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special issue on the transition economies

Leon Podkaminer et al.

Transition Countries on the Eve of EU Enlargement

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The transition countries approach the EU enlargement in May 2004 with GDP growth outperforming the 'old' EU. In 2003, Poland's economy resumed quite strong growth after two years of stagnation. Growth accelerated also in the Czech Republic, while it experienced some moderate slowdown in Romania, Bulgaria, Croatia, Hungary, Slovenia and Slovakia. A definite growth slowdown was only recorded in Serbia and Montenegro. Finally, Russia and Ukraine performed very well, registering significant and balanced growth.

The prolonged near-stagnation in the EU has had limited impacts on GDP growth in the transition (and even the accession) countries. The levels of synchronization of their business cycles with that of the EU are not yet very high. Continuing structural and institutional adaptations, as well as ongoing gains in labour productivity remain important for maintaining export competitiveness. In 2003 the task of enhancing competitiveness benefited from the strengthening of the euro vs. the US dollar, which happened to coincide with the real depreciation of some accession countries' currencies vs. the euro. Apart from the beneficial cost developments, which are vital for the competitiveness of price-elastic (and essentially low value-added) products, the much more essential structural changes in the composition of exports have certainly continued.

For Russia, external conditions were favourable in 2003: steep rises in the world-market commodity prices translated into a substantial growth acceleration, which spilled over into Ukraine.

Net exports have played an important, and positive, role in Slovakia and Poland. In all other accession countries GDP growth was depressed on account of the performance of net exports. High negative impacts of foreign trade were recorded in Slovenia and Hungary. The relatively sluggish growth in Slovenia may, to some extent, be a consequence of the overprotective policy of sheltering producers from foreign competition through constant devaluation. The Hungarian developments are traced back to an unsound fiscal policy combined with the chaotic nature of the monetary policy.

Fiscal deficits are rather high in the countries acceding to the EU in 2004. This is an unintended effect of the policy stipulating reductions in both taxation and public spending. In practice cuts in taxes are hard to complement with cuts in spending. Given the tax competition among the transition countries, high deficits may persist. Fiscal consolidation, likely to be urged by the EU Commission, may be difficult to carry through.

Growth in the five CEE acceding countries will speed up in 2004. But this is not related to accession itself. The impacts of the latter, both positive and negative, are likely to surface only in 2005. The combined effects of those impacts cannot yet be reliably quantified.

Russia's and Ukraine's GDP growth is likely to slow down, though remaining quite high. Moderate and fairly stable growth is also expected in other transition countries not yet acceding to the EU. However, those countries will also be running very high current account deficits. This is rather unlikely to have significantly negative effects on growth in 2004. Such effects may appear later on (possibly already in 2005).

Keywords: *Central and East European transition countries, EU enlargement, industry, productivity, foreign trade, exchange rates, inflation, fiscal deficits, trade, Bulgaria, Croatia, Czech Republic, Hungary, Macedonia, Poland, Romania, Russia, Slovakia, Slovenia, Serbia and Montenegro, Ukraine*

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

Figure I

Gross domestic product

real change in % against preceding year

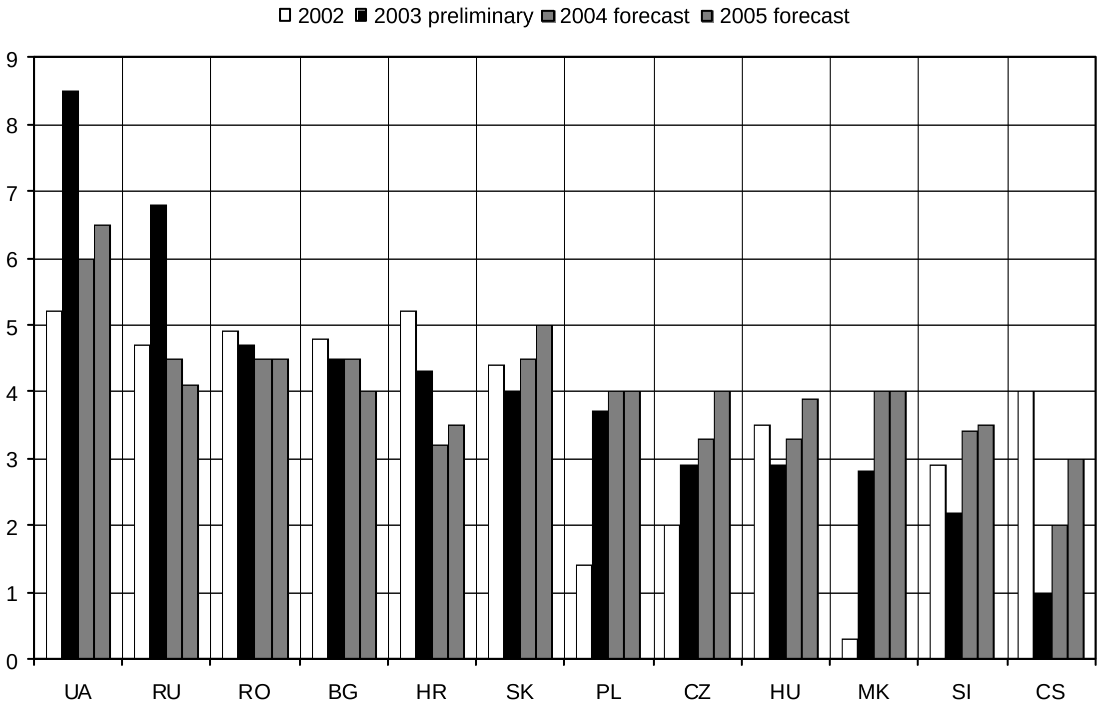

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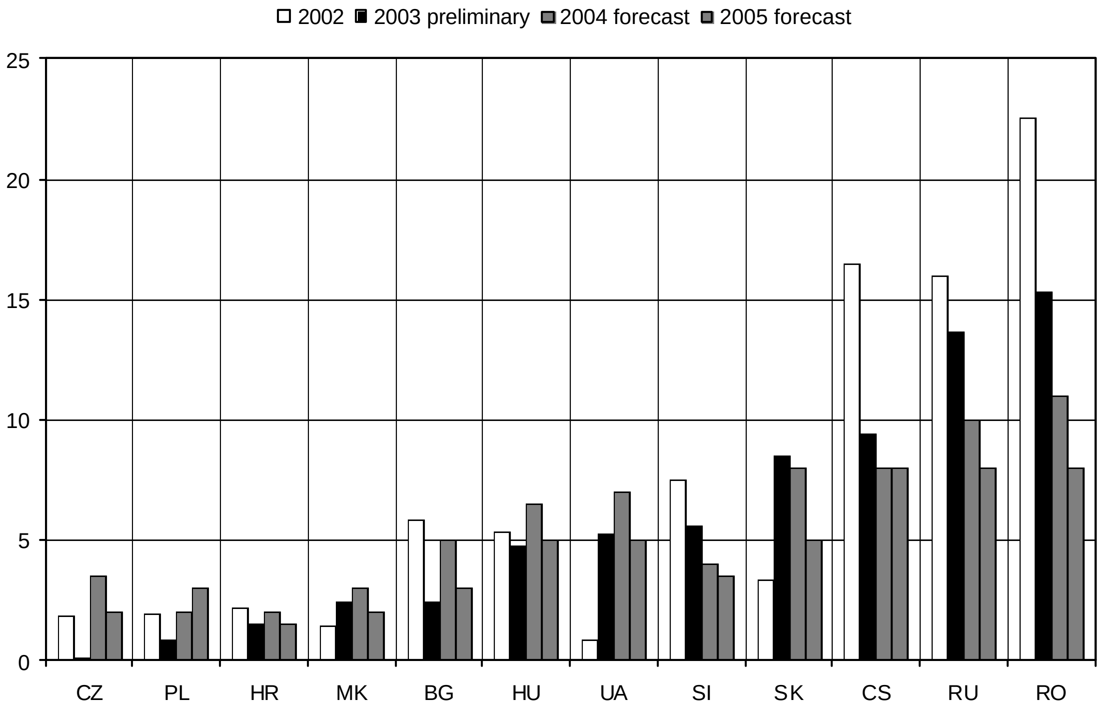
Figure II

Consumer price inflation

annual change in % against preceding year



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OVERVIEW

*Leon Podkaminer**

Transition countries on the eve of EU enlargement

External environment

The prolonged weakness of the EU economy which started around the second quarter of 2001 seems to have had fairly restricted impacts on GDP growth in the transition countries. This outcome is not surprising in the case of Russia, Ukraine and other CIS member states whose dependence on trade with the EU is less pronounced than that of the Central, East and Southeast European transition countries. In the case of the accession countries, a pronounced growth slowdown occurred primarily in 2001 (or in 2002 in the Baltic countries). In some cases growth even accelerated in 2002-2003, the continuing weakness of the EU (and particularly the German) economy notwithstanding. Although the current growth rates as a rule fall short of those registered in 2000 (or some time earlier), the EU stagnation did not spill over to the accession countries. The revealed ability of the accession countries to accommodate to a stagnation in the EU may be attributed to various factors. First, it attests to a still relatively low synchronization of the business cycles in the EU and the accession countries. This may be the result of the impacts of continuing longer-term structural and institutional changes. Besides, specific macroeconomic circumstances (e.g. arising out of currency, fiscal or current account difficulties which those countries often experienced) are still reflecting some current developments and policies more or less irrespectively of what goes on in the EU. A higher degree of synchronization is yet to come. Only upon a more formal subordination of the accession countries' fiscal and monetary policies to the EU guidelines there will be a gradual alignment of their business cycles with those of the 'old' EU. But that process may take at least several years.

The continuing structural and institutional adaptations are believed to have been important for the maintenance of growth in the face of EU stagnation. Essential for these longer-term structural changes is the ongoing strong rise in labour productivity in industry, usually coupled with remarkable gains in unit labour costs. It is believed that already in 2002 industrial labour productivity and unit labour cost developments helped to overcome the effects of real appreciation, hence securing further gains in competitiveness of exports on the EU markets. In 2003 the task of enhancing external competitiveness has been even

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easier as the strengthening of the euro vs. the US dollar happened to coincide with real depreciation, vs. the euro, of the currencies of some accession countries. Apart from the beneficial cost developments, which are vital for maintaining the competitiveness of price-elastic (and mostly low value-added) export products, much more essential structural changes have certainly continued. These changes, involving the creation of capacities (both human and capital) capable of supplying price-inelastic/higher value-added goods, in many cases seem to be important for satisfactory foreign trade developments even if the overall business climate abroad is bad – and even if there are signs of some real appreciation. The importance of finding a proper niche on the international markets is evidenced by the spectacular expansion of Slovak exports in 2003. In the case of the Slovak Republic there are quite a few clearly identifiable items (mostly automobiles) which embody the ongoing structural changes. In other countries which have not recently seen comparably high inflows of foreign direct investment into large green-field manufacturing establishments, the quality and trade composition improvements may have been more gradual and dispersed over larger arrays of goods and thus less easy to identify.

For Russia the external conditions were favourable: steep rises in the world market prices of energy translated into substantial growth acceleration. And the Russian prosperity spilled over into Ukraine.

The long-awaited recovery in the EU, to materialize in 2004, is generally expected to be capable of adding even more vigour to GDP growth in the accession countries, via higher demand for their exports. A further rise in the transition countries' exports to the EU cannot be taken for granted though. First, one must count on a further expansion of competitive exports from China. These exports will compete with the acceding countries' traditional (but increasingly also with more advanced) goods exported to the EU. Some losses in domestic production will result from the adoption of the common external EU tariffs, which for some items (such as textiles) are lower than the present national ones. In addition, even if there is a rise in demand for the accession countries' goods, actual exports may be restricted by the size of the existing production capacities. Besides, the composition of EU demand may change once its own growth accelerates. With rising incomes in the EU one can expect shifts in demand, away from lower-priced (and lower-quality) goods which still tend to dominate in the accession countries' exports. Apart from this, some accession countries' producers (especially domestic-owned and small ones) will be bearing additional, even if largely transitional adjustment costs of meeting various EU standards and regulations. This is likely to erode somewhat the cost competitiveness of some of their exports. The unification of indirect taxes (higher VAT on items so far treated preferentially) and higher excise tax rates on e.g. tobacco will add to inflation (and also reduce real household disposable incomes and consumption to some extent), thus slowing down the overall domestic demand and GDP growth.

