-2.1	-2.4	-3.1	-2.1	-2.0	-2.0	-2.0
Exports of goods, BOP, EUR mn	68107	77595	84845	70983	88076	100371	110000	123000	139000
annual growth rate in %	17.9	13.9	9.3	-16.3	24.1	14.0	10	12	13
Imports of goods, BOP, EUR mn	66021	75922	83811	67684	85985	95845	104000	115000	130000
annual growth rate in %	17.5	15.0	10.4	-19.2	27.0	11.5	9	11	13
Exports of services, BOP, EUR mn	11282	12643	14910	13924	15812	15898	16000	18000	20000
annual growth rate in %	18.2	12.1	17.9	-6.6	13.6	0.5	3	10	10
Imports of services, BOP, EUR mn	9556	10512	11949	11126	12839	13200	14000	15000	17000
annual growth rate in %	15.4	10.0	13.7	-6.9	15.4	2.8	3	10	10
FDI inflow, EUR mn	4363	7667	4467	2082	5104	3687	3000	4000	4000
FDI outflow, EUR mn	1172	1187	2964	685	1283	570	1300	1300	1300
Gross reserves of NB excl. gold, EUR mn	23684	23456	26386	28556	31357	31000	.	.	.
Gross external debt, EUR mn	43513	51744	60511	61940	71379	78000	.	.	.
Gross external debt in % of GDP	36.8	39.2	39.2	43.8	47.8	50.0	.	.	.
Average exchange rate CZK/EUR	28.34	27.77	24.95	26.44	25.28	24.59	25.00	24.75	24.50
Purchasing power parity CZK/EUR	17.24	17.17	18.24	18.46	18.47	18.13	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees, including part of the Ministry of Defence and the Ministry of the Interior. From 2009 all enterprises covered. - 3) Two-week repo rate.

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

Leon Podkaminer

The Czech Republic:
Self-inflicted pain

GDP growth has been slowing down throughout 2011, from over 3% in the first quarter of the year to an estimated 0.5% in the last. Consumption, both private and public, has been contracting throughout the year at ever faster speed. In the first quarter private consumption fell 0.1% and public consumption by 0.3%: in the fourth quarter the estimated rates of contraction were already 0.7% and 4.4% respectively. Gross capital formation still increased in the first half of 2011 (chiefly on account of strongly increasing stocks), only to decline precipitously in the second half of the year (this time primarily due to plummeting stocks, with gross fixed capital formation down by about 1%). Foreign trade developments also show clear signs of deterioration. In the first quarter the volumes of exports and imports of goods and services rose by 19.3% and 18.7% respectively: in the fourth quarter the respective growth rates were, according to provisional estimates, 6.2% and 0.8%. Overall, the current estimates suggest that the GDP growth in 2011 was about 1.7-1.8%. The contribution of foreign trade to the overall growth was about 2.8 percentage points (p.p.). The contributions of all other expenditure items were negative (private consumption -0.2 p.p., public consumption -0.5 p.p., gross fixed capital formation -0.1 p.p. and change in stocks -0.2 p.p.).

Even though inflation (driven by hikes in indirect tax rates and in prices of imported energy carriers) surpasses its 2% target, the Czech National Bank keeps the policy rate at 0.75%. The interest rate on three-month interbank loans has been stable at slightly over 1% which shows that the money market conditions are about normal. Interest rates on loans to non-financial corporations are low and falling (recently at 2.7% on average), interest rates on lending to households are also declining and fairly low especially on mortgage loans (for example, the average interest rate on new mortgage loans extended for 5 to 10 years was 4.1% in November 2011). The financial standing of the banking sector remains very strong, with the most recent Capital Adequacy Ratio of 15.7% (as of end-September 2011). Non-performing loans (currently 5.3% of the stock of loans to households, 8.5% of the stock of loans to corporations) have been creeping upwards. However, even if a 'double dip' scenario materializes, the whole banking sector's stability would not – according to the recent stress tests carried out at the Czech National Bank – be seriously jeopardized. The sector should retain the ability to perform its functions vis-á-vis the real economy, even if its profits get squeezed[20]. (But of course, some of the foreign-owned banks may be ordered to concentrate on helping their 'ailing parents' in the euro area.)

Low nominal interest rates and the strong banking sector did not lead to a monetary expansion. Money supply (M3) stock rose by a mere 3.1% in 2011, with the stock of loans to households rising

[20] In the first three quarters of 2011 banks' net profit fell nominally by some 3.5% over the same period of 2010. (In current euro terms the net profits remained constant at about EUR 1.7 billion.)

by 5.3% and to the corporate sector by 5.8%. Neither households nor the corporate sector are in any way over-indebted (the stock of the non-financial private sector's debt falls short of 55% of the GDP). The stagnant demand for loans reflects the negative growth in real incomes of households and in the operating surplus of the corporate sector. These latter developments could only be expected given the orientation of the fiscal policy.

To gain some understanding of the current trends, one has to consider the socio-economic agenda of the current liberal-conservative government (in power since mid-2010). In economic terms that agenda envisages further liberalization of regulations restricting labour market flexibility and entrepreneurship. Operationally, fiscal consolidation has been the highest priority.[21] Active measures carried out to restrict the public sector deficits amounted to about 2.8% of the GDP in 2010. According to the Finance Ministry's *Convergence Programme of the Czech Republic* (April 2011)[22], further measures to be carried out in 2011 were to amount to another 2.1% of the GDP. These measures, including cuts in social benefits, in the public sector wage bill, and other expenditures (as well as further hikes in indirect tax rates) were to push the deficit to 4.2% of the GDP in 2011. In actual fact the deficit in 2011 may have been as low as 3.5%. But that 'success' seems to have come at the expense of the unexpected real growth slowdown and accelerating contraction of consumption and investment. Indeed, the Ministry's July 2011 expectations for 2011 stipulated positive growth in private consumption (+0.5%) and gross fixed capital formation (+1.9%). It foresaw a rise in domestic demand (+0.6%) and a 1.9 p.p. contribution of foreign trade to the overall GDP growth (which was to reach 2.5%). In actual fact domestic demand fell by 1% while the contribution of foreign trade to the eventual 1.7% GDP growth reached 2.8%.

The performance of foreign trade prevented a deep recession in 2011. Some mild nominal (and more pronounced real effective) depreciation of the Czech koruna in the fourth quarter of 2011 may have played a role in supporting growth of exports and – more importantly – in limiting growth of imports. The fact that exports expanded quite strongly even in the fourth quarter of 2011 seems to indicate that the fears about the overall growth slowdown in the euro area (and Germany in particular) may have been exaggerated, so far. Under the assumption of continuing 'muddling through' in the euro area, the Czech economy could avoid recession in 2012. Growth in Czech imports would then be strongly depressed by falling, or stagnant, domestic demand while exports may continue to rise, even though at very moderate rates. Of course, a full-scale recession in the euro area would have devastating effects on Czech exports and overall GDP growth (as in 2009 when exports fell close to 11% in real terms, thereby helping to push the Czech GDP down by over 4%). Worse still, if exports are hit by recession in the euro area, the current government's likely response may be to *tighten* its fiscal stance (for example by raising indirect taxes) so as to offset the shortfall of budgetary revenue.

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21 TOP 09, one of the three parties forming the ruling coalition, proudly designates itself as 'fiscally conservative'. The Finance Minister, Miroslav Kalousek, is one of the leaders of the party (which is chaired by Prince Karel Schwarzenberg).

22 The substance and goals of the Czech government's fiscal consolidation programme were detailed in *wiiw Current Analyses and Forecasts*, Issue 8 (July 2011).

With the public debt/GDP ratio less than 41%, the Czech Republic would seem to be in no need to enforce radical cuts in current public sector expenditures. The burden of servicing public debt is low and the government does not need to worry about financing its long-term debt (at about 3.4% the yields on this debt are fairly low). The reasons why – given such circumstances – the authorities felt compelled to start a multi-year fiscal consolidation programme go beyond standard macroeconomics. Apparently, the leading politicians believe in some sort of 'supply-side economics'. Right now external conditions diverge from the benign scenario assumed two years ago, at the inception of the programme. Yet this divergence does not result in any visible relaxation of the fiscal policy stance. This inflexibility can have many reasons. One of them is the fact that Czech society at large seems to be able to tolerate bad policy longer than elsewhere.[23] In May 2011 the Czech Trade Unions did try to organize a general strike to protest the course of economic policy: the attempt failed rather miserably. The fact that so far unemployment statistics do not show much deterioration on the labour market also blunts the public propensity to voice discontent.[24]

Should the euro area continue to 'muddle through' and thus avoid deep recession in 2012, the Czech economy would escape recession as well. But its growth in 2012 will be depressed by the stubborn attempts to meet the fiscal targets, no matter what. A euro area recovery in 2013 and beyond would naturally (by way of stronger demand for imports) help speed up growth in the Czech Republic. In addition, the fiscal consolidation measures will by then become less intense (also because of the next regular parliamentary elections to be held in 2014). Good financial standing of the banking and corporate sectors, relatively low level of household debt, combined with competent policy of the Czech National Bank (determined to keep a very relaxed policy even in face of temporary hikes in inflation) should, by then, help accelerate growth – first of investments and then of private consumption and overall GDP.

23 On the same principle the public seems to have become used to endemic corruption in high places.

24 The Czech economy still disposes of a labour market 'safety valve' in the form of a pool of foreign workers (at least 6% of total employment). In 2011 total employment rose (marginally), but the estimated number of foreign workers employed fell by about 2%. Another development bearing on unemployment figures is the tendency for an increase in the number of 'entrepreneurs and self-employed'.

Table EE

Estonia: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 [1]	2012	2013 Forecast	2014
Population, th pers., average [2]	1343.5	1341.7	1340.7	1340.3	1340.2	1317.5	1311	1305	1298
Gross domestic product, EUR mn, nom.	13390.8	16069.4	16304.2	13839.6	14305.3	16200	17100	18500	20200
annual change, % (real)	10.0	7.5	-3.6	-14.3	2.2	7.5	1.9	4	5
GDP/capita (EUR at exchange rate)	10000	12000	12200	10300	10700	12300	.	.	.
GDP/capita (EUR at PPP)	15600	17500	17300	14900	15700	17400	.	.	.
Consumption of households, EUR mn, nom.	7254.1	8517.0	8656.9	7200.8	7235.1	7800	.	.	.
annual change in % (real)	13.5	8.8	-6.4	-16.1	-1.7	4.1	2	2.2	3
Gross fixed capital form., EUR mn, nom.	4817.4	5710.3	4846.6	2972.8	2693.7	3350	.	.	.
annual change in % (real)	23.0	9.3	-15.1	-37.8	-9.1	20	6	7	9
Gross industrial production									
annual change in % (real)	9.9	6.4	-5.2	-24.0	20.9	17.8	3	8	10
Gross agricultural production (EAA)									
annual change in % (real)	-2.1	12.5	-1.2	2.8	-4.0	1.3	.	.	.
Construction industry									
annual change in % (real)	26.9	13.5	-13.3	-29.8	-12.4	22.2	.	.	.
Employed persons - LFS, th, average	646.3	655.3	656.5	595.8	570.9	609.2	615	630	640
annual change in %	6.4	1.4	0.2	-9.2	-4.2	6.7	1	2	2
Unemployed persons - LFS, th, average	40.5	32.0	38.4	95.1	115.9	86.9	.	.	.
Unemployment rate - LFS, in %, average	5.9	4.7	5.5	13.8	16.9	12.5	11.5	10	9
Reg. unemployment rate, in %, end of period	1.9	2.2	4.6	13.3	10.1	7.3	.	.	.
Average gross monthly wages, EUR	601	725	825	784	792	831	.	.	.
annual change in % (real, gross)	11.6	13.0	3.2	-4.9	-1.8	-0.1	.	.	.
Consumer prices (HICP), % p.a.	4.5	6.7	10.6	0.2	2.7	5.1	3.3	3.8	4
Producer prices in industry, % p.a.	4.2	8.1	8.0	0.7	3.2	4.3	.	.	.
General governm. budget, EU-def., % GDP									
Revenues	36.1	36.4	36.5	43.2	40.9	39.3	38.5	39.5	39.0
Expenditures	33.6	34.0	39.5	45.2	40.6	38.0	40.5	40.0	38.5
Net lending (+) / net borrowing (-)	2.5	2.4	-2.9	-2.0	0.3	1.3	-2.0	0.5	0.5
Public debt, EU-def., in % of GDP	4.4	3.7	4.5	7.2	6.7	5.5	7	6	5
Central bank policy rate, % p.a., end of period [3]	3.76	7.03	7.02	2.83	0.92	1.00	.	.	.
Current account, EUR mn	-2053	-2563	-1577	513	513	498	0	-300	-500
Current account in % of GDP	-15.3	-15.9	-9.7	3.7	3.6	3.1	0	-1.6	-2.5
Exports of goods, BOP, EUR mn	7774	8132	8542	6551	8777	12084	12900	14300	16300
annual growth rate in %	22.5	4.6	5.0	-23.3	34.0	38	7	11	14
Imports of goods, BOP, EUR mn	10078	10774	10664	7109	9028	12251	13200	14700	17300
annual growth rate in %	27.6	6.9	-1.0	-33.3	27.0	36	8	11	18
Exports of services, BOP, EUR mn	2871	3289	3537	3174	3422	3974	4100	4400	4900
annual growth rate in %	9.9	14.6	7.5	-10.3	7.8	16	3	7	11
Imports of services, BOP, EUR mn	1980	2247	2293	1815	2109	2696	2800	3000	3400
annual growth rate in %	11.7	13.5	2.0	-20.8	16.2	28	4	7	13
FDI inflow, EUR mn	1432	1986	1181	1323	1162	249	.	.	.
FDI outflow, EUR mn	880	1277	761	1115	100	-1121	.	.	.
Gross reserves of NB excl. gold, EUR mn [4]	2115	2236	2814	2758	1904	150	.	.	.
Gross external debt, EUR mn	12944	17406	19039	17256	16481	15650	.	.	.
Gross external debt in % of GDP	96.7	108.3	116.8	124.7	115.2	96.6	.	.	.
Average exchange rate EUR/EUR	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1	1	1
Purchasing power parity EUR/EUR	0.6388	0.6834	0.7020	0.6922	0.6808	0.7060	.	.	.

Note: Estonia has introduced the Euro from 1 January 2011. Up to and including 2010 all time series in EKK as well as the exchange rates and PPP rates have been divided for statistical purposes by the conversion factor 15.6466 (EKK per EUR) to a kind of statistical EUR (euro-fixed). Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Account of Agriculture (EAA).

1) Preliminary and wiiw estimates. - 2) Estimation based on population census 2011. - 3) From 2011 official refinancing operation rates for euro area (ECB), TALIBOR one-month interbank offered rate before (Estonia had a currency board). - 4) From January 2011 (Euro introduction) only foreign currency reserves denominated in non-euro currencies.

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

Sebastian Leitner

Estonia:
Weakness of external demand will drag down strong recovery

The first year after the accession to the eurozone saw a very strong revival of economic activity in Estonia with a GDP growth rate of 7.5% in real terms. Goods exports rose by almost 40% in nominal terms year on year, particularly fast to Russia and Sweden, but also to other Northern European countries (except for Finland and Germany). The nominal level of exports in 2011 already surpassed the pre-crisis level of 2008 by more than 40% in nominal terms. Also total industrial production grew for the second year by almost 20%, thus Estonian companies started raising their investments again after the economic crisis. Strong impulses came from the manufacturing sector, which more than doubled its purchases for new equipment. Even construction activity, although still on a much lower level than before the crisis, regained momentum and grew by more than 20% in 2011. Another important driver of high GDP growth was household consumption, which rose by about 4% in real terms, triggered by the revival of employment growth.

However, the figures for the 4th quarter of 2011 already showed that external demand is substantially losing momentum, especially in Germany, and even declining nominally in Sweden. The latter is also due to the economic troubles of the mother company of Elcoteq Tallinn, the latter being one of the main Estonian exporters performing assembly work predominantly for Swedish electronics producers. The mother company went bankrupt in October 2011; by the end of January 2012 three investors expressed interest in taking over the profitable Tallinn subsidiary. Thus the continuation of the production site currently working below capacity seems assured. For 2012 in general, however, the external demand of the EU markets will be much weaker than last year following the European-wide fiscal consolidation process and the cautious credit supply of the EU banking sector. Thus we expect export growth to decline substantially.

In 2011 the labour market showed a remarkable recovery. Although the overall employment level is still about 6% below the 2008 peak, the growth rate amounted to 6.7% in 2011. New jobs were created in manufacturing in particular, but also in transport and communications and in construction, while the public service sectors have not been hiring new staff. The unemployment rate fell by more than 4 percentage points to 12.5% in 2011 on average. As economic growth will dwindle this year, a further improvement of the labour market situation will take a longer time.

Corresponding to the revival in the labour market also gross wages recovered and contributed to the above-mentioned upswing of household consumption in 2011. Since sluggish external demand will also reduce the growth of income in 2012, consumer expectations and those of the retail sector have already declined in the past three months. Nevertheless, we expect that household consumption will still be growing in 2012, although by only 2% in real terms.

With lower growth of wages and a decline in Europe-wide growth of demand, the rise in prices of imported and home-produced goods should decline. While in 2011 the revival of economic growth together with rising prices of imported oil products caused consumer prices to increase by slightly above 5% p.a., for 2012 the inflation rate is expected to amount to only 3.3%.

Although investments increased strongly in 2011, both the corporate and the household sector were still in a process of deleveraging. The combined debt of non-financial enterprises and households declined from 103% of GDP in December 2009 to 80% at the end of 2011; at the same time the gross external debt of the Estonian economy fell from 125% of GDP to slightly below 100%. It should be pointed out that the Estonian share of non-performing loans of 4.5% of total loans is the lowest among the new EU member states.

With economic activity strongly reviving, government revenues increased and the fiscal year 2011 once again ended with a surplus of the general government of more than 1% of GDP. The budget of 2012 foresees a deficit of about 2%, since public investments and social expenditures are planned to rise by about 10%. Moreover, the defence budget is raised to 2% of GDP. In the years thereafter the deficit is to decline again.

The medium-term economic outlook for 2013 and 2014 holds many uncertainties. The value of Estonian goods and services exports amounts to 100% of GDP, which highlights the strong dependence of economic activity on developments in external markets. Thus even the forecast for 2012 could easily change for the better or worse within the coming months. The insecurity concerning the financial and demand developments in the European Union could bring about an even stronger decline of external demand. However, the latest figures on economic activity in Northern European countries and the USA in early 2012 could be interpreted as a sign that the recessionary expectations prevailing at the end of 2011 may have been too gloomy. In any case, having reduced the external imbalances of the pre-crisis period to a large extent, the Estonian economy today is less vulnerable to shocks in financial markets; also, a worldwide trade deterioration as experienced in 2008 is not likely to come about. Thus we expect that 2012 will be a year of slow GDP growth of only 1.9%. In 2013 and 2014 a slight revival of external demand should bring forth again a positive contribution of net trade, which is expected to give some impulse also to an increase of corporations' investments. Assuming that the growth slowdown in 2012 will cause no major job cuts in the manufacturing sector, we are likely to see a swifter rise in wages again in 2013 and 2014 since the potential of skilled labour force is quite scarce in Estonia. Thus also the growth of household demand is likely to recover rather quickly.

Sándor Richter

Hungary:
Economic policy turn ahead?

In mid-November 2011 the Hungarian government announced that it would turn to the IMF and the EU for assistance. Why does Hungary need a new agreement with the IMF and the EU? While the Hungarian economy without doubt struggles with serious problems, its general condition in early 2012 is much better than it was in the critical days of October 2008, when the country turned to the IMF-EU tandem last time. Foreign currency reserves are now more than twice as high as then, the current account balance is in surplus and banks have sufficient liquidity. The reason is that one and a half years after its landslide election victory, Prime Minister Victor Orbán and his ‘unconventional’ economic policy, a centrepiece of Mr. Orbán’s political credo, face a massive loss of confidence in the international community.

Confining the issues discussed here to those of economic relevance, the list of troubles begins with the increasing confrontation with the European Union. Some laws adopted in the legislative rush of the last months of 2011 have been found by experts of the Commission to be in conflict with EU law. These include the flat personal income tax and the status of the central bank – laws where amendment needs a 2/3 majority. The PM’s claim to tie in this way the hands of the next governments over more legislative periods ahead was not welcome by the EU. The second front in the EU-Hungary confrontation is that of the budget. Hungary has been under the Excessive Deficit Procedure since its entry to the EU, the longest time for any EU member. Though Hungary’s general government deficit will remain, even in the judgement of the Commission, below 3% of the GDP this year, the Commission is of the (justified) opinion that Hungary’s fiscal stance is not sustainable in the medium term. The required maximum 3% GDP proportional deficit cannot be observed in 2013 without fiscal adjustments. This opinion of the Commission may have grave consequences: in the absence of further fiscal consolidation Hungary may lose one third of the transfers from the Cohesion Fund of the Community budget. In money terms, that equals a loss of nearly EUR 500 million between 2013 and 2015. The third frontline is the EU’s new ‘six pack’ governance package. In the first ‘Alert Mechanism Report’ Hungary was placed in the group of member states where an in-depth analysis of the economic situation has been initiated by the Commission to investigate imbalances and emerging risks. Of Hungary’s peers in the region, only Slovenia and Bulgaria are in this group.

Apart from the confrontation with the EU, Hungary has repeatedly received critical remarks from the US. Although this criticism is predominantly focused on the dismantling of western-style democracy in Hungary, the economic consequences that may appear during the forthcoming negotiations with the IMF are not negligible. Hungary’s position in the global arena has deteriorated as well. In January 2011 also Fitch Ratings, the last of the three leading credit rating agencies where Hungary had still been in the investment category, downgraded Hungary’s sovereign debt to junk.

Table HU

Hungary: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 1)	2012	2013 Forecast	2014
Population, th pers., average	10071	10056	10038	10023	10000	9960	9940	9920	9900
Gross domestic product, HUF bn, nom.	23675.9	24991.8	26545.6	25622.9	26747.7	28150	29100	30500	32100
annual change in % (real)	3.9	0.2	0.9	-6.8	1.3	1.7	-1	2	3
GDP/capita (EUR at exchange rate)	8900	9900	10500	9100	9700	10100	.	.	.
GDP/capita (EUR at PPP)	14900	15400	16000	15200	15800	16400	.	.	.
Consumption of households, HUF bn, nom.	12369.8	13363.6	13985.5	13568.3	13854.2	14300	.	.	.
annual change in % (real)	2.0	1.0	-0.5	-6.4	-2.1	0	-1.5	0	2
Gross fixed capital form., HUF bn, nom.	5148.0	5444.2	5760.0	5295.2	4806.3	4750	.	.	.
annual change in % (real)	-2.7	3.8	2.9	-11.0	-9.7	-4.5	-1	2	3
Gross industrial production									
annual change in % (real)	9.9	7.9	-0.2	-17.6	10.5	5.4	3	4	8
Gross agricultural production (EAA)									
annual change in % (real)	-3.0	-12.5	27.7	-10.3	-11.5	9.4	.	.	.
Construction industry									
annual change in % (real)	-0.7	-14.0	-5.2	-4.4	-10.4	-7.7	0	5	8
Employed persons - LFS, th, average	3930.0	3926.2	3879.4	3781.8	3781.2	3811.9	3810	3830	3850
annual change in %	0.7	-0.1	-1.2	-2.5	0.0	0.8	0	0.5	0.5
Unemployed persons - LFS, th, average	316.7	312.0	329.1	420.7	474.8	467.9	.	.	.
Unemployment rate - LFS, in %, average	7.5	7.4	7.8	10.0	11.2	10.9	11	10.5	10
Reg. unemployment rate, in %, end of period	9.1	10.1	10.9	13.6	13.3	12.5	.	.	.
Average gross monthly wages, HUF 2)	171351	185018	198741	199837	202525	213054	.	.	.
annual change in % (real, net)	3.6	-4.6	0.8	-2.3	1.8	2.4	.	.	.
Consumer prices (HICP), % p.a.	4.0	7.9	6.0	4.0	4.7	3.9	5	3.5	3.1
Producer prices in industry, % p.a.	6.6	0.3	4.6	4.5	6.3	2.5	.	.	.
General governm.budget, EU-def., % GDP									
Revenues	42.7	45.6	45.5	46.9	45.2	52.0	.	.	.
Expenditures	52.1	50.6	49.2	51.4	49.5	48.5	.	.	.
Net lending (+) / net borrowing (-)	-9.4	-5.1	-3.7	-4.5	-4.3	3.5 3)	-3	-3	-3
Public debt, EU-def., in % of GDP	65.9	67.0	72.9	79.7	81.3	80.3	81	80	79
Central bank policy rate, % p.a., end of period 4)	8.00	7.50	10.00	6.25	5.75	7.00	.	.	.
Current account, EUR mn	-6634	-7224	-7728	-153	1061	2000	2200	1800	1100
Current account in % of GDP	-7.4	-7.3	-7.3	-0.2	1.1	2.0	2.2	1.7	1.0
Exports of goods, BOP, EUR mn	58378	67811	72043	57397	68964	79300	85600	95000	105500
annual growth rate in %	17.5	16.2	6.2	-20.3	20.2	15	8	11	11
Imports of goods, BOP, EUR mn	60840	68500	73233	55028	65735	74600	80200	87800	97000
annual growth rate in %	16.5	12.6	6.9	-24.9	19.5	13.5	7.5	9.5	10.5
Exports of services, BOP, EUR mn	10876	12574	13804	13305	14642	15370	16000	17600	19400
annual growth rate in %	5.1	15.6	9.8	-3.6	10.0	5	4	10	10
Imports of services, BOP, EUR mn	9447	11231	12287	11319	11735	12320	12800	13800	14900
annual growth rate in %	3.4	18.9	9.4	-7.9	3.7	5	4	8	8
FDI inflow, EUR mn	5468	2861	4225	1140	1363	-1000	.	.	.
FDI outflow, EUR mn	3118	2646	1503	1321	942	400	.	.	.
Gross reserves of NB, excl. gold, EUR mn	16384	16305	23807	30648	33667	37655	.	.	.
Gross external debt, EUR mn	86681	103988	123454	136879	137602	139000	.	.	.
Gross external debt in % of GDP	96.8	104.6	117.0	149.8	141.7	137.9	.	.	.
Average exchange rate HUF/EUR	264.26	251.35	251.51	280.33	275.48	279.37	295	290	285
Purchasing power parity HUF/EUR	157.79	161.74	165.55	168.29	169.20	172.32	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary and wiiw estimates. - 2) Enterprises with 5 and more employees. - 3) Including the one-off effect of nationalisation of the private pension funds' assets. Without that effect general government buget balance is forecast to attain -5.5% of the GDP. - 4) Base rate (two-week NB bill).

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

The above-described worsening of Hungary's international position went hand in hand with a deterioration of important economic indicators. The exchange rate of the forint had been weakening continuously since the summer of 2011 with a sudden breakdown in early January, when the HUF/EUR rate surpassed the weakest quotation of the forint during the climax of the crisis in early 2009. Despite the relaxation experienced since then, the exchange rate has remained weak and volatile. By the end of 2011 Hungary's CDS spreads ranged between 600 and 700 basis points, also surpassing the values recorded in the worst days in 2009. Moreover, while in 2009 Hungary moved in unison with its peers in the region, this time there is a huge and growing difference compared to those countries. Finally, Hungary's sovereign foreign currency bond spreads rose from 250 basis points in April 2011 to close to 900 basis points by the end of last year. It is important to mention here that positive expectations of the markets concerning the outcome of the (not yet started) negotiations between the government and the IMF/EU improved both the CDS spreads and the bond yields in February. The exchange rate depreciation, the high CDS spreads and bond yields, and the slowdown of FDI inflow indicate clearly a crisis of confidence. Even if an unambiguous causality cannot be proved, the political attitude of the Orbán government may be the main factor behind the weakened confidence. Major elements of this attitude are the confrontational course of the government with the EU at various junctures, the chasing away of and the return to the IMF, hostile rhetoric towards banks and towards foreign ownership more generally (though not in manufacturing sectors), retroactive taxes, lack of dialogue with social partners, unpredictability and, last but not least, the generally perceived weakened rule of law. The government claims, to some extent with good reasons, that what it really needs from the IMF and the EU is not financial assistance but a sort of insurance that Hungary is 'OK' and international investors have no reason not to trust this government. The problem is that neither the IMF nor the EU will be ready to underwrite this as long as they are not convinced that Hungary is on the way back to sustainable fiscal policy and accepts classic values of a western-type market economy and democracy. Whether the Orbán government will be ready to accept this (or will eventually be unable not to comply) is currently (early March 2012) an open question. An agreement (with all the typical conditionalities) may help to restore confidence in Hungary relatively soon. Should the negotiations collapse (or even not be started in the first place) the negative phenomena recorded in the second half of 2011 and in early 2012 may reappear and lead to a drying-out of the market for Hungarian government securities, or the interest to be paid remains so high that a lasting market-based financing of the debt rollover results in an unsustainable increase of public debt. In the latter case, an accelerating negative spiral may lead to Hungary's insolvency. In that scenario a return to the negotiation table with the IMF and the EU is again an option. The other option is the uncontrolled default.

This gloomy picture is, however, not in strict accord with that revealed by macroeconomic data. In 2011 GDP expanded by 1.7%, a relatively good performance in the EU-27. The only contribution to economic growth may have come from net exports. Private consumption, after declining three years in a row, may have stagnated last year. In gross fixed capital formation the trend is improving, but even that means only a slower, yet significant, pace of contraction compared to the previous two years. Some contribution to growth came from industry, where the rate of expansion was nevertheless only half of that in 2010. Contrary to the weak performance in 2009 and 2010, agriculture had an exceptionally good year in 2011. As the GDP data reveal, the only real success story is that of foreign trade. The increase in exports was in the double-digit range and substantially higher than that of imports. The current account balance, which had undergone a trend reversal in 2008/2009 (from -7.3% to -0.2% of the GDP), was positive in 2011, when it may have amounted to 2% or even more of the GDP.

Slowed down financial intermediation is a major concern. Lending to the private sector, expanding by about 20% annually before 2008, turned negative in 2009 and the contraction gained momentum in 2011 (4%). While stagnating consumption and falling investment may have been the reason for the decline in credits from the demand side, the causality may easily be reversed: expensive credits coupled with a very conservative lending policy can be seen behind the decline of financial intermediation as well. A definitive explanation of the phenomenon is related to the difficulties the banks have to cope with. The extremely high levy charged on the financial institutions totalled HUF 140 billion (0.5% of GDP) in 2011. Additionally, last year the government launched a campaign for early repayment of foreign exchange (mainly CHF) denominated mortgage loans. Debtors were invited to pay back their loans at a preferential fixed exchange rate. The difference between the market and the fixed exchange rate had to be covered by the banks. According to various estimations, 900,000 to one million contracts were potentially involved, of which about 20% may have actually participated in the early repayment scheme. (That means that FX mortgage loans, amounting to about 15-16% of the GDP even after the completion of the early repayment scheme, remain a major concern.) The loss on the early repayment scheme amounted to HUF 200-300 billion (0.7% to 1% of GDP). The share of non-performing loans rose from 8.5% in 2009 to 12.5% in 2010 and 14.5% in 2011.

Fiscal consolidation has been an issue of outstanding importance since 2006. By 2009 the general government deficit was reduced, in three distinct waves, from over 10% to 4.5% by the second Gyurcsány and the Bajnai governments. The second and third waves of fiscal consolidation took place already under the auspices of the IMF/EU agreement. The pains related to the waves of fiscal consolidation are among the main explanatory factors behind the landslide election victory of the Fidesz party in 2010. Fidesz considered the fiscal consolidation oriented economic policy of the socialist-liberal and later of the technical government completely wrong and propagated an alternative economic policy without any painful restrictions. After the election victory the new Fidesz government started with measures to stimulate the expansion of the economy in the hope of 'growing out' of the fiscal deficit and public debt. These included a radical tax reduction programme (first of all the personal income tax and corporate tax were reduced). As it became clear that the EU would not tolerate a fiscal defcit substantially higher than 3% – which would have been the initial price for the planned new growth path of the economy – the government started to improvise measures in order to fill the gaps opening up on the revenue side of the budget. First the levy on financial institutions was introduced, followed by sector-specific taxes for the large, predominantly foreign-owned companies in the telecommunications, energy and retail sectors. The assets of the mandatory second-pillar pension funds were nationalized, with the largest part of these revenues allocated to reducing public debt and with a smaller one financing the 2011 budget.

But economic growth has not taken off. One year after its inauguration the government made an economic policy half-turn and announced that the fight against public debt would be the new focus of its efforts. It adopted a detailed programme (Széll Kálmán Plan) including measures aimed at attaining a deficit of less than 3% (relative to GDP) by 2012. The seemingly good fiscal stance in 2011 disguises the challenges to be faced. The 2011 fiscal surplus (about 3.5% of GDP) was achieved through accounting of the revenues from the nationalization of the pension fund assets in that single year and conceals the fact that actually a considerable fiscal loosening occurred last year. Cleared from the pension funds effect, the fiscal balance would show a deficit of about 5.5% of GDP. That means that part of the fiscal consolidation achieved in 2008-2009 has been lost last year. Though the European Commission and the majority of observers including the wiiw assume that Hungary's fiscal deficit will be around 3% of the GDP in 2012, securing this result requires considerable additional efforts. This year the fiscal tightening compared to 2011 may amount to 2-3% of the GDP, and may necessitate extraordinary interventions over the year. The really difficult year, however, will be 2013, when all sector-specific taxes and half of the bank levy will be phased out, and it is difficult to see what will replace these revenue elements.

The uncertainties around the forecast for 2012 and 2013 are much larger than they usually are. Our baseline scenario assumes an agreement with the IMF and the EU and a partial restoration of confidence. This will not help economic growth in the short run, and in fact wiiw predicts a recession in the range of zero growth to 2% decline. This is due to declining consumption and investment caused by the required austerity measures. Again net exports alone will somewhat counterbalance other, contracting components of the GDP. For 2013 a moderate expansion of the economy is projected: consumption will still stagnate, but a (hoped-for) restoration of confidence will allow for an upturn of investment activities and that will be supplemented by the positive contribution of net exports to the GDP. Nevertheless, the deteriorating growth outlook in the eurozone may slow down the expansion of Hungarian exports. Finally, a possible agreement with the IMF and the EU, and the conditionalities attached, will seriously affect the development of the Hungarian economy in the short and medium run.

