

PRESS RELEASE

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wiiw Forecast for Central, East and Southeast Europe, and China: The Big Boom is Over, but Growth Remains Strong

After a period of exceptionally high growth in the whole region of Central, East and Southeast Europe in the past two years, there has been some slowdown in GDP growth. Nevertheless growth remains largely robust. In particular the new member states of the EU (NMS) appear to be largely decoupled from negative global impacts, experiencing only a moderate slowdown in growth, except for the Baltics. The NMS feel, of course, the effects of external price or supply shocks. These effects should however be transient, provided there are no further price shocks in world markets. These are the main results of the medium-term forecast published by the Vienna Institute for International Economic Studies (wiiw).

The resilience of the **NMS** derives from growing labour productivity partly offsetting the combined effects of appreciating currencies and rising wage costs. Therefore the slowdown is generally more moderate than commonly expected (with the exception of the Baltic countries, where more pronounced adjustments took place). The semi-sovereign monetary policies pursued in the major NMS bear many risks, yet on the whole they have proven effective in preventing the rise of both excessive credit booms and excessive real appreciation.

The economies of the EU candidate and potential candidate countries in **Southeast Europe** continue to catch up vis-à-vis the EU. Southeast Europe (SEE-7: Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Serbia and Turkey) has turned into a high-growth region in recent years, but some deceleration of real GDP growth has become visible there too. The slowdown was most pronounced in **Turkey** after several years of very high growth. We reckon with an improving international business climate and expect the SEE-7 to return to higher growth by the year 2010. Inflation has calmed down, but it is still a matter of concern especially in **Serbia** and **Turkey**, the two countries where its dynamism was accompanied by currency depreciation against the euro. The countries are also faced with higher bills for imports of energy and food, so that the gap in the current account has widened. Unemployment is high, a fact that will not change substantially during the next few years.

Inflation calms down

The whole region was hit by the external price shock that swiftly resulted in a rapid surge in domestic prices for food and energy. The report argues that the worldwide hike in energy and food prices in the period 2007-2008 is primarily a supply-side shock caused by production shortfalls that can be traced back to weather conditions or specific factors restricting production. Authorities in the

countries of Central, East and Southeast Europe seem to be taking the current **inflation acceleration** in an unusually light manner. Some of the countries (those on a fixed exchange rate regime) lack the means to respond. Others respond weakly (if at all) because they expect a growth slowdown and harbour concerns over the continuing appreciation of local currencies. In the longer term, inflation and unit labour costs are shown to be moving mostly in tandem. Rising wages will not incur much of an inflationary risk as long as roughly matched by gains in labour productivity. As this holds true on the whole for the NMS, their longer-term inflation prospects are quite good. Price-wage spirals are not expected to spin out of control. In the absence of another round of world-market price shocks, inflation will subside fairly quickly. In the West Balkans, the inflationary spike will also be overcome relatively swiftly. Disinflation, however, will be slower in Kazakhstan, Russia, Turkey and Ukraine, given that it will be starting from much higher levels than elsewhere.

Regional focus: Russian Federation

The **Russian** economy has been booming in the past decade, largely owing to surging energy prices and export revenues. Apart from rising assertiveness, the shadow side of this boom has been widespread corruption and deteriorating external relations – not only with the EU. The key challenges are – apart from the fight against corruption and bureaucratic obstacles – the diversification of the economy using Industrial Policy tools and government-sponsored investment programmes. The wiiw forecast for Russian GDP growth in the coming years reckons with ongoing reliance on the (modernized) energy sector, possibly with a few high-tech niches, and an average annual GDP growth of around 6% in 2010. The expected modest growth slowdown appears inevitable, at least until the end of the decade, before any (uncertain) modernization efforts start to bear fruit.