Table 1

Gross domestic product

real change in % against preceding year

	1995	1997	1998	1999	2000	2001	2002	2003 1)	2004 forecast	2005 forecast	Index 1990=100 2003	Index 1995=100 2003
Czech Republic	5.9	-0.8	-1.0	0.5	3.3	3.1	2.0	2.9	3.3	4	109.5	115.0
Hungary	1.5	4.6	4.9	4.2	5.2	3.8	3.5	2.9	3.3	3.9	119.3	134.6
Poland	7.0	6.8	4.8	4.1	4.0	1.0	1.4	3.7	4	4	152.0	136.4
Slovak Republic	5.8	4.6	4.2	1.5	2.0	3.8	4.4	4.0	4.5	5	116.6	134.9
Slovenia	4.1	4.6	3.8	5.2	4.6	2.9	2.9	2.2	3.4	3.5	129.9	133.8
CEEC-5 2)	5.6	4.6	3.5	3.2	3.9	2.2	2.2	3.4	3.8	4.0	132.6	131.4
Estonia	4.3	9.8	4.6	-0.6	7.3	6.5	6.0	4.4	5.6	5.1	103.6	149.9
Latvia	-0.8	8.4	4.8	2.8	6.8	7.9	6.1	7.0	5.2	5.7	78.6	158.4
Lithuania	3.3	7.0	7.3	-1.8	4.0	6.5	6.8	7.5	5.7	6	87.0	150.1
CEEC-8 2)	5.4	4.9	3.7	2.9	4.0	2.6	2.5	3.6	3.9	4.2	129.6	132.9
Bulgaria	2.9	-5.6	4.0	2.3	5.4	4.1	4.8	4.5	4.5	4	92.4	109.4
Romania	7.1	-6.1	-4.8	-1.2	2.1	5.7	4.9	4.7	4.5	4.5	97.7	108.8
CEEC-10 2)	5.6	2.8	2.6	2.4	3.8	3.1	3.0	3.8	4.0	4.2	122.4	128.3
Croatia	6.8	6.8	2.5	-0.9	2.9	4.4	5.2	4.3	3.2	3.5	98.1	135.4
Macedonia	-1.1	1.4	3.4	4.3	4.5	-4.5	0.3	2.8	4	4	89.7	113.9
Serbia and Montenegro 3)	6.1	7.4	2.5	-18.0	5.0	5.5	4.0	1.0	2	3	53.4	111.2
Russia	-4.1	1.4	-5.3	6.4	10.0	5.1	4.7	6.8	4.5	4.1	79.0	127.3
Ukraine	-12.2	-3.0	-1.9	-0.2	5.9	9.2	5.2	8.5	6	6.5	53.8	112.7
Armenia	6.9	3.3	7.3	3.3	5.9	9.6	12.9	15.1	.	.	96.6	182.9
Azerbaijan	-11.8	5.8	10	7.4	11.1	9.9	10.6	10.9	.	.	79.4	189.6
Belarus	-10.4	11.4	8.4	3.4	5.8	4.1	4.7	6.5	.	.	102.9	157.6
Georgia	2.6	10.6	2.9	3	2	4.5	5.4	8.3	.	.	44.8	158.6
Kazakhstan	-8.2	1.7	-1.9	2.7	9.8	13.2	9.5	9.1	.	.	93.9	152.9
Kyrgyzstan	-5.4	9.9	2.1	3.7	5.4	5.3	-0.5	6.5	.	.	74.2	146.6
Moldova	-1.4	1.6	-6.5	-3.4	2.1	6.1	7.2	6.2	.	.	42.0	106.5
Tajikistan	-12.4	1.7	5.3	3.7	8.3	10.2	9.1	10.2	.	.	76.6 4)	132.7
Turkmenistan	-7.7	.	.	.	.	.	.	.	.	.	.	.
Uzbekistan	-0.9	5.2	4.4	4.4	4.0	4.5	3	.	.	.	106.0 5)	130.5 5)
CIS	-5.3	1.0	-3.6	4.6	8.3	6.0	4.8	7.0	.	.	75.4	126.9

Notes: 1) Preliminary. - 2) wiiw estimate. - 3) Up to 1998 Gross Material Product. - 4) 1992 = 100. - 5) Year 2002.

Source: wiiw Database incorporating national statistics, forecast: wiiw and European Commission (2003) for Baltic States.

Another external factor possibly affecting the overall performance of the accession countries in the coming years will be the formal requirements to bring the national fiscal and monetary policies in line with those of the EU. In most cases attempts at satisfying these requirements are likely to slow down growth. The required cuts in budget deficits, primarily meaning curtailing public consumption, investment and social transfers, will imply lower GDP growth. Nonetheless the initial budget deficits are likely to increase on account of the accession. There will be shortfalls in revenues as the customs duties collected will no longer be available nationally. Then, administrative costs are likely to balloon as there will be a quantum jump in information flows between the EU and the national authorities, and in the related red tape.

On a more positive side, the prospects of transfers from the EU will probably accelerate investment, both private and public. Quite certainly though the acceleration of inflows is unlikely to start precisely on the 1st of May 2004. Investors, both national and foreign, are likely to be cautious, initially. Medium-size firms in particular may well adopt a wait-and-see attitude at first. It is similarly far from obvious whether the accession will have immediate and large effects on cross-border labour mobility. A high outflows of workforce can be expected later on, as the incumbent EU countries relax the restrictions on the free movement of people. Migrations, especially from Poland where unemployment (particularly among the young) is high, will probably be large.

The second-wave accession countries – Bulgaria and Romania (and Croatia, also aspiring to join in 2007) – as well as Macedonia and Serbia-Montenegro are likely to benefit from an eventual EU recovery too. That factor will play a lesser role in the case of Russia and Ukraine. A not unlikely weakening of the world market energy prices would exert a negative impact on growth both in the former country, and then indirectly in the latter. Moreover, there may be some truth in the claims made by the authorities of both countries that the EU enlargement would adversely affect their growth.

Sources of GDP growth: leading role of household consumption

In 2003 growth accelerated significantly in Russia and Ukraine, reaching very high levels. High growth, but no acceleration was recorded in Romania and Bulgaria. In Poland and Macedonia growth resumed after two years of stagnation (or even recession in the latter country). Growth accelerated also in the Czech Republic, Latvia and Lithuania. In the remaining countries (Croatia, Hungary, Slovenia and Slovakia, Estonia) growth slowed down somewhat from levels ranging between 2.9% and 6.0% (2002) to levels ranging between 2.2% and 4.4%. A definite growth slowdown was recorded only in Serbia-Montenegro.

Judging by the provisional estimates for the year 2003, private consumption continues to be the main source of GDP growth. The only exception is Slovakia where private consumption stagnated (while government consumption was falling). Growth in gross fixed

Table 2

Contributions to the GDP growth rates by individual GDP components, 2000-2003

in percentage points

	2000	**2001**	**2002**	**1-3 Q 2003 prelim.**	**2000**	**2001**	**2002**	**1-3 Q 2003 prelim.**
		Czech Republic				**Hungary**		
Final consumption expenditure	1.2	2.9	3.2	3.3	3.3	3.9	6.5	5.3
Household final consumption	1.3	2.0	2.1	3.2	2.8	2.9	5.5	4.8
Final consumption (Govt. +NPISH)	-0.1	0.9	1.1	0.1	0.5	1.0	1.0	0.5
Gross capital formation	3.1	2.5	0.5	1.0	1.7	-1.9	-1.1	2.9
Gross fixed capital formation	1.7	1.8	0.2	0.7	1.8	0.8	1.7	0.4
Balance of goods and NFS	-1.0	-2.3	-1.7	-1.6	0.2	1.9	-1.9	-5.6
Exports of goods and NFS	12.3	9.7	2.4	5.1	13.7	6.6	2.9	3.4
Imports of goods and NFS	13.3	12.0	4.2	6.7	13.4	4.8	4.9	8.9
Stat. Discrepancy	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*
GDP growth rate, real in %	3.3	3.1	2.0	2.7	5.2	3.8	3.5	2.7
		Poland				**Slovakia**		
Final consumption expenditure	2.0	1.3	2.4	2.1	-0.1	3.5	3.8	0.0
Household final consumption	1.7	1.3	2.1	2.0	-0.5	2.6	2.8	0.0
Final consumption (Govt. +NPISH)					0.3	0.9	1.0	0.0
Gross capital formation	1.0	-3.3	-1.6	-0.4	0.3	4.0	0.6	-1.5
Gross fixed capital formation	0.7	-2.2	-1.5	-0.3	-2.0	3.6	-0.3	-0.2
Balance of goods and NFS	1.1	2.9	0.6	1.6	1.9	-3.7	0.0	5.5
Exports of goods and NFS	6.1	1.0	1.4	.	9.4	4.8	4.3	17.1
Imports of goods and NFS	5.1	-1.9	0.9	.	7.4	8.4	4.3	11.5
Stat. Discrepancy	*-0.1*	*0.1*	*0.1*		*0*	*0*	*0*	*0*
GDP growth rate, real in %	4.0	1.0	1.4	3.5	2.0	3.8	4.4	4.0
		Slovenia				**Bulgaria**		
Final consumption expenditure		2.2	1.1	2.3	5.0	3.9	3.6	4.9
Household final consumption		1.3	0.5	1.6	3.0	3.7	2.9	
Final consumption (Govt. +NPISH)		0.9	0.6	0.7	2.0	0.2	1.3	
Gross capital formation		-1.1	1.0	1.7	2.2	3.8	1.1	3.4
Gross fixed capital formation		-0.1	0.3	1.3	2.4	3.9	1.7	3.0
Balance of goods and NFS		1.8	0.8	-1.9	-1.9	-3.5	0.3	-4.2
Exports of goods and NFS		3.6	3.8	1.8	7.5	5.0	3.3	5.4
Imports of goods and NFS		1.8	2.9	3.6	9.4	8.5	3.0	9.6
Stat. Discrepancy		*0*	*0*	*0*	*0.1*	*-0.1*	*-0.1*	
GDP growth rate, real in %		2.9	2.9	2.2	5.4	4.1	4.8	4.1
				1-2 Q 2003				
		Romania				**Russia**		
Final consumption expenditure	1.3	5.3	2.6	4.4		4.4	4.6	3.9
Household final consumption	-0.6	4.5	2.2	4.8		4.5	4.2	3.6
Final consumption (Govt. +NPISH)	1.9	0.8	0.4	0.4		-0.1	0.4	0.3
Gross capital formation	3.2	3.4	1.6	1.4		3.1	-0.5	3.2
Gross fixed capital formation	1.0	1.7	1.6	1.4		1.7	0.5	1.8
Balance of goods and NFS	-2.4	-3.3	0.7	-1.8		-2.9	0.4	-0.6
Exports of goods and NFS	6.1	3.8	5.8	4.8		1.8	4.3	5.6
Imports of goods and NFS	8.5	7.0	5.2	6.6		4.8	4.0	6.2
Stat. Discrepancy	*0*	*0.2*	*0*	*0.7*		*0.4*	*0.2*	*0.2*
GDP growth rate, real in %	2.1	5.7	4.9	4.7		5.1	4.7	6.7

Source: wiiw Database incorporating national statistics.