Table LV

Latvia: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 1)	2012	2013 Forecast	2014
Population, th pers., average 2)	2287.9	2276.1	2266.1	2254.8	2239.0	2067.4	2047	2037	2027
Gross domestic product, LVL mn, nom.	11126.6	14720.7	16084.7	13070.4	12738.7	14000	14600	15500	16500
annual change in % (real)	11.1	9.6	-3.3	-17.8	-0.3	5.3	2	3.3	3.5
GDP/capita (EUR at exchange rate)	7000	9200	10100	8200	8000	9600	.	.	.
GDP/capita (EUR at PPP)	12200	13900	14100	12000	12500	14500	.	.	.
Consumption of households, LVL mn, nom.	7166.1	9049.0	9903.6	7889.3	7908.0	8690	.	.	.
annual change in % (real)	21.6	14.6	-5.8	-22.8	0.6	4.4	2.5	3	3.5
Gross fixed capital form., LVL mn, nom.	3665.9	5013.3	4769.6	2820.3	2487.2	3180	.	.	.
annual change in % (real)	16.3	7.9	-13.7	-37.4	-12.2	21	6	8	8
Gross industrial production 3)									
annual change in % (real)	6.5	1.1	-3.2	-18.1	14.9	9.0	4	8	10
Gross agricultural production (EAA)									
annual change in % (real)	-1.9	10.8	0.2	-0.7	-2.4	1.7	.	.	.
Construction industry									
annual change in % (real)	13.3	13.6	-3.1	-34.9	-23.4	12.4	.	.	.
Employed persons - LFS, th, average	1087.1	1118.0	1124.5	983.1	940.9	970.5	980	990	1010
annual change in %	5.2	2.8	0.6	-12.6	-4.3	3.1	1	1	2
Unemployed persons - LFS, th, average	79.5	71.3	90.5	203.2	216.1	176.5	.	.	.
Unemployment rate - LFS, in %, average	6.8	6.0	7.5	17.1	18.7	15.3	14	13	12
Reg. unemployment rate, in %, end of period	6.5	4.9	7.0	16.0	14.3	11.5	.	.	.
Average gross monthly wages, LVL	302	398	479	461	445	465	.	.	.
annual change in % (real, net)	15.6	19.9	6.2	-5.6	-6.5	0.3	.	.	.
Consumer prices (HICP), % p.a.	6.6	10.1	15.2	3.3	-1.2	4.2	2.3	2.5	3.0
Producer prices in industry, % p.a.	10.3	16.1	11.4	-4.6	2.8	7.4	.	.	.
General government budget, EU-def., % GDP									
Revenues	37.8	35.6	34.9	34.6	36.1	37	36.5	37.0	37.5
Expenditures	38.3	35.9	39.1	44.2	44.4	41	39.3	39.5	39.5
Net lending (+) / net borrowing (-)	-0.5	-0.4	-4.2	-9.6	-8.2	-4	-2.8	-2.5	-2.0
Public debt, EU-def., in % of GDP	10.7	9.0	19.8	36.7	44.7	43	42.4	41.2	39.5
Central bank policy rate, % p.a., end of period 4)	5.0	6.0	6.0	4.0	3.5	3.5	.	.	.
Current account, EUR mn	-3603	-4710	-3014	1598	535	-160	-400	-550	-700
Current account in % of GDP	-22.5	-22.4	-13.2	8.6	3.0	-0.8	-1.9	-2.5	-3.0
Exports of goods, BOP, EUR mn	4929	6020	6531	5253	6813	8600	9200	10300	11800
annual growth rate in %	14.3	22.1	8.5	-19.6	29.7	26	7	12	15
Imports of goods, BOP, EUR mn	9032	11074	10603	6575	8084	10300	11200	12500	14400
annual growth rate in %	33.7	22.6	-4.3	-38.0	23.0	27	9	12	15
Exports of services, BOP, EUR mn	2121	2707	3088	2747	2763	3100	3300	3600	4000
annual growth rate in %	21.7	27.6	14.1	-11.0	0.6	12	6	9	11
Imports of services, BOP, EUR mn	1586	1974	2169	1625	1666	1850	2000	2200	2450
annual growth rate in %	26.3	24.5	9.9	-25.1	2.5	11	8	10	11
FDI inflow, EUR mn	1339	1705	869	68	284	1150	.	.	.
FDI outflow, EUR mn	136	270	169	-44	16	50	.	.	.
Gross reserves of NB excl. gold, EUR mn	3346	3860	3514	4572	5472	4643	.	.	.
Gross external debt, EUR mn	18128	26835	29763	29097	29978	29600	.	.	.
Gross external debt in % of GDP	113.4	127.6	130.0	157.1	166.8	149.3	.	.	.
Average exchange rate LVL/EUR	0.6962	0.7001	0.7027	0.7057	0.7087	0.7063	0.71	0.71	0.71
Purchasing power parity LVL/EUR	0.4000	0.4664	0.5051	0.4814	0.4543	0.4669	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary and wiiw estimates. - 2) From 2011 according to census March 2011. - 3) Enterprises with 20 and more employees. - 4) Refinancing rate of National Bank.

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

Sebastian Leitner

Latvia:
Aiming for euozone accession

The revival of the Latvian GDP growth rate to 5.3% year on year that could be observed in 2011 was triggered largely by an upswing in domestic demand. Exports increased substantially in the first half of 2011, but growth rates declined markedly throughout the rest of the year. After gross fixed capital investment had declined for three years to below half of the level of 2007, outlays especially for machinery and equipment started rising again in 2011, by about 20% in real terms. Also households started to spend again, increasing consumption by 4.4% in real terms. The current account, which still had a surplus of 3% in 2010, once again moved into the red although the deficit, at about -1%, is still small.

The growth rates of external demand, being vibrant in the first half of 2011, dwindled towards the end of the year. Looking at the export structure, it can be observed that the core of the production structure of the country is still the wood industry and, to a minor extent, crude and semi-processed iron and steel, while the further processing sectors (i.e. pulp, paper, furniture and machinery) remain underdeveloped. In 2012 the growth in external demand especially of Western European countries is expected to decline even further. The same is likely to be the case for exports to Latvia's main trade partners Estonia and Lithuania. Only the growth of eastward exports is expected to remain somewhat more stable this year.

With growth of exports and industrial production slowing down, the investment activity, which recovered in 2011, is likely to fall off again in 2012. The same development is expected for foreign direct investment. In 2011 inflows particularly to the real estate sector recuperated, while inflows to the manufacturing sectors remained small. The corporate and the household sector are deleveraging quite strongly; in the course of 2011 the stock of bank loans to the private sector declined by almost 8%. The share of non-performing loans (overdue more than 90 days) decreased only gradually, to 18% in September 2011, the highest figure among the new EU member states.

Consumption will not develop as vibrantly in 2012 compared to last year because of the slowdown of general economic activity and a low employment growth rate. However, average gross and real wages are likely to increase somewhat in the private sector. Moreover, due to the outward migration the inflow of remittances has increased in the past three years, financing households' consumption outlays. With domestic demand remaining strong, the growth rate of imports will once again surpass that of exports. Thus we expect the current account deficit to grow to 2% of GDP and net exports to have a negative impact on GDP growth in 2012.

The outstanding target of the Latvian government for 2012 is to fulfil the Maastricht criteria in order to be accepted to join the eurozone in 2014. Thus, the key indicator to be observed is the development of consumer prices, which increased by not less than 4.2% in 2011. Obviously, last year's inflation was driven by rising prices for imported food and energy as well as by increases in VAT and excise tax rates. The government will thus refrain from increasing the tax wedge on consumption in 2012 and the year after, at least until the decision of the ECOFIN in mid-2013. However, there is still the danger that the average inflation rate of the three 'best performing' countries in the eurozone falls below 0.8% in 2012 due to recessionary developments. Then the case of Latvia would become a play for the political stage in Brussels despite a low inflation rate, which we expect to be 2.3% for the whole year of 2012 on average.

Furthermore, the Latvian government is obviously eager to reduce the budget deficit below the Maastricht criterion of 3% in 2012. The rise in economic activity and consumption, together with the increases in indirect taxation, resulted in budget revenues growing by one percentage point to 37% of GDP in 2011. In parallel, the cuts in public wages and reduction of spending in the fields of defence, health and education reduced the ratio of public expenditures to GDP from more than 44% in 2010 to about 41% in 2011. The budget for 2012 foresees further nominal restraint on the public wage bill, as well as a cut of public investments and various subsidies to the corporate sector, but also of social transfers. Even the IMF points to the fact that the tax structure and the austerity measures are highly unfavourable towards low-income earners.

We expect the budget deficit to decline to 2.8% in 2012. At the end of 2011 the IMF-EU rescue programme to Latvia came to an end, thus from this year onwards the repayment of borrowed funds has to be arranged. Since in total the Latvian government had to draw on only USD 4.1 billion of the USD 7.5 billion rescue package and its long-term government bond yields are comparable to those of Poland, Lithuania and the Slovak Republic, it should not have problems meeting its refinancing needs.

The situation on the labour market remains strained, with an unemployment rate of more than 15% on average in 2011. Notably, no employment recovery took place in industry; only in the service sectors can some revival be observed. Half of the 4% growth in employment in 2011 can be traced back to an increase in (formal or informal) jobs in agriculture. In the coming two years we expect employment growth to be even more sluggish, increasing by not more than 1% per year.

The 2011 census figures show that the population living in Latvia declined dramatically, by about 13% compared to 2000; this was an even stronger decline than in the period of the transitional crisis from 1989 to 2000 (-11%). While in the past decade the natural decrease of the population resulted in a reduction by about 120 thousand persons, net emigration caused another decline in the population figure by about 190 thousand people. In the past three years in particular more than 100 thousand persons are estimated to have left the country to make a living abroad. These developments are a threat to the future growth potential of the Latvian economy. Even more critical appears the situation if we look at the development of the demographic structure highlighted in the 2011 census; the number of people aged 0 to 14 years declined by 32% from 2000 to 2011, which is likely to pose a problem for long-term economic growth for Latvia.

Driven by a decline of external demand growth, 2012 will bring about an end to last year's swift GDP revival. We expect economic output to increase by only 2% in real terms. In 2013 and 2014 a gradual recovery of goods exports shall bring forth again an increase of corporations' investments. This should also trigger a swifter rise in wages. Thus household demand is likely to recover as well. Accordingly, we expect GDP to grow at a higher rate, by 3.3% in 2013 and 4% in 2014.

Table LT

Lithuania: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 1)	2012	2013 Forecast	2014
Population, th pers., average 2)	3394.1	3375.6	3358.1	3339.5	3286.8	3053.8	3023	3008	2993
Gross domestic product, LTL mn, nom.	83227.1	99229.3	112083.7	91914.0	95074.3	105712.5	110600	117900	126900
annual change in % (real)	7.8	9.8	2.9	-14.8	1.4	5.9	2.1	3.5	4
GDP/capita (EUR at exchange rate)	7100	8500	9700	8000	8400	10000	.	.	.
GDP/capita (EUR at PPP)	13100	14800	15400	12800	14000	16200	.	.	.
Consumption of households, LTL mn, nom.	53911.5	63540.4	73406.1	63308.6	60994.3	67400	.	.	.
annual change in % (real)	9.9	11.3	4.2	-17.4	-5.0	5.8	2.5	3	4
Gross fixed capital form., LTL mn, nom.	21038.0	27918.8	28370.0	15807.9	15488.5	18930	.	.	.
annual change in % (real)	19.3	21.8	-5.2	-39.5	1.0	15.5	5	7	9
Gross industrial production (sales)									
annual change in % (real)	6.5	2.4	5.5	-14.6	6.7	7.4	3	5	7
Gross agricultural production (EAA)									
annual change in % (real)	-4.1	8.2	8.8	1.0	-7.2	3.5	.	.	.
Construction industry									
annual change in % (real)	21.7	22.2	4.0	-48.5	-7.7	22.2	.	.	.
Employed persons - LFS, th, average	1499.0	1534.2	1520.0	1415.9	1343.7	1370.9	1380	1395	1410
annual change in %	1.7	2.3	-0.9	-6.8	-5.1	2.0	1	1	1
Unemployed persons - LFS, th, average	89.4	69.0	94.3	225.1	291.1	248.8	.	.	.
Unemployment rate - LFS, in %, average	5.6	4.3	5.8	13.7	17.8	15.4	15	14	13
Reg. unemployment rate, in %, end of period 3)	3.7	3.3	4.4	12.5	14.4	11.0	.	.	.
Average gross monthly wages, LTL	1495.7	1802.4	2151.7	2056.0	1988.1	2028	.	.	.
annual change in % (real, net)	14.9	17.0	10.1	-7.2	-4.3	-2.0	.	.	.
Consumer prices (HICP), % p.a.	3.8	5.8	11.1	4.2	1.2	4.1	2.5	3	3.5
Producer prices in industry, % p.a.	7.3	7.0	18.2	-13.5	10.3	13.9	.	.	.
General goverm.budget, EU-def., % GDP									
Revenues	33.0	33.6	33.9	34.3	33.8	32.8	32.5	33.2	34.0
Expenditures	33.5	34.6	37.2	43.8	40.9	38.1	35.8	36.0	36.5
Net lending (+) / net borrowing (-)	-0.4	-1.0	-3.3	-9.5	-7.1	-5.3	-3.3	-2.8	-2.5
Public debt, EU-def., in % of GDP	17.9	16.8	15.5	29.4	38.0	37.5	37.0	35.7	34.0
Central bank policy rate, % p.a., end of period 4)	3.65	6.80	7.84	1.57	1.07	1.24	.	.	.
Current account, EUR mn	-2551	-4149	-4194	1182	410	-517	-800	-1000	-1500
Current account in % of GDP	-10.6	-14.4	-12.9	4.4	1.5	-1.7	-2.5	-2.9	-4.1
Exports of goods, BOP, EUR mn	11262	12509	16077	11797	15651	20173	21600	25000	29600
annual growth rate in %	18.7	11.1	28.5	-26.6	32.7	29	7	16	18
Imports of goods, BOP, EUR mn	14600	16788	20280	12648	16921	21647	23600	27200	32500
annual growth rate in %	23.2	15.0	20.8	-37.6	33.8	28	9	15	19
Exports of services, BOP, EUR mn	2879	2931	3240	2657	3115	3628	3900	4300	4800
annual growth rate in %	15.0	1.8	10.5	-18.0	17.2	16	8	10	12
Imports of services, BOP, EUR mn	2018	2471	2835	2140	2141	2578	2800	3100	3550
annual growth rate in %	21.9	22.4	14.7	-24.5	0.0	20	9	11	15
FDI inflow, EUR mn	1448	1473	1341	47	568	1012	.	.	.
FDI outflow, EUR mn	232	437	229	157	60	121	.	.	.
Gross reserves of NB excl. gold, EUR mn	4308	5159	4458	4472	4788	6120	.	.	.
Gross external debt, EUR mn	14442	20547	23009	23163	24071	24550	.	.	.
Gross external debt in % of GDP	59.9	71.5	70.9	87.0	87.4	80.2	.	.	.
Average exchange rate LTL/EUR	3.4528	3.4528	3.4528	3.4528	3.4528	3.4528	3.45	3.45	3.45
Purchasing power parity LTL/EUR	1.8661	1.9824	2.1710	2.1498	2.0621	2.1211	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary and wiiw estimates. - 2) From 2011 according to census March 2011. - 3) In % of working age population. - 4) VILIBOR one-month interbank offered rate (Lithuania has a currency board).

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

Sebastian Leitner

Lithuania:
Exports trigger cyclical downturn

The revival of domestic demand triggered the high growth of GDP of 5.9% in real terms in 2011. Both household consumption and gross fixed capital investment recovered after a substantial decline lasting for more than two years. Although external demand remained lively, overall growth figures of exports shrank compared to 2010. Due to the strong growth of internal demand imports rose again faster than external demand, thus the current account moved into deficit for the first time after the crisis amounting to -1.7% of GDP in 2011.

Throughout the past year export growth figures declined steadily, dropping to single digits in nominal terms in the 4th quarter of 2011. Moreover, more than a third of the export growth last year can be attributed to mineral fuels triggered by rising oil prises. However, external demand developed quite strongly from the Baltic neighbours Estonia and Latvia, from Russia and Belarus as well as from the Netherlands, Sweden and France. Given the decline in economic activity in the Northern and Western European countries, Lithuanian export growth is going to decline considerable in 2012 and to revive only gradually thereafter.

Gross fixed capital investment showed a strong upswing in the first half of 2011 which triggered also some revival of activity in the construction sector. About three quarters of total investments went into the manufacturing sector, most prominently investments in the Lithuanian refinery of Mazeiku Nafta. However, already in the 3rd quarter of last year investment activity started to flatten out. With low output growth in the manufacturing sector, investment growth is expected to remain rather low, most likely at about 5% year on year in 2012 at best. Corporations as well as households are deleveraging quite strongly, the stock of outstanding loans to the private non-financial sector declined from the end of 2010 until the end of 2011 once again by about 7%. Moreover, the share of non-performing loans (overdue more than 60 days) declined throughout 2011 from almost 20% to about 16%.

In January 2012 the state-owned company Klaipedos Nafta, operator of the port in Klaipeda, announced that it will build an offshore platform for imports of liquefied natural gas (LNG) in cooperation with the Norwegian company Hoegh LNG by the end of 2014. The Ministry of Energy has already submitted a draft resolution to permit the building of the floating storage and regasification unit. The Lithuanian government is eager to reduce its dependency on Russian gas supplies. Accordingly, in February 2012 it was announced that the Polish and Lithuanian gas grid operators plan to build a 560 km pipeline until the end of 2018, which would then connect the grids of the Baltic States with Central Europe.

Consumption of households increased surprisingly strongly in 2011, by 5.8% in real terms, although the revival in the labour market was meagre and real wages were still on the decline last year. However, due to strongly increased outward migration, workers' remittances rose as well and 'envelope payments' – which were common in Lithuania even before the crisis in order to reduce the tax wedge – account for a rising share in total income. Nevertheless, the dynamic of consumption growth will decline in 2012, given the reduced growth of external demand. We therefore expect household consumption to increase by only 2.5% in real term this year.

Although household consumption revived quite strongly and exports developed not too bad, the growth of industrial production remained below potential and rose by only 7.4% in real terms in 2011. In the 4^{th} quarter of last year output already declined by 1% year on year.

The situation of the labour market remained disappointing in the year 2011. After a fall of employment of more than 12% during the economic crisis, the number of jobs increased by only 2% last year. Accordingly average gross wages rose by just 2% in nominal terms but declined for another year by 2% in real terms. As in Latvia, outward migration was one of the few possibilities especially for young Lithuanians to cope with the crisis. According to LFS statistics about 15% of those aged 15 to 30 years left the country between the end of 2008 and the end of 2011.

Given the revival in domestic demand and the rise in prices for imported fossil fuels, consumer price increases – 4.1% on average in 2011 – remained below expectations. This reflects the strained situation on the labour market and thus the subdued development of gross wages. With overall economic activity levelling off, inflation will slow down to about 2.5% in 2012.

The 2012 budget foresees a reduction of the deficit to 3%. Due to the reduced growth forecast for 2012 the parliament had to amend additional austerity measures in order to further reduce the budget deficit which fell from 7.1% in 2010 to about 5.3% last year. Thus the budget stipulates a 4% cut in public expenditures. Apart from reducing outlays for investment projects of various ministries, the Lithuanian government will reduce the transfers from the social-security tax to private retirement funds. State-owned enterprises will have to divert a portion of their profits to the government budget and an increase in taxes on luxury goods and real estate was approved. Given the uncertainties concerning external demand developments in 2012, the target of a deficit close to 3% might be missed this year. However, if both the deficit and the inflation Maastricht criteria should be met in 2012 the Lithuanian government might stick to its announcement to apply for eurozone entry 'as soon as possible' and thus decide by the end of the year to envisage already 2014 as the preferred entry date, as its neighbour Latvia.

Parliamentary elections are scheduled for October 2012. As is mostly the case ahead of Lithuanian elections, start-up parties are in the line to pop up also this year. Vladimir Romanov, a Lithuanian billionaire and majority stakeholder of the fifth largest Lithuanian bank 'Ukio Bankas', wants to set up a populist, centre-oriented party; Kristina Brazauskienė, widow of the 2010 deceased Lithuanian President Algirdas Brazauskas, founded the 'Democratic Labour and Unity Party' in mid-February 2012. Moreover, the political landscape changed due to the split-up of the third largest party in the parliament, the ‘National Resurrection Party’, which is part of the centre-right coalition government led by Prime Minster Andrius Kubilius. The conservative wing formed the movement ‘Christian Party’ in January 2010, while the liberal wing of the ‘Resurrection Party’ merged into the ‘Liberal and Centre Movement’. The strongest party by far in the government, the ‘Homeland Union’ led by PM Kubilius, is running low in the polls, thus the strongest opposition party, the ‘Social Democratic Party of Lithuania’, might have the chance to regain the post of the prime minister, which they held from 2004 to 2006.

One important issue will continue to attract public attention in the months to come: the aftermath of the nationalization to the rescue of the third largest Lithuanian credit institute, Snoras banka, which took place due to liquidity problems in November 2011. About 26 thousand clients have submitted their claims and have to be reimbursed to a large part by the Lithuanian deposit insurance fund. Since the assets of the fund are too low to compensate the depositors of Snoras, the government’s borrowing needs will increase in the medium term.

For 2013 and 2014 we expect external demand, particularly for oil fuels, to revive again. Thus, after a year of slow GDP growth of only 2.1% in real terms in 2012, the subsequent two years should bring about a revival including also an increase in corporations’ investments. Based on the assumption that the growth slowdown in 2012 will cause no major job cuts in the manufacturing sector, we also expect a faster rise in wages. Accordingly, the growth of household demand is likely to recover as well and GDP growth is expected to accelerate to 3.5% in 2013 and 4% in 2014.

Table PL

Poland: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 [1]	2012	2013 Forecast	2014
Population, th pers., average [2]	38141	38121	38126	38152	38184	38230	38217	38204	38185
Gross domestic product, PLN bn, nom.	1060.0	1176.7	1275.4	1343.4	1415.4	1530	1620	1730	1840
annual change in % (real)	6.2	6.8	5.2	1.6	4.0	4.3	3	4.1	4.3
GDP/capita (EUR at exchange rate)	7100	8200	9500	8100	9300	9700	.	.	.
GDP/capita (EUR at PPP)	12300	13600	14100	14300	15300	16200	.	.	.
Consumption of households, PLN bn, nom.	652.8	701.6	773.8	809.7	857.0	920	.	.	.
annual change in % (real)	5.0	4.9	5.7	2.1	3.2	3.1	2.2	4	4.5
Gross fixed capital form., PLN bn, nom.	208.3	253.7	283.9	284.6	281.2	330	.	.	.
annual change in % (real)	14.9	17.5	9.7	-1.3	-0.1	8.7	3.5	6	7
Gross industrial production (sales) [3]									
annual change in % (real)	12.1	9.3	2.6	-3.7	11.1	6.9	6	6	6
Gross agricultural production (EAA)									
annual change in % (real)	-1.1	5.2	1.3	4.7	-11.4	-6.6	.	.	.
Construction industry [3]									
annual change in % (real)	15.9	16.4	9.8	4.7	3.9	15.5	.	.	.
Employed persons - LFS, th, average	14593.6	15240.5	15799.8	15868.0	15960.5	16120	16200	16440	16690
annual change in %	3.4	4.4	3.7	0.4	0.6	1	0.5	1.5	1.5
Unemployed persons - LFS, th, average	2344.3	1618.8	1210.7	1411.1	1699.3	1870	.	.	.
Unemployment rate - LFS, in %, average	13.9	9.6	7.1	8.2	9.6	10	9	8.5	8
Reg. unemployment rate, in %, end of period	14.8	11.4	9.5	11.9	12.3	12.5	12	11	10
Average gross monthly wages, PLN	2475.9	2672.6	2942.2	3101.7	3225.0	3386	3520	3680	3870
annual change in % (real, gross)	4.0	5.5	5.9	2.0	1.5	1.1	1.5	2	3
Consumer prices (HICP), % p.a.	1.3	2.6	4.2	4.0	2.7	3.9	2.5	2.5	2
Producer prices in industry, % p.a.	1.8	2.0	2.4	3.9	2.3	7.5	4	3	2.5
General governm.budget, EU-def., % GDP									
Revenues	40.2	40.3	39.5	37.2	37.5	40.3	41	41.0	41
Expenditures	43.9	42.2	43.2	44.5	45.4	44.5	44.5	44.0	44
Net lending (+) / net borrowing (-)	-3.6	-1.9	-3.7	-7.3	-7.8	-4.2	-3.5	-3.1	-3
Public debt, EU-def., in % of GDP	47.7	45.0	47.1	50.9	54.9	53.7	54	54	54
Central bank policy rate, % p.a., end of period [4]	4.0	5.0	5.0	3.5	3.5	4.5	4.5	4.3	4.0
Current account, EUR mn [5]	-10421	-19253	-23818	-12153	-16486	-15220	-15500	-18000	-18700
Current account in % of GDP [5]	-3.8	-6.2	-6.6	-3.9	-4.7	-4.1	-4.0	-4.3	-4.2
Exports of goods, BOP, EUR mn [5]	93382	105883	120953	101715	124998	137981	148300	159400	172200
annual growth rate in %	20.4	13.4	14.2	-15.9	22.9	10.4	7.5	7.5	8
Imports of goods, BOP, EUR mn [5]	99208	119707	141896	107140	133893	148284	159400	172200	186000
annual growth rate in %	23.9	20.7	18.5	-24.5	25.0	10.7	7.5	8	8
Exports of services, BOP, EUR mn [5]	16349	21018	24207	20717	24718	26304	27600	29800	32200
annual growth rate in %	24.8	28.6	15.2	-14.4	19.3	6.4	5	8	8
Imports of services, BOP, EUR mn [5]	15768	17583	20729	17294	22381	21449	22500	24800	26800
annual growth rate in %	25.9	11.5	17.9	-16.6	29.4	-4.2	5	10	8
FDI inflow, EUR mn [5]	15737	17241	10135	9339	6699	9929	.	.	.
FDI outflow, EUR mn [5]	7137	4018	3071	3331	4149	4092	.	.	.
Gross reserves of NB excl. gold, EUR mn	35237	42675	42299	52734	66253	71691	.	.	.
Gross external debt, EUR mn	128968	158624	173736	194396	236018	240000	.	.	.
Gross external debt in % of GDP	47.4	51.0	47.8	62.6	66.6	64.6	.	.	.
Average exchange rate PLN/EUR	3.8959	3.7837	3.5121	4.3276	3.9947	4.1206	4.15	4.15	4.15
Purchasing power parity PLN/EUR	2.2646	2.2699	2.3746	2.4703	2.4247	2.4730	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary and wiiw estimates. - 2) From 2011 according to census March 2011. - 3) Enterprises with 10 and more employees. - 4) Reference rate (7-day open market operation rate). - 5) Including Special Purpose Entities (SPEs).

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

Leon Podkaminer

Poland:
Economy decoupled from the eurozone crisis

Growth has continued in the fourth quarter of 2011. Provisional estimates suggest that the performance of the economy has even improved, at least with respect to foreign trade and gross fixed investment. The estimates suggest that Poland's GDP rose by 4.3% in the whole of 2011. The contribution to the yearly GDP growth rate of rising private consumption was 1.8 percentage points (p.p.), followed by the contributions of gross fixed capital formation (1.7 p.p.), and of foreign trade and an increase in stocks (0.5 and 0.4 p.p. respectively). The contribution of falling government consumption was negative (-0.1 p.p.). Gross value added rose strongly in construction (11.8%) and industry (6.3%), while trailing behind in market services (3.2%) and contracting in non-market services.

The enterprise sector (non-financial firms active outside agriculture, employing over 49 persons) has performed quite well: its net profits earned during the first three quarters of 2011 reached PLN 77.4 billion (roughly equivalent to EUR 19 billion) – 15% more than the year previous. Overall the financial standing of the corporate sector is very good. Profits of exporting firms rose close to 25%, no doubt partly reflecting the relative weakness of the Polish currency. Exporting firms' financial standing continues to be even extraordinarily good: the marked slowdown of growth of the major importing partners has not yet affected Polish exporters. Profitability indicators of the whole enterprise sector have improved, liquidity indicators are strong. 73% of all firms (generating 85% of the whole sector's sales) made net profits in the first three quarters of the year. After about two years of pre-emptive accumulation of idle cash balances, the enterprise sector's attitudes seem to have changed as concerns expansion of productive capacities. The sector's outlays for fixed investment (PLN 62.2 billion) rose by more than 12% in real terms during the first three quarters of 2011. (In the same period of 2010 those outlays had fallen by over 11%.) The change in investment propensity is especially visible in manufacturing where investment outlays have increased over 10% (after having fallen over 25% in the same period of 2010).

The financial standing of the banking system remains quite strong. The Capital Adequacy Ratio stood at 13% at the end of November 2011. The share of 'endangered' credits in the total stock of credits (7.5% at the end of September 2011) has fallen (from 7.9% the year previous). During the first 11 months of 2011 the banking sector made net profit close to PLN 14.5 billion (38% up on the same period of 2010). While the net interest income rose only by 13.3%, the bulk of profit registered comes from strongly reduced provisions, demonstrating the sector's strength. The high profits earned in 2011 are likely to increase banks' own capital base, thereby further strengthening their resilience.

Expansion of lending has been relatively moderate: within the first 11 months of 2011 the stock of loans rose by 15% nominally (or merely about 9% if adjusted for the exchange-rate effects). The sluggishness of lending reflects the entrenched risk awareness on both sides of the market for loans, as well as the fact that the corporate sector does not depend too much on bank credit. Additionally, the series of hikes in the policy interest rates executed by the inflation-averse National Bank of Poland (in January, April, May and June 2011) was transmitted into higher interbank and retail interest rates. Within the year both the deposit and lending rates have risen by 0.7-1 percentage points. (Recently the average interest rate on loans to firms has stood at 6.6%, the average interest on PLN-denominated housing credit at 7.2%.) Lending to firms has been rising at roughly the same speed as to households. Of course the composition of lending has been changing. Investment loans to firms (especially the small and medium-sized) have recently started to rise much faster than the loans financing current activities. Credit to the household sector (which has started to lag behind the credit to firms) is dominated by loans financing housing investment/acquisition. Housing loans (of which some 20% are still denominated in foreign currencies, primarily Swiss franc) are rising most dynamically, while the stock of consumer credit is actually contracting.

Despite the overall good standing of the banking system, some residual risks do exist. At the end of September 2011 banks' foreign-exchange assets accounted for 27.9% of their balance sheets while their liabilities for only 22.1%. This (continuing) misalignment reflects a broader structural problem. The non-financial sector's deposits in the domestic banking have grown fairly sluggishly. Such deposits account for merely 62% of all banks' liabilities, with as much as 23% of deposits and credits coming from the financial sector (out of which 16.4% from non-resident financial institutions – primarily the foreign 'mother-banks'). An abrupt withdrawal of a sizeable portion of these resources would certainly restrict the ability of domestic banks to fund the domestic economy. But the likelihood of such a development does not seem very high because of high profits to be earned on banking activities in Poland. More likely, the foreign banking groups facing difficulties outside Poland may need to sell their local 'daughters' to others – also to the 'native' Polish banks or other financial groups.

The budget law for 2012 stipulates some restrictions on public sector spending (especially as concerns spending by local governments and by the public health-service system) and higher taxation (mainly in the form of the 2 percentage points hike in social security contribution falling on employers). In effect the fiscal deficit is to fall from about 4.2% of the GDP in 2011 to less than 3% in 2012. This ambitious goal, probably announced to reassure the 'financial markets' (and the European Commission), may be hard to achieve. For example, under the impact of widely articulated public discontent over the cuts in subsidies to pharmaceuticals, the government has already (in January 2012) promised to 'reconsider' the issue. It is quite likely that actual public spending will eventually be somewhat higher than planned. However, even if the fiscal deficit/GDP ratio still exceeds the 4% mark in 2012, public debt (less than about 53.5% of the GDP) is unlikely to be a major problem. The demand for Polish 10-year treasury bonds continues to be fairly strong and yields on them are still quite moderate. This is unlikely to change very much even if things worsen further in the euro area.

The PLN/EUR exchange rate hovered below 4 for about a year (August 2010 to July 2011). Then a strong depreciation tendency set in, peaking in the first week of January 2012 with a rate of 4.52. It is quite generally believed that the depreciation tendency had much to do with the moods prevailing in the international capital/exchange rate markets in the second half of 2011. In particular, the Hungarian sovereign-debt crisis is assumed to have impacted depreciation in a number of the EU's new member states. To prevent such a contagion-based depreciation from developing into a panic of its own, the National Bank of Poland intervened several times on the forex market. Eventually, the depreciation tendency suddenly stopped for no apparent reason and a fast appreciation started. Within four weeks starting on 7 January 2012 the PLN/EUR rate strengthened from 4.52 to 4.18. This is good news to the National Bank (as the 'imported inflation' is now likely to go down), the Finance Ministry (the burden of foreign public debt will be eased) and households whose debt is denominated in foreign currencies. However, it is less of good news to the sectors producing tradable goods and services. Further strong appreciation of the zloty would surely be detrimental to Poland's growth in 2012. But such an appreciation would seem to require a definite improvement of things in the euro area: then the general confidence in the zloty (and other marginal currencies) may strengthen. Assuming the crisis in the euro area will drag on some time, the appreciation of the zloty may come to an end before it does too much harm to the productive sector.

The general deterioration of conditions in the euro area (even in Germany) in the second half of 2011 has already affected the performance and prospects in most new member states. But so far Poland has kept its growth momentum. Growth in 2012 is likely to be satisfactory (though of course lower than in 2011) even if the euro area stagnates. The domestic economy is in no need for any meaningful deleveraging while fiscal and monetary policies will quite certainly not chase any over-ambitious goals. As in 2009 the Polish economy will benefit from its size, versatility and relative closedness. But the exchange rate volatility will continue to be a source of surprises which can be either pleasant or unpleasant.

Table RO

Romania: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 [1]	2012	2013	2014
								Forecast	
Population, th pers., average [2]	21588	21547	21514	21480	21438	19043	19000	18950	18900
Gross domestic product, RON mn, nom.	344651	416007	514700	501139	522561	573000	613500	670000	725000
annual change in % (real)	7.9	6.3	7.4	-6.6	-1.6	2.5	1	3	3
GDP/capita (EUR at exchange rate)	4500	5800	6500	5500	5800	7100	.	.	.
GDP/capita (EUR at PPP)	9100	10400	11700	11000	11400	13300	.	.	.
Consumption of households, RON mn, nom.	233135	273418	327928	304667	327562	354000	.	.	.
annual change in % (real)	12.9	12.0	9.0	-10.4	-0.4	1	1	2	3
Gross fixed capital formation, RON mn, nom.	88272	125645	164279	122442	125227	138000	.	.	.
annual change in % (real)	19.9	30.3	15.6	-28.1	-2.1	3	3	5	6
Gross industrial production [3]									
annual change in % (real)	9.3	10.3	2.6	-5.5	5.5	5.6	3	5	5
Gross agricultural production (EAA)									
annual change in % (real)	2.4	-17.7	21.2	-2.2	1.0	9.9	.	.	.
Construction industry [3]									
annual change in % (real)	15.4	33.2	26.7	-15.0	-13.2	2.8	.	.	.
Employed persons - LFS, th, average	9291.2	9353.3	9369.1	9243.5	9239.4	9200	9150	9150	9200
annual change in %	1.9	0.7	0.2	-1.3	0.0	-0.4	-0.5	0	0.5
Unemployed persons - LFS, th, average	728.4	640.9	575.5	680.7	725.1	723	.	.	.
Unemployment rate - LFS, in %, average	7.3	6.4	5.8	6.9	7.3	7.3	7.5	7	7
Reg. unemployment rate, in %, end of period	5.2	4.0	4.4	7.8	7.0	5.1	.	.	.
Average gross monthly wages, RON	1146	1396	1761	1845	1902	1995	.	.	.
annual change in % (real, net)	9.0	14.7	16.5	-1.5	-3.7	-0.9	.	.	.
Consumer prices (HICP), % p.a.	6.6	4.9	7.9	5.6	6.1	5.8	4	4	4
Producer prices in industry, % p.a.	9.5	7.5	15.3	1.8	6.3	8.9	.	.	.
General governm.budget, EU-def., % GDP									
Revenues	33.3	35.3	33.6	32.1	33.4	34.0	.	.	.
Expenditures	35.5	38.2	39.3	41.1	40.2	38.5	.	.	.
Net lending (+) / net borrowing (-)	-2.2	-2.9	-5.7	-9.0	-6.8	-4.5	-3.5	-3	-3
Public debt, EU-def., in % of GDP	12.4	12.8	13.4	23.6	31.0	32	34	34	34
Central bank policy rate, % p.a., end of period [4]	8.75	7.50	10.25	8.00	6.25	6.00	.	.	.
Current account, EUR mn	-10220	-16758	-16178	-4938	-5518	-5679	-6500	-7000	-8500
Current account in % of GDP	-10.5	-13.4	-11.6	-4.2	-4.4	-4.2	-4.6	-4.5	-4.9
Exports of goods, BOP, EUR mn	25953	29542	33656	29091	37368	45018	48200	54000	60500
annual growth rate in %	16.6	13.8	13.9	-13.6	28.5	20.5	7	12	12
Imports of goods, BOP, EUR mn	37765	47365	52729	35959	44970	52482	56200	61800	69800
annual growth rate in %	25.6	25.4	11.3	-31.8	25.1	16.7	7	10	13
Exports of services, BOP, EUR mn	5585	6885	8751	7061	6622	7275	7800	8600	9300
annual growth rate in %	36.2	23.3	27.1	-19.3	-6.2	9.9	7	10	8
Imports of services, BOP, EUR mn	5581	6475	8091	7352	6220	6893	7400	8100	8900
annual growth rate in %	25.4	16.0	25.0	-9.1	-15.4	10.8	7	10	10
FDI inflow, EUR mn	9060	7280	9501	3490	2219	1917	.	.	.
FDI outflow, EUR mn	338	206	186	-61	-16	-3	.	.	.
Gross reserves of NB excl. gold, EUR mn	21299	25325	25977	28249	32606	33200	.	.	.
Gross external debt, EUR mn	41196	58628	72354	81206	92458	98606	.	.	.
Gross external debt in % of GDP	42.1	47.0	51.8	68.7	74.5	72.9	.	.	.
Average exchange rate RON/EUR	3.5258	3.3353	3.6826	4.2399	4.2122	4.2391	4.3	4.3	4.2
Purchasing power parity RON/EUR	1.7604	1.8627	2.0425	2.1125	2.1445	2.2574	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary and wiiw estimates. - 2) From 2011 according to census October 2011. - 3) Enterprises with 4 and more employees. - 4) One-week repo rate.