wiiw Forecast Ukraine: Booming household consumption

Ukraine's economy keeps performing well, largely on account of the booming household consumption backed by expanding credit and generous social transfers. The dramatic surge in food prices has driven consumer inflation to above 30%; however, inflationary pressures should subside in the second half of 2008, not least thanks to the expected good grain harvest. The immediate growth prospects are good. The economic growth is home-driven, the widening external imbalances are covered by strong inflows of FDI, which are likely to pick up further following the country's recent WTO accession.

wiiw Forecast Kazakhstan: Banking crisis

Banking sector problems remain central to the economic development of **Kazakhstan**. On the positive side, the government has sufficient financial resources to withstand the crisis. Problems resulting from the banking crisis forced us to reduce our forecast for the GDP growth. But we have also revised our inflation forecast downwards primarily due to higher efficiency of government's policy which has included a broad spectrum of measures.

wiiw Forecast China: Curbing inflation while sustaining growth

Also in **China** the fast economic growth has moderately cooled down and the slowing down of the global economy will probably have a significant impact only in the months to come. Because of rapidly rising prices, China's policy makers will have to balance measures to fight inflation against the weakening economic outlook.

You may find more detailed analysis and forecasts in the new issue of the '**Current Analyses and Forecasts**' series, published by the Vienna Institute for International Economic Studies (wiiw). The report provides a comprehensive analysis of the current situation in **Central, East and Southeast Europe, Kazakhstan, Turkey, Ukraine and China**, as well as an assessment of economic prospects in the period 2008-2010 (see Table). The report is complemented by brief country studies, a **special section on inflation in the region**, an analysis of the economic prospects of **Russia**, as well as selected **indicators of competitiveness**.

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Overview developments 2006-2007 and outlook 2008-2010