Figure 1a

Quarterly GDP growth rates

in %, year-on-year

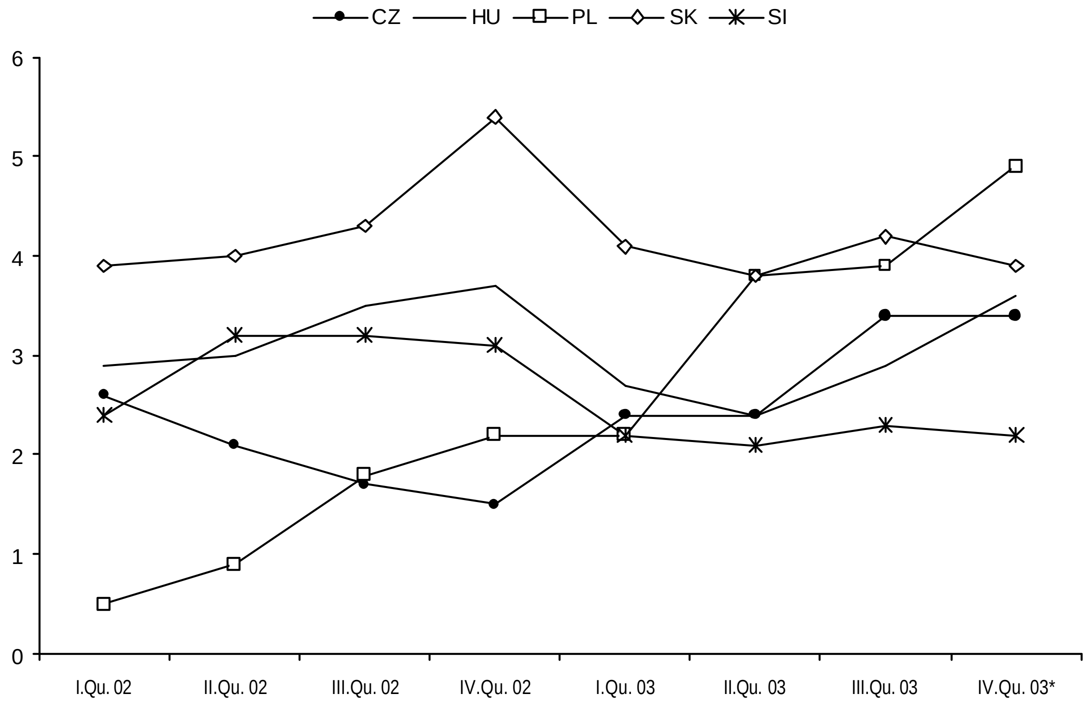
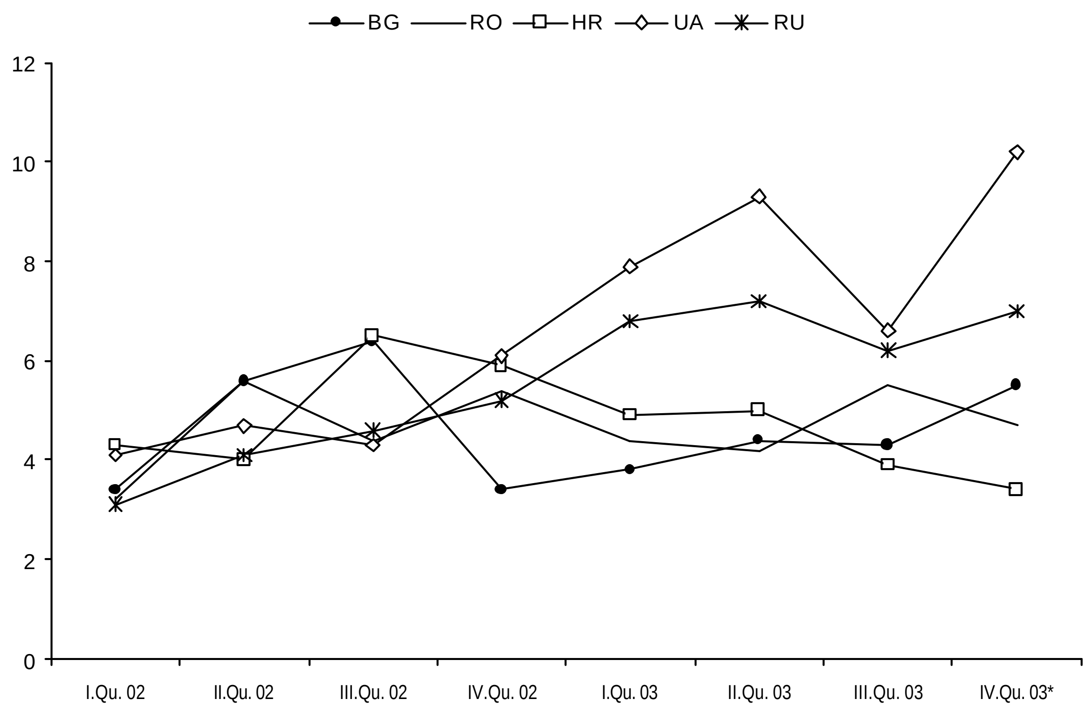


Figure 1b

Quarterly GDP growth rates

in %, year-on-year



Note: * Estimate.

Source: National statistics; wiiw estimate for IV.Qu.03.

capital formation contributed to the overall GDP growth in Romania, Bulgaria, Slovenia and the Czech Republic. In Hungary the investments' contribution was marginal (but still positive), while in Slovakia and Poland that contribution was even negative.

Table 3

Gross fixed capital formation

real change in % against preceding year

	1995	1997	1998	1999	2000	2001	2002	2003 1)	2004 forecast	2005 forecast	Index 1990=100 2003	Index 1995=100 2003
Czech Republic	19.8	-2.9	0.7	-1.0	5.4	5.5	0.6	2.2	4	6	132.5	119.6
Hungary	-4.3	9.2	13.3	5.9	7.7	3.5	7.2	3.5	5	6	165.6	172.7
Poland	16.5	21.7	14.2	6.8	2.7	-8.8	-5.8	-0.9	5	6	198.8	155.3
Slovak Republic	0.6	15.0	11.0	-19.6	-7.2	13.9	-0.9	-0.5	2	5	91.7	138.1
Slovenia	16.8	11.6	11.3	19.1	0.2	-0.4	1.3	5.5	6	6	195.6	171.9
Bulgaria	16.1	-20.9	35.2	20.8	15.4	23.3	9.3	18	.	.	134.4	186.8
Romania	7.0	1.7	-5.7	-4.8	5.5	9.2	8.3	8	7	7	137.8	129.9
Croatia	.	26.4	2.5	-3.9	-3.8	7.1	10.1	17.5	10	7	32.8	228.3
Macedonia	10.2	-4.3	-2.6	-1.4	-3.2	-8.6	.	.	.	.	64.2 3)	86.6 3)
Serbia & Montenegro 2)	-3.7	0.8	-2.2	-29.7	13.3	.	.	.	.	.	23.4 4)	74.1 4)
Russia 2)	-10.0	-5.0	-12.0	5.3	17.7	8.7	2.6	12.5	9	9	32.9	106.7
Ukraine 2)	-35.1	-8.8	6.1	0.4	14.4	20.8	8.9	25	15	15	37.6	142.4

Notes: 1) Preliminary. - 2) Gross fixed investment. - 3) Year 2001. - 4) Year 2000.
Source: wiiw Database incorporating national statistics.

The contribution to GDP growth of net exports of goods and non-factor services played an important positive role in Slovakia and Poland. In Slovakia the expansion of net exports hugely overcompensated the negative effects of all other GDP components. It is worth noting that only two years ago net exports' contribution to GDP growth in this country was strongly negative.

In all other accession countries (excepting Poland) the GDP growth was depressed on account of the performance of net exports. While this is not a surprising outcome in Romania and Bulgaria, rather unexpectedly a fairly high negative contribution of net exports occurred in Slovenia. Finally, in Hungary the large negative contribution recorded in 2002 (-1.9 percentage points) rose quite dramatically (to -5.6 percentage points) in the first three quarters of 2003.

Factors behind consumption and investment growth

In normal circumstances, private household consumption stands in an approximately stable proportion to household disposable income. The growth rate of private consumption is therefore normally roughly the same as that of real household disposable income. The stable consumption/disposable income relationship is however often perturbed by other factors such as unemployment trends and expectations, the level of household debts or interest rates on consumer credit (and the access to consumer credit). Besides, one often observes a slow downward drift in the consumption/disposable income ratio, especially in low-income countries as their income levels rise.

The quite strong increases in household consumption in 2003 reflect, to varying degrees, rising household disposable incomes and changes in the propensity to consume. Both factors contributed to the rise in consumption in Bulgaria, Romania and Russia (probably also in Ukraine and Croatia) as well as in Hungary. The consolidation of the banking systems and some reductions in the interest rates have been important (e.g. in Bulgaria, Croatia and Romania) by facilitating an expansion of consumer credit. The stagnation of consumption in Slovakia can be put down to two developments: (1) a pronounced change in the composition of household disposable income (fall in the share of wage income) reducing the overall households' propensity to consume, and (2) the attempted fiscal consolidation. Huge increases in indirect taxes, carried over into consumer prices, reduced real household disposable incomes, and hence consumption. (Another sign of the restrictive stance of Slovak fiscal policy in 2003 is the contraction of the volume of public consumption.) In Hungary the change in the composition of household disposable income raised the share of wage income, thereby additionally strengthening the growth of consumption – at the expense of growth of savings. In addition, in Hungary preferential (publicly subsidized) credit to housing construction played an important role. In Poland the lower than anticipated inflation has been strengthening real household income, though the latter's composition has been changing similarly as in Slovakia. Moreover, as indicated by the performance of capital formation, in Poland the rising non-wage household incomes may have been primarily spent on consumption, rather than saved.

In 2003 gross fixed capital formation rose impressively in the countries not acceding to the EU in 2004. Of course it is not the fact that they are the 'lefts-out' which has been essential for their investment performance. Rather, they had suffered much more severely than the acceding countries from the contraction of investment in the early 1990s. Their investment recovery started much later, and it took much longer to stabilize their macroeconomic situation and to create the institutional (including legal) environment conducive to private investment. The levels of fixed capital formation in the post-Yugoslav and post-Soviet countries are still very low compared with 1990. Under such conditions high investment growth is quite natural. One can observe that this process continues also in Bulgaria and Romania, which are in the process of catching up (in terms of the indices of fixed capital formation) with the acceding countries. Actually Bulgaria and Romania even managed to overtake Slovakia in this respect. The dynamism of investment in all countries not acceding to the EU in 2003 signals a general perception of good times ahead. Of course, investors may err, or overextend, or misallocate their investments. The risks of high but 'bad' investments seem rather low in Bulgaria and Romania, where foreign investors (more experienced and presumably more rational) are very active. In Russia and Ukraine such risks are perhaps higher: investments going primarily into the extraction of energy, transportation (pipelines), or 'heavy' industries need not generate high returns in the future.

The growth of gross fixed capital formation in the acceding countries has recently been rather anaemic and – in the first place – very unstable. Generally, this cannot be easily related to the EU business cycle though. In Poland, Slovakia, Hungary and Slovenia investment growth suddenly decelerated (actually plummeted in Slovakia) in 1999-2000, after extended domestic investment booms (and prior to the advent of the EU stagnation). Of course, more recently the EU business climate may have contributed to the depressed state of investment in the acceding countries. But other factors may have played a role as well. In the Czech Republic the exchange rate crisis of 1997 left a lasting legacy (shattered business confidence, high debts throughout much of the corporate sector, deteriorated balance sheets of the banks, etc.). In Poland and Hungary there has been a slowdown in the net foreign direct investment inflow (with stable inflows and rising FDI outflows in the latter country). Besides, national macroeconomic policies (e.g. in Slovakia, or Poland) dealt with problems such as high current account or budget deficits, or too slow a pace of disinflation, in a way that affected investment. For example, the very high interest rates prevailing, until recently, in Poland could have hardly prevented investment from falling. Finally, one should be reminded of the fact that any phase of high investment is bound to be accompanied by an accumulation of corporate debts. In due time the rising debt tends to be followed by a period of investment slowdown. The recent period of weak investment activity in the acceding countries may therefore represent a post-boom consolidation phase. (Of course, when investment is financed largely from own funds of enterprises, such as in Russia and Ukraine, the rising debts do not brake the boom.)

In most acceding countries (even in Hungary) the conditions for a stronger investment recovery seem good at present. Domestic interest rates are low, by historical standards, corporate income taxes are generally falling, and the recent trends in wages, labour productivity and producer prices (in industry at least) suggest that the profitability of the corporate sector has been rising. What remains lacking is perhaps a more widespread confidence on the part of the investors. Unless they are convinced that the goods to be produced with the newly installed capacities will be demanded at 'good prices', they may defer their investments to some future dates.