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

Gábor Hunya

Romania:
Slowdown after boom

The Romanian economy grew ahead of expectation in 2011, only to steer into a slowdown in 2012. The fourth quarter of 2011 already turned negative compared to the previous one and this is likely to be also the case for the first quarter of 2012, to be followed by a modest upswing towards the end of the year. In 2011 the Romanian GDP grew by 2.5% due to an exceptional 10% growth in agriculture and related processing activities in the wake of a bumper harvest. This has positively affected household consumption in the countryside while real wages were lower than in the previous year. Investments picked up after two years of decline while net exports deteriorated slightly. Prudent monetary and fiscal policies including the effects of the severe austerity measures introduced in mid-2010 were directed to preserving stability. Romania has built up some confidence but is still considered as one of the most vulnerable countries mainly due to its high private external debt and perceived political instability. As a major source of confidence, Romania has a two-year precautionary agreement with the international financial organizations and the government formulates its fiscal plans and reform agenda in accordance with the IMF.

Industrial production showed robust growth of about 6% during 2011 surpassing the pre-crisis level of 2008. Manufacturing of motor vehicles, electrical and other machinery boosted production by more than 10%. These are industries dominated by foreign affiliates which sell most of their products abroad. The production of chemicals and non-metallic minerals recovered as well while the output of light industry branches in consumer goods production was declining. The electronics industry, a previously booming activity, shrank in the last few months of 2011 when Nokia, suffering a loss of global competitiveness, started running down its production facility near Cluj. The mobile phone producer has closed down its just three-year-old plant, causing a major blow to industrial production and exports that will be felt in the first half of 2012. However, the Italian home appliance manufacturer De'Longhi will settle in the buildings and Bosch will locate an automotive part production facility in the adjacent industrial park. This means that employment and exports will be restored in the second half of 2012. By that time, also Ford's car assembly plant in Craiova will be in operation producing and exporting the B-Max model. Transport equipment has reached a share of 41% in Romania's exports, and the dependence on this branch is bound to increase. The SME sector is still subject to the impact of sluggish domestic demand, although construction activity has somewhat recovered from a severe slump. The number of private sector bankruptcies declined by 10% in 2011 but was still much higher than before 2009.

The labour market indicators have hardly reacted to changes in output in recent years. The employment rate was flat at 63-65% throughout 2005-2011 and the unemployment rate climbed only 1.5 percentage points to 7.3% in 2009-2010 where it remained in 2011. As a result of the new labour code, temporary work contracts have become more widespread and registered unemployment declined. Some items of the labour market statistics will have to be adjusted to the lower than previously assumed population figures. Official statistics recorded a living population of the country of 21.4 million in 2011 but the census found only 19.0 million present – migrants comprise the difference – which causes a jump in per capita GDP.

The inflation rate rose until June 2011 when the impact of the previous year's VAT hike vanished. Monthly inflation declined thereafter leading to a year-end rate of 3.1%. This gives room for the government to adjust administered prices in the energy sector and still reach an average inflation rate of about 4% for 2012, the lowest since transition started. The decline in inflation allowed the National Bank to lower the policy interest rate in several steps, from 6.25% in October 2011 to 5.5% in February 2012. The annual interest rate on the deposit facility has been cut to 1.75% from 2.00%, while the overnight (Lombard) rate became 9.75% a year versus 10.00% previously. Further policy rate cuts may be necessary to follow the decline in inflation and stimulate economic growth. At the same time the country must stay attractive for financial investors to refinance old debt and finance the current account deficit. There was no credit squeeze in 2011. New loans to the private sector rose by 6.6% year on year in December (3.3% in real terms), of which RON-denominated loans rose by 5.6% and foreign currency-denominated loans expressed in RON by 7.2%. The banking sector booked a loss of RON 430 million (EUR 100 million) in 2011 compared to RON 516 million in 2010. Meanwhile the government implemented the facilities to put a 'troubled bank' under special administration, allowing a bankrupt bank's assets and liabilities to be taken over by another bank in an orderly manner if necessary. Last year, the banks continued their restructuring activities by closing 2% of the network and laying off 1.5% of the workforce.

The fiscal situation as of end-2011 is relatively good as revenues surpassed expectations due to economic growth and expenditures were kept at the scheduled level. The severe public sector wage cuts of mid-2010 were still felt in the wage bill decline in 2011. There have been some nominal wage increases while the number of employees was reduced. Nominal wages are bound to rise in 2012 in the wake of the statutory minimum salary hike to RON 700. The IMF is not pressing for more austerity in view of the current growth deceleration and even pleads for some public sector salary increases in order to boost domestic demand. The government is more concerned that revenues may fall short of plans, which is quite likely. Given the slowdown in economic growth, the government will have to make a difficult choice. It may abandon the plan to restrict the cash deficit to 1.9% of GDP (IMF target 2.1%, about 3% in ESA terms) or relax it in order to avoid additional austerity measures and even satisfy some of the wage demands. But if it finds external financing too costly, it may stick to the deficit target and keep down expenditures. The intentions of the new government inaugurated in February 2012 are not clear in this respect. According to the priorities laid down in the budget law, the government would prefer spending on investments rather than on wages. Public investments would first of all aim at absorbing EU funds. This is on the top of the political agenda with its co-financing needs, and administrative challenges. Support to this goal has been provided by the EU Commission by reducing the statutory co-financing rate.

Structural reforms agreed with the IMF include the identification of loss-making public sector companies and the reduction of their losses. The envisaged healthcare reform which aimed at controlling expenditures failed partly due to pressure from the street in January 2012 and will not be implemented at least before the elections later this year. State-owned enterprises are set under special surveillance and many of them are put on the privatization list. It remains to be seen whether there will be sufficient demand for these and at what price. Public sector arrears have been reduced by the end of last year but they may re-emerge if revenues fall short of expectations. All these policies, if implemented, will reduce the gap between cash and ESA deficit of the general government.

A financial crisis may emerge due to the high level of non-performing loans and the expected credit squeeze due to further deleveraging of foreign banks. Default on private debt on a massive scale is becoming quite likely in view of the high level of non-performing loans. The share of these increased from 11.9% in December 2010 to 14.1% in December 2011. The National Bank of Romania started to take action to smooth the process of debt restructuring and lower the risk of default. Depending on the behaviour of individual foreign banks, the level of risk may differ from bank to bank. Fitch downgraded Romanian banks to the second worst mark 'D' in December 2011 as the assets of the Romanian banking sector were rated as of poor quality which could worsen as a result of the impact of the eurozone crisis. Still, capitalization is in good order.

The external sector has maintained a relatively high current account deficit, above 4% of GDP over the past couple of years, and no change in this respect is expected under normal circumstances. The decisive item in the current account balance is the balance of trade in goods and services, which has slightly improved in 2011. The net income flows were increasingly negative while the flows of net current transfers (mostly remittances from Romanians working abroad) were higher than in the previous year. The rebound of private transfers goes against the expected impact of the economic calamities in the migrants' main target countries Italy and Spain, but this might change in the coming year with a gloomy growth prospect in these countries. Capital inflows of various forms outpaced the current account deficit, leading to further accumulation of National Bank reserves that are now covering 7 months of goods and services imports.

Forecasting key indicators is most uncertain as it depends to a large extent on external developments. GDP growth forecasts for 2012 have been scaled back in recent months due to forecasted stagnation in the eurozone. Our forecast is that in 2012 Romania's growth will slow down to 1% because of slow growth of export markets and a credit squeeze. Growth will be driven by private consumption and recovering investments generated by EU projects. The wiiw forecast reckons with some fiscal relaxation, to a deficit of 3.5% of GDP. The government will most probably give in to political pressure before the upcoming elections and allow for some public sector wage rises. While agriculture will not repeat its previous year results, the countryside population may have ample reserves to keep up their consumption levels.

A major factor of the economic slowdown is the expected stop in credit expansion due to the restructuring of the balance sheets of Greek and Austrian banks and provisioning requirements. In case of turmoil on the financial markets, Romania might be affected through the foreign banks whose subsidiaries control the banking sector of the country. Romania may rely on the EUR 5 billion preventive loan agreement with the IMF, WB and EU if private sources dry up. Public debt is not expected to rise above 35% of GDP and the fiscal deficit will stay below 3.5% of GDP while total external debt may not increase above 75% of GDP. The forecast for 2013 and 2014 is based on external and internal conditions without any unexpected shocks. In view of a protracted shortage of external financing, the expected medium-term growth is only around 3% annually, down from 4% previously forecasted.

There is also a major political risk looming. The present coalition led by the National Liberal Party will likely serve its mandate until the parliamentary elections in November 2012 – but it may also break up at any point if one of the partners thinks that it has better chances in the elections without the other. The government reshuffle of February 2012 has brought in some brighter faces without any new agenda. The opposition managed to form a social-liberal-conservative electoral coalition which has good chances to replace the current one. Recently they decided to abstain from parliamentary sessions to trigger early elections. Street protests in January 2012 have marked dissatisfaction with the government and especially the president who interferes in the current businesses more than legally stipulated. A more severe crisis is looming if the opposition wins the elections scheduled for November. They are likely to get into conflict with the president, who is on the side of the current coalition. Such cohabitation may lead to a stalemate and the disruption of public governance; fights between institutions can block the functioning of the state.

Doris Hanzl-Weiss

Slovakia: Successful year achieved, challenges ahead

GDP continued to grow in 2011, albeit slower than in 2010: Growth reached above 3%, compared to 4.2% in the year before. While growth was robust during the first half of the year, dynamics slowed down in the third quarter 2011, but surprisingly improved again in the fourth (preliminary data suggest an increase of 0.9% month on month and 3.4% year on year). The main source of growth has been net exports due to increased exports to Slovakia's main trading partners Germany and the Czech Republic. Exports of motor cars were particularly buoyant. This success is based on improved competitiveness as a result of declining unit labour costs. On the other hand, final consumption as well as gross capital formation contributed negatively to growth in 2011. While household consumption stagnated, government consumption declined due to fiscal consolidation taking place. Although the employment situation somewhat improved, household consumption remained flat as real wages were eroded by high inflation. Gross capital formation declined, but gross fixed capital formation developed favourably (+4.7% in the first three quarters). This points to destocking of inventories taking place in expectation of diminishing demand for the country's exports.

In 2011, industrial production increased by 6.9%, with manufacturing expanding by 8.9%. The highest growth sectors were machinery and equipment (+20.8%) and transport equipment (+17.3%) – the latter being the main industrial sector in Slovakia due to its important car industry. Two sectors declined, the computer and electronic products sector (-7.7%) and pharmaceuticals (-3.7%). The former sector benefited from the opening of a production plant by Taiwanese Au Optronics in June, while it suffered some setbacks too[25]. Apart from industry, contributions to GDP were slightly positive for construction but remained negative for agriculture and services in 2011.

Inflation – after reaching historically low levels below 1% in 2009 and 2010 – was among the highest in the eurozone in 2011. The price increase of 4.1% resulted from rising energy and food prices and was also due to fiscal consolidation measures. VAT was temporarily increased at the beginning of the year from 19% to 20% and certain tax exemptions were cancelled.

After two years of deterioration, the situation on the labour market improved in 2011 as real growth transferred to the labour market: employment grew by about 1.5% and unemployment fell by 1 percentage point to 13.4%. Overall, Slovakia has one of the highest unemployment rates in Europe, with a particularly high rate of long-term unemployment and youth unemployment. In addition, regional differences within the country are large and the eastern part faces even higher unem-

[25] In August 2011, Hansol, the Korean-based producer of components for television sets, terminated production and laid off 1400 persons; Samsung has applied for a EUR 28 million tax relief in order to continue production in Slovakia; and in January this year, Foxconn announced the layoff of 600 employees, citing global difficulties in LCD television sales.

Table SK

Slovakia: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 [1]	2012	2013 Forecast	2014
Population, th pers., average	5391.4	5397.3	5406.6	5418.6	5430.1	5445	5460	5480	5490
Gross domestic product, EUR mn, nom.	55001.6	61449.7	66932.3	62895.5	65887.4	70800	73700	78200	83800
annual change in % (real)	8.3	10.5	5.9	-4.9	4.2	3.3	1.5	3	4
GDP/capita (EUR at exchange rate)	8300	10200	11900	11600	12100	13000	13500	14300	15300
GDP/capita (EUR at PPP)	15000	16900	18200	17000	18000	18800	.	.	.
Consumption of households, EUR mn, nom.	30891.1	33902.0	37572.7	37640.2	37740.0	39300	.	.	.
annual change in % (real)	5.9	7.0	6.0	0.1	-0.8	0	0.5	1.5	2.5
Gross fixed capital form., EUR mn, nom.	14588.8	16096.5	16575.9	13024.8	14615.5	15900	.	.	.
annual change in % (real)	9.3	9.0	1.0	-19.7	12.4	4.5	2.5	3	4
Gross industrial production									
annual change in % (real)	15.7	17.0	3.3	-13.8	18.8	6.9	4	6	7
Gross agricultural production (EAA)									
annual change in % (real)	-2.9	-4.5	10.6	-12.3	-8.2	7.5	.	.	.
Construction industry									
annual change in % (real)	14.9	5.7	11.9	-11.2	-4.6	-1.7	.	.	.
Employed persons - LFS, th, average	2302.3	2357.7	2433.7	2366.3	2317.5	2352	2350	2390	2430
annual change in %	3.9	2.4	3.2	-2.8	-2.1	1.5	0	1.5	1.5
Unemployed persons - LFS, th, average	355.4	295.7	255.7	323.5	389.2	366	.	.	.
Unemployment rate - LFS, in %, average	13.4	11.1	9.5	12.0	14.4	13.4	13.5	13	12.5
Reg. unemployment rate, in %, end of period	9.4	8.0	8.4	12.7	12.5	13.6	13.5	13	12.5
Average gross monthly wages, EUR	623	669	723	745	769	790	.	.	.
annual change in % (real, gross)	3.9	4.4	3.4	1.4	2.3	-1	.	.	.
Consumer prices (HICP), % p.a.	4.3	1.9	3.9	0.9	0.7	4.1	2.5	3	3
Producer prices in industry, % p.a.	3.0	-1.4	2.5	-6.6	0.1	4.4	2	3	3
General governm.budget, EU-def., % GDP									
Revenues	33.3	32.4	32.8	33.5	32.3	33.1	.	.	.
Expenditures	36.5	34.2	34.9	41.5	40.0	38.9	.	.	.
Net lending (+) / net borrowing (-)	-3.2	-1.8	-2.1	-8.0	-7.7	-5.7	-5.0	-4.7	-4.4
Public debt, EU-def., in % of GDP	30.5	29.6	27.8	35.5	41.0	43.5	46.8	48.6	49.7
Central bank policy rate, % p.a., end of period [2]	4.75	4.25	2.50	1.00	1.00	1.00	.	.	.
Current account, EUR mn	-3490	-2912	-4021	-1627	-2278	0	-500	-1000	-1500
Current account in % of GDP	-7.8	-5.3	-6.2	-2.6	-3.5	0	-0.7	-1.3	-1.8
Exports of goods, BOP, EUR mn	33144	42260	49521	39721	48791	57000	61000	66000	71000
annual growth rate in %	29.2	27.5	17.2	-19.8	22.8	17	7	9	8
Imports of goods, BOP, EUR mn	35227	42916	50280	38775	48652	55500	59000	64000	69000
annual growth rate in %	27.8	21.8	17.2	-22.9	25.5	14	6	8	8
Exports of services, BOP, EUR mn	4321	5140	6001	4342	4398	4700	5100	5700	6600
annual growth rate in %	22.0	19.0	16.8	-27.6	1.3	7	8	12	15
Imports of services, BOP, EUR mn	3716	4751	6488	5367	5140	5200	5600	6300	7200
annual growth rate in %	13.1	27.9	36.6	-17.3	-4.2	1	8	12	15
FDI inflow, EUR mn	3729	2636	3323	-4	335	500	500	.	.
FDI outflow, EUR mn	406	441	376	652	250	500	.	.	.
Gross reserves of NB excl. gold, EUR mn [3]	9639	12280	12674	481	541	659	.	.	.
Gross external debt, EUR mn	24449	30156	37286	45338	49262	55000	.	.	.
Gross external debt in % of GDP	54.9	55.0	57.8	72.1	74.8	77.7	.	.	.
Average exchange rate EUR/EUR	1.2359	1.1211	1.0377	1.0000	1.0000	1.0000	1	1	1
Purchasing power parity EUR/EUR	0.6816	0.6721	0.6813	0.6810	0.6758	0.6922	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary and wiiw estimates. - 2) From 2009 official refinancing operation rates for euro area (ECB), two-week repo rate of NB before. - 3) From January 2009 (euro introduction) foreign currency reserves denominated in non-euro currencies only.

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

ployment rates (nearly 20% in the Košice region). The highest unemployment rate is found among the Roma minority population.

After a hike in the level of public debt from 28% in 2008 to 41% of GDP in 2010, public debt increased further in 2011. It is expected to reach about 44% of GDP – still much lower than in other eurozone countries. Fiscal consolidation is taking place but at a lower rate than envisaged. The reform-oriented cabinet of Prime Minister Iveta Radičová announced an ambitious consolidation programme for the years 2011-2013 (2011 deficit target 4.9%, 2012 target 3.8%, 2013 less than 3%). In theory, the envisaged target was met in 2011. Official statements announced a state deficit of 4.6% for 2011, i.e. 0.3 percentage points less than planned. However, the inclusion of outstanding debt of state-owned railway companies and hospitals for the period 2008-2010 increases the overall public finance deficit by 1% of GDP to about 5.7% in 2011. Also the fall of the government in October over the vote on ratification of the European Financial Stability Facility (EFSF) stopped reform projects affecting the budget for this year (e.g. failure of payroll-tax reform). Still, the interim government managed to pass the budget for 2012: the deficit is officially projected to reach 4.6% of GDP instead of the originally planned 3.8% of GDP. Priority is given to highway construction and pay rises for teachers and doctors (after protests led to a state of emergency in fifteen hospitals in December 2011). A banking tax has been introduced as of 1 January 2012. In addition, the parliament has approved a constitutional debt brake law seeking to limit public debt at 60% of GDP. As the consolidation process will depend on the forthcoming election results, we have so far carried forward the projected deficit for 2012 to the coming years.

Regarding the Slovak banking sector, 95% of bank assets are in foreign ownership, with a dominance of Austrian banks. The capitalization of banks is at a prudent level, the capital adequacy ratio stands at about 12.7% (as of 30 June 2011). In the first half of 2011 banks' profits soared by 79% in year-on-year terms, mainly due to a decline in the costs of non-performing loans. The ratio of non-performing loans was decreasing steadily during 2011 (from 5.8% in January to 5.4% in December 2011), with the ratio of non-performing loans to both households and corporations declining slightly (as of December 2011, the ratio was 4.5% for household loans and 7.1% for corporate loans). Bank lending to households increased in the first half of 2011 while weak demand persisted among corporations (except industry) due to some deleveraging process going on.

Good news comes from the main automotive companies, all located in the more prosperous western regions of Slovakia; they have reported successful figures for 2011 and have announced new investment plans for the future: (1) VW Bratislava plans to expand welding and body building capacities as well as to open a research and innovation centre. Investment is said to reach EUR 1.5 billion in the coming years. In addition, the company is creating 650 new jobs and launches a third shift from April onwards producing models of the New Small Family car series. (2) The PSA Peugeot Citroen plant located in Trnava started to hire 900 persons for work on a new car model and a third shift. (3) KIA Motors Slovakia (Žilina) reported a 20% rise in car production and a 12% increase in engine production in 2011. – In general, the economic sentiment indicator was at its height at the beginning of the year 2011 but fell continuously from July onwards. In December 2011 and January 2012 it again improved slightly, thanks to growing confidence of entrepreneurs in industry and of consumers.

Overall, wiiw has revised its growth forecast for Slovakia downwards, mainly because of the ongoing European debt crisis and the worsened outlook for Slovakia's main trading partners Germany and the Czech Republic. Thus we expect GDP to grow by 1.5% this year (down from previously 2.1%). GDP growth will accelerate to 3% in 2013 and about 4% in 2014. Although trade growth will slow down this year, net exports may remain the main driver of GDP growth provided that external demand stemming from Germany and the Czech Republic does not weaken even more. With a new government, probably dominated by the leftist Smer party of Robert Fico, we can expect fiscal consolidation in Slovakia to be weaker than envisaged. As a result, the so far stagnating private consumption might contribute modestly to GDP growth. Although positive news has cropped up recently, major downside risks prevail over the resolution of the European debt crisis. In addition, uncertainties derive from the forthcoming parliamentary elections to be held on 10 March 2012, which are overshadowed by a large corruption scandal.

Hermine Vidovic

Slovenia:
Slipping into recession again

GDP growth lost momentum from quarter to quarter and growth reached only 0.5% in the whole year 2011. Growth was backed by external demand, while household and government consumption remained stagnant and investments continued to decline. Gross fixed capital formation fell by 12%, hitting particularly the construction sector where the output contraction continued: in 2011 construction fell by another 25%, which is the largest drop since the outbreak of the crisis; the negative tendencies were felt equally in all segments of the construction sector, with residential building suffering most (investment in machinery and equipment fell as well). Future prospects are gloomy as well since the value of construction orders has fallen significantly recently.

During 2004-2008 Slovenia's construction industry was one of the most booming in Europe, increasing its share in GDP from 5.8% to 8.5%; however, this success was based on excessive borrowing. The dramatic drop of construction output thereafter is mainly due to declining demand both for old and new housing and shrinking public works related to transport and infrastructure. Thus, quite a number of construction companies went bankrupt; for instance, two of the biggest enterprises in that sector, SCT and Vegrad, have gone into receivership in the past two years; this triggered bankruptcies among small suppliers as well. Consequently the credit crunch became a major problem as banks stopped providing new credits and refinancing of short-term credits to firms. Some Slovenian economists argue that only the rehabilitation of the banking sector, Nova Ljubljanska Banka in particular, could help relieve the credit crunch.

Along with the slowdown in foreign demand, industrial production growth lost momentum from mid-2011 and rose by only 3.5% in the year as a whole. Within manufacturing, output of car production, one of Slovenia's major export industries, remained stagnant. The manufacture of computer and optical products, leather and related products, basic metals and fabricated metal products reported remarkable increases in production, while output of labour-intensive branches such as in the textile and furniture industries continued to decline. The crisis has made the structural weaknesses of Slovenia's economy visible: productivity is low compared to other new EU member states due to the small share of high-tech industries and knowledge-based services, and wages are too high, hence unit labour costs are the highest among the NMS. Productivity is far behind the EU average, such as in the manufacture of machinery and equipment and in the manufacture of electrical and fibre-optics equipment; productivity increases were strongest in the production of motor vehicles (dominated by foreign ownership), yet output stagnated and jobs were cut. There are, however, additional signs that the crisis has speeded up (passive) restructuring as the export

Table SI

Slovenia: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 [1]	2012	2013	2014
								Forecast	
Population, th pers., average	2006.9	2018.1	2021.3	2039.7	2048.6	2050	2050	2050	2050
Gross domestic product, EUR mn, nom.	31045.0	34562.3	37279.5	35310.6	35415.8	36300	36660	37950	39290
annual change in % (real)	5.8	6.9	3.6	-8.0	1.4	0.4	-1	1.5	1.5
GDP/capita (EUR at exchange rate)	15500	17100	18400	17300	17300	17700	17900	18500	19200
GDP/capita (EUR at PPP)	20700	22100	22700	20500	20700	21100	.	.	.
Consumption of households, EUR mn, nom.	16167.4	17841.5	19543.5	19434.3	19577.4	19990	.	.	.
annual change in % (real)	2.8	6.0	3.9	-0.2	-0.6	0	-0.5	-0.3	0.4
Gross fixed capital form., EUR mn, nom.	8234.6	9603.6	10729.7	8267.5	7650.6	6870	.	.	.
annual change in % (real)	10.4	13.3	7.8	-23.3	-8.3	-12	-5	0	4
Gross industrial production									
annual change in % (real)	5.7	7.1	2.4	-17.3	6.2	2.5	1.5	2	3
Gross agricultural production (EAA)									
annual change in % (real)	-7.4	3.9	-1.9	0.0	-0.3	-0.8	.	.	.
Construction industry [2]									
annual change in % (real)	15.7	18.5	15.5	-20.9	-16.9	-25.4	.	.	.
Employed persons - LFS, th, average	961	985	996	981	966	940	920	910	920
annual change in %	1.3	2.5	1.1	-1.5	-1.5	-2.7	-2	-1	1
Unemployed persons - LFS, th, average	61	50	46	61	75	80	.	.	.
Unemployment rate - LFS, in %, average	6.0	4.8	4.4	5.9	7.3	8	8.5	9	8.5
Reg. unemployment rate, in %, end of period	8.6	7.3	7.0	10.3	11.8	12.1	12.5	12.5	11.5
Average gross monthly wages, EUR	1213	1285	1391	1439	1495	1525	.	.	.
annual change in % (real, net)	2.5	4.2	2.0	2.5	2.1	0.3	.	.	.
Consumer prices (HICP), % p.a.	2.5	3.8	5.5	0.9	2.1	2.1	2	2	2
Producer prices in industry, % p.a.	2.3	4.4	3.9	-1.4	2.0	4.6	3	3	3
General governm.budget, EU-def., % GDP									
Revenues	43.2	42.4	42.4	43.2	44.3	45	43.1	43	42
Expenditures	44.6	42.5	44.2	49.3	50.1	50.5	48.1	47.5	46
Net lending (+) / net borrowing (-)	-1.4	0.0	-1.9	-6.1	-5.8	-5.5	-5.0	-4.5	-4
Public debt, EU-def., in % of GDP	26.4	23.1	21.9	35.3	38.8	45	49	52	55
Central bank policy rate, % p.a., end of period [3]	3.75	4.00	2.50	1.00	1.00	1.00	.	.	.
Current account, EUR mn	-772	-1646	-2574	-455	-297	-168	-200	-300	-400
Current account in % of GDP	-2.5	-4.8	-6.9	-1.3	-0.8	-0.5	-0.5	-0.8	-1.0
Exports of goods, BOP, EUR mn	17028	19799	20032	16167	18387	20675	21700	23000	24600
annual growth rate in %	16.6	16.3	1.2	-19.3	13.7	12.4	5	6	7
Imports of goods, BOP, EUR mn	18179	21465	22681	16871	19591	21971	22400	23100	24500
annual growth rate in %	16.3	18.1	5.7	-25.6	16.1	12.1	2	3	6
Exports of services, BOP, EUR mn	3573	4146	4956	4347	4634	4992	5300	5600	6200
annual growth rate in %	11.2	16.0	19.5	-12.3	6.6	7.7	6	6	10
Imports of services, BOP, EUR mn	2580	3098	3533	3182	3325	3376	3400	3500	3700
annual growth rate in %	12.5	20.1	14.0	-9.9	4.5	1.5	2	4	5
FDI inflow, EUR mn	514	1106	1330	-470	274	786	800	.	.
FDI outflow, EUR mn	687	1316	983	174	-59	-8	.	.	.
Gross reserves of NB excl. gold, EUR mn [4]	5342	666	623	671	695	642	.	.	.
Gross external debt, EUR mn	24067	34783	39234	40294	40699	41444	.	.	.
Gross external debt in % of GDP	77.5	100.6	105.2	114.1	114.9	114.2	.	.	.
Average exchange rate EUR/EUR	0.9998	1.0000	1.0000	1.0000	1.0000	1.0000	1	1	1
Purchasing power parity EUR/EUR	0.7464	0.7750	0.8114	0.8451	0.8339	0.8377	.	.	.

Note: Gross industrial production, construction output and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees and output of some non-construction enterprises.- 3) From 2007 official refinancing operation rates for euro area (ECB), main refinancing rate of NB before. - 4) From January 2007 (euro introduction) only foreign currency reserves denominated in non-euro currencies.

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

share of high-tech products has increased significantly since the outbreak of the crisis, while the proportion of low-tech exports declined or became almost nil.[26]

Foreign trade dynamics worsened particularly in the second half of 2011: in nominal terms goods exports and imports were up 13% each (versus 19.5% and 22% respectively in the first quarter). The trade deficit remained almost unchanged compared with a year earlier; owing to a rising surplus in services trade along with a surplus in the balance of transfers, the current account closed only slightly negative. Since the beginning of the crisis the share of exports directed towards the successor states of the former Yugoslavia has been steadily on the decline, from 17% in 2008 to 14% in 2011, while on the import side there has been a slight increase from 7% to 9%. The inflow of FDI exceeded the amount reached in 2010.

The deterioration on the labour market continued. Based on Labour Force Survey data, the number of employed fell by 3% in 2011, which is the strongest decline since the outbreak of the crisis. Employment losses were highest in construction, manufacturing and – to a lesser extent – in market services, trade in particular. By contrast, jobs were created in the non-market services sector, such as health, education and social work; also agriculture reported job increases, which may have acted as an employer of last resort. The LFS unemployment rate rose to slightly over 8% and thus almost doubled compared to the pre-crisis level, but is still below the EU average. Unemployment based on registration data has shown a steady increase since September 2008; at the end of December the unemployment rate was at 12%. Given the low GDP growth or even declining economic activity, the risk of rising unemployment is imminent. The Ministry of Labour considers long-term unemployment, the rising share of older workers becoming unemployed and the skill mismatch as the biggest challenges on the labour market in 2012.

Following the parliamentary elections on 4 December 2011, the Slovenian parliament confirmed Janez Jansa, head of the Slovenian Democratic Party (SDS), as the new prime minister on 28 January 2012. This move came after the winner of the elections, Zoran Jankovic, the mayor of Ljubljana and head of the Positive Slovenia party, had failed to form a coalition. Apart from the SDS the coalition consists of four parties: the conservative People's Party (SLS), the Christian People’s Party New Slovenia (NSi) and the civic list Gregor Virant (minister in the first Jansa government). The five parties hold 50 out of 90 seats in the Slovenian parliament. The new government was confirmed by the Slovenian parliament on 10 February 2012. Considering that the coalition’s parties have quite diverging interests (for instance, the pensioner’s party left the former government because of disputes over the pension reform), conflicts seem to be inevitable. Moreover, President Danilo Turk stated that Prime Minister Jansa was lacking legitimacy for the post because of an ongoing trial in which Mr. Jansa is charged with bribery over a Finnish armoured vehicles deal in 2006.

[26] For further details see: Government of the Republic of Slovenia, Competitiveness of the Slovenian Economy, Review and Measures, 17 February 2011.

Since September 2011 all major credit rating agencies have cut Slovenia's credit rating due to political instability and lack of reforms. In January 2012 Standard & Poor's and Fitch again downgraded Slovenia's credit rating. S&P cut the rating by one level to A+ and Fitch downgraded the long-term sovereign credit rating from AA- to A- with a negative outlook; in February Moody's cut Slovenia's sovereign rating from A2 to A1 with a negative outlook. At the same time the credit ratings of banks were downgraded as well: Slovenian banks show low capital adequacy compared with the euro area, non-performing loans have been on a steady increase and stood at about 10% of total loans in October 2011 (up from 7% a year earlier) and the stock of loans is declining. Slovenian banks – mostly domestically owned – are very much exposed to highly indebted companies in the construction and real estate sectors, but also in leveraged buy-out holding companies. Janez Sustersic, the new Minister of Finance, stated that the government may have to provide another EUR 400 million capital injection for Nova Ljubljanska Banka if the country's biggest bank fails to attract other investors.

According to first estimates the general government deficit stood at 5.5% of GDP in 2011. The dynamics of public debt growth, although still low than in a number of other eurozone countries, has become a major concern in the past couple of years, when it rose from 22% in 2008 to 45% in 2011. Available data indicate that Slovenia's net budgetary position vis-à-vis the EU budget was positive in the first eleven months of 2011. In terms of receipts from and payments to the EU funds the country realized about 79% and 94% respectively of the planned volume for that year. The absorption capacity of EU funds was highest in agriculture and lowest with respect to the Cohesion Fund. Fiscal consolidation is considered as one of the major tasks of the new government. Expenditures are to be cut to 45% of the GDP in the next couple of years and the public debt to GDP ratio may not exceed 46% of the GDP. The general government deficit is to be reduced to zero by 2015. As a first step, the prime minister announced to cut budgetary expenditures in 2012 by 5% in the frame of a supplementary budget to be adopted soon (the 2012 budget bill was passed already in 2010). In addition, the coalition agreement envisages tax reliefs; e.g. the corporate income tax should be gradually reduced to 15%. With regard to pensions it is planned that early retirement will be curbed and 'that pensions will depend more on years of service than on retirement age and voluntary extension of employment beyond retirement age will be intensified'. Already in December the Slovenian parliament has adopted a bill on freezing public sector wages and pensions until June 2012.

Slovenia's economic prospects will largely depend on the success or failure of the new government's structural reforms, e.g. related to the pension system, withdrawal of the state from a number of enterprises and/or a viable solution regarding the majority state-owned Nova Ljubljanska Banka. Improvements in competitiveness are indispensable. Given the need for fiscal consolidation and in view of the growth slowdown in the EU, wiiw expects the GDP to decline by 1% in 2012. Growth will rebound only slightly in the following two years. Public investment will need some time to recover and will regain strength in 2013 or even only in 2014. Consequently a recovery on the labour market, if at all, may be expected only in the second half of 2013 or at the beginning of 2014 – provided economic growth gathers momentum.

Hermine Vidovic

Croatia:
Recession continues

Croatia's protracted economic downturn came to a preliminary halt in 2011, when GDP de facto stagnated. Gross fixed capital formation, on the decline since 2009, dropped by another 7%; both household consumption and government consumption, having decreased in 2010, showed a slight increase last year. In construction, where the output had shrunk from 2009 onwards, the negative tendencies continued with output down by 9%. Currently there is no evidence of recovery in the construction sector: there is a large number of unsold apartments on the market, investments both of the private and the corporate sectors are declining and a new cycle of infrastructure investments has not yet started. In industry production decreased for the third consecutive year and employment fell by another 3.7%. As a result of even more strongly declining employment, productivity in industry increased by 3%.

External trade lost momentum in 2011 with both exports of goods and services growing only slightly while imports contracted, particularly in services trade. The main reason behind the poor export performance was the decline in exports of the shipbuilding industry – the country's most important export sector. Owing to the reduction of the trade deficit the current account deficit continued to shrink and ended up balanced in 2011. As for FDI, net inflows were considerably higher than in 2010, but far below the levels achieved in the pre-crisis period. In 2011, FDI was directed primarily towards the financial sector, basic metals and real estate. At the end of 2011 the foreign debt stood at EUR 46.5 billion, i.e. about the same level as in December 2010. This corresponds to a debt to GDP ratio of slightly over 100%.