	GDP					Consumer prices					Unemployment, based on LFS ¹⁾					Current account				
	real change in % against previous year					change in % against previous year					rate in %, annual average					in % of GDP				
	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010
	Forecast					Forecast					Forecast					Forecast				
Czech Republic	6.8	6.6	4.7	5	5	2.5	2.8	6	2.8	2.5	7.1	5.3	5.0	5	4.5	-3.2	-2.5	-3.0	-2.5	-2.5
Hungary	3.9	1.3	2.5	3.4	4.3	3.9	8.0	6.6	3.8	3.0	7.5	7.4	7.8	7.8	7.5	-6.0	-5.0	-4.5	-4.2	-4.0
Poland	6.2	6.6	5.5	5.3	5	1.0	2.5	4	3	2.6	13.8	9.6	9	8	8	-2.7	-3.7	-4.7	-5.4	-4.9
Slovak Republic	8.5	10.4	7.5	6	6	4.5	2.8	3.8	3.5	3.5	13.3	11.0	10	10	9	-7.0	-5.3	-5.4	-6.0	-7.0
Slovenia	5.7	6.1	4.3	4.3	4.8	2.5	3.6	6	5	3.5	6.0	4.9	5	4.7	4.6	-2.8	-4.9	-4.3	-3.7	-3.4
NMS-5 ²⁾³⁾	6.1	6.0	5.0	5.0	5.0	2.1	3.5	4.9	3.2	2.8	11.4	8.5	8.1	7.6	7.3	-3.7	-3.9	-4.4	-4.6	-4.4
Bulgaria	6.3	6.2	6	6	6.2	7.3	8.4	12	8	5	9.0	6.9	6.0	5.6	5.2	-17.8	-21.5	-20.0	-18.5	-16.6
Romania	7.9	6.0	6.5	5	6	6.6	4.8	8	7	5	7.3	6.4	6.0	6	6	-10.4	-14.0	-14.6	-14.3	-13.0
Estonia	11.2	7.1	0.5	2	4	4.4	6.6	11	8	7	5.9	4.7	5.5	6.5	8	-15.5	-17.4	-9.9	-9.9	-10.2
Latvia	12.2	10.3	2.5	1	4	6.5	10.1	17	14	10	6.8	6.1	6.5	7	8	-22.5	-22.9	-16.9	-14.5	-14.6
Lithuania	7.7	8.8	6	5.5	5	3.7	5.7	11	9	10	5.6	4.3	4.5	4.5	5	-10.8	-13.7	-14.1	-12.9	-14.8
NMS-10 ²⁾³⁾	6.6	6.2	5.2	4.9	5.2	3.2	4.3	6.3	4.6	3.7	10.0	7.7	7.3	7.0	6.8	-5.9	-7.0	-7.1	-7.1	-6.9
EU-15 ³⁾⁴⁾	2.9	2.7	1.7	1.5	.	2.2	2.1	3.2	2.2	.	7.7	7.0	6.8	7.0	7.0	-0.14	-0.10	.	.	.
EU-25 ²⁾³⁾	3.2	3.0	2.0	1.8	.	2.2	2.3	3.4	2.4	.	8.2	7.2	7.0	7.1	7.0	-0.40	-0.41	.	.	.
EU-27 ²⁾³⁾	3.3	3.1	2.1	1.9	.	2.3	2.2	3.6	2.5	.	8.2	7.1	6.9	7.0	7.0	-0.52	-0.59	.	.	.
Croatia	4.8	5.6	4.2	4.5	5	3.2	2.9	5.5	4	3.5	11.1	10.0	9.8	9.4	9	-7.9	-8.6	-8.0	-8.0	-7.4
Macedonia	4.0	5.1	5	6	6	3.2	2.3	6	3	3	36.0	34.9	35	34	33	-0.9	-3.1	-3.2	-3.0	-2.7
Turkey	6.9	4.5	4.0	5	6	9.6	8.8	10.5	9	7	9.9	9.9	12	11	9	-6.1	-5.8	-6.3	-5.6	-5.2
Albania ⁵⁾	5.5	6.0	5.8	6.0	6.1	2.4	2.9	4.1	3.1	3.0	13.6	14.0	13	12	11	-6.5	-10.5	-9.8	-10.1	-10.8
Bosnia & Herzegovina	6.7	6.0	4.5	5	6	6.2	1.5	6.5	2.5	2	31.1	29.0	29	28	27	-8.4	-13.1	-13.4	-12.1	-10.8
Montenegro	8.6	8.2	6	6	6	3.0	4.2	5	3	3	29.6	19.0	18	18	19	-24.7	-41.6	-29.6	-22.4	-21.9
Serbia	5.7	7.5	5	5	5	11.7	7.0	12	10	8	20.9	18.8	21	23	23	-12.0	-16.9	-13.5	-12.3	-11.1
Kazakhstan	10.6	8.7	5.5	6.5	7.5	8.6	10.8	11	9.5	9	7.8	7.0	7.5	7	6	-2.4	-6.9	-4.1	-3.8	-3.0
Russia	7.4	8.1	7.3	6.8	6.0	9.7	9.1	15	13	9	7.2	6.1	5.8	5.5	5.5	9.6	6.1	4.5	0.4	-1.1
Ukraine	7.3	7.6	6.5	6	6	9.1	12.8	18	14	10	6.8	6.4	6.4	6.6	6.8	-1.5	-4.2	-6.3	-5.8	-5.3
China ⁶⁾	11.1	11.9	10	9.7	10	1.5	4.8	7	6	5	4.1	4.0	4.3	4.3	4.2	9.4	10.7	8.7	7.7	6.9

Note: NMS: The New EU Member States.

1) LFS - Labour Force Survey. - 2) wiiw estimate. - 3) Current account data include flows within the region. - 4) Consumer prices refer to Euro area (15 countries) from 2007. - 5) Registered unemployment rate, end of period. - 6) Registered urban unemployment rate, end of period.

Source: wiiw (June 2008), Eurostat; forecasts: wiiw, European Commission (Spring 2008) for EU-15 and Euro area (15 countries).