Table 4

Foreign trade of Central and Eastern Europe, EUR million

(based on customs statistics)

		1998	1999	2000	2001	2002	2003 1)	2002	2003	2004	2005
										forecast	
									change in %		
Czech Republic	Exports	23068	24640	31483	37251	40711	43068	9.3	5.8	8	11
	Imports	25287	26386	34876	40675	43026	45303	5.8	5.3	7	10
	Balance	-2219	-1746	-3393	-3424	-2315	-2236	.	.	.	.
Hungary 2)	Exports	20477	23491	30545	34082	36523	37070	7.2	1.5	7	9
	Imports	22871	26288	34856	37654	39939	41860	6.1	4.8	6	8
	Balance	-2394	-2797	-4312	-3572	-3417	-4790	.	.	.	.
Poland	Exports	25145	25729	34383	40375	43400	46400	7.5	7	6	6
	Imports	41539	43151	53122	56223	58307	59500	3.7	2	3	7
	Balance	-16394	-17422	-18739	-15848	-14907	-13100	.	.	.	.
Slovakia	Exports	9541	9602	12880	14115	15270	19440	8.2	27	14	16
	Imports	11635	10628	13860	16488	17517	19730	6.2	13	16	17
	Balance	-2094	-1025	-980	-2372	-2247	-290	.	.	.	.
Slovenia	Exports	8052	8037	9505	10349	10966	11250	6.0	3	5	5
	Imports	8999	9482	10996	11345	11578	12200	2.0	5	6	4
	Balance	-947	-1445	-1491	-997	-612	-950	.	.	.	.
CEEC-5	Exports	86283	91499	118795	136172	146870	157228	7.9	7.1	8	9
	Imports	110331	115935	147709	162385	170368	178593	4.9	4.8	6	9
	Balance	-24049	-24436	-28915	-26213	-23498	-21366	.	.	.	.
Bulgaria 3)	Exports	3841	3734	5253	5714	6063	6600	6.1	9	8	6
	Imports	4476	5140	7085	8128	8411	9500	3.5	13	6	5
	Balance	-635	-1406	-1832	-2414	-2348	-2900	.	.	.	.
Romania	Exports	7412	7977	11273	12722	14675	15600	15.4	6	7	7
	Imports	10569	9927	14235	17383	18881	21100	8.6	12	10	6
	Balance	-3157	-1950	-2962	-4661	-4206	-5500	.	.	.	.
CEEC-7	Exports	97536	103210	135321	154608	167608	179428	8.4	7.1	8	9
	Imports	125376	131002	169030	187896	197660	209193	5.2	5.8	7	8
	Balance	-27840	-27792	-33709	-33288	-30052	-29766	.	.	.	.
Croatia 4)	Exports	4046	4027	4818	5210	5187	5500	-0.4	6	4	4
	Imports	7477	7324	8588	10232	11325	12400	10.7	9.5	6	6
	Balance	-3431	-3297	-3770	-5022	-6137	-6900	.	.	.	.
Macedonia	Exports	1170	1117	1431	1292	1181	1200	-8.6	1	8	4
	Imports	1709	1665	2266	1891	2111	2030	11.7	-4	8	5
	Balance	-539	-548	-835	-599	-931	-830	.	.	.	.
Serbia & Montenegro 5)	Exports	2518	1391	1808	2097	2399	2270	14.4	-5	4	5
	Imports	4283	3081	3892	5391	6647	6440	23.3	-3	0	0
	Balance	-1766	-1690	-2084	-3294	-4249	-4170	.	.	.	.
Russia 6)	Exports	66467	70820	113672	113748	113558	120000	-0.2	6	1	4
	Imports	51798	37061	48552	60025	64521	66400	7.5	3	6	8
	Balance	14668	33759	65120	53723	49037	53600	.	.	.	.
Ukraine	Exports	11283	10856	15771	18159	19004	20500	4.7	8	9	6
	Imports	13103	11104	15104	17612	17967	20000	2.0	11	12	8
	Balance	-1820	-248	667	547	1037	500	.	.	.	.

Notes: 1) Preliminary. - 2) Including trade of firms with customs free legal status. - 3) From 1999 according to new methodology. - 4) From 2000 according to new methodology. - 5) From 1999 excluding Kosovo and Metohia. - 6) Based on balance of payments statistics; including estimate of non-registered trade.

Source: wiiw Database incorporating national statistics.

Trade performance: robust growth of exports

The combined merchandise exports of the seven accession countries (five CEE countries acceding in May 2004, and Bulgaria plus Romania) rose by 7% in 2003, in current euro terms. As the euro strengthened significantly vs. the US dollar in 2003, the 'real' dynamics of the accession countries' exports (part of which is invoiced in USD) was actually even higher. Thus, compared with 2002, exports have generally performed quite well. However, there are significant differences among the individual countries concerning their export performance. The spectacular acceleration of exports in Slovakia is attributed to a few large foreign manufacturing projects that have recently gone on stream. But exports of Hungary, which has also (if less recently) been the target of large foreign direct investment, performed quite weakly – even worse than Slovenia's, which has attracted significantly less FDI than Hungary. While the exports generated by the Hungarian FDI firms have not been really affected by the exchange rate/cost developments (actually those exports rose quite strongly), exports of the domestically-owned firms have suffered. One may suspect that the entire export offers of domestically-owned Hungarian and Slovenian firms have appeared less attractive, given the current state of the EU economy (and the overall situation on the international markets).

Another factor possibly responsible for sagging exports – the differential between the trends in domestic unit labour costs and exchange rates – does certainly not apply in Slovenia. As a matter of fact the real exchange rate of the Slovenian tolar continues to depreciate (in terms of industrial unit labour costs), or is roughly constant (in terms of industrial producer prices). This may suggest that Slovenia's defensive exchange rate policy, which has been focussed on preventing real appreciation, has probably had a negative side effect as it has not induced a more pronounced restructuring towards higher-quality/value-added products. Sheltered by the steady real depreciation, Slovenian exporters could – for several years – perform quite satisfactorily because initially they produced goods qualitatively superior (if also more costly to produce) to those supplied by their competitors in the region, or elsewhere. In the meantime the competitors may have caught up, or surpassed, the Slovenian exporters in terms of quality, without yet approaching their cost levels.

Movements in the real exchange rates seem to have played a more conventional, but nonetheless very important role in the case of Hungarian exports. The Hungarian real exchange rate was quite stable from the fourth quarter of 2001, but earlier there had been a strong real appreciation (whose mild correction occurred only in the closing months of 2003). This may have affected exports of more traditional price-elastic goods, and thus the entire volume of Hungarian exports.

Table 5

Trade of Central and Eastern European countries with the EU-15, EUR million

(based on customs statistics)

		1998	1999	2000	2001	2002	2003 [1]	2002	2003
								change in %	
Czech Republic	Exports	14761	17052	21588	25682	27848	30071	8.4	8.0
	Imports	16054	16945	21637	25139	25902	26827	3.0	3.6
	Balance	-1293	107	-49	543	1946	3245	.	.
Hungary [2]	Exports	14940	17906	22939	25315	27442	27280	8.4	-1
	Imports	14664	16929	20354	21761	22467	23100	3.2	3
	Balance	276	977	2586	3554	4975	4180	.	.
Poland	Exports	17173	18127	24037	27942	29820	31790	6.7	7
	Imports	27268	28016	32494	34512	35971	36260	4.2	1
	Balance	-10096	-9889	-8457	-6570	-6151	-4470	.	.
Slovakia	Exports	5309	5701	7602	8450	9246	11670	9.4	26
	Imports	5833	5493	6775	8207	8814	10160	7.4	15
	Balance	-524	208	827	243	432	1510	.	.
Slovenia	Exports	5271	5304	6060	6430	6509	6550	1.2	1
	Imports	6242	6530	7451	7674	7871	8200	2.6	4
	Balance	-972	-1226	-1391	-1244	-1362	-1650	.	.
CEEC-5	Exports	57453	64090	82227	93819	100865	107358	7.5	6.4
	Imports	70061	73913	88712	97293	101025	104547	3.8	3.5
	Balance	-12608	-9823	-6485	-3474	-160	2815	.	.
Bulgaria [3]	Exports	1905	1942	2684	3129	3375	.	7.9	.
	Imports	2010	2486	3119	4011	4226	.	5.3	.
	Balance	-105	-544	-435	-882	-850	.	.	.
Romania	Exports	4783	5214	7163	8619	9853	10560	14.3	7
	Imports	6097	6004	7996	9957	11039	12220	10.9	11
	Balance	-1314	-790	-833	-1338	-1187	-1660	.	.
CEEC-7	Exports	64141	71245	92074	105567	114093	.	8.1	.
	Imports	78168	82403	99827	111261	116290	.	4.5	.
	Balance	-14027	-11157	-7753	-5694	-2197	.	.	.
Croatia [4]	Exports	1927	1960	2619	2821	2742	3000	-2.8	9
	Imports	4440	4136	4756	5844	6316	6970	8.1	10
	Balance	-2513	-2175	-2137	-3023	-3574	-3970	.	.
Macedonia	Exports	516	506	612	632	603	660	-4.6	10
	Imports	620	677	866	803	947	890	17.9	-7
	Balance	-104	-172	-254	-171	-344	-230	.	.
Serbia & Montenegro [5]	Exports	965	504	700	897	981	980	9.3	0
	Imports	1847	1276	1610	2214	2833	2770	27.9	-2
	Balance	-882	-772	-910	-1317	-1852	-1790	.	.
Russia [6]	Exports	20721	23290	39927	40992	39750	.	-3.0	.
	Imports	14047	10479	12061	17232	19346	.	12.3	.
	Balance	6674	12810	27867	23760	20404	.	.	.
Ukraine	Exports	1892	1986	2813	3323	3381	3970	1.7	17
	Imports	2831	2249	3118	3820	4273	4910	11.8	15
	Balance	-939	-263	-305	-497	-893	-940	.	.

Notes: 1) Preliminary. - 2) Including trade of firms with customs free legal status. - 3) From 1999 according to new methodology. - 4) From 2000 according to new methodology. - 5) From 1999 excluding Kosovo and Metohia. - 6) Registered trade only.

Source: wiiw Database incorporating national statistics.

The fact that Croatia, Bulgaria and Romania, which all specialize in much less sophisticated products than Hungary and Slovenia, prove capable of increasing exports much more strongly with essentially stable (or even appreciating, in the case of Bulgaria) real exchange rates would indicate that at present the foreign demand for their products is relatively strong. This may also reflect an improving quality/price relationship of their exports. Finally, one may contrast the export performance of the Czech Republic and Poland. Their quite similar export growth rates may reflect different developments because in the Czech Republic changes in the real exchange rates have (until recently) been minimal, while Poland has been experiencing quite strong real depreciation since the third quarter of 2001. This does not necessarily mean that the Czech exports are more price-inelastic (and hence capable of generating high value added) while the Polish exports are more price-elastic (and not capable of generating high value added). The ongoing correction of the Polish real exchange rate may have been indispensable for the expansion of exports of even high value-added and price-inelastic goods (formerly suppressed by inordinately strong real appreciation). But, the more detailed trade data suggest that on the whole Czech exports are currently superior, in terms of their quality composition, to the Polish ones.

Exports of Russia and Ukraine performed very well even in euro terms. Of course, as these two countries depend much less on trade transacted in euro (with the US dollar playing an incomparably larger role in Russia than in other transition countries), their exports rose massively in US dollar (and also real) terms. In the case of Russia this is not really a great achievement, given the rise of the world market prices of energy which still dominates its exports. In the case of Ukraine, which is a less significant exporter of energy, the solid export performance attests to a more successful industrial consolidation, at least as compared to Russia.

On the imports side, one observes quite substantial increases in Slovakia, Bulgaria, Romania, Ukraine and Croatia. Slovakia's import expansion is a reflection of the expansion of exports, which require large quantities of imported components. Overall, the strong growth of imports in Bulgaria, Romania, Ukraine and Croatia reflects the quite high GDP growth rates registered (and also generally high growth rates of fixed capital formation). Poland's imports rose minimally, which is also understandable given the stagnation of its fixed capital formation, and the recent adjustments in the real exchange rate. In the Czech Republic imports grew broadly in line with exports. In Hungary and Slovenia, however, the acceleration of imports is rather difficult to square with the reported rates of growth of GDP, exports and fixed (business) investment. In Hungary the expansion of imports may be attributed to a shift in the composition of household demand, away from domestic to imported goods. Such an outcome is consistent with the inordinately high growth of private disposable incomes (due to the relaxation of fiscal policy) under the conditions of real appreciation of the Hungarian currency.

Figure 2a

Real appreciation*, 2001-2003 (base month January 2001)

(national currency vis-à-vis EUR, PPI-deflated)