Maturing foreign currency obligations, low inflow of foreign funds and the weak export performance have all exerted a steady pressure on the Croatian currency in recent months; the exchange rate hit a seven-year low in January 2012. In response to the continued downward pressure on the kuna against the euro the Croatian National Bank intervened repeatedly on the foreign exchange market to support the domestic currency in 2011 and at the beginning of 2012. In addition the CNB raised the minimum reserve requirement for banks from 14% to 15% on 27 January 2012 (in September 2011 it had been raised from 13% to 14%). This measure should lead to the withdrawal of excess liquidity from banks, worth EUR 400 million, which is probably thought to stop the outflow of money (to the foreign mother banks). Željko Rohatinski, governor of the Croatian National Bank, emphasized that the CNB will adhere to its exchange rate policy and will be ready to further tighten liquidity rather than risking the depletion of its currency reserves. As regards joining the eurozone, the governor stated that Croatia should adopt the euro once it meets the criteria. The new Minister of Finance, Slavko Linić, is more cautious in this regard and

Table HR

Croatia: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 [1]	2012	2013 Forecast	2014
Population, th pers., average	4440.0	4436.0	4434.5	4429.1	4417.8	4435	4435	4435	4435
Gross domestic product, HRK mn, nom.	291044	318308	345015	335189	334564	343300	347700	359600	374100
annual change in % (real)	4.9	5.1	2.2	-6.0	-1.2	0.3	-1.2	1	2
GDP/capita (EUR at exchange rate)	9000	9800	10800	10300	10400	10400	10500	10900	11300
GDP/capita (EUR at PPP - wiiw)	13700	15200	15900	14900	14900	15100	.	.	.
Consumption of households, HRK mn, nom.	168999	184979	197943	185651	186098	190800	.	.	.
annual change in % (real)	3.2	6.3	0.8	-8.5	-0.9	0.2	-0.2	0.5	1
Gross fixed capital form., HRK mn, nom.	75783	83514	95572	83386	72373	68900	.	.	.
annual change in % (real)	11.1	7.1	8.2	-11.8	-11.3	-7	-3	1.5	3
Gross industrial production [2]									
annual change in % (real)	4.2	4.9	1.2	-9.2	-1.4	-1.2	1	2.5	3
Gross agricultural production									
annual change in % (real)	4.4	-3.9	8.0	-0.8	-8.2	.	.	.	.
Construction output [2]									
annual change in % (real)	9.4	2.4	11.8	-6.5	-15.9	-9	.	.	.
Employed persons - LFS, th, average	1586	1615	1636	1605	1541	1485	1470	1470	1480
annual change in %	0.8	1.8	1.3	-1.8	-4.0	-3.6	-1	0	1
Unemployed persons - LFS, th, average	199	171	149	160	206	235	.	.	.
Unemployment rate - LFS, in %, average	11.1	9.6	8.4	9.1	11.8	13.7	14	14	13
Unemployment rate, reg., in %, end of period	17.0	14.7	13.7	16.7	18.8	18.7	19	18.5	18
Average gross monthly wages, HRK	6634	7047	7544	7711	7679	7750	7750	7800	7850
annual change in % (real, net)	1.9	2.2	0.8	0.2	-0.5	-0.3	.	.	.
Consumer prices, % p.a.	3.2	2.9	6.1	2.4	1.1	2.3	2.5	2.4	2
Producer prices in industry, % p.a. [3]	2.7	3.5	8.3	-0.4	4.3	6.4	4	3	3
General governm.budget, EU-def., % GDP [4]									
Revenues	.	.	39.1	36.4	35.0	36	36	36	35.5
Expenditures	.	.	40.4	40.5	39.9	41	40	40	39
Deficit (-) / surplus (+)	-2.9	-2.4	-1.4	-4.1	-4.9	-5	-4	-4	-3.5
Public debt, EU-def., in % of GDP [4]	35.4	32.9	29.2	35.1	41.3	43.9	48	52	55
Central bank policy rate, % p.a.,end of period [5]	3.50	4.06	6.00	6.00	6.00	6.00	.	.	.
Current account, EUR mn	-2623.9	-3114.6	-4196.7	-2379.7	-535.0	0	-300	-500	-600
Current account in % of GDP	-6.6	-7.2	-8.8	-5.2	-1.2	0	-0.6	-1.0	-1.2
Exports of goods, BOP, EUR mn	8463.6	9192.5	9814.0	7703.2	9102.3	9500	9600	10000	10600
annual growth rate in %	17.2	8.6	6.8	-21.5	18.2	4.4	1	4	6
Imports of goods, BOP, EUR mn	16807.8	18626.5	20607.8	15090.1	15054.3	14900	14900	15300	16100
annual growth rate in %	14.0	10.8	10.6	-26.8	-0.2	-1	0	3	5
Exports of services, BOP, EUR mn	8526.8	9114.7	10090.6	8453.9	8489.5	8750	8900	9200	9700
annual growth rate in %	5.9	6.9	10.7	-16.2	0.4	3.1	2	3	5
Imports of services, BOP, EUR mn	2750.6	2748.1	3016.0	2684.1	2603.0	2450	2500	2550	2700
annual growth rate in %	3.0	-0.1	9.7	-11.0	-3.0	-5.9	2	2	6
FDI inflow, EUR mn	2764.8	3651.3	4218.6	2379.8	280.9	1200	1500	.	.
FDI outflow, EUR mn	208.2	216.1	972.7	888.2	-112.3	50	.	.	.
Gross reserves of NB excl. gold, EUR mn	8725.3	9307.4	9120.9	10375.8	10660.3	11194.9	.	.	.
Gross external debt, EUR mn [6]	29725.0	33720.8	39764.4	43745.3	46495.6	46500	.	.	.
Gross external debt in % of GDP [6]	74.8	77.7	83.3	95.8	101.3	100.7	.	.	.
Exchange rate HRK/EUR, average	7.3228	7.3360	7.2232	7.3396	7.2862	7.4339	7.5	7.45	7.45
Purchasing power parity HRK/EUR	4.7875	4.7289	4.9004	5.0664	5.0929	5.1284	.	.	.

Note: Gross industrial production, construction output and producer prices in industry refer to NACE Rev. 2.

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) Domestic output prices. - 4) According to ESA'95, excessive deficit procedure. - 5) Average weighted repo rates. - 6) From 2008 and 2009 new reporting systems.

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

admitted that joining the eurozone will take a long time. Croatian economists believe that the country could adopt the euro only at the end of this decade. Given the fragility of the Croatian economy it is questionable whether the EU/ECB will allow Croatia to join the EMU any time soon.

Croatia's labour market has been hit hard by the recession and it has not stabilized yet. Labour Force Survey data indicate that the number of employed fell by another 3.5% in 2011, which is by about 150 thousand persons less than in 2008. The unemployment rate stood at 13.7%, up from 8.4% in 2008. At the same time the activity rate and the employment rate fell by 3 and 5 percentage points respectively. Registered unemployment – traditionally higher than the LFS rate – stood at 18.7% in December, the same rate as a year earlier. Public spending on labour market policies was mainly concentrated on passive measures (unemployment benefits in particular) while spending on active labour market programmes was even cut because of fiscal constraints. The downward pressure on wages that has been felt since the outbreak of the crisis has continued in 2011; during the first quarter of the year real net wages fell by 0.3%.

In February 2012 the parliament adopted the budget for 2012 which is based on three principles: (i) commitment to the Fiscal Responsibility Act approved by the former government in order to gradually reduce the deficit and stabilize and/or cut public debt; (ii) creation of preconditions for starting economic growth; and (iii) protection of the most vulnerable groups of the society. The budget is based on the assumption of 0.8% GDP growth in 2012 and envisages the reduction of budgetary spending by HRK 4 billion (EUR 540 million) through cuts in expenditures on public sector employment (administration and public enterprises), the reduction of subsidies for agriculture and Croatian Railways, lowering the support for citizens and households as well as the reduction of 'other expenditures'. Expenditures on pensions will increase by HRK 500 million and interest payments by HRK 1.2 billion (to HRK 9.5 billion). Revenues are envisaged to grow by 0.5% in 2012, however, most of the announced measures are either contributing to a reduction of revenues or will be neutral: for instance, revenue gains by raising the VAT rate from 23% to 25% (excluding VAT on baby food, oils, fats, and water bills, which will be cut to 10%) will be offset by lower revenues owing to the reduction of the health insurance rate from 15% to 13%.[27] The ceiling of non-taxable income will be raised from HRK 1800 to HRK 2200. Revenues up to HKR 2 billion should come from the privatization of the biggest local insurer Croatia Osiguranje, Postanska banka and state assets and holdings in private companies. Overall, the assumptions underlying the budget forecast seem to be too optimistic, since all recent forecasts provided by international organizations, banks and even the Croatian National Bank predict a GDP decline in 2012. Details on how to cut expenditures on the public sector wage bill are missing and unclear, but contrary to initial statements of politicians, layoffs can no longer be ruled out. According to the Minister of Finance, Croatia intends to raise about EUR 1.6 billion on international markets and about EUR 1.3 billion on the domestic market.

In November 2011 the Croatian National Bank withdrew the licence for the small Split-based Credo Bank because of inadequate capitalization and decided to 'closely watch' four other small banks.

27 The announced changes in the tax system are envisaged to increase the competitiveness of enterprises through the taxation of consumption and the reduction of labour costs.

The action has fuelled fears in the public that the whole banking sector was in trouble. In September 2011 the ratio of non-performing loans to total loans increased to 12.2% from 11.2% in December 2010. Under the assumption that the economy will not recover in 2012 the Croatian National Bank estimates that the share of NPL may increase to 17% by the end of the year.

On 9 December 2011 the EU and Croatia signed the accession treaty; Croatia is expected to become a full member of the EU on 1 July 2013. In a referendum held on 22 January 2012, 66% of the Croatian electorate voted in favour of the country joining the EU. The voters' turnout was, however, very low at 43.6%. During 2012 the accession treaty needs to be ratified by the parliaments of all 27 current EU member states and by the European Parliament. Until accession, the EU will closely monitor the implementation of the commitments Croatia has to achieve – particularly in the areas of the judiciary, competition (shipyards) and freedom of movement – before the country can become an EU member.

At the parliamentary elections held on 4 December 2011, the centre-left 'Kukuriku' coalition consisting of four centre-left parties (Social Democrats, People's Party–Liberal Democrats, Istrian Democratic Assembly and Croatian Party of Pensioners) won 80 out of 151 seats in the Croatian parliament. The conservative Croatian Democratic Union (HDZ), ruling Croatia for 17 out of 20 years since the country's gaining independence, suffered the worst defeat in the party's history. The new government, headed by Zoran Milanović from the Social Democrats, took office on 23 December 2011.

Prospects for 2012 and 2013 are dampened by the poor economic outlook in the EU, which will have a negative effect not only on Croatia's exports of goods but also on services, tourism in particular. In addition, domestic demand will recover only slowly: household consumption will remain flat as a consequence of high unemployment and weak credit activity; investments will not recover any time soon. Thus, GDP will decline by about 1% in 2012 and rebound if at all only in 2013. Uncertainties emanating from the ailing western banking system – 90% of Croatian banking assets are in foreign (mostly Austrian and Italian) ownership – constitute a serious downward risk. Employment will continue to contract as the labour market will react with a time lag to production growth; the unemployment rate is expected to remain at around 14% in 2012 and 2013 and decrease only slowly thereafter. The current account deficit will remain within moderate limits. Major challenges for the new government are fiscal consolidation against the background of high unemployment and servicing foreign debt. EU accession in mid-2013 may stimulate foreign investment flows. Still, a number of challenges related to competitiveness remain, such as accelerating structural reforms, speeding up privatization and improving the investment climate.

Vladimir Gligorov

Macedonia:
Downside risks

The optimistic forecasts from a few months back have been scaled down due to increased uncertainty in the external environment. Much will still depend on the ability of the government to sustain its policy stance. This has been characterized by more active fiscal policy and also more relaxed monetary policy than was characteristic in the pre-crisis period. Together with recovering foreign direct investments and strong growth of exports, that has led to a rather shallow and short-lived recession in 2009 and a recovery in 2010 and 2011, with growth of around 3.5% in the latter year.

However, current prospects are for a slowdown of growth to just above 2% with downside risks in 2012. The constraint on growth is not public spending as public debt is rather low at around 35% of GDP. However, the costs of borrowing at international commercial markets are high and probably prohibitive. The external constraint is also not as strong as in some other countries in the neighbourhood, as foreign debt is around 65% of GDP. Finally, overall private debt, of households and corporations, is rather low and should not require too much effort at deleveraging. Still, credit conditions are tight mostly because of the reluctance of the banks to extend credits due to higher uncertainty.

In that, one major concern is the state of the largest bank, Stopanska banka, which is owned by the National Bank of Greece. Though it is not easy to assess the risks of contagion that the possible increased problems of Greek banks may have on Stopanska banka, there is no doubt that in a worst case scenario, when the Greek banking sector bankrupts because the Greek state declares a moratorium on its foreign debts, the banking sector in Macedonia may be faced with balance sheet problems. In any case, strong support of credit expansion cannot be expected in the current circumstances.

As the country's currency is on a strict peg with the euro since 1994, with only one bout of devaluation in 1997, it has pinned its growth strategy on increased exports, preferably financed by foreign investments. That has resulted in a somewhat subdued growth record in the past 15 or so years, but has also strengthened the macroeconomic stability in adverse circumstances as has been evidenced in the current global crisis. Still, the space for more relaxed policy is rather limited and has probably been exhausted in the past three years.

This growth strategy has led to persistent high unemployment which fell only slightly before the crisis and has declined somewhat even in the past few years, but the slowdown of growth will take its toll in falling employment. With the unemployment rate at 30%, that is bad news, though social sustainability has proved to be rather high irrespective of depressed labour market conditions.

Table MK

Macedonia: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 [1]	2012	2013 Forecast	2014
Population, th pers., mid-year	2040.2	2043.6	2046.9	2050.7	2055.0	2060	2065	2070	2075
Gross domestic product, MKD mn, nom. [2]	320059	364989	411728	410734	424762	456800	481300	510600	544300
annual change in % (real) [2]	5.0	6.1	5.0	-0.9	1.8	3.5	2.3	3	3.5
GDP/capita (EUR at exchange rate)	2600	2900	3300	3300	3400	3600	.	.	.
GDP/capita (EUR at PPP - wiiw)	7200	7700	8400	8500	8700	9100	.	.	.
Consumption of households, MKD mn, nom. [2][3]	250309	279880	330399	314376	319975	346000	.	.	.
annual change in % (real) [2][3]	7.5	8.1	7.4	-4.7	1.6	4	2	2	2
Gross fixed capital form., MKD mn, nom. [2]	56485	71557	86403	81872	82968	94800	.	.	.
annual change in % (real) [2]	7.7	17.1	5.4	-8.3	-1.0	10	4	4	4
Gross industrial production [4]									
annual change in % (real)	5.9	3.9	5.1	-8.7	-4.8	3.3	5	5	5
Gross agricultural production (EAA)									
annual change in % (real)	7.0	-2.2	5.4	-2.3	8.0	.	.	.	.
Construction output, hours worked									
annual change in % (real)	-11.9	9.7	-9.6	-2.1	5.8	10	5	5	5
Employed persons - LFS, th, average	570.4	590.2	609.0	629.9	637.9	650	660	670	680
annual change in %	4.6	3.5	3.2	3.4	1.3	1.9	1.5	1.5	1.5
Unemployed persons - LFS, th, average	321.3	316.9	310.4	298.9	300.4	292	.	.	.
Unemployment rate - LFS, in %, average	36.0	34.9	33.8	32.2	32.0	31	31	31	31
Unemployment rate, reg., in %, end of period	.	.	.	.	.	.	.	.	.
Average gross monthly wages, MKD [5]	23036	24136	26229	29922	30225	30830	.	.	.
real growth rate, % (net wages) [5]	3.9	5.5	1.9	25.0	1.4	-2	.	.	.
Consumer prices, % p.a.	3.2	2.3	8.3	-0.8	1.6	3.9	3	3	3
Producer prices in industry, % p.a. [6]	6.8	2.5	10.1	-7.2	8.7	11.1	.	.	.
General governm. budget, nat.def., % GDP [7]									
Revenues	32.5	32.8	33.1	31.3	31.1	30.0	.	.	.
Expenditures	33.0	32.2	34.1	33.9	33.6	32.5	.	.	.
Deficit (-) / surplus (+)	-0.5	0.6	-0.9	-2.7	-2.5	-2.5	-1	-1	-1
Public debt, nat.def., in % of GDP	38.8	32.3	27.9	31.7	35.6	35.0	34	33	32
Central bank policy rate, %, p.a., end of period [8]	5.74	4.77	7.00	8.50	4.11	4.00	.	.	.
Current account, EUR mn	-23.4	-421.2	-862.2	-457.1	-150.4	-410	-450	-400	-400
Current account in % of GDP	-0.4	-7.1	-12.8	-6.8	-2.2	-5.5	-5.8	-4.8	-4.5
Exports of goods, BOP, EUR mn	1914.0	2472.2	2692.6	1932.6	2492.8	3240	3890	4670	5370
annual growth rate in %	16.5	29.2	8.9	-28.2	29.0	30	20	20	15
Imports of goods, BOP, EUR mn	2915.5	3653.3	4455.1	3492.2	3960.7	4950	5940	7130	8200
annual growth rate in %	16.6	25.3	21.9	-21.6	13.4	25	20	20	15
Exports of services, BOP, EUR mn	479.1	597.3	692.0	617.6	693.8	830	955	1051	1156
annual growth rate in %	14.9	24.7	15.9	-10.8	12.3	19.6	15	10	10
Imports of services, BOP, EUR mn	461.7	569.1	682.8	601.1	644.4	710	781	859	962
annual growth rate in %	3.4	23.3	20.0	-12.0	7.2	10.2	10	10	12
FDI inflow, EUR mn	344.8	506.0	399.9	145.0	159.1	210	200	250	300
FDI outflow, EUR mn	0.1	-0.9	-9.5	8.1	1.4	0	0	0	0
Gross reserves of NB, excl. gold, EUR mn	1311.3	1400.1	1361.0	1429.4	1482.7	1801.9	.	.	.
Gross external debt, EUR mn	2503.4	2841.1	3304.2	3780.4	4133.8	4800	.	.	.
Gross external debt in % of GDP	47.9	47.6	49.2	56.4	59.9	64.7	.	.	.
Exchange rate MKD/EUR, average	61.19	61.18	61.27	61.27	61.52	61.53	61.5	61.5	61.5
Purchasing power parity MKD/EUR	21.93	23.15	23.93	23.59	23.83	24.37	.	.	.

Note: Gross industrial production and producer prices refer to NACE Rev. 2. Gross agricultural production refers to Economic Accounts for Agriculture (EAA).

1) Preliminary and wiiw estimates. - 2) According to ESA'95 (FISIM reallocated to industries, including non-observed economy, real growth rates based on previous year prices). - 3) Including Non-Profit Institutions Serving Households (NPISHs). - 4) Enterprises with 10 and more employees. - 5) From 2009 including allowances for food and transport. - 6) Domestic output prices. - 7) Refers to central government budget and extra-budgetary funds. - 8) Central Bank bills (28-days).

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

Political stability is also not threatened as the current government was re-elected with a comfortable margin in the early elections held in late spring of the last year. There are persistent problems between Macedonians and Albanians that resulted in the postponement of the regular census, but those have been manageable for the most part.

Macedonia has been a candidate country for EU membership since 2006 and has yet to start the negotiations with the EU due to Greece's objection to its use of the name Macedonia and the consequent veto in the EU Council to the start of negotiations. So, the EU Commission regularly recommends an immediate start of negotiations, and the EU Council cannot take that decision. At the moment there is no sign that this stalemate will be broken in the near or even more distant future.

Table ME

Montenegro: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 1)	2012	2013 Forecast	2014
Population, th pers., mid-year 2)	624.2	626.2	628.8	631.5	618.8	620	621	622	623
Gross domestic product, EUR mn, nom. 3)	2149.0	2680.5	3085.6	2981.0	3103.9	3300	3400	3600	3800
annual change in % (real) 3)	8.6	10.7	6.9	-5.7	2.5	2	1	2	3
GDP/capita (EUR at exchange rate)	3400	4300	4900	4700	5000	5300	.		.
GDP/capita (EUR at PPP - wiiw)	8400	10000	10700	9700	10100	10500	.	.	.
Consumption of households, EUR mn, nom. 3)	1660.9	2369.0	2814.8	2503.7	2550.7	2680	.	.	.
annual change in % (real) 3)	.	.	12.1	-12.9	2.0	2	2	3	3
Gross fixed capital form., EUR mn, nom. 3)	469.8	867.1	1180.2	797.6	655.1	640	.	.	.
annual change in % (real) 3)	.	.	27.3	-30.1	-18.5	-5	2	5	5
Gross industrial production 4)									
annual change in % (real)	1.0	0.1	-2.0	-32.2	17.5	-10.3	5	5	5
Net agricultural production	.	.	.	.	.	.	.	.	.
annual change in % (real)	1.9	-11.0	10.0	3.0	2.0	2	.	.	.
Construction output 5)	.	.	.	.	.		.	.	.
annual change in % (real)	28.0	23.6	20.7	-19.2	-7.4	5	5	5	5
Employed persons - LFS, th, average 6)	178.4	217.4	218.8	212.9	208.2	198	198	200	210
annual change in %	-0.3	21.9	0.6	-2.7	-2.2	-5	0	1	5
Unemployed persons - LFS, th, average 6)	74.8	52.1	45.3	50.9	50.9	50	.	.	.
Unemployment rate - LFS, in %, average 6)	29.6	19.3	17.2	19.3	19.6	20	20	20	19
Unemployment rate, reg., %, average	20.5	16.5	14.4	15.1	16.9	15.8	18	17	16
Average gross monthly wages, EUR 7)	377	497	609	643	715	722	.	.	.
real growth rate, % (net wages) 7)	12.0	15.0	14.6	7.6	3.0	-2.0	.	.	.
Consumer prices, % p.a.	3.0	4.2	7.4	3.4	0.5	3.1	3	3	3
Producer prices in industry, % p.a. 8)	3.6	8.5	14.0	-3.9	-0.9	3.2	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	45.4	50.0	49.1	45.8	40.9	41	.	.	.
Expenditures	42.7	43.3	47.5	49.4	43.9	44	.	.	.
Deficit(-)/Surplus(+)	2.7	6.7	1.7	-3.6	-3.0	-3	-1	-1	-1
Public debt, nat. def., in % of GDP	32.6	27.5	29.0	38.2	40.9	44	44	42	41
Central bank policy rate, % p.a., end of period 9)	9.06	8.34	8.81	8.85	8.98	10.00	9	9	8
Current account, EUR mn	-531.2	-1077.5	-1583.7	-896.3	-764.2	-550	-700	-800	-800
Current account in % of GDP	-24.7	-40.2	-51.3	-30.1	-24.6	-16.7	-20.6	-22.2	-21.1
Exports of goods, BOP, EUR mn	648.3	483.4	450.4	296.3	356.6	430	470	520	570
annual growth rate in %	40.8	-25.4	-6.8	-34.2	20.4	20.6	10	10	10
Imports of goods, BOP, EUR mn	1497.7	2090.6	2552.3	1668.0	1623.8	1750	1930	2120	2330
annual growth rate in %	53.7	39.6	22.1	-34.6	-2.7	7.8	10	10	10
Exports of services, BOP, EUR mn	418.0	673.0	750.6	680.5	747.0	860	950	1050	1160
annual growth rate in %	26.8	61.0	11.5	-9.3	9.8	15.1	10	10	10
Imports of services, BOP, EUR mn	220.9	234.0	351.2	295.9	336.8	340	360	380	400
annual growth rate in %	64.6	5.9	50.1	-15.8	13.8	1	5	5	5
FDI inflow, EUR mn	496.0	682.7	655.7	1099.4	574.2	300	500	800	1000
FDI outflow, EUR mn	26.0	115.0	73.7	32.9	22.1	5	20	20	50
Gross reserves of NB, excl. gold, EUR mn 10)	172.8	259.0	216.6	172.8	164.6	175	.	.	
Gross external public debt, EUR mn	504.0	462.1	481.7	699.9	912.4	1000	.	.	.
Gross external public debt in % of GDP	23.5	17.2	15.6	23.5	29.4	30.3	.	.	.
Purchasing power parity EUR/EUR 11)	0.4077	0.4294	0.4596	0.4884	0.4964	0.5093	.	.	.

1) Preliminary and wiiw estimates. - 2) From 2010 according to census April 2011. - 3) According to ESA'95 (including non-observed economy, real growth rates based on previous year prices.). From 2007 FISIM reallocated to industries. - 4) Excluding small enterprises in private sector and arms industry. - 5) Gross value added. - 6) Until 2007 as of October. - 7) From 2007 wages of employees who actually received wages (previously wage bill divided by all registered employees). - 8) Domestic output prices. - 9) Average weighted lending interest rate of commercial banks (Montenegro uses the euro as national currency). - 10) Data refer to reserve requirements of Central Bank. - 11) wiiw estimates based on the 2005 International Comparison Project benchmark and Eurostat.

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

Vladimir Gligorov

Montenegro:
Instability looming

The recovery is slowing down and the problems are aggravating. Montenegro faced the crisis with very large external imbalances and a rather favourable fiscal position. Large inflows of foreign investment before the crisis led to significant fiscal revenues and made it possible to accumulate significant reserves. Those have in all probability been exhausted in the support of the banking system and in the bail-out of the loss making enterprises. That is a never ending story as the recent instalment of the problems with the Aluminijski kombinat testifies. The investment in it by Oleg Deripaska was guaranteed by the government and that guarantee is being called now. That is over EUR 100 million, which is quite a bill for a EUR 3.3 billion economy. That may prove a hard test for the government to pass.

Apart from that, the slowdown is driven mainly by the necessity to rebalance the external accounts in view of declining foreign investments. Tourism plays the main role in that and it has done rather well last year and is expected to continue to do well in the coming years. Industry is a drag on the economy as it continues to shrink. Similarly, the contribution of agricultural production is not very high and cannot be expected to improve too much in the future. Other services depend to a significant extent on the budget and there is certainly still room for the government to run fiscal deficits. Public debt stands at about 44% and is still in sustainable territory. However, the slowdown of growth and possible stagnation or even a bout of recession can prove quite harmful.

In the short run, growth will slow down due to unfavourable external developments and increased problems in the financial and public sectors. In the medium run, recovery is predicated on the maintenance of macroeconomic stability. That may prove to be hard to achieve given the growing problems with the political acceptability of rising fiscal support for loss making enterprises.

It is expected that Montenegro will start negotiating for membership with the EU during or at the end of this year. That is important for the stability of the country, but a more sustained recovery will depend on the ability of the government to restructure the corporate and the financial sectors. So, in the medium run, rather sluggish growth is to be expected if stability is maintained.

Table TR

Turkey: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 1)	2012	2013	2014
								Forecast	
Population, th pers., average	69395	70215	71095	72050	73003	73950	75200	76100	77000
Gross domestic product, TRY bn, nom.	768.9	856.1	950.5	952.6	1103.7	1270	1430	1640	1860
annual change in % (real)	6.9	4.7	0.7	-4.8	9.0	8.4	3.0	5.0	5.0
GDP/capita (EUR at exchange rate)	6100	6800	7000	6100	7600	7300	7600	7700	8100
GDP/capita (EUR at PPP - wiiw)	10600	11500	11700	10900	12000	12900	15100	18000	20100
Consumption of households, TRY bn, nom.	534.8	601.2	663.9	680.8	787.3	910	.	.	.
annual change in % (real)	4.6	5.5	-0.3	-2.3	6.7	9	4	4	5
Gross fixed capital form., TRY bn, nom.	169.0	180.6	189.1	160.7	206.9	270	.	.	.
annual change in % (real)	13.3	3.1	-6.2	-19.0	29.9	22	-2	10	10
Gross industrial production									
annual change in % (real)	7.3	7.0	-0.6	-9.7	13.1	8.7	4	7	8
Gross agricultural production									
annual change in % (real)	1.3	-7.3	.	.	.	.	.	.	.
Construction industry									
annual change in % (real)	18.4	5.5	-7.6	-16.3	17.5	12.0	5	7	9
Employed persons - LFS, th, avg.	20433	20750	21193	21271	22593	24000	24100	24650	25800
annual change in %	1.8	1.5	2.1	0.4	6.2	6.2	0.4	2.3	4.7
Unemployed persons - LFS, th, average	1950	2019	2279	3053	2696	2400	2700	2800	2850
Unemployment rate - LFS, in %, average	8.8	8.9	9.8	12.7	10.7	9.2	10.1	10.2	9.9
Reg. unemployment rate, in %, average	.	.	.	.	.	.	.	.	.
Average gross monthly wages, manuf.ind., TRY	1301	1437	1590	.	.	.	.	.	.
annual change in % (real)	2.1	1.6	0	.	.	.	.	.	.
Consumer prices (HICP), % p.a.	9.3	8.8	10.4	6.3	8.6	6.5	9.1	9.0	8.0
Producer prices in industry, % p.a. 2)	9.7	6.0	13.0	1.0	6.2	12.4	12	8	7
General governm. budget, EU-def., % GDP 3)									
Revenues	34.0	33.4	32.0	32.7	33.1	33.5	32.9	33.0	33.5
Expenditures	33.2	34.5	34.2	39.4	36.6	36.0	36.2	35.4	36.0
Deficit (-) / surplus (+)	0.8	-1.1	-2.2	-6.7	-3.5	-2.5	-3.3	-2.4	-2.5
Public debt, EU-def., in % of GDP 3)	46.1	39.4	39.5	45.5	43.2	42.5	41	38	36
Central bank policy rate, %, p.a., end of period 4)	22.50	20.00	17.50	9.00	6.50	5.75	6.25	6.25	6.25
Current account, EUR mn	-25595	-27915	-28108	-9995	-35930	-57000	-52000	-54000	-56000
Current account in % of GDP	-6.0	-5.8	-5.6	-2.3	-6.5	-10.5	-9.1	-9.2	-9.0
Exports of goods, BOP, EUR mn	74397	84001	95484	78616	91292	103000	112000	128000	147000
annual change in %	17.8	12.9	13.7	-17.7	16.1	12.8	9	14	15
Imports of goods, BOP, EUR mn	106996	118053	131095	96145	133986	169000	179000	193000	212000
annual change in %	19.1	10.3	11.0	-26.7	39.4	26.1	6	8	10
Exports of services, BOP, EUR mn	20165	21116	23928	23923	26176	28600	31000	34000	37000
annual growth rate in %	-7.0	4.7	13.3	0.0	9.4	9.3	8	9	9
Imports of services, BOP, EUR mn	9352	11408	12186	12105	14897	15300	16000	17000	19000
annual growth rate in %	1.4	22.0	6.8	-0.7	23.1	2.7	0	6	12
FDI inflow, EUR mn	15916	16238	13217	6085	6986	9000	10000	8000	112000
FDI outflow, EUR mn	713	1568	1707	1110	1108	1450	1500	1500	1600
Gross reserves of CB, excl. gold, EUR mn	46251	49804	51022	49088	60411	60538	.	.	.
Gross external debt, EUR mn	157710	169471	201449	186351	216669	229000	.	.	.
Gross external debt in % of GDP	37.1	35.4	40.4	42.3	39.2	42.2	.	.	.
Average exchange rate TRY/EUR	1.8090	1.7865	1.9064	2.1631	1.9965	2.3378	2.50	2.80	3.00
Purchasing power parity TRY/EUR	1.0405	1.0643	1.1385	1.2171	1.2605	1.3362	1.26	1.2	1.2

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

1) Preliminary and wiiw estimates. - 2) Domestic output prices. - 3) According to ESA'95 excessive deficit procedure. - 4) From 2010 one-week repo rate, overnight lending rate before.

Source: National statistics (Central Bank, Turkish Statistical Institute – TSI, etc.), Eurostat. Forecasts by wiiw.

Josef Pöschl

Turkey:
Slowdown? Or even recession?

Economists have predicted a sharp deceleration of Turkey's GDP growth for quite some time. Throughout 2011 however, each quarter's performance was surprisingly strong. Fourth-quarter data are not on the table yet, but growth is likely to be above 5% year-on-year once again. Were the Cassandras wrong when trying to paint a rather black picture?

In more recent weeks, signs of a slowdown have become more visible. The growth rates of industrial output, exports and imports all have decelerated. The Consumer Confidence Index has been on the pessimistic side all the time; only in mid-2011 it had come close to a neutral stance. The Real Sector Confidence Index, in its seasonally adjusted version, was on the positive side throughout 2011; it declined somewhat, but not substantially, towards the end of the year and beginning of 2012.

In many respects, Turkey's economic performance is in sharp contrast to what we have seen in recent years in large parts of Europe. Turkey's recovery from the shock in late 2008 was fast and strong, and in the 2010-2011 period, in three quarters out of eight GDP growth was above 10%. Domestic demand was the driving force – not only gross fixed investment, but increasingly also private consumption. Obviously, the mentioned pessimism did not prevent households from increasing their spending. Fiscal and monetary policy helped to bring this boom about starting from 2009; later on, monetary policy tried to fight overheating through not purely conventional measures.

High real GDP growth combined with a rate of inflation between 5% and 10% provoked a nice swelling of government revenues, and over large parts of the year they exceeded expenditures. Growing revenues are a comfortable background for a fiscal policy which is more growth- than stability-oriented. Central and local governments are running a large number of construction projects. Monetary policy felt a bit more challenge, as it would be a bad signal if inflation climbed over 10% year-on-year for a longer period. The central bank leadership rejected the standard recommendation, an increase in the policy rate. In fact, such a policy might have provoked a currency appreciation. This would have dealt a blow to the competitiveness of locally produced products. In Turkey, in several product categories European or Japanese products have a better quality reputation than local products, so that wealthier people in particular tend to buy foreign products in spite of their higher prices. In addition, Turkish producers do not cover the whole range of products demanded by consumers and investors. This is why the trade deficit and the gap in the current account have widened dramatically in the context of extreme GDP growth and high imports of investment goods. The deficit in the current account almost doubled from 2010 to 2011. It went up to approximately 10% of GDP. More saving as the cure against high deficit is not popular in Turkey; and it is hard to see how more saving might increase the quality and therefore competitiveness of Turkish brands.

The explosive expansion of the current account deficit has scared financial investors. Turkey absorbs much more goods and services than are produced within the country. The gap is financed from external sources, credits predominantly. The lesson learnt in more recent years all over the globe is that a high degree of indebtedness can be dangerous even if it is accumulated mainly by the private sector. In mid-2011 the Turkish currency started depreciating, and for some time the central bank let it go that way. In more recent months, however, it has intervened in support of the Turkish lira. The lira has stabilized and to some degree even re-appreciated. It is not likely that this will last forever. Renewed depreciation would support the competitiveness of domestic production, but the problem is how to keep it within limits, so that inflation will not exceed the magic mark of 10%.

Prime Minister Erdogan has launched a fight against the 'high interest rate lobby'. He dislikes austerity measures as tools to lower inflation and the imbalance in the current account. This may also be one motive for keeping distance from the IMF. So far, this policy has been a success, also in terms of election results of his party. The central bank has an independent status but supports this policy, for example by keeping the policy rate low. To cope with the need of restricting the growth of bank loans, the central bank has introduced high reserve requirements for commercial banks. For quite some time it seemed as if that measure would not have the expected impact. In more recent months, however, credit growth has decelerated, for whatever reason. The central bank's survey of bank loans points to a tightening in the course of the last quarter of 2011, and especially in last December.

There is no sign so far that Turkish commercial banks might have been severely infected by the 'European disease'. As it seems, up to now Turkey is benefiting from the reforms implemented under the authorship of Kemal Dervis after the crisis in 2001. It is unclear how much Turkey's GDP growth will decelerate in 2012. Analysts' forecasts differ over a wide range. Unless circumstances are very exceptional, Turkey is likely to return to relatively high growth after 2012.

Politically, it proved difficult to maintain the 'no problems' policy with the neighbourhood in the longer run. Relations with Syria have worsened; Iraq is an important trading partner, but for Turkey Iraq's severe internal conflict is a problem. A Cyprus compromise is not in sight. Iran is a problem too, of course. The Turkish government and public would not appreciate military action against Iran, but may also not like the idea of Iran becoming a nuclear power. Turkey is just planning its nuclear power future, by building two nuclear power plants. The politically much less troublesome neighbourhood lies in the west, north and northeast of Turkey. Turkish business has been active there for a long time.

In Turkey, economic agents tend to expect a continuation of the positive economic development in 2012 and thereafter: Growth slowdown, temporarily, yes; recession unlikely.

Mario Holzner

Albania:
Arcane setback in growth

Contradictory and piecemeal information make it difficult to evaluate the current state of the Albanian economy and even more difficult to talk about forecasting future developments. In the second quarter of 2011 – GDP data have only been released in December – real growth was almost stagnant. The release of this bad news was delayed by more than four months. Speculations about the trustworthiness and political instrumentalization of Albanian national accounts data have in the meantime been fuelled by a recent decision putting the country's national institute of statistics (INSTAT) under the exclusive control of Prime Minister Sali Berisha's office. Expectations regarding the economic performance of future quarters are low although the most recent publication of third-quarter GDP data shows a return of growth.

However, Albania's export performance in 2011 was exceptionally good. This is notwithstanding the severe drought in the Balkans in 2011 and the subsequent massive drop in Albanian hydro-power electricity production by about 50%, which under normal circumstances is a major source of export revenue. Even Albania's exports to its ailing principal trading partners Italy and Greece increased by 28% and 16% respectively. In particular, minerals and fuels exports rose strongly, but also textiles and footwear as well as construction materials exports expanded. It might be that Albanian goods have a marked price advantage on shrinking markets in the neighbourhood and can thus profit from the eurozone crisis. However, it could also be that the crises of Italy and Greece have not yet hit the export figures but might show up strongly in the following quarters.

Remittances from Albanian emigrants working mostly in Italy and Greece showed a significant drop of about 9% year-on-year in the first three quarters of 2011. This coincides with anecdotal evidence of thousands of Albanians moving back from Greece where they have lost their jobs. One supposed consequence of this development is a fall in construction output. Data on new loans to construction businesses show a drop of more than 16% year-on-year for the first eleven months of 2011. Also the construction confidence indicator marks an all-time low.

Yet by the end of 2011 the consumer confidence indicator displayed an all-time high. Also new loans to households increased by almost 15% year-on-year over the first eleven months of 2011. Moreover sales, maintenance and repair of motor vehicles performed extremely well by mid-2011, which is seen as a positive forward-looking indicator for household demand. Still, the mostly foreign-owned banking sector continues to tighten credit standards to both the household and the business sector. The growth of new loans to the total economy fell to less than 4% in 2011. This is most likely a reaction to the strong rise in non-performing loans to 18.1% in the third quarter 2011, up from 13.5% a year earlier. The banking sector's capital adequacy ratio remained constant at about 15%.

Table AL

Albania: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 1)	2012	2013	2014
								Forecast	
Population, th pers., average	3146.8	3161.3	3182.0	3194.4	3210	3220	3240	3260	3280
Gross domestic product, ALL bn, nom. 2)	882.2	967.7	1089.3	1151.0	1220	1290	1360	1450	1560
annual change in % (real) 2)	5.4	5.9	7.5	3.3	3.6	1.9	2.2	2.6	3.4
GDP/capita (EUR at exchange rate)	2300	2500	2800	2700	2800	2900	.	.	.
GDP/capita (EUR at PPP - wiiw)	5500	5800	6400	6500	6600	6800	.	.	.
Consumption of households, ALL bn, nom. 2)	680.3	775.1	861.9	910	970	1030	.	.	.
annual change in % (real) 2)	4.7	10.7	6.7	3	3	3	3	4	5
Gross fixed capital form., ALL bn, nom. 2)	343.9	374.1	415.1	430	400	420	.	.	.
annual change in % (real) 2)	13.0	5.5	9.5	5	-7	2	1	4	6
Gross industrial production 3)									
annual change in % (real)	12.1	-9.7	8.7	7.2	20	2	6	4	7
Gross agricultural production 4)									
annual change in % (real)	3.1	2.7	7.1	2.0	9	3	3	2	3
Construction output total 3)									
annual change in % (real)	10.5	12.2	10.9	0.4	-25	1	1	5	4
Employed persons - LFS, th 5)	.	1197.7	1123.3	1160.5	1200	1200	1180	1200	1220
annual change in %	.	.	-6.2	3.3	3.4	0	-2	2	2
Employment reg. total, th pers., end of period	935.1	965.5	974.1	899.3	916.9	930.0	910	930	950
annual change in %	0.3	3.3	0.9	-7.7	2.0	1.4	-2	2	2
Unemployed persons - LFS, th 5)	.	184.8	168.6	185.0	190	200	210	200	190
Unemployment rate - LFS, in % 5)	.	13.5	13.0	13.8	13.7	14	15	14	13
Unemployment rate, reg., in %, end of period	13.8	12.9	12.7	13.9	13.5	13.3	14	13	12
Average gross monthly wages, ALL	21842	27350	34277	36075	38492	41030	.	.	.
annual change in % (real, gross)	6.7	21.6	21.2	2.9	3.1	3.0	3	8	4
Consumer prices, % p.a.	2.4	2.9	3.4	2.3	3.5	3.5	3	4	4
Producer prices in industry, % p.a.	0.8	3.5	6.5	-1.6	0.3	2.5	2	4	4
General governm.budget, nat.def., % GDP									
Revenues	26.0	26.0	26.7	26.0	26.6	25	26	27	28
Expenditures	29.3	29.5	32.3	33.0	29.7	30	31	35	34
Deficit (-) / surplus (+)	-3.3	-3.5	-5.5	-7.0	-3.1	-5	-5	-8	-6
Public debt, nat. def., in % of GDP 6)	56.0	53.9	55.2	59.7	58.2	60	62	66	67
Central bank policy rate, % p.a., end of period 7)	5.50	6.25	6.25	5.25	5.00	4.75	4	3.8	4.3
Current account, EUR mn	-471.0	-824.2	-1381.2	-1321.4	-1040.5	-1300	-1300	-1400	-1550
Current account in % of GDP	-6.6	-10.5	-15.6	-15.2	-11.8	-14.1	-13.1	-12.7	-12.9
Exports of goods, BOP, EUR mn	630.6	786.3	917.5	750.7	1171.5	1400	1550	1650	1750
annual growth rate in %	18.9	24.7	16.7	-18.2	56.1	19.5	11	6	6
Imports of goods, BOP, EUR mn	2289.6	2890.4	3348.9	3054.4	3254.2	3500	3700	3900	4100
annual growth rate in %	14.1	26.2	15.9	-8.8	6.5	7.6	6	5	5
Exports of services, BOP, EUR mn	1156.6	1421.3	1687.8	1771.4	1702.4	1700	1900	2000	2100
annual growth rate in %	19.6	22.9	18.7	5.0	-3.9	-0.1	12	5	5
Imports of services, BOP, EUR mn	1188.1	1402.3	1618.3	1597.5	1520.7	1600	1700	1800	1900
annual growth rate in %	7.3	18.0	15.4	-1.3	-4.8	5.2	6	6	6
FDI inflow, EUR mn	258.6	481.1	665.2	696.4	831.5	650	700	800	900
FDI outflow, EUR mn	8.3	17.5	55.4	28.2	8.9	10	20	30	40
Gross reserves of NB excl. gold, EUR mn 8)	1329.2	1415.9	1626.1	1607.8	1842.1	1853.1	.	.	.
Gross external debt, EUR mn	1878.4	2220.6	3212.1	3372.0	3750.6	4300	.	.	.
Gross external debt in % of GDP	26.2	28.4	36.2	38.7	42.4	46.8	.	.	.
Exchange rate ALL/EUR, average	123.08	123.63	122.80	132.06	137.79	140.33	137	132	130
Purchasing power parity ALL/EUR 9)	51.22	52.39	53.48	55.39	57.83	59.06	.	.	.

1) Preliminary and wiiw estimates. - 2) According to ESA'95 (including non-observed economy, real growth rates based on previous year prices). - 3) Gross value added. - 4) Gross value added of agriculture, forestry and fishing. - 5) Survey once a year (June or September-October), wiiw estimate in 2010 and 2011. - 6) Based on IMF data. - 7) One-week repo rate. - 8) From 2009 international reserves (foreign assets of NB before). - 9) wiiw estimates based on the 2005 International Comparison Project benchmark and Eurostat.

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

In order to keep up liquidity, the Bank of Albania injected some lek 280 billion (euro 2 billion) into the banking system in the third quarter of 2011. Due to falling inflationary expectations and for the purpose of boosting the banks' willingness to increase lending to the economy, the central bank cut its policy interest rate by 25 bp to 4.5% by the end of January 2012. This is the lowest level in the past decade and it can be expected that the interest rate will be cut further during 2012.

While government revenues stagnated, expenditures increased by more than 5% year-on-year in the first eleven months of 2011. Public capital expenditures increased above average with major infrastructural works under way. This is probably one of the reasons why the unemployment rate remains stable below 14%. However, public debt is on the rise and will most likely surpass the legal limit of 60% of GDP in 2012. Given the government's unrealistically high expectations of GDP growth of above 4% and the fact that the country's next parliamentary elections are scheduled for 2013, public debt will probably increase further in the years to come.

There are still a few government assets to be privatized as well. The state-owned oil company Albpetrol, five small and medium-sized hydro power plants and remaining minority stakes in the fixed line operator Albtelecom and the Armo oil refinery are the key remaining assets the government plans to privatize in 2012. This has the potential to increase FDI in 2012 as compared to 2011, when foreign direct investment dropped by about a quarter as against a year earlier.

Our rather optimistic forecast expects GDP growth of 1.9% in 2011 and 2.2% in 2012 respectively and a stronger increase to 2.6% in 2013 and 3.4% in 2014, the latter due to the election cycle and induced populist government spending. The assumption is that the government has no problems financing fiscal expansion, that heavy rainfall in early 2012 will bring the vital electricity production back to normal and that export growth will continue despite the eurozone crisis (also with the help of further increasing crude oil export production capacities); remittances will tend to stabilize or at least fall at a slower pace as further unemployment in Greece might rather hit the public sector, where Albanians are not employed. Obviously, the risks are on the downside, very much so.

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 [1]	2012	2013 Forecast	2014
Population, th pers., mid-year	3842.8	3842.9	3842.3	3843.0	3843.1	3843	3843	3842	3842
Gross domestic product, BAM mn, nom. [2]	19333.0	21835.9	24759.0	24050.9	24583.9	26100	26800	27700	28800
annual change in % (real) [2]	5.9	6.1	5.6	-2.9	0.7	2.2	0.5	1.5	2.0
GDP/capita (EUR at exchange rate)	2600	2900	3300	3200	3300	3500	3600	3700	3800
GDP/capita (EUR at PPP - wiiw)	5700	6300	6700	6400	6600	6800	.	.	.
GDP by expend. approach, BAM mn, nom. [2]	21152.5	24424.3	28115.6	27895.2	27954.5	.	.	.	.
Consumption of households, BAM mn, nom. [2]	18064.0	19911.6	22468.0	21630.5	21828.0	22700	.	.	.
annual change in % (real) [2]	4.5	5.9	6.0	-3.9	-1.0	0.2	0	1	1
Gross fixed capital form., BAM mn, nom. [2]	4532.4	6142.7	7565.1	5951.7	5344.5	5800	.	.	.
annual change in % (real) [2]	-9.7	28.2	16.1	-22.4	-11.1	5.4	2	4	5
Gross industrial production [3]									
annual change in % (real)	11.5	6.4	11.0	-3.3	1.6	5.6	2	5	7
Gross agricultural production									
annual change in % (real)	4.0	-3.1	8.8	0.7	.	.	.	.	.
Construction output total [4]									
annual change in % (real)	2.1	14.5	16.9	-7.2	-12.4	.	.	.	.
Employed persons - LFS, th, April	811.0	849.6	890.2	859.2	842.8	816	810	810	812
annual change in %	.	4.8	4.8	-3.5	-1.9	-3.2	-0.7	0.0	0.2
Employees total - reg., th, average	653.3	686.1	705.6	697.6	688.2	690	682	685	685
annual change in %	1.6	5.0	2.9	-1.1	-1.3	0.3	-1.2	0.4	0.0
Unemployed persons - LFS, th, April	366.8	346.7	272.0	272.3	315.1	310.9	315	313	312
Unemployment rate - LFS, in %, April	31.1	29.0	23.4	24.1	27.2	27.6	28	28	28
Unemployment rate, reg., in %, end of period	44.1	42.5	40.6	42.4	42.7	43.5	44	44	44
Average gross monthly wages, BAM	869	954	1113	1204	1217	1270	1280	1300	1350
annual change in % (real, net)	2.3	8.4	8.4	5.6	-1.1	-1.4	.	.	.
Consumer prices, % p.a.	6.2	1.5	7.5	-0.4	2.1	3.7	2	2	2
Producer prices in industry, % p.a. [5]	.	.	8.6	-3.2	0.9	3.7	2	2	2
General governm.budget, nat.def., % GDP									
Revenues	44.9	45.1	44.1	43.1	44.4	44	43.5	43.5	44.0
Expenditures	42.0	44.0	46.3	47.5	46.9	46.5	46.5	46.0	46.5
Deficit (-) / surplus (+)	2.9	1.2	-2.2	-4.5	-2.5	-2.5	-3.0	-2.5	-2.5
Public debt, nat. def., in % of GDP [6]	21.9	29.7	30.7	35.3	38.9	39	41	42	43
Central bank policy rate, % p.a., end of period [7]	.	.	.	.	.	.	.	.	.
Current account, EUR mn [8]	-783.5	-1190.6	-1771.3	-768.4	-766.0	-1150	-1150	-1200	-1400
Current account in % of GDP	-7.9	-10.7	-14.0	-6.2	-6.1	-8.6	-8.4	-8.5	-9.5
Exports of goods, BOP, EUR mn [8]	2687.2	3091.5	3522.0	2920.2	3729.3	4350	4500	5000	5700
annual growth rate in %	30.5	15.0	13.9	-17.1	27.7	16.6	3	11	14
Imports of goods, BOP, EUR mn [8]	6092.9	7233.6	8344.6	6330.1	6976.9	8000	8500	9500	11000
annual growth rate in %	1.2	18.7	15.4	-24.1	10.2	14.7	6	12	16
Exports of services, BOP, EUR mn [8]	904.3	1061.7	1132.0	1033.8	972.6	950	950	1000	1060
annual growth rate in %	13.2	17.4	6.6	-8.7	-5.9	-2.3	0	5	6
Imports of services, BOP, EUR mn [8]	369.9	422.3	467.7	461.8	447.3	440	440	450	470
annual growth rate in %	4.9	14.2	10.8	-1.3	-3.1	-1.6	0	2	4
FDI inflow, EUR mn [8]	610.9	1519.8	683.8	180.5	173.6	250	100	200	300
FDI outflow, EUR mn [8]	3.2	20.5	11.3	4.4	31.7	0	0	0	0
Gross reserves of NB excl. gold, EUR mn [9]	2787.5	3424.9	3218.9	3143.8	3267.6	3207.0	3150	3200	3200
Gross external public debt, EUR mn	2081.5	2025.4	2168.0	2676.2	3215.4	3398.3	3700	4000	4000
Gross external debt in % of GDP	21.1	18.1	17.1	21.8	25.6	25.5	.	.	.
Exchange rate BAM/EUR, average	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.96	1.96	1.96
Purchasing power parity BAM/EUR [10]	0.8754	0.9008	0.9658	0.9842	0.9742	0.9963	.	.	.

1) Preliminary and wiiw estimates. - 2) According to ESA'95 (including non-observed economy, real growth rates based on previous year prices). - 3) Until 2008 wiiw estimates based on weighted averages for the two entities (Federation BH and Republika Srpska). - 4) According to gross value added. - 5) Domestic output prices. - 6) Based on IMF data. - 7) Bosnia and Herzegovina has a currency board. There is no policy rate and even no money market rate available. - 8) Converted from national currency with the average exchange rate. - 9) Including investment in foreign securities. - 10) wiiw estimates based on the 2005 International Comparison Project benchmark and Eurostat.

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

Josef Pöschl

Bosnia and Herzegovina:
Political breakthrough in times of economic stagnation

The ‘chance of getting things moving’ (so the title of our report from July 2011) has been missed so far. After the elections in October 2010, those in favour of major changes had not enough power to push changes through. Negotiations ended up in a deadlock. Only recently, at the end of 2011, have the political parties found a compromise regarding the formation of a central government on the basis of the election results. For more than a year, the EU, the USA and the IFIs had urged in vain to take that step. Ultimately, the threat of bankruptcy and the fact that there was no longer a legal basis for paying salaries to public servants gave the decisive kick. The parties also agreed on the budget, certainly the primary concern, on the law on census and on legislation regulating state aid. The agreement still may face many roadblocks, but it opens the way for a continuation of cooperation with the IMF in the context of the existing stand-by agreement. Once more, all this confirms that the country’s political class is well trained in finding emergency solutions after having reached the edge of the abyss. Now, there is a ‘chance of getting things moving’, but the economic environment is becoming less friendly.

In the first half of 2011, the economy was doing relatively well. Meanwhile, the more chilly European business climate exerts a negative impact. Whereas for the whole year industrial production grew, it declined in December (by 6.5% year-on-year). The year-on-year rise of producer and consumer prices was also much lower in December as compared to whole year rates. The banking sector performed well in 2011, and the share of non-performing loans declined. The expansion of loans was moderate, however. Depending on the development in 2012, some banks may need a capital increase. It is important to continue with the Vienna Initiative, which is linked to the stand-by arrangement with the IMF.

BiH entrepreneurs are used to operating in a harsh business environment. A higher rate of bankruptcies can be observed, but a fully-fledged crisis is unlikely. Much more likely is very low GDP growth in 2012, or slight decline. In metallurgy, the situation has worsened. The sector is a backbone of the BiH economy and accounts for a major share of exports; another one is wood processing. These items’ producer prices declined. Also energy production is important, and the reorganization of production and distribution is a big topic currently. Of course, there is unwillingness to create a fully integrated countrywide system.

Coming closer to obtaining candidate status for EU membership will be feasible after the formation of the central government, should it be able to push through the smooth execution of all that has been agreed. After the signing of the Stabilization and Association Agreement (SAA) and the Interim Trade Agreement almost four years ago not much has happened. The main highlight in atmospheric terms was the removal of visa requirements for entering Schengen countries at the end of 2010. For BiH entrepreneurs, it has become easier to establish and intensify contacts with that region. However, non-trade barriers have remained high, especially in terms of meeting standardization requirements. Politics do not care enough about this issue, and this adds to the high trade deficit, which is a long-term feature of the BiH economy. Export growth will depend mainly on the business climate in Croatia, Germany and Italy; most probably, it will be rather weak in 2012 and somewhat stronger thereafter.

In times of low growth or recession, the current account in per cent of GDP usually declines, but this never means a structural change. Croatia's forthcoming EU membership threatens to have negative consequences for some categories of export goods, especially in the area of unprocessed and processed agricultural products. The EU finances a programme aimed at improving the basis for agricultural exports. Other programmes funded by the EU as well as by the IFIs are the main source for the funding of public investment into physical infrastructure. Education, support to SMEs, and judiciary and police reform are also part of the agenda of EU support.

Expenditures out of the government budget are high compared to revenues, in particular on some lower government levels. The finance minister of the Federation of BiH considers the introduction of progressive income taxation.

The consequence of low or no growth is further pauperization of a part of the population. Only a small fraction of persons in working age enjoys official employment status, and for the majority of people the cost of living tends to increase more than their income.

BiH has economic potential. In the case of external conditions getting more favourable again in late 2012 or 2013, significant GDP growth will return. The main incentive needs to come from outside, as we cannot count with high growth of domestic demand up to 2014.

Vladimir Gligorov

Serbia:
Stagnation at Best

The growth forecast has been revised down in recent discussions with the IMF mission to 0.5% for 2012. The mission could not agree on the fiscal policy for this year and postponed the approval of the precautionary stand-by agreement for after the upcoming general elections. They should take place in early May. Still, the IMF staff left an aid-memoire in which it outlined its recommendations to the new government's economic policy programme.

The model the IMF suggests is based on fiscal consolidation to ensure macroeconomic stability and structural reforms to spur growth. Though the forecast for the next couple of years of the implementation of that programme features an admittedly slow recovery, it is loaded with downside risks even without taking into account the political and even more the social sustainability of such a policy stance. Employment has been declining quite strongly since late 2008 and will continue to decline with a stagnating economy. In fact, the proposed structural reforms will certainly lead to rather significant shedding of labour in the public sector in particular and the unemployment rate, currently standing at above 24%, may shoot up to 30% in the next couple of years. Serbia has no experience with such a high unemployment rate and it is hard to predict the social response. In the past, outward migration tended to be a way to handle adverse labour market developments, but this may prove more difficult this time around.

The hope is that with macroeconomic stability, private and perhaps public investments will rise and thus spur growth and increase employment. The major problem is whether the external constraint will allow that. Foreign debt stands at just above EUR 24 billion and has increased only slightly over the last year, most of the current account deficit being covered by foreign direct investments of about EUR 1.5 billion in 2011. It is not expected that foreign credits will increase in the next few years and in fact the trade and current account deficits need to shrink further in order for foreign debts to be serviced. That will also limit the amount of foreign investment that is in accordance with external sustainability.

The increase of domestic investment cannot be too fast due to the pressure on the corporate sector to deleverage. Massive layoffs in the past three years have probably led to an improvement of the corporate balance sheets, but have significantly constrained private consumption. Public consumption has also declined because public revenues have declined rather sharply – about 5 percentage points since 2008 (from 44% of GDP to 39%) – and the ability to borrow has been constrained by high interest rates. As a consequence, public expenditures have declined from close to 46% in 2008 to about 43.5% in 2011. Much of this contraction of public revenues and especially public expenditures has happened in 2011. The IMF is recommending further fiscal consolidation because public

Table RS

Serbia: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 [1]	2012	2013 Forecast	2014
Population, th. pers., mid-year	7411.6	7381.6	7350.2	7320.8	7291.4	7280	7250	7220	7200
Gross domestic product, RSD bn, nom. [2]	1962.1	2276.9	2661.4	2713.2	2986.6	3400	3600	3800	4100
annual change in % (real) [2]	3.6	5.4	3.8	-3.5	1.0	1.9	0	1	2
GDP/capita (EUR at exchange rate)	3100	3900	4400	3900	4000	4500	.	.	.
GDP/capita (EUR at PPP - wiiw)	7700	8200	9000	8400	8700	9100	.	.	.
Consumption of households, RSD bn, nom. [2]	1492.7	1714.0	2023.6	2143.2	2300.0	2600	.	.	.
annual change in % (real) [3]	5.4	6	6	-2	2	1	0	1	1
Gross fixed capital form., RSD bn, nom. [2]	412.8	552.3	632.4	510.2	600.0	700	.	.	.
annual change in % (real) [3]	15.2	12	8	-5	-4	0	3	3	3
Gross industrial production									
annual change in % (real) [4]	4.2	4.1	1.4	-12.6	2.5	2.1	2	3	4
Gross agricultural production									
annual change in % (real)	-2.6	-11.7	13.7	1.3	1.0	0.8	2	3	3
Construction output [5]									
annual change in % (real)	5.9	10.8	4.7	-19.7	-7.8	17.7	3	3	3
Employed persons - LFS, th, average [6]	2630.7	2655.7	2821.7	2616.4	2396.2	2253.2	2150	2100	2100
annual change in %	-3.8	1.0	.	-7.3	-8.4	-6.0	-5	-2	0
Unemployed persons - LFS, th, average [6]	693.0	585.5	445.4	503.0	568.7	671.1	.	.	.
Unemployment rate - LFS, in %, average [6]	20.9	18.1	13.6	16.1	19.2	23.0	25	25	25
Unemployment rate, reg., in %, end of period	28.0	25.4	24.0	25.9	26.7	27.2	28	28	28
Average gross monthly wages, RSD [7]	31745	38744	45674	44147	47450	52733	.	.	.
real growth rate, % (net wages) [7]	11.4	19.5	3.9	0.2	0.7	0.2	.	.	.
Consumer prices, % p.a.	11.7	7.0	13.5	8.6	6.8	11.0	7	5	5
Producer prices in industry, % p.a. [8]	.	.	12.4	5.6	12.7	14.3	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	44.2	44.0	43.0	42.3	41.0	39	.	.	.
Expenditures	45.8	46.0	45.6	46.7	45.5	44	.	.	.
Deficit (-) / surplus (+), % GDP	-1.6	-2.0	-2.6	-4.5	-4.6	-5	-5	-4	-4
Public debt, nat.def., in % of GDP	37.7	30.9	29.2	34.8	42.9	45	48	49	49
Central bank policy rate, % p.a., end of period [9]	14.00	10.00	17.75	9.50	11.50	9.75	8	6	5
Current account, EUR mn	-2356.0	-5052.6	-7054.1	-2084.4	-2082.0	-2490	-2900	-3280	-3240
Current account in % of GDP	-10.1	-17.7	-21.6	-7.2	-7.2	-7.5	-9.0	-10.0	-9.5
Exports of goods, BOP, EUR mn	5109.0	6382.5	7416.0	5977.8	7402.5	8500	9400	10300	11500
annual growth rate in %	27.4	24.9	16.2	-19.4	23.8	15	10	10	12
Imports of goods, BOP, EUR mn	10090.0	13451.3	15917.2	11096.3	12175.8	14000	15400	16900	18600
annual growth rate in %	21.8	33.3	18.3	-30.3	9.7	15	10	10	10
Exports of services, BOP, EUR mn	1839.0	2304.0	2741.4	2500.0	2667.1	2930	3200	3500	3900
annual growth rate in %	39.3	25.3	19.0	-8.8	6.7	10	10	10	10
Imports of services, BOP, EUR mn	1880.0	2565.1	2926.1	2481.7	2661.9	2930	3200	3500	3900
annual growth rate in %	41.9	36.4	14.1	-15.2	7.3	10	10	10	10
FDI inflow, EUR mn	3392.4	2512.6	2017.5	1410.1	1003.1	2000	2000	2000	2000
FDI outflow, EUR mn	69.8	691.8	193.1	37.6	143.0	50	300	100	100
Gross reserves of NB, excl. gold, EUR mn	8857.9	9440.7	7938.5	10277.7	9554.9	10500	.	.	.
Gross external debt, EUR mn	14182.0	17139.0	21088.0	22487.0	23786.4	24000	.	.	.
Gross external debt in % of GDP	60.9	60.2	64.6	77.9	82.0	72.7	.	.	.
Exchange rate RSD/EUR, average	84.19	79.98	81.47	93.94	102.90	102.93	112	116	120
Purchasing power parity RSD/EUR [10]	34.42	37.59	40.16	44.35	46.92	51.59	.	.	.

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

1) Preliminary and wiiw estimates. - 2) According to ESA'95 (non-observed economy partially included, real growth rates based on previous year prices). - 3) wiiw estimate. - 4) Accorrding to gross value added. -5) From 2008 extended survey as of April and October (before October only). - 6) From 2009 including wages of employees working for sole proprietors. - 7) Domestic output prices. - 8) Two-week repo rate. - 9) wiiw estimates based on the 2005 International Comparison Project benchmark and Eurostat.

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

debt is projected to go well above 50% of GDP in this and the next year and that is deemed to be unsustainable and is anyway in violation of the law of fiscal responsibility that put the limit of public debt to GDP at 45%. How sensible that ceiling is may be a good question, but if the fiscal deficit is to go back to that level, it will have to experience a rather significant decline.

The suggestion is to hike the VAT rate and to cut expenditures on wages, pensions, and subsidies. The entrepreneurs are unhappy with the tax hike and a further decline of public expenditures will be recessionary. With such an economic programme in place, it will take few years of restructuring of the product and labour markets for fast growth to return. There are few if any alternative policy proposals ahead of the upcoming elections. It is not expected that the new government will accept the IMF proposal, at least not in the pure version, as it is more likely that it will continue to muddle through relying on improved external circumstances. Therefore, chances are the Serbian economy is in for a few years of stagnation, i.e. of growth between 0 this year and perhaps 2% in 2014.

Table KZ

Kazakhstan: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 1)	2012	2013 Forecast	2014
Population, th pers., average 2)	15308	15484	15674	16093	16323	16558	16700	16800	16900
Gross domestic product, KZT bn, nom.	10214	12850	16053	17008	21816	27301	31500	35400	39600
annual change in % (real)	10.7	8.9	3.3	1.2	7.3	7.5	6	5	5.5
GDP/capita (EUR at exchange rate)	4200	4900	5800	5100	6800	8100	9400	10500	11800
GDP/capita (EUR at PPP - wiiw)	8000	8800	8900	8500	9300	10000	.	.	.
Consumption of households, KZT bn, nom.	4547	5641	6871	7913	9721	11390	12920	14380	15850
annual change in % (real)	12.7	10.9	6.3	0.7	10.0	8	5	4	4
Gross fixed capital form., KZT bn, nom.	3084	3857	4309	4727	5307	6590	7540	8790	10250
annual change in % (real)	29.7	17.3	1.0	-0.8	3.8	3.5	8	9	10
Gross industrial production									
annual change in % (real)	7.0	5.0	2.1	2.7	10.0	3.5	4	5	7
Gross agricultural production									
annual change in % (real)	7.0	8.9	-6.4	13.9	-11.7	26.7	2	8	5
Construction industry									
annual change in % (real)	28.6	5.7	1.9	-3.2	1.0	2.7	5	8	8
Employed persons - LFS, th, average	7403.5	7631.8	7857.2	7903.4	8114.2	8302.8	8390	8470	8550
annual change in %	2.0	3.1	3.0	0.6	2.7	2.3	1	1	1
Unemployed persons - LFS, th, average	625.4	578.8	557.8	554.5	496.5	473.1	.	.	.
Unemployment rate - LFS, in %, average	7.8	7.3	6.6	6.6	5.8	5.4	5.2	5	5
Reg. unemployment rate, in %, end of period	1.1	0.8	0.7	0.6	.	.	.	.	.
Average gross monthly wages, KZT	40790	53238	60734	67639	77565	89887	.	.	.
annual change in % (real, gross)	10.3	17.8	-2.6	3.8	7.0	7.2	.	.	.
Consumer prices, % p.a.	8.6	10.8	17.1	7.3	7.1	8.5	8	7	6
Producer prices in industry, % p.a.	18.4	12.4	36.8	-22.0	25.2	20	6	7	6
General governm.budget, nat.def., % GDP									
Revenues and grants	27.9	22.5	25.1	20.6	19.7	19.7	.	.	.
Expenditures and net lending	20.4	24.1	27.2	23.5	22.1	21.8	.	.	.
Deficit (-) / surplus (+), % GDP	7.5	-1.7	-2.1	-2.9	-2.4	-2.1	-2.5	-1.5	-1.0
Public debt, nat. def., in % of GDP	11.3	7.1	8.3	12.2	14.7	16	16	16	15
Central bank policy rate % p.a., end of period 3)	9.0	9.0	10.5	7.0	7.0	7.5	.	.	.
Current account, EUR mn 4)	-1592	-6077	4298	-2917	2269	9776	8800	8100	8600
Current account in % of GDP	-2.5	-7.9	4.7	-3.5	2.0	7.3	5.6	4.6	4.3
Exports of goods, BOP, EUR mn 4)	30881	35309	48905	31506	45814	63856	69100	79400	89000
annual growth rate in %	35.8	14.3	38.5	-35.6	45.4	39.4	8	15	12
Imports of goods, BOP, EUR mn 4)	19216	24288	26128	20770	24065	30260	35500	42500	48900
annual growth rate in %	33.1	26.4	7.6	-20.5	15.9	25.7	17	20	15
Exports of services, BOP, EUR mn 4)	2246	2603	3007	3038	3199	3172	3490	3770	4000
annual growth rate in %	25.4	15.9	15.5	1.0	5.3	-0.8	10	8	6
Imports of services, BOP, EUR mn 4)	6979	8566	7556	7200	8518	7521	8590	9450	10390
annual growth rate in %	15.9	22.7	-11.8	-4.7	18.3	-11.7	14	10	10
FDI inflow, EUR mn 4)	5002	8120	9732	9496	8040	9434	10200	11200	10800
FDI outflow, EUR mn 4)	-306	2303	818	2265	5888	3133	3610	3900	4320
Gross reserves of NB excl. gold, EUR mn	14525	11970	13711	16184	21360	22697	.	.	.
Gross external debt, EUR mn	56252	65791	76278	78933	90029	93660	.	.	.
Gross external debt in % of GDP	87.2	85.9	84.1	95.5	80.7	70.0	.	.	.
Average exchange rate KZT/EUR	158.27	167.75	177.04	205.67	195.67	204.11	202	202	199
Purchasing power parity KZT/EUR, wiiw 5)	83.35	93.87	115.30	123.85	143.49	164.62	.	.	.

1) Preliminary and wiiw estimates. - 2) From 2009 according to census 2009. - 3) Refinancing rate of NB. - 4) Converted from USD with the average exchange rate. - 5) wiiw estimates based on the 2005 International Comparison Project benchmark.

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

Olga Pindyuk

Kazakhstan:
Strong growth continues, but problems in the banking sector remain

Kazakhstan's economy demonstrated outstanding performance in 2011, with real GDP increasing by 7.5%. We forecast that strong GDP growth of 5-6% in real terms will continue in 2012-2014. Improved prospects for the economy are reflected in the country's upgraded ratings by S&P and Fitch.[28] The oil sector will remain the backbone of the economy, accounting for the bulk of its exports and FDI. Non-fuel exports further decreased their share in 2011 by about 6 percentage points to 22%; metals are the second largest exports item with a share of about 12%. We base our forecast of Kazakhstan's robust economic performance on the assumption that the world oil price dynamics will continue to be favourable for the country, as prices will remain at around 100 USD per barrel.

In 2011, rapid growth in Kazakhstan's commodity exports brought about a record-high current account surplus at a level of 7.4% of GDP. Most of the export growth occurred in value terms owing to the increase in global oil prices – the average price of crude Brent increased by about 39% in 2011. The physical volume of oil production rose only by 1% in 2011 – the increase being so modest partly due to the strikes of oil field workers in the West of the country. In the next three years, oil prices are not expected to soar further, and therefore Kazakhstan will have to rely on an increase in the production volume to boost its oil export revenues. We forecast that the increase in oil production will be very moderate in 2012 – about 2%; higher oil output growth is expected in 2013 with the Kashagan oil field starting its operation. This oil field is expected to produce around 400 thousand barrels of oil per day in the first phase.[29] This would allow Kazakhstan to increase its oil output by about 25% in 2013, which will translate into 15% growth of merchandise exports in 2013.

Development of the Kashagan field and increasing production and transportation capacities of other major oil fields will provide for a stable significant influx of FDI into the country. After the Kazakh government muscled into the fourth largest oil field Karachaganak by forcing the Karachaganak Petroleum Operating Consortium to sell it 10% of the stakes at the end of 2011, the state now has stakes in all the major oil fields. Thus government policy in the oil sector is likely to be more stable and predictable for investors in the near future.

Investment growth is forecasted to speed up in 2012-2014 to about 8-10% and outpace household consumption growth. Investment is expected to grow not only in the oil extraction, but in other sectors as well. The president of Kazakhstan announced in January 2012 ambitious investment plans

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[28] In November 2011, Fitch Ratings upgraded Kazakhstan's long-term foreign issuer default ratings from 'BBB-' to 'BBB', while Standard & Poor's upgraded the rating from 'BBB' to 'BBB+'.