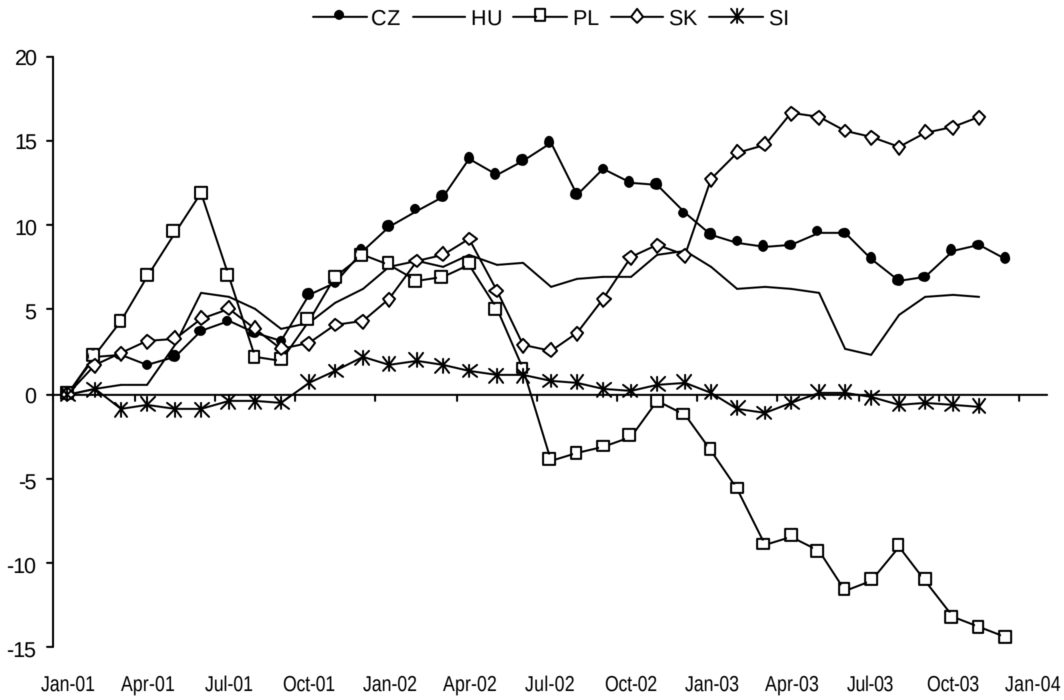
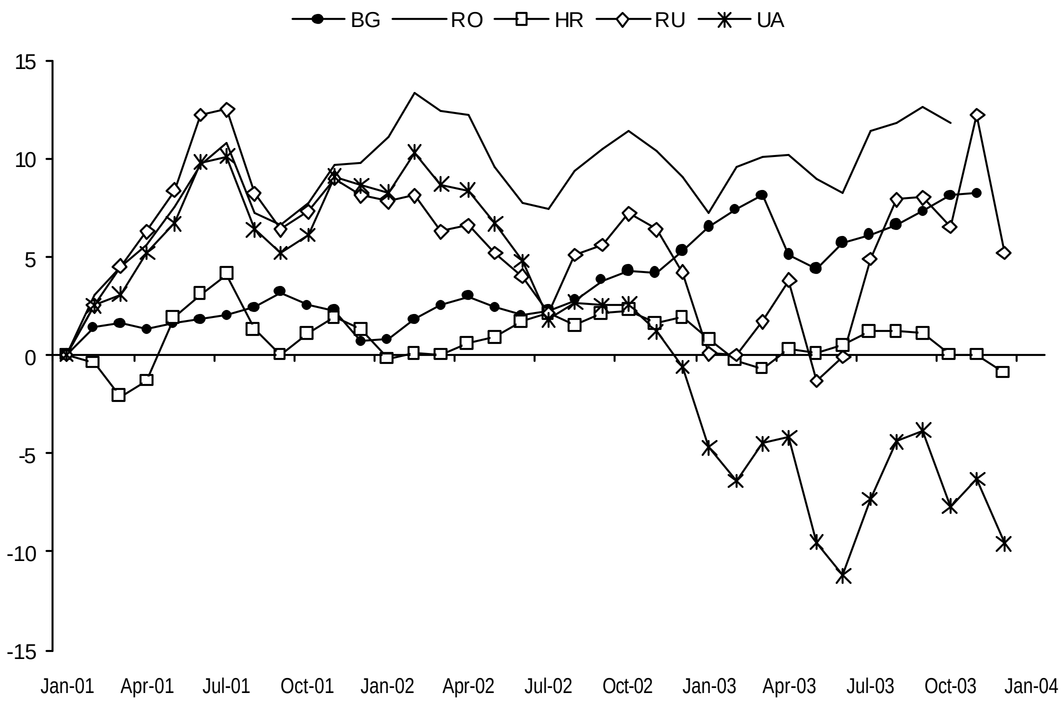


Figure 2b

Real appreciation*, 2001-2003 (base month January 2001)

(national currency vis-à-vis EUR, PPI-deflated)



* An increasing line means a real appreciation.

Source: wiiw Monthly Database incorporating national statistics.

The differential export/import developments resulted in rather large increases in the trade deficits in Hungary, Bulgaria, Romania and Croatia. These have not yet approached alarming levels and need not be of immediate concern. Russia' trade surplus has reached an unprecedented level. Slovakia's trade deficit improved tremendously, and there have been some marked improvements in the Czech and Polish trade deficits as well.

FDI in 2003: strongly contracting in the acceding countries, expanding elsewhere

After a record inflow of EUR 31 billion in 2002, FDI inflows in Central and Eastern Europe were just about EUR 18 billion last year. This is in sharp contrast to global developments: world-wide FDI in 2003 remained at the preceding year's level. FDI flows are expected to rebound in 2004 – but the transition countries are unlikely to experience much of a rebound, also because they have generally already quite high FDI/GDP ratios.

Table 6

Foreign direct investment inflow

based on the balance of payments, EUR million

Slovakia

	1995	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003** estimate
Czech Republic	1982	1140	1152	3317	5933	5404	6296	9887	4000
Hungary	3751	1886	1973	1857	1913	1834	2889	908	-600
Poland	2831	3592	4343	5676	6824	10334	6372	4371	3500
Slovakia	200	285	195	609	366	2089	1763	4260	600
Slovenia	117	138	295	194	99	149	412	1707	150
New EU Members-5	8882	7041	7957	11654	15135	19810	17732	21133	7650
Estonia	156	120	236	511	284	425	603	307	800
Latvia	138	305	462	317	325	445	182	407	350
Lithuania	56	122	313	824	457	412	499	772	600
Baltic countries	350	547	1011	1653	1066	1282	1284	1486	1750
New EU Members-8	9232	7589	8968	13306	16201	21091	19016	22619	9400
Bulgaria	70	87	446	478	775	1103	903	980	1270
Croatia	88	408	471	831	1377	1180	1743	1193	1300
Macedonia	7	9	27	114	31	189	493	82	50
Romania	324	210	1076	1805	980	1147	1294	1212	1300
Serbia and Montenegro	.	.	653	101	105	55	186	502	1000
Russia	1597	1992	4303	2424	3105	2933	3068	3640	3000
Ukraine	204	411	549	658	466	644	884	734	1000
Eastern Europe	11522	10705	16493	19717	23040	28342	27587	30961	18320

Source: National Banks of the respective countries according to balance of payments statistics; wiiw estimate for 2003.

Inflows into the five Central European countries acceding to the EU in 2004 were particularly low: they declined from EUR 21 billion in 2002 to 7.7 billion in 2003. The fall in FDI inflows was especially pronounced in those Central European countries where privatization, the main source of the record inflows in earlier years, has come to an end. This was the case in the Czech Republic, Slovakia and Slovenia where the 2002 inflow had been extraordinarily high and could hardly be repeated in any subsequent year. The Czech Republic and Poland still remained significant receivers of FDI with about EUR 4 billion, including also greenfield projects and the expansion of existing projects. New greenfield investments have started in Slovakia as well, promising higher inflows in the future.

Table 7

Foreign direct investment inward stock

based on the international investment position (IIP), EUR million

	1995	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003** estimate
Czech Republic	5741	6910	8367	12255	17479	23323	30717	37576	41000
Hungary	10108	12216	14807	16125	19439	21659	26503	29526	28000
Poland	6122	9229	13206	19247	25946	36792	46686	45739	48000
Slovak Republic	1013	1660	1888	2464	3174	5112	6327	8185	9500
Slovenia	1376	1612	2000	2369	2675	3110	2952	3918	4000
New EU Members-5	24359	31626	40268	52460	68712	89996	113185	124945	130500
Estonia	574	664	1040	1560	2454	2843	3573	4035	5400
Latvia	480	754	1140	1325	1782	2241	2652	2679	2800
Lithuania	274	564	942	1384	2050	2509	3023	3818	4000
Baltic countries	1328	1983	3123	4269	6285	7593	9248	10532	12200
New EU Members-8	25688	33609	43391	56729	74997	97590	122433	135476	142700
Bulgaria	273	360	806	1363	2392	2426	3129	3100	3600
Croatia	274	696	1266	1622	2568	3821	5336	6443	8000
Macedonia	28	37	63	177	208	397	890	972	1200
Romania	642	885	2128	3783	5447	6966	8656	8438	9200
Serbia and Montenegro	.	.	653	753	859	913	1099	1600	2500
Russia	3214	5206	9509	11933	15038	27175	41843	49299	52000
Ukraine	640	1050	1599	2257	2723	4164	5448	5329	6000
Eastern Europe	30758	41842	59415	78617	104231	143452	188834	210658	225200

Source: National Banks of the respective countries according to the international investment position (IIP). Cumulated EUR inflows for Bulgaria until 1997, Croatia until 1997, Macedonia, Serbia and Montenegro, Russia until 1999, Ukraine until 1999. wiiw estimate for 2003.

A negative FDI inflow was booked in Hungary in 2003, which is unique among the accession countries. This is in part the effect of the Hungarian statistical practice, which does not count reinvested profits as FDI. In 2002 and 2003 these reinvested profits amounted to about EUR 1 billion annually. Statistical issues aside, FDI inflows to Hungary have been adversely affected by the recent wage and exchange rate developments.

Labour-intensive production is leaving Hungary, moving to lower-cost countries such as Romania, Ukraine or China. While inward FDI declined, outward FDI increased in the case of Hungary and Slovenia (and is expected to rise also in Poland).

FDI inflows have shifted to countries that received relatively less previously, namely to South Eastern Europe as well as Russia and Ukraine. In South Eastern Europe, Bulgaria, Croatia and Romania all registered record inflows. Major inflows were related to the privatization of the oil company INA in Croatia and the DSK bank in Bulgaria. The rest was greenfield investment in a number of projects in the light industry, real estate and retail in Bulgaria and Romania. In Russia not only the oil and wood industry but also the food industry attracted new investment projects. The inflow of about EUR 3 billion may remain a record for some years. At the same time, Russia continues exporting more capital than importing it.

In 2004 no upsurge of FDI in the acceding countries is expected. The benefits of accession in the form of lower transaction costs and increasing stability is likely to make these countries more attractive later on.

Stable foreign financial position

The improvements in the trade balances have been reflected in quite radical contractions of the current account deficits in Slovakia and Poland. Conversely, the deterioration of the trade balances has led to much higher current account deficits in Hungary, Bulgaria and Romania. Net transfers (including nationals' remittances) helped to narrow the current account deficits in Croatia, Romania, Macedonia and Serbia-Montenegro. In addition, high positive net services payments were essential for Croatia. Russia's current account surplus is huge, on account of its huge merchandise trade surplus. Russia continues to be a large net exporter of capital. Ukraine's current account surplus is also very high – due primarily to a high surplus on services income (e.g. transit fees).

Despite a low (and falling) trade deficit, the current account deficit of the Czech Republic remains high. This has been due to the very high, and rising, deficit on net income transfers. The high FDI inflow recorded in recent years is now showing its ugly face. Even if good chunks of the profits earned on FDI actually do not leave the country (as they are being reinvested), potentially at least they can move out for good and thus become a matter of concern for the overall balance of payments. In this context one can consider the following question. Is a low (or even balanced) trade deficit a sign of a country's sufficient external competitiveness if, at the same time, its current account deficit is permanently very high (e.g. due to very high and permanent deficits on income transfers)? The answer does not seem to be an unqualified Yes. Under imaginable circumstances such a country can go bankrupt despite consistently high trade surpluses. (Incidentally, this has been the fate of many Latin American countries.) To stay afloat in the long run, a country with very high deficits on income transfers must be able to earn sufficiently high surpluses on merchandise trade and non-factor services. Having balanced trade accounts may not suffice. Accordingly, such a country must be much more competitive in its foreign trade in order to be able to finance the transfers exceeding the foreign investors' reinvested profits.

Table 8

Foreign financial position

EUR billion, end of period

	Gross external debt			**Reserves of National Bank (excluding gold) 1)**			**Current account EUR billion**				**Current account in % of GDP**			
	2001	**2002**	**2003**	**2001**	**2002**	**2003**	**2002**	**2003**	**2004 forecast**	**2005 forecast**	**2002**	**2003**	**2004 forecast**	**2005 forecast**
Czech Republic	25.4	25.1	24.4 2)	16.4	22.6	21.3	-4.7	-4.7	-4.8	-5.2	-6.4	-6.4	-6.1	-6.1
Hungary	37.6	38.6	43.0 2)	12.2	9.9	10.1	-2.8	-4.8	-4.6	-4.5	-4.0	-6.6	-5.7	-5.3
Poland	81.4	80.5	79.9 2)	29.0	27.4	25.8	-7.2	-3.5	-4.8	-6.0	-3.6	-1.9	-2.5	-3.0
Slovak Republic	12.5	12.7	13.5 2)	4.7	8.8	9.7	-2.1	-0.4	-0.5	-0.8	-8.0	-1.3	-1.5	-2.1
Slovenia	10.4	11.5	13.0 3)	4.9	6.7	6.8	0.3	0.1	0.1	-0.1	1.4	0.2	0.2	-0.4
Estonia	3.7	4.5	5.1 2)	0.9	1.0	1.1	-0.8	-1.1	-1.0	-0.8	-12.3	-14.6	-12.2	-8.5
Latvia	6.3	6.8	7.1 2)	1.3	1.2	1.9	-0.7	-0.8	-0.9	-1.0	-7.6	-8.9	-9.5	-9.6
Lithuania	6.0	5.9	6.3 2)	1.8	1.7	2.3	-0.8	-0.9	-1.0	-1.1	-5.3	-5.7	-5.8	-5.9
Bulgaria	12.0	10.8	10.6	3.7	4.2	5.0	-0.8	-1.6	-1.4	-1.3	-4.9	-8.9	-7.1	-6.2
Romania	13.5	14.6	15.5 4)	4.4	5.9	6.4	-1.6	-3.0	-3.5	-3.5	-3.4	-6.2	-6.8	-6.4
Croatia	12.8	14.8	18.0 3)	5.3	5.7	6.6 3)	-2.0	-1.5	-1.3	-1.2	-8.5	-6.1	-5.1	-4.5
Macedonia	1.6	1.5	1.4 2)	0.8	0.7	.	-0.3	-0.3	-0.3	-0.3	-8.6	-6.0	-5.5	-5.3
Serbia & Montenegro	13.3	11.4	15.8 4)	1.1	2.1	3.9 3)	-1.8	-1.5	-2.0	-2.0	-11.7	-8.8	-11.7	-11.7
Russia	171.6	146.0	138.5 3)	37.0	42.3	58.5	31.2	34.6	30.0	25.0	8.5	9.0	7.5	6.0
Ukraine	13.7	.	12.3 2)	3.4	4.1	5.7 4)	3.4	2.8	2.4	1.8	7.5	6.5	5.3	3.5

Notes: 1) Forex reserves, SDR and reserve position with the IMF. Including gold for the Czech Republic, Russia, Slovakia. Figures for Hungary correspond to total reserves of the country. - 2) September. - 3) November. - 4) October.