[29] By 2020, the Kashagan oil field should increase its output to the peak level of about 1.5 million barrels of oil per day and become the biggest field in the country in terms of production.

which are to be financed from the National Oil Fund. In particular, money has to be channelled into the construction of roads and railroads, a fertilizer plant (USD 2 billion), a heat and power plant (USD 2.3 billion), an oil refinery at the Atyrau oil field (USD 1.7 billion), a gas processing plant (USD 5 billion), and some other projects.

Increased oil production will allow growth in exports to speed up in 2013-2014. However, it will also mean higher repatriated income of foreign investors, which will put a downward pressure on the current account. The increase in domestic investment and FDI will translate into growth of imports of equipment and services. Thus, the current account surplus will gradually decrease from 5.7% of GDP in 2012 to 4.4% of GDP in 2014.

Credit in Kazakhstan started to increase in 2011: in December, the amount of outstanding loans increased by 15.7% year on year, as compared to -0.7% year on year in December 2010. However, non-performing loans are still on the rise – in December 2011, the share of non-performing loans reached 21.7%, 1.7 percentage points higher as compared with December 2010. The bulk of the non-performing loans are corporate ones, with construction, real estate and trade having the highest shares. It is these sectors that were hit the hardest in 2008, and the ongoing increase in the share of non-performing loans is a delayed consequence of that hit: companies stop servicing their debt and banks have to admit more bad loans in their portfolios. In the BTA bank, which was restructured as a result of the crisis[30], the share of non-performing loans reached about 75%. In January 2012, the bank defaulted on its USD 160 million Eurobond coupon payment, and Fitch Ratings has downgraded the bank's Long-term Issuer Default Rating to 'RD' from 'C'. Now another agreement on the bank's restructuring is being negotiated.

Kazakh banks still have limited access to external financing and its share in total liabilities has been steadily declining – from 45% at the end of 2008 to 20% at the end of 2011. Thus, deposits of firms and households have become a primary source of funding. There are 15 banks with foreign capital in Kazakhstan, but they account only for about 23% of the banking sector assets, and many of them, including the biggest foreign bank ATF belonging to UniCredit Bank Austria, experienced losses in 2011. This environment reinforces risk aversion of banks and prevents them from any faster issuance of new loans.

The National Bank of Kazakhstan introduced important measures to restore the banking system's health, such as removing tax impediments to writing off bad loans, discouraging foreign currency lending, and increasing minimum capital requirements. However, additional measures are needed to reduce non-performing loans and bring back banks' willingness to issue loans.

The Customs Union between Belarus, Kazakhstan and Russia has been moving to a new level of integration: in December 2011, the member countries agreed on the forming of a Single Economic Space in 2015 and created the supranational governing body – the Eurasian Economic Commis-

[30] Kazakhstan was the first country to experience a sudden stop of external financing in 2007. Two major banks, BTA and Alliance, which were extremely dependent on external financing, had to go through restructuring in 2010.

sion. Also, the government announced that the country is going to enter the WTO already in 2012, as bilateral negotiations with almost all the members of the Working Group have been successfully concluded.

Early parliamentary elections were held in Kazakhstan on 16 January 2012. According to the voting results, the pro-Presidential party Nur Otan lost its monopoly status in the parliament, as two other parties managed to get 7.3% of votes each. Observers from the Organization for Security and Co-operation in Europe (OSCE) called the elections orchestrated and not meeting the fundamental principles of democratic elections, as the rights of citizens were seriously limited and opposition was practically banned from the election process. The change in the parliament's composition did not cause any visible political adjustments as the government remained unchanged.

Human rights issues have been escalating in Kazakhstan. A prolonged strike of oil field workers for pay rise in Zhanaozen in the West of the country turned into a violent confrontation on 16 December 2011. Firing on protesters by police resulted in 15 people killed and about 100 people wounded. The investigation of the incident led to the arrest of several opposition leaders who are accused of inciting striking oil workers to violence. International human rights watchdogs criticize the arrests as politically motivated. However, these issues are not likely to translate into large-scale unrest as the opposition has limited influence on the society and the country's territory is too big for coordinated widespread actions.

Table RU

Russia: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 [1]	2012	2013	2014
								Forecast	
Population, th pers., average [2]	142487	142115	141956	141902	142938	142500	142000	141500	141000
Gross domestic product, RUB bn, nom. [3]	26917.2	33247.5	41276.8	38808.7	45166.0	54369.1	61800	68800	76700
annual change in % (real) [3]	8.2	8.5	5.2	-7.8	4.3	4.3	4.2	4.1	4.3
GDP/capita (EUR at exchange rate)	5500	6700	8000	6200	7800	9300	.	.	.
GDP/capita (EUR at PPP - wiiw)	11100	12500	13100	11900	12600	13400	.	.	.
Consumption of households, RUB bn, nom. [3]	12974.7	16031.7	19966.9	20985.9	23475.9	27221.1	.	.	.
annual change in % (real) [3]	12.2	14.3	10.6	-5.1	5.1	6.4	5.5	5	5
Gross fixed capital form., RUB bn, nom. [3]	4980.6	6980.4	9200.8	8535.7	9829.2	11398.0			.
annual change in % (real) [3]	18.0	21.0	10.6	-14.4	5.8	6.0	6	6	5
Gross industrial production [4]									
annual change in % (real)	6.3	6.3	2.1	-9.3	8.2	4.7	6	5	6
Gross agricultural production									
annual change in % (real)	3.6	3.4	10.8	1.4	-11.3	22.1	.	.	.
Construction output									
annual change in % (real)	18.1	18.2	12.8	-13.2	3.5	5.1	6	5	6
Employed persons - LFS, th, average	68855.0	70570.5	70965.1	69284.9	69804.0	70732.0	70500	70000	70000
annual change in %	1.0	2.5	0.6	-2.4	0.7	1.3	-0.3	-0.7	0.0
Unemployed persons - LFS, th, average	5312.0	4589.0	4791.5	6372.8	5636.0	5020.0	5000	5000	5000.0
Unemployment rate - LFS, in %, average	7.2	6.1	6.3	8.4	7.5	6.6	6.6	6.7	6.7
Unemployment rate, reg., in %, end of period	2.3	2.0	2.0	2.9	2.1	1.7	.	.	.
Average gross monthly wages, RUB	10633.9	13593.4	17290.1	18637.5	20952.0	23532.0	.	.	.
annual change in % (real, gross)	13.3	17.0	11.0	-3.0	5.2	3.5	.	.	.
Consumer prices, % p.a.	9.8	9.1	14.1	11.8	6.9	8.5	5	6	5
Producer prices in industry, % p.a. [5]	12.4	14.1	21.4	-7.2	12.2	19.0	15	10	7
General governm.budget, nat.def., % GDP									
Revenues	39.5	40.2	38.8	35.1	35.7	35.5	.	.	.
Expenditures	31.1	34.2	33.9	41.1	39.2	33.1	.	.	.
Deficit (-) / surplus (+), % GDP	8.4	6.0	4.9	-6.3	-3.5	2.5	0	0	0
Public debt, nat.def., in % of GDP [6]	8.6	6.7	5.7	8.3	8.6	9.2	8	7	7
Central bank policy rate, % p.a., end of period [7]	11.00	10.00	13.00	8.75	7.75	8.00	.	.	.
Current account, EUR mn [8]	75474	56818	70642	34961	53236	72603	60000	50000	40000
Current account in % of GDP	9.6	6.0	6.2	4.0	4.8	5.5	4.0	3.1	2.2
Exports of goods, BOP, EUR mn [8]	241960	258930	321792	218221	303421	372000	410000	445000	480000
annual growth rate in %	23.7	7.0	24.3	-32.2	39.0	22.6	10	9	8
Imports of goods, BOP, EUR mn [8]	130948	163282	199148	137960	188483	231000	280000	320000	360000
annual growth rate in %	30.2	24.7	22.0	-30.7	36.6	22.6	21	14	13
Exports of services, BOP, EUR mn [8]	24791	28681	34921	29918	34190	39200	45000	49000	53000
annual growth rate in %	23.8	15.7	21.8	-14.3	14.3	14.7	15	9	8
Imports of services, BOP, EUR mn [8]	35643	42481	51495	44185	56326	65700	80000	95000	100000
annual growth rate in %	14.7	19.2	21.2	-14.2	27.5	16.6	22	19	5
FDI inflow, EUR mn [8]	23675	40237	51177	26254	32802	35000	45000	50000	55000
FDI outflow, EUR mn [8]	18454	33547	37934	31407	39800	50000	45000	40000	35000
Gross reserves of CB, excl. gold, EUR mn	224305	318840	291916	290432	335191	350786	.	.	.
Gross external debt, EUR mn	237669	316903	340688	325697	369458	416460	.	.	.
Gross external debt in % of GDP	30.1	33.4	30.1	37.0	33.0	31.3	.	.	.
Exchange rate RUB/EUR, average	34.11	35.01	36.43	44.14	40.30	40.87	41	42	43
Purchasing power parity RUB/EUR, wiiw [9]	16.95	18.79	22.13	22.91	25.02	28.42	.	.	.

1) Preliminary and wiiw estimates. - 2) Resident population. From 2010 according to census October 2010. - 3) FISIM reallocated to industries, real growth rates based on previous year prices etc. - 4) Excluding small enterprices. - 5) Domestic output prices. - 6) wiiw estimate. - 7) Refinancing rate of Central Bank. - 8) Converted from USD with the average exchange rate. - 9) wiiw estimates based on the 2005 International Comparison Project benchmark.

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

Peter Havlik

Russian Federation:
Instability ahead?

The Russian economy grew by more than 4% in 2011, a bit faster than expected earlier, largely thanks to the acceleration of growth towards the end of that year. The better than expected GDP growth resulted from a robust recovery of fixed investment, construction (housing in particular) and also growing consumer expenditures. The contribution of net exports to GDP growth was sharply negative because of widely diverging volumes of exports and imports (see below). On the supply side, the strong upturn of agricultural output (+22%) – after a dismal grain harvest due to severe drought in 2010 – contributed not only to the growth of GDP, but also to the reduction of consumer price inflation in the final months of 2011. Given the strong recovery of oil prices and the related surge in export revenues (USD-based oil prices increased by 40% in 2011 compared to the previous year; export revenues were up by more than 20% in EUR terms), the trade balance and current account surpluses rose as well (the latter reached 5.4% of GDP in 2011). Growing export proceeds helped to increase government revenues and, despite some increase in nominal expenditures, to achieve a balance, perhaps even a small surplus, in the state budget.

Together with slightly expanding employment (and the related drop in unemployment), all these positive economic developments should have influenced the outcome of the December parliamentary elections in favour of the ruling party United Russia. The more surprising were the announced results, with United Russia reportedly receiving less than 50% of the votes, and the Communist Party collecting many protest votes. Surprising have also been the mass post-election protests after the official voting results were confronted with numerous evidence of cheating. The reports about voting count falsification have been widely circulated and commented on in the mass media and on the Internet. The obviously falsified election results added to the widespread popular disillusionment, especially among the middle class intelligentsia in Moscow and St. Petersburg. Disillusionment escalated after the previous announcement of the switch in the Medvedev-Putin ruling tandem after the next presidential election. The subsequent popular protests, in parallel with organized pro-regime supporters, abruptly changed the political landscape in Russia: the perceived stability and apathy was suddenly over and the victory of Vladmir Putin in the presidential elections on 4 March 2012 does not guarantee stability either.

Moderate economic growth notwithstanding, inflation has calmed down towards the end of 2011, in part thanks to the absence of food price hikes following last year's favourable harvest. Another factor mitigating inflationary pressures has been the nominal rouble appreciation – a by-product of surging export revenues and related foreign exchange inflows. In real terms (deflated with the producer price index), the rouble appreciated by nearly 50% against the euro between January

2009 and January 2012.[31] Nevertheless, the volatility of the rouble exchange rate has been considerable: after a short-lived but sharp nominal and real depreciation during the peak of the crisis at the turn of 2008/2009, the real appreciation of the rouble soon resumed and has been one of the factors behind surging imports (in nominal euro terms, both exports and imports grew by about 23% in 2011). However, the volume of exports de facto stagnated (oil and gas exports even declined) whereas the import volume expanded by an estimated more than 20%. That notwithstanding, foreign exchange reserves are being replenished (they exceeded USD 500 billion in early 2012), although capital flight accelerated again, most likely due to political uncertainties before the presidential elections in March 2012. The outflow of capital from Russia exceeded USD 85 billion in 2011; even net FDI was most likely again negative – already for the third consecutive year.

The banking sector has been slowly consolidating yet the liquidity crisis has not yet been completely overcome. The share of non-performing loans is gradually declining (to 4.2% of total credits as of December 2011). However, at least one third of troubled credits have been restructured and their maturity extended. Last but not least, the market for housing mortgages is recovering as well, supporting rising construction activity: the volume of outstanding housing mortgages reached RUR 613 billion in November 2011 – nearly twice as much as in November 2010 (yet still nearly 20% less than before the 2008 crisis).

As mentioned repeatedly in our previous assessments, the recent years – either before or after the crisis – have not been used for launching economic restructuring and institutional reforms which would bring about the badly needed improvements of the business climate. Russia is as dependent on exports of commodities as ever: oil and gas account for about two thirds of export revenues. Restructuring, modernization and the 'innovation development' preached by the authorities already for a number of years have so far been just empty slogans. The long-term strategic target of economic diversification and modernization remains high on the agenda and is being pursued, mostly verbally, by both current President Medvedev and (likely) future President Putin. Modernization prospects suffered another blow after President Medvedev's announcement in September that Vladimir Putin should stand for the next presidential elections in March 2012. The long-lasting anxiety whether either Mr. Putin or Mr. Medvedev will be the next president was thus finally resolved; the tandem will probably switch positions as Mr. Medvedev should succeed Mr. Putin as the next Prime Minister. Paradoxically, this news created some disappointment in both Russia and abroad.[32] Disappointments with this uninspiring switch in the ruling tandem result not least from a growing scepticism regarding modernization and fears that Russia will turn back- and inward in the coming years. As the modernization will likely stall, a rising number of people will give up initiative for resignation (according to polls, emigration is being considered by an ever growing number of young and educated Russians). The above-mentioned rigging of the

[31] Indeed, producer price inflation is hovering close to 20% as a consequence of rising energy prices. The CPI-deflated real rouble exchange rate appreciated by about 16% in the same period.

[32] See, for instance, *The Financial Times*, 29 September 2011, p. 9.

December 2011 parliamentary elections, the stubborn reaction of the authorities and the related widespread popular protests have all increased the forthcoming political risks.

Despite Mr. Putin's convincing victory already in the first election round on 4 March 2012, his authority and the room for manoeuvre will be far more constrained than previously considered. In particular, his relatively low support in Moscow (he received less than 50% there) will require policy adjustments in order to accommodate (hopefully not to suppress) protests of disappointed middle class inteligentsia. There have been a lot of other worrying signals as well. Besides growing nationalism (common to many opposition figures such as the leading anti-corruption blogger Alexei Navalny and others), the openly expressed praise for the Soviet past (in particular for the Brezhnev era) by both Messrs. Putin and Medvedev do not bode well for modernization and forward-looking policies either – despite official claims to the contrary. These and other disturbing signals (such as the public clash and the dismissal of Deputy Prime Minister and Finance Minister Alexei Kudrin in November 2011, Russia's vetoing the UN resolutions on Iran and Syria) foster the views that instead of 'forwards' (Medvedev's slogan 'Russia Forward') the forthcoming years of Putin's presidency will lead Russia backwards, or at least to social and economic stagnation.

The elements of Putin's intended economic programme and future policies have been made public recently. In his first programmatic declaration (from October 2011), Mr. Putin announced the priority of Euroasian (EurAz) integration of the post-Soviet space.[33] A certain progress in this direction, at least on paper, was made in October 2011 in St. Petersburg when eight CIS republics (including Ukraine) announced the establishment of a free trade area (energy and metals will at first be excluded). Another of Putin's recent articles praised the stability achieved under his rule as well as his own leadership qualities.[34] Last but not least, the economic programme of his next presidency was made public in a lengthy article published under the heading 'We Need a New Economy' at the end of January 2012.[35] Apart from stressing again 'stability', as well as repeating the necessity to overcome the 'raw materials character' of the economy via modernization and diversification while rejecting protectionism, the suggested economic reform blueprint represents a somewhat confusing mix of industrial policy measures, the rejection of 'state capitalism' (despite praising the experiences of China and – presumably South – Korea), the support of further privatizations and foreign direct investments.[36] The latter should be attracted inter alia by an expansion of the 'internal market' – not least thanks to the above-mentioned re-integration of the post-Soviet space.

33 The Customs Union of Belarus, Kazakhstan and Russia was launched already in 2010. Later on, this will be expanded by Kyrgyzstan and Tajikistan, with the ultimate Russian aim to get Ukraine eventually on board as well. The Customs Union was upgraded to a Common Economic Space starting from January 2012.

34 See *Izvestiya*, 16 January 2012.

35 See *Vedomosti*, 30 January 2012.

36 Including selling minority stakes in the natural gas monopoly Gazprom – see *Vedomosti*, 7 February 2012.

The business climate remains 'unsatisfactory' in Putin's view, despite efforts undertaken during the past couple of years by President Medvedev – an indirect criticism of the latter while avoiding to admit own responsibilities as Prime Minister. Possibly reacting to the widespread criticism of United Russia as the 'party of crooks and thieves', Mr. Putin also complained in unusually harsh words the lack of transparency, failures of the state apparatus – including customs and tax officials, the legal and court systems – mentioning even 'systemic corruption' and demanding the elimination of all remnants of the Soviet legislation from the business legal codex which may hinder entrepreneurship. Within the next couple of years, Mr. Putin aims at the improvement of Russia's ranking in the World Bank Doing Business indicator (currently 120 out of 183), to reach at least the current rank of Kazakhstan (47).[37] Last but not least, the state's role in the economy should be reduced and competition fostered while maintaining macroeconomic stability. Taken together, all these and other outlined measures should contribute to economic diversification, productivity increases and the development of high-tech industries. In all these areas, including job creation, SMEs should play crucial role.

Pre-election rhetoric notwithstanding, any significant breakthrough is unlikely in the near future. Rather, uncertainties have increased as Mr. Putin's future presidency will be much weaker than previous ones (comparisons with Yeltsin's second term are being made). External risks have also increased: a more pronounced recession in Europe and a slowdown in the global economy may result in lower oil prices. On the other hand, the escalation of conflicts in the Middle East would go in the other direction and lead to price increases. In view of all these recent developments, the wiiw baseline forecast scenario reckons with oil prices staying at around USD 100 per barrel in 2012 and thereafter (largely in view of the currently sluggish demand in the West and a projected subsequent mild recovery). The 'horror scenario', with oil prices falling below USD 70 per bbl with severe consequences for Russian export and state budget revenues, is highly unlikely.

The unimpressive or diminishing drive for reforms and restructuring in Russia, together with the prospect of a weaker next presidency by Putin, may well get reflected in the continuation of capital flight and a poor climate for investments. In the medium term, a certain modernization drive could come from WTO membership: the final obstacle for Russia's WTO accession – after 18 years of negotiations – was removed when Georgia gave up its veto to Russia's membership and the accession protocol was signed in December 2011.[38] In the baseline scenario, wiiw reckons with unspectacular GDP growth during 2012-2014, most likely around 4% per year. This scenario assumes no abrupt policy changes or external shocks and is charged with substantial downside risks. In particular, a recession in Europe would have severe consequences for Russia, largely via falling export (and fiscal) revenues.[39] In the baseline scenario, export revenues will grow rather

[37] We note that Belarus ranks 69th and Georgia 16th in the same World Bank ranking.

[38] After ratification, Russia will become a fully-fledged WTO member in 2012 – see *CASE Network E-briefs*, No. 01/2012, January 2012.

[39] Some analysts are fairly upbeat claiming that nowadays Russia is much better prepared to face the challenges which would stem from a crisis in Europe – see, for example, the analysis of the Gaidar Institute published in *Vedomosti*, 19 October 2011.

slowly (if at all) owing to stagnating volumes of exported oil and gas in the forecasting period (and there will be not much else to export since the progress in export diversification will be limited). Simultaneously, import volumes are expected to grow at a faster rate as household consumption and investment will gradually pick up, both fuelled by the ongoing real currency appreciation. In the medium and long run, economic reforms and investments (including FDI) may be stimulated by WTO membership. This (relatively optimistic) scenario implies an ongoing negative contribution of real net exports to GDP growth in the coming years and, in nominal terms, gradual reductions of the trade and current account surpluses. With some luck the annual CPI inflation will gradually drop to 5% and the budget deficit will remain balanced.

The relatively high oil prices (more than USD 100 per bbl) are a double-edged sword: on the one hand, export revenues (and taxes) fill government coffers enabling the state to finance various spending programmes which range from rising pensions, infrastructure investments and military expenditure. The Russian economy's growing vulnerability concerning commodity prices is certainly risky – as demonstrated during the 2008/2009 crisis. Besides, high revenues from commodity exports put off the pressure to diversify and modernize the economy, stimulate currency appreciation and impede the competitiveness of non-commodity exports (Dutch Disease syndrome). Therefore, a new collapse of world market energy prices (which appears rather unlikely at the moment) would result in major troubles for the Russian economy: a sharp fall in economic growth with a simultaneous increase in the fiscal deficit, both adversely affecting all components of GDP. The shrinking of the labour force due to demographic factors, emerging skill shortages made more severe through outward migration (mostly to the West) and the demand for unskilled workers being usually met by migrants (mostly from former Soviet republics) represent another major challenge constraining the future economic growth in Russia.

Table UA

Ukraine: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 [1]	2012	2013 Forecast	2014
Population, th pers., average	46788	46509	46258	46053	45871	45700	45600	45500	45400
Gross domestic product, UAH mn, nom.	544153	720731	948056	913345	1082569	1314000	1434900	1612100	1777300
annual change in % (real)	7.3	7.9	2.3	-14.8	4.1	5.2	4	5	5
GDP/capita (EUR at exchange rate)	1800	2200	2700	1800	2200	2600	.	.	.
GDP/capita (EUR at PPP - wiiw)	5200	5800	6000	5100	5400	5800	.	.	.
Consumption of households, UAH mn, nom.	319383	423174	582482	581733	686082	829900	.	.	.
annual change in % (real)	15.9	17.2	13.1	-14.9	7.0	12	6	7	6
Gross fixed capital form., UAH mn, nom.	133874	198348	250158	167644	195927	246400	.	.	.
annual change in % (real)	21.2	23.9	-1.2	-50.5	4.9	9	7	8	8
Gross industrial production									
annual change in % (real)	6.2	7.6	-5.2	-21.9	11.2	7.3	5	6	6
Gross agricultural production									
annual change in % (real)	2.5	-6.5	17.1	-1.8	-1.5	17.5	.	.	.
Construction output									
annual change in % (real)	9.9	15.6	-15.8	-48.2	-5.4	11.1	.	.	.
Employed persons - LFS, th, average	20730.4	20904.7	20972.3	20191.5	20266.0	20290	20300	20350	20400
annual change in %	0.2	0.8	0.3	-3.7	0.4	0.1	0	0.2	0.2
Unemployed persons - LFS, th, average	1515.0	1417.6	1425.1	1958.8	1785.6	1760	.	.	.
Unemployment rate - LFS, in %, average	6.8	6.4	6.4	8.8	8.1	8	7.9	7.7	7.5
Unemployment rate, reg., in %, end of period [2]	2.7	2.3	3.0	1.9	2.0	1.8	.	.	.
Average gross monthly wages, UAH [3]	1041.5	1351.1	1806.3	1905.9	2239.2	2633.0	.	.	.
annual change in % (real, gross)	18.4	15.0	6.8	-9.0	9.7	8.9	.	.	.
Consumer prices, % p.a.	9.1	12.8	25.2	15.9	9.4	8.0	5	7	5
Producer prices in industry, % p.a. [4]	9.6	19.5	35.5	6.5	20.9	19.0	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	31.6	30.5	31.4	29.9	29.1	30.3	.	.	.
Expenditures	32.3	31.6	32.8	34.0	35.0	32.1	.	.	.
Deficit (-) / surplus (+) [5]	-0.7	-1.1	-1.5	-4.1	-6.0	-1.8	-3	-3	-2.5
Public debt, nat.def., in % of GDP	14.8	12.3	20.0	34.8	39.9	36	34	33	32
Central bank policy rate, % p.a., end of period [6]	8.50	8.00	12.00	10.25	7.75	7.75	.	.	.
Current account, EUR mn [7]	-1289	-3849	-8721	-1242	-2274	-6666	-7500	-8000	-8500
Current account in % of GDP	-1.5	-3.7	-7.1	-1.5	-2.2	-5.6	-5.7	-5.7	-5.5
Exports of goods, BOP, EUR mn [7]	31048	36383	46274	28958	39321	49913	54900	63100	72600
annual growth rate in %	10.5	17.2	27.2	-37.4	35.8	26.9	10	15	15
Imports of goods, BOP, EUR mn [7]	35188	44100	57270	32046	45641	59851	65800	75700	87100
annual growth rate in %	21.3	25.3	29.9	-44.0	42.4	31.1	10	15	15
Exports of services, BOP, EUR mn [7]	9000	10337	12228	9936	12856	13839	15500	17100	18500
annual growth rate in %	19.9	14.9	18.3	-18.8	29.4	7.6	12	10	8
Imports of services, BOP, EUR mn [7]	7305	8571	11039	8248	9538	10517	11800	13500	15700
annual growth rate in %	20.7	17.3	28.8	-25.3	15.6	10.3	12	14	16
FDI inflow, EUR mn [7]	4467	7220	7457	3453	4893	5000	6000	7000	8000
FDI outflow, EUR mn [7]	-106	491	690	116	555	248	.	.	.
Gross reserves of NB excl. gold, EUR mn	16587	21635	21847	17825	25096	23593	.	.	.
Gross external debt, EUR mn	41391	54421	72109	72113	88363	95000	.	.	.
Gross external debt in % of GDP	48.2	52.2	58.6	85.8	86.0	80.2	.	.	.
Exchange rate UAH/EUR, average	6.335	6.918	7.708	10.868	10.533	11.092	11	11.5	11.5
Purchasing power parity UAH/EUR, wiiw [8]	2.229	2.663	3.417	3.921	4.366	4.958	.	.	.

1) Preliminary and wiiw estimates. - 2) In % of working age population. - 3) Excluding small enterprises. - 4) Domestic output prices. - 5) wiiw projections include transfers to Naftohaz. - 6) Discount rate of NB. - 7) Converted from USD with the average exchange rate. - 8) wiiw estimates based on the 2005 International Comparison Project benchmark.

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

Vasily Astrov

Ukraine:
Association agreement with the EU delayed

The eurozone crisis and the turbulence in international financial markets have so far had only a limited impact on Ukraine's real economy. After soaring by 6.6% in the third quarter (year-on-year), GDP posted still respectable 4.6% growth in the fourth quarter of 2011. This translated into 5.2% growth for 2011 as a whole – slightly above our earlier forecast. Judging by the booming retail trade turnover (by nearly 15% in real terms), private consumption was the main growth pillar last year, backed by both increased disposable incomes and a higher propensity to spend. Also the replenishment of inventories and investments in fixed capital (+21% in the first nine months of 2011) contributed strongly to economic growth, the latter benefiting in particular from the government-sponsored infrastructure projects ahead of the 2012 European football championship. At the same time, public consumption probably declined and real net exports became more negative, as imports grew ahead of exports.

Across sectors, agriculture grew the fastest in 2011, largely thanks to a record-high grain harvest: some 57 million tons, or 44% higher than in 2010. Construction output was boosted by the pick-up in investments, particularly in the second half of 2011. By contrast, industrial production slowed down by the end of the year, partly because of the weakening of global demand for Ukraine's key exports such as metals and chemicals.

Thanks to good economic performance and increased tax compliance, tax revenues rose by 20% in nominal terms in 2011. As a result, the official budget deficit fell to a mere 1.8% of GDP (from 6% of GDP the year before), even if fiscal policy was not overly restrictive. However, taking into account the losses of the state-owned energy company Naftohaz, the consolidated deficit reached some 3.5% of GDP. At the same time, the government's borrowing needs were mitigated by strong privatization receipts (0.9% of GDP), mostly stemming from the sale of Ukrtelecom to an Austria-based investment fund. Also, in the course of 2011, Ukraine did not receive any tranches within the framework of the IMF stand-by programme, as the government refused to comply with the IMF requirement of raising gas tariffs for households. As a result, by the end of 2011 the stock of public debt fell to 36% of GDP (from 40% at the end of 2010).

Fiscal prudence, strong economic growth and (still) fairly high inflation suggest that the ratio of public debt to GDP will probably decline further in the coming years – barring strong currency devaluation.[40] The government target for 2012 is to further reduce the budget deficit to 2.5% of GDP (including transfers to Naftohaz). The low planned deficit is not least a reflection of the recent borrowing difficulties the government has been facing in the environment of increased risk aversion and ele-

40 The share of public debt denominated in foreign currency stands at around 60%.

vated devaluation expectations. In September-October 2011, the yields on hryvnia-denominated bonds shot up markedly, prompting the government to issue US dollar-indexed bonds and ultimately US dollar-denominated bonds instead. The borrowing problems may well persist in the months to come given the still unresolved eurozone crisis and its possible spillovers to emerging markets. Therefore, reliance on privatization revenues, which in 2012 are targeted at UAH 10 billion, may become all the more important. On the government's privatization list are notably stakes in regional energy companies.

The turmoil in international financial markets and the devaluation expectations in the last four months of 2011 put the hryvnia under considerable pressure. In response, the National Bank drastically tightened monetary policy and sold USD 6.4 billion out of its reserves. So far, these efforts have proved successful: the depreciation pressures have recently subsided, and the exchange rate has never left the narrow band of 8-8.1 UAH per USD. It is however questionable whether this peg can be credibly sustained, given the marked widening of the current account deficit last year (to 5.6% of GDP, from 2.2% of GDP in 2010) and the potential fragility of external funding in the coming months.

On the one hand, as a result of the recent monetary policy tightening, the stock of outstanding consumer loans fell by nearly 4% in nominal terms in the last four months of 2011, and the overall dynamics of domestic credit was also negative. These developments came on top of the already weak lending activity last year,[41] partly caused by the ongoing losses of the banking sector (albeit on a much smaller scale than in 2010). Also, foreign-owned banks – which account for some 40% of the sector – kept new lending virtually frozen and even withdrew some of their funds in the last quarter of 2011. Household deleveraging, if it continues, should dampen the growth of private consumption and of import demand this year.

On the other hand, Ukraine's import bill in 2012 may be inflated by the much higher price of imported natural gas (which is tied to the price of oil products with a 6-month lag) – unless the ongoing talks with Russia's Gazprom on revising the contract terms prove successful. In the first quarter of 2012, Ukraine is paying USD 416 per thousand cubic metres of gas (compared to USD 310 in the first quarter of 2011). Should the talks with Gazprom bear no fruit, currency devaluation might be difficult to avoid. However, a one-time devaluation by e.g. 10-15% – provided it is conducted in an orderly manner, ensures the credibility of the new exchange rate and thus prevents a dangerous build-up of expectations of further devaluation – would benefit the economy. It would improve external competitiveness and reduce current account imbalances without proving too costly for the authorities in political terms. Also, thanks to the enacted ban on foreign currency lending, the share of domestic credit denominated in foreign exchange has been declining over the past few years (from 59% in 2008 to 40% in 2011) so that the impact of devaluation on domestic borrowers and financial sector stability should be more modest.

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[41] In 2011 as a whole, the stock of consumer loans also declined by 4% (on an end-year basis), while the overall credit to the economy posted a 10% growth in nominal terms.

The expected slower growth of both private consumption and investments in 2012 will translate into lower GDP growth which we project at some 4%, with risks on the downside. This pace of growth will probably be insufficient to bring down the unemployment rate, which will stay at around 8%. The poor economic performance in the eurozone should have only a moderate impact on Ukraine, whose foreign trade is geographically relatively well diversified. By contrast, the expected robust growth in Russia will continue benefiting Ukraine's exports of machinery. Although foreign trade developments should be more balanced than last year (we project imports and exports to grow at the same pace in 2012), the current account deficit is unlikely to improve even if the price of imported gas goes down, and will stay at about 6% of GDP. Inflationary pressures will most probably intensify: the low consumer price inflation last year (a mere 4.6% on an end-year basis) was caused by the one-time factor of plunging prices for sugar and vegetables after a bumper harvest, which is unlikely to be repeated. However, the low end-year inflation in 2011 will be reflected in a low *average* inflation this year, which we expect not to exceed 5%. For subsequent years, we expect a pick-up of economic growth to some 5%, provided the eurozone crisis is resolved and the prices for Ukraine's exported commodities stay at a reasonably high level.

Following the indictment of the opposition leader and former prime minister Yuliya Tymoshenko (on charges of exceeding her authority in signing the 2009 gas contract with Russia), the signing of an Association Agreement and a related Deep and Comprehensive Free Trade Agreement with the EU was put on hold in December 2011. The reason is EU concerns with political developments in Ukraine exemplified by Ms. Tymoshenko's indictment. The latter is widely seen as an example of selective use of the judicial system for political purposes, raising questions about the adherence of the Ukrainian government to European 'values'. Meanwhile, further criminal cases have been opened against Ms. Tymoshenko, mostly related to her activities as head of Ukraine's Unified Energy Systems in the late 1990s. It is highly unlikely that she will be released prior to the forthcoming parliamentary elections in October 2012. Therefore, the chances that the Association Agreement with the EU will be signed (let alone ratified) until then – or indeed before the end of the year – are slim.

The latter does not necessarily mean that Ukraine will be advancing its integration into the alternative Russian-dominated integration block: the Customs Union and the Common Economic Space of Russia, Belarus and Kazakhstan. Apart from tricky political issues, Ukraine's accession to the Customs Union is complicated by its trade obligations resulting from its WTO membership (even though Russia is now joining the WTO as well). However, the current gas price negotiations with Russia's Gazprom may result in joint ownership of Naftohaz – with or without the involvement of the EU which has recently also shown interest in negotiations. Such a deal could bring Ukraine the benefits of a lower gas price in the short run and better prospects for the modernization of its crippled gas pipeline network in the medium and long run, although the transit revenues will also need to be shared. Besides, it would make the South Stream gas pipeline project almost certainly redundant, while European countries importing Russian gas via Ukraine will likely benefit from the improved security of gas supplies.[42]

[42] The relevance of this issue was again demonstrated in January 2012 when the unusually cold weather in Ukraine and in vast parts of Europe resulted in gas supply shortages, with Russia and Ukraine putting the blame on each other as usual.

The October 2012 parliamentary elections will be held according to the new rules. Half of the MPs will be elected by majority vote (instead of the pure party-list proportional representation so far); the threshold for a party to get into the parliament will rise to 5% (from 3% before); and parties will not be allowed to form electoral blocks. These changes are aimed at favouring the big parties, notably the currently ruling Party of Regions, and have prompted the opposition forces to consolidate. Thus, the two smaller 'orange' parties (Reform and Order and People's Self-Defence) have announced their merger with Ms. Tymoshenko's Fatherland party, while more generally the 'orange' opposition parties have reportedly agreed to put up a list of joint candidates in majority constituencies. Also the new parliament will most probably be narrowly split between the pro-Russian and 'orange' forces, reflecting the country's profound regional divisions.