Source: wiiw Database incorporating national statistics, forecast: wiiw and European Commission (2003) for Baltic States.

To dispel any misunderstanding, at present no transition country (excepting perhaps Croatia) has to be very seriously concerned with the prospects of a near-future foreign-debt crisis. Taken together, the levels of foreign debts, currency reserves and current account deficits do not make up, as yet, any ‘explosive’ combination – especially when considered in the context of the current GDP levels. This applies even to the Baltic countries and Bulgaria, whose foreign debt levels are still not exorbitant, despite permanently high current account deficits. (Moreover, in the Baltic countries much of the foreign debt in fact represents liabilities of local affiliates of foreign firms owed to their mother companies abroad).

Strong industry performance

Industrial production generally accelerated in 2003. Gross industrial output rose spectacularly in Bulgaria, Lithuania and Ukraine in particular. Also in some other countries industrial growth appears to have been de-coupled from export growth. In Slovakia the very strong rise in exports is not associated with a comparable growth in industrial output. This is attributed to the stagnation of fixed capital formation and declining private consumption. In any case, it turns out that the association between exports and industrial output has been generally quite loose – though it has recently been important in some countries (Russia, Poland, the Czech Republic). A more precise characterization of factors underlying the industrial dynamics requires taking into account many more developments, e.g. the dynamics of imports competing with domestic production. This factor may have been of some importance in several countries where one observes relatively sluggish growth of production coupled with a deterioration of trade balances caused by a relatively faster rise in imports (Slovenia, Croatia, Romania).

Other factors considered as conducive to an expansion of industrial production include improvements in labour productivity. Labour productivity has been on the rise in the transition countries, though in 2003 in all cases (excepting Bulgaria) this has been coupled with falling industrial employment (which is the pattern observed over many years).

By taking into account, in addition to labour productivity, the growth rates of the average industrial wage and industrial producer prices, one arrives at the indices of real domestic unit labour costs. The indices of the 'real unit labour costs' reflect, with some qualifications, the extent of the 'profit squeeze' (due to the combined effects of price, wage and productivity developments). Calculations, conducted on the basis of quarterly data, indicate that Hungary has been the only accession country where there has been a rather strong profit squeeze (since the first quarter of 2001). In Slovenia and the Czech Republic the real unit labour cost indicators do not follow definite trends upward or downward (though they show some fairly strong seasonal fluctuations). In the remaining countries there has been a fall in the share of wage costs in industrial production. (In Poland, Slovakia, Romania and Croatia the 'wage squeeze' started already in the first quarter of 2002, in Bulgaria two quarters later.) The presence or absence of the profit squeeze need not have an immediate impact on the dynamics of industrial production. The profit squeeze may have a stimulating effect on production if the wage bill is rising (relative to the value of industrial output) which supports consumer demand for domestically produced industrial goods. By the same token the wage squeeze may in fact have a negative effect on industrial output.

However, two qualifications are in place here. The profit squeeze (implying falling profitability) may be detrimental to firms' future fixed investment, and hence also for the future demand for industrial investment goods. And the wage squeeze (implying rising profitability) may, in the medium term, be a necessary (but not a sufficient) condition for rising fixed investment, and hence for an acceleration of the production of capital goods. The recent evidence on profit squeeze suggests that industry's profitability may have improved in Poland, Slovakia, Romania, Croatia and Bulgaria. This may be conducive to investment. On account of profitability trends, investment conditions have stayed roughly unchanged in Slovenia and the Czech Republic, and deteriorated (quite strongly) in Hungary.

Table 9

Gross industrial production

real change in % against preceding year

	1995	1997	1998	1999	2000	2001	2002	2003 1)	2004 forecast	2005 forecast	Index 1990=100 2003	Index 1995=100 2003
Czech Republic	8.7	4.5	1.6	-3.1	5.4	6.5	4.8	5.5	5.5	6	99.3	130.2
Hungary	4.6	11.1	12.5	10.4	18.1	3.6	2.7	6.4	8.5	10	171.4	190.9
Poland 2)	9.7	11.5	3.5	3.6	6.7	0.6	1.4	6	7	7	184.9	149.4
Slovak Republic	8.3	2.7	5.0	-2.7	8.6	6.9	6.5	5.3	6	7	111.6	140.0
Slovenia	2.0	1.0	3.7	-0.5	6.2	2.9	2.4	1.4	2	2.5	95.8	119.4
CEEC-5 3)	8.2	8.5	4.6	2.3	8.4	3.2	2.9	5.7	6.6	7.0	146.0	148.3
Estonia	1.9	14.6	4.2	-3.4	14.6	8.9	5.9	10.2	.	.	83.0	172.7
Latvia	-3.7	13.8	3.1	-5.4	4.7	9.2	5.8	6	.	.	57.6	150.1
Lithuania	5.3	3.3	12.1	-9.9	2.2	16.0	3.1	16.1	.	.	53.5	155.5
CEEC-8 3)	7.9	8.5	4.8	1.8	8.2	3.7	3.0	6.0	.	.	140.2	149.0
Bulgaria	4.5	-5.4	-7.9	-8.0	8.2	1.6	0.6	14	10	8	72.0	106.2
Romania	9.4	-7.2	-13.8	-2.4	7.1	8.4	3.1	3	4	4	70.6	102.3
CEEC-10 3)	8.1	5.7	1.7	0.7	8.0	4.2	2.9	6.0	.	.	122.2	140.1
Croatia	0.3	6.8	3.7	-1.4	1.7	6.0	5.4	4.1	3.5	3	74.7	133.1
Macedonia	-10.7	1.6	4.5	-2.6	3.6	-3.0	-5.3	5	5	5	51.2	106.6
Serbia & Montenegro	3.8	9.5	3.6	-23.1	11.1	0.0	2.0	-2.7	0	2	43.3	102.5
Russia	-3.3	1.9	-5.2	11.0	11.9	4.9	3.7	7.0	5	4	66.5	134.1
Ukraine	-12.0	-0.3	-1.0	4.0	12.4	14.2	7.0	15.8	8	9	81.1	154.7

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

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

Of course, whether industrial firms actually accelerate their fixed investments will depend on other factors too (their debt positions, interest rates and access to external funds, sales prospects, strength of competition etc.). Domestic sales prospects depend quite strongly on wage developments. A too strong, protracted wage squeeze could actually be bad as far as the prospects of high domestic sales are considered. Besides, it is even less obvious to what extent eventual changes in investment activities will translate into higher demand for the domestically produced (rather than imported) capital goods.

Table 10

Labour productivity in industry

change in % against preceding year

	1995	1997	1998	1999	2000	2001	2002	2003 1)	Index 1990=100 2003	Index 1995=100 2003
Czech Republic 2)	10.6	9.2	3.7	1.7	9.5	5.5	6	9	159.9	166.5
Hungary 3)	10.2	13.7	11.9	10.5	17.7	4.8	4.4	8	275.4	213.3
Poland 4)	6.3	11.2	4.7	11.8	13.6	5.4	4.5	11.5	289.6	198.2
Slovak Republic	4.0	4.8	9.1	0.2	12.1	5.9	6.3	5	147.0	155.6
Slovenia	6.3	4.4	5.4	3.1	8.4	3.5	5.6	3	184.6	151.7
Bulgaria 5)	7.4	-2.8	-3.8	2.2	18.1	2.1	2.0	11	160.8	139.5
Romania 6)	13.7	-1.8	-7.4	11.3	13.8	6.9	13.7	12	176.7	168.9
Croatia 6)	6.6	11.9	8.7	3.9	4.3	9.6	9.6	7	181.3	189.1
Macedonia 7)	1.2	8.3	14.8	6.4	6.4	0.0	1.3	.	121.7 8)	185.0 8)
Serbia & Montenegro 7)	8.3	12.3	6.3	-19.1	16.4	3.1	10.2	.	72.7 8)	139.8 8)
Russia	5.4	8.6	0.8	11.8	10.1	5.0	6.2	.	100.4 8)	154.7 8)
Ukraine	-4.2	8.2	2.2	9.6	28.3	12.5	.	.	124.2 9)	180.2 9)

Notes: 1) Preliminary. - 2) Enterprises with 100 and more, from 1997 w ith 20 and more employees. From 2001 calculated with sales. - 3) Enterprises with more than 10, from 1999 more than 5 employees. - 4) For 2003 enterprises with more than 9 employees. - 5) Up to 1996 public sector only. - 6) Enterprises with more than 20 employees (for Romania from 1999). - 7) Excluding small enterprises. - 8) Year 2002. – 9) Year 2001.

Source: wiiw Database incorporating national statistics.

Another factor that needs to be considered here relates to the advances in external competitiveness.[1] In so far as changes in the latter are captured by real exchange rates (whether deflated by industrial producer prices, or unit labour costs, or in some other way) it is quite clear that the recovery of Poland's industrial production in 2003 can be linked to a strong real depreciation. A similar qualification applies to Ukraine, whose currency weakened considerably against the rouble, which is the currency of its main trade partner. In Croatia and Slovenia the roughly constant real exchange rate (in PPI terms) and a weak depreciation (in ULC terms) may have insulated industrial production from external impacts. Some mild real depreciation recently observed in the Czech Republic may have had a positive effect on production. The relatively strong real appreciation in terms of industrial producer prices going on in Slovakia was at least partly offset by a real depreciation in terms of industrial unit labour costs. Hungary is an interesting case because it experienced a strong real appreciation in both ULC and PPI terms in 2002. That was consistent with the relatively weak industrial growth in that year. More recently the real appreciation is being corrected (in both PPI and ULC terms) – and this is arguably one of the reasons of the rather strong industrial recovery that started in the closing months of

1 See also selected indicators of competitiveness in the Appendix.

2003. It is much more difficult to square the 2003 real exchange rate and industrial developments in Bulgaria. The fast growth of Bulgarian industrial output has not been undermined by the very strong real appreciation. This outcome attests to successful structural change in the Bulgarian industry, with rising supplies of products that withstand foreign competition even if their prices (or production costs) rise quite steeply.

Unemployment: stubbornly high

Given the fact that the demand for labour registered by sectors other than industry cannot absorb the existing excess labour supply, the rising industrial labour productivity supports unemployment which is high (or very high) in transition countries. Of course, achieving gains in labour productivity and unit labour costs is both possible to achieve and necessary for maintaining external competitiveness. But, in so far as keeping wages in the tradable sector 'competitively low' implies a general depression of wages and domestic demand, also for non-tradable services, this prevents a faster growth of output and employment in the non-tradable sector.

Total unemployment in the transition countries is unlikely to decline significantly in the coming years. One of the main justifications for this view is the fact that unemployment is not presently considered a major macroeconomic challenge but rather an issue related to labour market flexibility. The labour market reforms (including the progressing liberalization of the provisions of the Labour Codes) may however at best contribute to a slowdown in the growth of wages, whereas the cuts in unemployment benefits and the tightening of unemployment benefit eligibility criteria (also considered, or already underway in some transition countries) will at best improve the unemployment statistics, not the real situation. In so far as the labour market reforms may result in a slowdown of growth of disposable household incomes (on account of slower growth in wages and unemployment benefits) one can rather expect a rise in unemployment due to a weakening of consumer demand.

Some improvement in unemployment can be expected from the demographic developments in the medium and long term. In most countries the current population age structures suggests a slowdown in the numbers of new labour force entrants in the coming years. Only in Poland will there be net increases in the labour supply. In addition, Poland's open unemployment will be constantly supported by outflows of labour force from hugely over-manned agriculture. (A similar, though less intensive, process can be expected in Romania as well.)