Appendix

Selected indicators of competitiveness

Table A/1

GDP per capita at current PPPs (EUR), from 2011 at constant PPPs and population

	1991	1995	2000	2005	2007	2008	2009	2010	2011	2012	2013	2014
Bulgaria	4400	4600	5400	8200	10000	10900	10300	10700	11300	11300	11400	11700
Cyprus	10600	12800	16700	20300	23100	24700	23500	24200	24500	24400	24800	25800
Czech Republic	8800	11200	13500	17800	20600	20200	19300	19400	20100	20200	20700	21400
Estonia	5500	5300	8600	13900	17500	17300	14900	15700	17400	17700	18400	19300
Hungary	6800	7500	10300	14200	15400	16000	15200	15800	16400	16200	16500	17000
Latvia	6500	4600	6900	10800	13900	14100	12000	12500	14500	14800	15300	15800
Lithuania	7100	5200	7500	11900	14800	15400	12800	14000	16200	16500	17100	17800
Malta	9500	12700	16200	17600	19000	19700	19300	20200	20800	21000	21400	22300
Poland	4500	6200	9100	11500	13600	14100	14300	15300	16200	16700	17400	18100
Romania	4000	4800	5000	7900	10400	11700	11000	11400	13300	13400	13800	14200
Slovakia	5800	7000	9600	13500	16900	18200	17000	18000	18800	19100	19700	20500
Slovenia	8500	10900	15300	19700	22100	22700	20500	20700	21100	20900	21200	21500
NMS-12	5400	6500	8600	11800	14100	14700	14200	14900	16000	16200	16700	17300
Croatia	7000	6700	9500	12800	15200	15900	14900	14900	15100	14900	15000	15300
Macedonia	4300	4000	5100	6600	7700	8400	8500	8700	9100	9300	9600	9900
Montenegro	.	.	5600	6900	10000	10700	9700	10100	10500	10600	10800	11100
Turkey	3800	4400	8300	9700	11500	11700	10900	12000	13000	13400	14100	14800
Albania	1400	2000	3500	5000	5800	6400	6500	6600	6800	6900	7100	7300
Bosnia and Herzegovina	.	.	3900	5200	6300	6700	6400	6600	6800	6800	6900	7000
Serbia	.	.	5000	7100	8200	9000	8400	8700	9100	9100	9200	9400
Kazakhstan	.	3100	4200	7300	8800	8900	8500	9300	10000	10600	11100	11700
Russia	7700	5300	6600	10000	12500	13100	11900	12600	13400	14000	14600	15200
Ukraine	4700	2600	2800	4700	5800	6000	5100	5400	5800	6000	6300	6600
Austria	18700	19700	25100	28200	30900	31100	29300	30800	32100	32300	32900	33600
Germany	18200	18900	22400	26000	28900	29000	27200	28800	30100	30300	30800	31400
Greece	12200	12300	16000	20400	22500	23100	22100	21900	21000	20100	20200	20600
Ireland	12400	15200	25100	32600	36900	33300	30000	31100	31900	32100	32800	33500
Italy	16800	17800	22400	23700	26000	26100	24400	24600	25000	24700	24900	25400
Portugal	10600	11300	15500	17900	19600	19500	18800	19500	19500	18900	19100	19500
Spain	12800	13400	18500	22900	26200	25900	24200	24500	25000	24800	25100	25600
USA	21400	23300	30600	35700	37700	36700	34200	36100	37000	37600	38100	38900
EU-27 average	13700	14700	19000	22500	25000	25000	23500	24400	25300	25300	25700	26300

European Union (27) average = 100

	1991	1995	2000	2005	2007	2008	2009	2010	2011	2012	2013	2014
Bulgaria	32	31	28	36	40	44	44	44	45	45	44	44
Cyprus	77	87	88	90	92	99	100	99	97	96	96	98
Czech Republic	64	76	71	79	82	81	82	80	79	80	81	81
Estonia	40	36	45	62	70	69	63	64	69	70	72	73
Hungary	50	51	54	63	62	64	65	65	65	64	64	65
Latvia	47	31	36	48	56	56	51	51	57	58	60	60
Lithuania	52	35	39	53	59	62	54	57	64	65	67	68
Malta	69	86	85	78	76	79	82	83	82	83	83	85
Poland	33	42	48	51	54	56	61	63	64	66	68	69
Romania	29	33	26	35	42	47	47	47	53	53	54	54
Slovakia	42	48	51	60	68	73	72	74	74	75	77	78
Slovenia	62	74	81	88	88	91	87	85	83	83	82	82
NMS-12	39	44	45	52	56	59	60	61	63	64	65	66
Croatia	51	46	50	57	61	64	63	61	60	59	58	58
Macedonia	31	27	27	29	31	34	36	36	36	37	37	38
Montenegro	.	.	29	31	40	43	41	41	42	42	42	42
Turkey	28	30	44	43	46	47	46	49	51	53	55	56
Albania	10	14	18	22	23	26	28	27	27	27	28	28
Bosnia and Herzegovina	.	.	21	23	25	27	27	27	27	27	27	27
Serbia	.	.	26	32	33	36	36	36	36	36	36	36
Kazakhstan	.	21	22	32	35	36	36	38	40	42	43	44
Russia	56	36	35	44	50	52	51	52	53	55	57	58
Ukraine	34	18	15	21	23	24	22	22	23	24	25	25
Austria	136	134	132	125	124	124	125	126	127	128	128	128
Germany	133	129	118	116	116	116	116	118	119	120	120	119
Greece	89	84	84	91	90	92	94	90	83	79	79	78
Ireland	91	103	132	145	148	133	128	127	126	127	128	127
Italy	123	121	118	105	104	104	104	101	99	98	97	97
Portugal	77	77	82	80	78	78	80	80	77	75	74	74
Spain	93	91	97	102	105	104	103	100	99	98	98	97
USA	156	159	161	159	151	147	146	148	146	149	148	148
EU-27 average	100	100	100	100	100	100	100	100	100	100	100	100

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

Table A/2

Indicators of macro-competitiveness, 2005-2014

EUR based, annual averages

	2005	2008	2009	2010	2011	2012	2013	2014
							Forecast	
Bulgaria								
Producer price index, 2005=100	100.0	133.8	125.1	135.9	148.6	153.2	157.7	162.4
Consumer price index, 2005=100	100.0	129.4	132.6	136.6	141.2	145.4	149.8	154.3
GDP deflator, 2005=100	100.0	126.6	132.0	136.0	144.7	149.1	153.6	158.1
Exchange rate (ER), NC/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2005=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2005=100	100.0	119.3	121.1	122.2	122.5	123.3	124.8	126.0
Real ER (PPI-based), 2005=100	100.0	117.7	115.0	120.7	125.0	126.5	128.0	129.2
PPP, NC/EUR	0.7156	0.8355	0.8712	0.8729	0.9138	0.93	0.94	0.95
Price level, EU27 = 100	37	43	45	45	47	47	48	48
Average monthly gross wages, NC	324	545	609	647	707	730	760	800
Average monthly gross wages, EUR (ER)	166	279	311	331	361	370	390	410
Average monthly gross wages, EUR (PPP)	452	652	699	742	773	790	810	850
GDP nominal, NC mn	45484	69295	68322	70474	76170	78500	81900	86600
Employed persons - LFS, th.,average	2982	3361	3254	3053	2950	2930	2960	3000
GDP per employed person, NC	15253	20619	20999	23085	25824	26800	27700	28900
GDP per empl. person, NC at 2000 pr.	12001	12815	12514	13352	14042	14100	14200	14400
Unit labour costs, NC, 2005=100	100.0	157.6	180.5	179.8	186.5	191.9	198.4	206.0
Unit labour costs, ER adj., 2005=100	100.0	157.6	180.5	179.8	186.5	191.9	198.4	206.0
Unit labour costs, PPP adj., Austria=100	17.5	25.4	27.5	27.5	28.2	28.3	29.3	29.9
Czech Republic								
Producer price index, 2005=100	100.0	103.2	101.6	101.7	105.5	107.6	108.4	109.9
Consumer price index, 2005=100	100.0	111.7	112.4	113.7	116.2	119.9	122.3	124.8
GDP deflator, 2005=100	100.0	105.8	107.9	106.0	105.8	107.9	108.7	110.2
Exchange rate (ER), NC/EUR	29.78	24.95	26.44	25.28	24.59	25	24.75	24.5
ER nominal, 2005=100	100.0	83.8	88.8	84.9	82.6	83.9	83.1	82.3
Real ER (CPI-based), 2005=100	100.0	123.0	115.6	119.8	122.1	121.1	122.6	123.9
Real ER (PPI-based), 2005=100	100.0	108.4	105.2	106.4	107.4	105.9	105.9	106.3
PPP, NC/EUR	17.10	18.24	18.46	18.47	18.13	18.2	18.0	17.9
Price level, EU27 = 100	57	73	70	73	74	73	73	73
Average monthly gross wages, NC	18344	22592	23344	23797	24420	25100	26000	27200
Average monthly gross wages, EUR (ER)	616	906	883	941	993	1000	1050	1110
Average monthly gross wages, EUR (PPP)	1073	1238	1265	1289	1347	1380	1450	1520
GDP nominal, NC bn	3116	3848	3739	3775	3835	3930	4060	4260
Employed persons - LFS, th., average	4764	5003	4934	4885	4905	4910	4930	4950
GDP per employed person, NC	654084	769298	757803	772791	781871	800400	823500	860600
GDP per empl. person, NC at 2000 pr.	581925	647012	624734	648314	657587	660200	673900	694700
Unit labour costs, NC, 2005=100	100.0	110.8	118.5	116.4	117.8	120.6	122.4	124.2
Unit labour costs, ER adj., 2005=100	100.0	132.2	133.5	137.2	142.7	143.7	147.3	151.0
Unit labour costs, PPP adj., Austria=100	35.5	43.2	41.2	42.5	43.7	42.9	44.0	44.4
Estonia								
Producer price index, 2005=100	100.0	121.7	122.6	126.6	132.0	136.7	142.2	147.9
Consumer price index, 2005=100	100.0	123.3	123.6	127.0	133.4	137.8	143.0	148.8
GDP deflator, 2005=100	100.0	127.9	126.6	128.0	134.9	139.7	145.3	151.1
Exchange rate (ER), NC/EUR	1.000	1.000	1.000	1.000	1.0	1.0	1.0	1.0
ER, nominal, 2005=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2005=100	100.0	113.7	112.8	113.5	115.7	116.9	119.2	121.5
Real ER (PPI-based), 2005=100	100.0	107.1	112.6	112.5	111.0	112.9	115.4	117.7
PPP, NC/EUR	0.5997	0.7020	0.6922	0.6808	0.7060	0.72	0.73	0.75
Price level, EU27 = 100	60	70	69	68	71	72	73	75
Average monthly gross wages, NC	516	825	784	792	831	880	930	1000
Average monthly gross wages, EUR (ER)	516	825	784	792	831	880	930	1000
Average monthly gross wages, EUR (PPP)	860	1176	1132	1164	1177	1220	1270	1340
GDP nominal, NC mn	11182	16304	13840	14305	16200	17100	18500	20200
Employed persons - LFS, th., average	607.4	656.5	595.8	570.9	609.2	615	630	640
GDP per employed person, NC	18409	24835	23229	25059	26592	27800	29400	31600
GDP per empl. person, NC at 2000 pr.	14326	15116	14277	15233	15345	15500	15700	16300
Unit labour costs, NC, 2005=100	100.0	151.6	152.4	144.4	150.4	157.6	164.5	170.3
Unit labour costs, ER adj., 2005=100	100.0	151.6	152.4	144.4	150.4	157.6	164.5	170.3
Unit labour costs, PPP adj., Austria=100	38.7	54.0	51.3	48.7	50.1	51.3	53.5	54.6

(Table A/2 ctd.)

(Table A/2 ctd.)

	2005	2008	2009	2010	2011	2012	2013	2014
							Forecast	
Hungary								
Producer price index, 2005=100	100.0	111.9	116.9	124.3	127.4	133.1	136.7	139.7
Consumer price index, 2005=100	100.0	119.1	123.9	129.7	134.8	141.5	146.5	151.0
GDP deflator, 2005=100	100.0	114.9	119.0	122.6	126.9	132.5	136.1	139.1
Exchange rate (ER), NC/EUR	248.05	251.51	280.33	275.48	279.37	295	290	285
ER, nominal 2005=100	100.0	101.4	113.0	111.1	112.6	118.9	116.9	114.9
Real ER (CPI-based), 2005=100	100.0	108.3	100.1	104.5	103.8	100.9	104.4	107.4
Real ER (PPI-based), 2005=100	100.0	97.1	95.1	99.5	95.1	92.4	94.9	96.8
PPP, NC/EUR	153.62	165.55	168.29	169.20	172.32	176.8	178.5	178.8
Price level, EU27 = 100	62	66	60	61	62	60	62	63
Average monthly gross wages, NC	158343	198741	199837	202525	213054	220400	228100	239900
Average monthly gross wages, EUR (ER)	638	790	713	735	763	750	790	840
Average monthly gross wages, EUR (PPP)	1031	1200	1187	1197	1236	1250	1280	1340
GDP nominal, NC bn	22018	26546	25623	26748	28150	29100	30500	32100
Employed persons - LFS, th., average	3902	3879	3782	3781	3812	3810	3830	3850
GDP per employed person, NC	5643543	6842720	6775310	7073855	7384769	7637800	7963400	8337700
GDP per empl. person, NC at 2000 pr.	4113370	4341828	4151538	4205622	4243145	4202800	4264500	4369600
Unit labour costs, NC, 2005=100	100.0	118.9	125.0	125.1	130.4	136.2	138.9	142.6
Unit labour costs, ER adj., 2005=100	100.0	117.3	110.6	112.6	115.8	114.5	118.8	124.1
Unit labour costs, PPP adj., Austria=100	39.5	42.7	38.0	38.8	39.4	38.1	39.5	40.6
Latvia								
Producer price index, 2005=100	100.0	142.7	136.2	140.0	150.4	153.8	158.0	162.5
Consumer price index, 2005=100	100.0	135.2	139.6	137.9	143.7	147.0	150.7	155.2
GDP deflator, 2005=100	100.0	151.7	149.9	146.5	152.9	156.3	160.7	165.3
Exchange rate (ER), NC/EUR	0.6962	0.7027	0.7057	0.7087	0.7063	0.71	0.71	0.71
ER, nominal, 2005=100	100.0	100.9	101.4	101.8	101.5	102.0	102.0	102.0
Real ER (CPI-based), 2005=100	100.0	123.6	125.8	121.2	122.9	122.3	123.1	124.3
Real ER (PPI-based), 2005=100	100.0	124.4	123.4	122.2	124.7	124.6	125.8	126.8
PPP, NC/EUR	0.3607	0.5051	0.4814	0.4543	0.4669	0.47	0.47	0.48
Price level, EU27 = 100	52	72	68	64	66	66	67	67
Average monthly gross wages, NC	246	479	461	445	465	490	520	550
Average monthly gross wages, EUR (ER)	353	682	653	628	658	690	730	770
Average monthly gross wages, EUR (PPP)	681	948	958	979	996	1040	1100	1150
GDP nominal, NC mn	9000	16085	13070	12739	14000	14600	15500	16500
Employed persons - LFS, th., average	1034	1125	983	941	971	980	990	1010
GDP per employed person, NC	8707	14304	13295	13539	14426	14900	15700	16300
GDP per empl. person, NC at 2000 pr.	6776	7339	6903	7194	7341	7400	7600	7700
Unit labour costs, NC, 2005=100	100.0	180.0	184.1	170.6	174.6	182.6	188.6	196.9
Unit labour costs, ER adj., 2005=100	100.0	178.3	181.7	167.5	172.1	179.0	185.0	193.1
Unit labour costs, PPP adj., Austria=100	30.6	50.3	48.4	44.7	45.4	46.1	47.7	49.0
Lithuania								
Producer price index, 2005=100	100.0	135.7	117.3	129.5	147.5	151.1	155.6	161.1
Consumer price index, 2005=100	100.0	122.0	127.1	128.6	133.9	137.2	141.4	146.3
GDP deflator, 2005=100	100.0	127.1	122.4	124.8	131.1	134.3	138.3	143.1
Exchange rate (ER), NC/EUR	3.453	3.453	3.453	3.453	3.453	3.45	3.45	3.45
ER, nominal, 2005=100	100.0	100.0	100.0	100.0	100.0	99.9	99.9	99.9
Real ER (CPI-based), 2005=100	100.0	112.5	116.1	115.0	116.2	116.5	117.9	119.6
Real ER (PPI-based), 2005=100	100.0	119.4	107.8	115.0	124.0	125.0	126.4	128.3
PPP, NC/EUR	1.776	2.171	2.150	2.062	2.132	2.15	2.17	2.20
Price level, EU27 = 100	51	63	62	60	62	62	63	64
Average monthly gross wages, NC	1276	2152	2056	1988	2028	2130	2260	2430
Average monthly gross wages, EUR (ER)	370	623	595	576	587	620	660	700
Average monthly gross wages, EUR (PPP)	719	991	956	964	951	990	1040	1100
GDP nominal, NC mn	72402	112084	91914	95074	105713	110600	117900	126900
Employed persons - LFS, th., average	1474	1520	1416	1344	1371	1380	1395	1410
GDP per employed person, NC	49123	73739	64916	70756	77112	80100	84500	90000
GDP per empl. person, NC at 2000 pr.	45400	53629	49030	52412	54381	55100	56500	58100
Unit labour costs, NC, 2005=100	100.0	142.7	149.2	134.9	132.7	137.5	142.3	148.8
Unit labour costs, ER adj., 2005=100	100.0	142.7	149.2	134.9	132.7	137.6	142.4	148.9
Unit labour costs, PPP adj., Austria=100	29.1	38.3	37.8	34.3	33.3	33.7	34.9	35.9

(Table A/2 ctd.)

(Table A/2 ctd.)

	2005	2008	2009	2010	2011	2012	2013	2014
							Forecast	
Poland								
Producer price index, 2005=100	100.0	106.4	110.5	113.1	121.6	126.4	130.2	133.5
Consumer price index, 2005=100	100.0	108.3	112.6	115.6	120.1	123.1	126.2	128.7
GDP deflator, 2005=100	100.0	108.7	112.8	114.3	118.4	121.7	124.9	127.3
Exchange rate (ER), NC/EUR	4.023	3.512	4.328	3.995	4.121	4.15	4.15	4.15
ER, nominal, 2005=100	100.0	87.3	107.6	99.3	102.4	103.2	103.2	103.2
Real ER (CPI-based), 2005=100	100.0	114.4	95.6	104.1	101.7	101.2	101.9	101.9
Real ER (PPI-based), 2005=100	100.0	107.2	94.4	101.2	99.8	101.3	102.4	103.0
PPP, PLZ/EUR	2.233	2.375	2.470	2.425	2.473	2.50	2.52	2.52
Price level, EU27 = 100	56	68	57	61	60	60	61	61
Average monthly gross wages, NC	2361	2942	3102	3225	3386	3520	3680	3870
Average monthly gross wages, EUR (ER)	587	838	717	807	822	850	890	930
Average monthly gross wages, EUR (PPP)	1057	1239	1256	1330	1369	1410	1460	1540
GDP nominal, NC bn	983	1275	1343	1415	1530	1620	1730	1840
Employed persons - LFS, th., average	14116	15800	15868	15961	16120	16200	16440	16690
GDP per employed person, NC	69661	80725	84659	88679	94913	100000	105200	110200
GDP per empl. person, NC at 2000 pr.	61375	65417	66140	68372	70620	72400	74200	76200
Unit labour costs, NC, 2005=100	100.0	116.9	121.9	122.6	124.7	126.4	128.9	132.0
Unit labour costs, ER adj., 2005=100	100.0	133.9	113.3	123.5	121.7	122.5	125.0	128.0
Unit labour costs, PPP adj., Austria=100	41.5	51.2	40.9	44.7	43.6	42.8	43.7	44.0
Romania								
Producer price index, 2005=100	100.0	135.7	138.2	147.0	160.1	169.7	179.9	189.0
Consumer price index, 2005=100	100.0	120.7	127.4	135.2	143.0	148.8	154.7	160.9
GDP deflator, 2005=100	100.0	144.7	150.8	159.9	171.0	181.3	192.2	201.9
Exchange rate (ER), NC/EUR	3.621	3.683	4.240	4.212	4.239	4.3	4.3	4.2
ER, nominal, 2005=100	100.0	101.7	117.1	116.3	117.1	118.8	118.8	116.0
Real ER (CPI-based), 2005=100	100.0	109.5	99.4	103.9	106.0	106.2	108.5	113.3
Real ER (PPI-based), 2005=100	100.0	117.5	108.5	112.3	115.0	118.1	123.0	129.7
PPP, NC/EUR	1.700	2.042	2.113	2.144	2.257	2.35	2.45	2.52
Price level, EU27 = 100	47	55	50	51	53	55	57	60
Average monthly grross wages, NC	968	1761	1845	1902	1995	2100	2230	2390
Average monthly gross wages, EUR (ER)	267	478	435	452	471	490	520	570
Average monthly gross wages, EUR (PPP)	569	862	873	887	884	890	910	950
GDP nominal, NC mn	288955	514700	501139	522561	573000	613500	670000	725000
Employed persons - LFS, th., average	9115	9369	9244	9239	9200	9150	9150	9200
GDP per employed person, NC	31702	54936	54215	56558	62283	67000	73200	78800
GDP per empl. person, NC at 2000 pr.	11733	14054	13308	13092	13481	13700	14100	14400
Unit labour costs, NC, 2005=100	100.0	151.9	168.0	176.1	179.4	185.8	191.7	201.2
Unit labour costs, ER adj., 2005=100	100.0	149.3	143.5	151.4	153.2	156.5	161.4	173.4
Unit labour costs, PPP adj., Austria=100	34.0	46.8	42.4	44.9	44.9	44.8	46.2	48.8
Slovakia								
Producer price index, 2005=100	100.0	104.1	97.2	97.3	101.6	103.6	106.7	109.9
Consumer price index, 2005=100	100.0	110.4	111.4	112.2	116.8	119.1	122.7	126.4
GDP deflator, 2005=100	100.0	107.1	105.8	106.3	110.6	113.4	116.8	120.4
Exchange rate (ER), NC/EUR	1.2813	1.0377	1.0	1.0	1.0	1.0	1.0	1.0
ER, nominal, 2005=100	100.0	81.0	78.0	78.0	78.0	78.0	78.0	78.0
Real ER (CPI-based), 2005=100	100.0	125.7	130.4	128.6	129.8	129.4	131.0	132.2
Real ER (PPI-based), 2005=100	100.0	113.1	114.4	110.8	109.4	109.7	111.0	112.1
PPP NC/ EUR	0.6761	0.6813	0.6810	0.6758	0.6922	0.70	0.71	0.71
Price level, EU27 = 100	53	66	68	68	69	70	71	71
Average monthly gross wages, NC	573	723	745	769	790	810	850	900
Average monthly gross wages, EUR (ER)	448	697	745	769	790	810	850	900
Average monthly gross wages, EUR (PPP)	848	1061	1093	1138	1141	1160	1200	1260
GDP nominal, NC mn	49314	66932	62896	65887	70800	73700	78200	83800
Employed persons - LFS, th., average	2215	2434	2366	2318	2352	2350	2390	2430
GDP per employed person, NC	22262	27502	26580	28430	30102	31400	32700	34500
GDP per empl. person, NC at 2000 pr.	17881	20632	20182	21473	21867	22200	22500	23000
Unit labour costs, NC, 2005=100	100.0	109.3	115.0	111.7	112.7	113.8	117.8	122.0
Unit labour costs, ER adj., 2005=100	100.0	134.9	147.4	143.1	144.3	145.8	150.9	156.3
Unit labour costs, PPP adj., Austria=100	31.0	38.6	39.8	38.7	38.6	38.1	39.4	40.2

(Table A/2 ctd.)

(Table A/2 ctd.)

	2005	2008	2009	2010	2011	2012	2013	2014
							Forecast	
Slovenia								
Producer price index, 2005=100	100.0	110.9	109.4	111.5	116.6	120.1	123.7	127.4
Consumer price index, 2005=100	100.0	112.3	113.3	115.6	118.0	120.4	122.8	125.3
GDP deflator, 2005=100	100.0	110.7	114.1	112.8	115.1	117.5	119.8	122.2
Exchange rate (ER), NC/EUR	0.9997	1.0	1.0	1.0	1.0	1.0	1.0	1.0
ER, nominal, 2005=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2005=100	100.0	103.5	103.4	103.4	102.4	102.1	102.3	102.3
Real ER (PPI-based), 2005=100	100.0	97.6	100.5	99.1	98.0	99.2	100.4	101.4
PPP, NC/EUR	0.7306	0.8114	0.8451	0.8339	0.8377	0.84	0.84	0.84
Price level, EU27 = 100	73	81	85	83	84	84	84	84
Average monthly gross wages, NC	1157	1391	1439	1495	1525	1550	1580	1620
Average monthly gross wages, EUR (ER)	1157	1391	1439	1495	1525	1550	1580	1620
Average monthly gross wages, EUR (PPP)	1584	1715	1703	1793	1820	1850	1880	1930
GDP nominal, NC mn	28722	37280	35311	35416	36300	36660	37950	39290
Employed persons - LFS, th., average	949	996	981	966	940	920	910	920
GDP per employed person, NC	30259	37425	36006	36662	38617	39800	41700	42700
GDP per empl. person, NC at 2000 pr.	23366	26099	24377	25094	25900	26200	26900	27000
Unit labour costs, NC, 2005=100	100.0	107.7	119.2	120.3	118.9	119.5	118.6	121.2
Unit labour costs, ER adj., 2005=100	100.0	107.6	119.2	120.3	118.8	119.4	118.6	121.1
Unit labour costs, PPP adj., Austria=100	62.1	61.6	64.4	65.2	63.7	62.4	62.0	62.3
Croatia								
Producer price index, 2005=100	100.0	115.1	114.6	119.5	127.2	132.3	136.2	140.3
Consumer price index, 2005=100	100.0	112.7	115.4	116.6	119.3	122.3	125.2	127.7
GDP deflator, 2005=100	100.0	114.8	118.7	119.9	122.7	125.8	128.8	131.3
Exchange rate (ER), NC/EUR	7.400	7.223	7.340	7.286	7.434	7.5	7.45	7.45
ER, nominal, 2005=100	100.0	97.6	99.2	98.5	100.5	101.4	100.7	100.7
Real ER (CPI-based), 2005=100	100.0	106.5	106.2	106.0	103.0	102.3	103.6	103.6
Real ER (PPI-based), 2005=100	100.0	103.8	106.2	107.9	106.5	107.8	109.8	110.9
PPP, NC/EUR	4.677	4.900	5.066	5.093	5.128	5.17	5.20	5.20
Price level, EU27 = 100	63	68	69	70	69	69	70	70
Average monthly gross wages, NC	6248	7544	7711	7679	7750	7930	8160	8410
Average monthly gross wages, EUR (ER)	844	1044	1051	1054	1043	1060	1100	1130
Average monthly gross wages, EUR (PPP)	1336	1539	1522	1508	1511	1540	1570	1620
GDP nominal, NC mn	266652	345015	335189	334564	343300	347700	359600	374100
Employed persons - LFS, th., average	1573	1636	1605	1541	1485	1470	1470	1480
GDP per employed person, NC	169518	210954	208802	217080	231178	236500	244600	252800
GDP per empl. person, NC at 2000 pr.	140854	152633	146158	150416	156572	156300	157800	159900
Unit labour costs, NC, 2005=100	100.0	111.4	118.9	115.1	111.6	114.4	116.6	118.6
Unit labour costs, ER adj., 2005=100	100.0	114.2	119.9	116.9	111.1	112.9	115.8	117.8
Unit labour costs, PPP adj., Austria=100	52.1	54.8	54.4	53.1	49.9	49.5	50.8	50.8
Macedonia								
Producer price index, 2005=100	100.0	120.5	111.9	121.6	135.1	139.1	143.3	147.6
Consumer price index, 2005=100	100.0	114.3	113.4	115.2	119.7	123.3	127.0	130.8
GDP deflator, 2005=100	100.0	119.3	120.1	122.0	126.8	130.6	134.5	138.5
Exchange rate (ER), NC/EUR	61.30	61.27	61.27	61.52	61.53	61.5	61.5	61.5
ER, nominal, 2005=100	100.0	100.0	100.0	100.4	100.4	100.3	100.3	100.3
Real ER (CPI-based), 2005=100	100.0	105.5	103.6	102.7	103.5	104.2	105.5	106.5
Real ER (PPI-based), 2005=100	100.0	106.1	102.8	107.6	113.2	114.6	115.9	117.1
PPP, NC/EUR	21.97	23.93	23.59	23.83	24.37	24.7	25.0	25.2
Price level, EU27 = 100	36	39	38	39	40	40	41	41
Average monthly gross wages, NC [1)]	21330	26229	29922	30225	30830	32400	34000	35700
Average monthly gross wages, EUR (ER)	348	428	488	491	501	530	550	580
Average monthly gross wages, EUR (PPP)	971	1096	1269	1268	1265	1310	1360	1420
GDP nominal, NC mn	295052	411728	410734	424762	456800	481300	510600	544300
Employed persons - LFS, th., average	545.3	609.0	629.9	637.9	650	660	670	680
GDP per employed person, NC	541129	676056	652061	665923	702769	729200	762100	800400
GDP per empl. person, NC at 2000 pr.	481346	504256	482973	485543	493171	496800	504100	514100
Unit labour costs, NC, 2005=100	100.0	117.4	139.8	140.5	141.1	147.2	152.2	156.7
Unit labour costs, ER adj., 2005=100	100.0	117.4	139.9	140.0	140.5	146.7	151.7	156.2
Unit labour costs, PPP adj., Austria=100	33.8	36.5	41.1	41.2	40.9	41.7	43.1	43.7

1) From 2009 including allowances for food and transport.

(Table A/2 ctd.)

(Table A/2 ctd.)

	2005	2008	2009	2010	2011	2012	2013	2014
							Forecast	
Montenegro								
Producer price index, 2005=100	100.0	128.1	123.1	122.0	125.9	128.5	133.4	136.7
Consumer price index, 2005=100	100.0	115.3	119.2	119.8	123.5	127.2	131.0	135.0
GDP deflator, 2005=100	100.0	132.3	135.5	137.7	143.5	146.4	152.0	155.8
Exchange rate (ER), EUR/EUR	1	1	1	1	1	1	1	1
Real ER (CPI-based), 2005=100	100.0	106.3	108.8	107.1	107.1	107.9	109.1	110.2
Real ER (PPI-based), 2005=100	100.0	109.5	114.4	114.2	112.7	112.2	113.0	112.5
PPP, NC/EUR	0.4199	0.4596	0.4884	0.4964	0.5093	0.51	0.52	0.52
Price level, EU27 = 100	42	46	49	50	51	51	52	52
Average monthly gross wages, NC	326	609	643	715	722	760	810	860
Average monthly gross wages, EUR (PPP)	777	1325	1316	1440	1418	1490	1560	1640
GDP nominal, NC mn	1815.0	3085.6	2981.0	3103.9	3300	3400	3600	3800
Employed persons - LFS, th., average	178.8	218.8	212.9	208.2	198	198	200	210
GDP per employed person, NC	10150	14102	14002	14912	16667	17200	18000	18100
GDP per empl. person, NC at 2000 pr.	6846	7187	6968	7303	7831	7900	8000	7800
Unit labour costs, NC, 2005=100	100.0	177.7	193.5	205.3	193.3	201.7	212.3	231.2
Unit labour costs, PPP adj., Austria=100	30.3	49.7	51.1	54.3	50.6	51.5	54.2	58.1
Albania								
Producer price index, 2005=100	100.0	111.1	109.2	109.5	112.2	114.5	119.1	123.8
Consumer price index, 2005=100	100.0	108.9	111.4	115.3	119.4	123.0	127.9	133.0
GDP deflator, 2005=100	100.0	111.4	114.0	116.6	121.0	124.8	129.7	135.0
Exchange rate (ER), NC/EUR	124.2	122.8	132.1	137.8	140.3	137	132	130
ER, nominal, 2005=100	100.0	98.9	106.3	111.0	113.0	110.3	106.3	104.7
Real ER (CPI-based), 2005=100	100.0	101.6	95.7	93.0	91.7	94.5	100.2	103.8
Real ER (PPI-based), 2005=100	100.0	98.8	94.4	87.7	83.5	85.7	90.9	94.1
PPP, NC/EUR	52.13	53.48	55.39	57.83	59.06	59.9	61.1	62.3
Price level, EU27 = 100	42	44	42	42	42	44	46	48
Average monthly gross wages, NC	19993	34277	36075	38492	41030	43500	47000	51300
Average monthly gross wages, EUR (ER)	161	279	273	279	292	320	360	390
Average monthly gross wages, EUR (PPP)	384	641	651	666	695	730	770	820
GDP nominal, NC bn	815	1089	1151	1220	1290	1360	1450	1560
Employed persons - LFS, th., Oct [2)]	932	1123	1161	1200	1200	1180	1200	1220
GDP per employed person, NC	874565	969738	991831	1016667	1075000	1152500	1208300	1278700
GDP per empl. person, NC at 2000 pr.	746612	742980	742889	744265	758431	788200	795200	808800
Unit labour costs, NC, 2005=100	100.0	172.3	181.3	193.1	202.0	206.1	220.7	236.9
Unit labour costs, ER adj., 2005=100	100.0	174.2	170.5	174.1	178.8	186.8	207.7	226.3
Unit labour costs, PPP adj., Austria=100	21.6	34.6	32.0	32.7	33.2	33.9	37.7	40.4
Bosnia and Herzegovina								
Producer price index, 2007=100	.	108.6	105.1	106.1	110.0	112.2	114.4	116.7
Consumer price index, 2005=100	100.0	115.9	115.4	117.8	122.2	124.6	127.1	129.7
GDP deflator, 2005=100	100.0	121.1	121.2	123.0	127.8	130.6	133.0	135.5
Exchange rate (ER), NC/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2005=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2005=100	100.0	106.9	105.4	105.4	106.0	105.7	105.9	105.9
Real ER (PPI-based), 2007=100	.	102.2	103.3	100.8	98.9	99.2	99.4	99.4
PPP, NC/EUR	0.8579	0.9658	0.9842	0.9742	0.9963	1.00	1.00	1.00
Price level, EU27 = 100	44	49	50	50	51	51	51	51
Average monthly gross wages, NC	796	1113	1204	1217	1270	1300	1340	1380
Average monthly gross wages, EUR (ER)	407	569	615	622	649	660	690	710
Average monthly gross wages, EUR (PPP)	928	1152	1223	1249	1275	1300	1340	1380
GDP nominal, NC mn	17218	24759	24051	24584	26100	26800	27700	28800
Employed persons - LFS, th., April [3)]	641.5	890.2	859.2	842.8	816.0	810	810	812
GDP per employed person, NC	26839	27812	27992	29168	31984	33100	34200	35500
GDP per empl. person, NC at 2000 pr.	22653	19377	19491	20014	21123	21400	21700	22100
Unit labour costs, NC, 2005=100	100.0	163.4	175.6	172.9	171.0	172.8	175.6	177.6
Unit labour costs, ER adj., 2005=100	100.0	163.4	175.6	172.9	171.0	172.8	175.6	177.6
Unit labour costs, PPP adj., Austria=100	29.2	44.0	44.7	44.1	43.1	42.5	43.2	43.0

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

(Table A/2 ctd.)

(Table A/2 ctd.)