With the EU accession and a (partial and gradual) liberalization of cross-border movements of the labour flows one can expect some migratory pressures coming from the acceding to the incumbent EU countries. The size of those flows remains uncertain – the various studies come to widely differing estimates. In all probability those flows will not be very high, at least initially (in 2004 and 2005). Later on they may become more significant. Poland is the most likely country to 'export' its high surpluses of labour to the rich EU countries. Large remittances would then flow in the opposite direction. But it may be fair to add that at present the internal, interregional, labour mobility is quite low in the accession countries. This may however be due to the unavailability of affordable housing in the more affluent regions of the accession countries. Besides, the comparatively more generous social (e.g. unemployment) benefits to which the migrants from the acceding countries will eventually be entitled in the 'old' EU countries will magnify the attraction of migration.

Table 11

Unemployment, LFS definition, annual averages

	in 1000 persons				rate in %					
	2000	**2001**	**2002**	**2003** 1)	**2000**	**2001**	**2002**	**2003** 2)	**2004** forecast	**2005**
Czech Republic 2)	455	421	374	399	8.8	8.1	7.3	8.1	8.2	8.0
Hungary	263	233	239	245	6.4	5.7	5.8	5.9	6	6
Poland	2785	3170	3431	3347	16.1	18.2	19.9	20.0	20	19
Slovak Republic	485	508	487	460	18.6	19.2	18.5	18.0	16	15
Slovenia	68	63	62	64	7.0	6.4	6.4	6.7	6.3	6
CEEC-5 3)	4055	4395	4593	4515	13.5	14.5	15.3	15.4	15.3	14.6
Estonia	89.9	83.1	67.2	65	13.6	12.6	10.3	10.0	10	10
Latvia	159.0	145.0	134.5	125	14.5	13.1	12.0	10.8	10	10
Lithuania	275.7	284.0	224.4	210	15.4	17.4	13.8	12.7	12	11
CEEC-8 3)	4580	4907	5019	4915	13.6	14.5	15.0	15.0	14.8	14.2
Bulgaria	567	664	592	461	16.9	19.7	17.8	14.5	14	13
Romania 4)	821	750	845	740	7.1	6.6	8.4	8	8	7
CEEC-10 3)	5968	6321	6456	6116	12.3	13.0	13.8	13.5	13.4	12.5
Croatia	298	277	266	253	16.1	15.9	14.8	14	14	13.5
Macedonia	262	263	263	316	32.2	30.5	31.9	36.7	36	35
Serbia & Montenegro	481	490	517	520	12.6	12.9	13.8	14	15	15
Russia	7515	6416	5712	6043	10.5	9.1	8.0	8.5	8	9
Ukraine	2708	2517	2301	2071	11.7	11.1	10.1	9.5	9	8.5

Notes: 1) Preliminary. - 2) From 2002 weighted according to census 2001. - 3) wiiw estimate. - 4) From 2002 new methodology in accordance to EU definitions.

Source: wiiw Database incorporating national statistics, forecast: wiiw and European Commission (2003) for Baltic States.

Inflation, monetary policy and exchange rate issues

The progress on inflation reduction has been highly satisfactory in most transition countries. Even in Russia and Romania is inflation being reduced steadily, if gradually, without resorting to over-restrictive policies. In Slovakia, where inflation was much higher in 2003 than in 2002, the disinflation in market-determined prices has continued and the jump in recorded inflation is ascribed to the government's decisions (e.g. on indirect tax rates and deregulation of pricing of services, often supplied by monopolistic providers). Inflation in countries which have formally fixed their exchange rates and adopted currency-board exchange rate/monetary regimes (the Baltic countries and Bulgaria) has eventually fallen to low levels.

Even more impressive disinflation occurred in the Czech Republic and Poland, which have been pursuing quite opposite (as compared to the above countries) monetary/exchange rate regimes for the past several years, namely floating exchange rates coupled with inflation targeting. However, in Poland the policy which brought inflation to a low level was much more crude, and costly. It resorted, for several years, to excessively high interest rates which undercut investment, snowballed debts (including public debt) and unduly strengthened the Polish currency. In effect the monetary policy has engineered stagnation (2001-2002), with a quantum jump in unemployment and deteriorating budget deficits. Under such conditions the disinflation cannot be judged a big policy success. In the Czech Republic the policy has been more pragmatic and opportunistic. It also involved cleverly timed and executed occasional unannounced interventions aimed at discouraging unwelcome inflows of short-term capital and undesirable excessive nominal appreciation.

Table 12

Consumer price inflation

change in % against preceding year

	1995	1997	1998	1999	2000	2001	2002	2003 1)	2004 forecast	2005 forecast
Czech Republic	9.1	8.5	10.7	2.1	3.9	4.7	1.8	0.1	3.5	2
Hungary	28.2	18.3	14.3	10.0	9.8	9.2	5.3	4.7	6.5	5
Poland	27.8	14.9	11.8	7.3	10.1	5.5	1.9	0.8	2	3
Slovak Republic	9.9	6.1	6.7	10.6	12.0	7.1	3.3	8.5	8	5
Slovenia	13.5	8.4	7.9	6.1	8.9	8.4	7.5	5.6	4	3.5
Estonia	29.0	11.2	8.2	3.3	4.0	5.8	3.6	1.3	4	4
Latvia	25.0	8.4	4.7	2.4	2.6	2.5	1.9	2.9	3	3
Lithuania	39.6	8.9	5.1	0.8	1.0	1.3	0.3	-1.2	2	3
Bulgaria	62.1	1058.4	18.7	2.6	10.3	7.4	5.8	2.4	5	3
Romania	32.3	154.8	59.1	45.8	45.7	34.5	22.5	15.3	11	8
Croatia 2)	2.0	3.6	5.7	4.2	6.2	4.9	2.2	1.5	2	1.5
Macedonia 2)	15.9	4.4	0.8	-1.1	10.6	5.2	1.4	2.4	3	2
Serbia & Montenegro	78.6	21.6	29.9	44.9	86.0	88.9	16.5	9.4	8	8
Russia	197.5	14.8	27.6	85.7	20.8	21.6	16.0	13.6	10	8
Ukraine	376.8	15.9	10.6	22.7	28.2	12.0	0.8	5.2	7	5

Notes: 1) Preliminary. - 2) Retail prices.

Source: wiiw Database incorporating national statistics, forecast: wiiw and European Commission (2003) for Baltic States.

Hungary and Slovenia performed less satisfactorily. A relative slowness of disinflation is actually a structural, built-in feature of the Slovenian economy. Given the slow pace of industrial restructuring, the constant nominal devaluation – aimed at keeping the real exchange rate roughly unchanged – feeds domestic inflation through steady increases in nominal prices/costs of imports. In Hungary, which has formally adopted inflation targeting in 2001, the National Bank has in practice tried to target the level of the exchange rate as well. As is well known, the policy aimed at meeting two separate, and openly expressed, targets (inflation and the exchange rate level) with a single instrument (the interest rate) is very hard to conduct, especially with fully liberalized capital flows. As it turned out, in Hungary that policy failed, just a couple of months ago, rather miserably on both counts. Inflation eventually turned out to be much higher than targeted, while the exchange rate has appeared very volatile and costly to manipulate and virtually impossible to keep at the desired level. The National Bank wasted large amounts of money on futile currency interventions. Besides, it has raised the interest rates to very high levels, which sooner or later may attract inflows of hot money and increase the exchange rate volatility.

Table 13

Producer prices in industry

change in % against preceding year

	1995	1997	1998	1999	2000	2001	2002	2003 [1]	2004 forecast	2005 forecast
Czech Republic	7.6	4.9	4.9	1.0	4.9	2.9	-0.5	-0.3	1.1	0.5
Hungary	28.9	20.4	11.3	5.1	11.6	5.2	-1.8	2.4	5	3
Poland	25.4	12.2	7.3	5.7	7.8	1.6	1.0	2.6	3	3
Slovak Republic	9.0	4.5	3.3	4.3	10.8	6.5	2.1	8.1	7	4
Slovenia	12.8	6.1	6.0	2.1	7.6	8.9	5.1	2.5	2	1.5
Estonia	25.6	8.8	4.2	-1.2	4.9	4.4	0.4	0.2	.	.
Latvia	11.9	4.1	1.9	-4.0	0.6	1.7	1.0	3.2	.	.
Lithuania	28.3	6.0	-4.4	1.7	16.0	-3.0	-2.8	-0.5	.	.
Bulgaria	53.4	971.1	18.7	2.8	17.5	3.8	1.2	3.7	.	.
Romania	35.1	152.7	33.2	44.5	53.4	41.0	24.6	22	15	10
Croatia	0.7	2.3	-1.2	2.6	9.7	3.6	-0.4	1.9	2	2
Macedonia	4.7	4.2	4.0	-0.1	10.7	2.0	-0.9	0	2	2
Serbia & Montenegro	57.7	19.5	25.5	44.2	106.0	85.1	8.7	4.6	5	5
Russia	236.5	15.0	7.1	58.9	46.6	19.1	11.8	15.6	12	10
Ukraine	488.8	7.7	13.2	31.1	20.9	8.6	3.1	7.8	5	5

Note: 1) Preliminary.

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

Figure 3a

Minimum interest rates

nominal NB leading rate in % p.a.

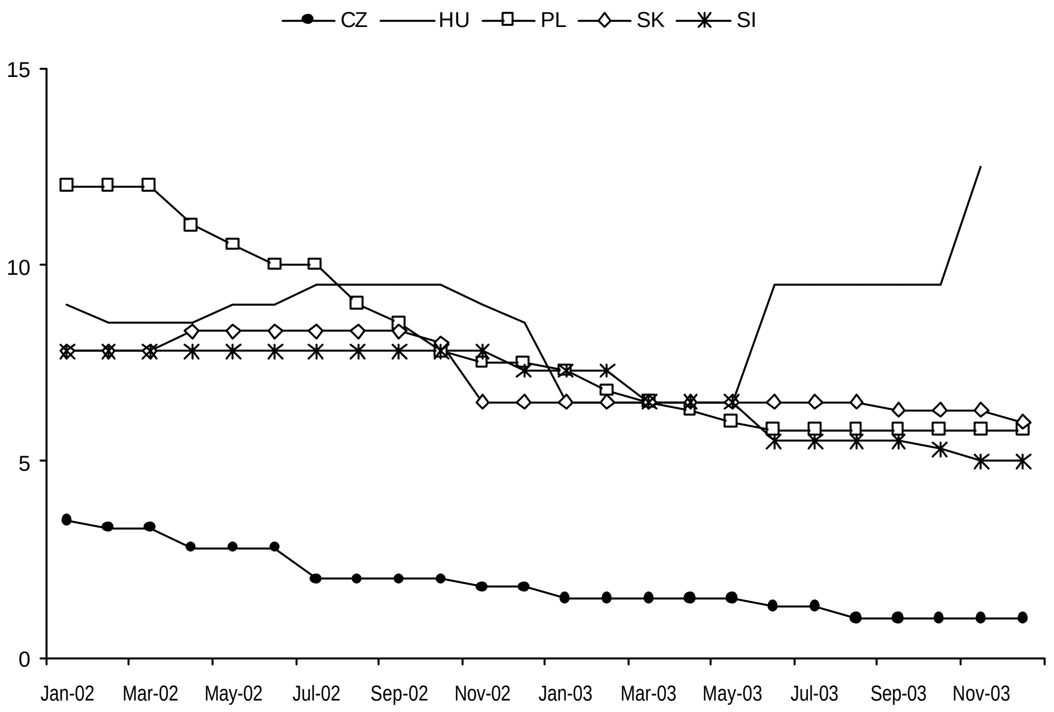
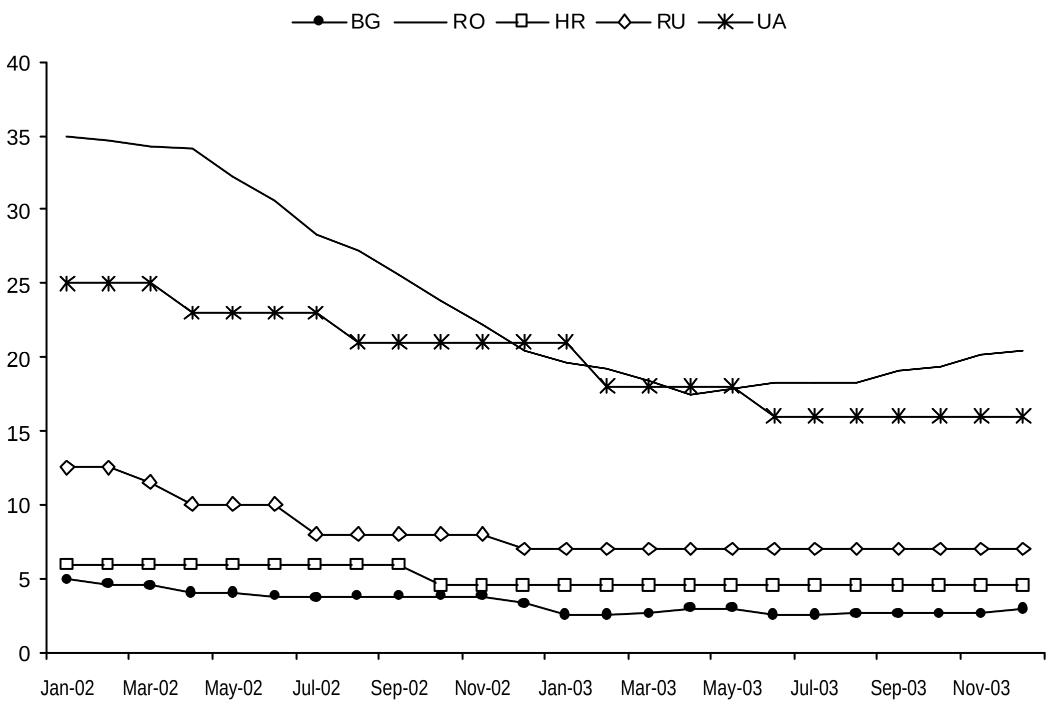


Figure 3b

Minimum interest rates

nominal NB leading rate in % p.a.