	2005	2008	2009	2010	2011	2012	2013	2014
							Forecast	
Serbia								
Producer price index, 2007=100	100.0	134.9	142.3	160.4	174.7	194.2	202.9	214.6
Consumer price index, 2005=100	100.0	135.7	147.3	157.4	174.7	186.9	196.2	206.0
GDP deflator, 2005=100	100.0	139.5	147.4	160.7	179.5	190.0	198.6	210.1
Exchange rate (ER), NC/EUR	82.91	81.47	93.94	102.90	102.93	112	116	120
ER, nominal, 2005=100	100.0	98.3	113.3	124.1	124.2	135.1	139.9	144.7
Real ER (CPI-based), 2005=100	100.0	127.3	118.7	113.4	122.0	117.3	116.8	116.3
Real ER (PPI-based), 2005=100	100.0	120.8	115.4	114.9	124.2	118.8	117.7	118.0
PPP, NC/EUR	31.73	40.16	44.35	46.92	51.59	53.7	55.1	57.1
Price level, EU27 = 100	38	49	47	46	50	48	48	48
Average monthly gross wages, NC	25514	45674	44147	47450	52733	56420	59830	63450
Average monthly gross wages, EUR (ER)	308	561	470	461	512	500	520	530
Average monthly gross wages, EUR (PPP)	804	1137	995	1011	1022	1050	1090	1110
GDP nominal, NC bn	1683	2661	2713	2987	3400	3600	3800	4100
Employed persons - LFS, th., average	2733	2822	2616	2396	2253	2150	2100	2100
GDP per employed person, NC	615891	943178	1036985	1246373	1508959	1674400	1809500	1952400
GDP per empl. person, NC at 2000 pr.	182488	200289	208424	229850	249097	261100	269900	275300
Unit labour costs, NC, 2005=100	100.0	163.1	151.5	147.7	151.4	154.6	158.6	164.8
Unit labour costs, ER adj., 2005=100	100.0	166.0	133.7	119.0	122.0	114.4	113.3	113.9
Unit labour costs, PPP adj., Austria=100	35.6	54.5	41.4	37.0	37.4	34.3	34.0	33.6
Russia								
Producer price index, 2005=100	100.0	155.7	144.5	162.1	192.8	221.7	243.9	261.0
Consumer price index, 2005=100	100.0	136.7	152.8	163.4	177.2	186.1	197.3	207.1
GDP deflator, 2005=100	100.0	154.7	157.7	176.0	203.2	221.6	237.0	253.3
Exchange rate (ER), NC/EUR	35.26	36.43	44.14	40.30	40.87	41	42	43
ER, nominal, 2005=100	100.0	103.3	125.2	114.3	115.9	116.3	119.1	121.9
Real ER (CPI-based), 2005=100	100.0	122.0	111.5	127.8	132.7	135.7	138.0	138.7
Real ER (PPI-based), 2005=100	100.0	132.6	106.1	126.0	139.9	157.6	166.2	170.3
PPP, NC/EUR	15.06	22.13	22.91	25.02	28.42	30.5	32.0	33.5
Price level, EU27 = 100	43	61	52	62	70	74	76	78
Average monthly gross wages, NC	8555	17290	18638	20952	23532	26070	29020	31990
Average monthly gross wages, EUR (ER)	243	475	422	520	576	640	690	740
Average monthly gross wages, EUR (PPP)	568	781	814	837	828	860	910	950
GDP nominal, NC bn	21610	41277	38809	45166	54369	61800	68800	76700
Employed persons - LFS, th., average	68169	70965	69285	69804	70732	70500	70000	70000
GDP per employed person, NC	317003	581650	560133	647041	768663	876600	982900	1095700
GDP per empl. person, NC at 2000 pr.	144166	171042	161528	167159	172061	179900	188600	196700
Unit labour costs, NC, 2005=100	100.0	170.4	194.4	211.2	230.5	244.2	259.3	274.1
Unit labour costs, ER adj., 2005=100	100.0	164.9	155.3	184.8	198.9	210.0	217.7	224.8
Unit labour costs, PPP adj., Austria=100	25.9	39.3	35.0	41.7	44.4	45.8	47.4	48.2
Ukraine								
Producer price index, 2005=100	100.0	177.5	189.0	228.5	271.9	285.5	305.5	320.8
Consumer price index, 2005=100	100.0	154.1	178.6	195.4	211.0	221.5	237.0	248.9
GDP deflator, 2005=100	100.0	181.1	204.7	232.9	268.8	282.2	302.0	317.1
Exchange rate (ER), NC/EUR	6.389	7.708	10.868	10.533	11.092	11	11.5	11.5
ER, nominal, 2005=100	100.0	120.6	170.1	164.9	173.6	172.2	180.0	180.0
Real ER (CPI-based), 2005=100	100.0	117.8	95.9	106.0	105.4	109.1	109.7	112.9
Real ER (PPI-based), 2005=100	100.0	129.4	102.1	123.2	131.7	137.0	137.8	141.8
PPP, NC/EUR	1.9861	3.4175	3.9206	4.3657	4.9579	5.12	5.38	5.53
Price level, EU27 = 100	31	44	36	41	45	47	47	48
Average monthly gross wages, NC	806	1806	1906	2239	2633	2930	3350	3730
Average monthly gross wages, EUR (ER)	126	234	175	213	237	270	290	320
Average monthly gross wages, EUR (PPP)	406	529	486	513	531	570	620	670
GDP nominal, NC mn	441452	948056	913345	1082569	1314000	1434900	1612100	1777300
Employed persons - LFS, th., average	20680	20972	20192	20266	20267	20300	20350	20400
GDP per employed person, NC	21347	45205	45234	53418	64834	70700	79200	87100
GDP per empl. person, NC at 2000 pr.	11942	13960	12362	12828	13494	14000	14700	15400
Unit labour costs, NC, 2005=100	100.0	191.7	228.4	258.6	289.0	310.0	337.6	358.8
Unit labour costs, ER adj., 2005=100	100.0	158.9	134.2	156.8	166.5	180.0	187.5	199.3
Unit labour costs, PPP adj., Austria=100	26.4	38.6	30.8	36.1	37.8	40.0	41.6	43.5

(Table A/2 ctd.)

(Table A/2 ctd.)

	2005	2008	2009	2010	2011	2012	2013	2014
							Forecast	
Austria								
Producer price index, 2005=100	100.0	114.0	105.5	110.8	120.0	122.8	124.7	126.7
Consumer price index, 2005=100	100.0	107.1	107.6	109.6	113.2	115.6	117.8	120.3
GDP deflator, 2005=100	100.0	105.8	106.9	108.8	111.2	113.7	115.5	117.3
Real ER (CPI-based), 2005=100	100.0	98.7	98.3	98.1	98.2	98.1	98.2	98.2
Real ER (PPI-based), 2005=100	100.0	100.3	97.0	98.5	100.9	101.4	101.2	100.8
PPP, NC/EUR	1.0589	1.0904	1.1226	1.1077	1.1150	1.115	1.118	1.113
Price level, EU27 = 100	106	109	112	111	112	111	112	111
Average monthly gross wages, EUR	2790	3087	3154	3200	3290	3380	3440	3530
Average monthly gross wages, EUR (PPP)	2635	2831	2809	2889	2951	3032	3078	3172
GDP nominal, NC mn	245243	282746	274818	286200	300900	310100	322200	333800
Employed persons - LFS, th., average	3824	4090	4078	4100	4150	4170	4190	4230
GDP per employed person, NC	64126	69131	67395	69800	72500	74400	76900	78900
GDP per empl. person, NC at 2000 pr.	59243	60389	58263	59284	60235	60400	61500	62100
Unit labour costs, NC, 2005=100	100.0	108.5	115.0	114.6	116.0	118.8	118.8	120.7
Unit labour costs, PPP adjusted	0.59	0.64	0.67	0.67	0.68	0.70	0.70	0.71

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

The development of unit labour costs is defined as average gross wages per employee relative to labour productivity (real GDP per employed person).

PPP rates have been taken from Eurostat based on the benchmark results 2005. For Albania, Bosnia and Herzegovina, Montenegro and Serbia available data 2005-2010 have been extrapolated by wiiw with GDP deflators. Russia and Ukraine are estimated by wiiw using the OECD PPP benchmark results 2005 and extrapolation with GDP price deflators.

Real exchange rates: Increasing values mean real appreciation.

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

Table A/3

Indicators of macro-competitiveness, 2005-2014

annual changes in %

	2005	2008	2009	2010	2011	2012	2013 Forecast	2014	2005-08 average
Bulgaria									
GDP deflator	7.3	8.4	4.3	3.0	6.4	3.1	3.0	3.0	8.0
Exchange rate (ER), EUR/NC	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	3.6	8.0	1.5	0.9	0.3	0.7	1.2	1.0	5.4
Real ER (PPI-based)	3.4	4.4	-2.3	5.0	3.5	1.3	1.2	0.9	5.0
Average gross wages, NC	10.7	26.5	11.8	6.3	9.1	3.3	4.1	5.3	16.8
Average gross wages, real (PPI based)	2.6	14.1	19.5	-2.1	-0.2	0.3	1.1	2.2	6.6
Average gross wages, real (CPI based)	4.4	13.0	9.1	3.2	5.6	0.3	1.1	2.2	8.0
Average gross wages, EUR (ER)	10.6	26.5	11.8	6.3	9.1	2.4	5.4	5.1	16.8
Employed persons (LFS)	2.0	3.3	-3.2	-6.2	-3.4	-0.7	1.0	1.4	3.6
GDP per empl. person, NC at 2000 prices	4.3	2.8	-2.3	6.7	5.2	0.4	0.7	1.4	2.7
Unit labour costs, NC at 2000 prices	6.2	23.1	14.5	-0.4	3.8	2.9	3.4	3.8	13.7
Unit labour costs, ER (EUR) adjusted	6.0	23.1	14.5	-0.4	3.8	2.9	3.4	3.8	13.7
Czech Republic									
GDP deflator	-0.3	1.9	2.0	-1.7	-0.3	2.0	0.8	1.4	1.3
Exchange rate (ER), EUR/NC	7.1	11.3	-5.6	4.6	2.8	-1.6	1.0	1.0	6.3
Real ER (CPI-based)	6.5	14.1	-6.0	3.6	1.9	-0.8	1.2	1.0	7.0
Real ER (PPI-based)	3.3	5.2	-3.0	1.2	0.9	-1.5	0.0	0.4	2.9
Average gross wages, NC	5.0	7.8	3.3	1.9	2.6	2.8	3.6	4.6	6.6
Average gross wages, real (PPI based)	4.5	7.4	4.9	1.9	-1.1	0.8	2.8	3.2	5.7
Average gross wages, real (CPI based)	3.3	1.4	2.7	0.8	0.4	-0.4	1.6	2.6	3.3
Average gross wages, EUR (ER)	12.5	20.0	-2.5	6.6	5.5	0.7	5.0	5.7	13.4
Employed persons (LFS)	1.2	1.6	-1.4	-1.0	0.4	0.1	0.4	0.4	1.5
GDP per empl. person, NC at 2000 prices	5.4	1.5	-3.4	3.8	1.4	0.4	2.1	3.1	4.0
Unit labour costs, NC at 2000 prices	-0.3	6.2	7.0	-1.8	1.2	2.4	1.5	1.5	2.5
Unit labour costs, ER (EUR) adjusted	6.7	18.2	1.0	2.7	4.0	0.7	2.5	2.5	9.0
Estonia									
GDP deflator	6.1	5.3	-1.0	1.1	5.3	3.6	4.0	4.0	7.9
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	1.9	6.7	-0.8	0.6	1.9	1.0	2.0	2.0	3.7
Real ER (PPI-based)	-2.3	1.7	5.2	-0.2	-1.3	1.8	2.2	2.0	1.1
Average gross wages, NC	10.8	13.9	-5.0	1.1	4.9	5.9	5.7	7.5	15.4
Average gross wages, real (PPI based)	8.9	5.4	-5.7	-2.1	0.6	2.2	1.6	3.4	9.4
Average gross wages, real (CPI based)	6.4	3.0	-5.2	-1.6	-0.2	2.5	1.8	3.4	8.4
Average gross wages, EUR (ER)	10.8	13.9	-5.0	1.1	4.9	5.9	5.7	7.5	15.4
Employed persons (LFS)	2.0	0.2	-9.2	-4.2	6.7	1.0	2.4	1.6	2.5
GDP per empl. person, NC at 2000 prices	6.7	-3.8	-5.5	6.7	0.7	1.0	1.3	3.8	3.0
Unit labour costs, NC at 2000 prices	3.9	18.5	0.6	-5.3	4.1	4.8	4.3	3.6	12.0
Unit labour costs, ER (EUR) adjusted	3.9	18.5	0.6	-5.3	4.1	4.8	4.3	3.6	12.0
Hungary									
GDP deflator	2.5	5.3	3.6	3.1	3.5	4.4	2.8	2.2	4.2
Exchange rate (ER), EUR/NC	1.5	-0.1	-10.3	1.8	-1.4	-5.3	1.7	1.8	0.0
Real ER (CPI-based)	2.7	2.2	-7.6	4.4	-0.6	-2.8	3.4	2.9	2.7
Real ER (PPI-based)	0.4	-1.6	-2.1	4.6	-4.3	-2.8	2.7	1.9	-0.6
Average gross wages, NC	8.8	7.4	0.6	1.3	5.2	3.4	3.5	5.2	8.1
Average gross wages, real (PPI based)	5.5	2.7	-3.8	-4.7	2.6	-0.9	0.7	2.9	4.3
Average gross wages, real (CPI based)	5.1	1.3	-3.3	-3.2	1.2	-1.5	0.0	2.0	2.6
Average gross wages, EUR (ER)	10.4	7.3	-9.8	3.1	3.7	-1.7	5.3	6.3	8.1
Employed persons (LFS)	0.0	-1.2	-2.5	0.0	0.8	0.0	0.5	0.5	-0.1
GDP per empl. person, NC at 2000 prices	3.9	2.1	-4.4	1.3	0.9	-1.0	1.5	2.5	2.3
Unit labour costs, NC at 2000 prices	4.7	5.2	5.2	0.0	4.3	4.4	2.0	2.6	5.6
Unit labour costs, ER (EUR) adjusted	6.3	5.1	-5.7	1.8	2.8	-1.1	3.8	4.4	5.7
Latvia									
GDP deflator	10.1	12.9	-1.2	-2.3	4.4	2.2	2.8	2.9	13.7
Exchange rate (ER), EUR/NC	-4.5	-0.4	-0.4	-0.4	0.3	-0.5	0.0	0.0	-1.4
Real ER (CPI-based)	-0.1	10.7	1.8	-3.7	1.4	-0.5	0.7	1.0	5.4
Real ER (PPI-based)	-1.0	4.5	-0.8	-1.0	2.0	-0.1	1.0	0.8	5.4
Average gross wages, NC	16.5	20.5	-3.8	-3.5	4.5	5.4	6.1	5.8	22.8
Average gross wages, real (PPI based)	7.9	8.1	0.9	-6.1	-2.7	3.1	3.3	2.8	10.2
Average gross wages, real (CPI based)	9.0	4.5	-6.8	-2.3	0.3	3.0	3.5	2.7	12.0
Average gross wages, EUR (ER)	11.3	20.0	-4.2	-3.9	4.8	4.8	5.8	5.5	21.1
Employed persons (LFS)	1.6	0.6	-12.6	-4.3	3.1	1.0	1.0	2.0	2.5
GDP per empl. person, NC at 2000 prices	8.5	-3.8	-5.9	4.2	2.0	0.8	2.7	1.3	4.1
Unit labour costs, NC at 2000 prices	7.4	25.2	2.3	-7.4	2.4	4.5	3.3	4.4	17.9
Unit labour costs, ER (EUR) adjusted	2.6	24.8	1.9	-7.8	2.7	4.0	3.3	4.4	16.3

(Table A/3 ctd.)

Table A/3 (ctd.)

	2005	2008	2009	2010	2011	2012	2013 Forecast	2014	2005-08 average
Lithuania									
GDP deflator	6.6	9.7	-3.7	2.0	5.0	2.5	3.0	3.5	7.9
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Real ER (CPI-based)	0.5	7.1	3.1	-0.9	1.0	0.3	1.2	1.5	3.1
Real ER (PPI-based)	7.2	11.2	-9.7	6.7	7.8	0.8	1.2	1.5	6.4
Average gross wages, NC	11.0	19.4	-4.4	-3.3	2.0	5.0	6.1	7.5	17.0
Average gross wages, real (PPI based)	-0.5	1.0	10.5	-12.4	-10.4	2.5	3.0	3.9	5.4
Average gross wages, real (CPI based)	8.2	7.5	-8.3	-4.4	-2.0	2.5	3.0	3.9	10.6
Average gross wages, EUR (ER)	11.0	19.4	-4.4	-3.3	2.0	5.6	6.5	6.1	17.0
Employed persons (LFS)	2.6	-0.9	-6.8	-5.1	2.0	0.7	1.1	1.1	1.4
GDP per empl. person, NC at 2000 prices	5.1	3.9	-8.6	6.9	3.8	1.3	2.5	2.8	5.5
Unit labour costs, NC at 2000 prices	5.7	14.9	4.5	-9.5	-1.7	3.7	3.5	4.6	10.8
Unit labour costs, ER (EUR) adjusted	5.7	14.9	4.5	-9.5	-1.7	3.7	3.5	4.6	10.8
Poland									
GDP deflator	2.6	3.1	3.7	1.3	3.6	2.8	2.6	2.0	2.8
Exchange rate (ER), EUR/NC	12.5	7.7	-18.8	8.3	-3.1	-0.7	0.0	0.0	6.6
Real ER (CPI-based)	12.5	8.3	-16.5	8.9	-2.3	-0.5	0.7	0.0	6.5
Real ER (PPI-based)	8.5	3.9	-12.0	7.2	-1.4	1.5	1.2	0.5	3.8
Average gross wages, NC	3.8	10.1	5.4	4.0	5.0	4.0	4.5	5.2	6.7
Average gross wages, real (PPI based)	3.4	7.5	1.5	1.6	-2.3	0.0	1.5	2.6	4.9
Average gross wages, real (CPI based)	1.7	5.6	1.4	1.3	1.1	1.4	2.0	3.1	4.0
Average gross wages, EUR (ER)	16.8	18.6	-14.4	12.6	1.8	3.4	4.7	4.5	13.6
Employed persons (LFS)	2.3	3.7	0.4	0.6	1.0	0.5	1.5	1.5	3.5
GDP per empl. person, NC at 2000 prices	1.3	1.4	1.1	3.4	3.3	2.5	2.5	2.7	1.9
Unit labour costs, NC at 2000 prices	2.5	8.6	4.3	0.6	1.7	1.4	2.0	2.4	4.6
Unit labour costs, ER (EUR) adjusted	15.4	16.9	-15.4	9.0	-1.5	0.7	2.0	2.4	11.5
Romania									
GDP deflator	12.2	15.2	4.2	6.0	6.9	6.0	6.0	5.1	12.9
Exchange rate (ER), EUR/NC	11.9	-9.4	-13.1	0.7	-0.6	-1.4	0.0	2.4	2.4
Real ER (CPI-based)	19.4	-5.8	-9.2	4.6	2.0	0.2	2.2	4.4	6.9
Real ER (PPI-based)	16.1	-1.7	-7.7	3.5	2.4	2.7	4.2	5.4	8.1
Average gross wages, NC	18.3	26.1	4.8	3.1	4.9	5.3	6.2	7.2	21.1
Average gross wages, real (PPI based)	9.4	9.4	2.9	-3.1	-3.7	-0.7	0.2	2.0	10.0
Average gross wages, real (CPI based)	8.4	16.9	-0.8	-2.8	-0.9	1.2	2.1	3.1	13.1
Average gross wages, EUR (ER)	32.3	14.2	-9.0	3.8	4.2	4.1	6.1	9.6	24.0
Employed persons (LFS)	-0.5	0.2	-1.3	0.0	-0.4	-0.5	0.0	0.5	0.6
GDP per empl. person, NC at 2000 prices	4.6	7.2	-5.3	-1.6	3.0	1.6	2.9	2.1	5.8
Unit labour costs, NC at 2000 prices	13.0	17.7	10.6	4.8	1.9	3.6	3.2	4.9	14.5
Unit labour costs, ER (EUR) adjusted	26.5	6.6	-3.9	5.5	1.2	2.1	3.2	7.4	17.2
Slovakia									
GDP deflator	2.4	2.9	-1.2	0.5	4.0	2.6	3.0	3.0	2.3
Exchange rate (ER), EUR/NC	3.7	8.0	3.8	0.0	0.0	0.0	0.0	0.0	6.4
Real ER (CPI-based)	4.3	8.3	3.7	-1.4	1.0	-0.3	1.2	1.0	7.0
Real ER (PPI-based)	2.9	4.2	1.2	-3.2	-1.2	0.2	1.2	1.0	3.9
Average gross wages, NC	9.2	8.1	3.0	3.3	2.7	2.5	4.9	5.9	8.3
Average gross wages, real (PPI based)	5.6	5.5	10.3	3.2	-1.6	0.5	1.9	2.8	6.3
Average gross wages, real (CPI based)	6.2	4.0	2.0	2.6	-1.3	0.5	1.9	2.8	4.9
Average gross wages, EUR (ER)	13.2	16.8	6.9	3.3	2.7	2.5	4.9	5.9	15.2
Employed persons (LFS)	2.1	3.2	-2.8	-2.1	1.5	-0.1	1.7	1.7	2.9
GDP per empl. person, NC at 2000 prices	4.5	2.6	-2.2	6.4	1.8	1.5	1.4	2.2	4.8
Unit labour costs, NC at 2000 prices	4.5	5.4	5.3	-2.9	0.9	1.0	3.5	3.6	3.4
Unit labour costs, ER (EUR) adjusted	8.3	13.9	9.2	-2.9	0.9	1.0	3.5	3.6	9.9
Slovenia									
GDP deflator	1.6	4.1	3.0	-1.1	2.1	2.0	2.0	2.0	3.0
Exchange rate (ER), EUR/NC	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1
Real ER (CPI-based)	0.1	1.8	-0.1	0.0	-1.0	-0.3	0.2	0.0	0.9
Real ER (PPI-based)	-2.4	-2.2	2.9	-1.4	-1.1	1.2	1.2	1.0	-1.2
Average gross wages, NC	3.6	8.3	3.4	3.9	2.0	1.7	1.9	2.5	5.7
Average gross wages, real (PPI based)	1.7	4.3	4.9	1.9	-2.5	-1.3	-1.0	-0.5	2.5
Average gross wages, real (CPI based)	1.1	2.6	2.5	1.8	-0.1	-0.3	-0.1	0.5	2.0
Average gross wages, EUR (ER)	3.4	8.3	3.4	3.9	2.0	1.7	1.9	2.5	5.6
Employed persons (LFS)	0.7	1.1	-1.5	-1.5	-2.7	-2.1	-1.1	1.1	1.4
GDP per empl. person, NC at 2000 prices	3.3	2.5	-6.6	2.9	3.2	1.2	2.7	0.4	3.7
Unit labour costs, NC at 2000 prices	0.3	5.6	10.7	0.9	-1.2	0.5	-0.7	2.2	1.9
Unit labour costs, ER (EUR) adjusted	0.1	5.6	10.7	0.9	-1.2	0.5	-0.7	2.2	1.9

(Table A/3 ctd.)

Table A/3 (ctd.)

	2005	2008	2009	2010	2011	2012	2013	2014	2005-08
							Forecast		average
Croatia									
GDP deflator	3.3	6.1	3.4	1.0	2.3	2.5	2.4	2.0	4.4
Exchange rate (ER), EUR/NC	1.3	1.6	-1.6	0.7	-2.0	-0.9	0.7	0.0	0.9
Real ER (CPI-based)	2.4	3.9	-0.2	-0.3	-2.7	-0.7	1.3	0.0	2.2
Real ER (PPI-based)	-0.2	3.5	2.3	1.6	-1.3	1.3	1.9	1.0	0.9
Average gross wages, NC	4.4	7.1	2.2	-0.4	0.9	2.3	2.9	3.1	6.0
Average gross wages, real (PPI based)	1.7	-1.1	2.7	-4.5	-5.1	-1.6	-0.1	0.1	1.6
Average gross wages, real (CPI based)	1.0	0.9	-0.2	-1.5	-1.3	-0.2	0.5	1.0	2.0
Average gross wages, EUR (ER)	5.7	8.7	0.6	0.3	-1.1	1.7	3.8	2.7	6.9
Employed persons (LFS)	0.7	1.3	-1.8	-4.0	-3.6	-1.0	0.0	0.7	1.1
GDP per empl. person, NC at 2000 prices	3.6	0.9	-4.2	2.9	4.1	-0.2	1.0	1.3	2.9
Unit labour costs, NC at 2000 prices	0.8	6.1	6.7	-3.2	-3.0	2.5	1.9	1.7	2.9
Unit labour costs, ER (EUR) adjusted	2.1	7.8	5.0	-2.5	-5.0	1.6	2.6	1.7	3.9
Macedonia									
GDP deflator	3.8	7.5	0.7	1.6	3.9	3.0	3.0	3.0	5.5
Exchange rate (ER), EUR/NC	0.1	-0.1	0.0	-0.4	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	-1.6	4.3	-1.8	-0.9	0.7	0.7	1.2	1.0	0.9
Real ER (PPI-based)	-0.9	3.5	-3.1	4.7	5.1	1.2	1.2	1.0	1.3
Average gross wages, NC [1)]	2.7	8.7	9.0	1.0	2.0	5.1	4.9	5.0	6.0
Average gross wages, real (PPI based)	-0.5	-1.3	17.5	-7.1	-8.2	2.0	1.9	1.9	0.4
Average gross wages, real (CPI based)	2.2	0.3	9.9	-0.6	-1.8	2.0	1.9	1.9	2.4
Average gross wages, EUR (ER)	2.8	8.5	9.0	0.6	2.0	5.8	3.8	5.5	6.0
Employed persons (LFS)	4.3	3.2	3.4	1.3	1.9	1.5	1.5	1.5	3.9
GDP per empl. person, NC at 2000 prices	0.1	1.7	-4.2	0.5	1.6	0.7	1.5	2.0	1.2
Unit labour costs, NC at 2000 prices	2.6	6.9	13.8	0.5	0.4	4.3	3.4	3.0	4.8
Unit labour costs, ER (EUR) adjusted	2.7	6.7	13.8	0.1	0.4	4.4	3.4	3.0	4.8
Montenegro									
GDP deflator	4.3	7.7	2.4	1.6	4.2	2.0	3.8	2.5	8.4
Real ER (CPI-based)	0.1	3.6	2.4	-1.6	0.0	0.7	1.2	1.0	1.6
Real ER (PPI-based)	0.0	-2.1	4.4	-0.2	-1.4	-0.4	0.8	-0.5	2.3
Average gross wages, NC	7.8	22.5	5.6	11.2	1.0	5.3	6.6	6.2	19.1
Average gross wages, real (PPI based)	5.6	7.5	9.9	12.2	-2.1	3.2	2.7	3.6	11.3
Average gross wages, real (CPI based)	5.4	14.1	2.1	10.6	-2.1	2.2	3.5	3.1	14.3
Employed persons (LFS)	-4.5	0.6	-2.7	-2.2	-4.9	0.0	1.0	5.0	4.0
GDP per empl. person, NC	13.9	14.4	-0.7	6.5	11.8	3.2	4.7	0.6	12.2
GDP per empl. person, NC at 2000 prices	9.1	6.2	-3.0	4.8	7.2	0.9	1.3	-2.5	3.5
Unit labour costs, NC at 2000 prices	-1.2	15.3	8.9	6.1	-5.8	4.3	5.2	8.9	15.1
Unit labour costs, ER (EUR) adjusted	-1.2	15.3	8.9	6.1	-5.8	4.3	5.2	8.9	15.1
Albania									
GDP deflator	2.6	4.7	2.3	2.3	3.8	3.2	3.9	4.0	3.4
Exchange rate (ER), EUR/NC	2.8	0.7	-7.0	-4.2	-1.8	2.4	3.8	1.5	1.0
Real ER (CPI-based)	3.0	0.3	-5.8	-2.8	-1.4	3.1	6.0	3.5	1.1
Real ER (PPI-based)	3.5	1.0	-4.5	-7.1	-4.8	2.7	6.0	3.5	0.6
Average gross wages, NC	5.0	25.3	5.2	6.7	6.6	6.0	8.0	9.1	15.8
Average gross wages, real (PPI based)	0.1	17.7	7.0	6.4	4.0	3.9	3.9	5.0	11.5
Average gross wages, real (CPI based)	2.6	21.2	2.9	3.1	3.0	2.9	3.9	5.0	12.7
Average gross wages, EUR (ER)	8.0	26.2	-2.1	2.3	4.7	9.4	12.5	8.3	17.0
Employed persons (LFS) [2)]	0.3	-6.2	3.3	3.4	0.0	-1.7	1.7	1.7	-1.0
GDP per empl. person, NC at 2000 prices	5.4	14.6	0.0	0.2	1.9	3.9	0.9	1.7	7.2
Unit labour costs, NC at 2000 prices	-0.3	9.3	5.3	6.5	4.6	2.0	7.1	7.3	8.0
Unit labour costs, ER (EUR) adjusted	2.5	10.1	-2.1	2.1	2.7	4.5	11.2	9.0	9.1
Bosnia and Herzegovina									
GDP deflator	4.0	7.4	0.1	1.5	3.9	2.2	1.8	1.9	5.9
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	0.8	3.7	-1.4	0.0	0.6	-0.3	0.2	0.0	1.9
Real ER (PPI-based)	.	2.2	1.1	-2.4	-1.9	0.2	0.2	0.0	.
Average gross wages, NC	6.5	16.7	8.1	1.1	4.4	2.4	3.1	3.0	10.4
Average gross wages, real (PPI based)	.	7.4	11.7	0.2	0.7	0.4	1.1	1.0	.
Average gross wages, real (CPI based)	3.4	8.5	8.6	-1.0	0.7	0.4	1.1	1.0	5.7
Average gross wages, EUR (ER)	6.5	16.7	8.1	1.1	4.4	2.4	3.1	3.0	10.4
Employed persons (LFS) [3)]	0.5	4.8	-3.5	-1.9	-3.2	-0.7	0.0	0.2	2.8
GDP per empl. person, NC at 2000 prices	3.3	0.8	0.6	2.7	5.5	1.3	1.4	1.8	2.5
Unit labour costs, NC at 2000 prices	3.0	15.8	7.5	-1.6	-1.1	1.0	1.7	1.1	7.7
Unit labour costs, ER (EUR) adjusted	3.0	15.8	7.5	-1.6	-1.1	1.0	1.7	1.1	7.7

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

(Table A/3 ctd.)

Table A/3 (ctd.)

	2005	2008	2009	2010	2011	2012	2013	2014	2005-08
							Forecast		average
Serbia									
GDP deflator	15.7	12.6	5.7	9.0	11.7	5.9	4.5	5.8	12.7
Exchange rate (ER), EUR/NC	-12.5	-1.8	-13.3	-8.7	0.0	-8.1	-3.4	-3.3	-2.9
Real ER (CPI-based)	-0.5	7.5	-6.7	-4.5	7.6	-3.9	-0.4	-0.5	6.1
Real ER (PPI-based)	-4.1	3.9	-4.4	-0.5	8.1	-4.4	-0.9	0.2	3.7
Average gross wages, NC	24.1	17.9	-3.3	7.5	11.1	7.0	6.0	6.1	22.1
Average gross wages, real (PPI based)	8.7	4.9	-8.4	-4.6	-2.8	1.0	1.5	0.3	9.6
Average gross wages, real (CPI based)	6.8	3.9	-11.0	0.6	0.1	0.0	1.0	1.0	9.0
Average gross wages, EUR (ER)	8.6	15.7	-16.2	-1.9	11.1	-2.4	4.0	1.9	18.6
Employed persons (LFS)	-6.7	6.3	-7.3	-8.4	-6.0	-4.6	-2.3	0.0	-0.9
GDP per empl. person, NC at 2000 prices	13.0	-2.3	4.1	10.3	8.4	4.8	3.4	2.0	5.5
Unit labour costs, NC at 2000 prices	9.8	20.6	-7.1	-2.5	2.5	2.1	2.6	4.0	15.7
Unit labour costs, ER (EUR) adjusted	-3.9	18.4	-19.4	-11.0	2.5	-6.2	-1.0	0.5	12.4
Russia									
GDP deflator	19.3	18.0	2.0	11.6	15.4	9.1	6.9	6.9	16.5
Exchange rate (ER), EUR/NC	1.6	-3.9	-17.5	9.5	-1.4	-0.3	-2.4	-2.3	-0.4
Real ER (CPI-based)	11.8	5.8	-8.7	14.7	3.8	2.3	1.6	0.5	8.1
Real ER (PPI-based)	17.7	9.9	-20.0	18.8	11.0	12.6	5.5	2.5	11.8
Average gross wages, NC	26.9	27.2	7.8	12.4	12.3	10.8	11.3	10.2	26.6
Average gross wages, real (PPI based)	5.2	4.8	16.1	0.2	-5.6	-3.7	1.2	3.0	8.1
Average gross wages, real (CPI based)	12.8	11.5	-3.6	5.2	3.5	5.5	5.0	5.0	13.7
Average gross wages, EUR (ER)	28.9	22.3	-11.0	23.1	10.8	11.2	7.8	7.2	26.0
Employed persons (LFS)	1.3	0.6	-2.4	0.7	1.3	-0.3	-0.7	0.0	1.3
GDP per empl. person, NC at 2000 prices	5.0	4.6	-5.6	3.5	2.9	4.6	4.8	4.3	5.6
Unit labour costs, NC at 2000 prices	20.9	21.6	14.1	8.6	9.1	6.0	6.2	5.7	19.8
Unit labour costs, ER (EUR) adjusted	22.8	16.9	-5.8	19.0	7.6	5.6	3.7	3.2	19.3
Ukraine									
GDP deflator	24.5	28.6	13.0	13.8	15.4	5.0	7.0	5.0	22.5
Exchange rate (ER), EUR/NC	3.5	-10.3	-29.1	3.2	-5.0	0.8	-4.3	0.0	-3.8
Real ER (CPI-based)	14.9	8.4	-18.6	10.6	-0.5	3.5	0.5	2.9	7.9
Real ER (PPI-based)	15.9	14.5	-21.1	20.6	6.9	4.0	0.5	2.9	10.7
Average gross wages, NC	36.7	33.7	5.5	17.5	17.6	11.3	14.3	11.3	32.3
Average gross wages, real (PPI based)	17.2	-1.3	-0.9	-2.8	-1.2	6.0	6.9	6.0	10.3
Average gross wages, real (CPI based)	20.5	6.8	-9.0	7.4	8.9	6.0	6.9	6.0	15.0
Average gross wages, EUR (ER)	41.5	20.0	-25.2	21.2	11.7	13.7	7.4	10.3	27.3
Employed persons (LFS)	1.9	0.3	-3.7	0.4	0.0	0.2	0.2	0.2	0.8
GDP per empl. person, NC at 2000 prices	0.8	2.0	-11.4	3.8	5.2	3.7	5.0	4.8	4.2
Unit labour costs, NC at 2000 prices	35.6	31.1	19.2	13.2	11.8	7.3	8.9	6.3	27.0
Unit labour costs, ER (EUR) adjusted	40.3	17.7	-15.5	16.8	6.2	8.2	4.2	6.3	22.2
Austria									
GDP deflator	2.0	1.8	1.0	1.8	2.2	2.3	1.6	1.6	1.9
Real ER (CPI-based)	0.1	-0.5	-0.5	-0.2	0.2	-0.2	0.1	0.1	-0.3
Real ER (PPI-based)	-2.0	0.2	-3.3	1.5	2.5	0.5	-0.2	-0.4	-0.4
Average gross wages, NC	2.6	3.4	2.2	1.5	2.8	2.7	1.8	2.6	3.2
Average gross wages, real (PPI based)	0.5	-2.8	10.3	-3.4	-5.1	0.4	0.2	1.0	-0.6
Average gross wages, real (CPI based)	0.3	0.2	1.7	-0.4	-0.5	0.6	-0.1	0.5	0.9
Employed persons (LFS)	2.1	1.5	-0.3	0.5	1.2	0.5	0.5	1.0	2.2
GDP per empl. person, NC at 2000 prices	0.2	-0.1	-3.5	1.8	1.6	0.3	1.8	1.0	0.5
Unit labour costs, NC at 2000 prices	2.4	3.6	5.9	-0.3	1.2	2.5	0.0	1.6	2.7
Unit labour costs, ER (EUR) adjusted	2.4	3.6	5.9	-0.3	1.2	2.5	0.0	1.6	2.7

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

Sources: wiiw Database incorporating national and Eurostat statistics, wiiw estimates. Forecasts by wiiw.

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