Source: wiiw Monthly Database incorporating national statistics.

Figure 4a **Nominal exchange rate movements, 2001-2003 (base month January 2001)**

(national currency vis-à-vis EUR)

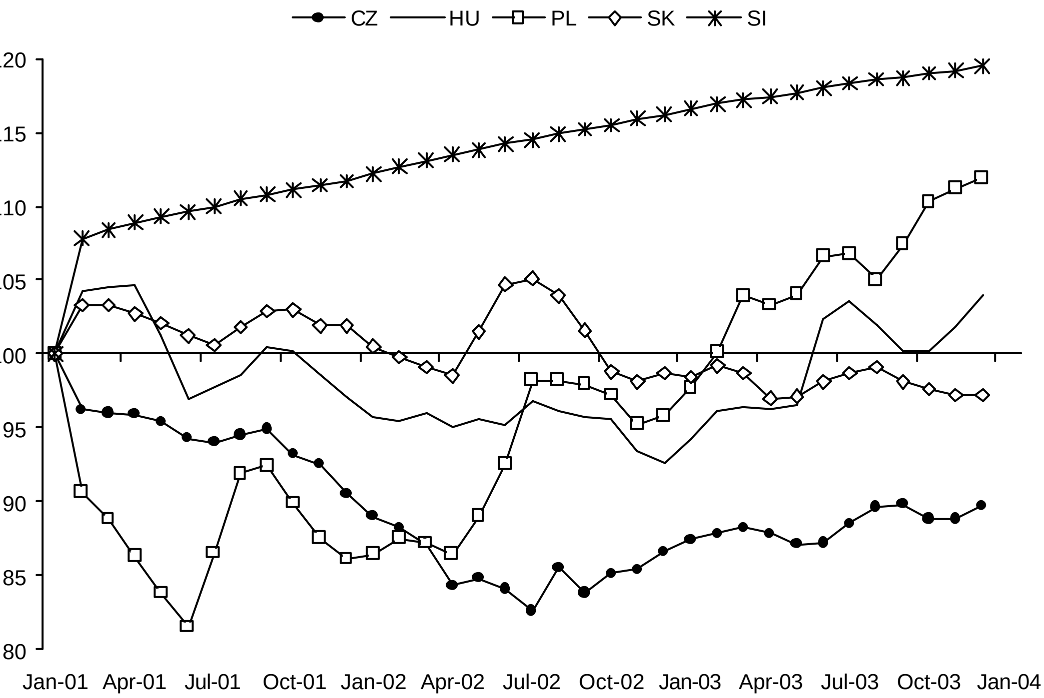
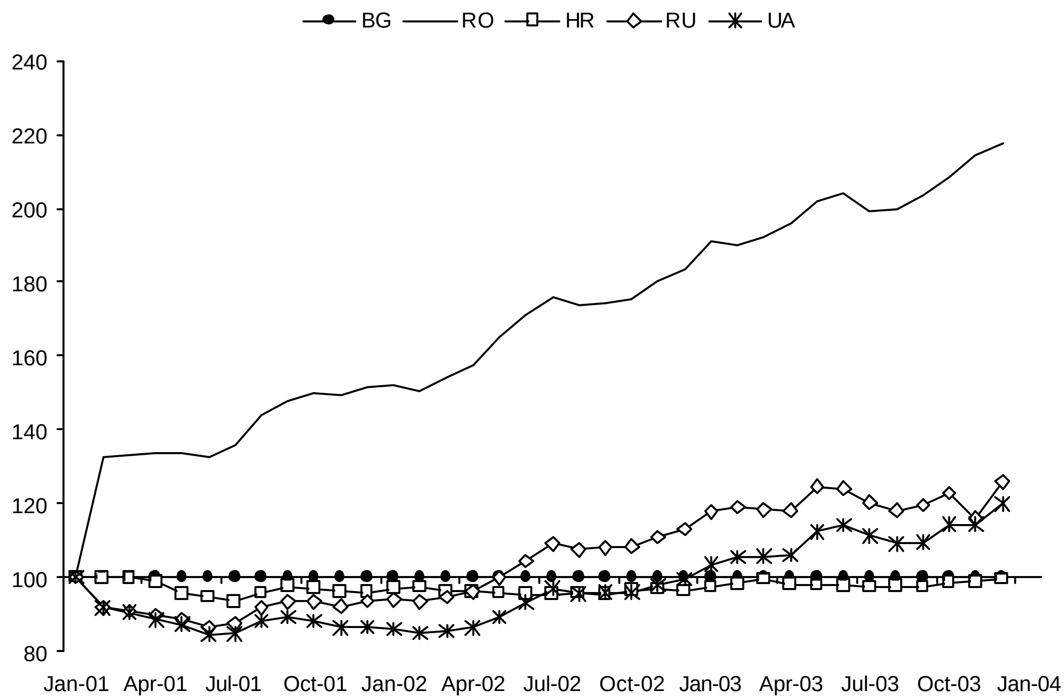


Figure 4b **Nominal exchange rate movements, 2001-2003 (base month January 2001)**

(national currency vis-à-vis EUR)



Source: wiiw Monthly Database incorporating national statistics.

The recent inflation/exchange rate experiences of the five Central European countries acceding to the EU in May 2004 throw some light on the issue of their adopting the euro. The European Central Bank and the EU Commission have repeatedly signalled reservations about those countries adopting the euro anytime soon. Despite this, the Polish, Hungarian and Slovenian authorities had (until recently) ambitious plans for adopting the euro 'as soon as possible'. The Czech and Slovak authorities have been much more pragmatic. In their assessment much more progress must be made on institutional, structural and real convergence before it would make sense to consider the adoption of the euro. Recently also the Hungarians and Poles seem to have second thoughts about the early introduction of the euro, and only the Slovenians continue to be keen on the idea. The change of mind may have much to do with the recent Hungarian exchange rate turmoil.

Essentially, the adoption of the euro requires at least two years' participation in the ERM II exchange rate/monetary mechanism. But that mechanism is strangely similar to the arrangement which Hungary experimented with in 2003. (It is perhaps no coincidence that an earlier version of that mechanism, the ERM, collapsed in the early 1990s when much more developed and stable economies, such as France or Sweden, participated in it.) It may be added that Slovenia's eventual early (this or next year) participation in the ERM II is likely to be troublesome for that country even if the risks of high speculative capital inflows/outflows are in this case much lower than they would be for Poland or Hungary. (Being a much smaller economy with less developed debt markets brings the advantage of being overlooked by speculative capital. The same applies even more to the Baltic countries, where debt markets are virtually non-existent.) Slovenia has muddled through with the built-in inflation-devaluation spiral. Stopping that spiral on a single day, balances may move out of equilibrium rather fast. The ± 15% corridor for the allowed fluctuations of the currency around the fixed exchange rate parity may turn out insufficient – and may expose the weaknesses of the Slovenian economy. If the parity is too weak, it may provoke higher inflation. In either case the exchange rate volatility would probably be very high. There is no guarantee that the weak edge of the corridor will not be hit. That would necessitate costly adjustments (high interest rates, possibly currency interventions), interfering with the otherwise not very impressive real growth. Worse still, the costs of adjustments may well turn out to be unproductive as in the end the initial ERM II fixed parity of the Slovenian currency may have to be devalued anyway.

For some accession countries, forecasts for 2004 and 2005 envision a slight rise in inflation. This is to be expected under some GDP growth acceleration, the recent increases in industrial producer prices and, in some cases, currency depreciation. However, the expected inflation acceleration is primarily related to higher indirect tax rates. The higher indirect tax rates (or in some cases lower subsidies) that are being introduced relate to the upcoming EU accession. Some tax rates have to be raised because this is required by the

EU regulations. Then, there is an intention on the part of the national governments to cut their public sector deficits – as they are likely to be soon ordered by the EU Commission (the guardian of the Growth and Stability Pact) to do anyway. Thus, in actual fact the inflationary acceleration is, to some extent, an expression of a fiscal tightening. Hopefully, this will be well understood by the national central banks. Otherwise they may respond with more restrictive monetary policies.

Fiscal issues: high deficits in the acceding countries and uncertain outlook

Judged by the size of their central budget deficits (in relation to GDP) the fiscal situation of Russia, Ukraine, Bulgaria, Macedonia and Romania is quite comfortable. The same applies to Slovenia (where even the general budget deficit was very small).

Table 14

Central government budget balance in % of GDP

	1995	1996	1997	1998	1999	2000	2001	2002	2003 [1)]
Czech Republic	0.5	-0.1	-0.9	-1.6	-1.6	-2.3	-3.1	-2.0	-4.7
Hungary	-5.5	-1.9	-4.0	-5.5	-3.0	-2.8	-2.7	-8.8	-4.0
Poland	-2.4	-2.4	-1.2	-2.4	-2.0	-2.2	-4.3	-5.1	-4.6
Slovak Republic	-1.5	-4.1	-5.2	-2.5	-1.8	-3.0	-4.5	-4.8	-4.5
Slovenia	0.9	0.7	-1.1	-1.1	-0.5	-0.9	-1.1	-2.6	-1
Bulgaria	-6.6	-10.8	-3.6	1.3	1.9	-0.7	-2.2	0.0	-0.3
Romania	-4.1	-4.9	-3.6	-2.8	-2.5	-3.6	-3.1	-3.1	-2.7
Croatia	-0.7	-0.1	-0.9	0.9	-1.8	-4.0	-2.6	-2.0	-3
Macedonia	.	.	0.0	0.0	0.3	2.3	-2.5	-1.7	0
Serbia and Montenegro	.	.	0.0	0.0	.	.	.	.	.
Russia	-3.0	-3.7	-4.0	-5.6	-1.1	1.4	3.0	1.4	2
Ukraine	.	-4.9	-6.8	-2.1	-1.5	0.4	-0.3	0.5	-0.4

Note: 1) Preliminary.

Source: wiiw Database incorporating national statistics.

The praise of the fiscal prudence of these countries must however be qualified on two counts. First, it is not clear to what extent the actual general government (i.e. the whole public sector's) deficits are higher than the central government budget deficits. In Bulgaria and Romania (whose fiscal conduct is closely monitored by the IMF) also the general government deficits are kept in check. Whether this is the case in all other countries (except Slovenia) is more debatable. One can be suspicious about e.g. Macedonia and Croatia. (In actual fact, the Croatian general government budget deficit was much higher than the central one, in both 2002 and 2003.) It is interesting to observe that the wars fought by, or in, these two countries appear (if one believes the statistics) to have been financed without these states making budget deficits. In the case of Russia and Ukraine one similarly may have doubts about the coverage of the fiscal statistics. For instance, one may wonder whether the practice, endemic only a few years ago, of delaying payments to public sector employees, or transfers to retirees, has really been eliminated. Secondly, one may consider the social and (long-term) economic soundness of a policy of balanced, or near-balanced, budgets of most of the countries listed above. A policy of 'sound' (balanced) budgets that tolerates mass poverty, depravation, or the rise in illiteracy can hardly be called socially sound. Such a policy is actually insane in longer-term economic terms. Being virtually disinterested in upgrading human capital and the physical and institutional (e.g. security and justice) infrastructure, it is unlikely to contribute to satisfactory long-run outcomes, even if it manages to produce fiscal surpluses over many years.

Four acceding countries (Poland, Hungary, the Czech Republic and Slovakia) have closed the year 2003 with rather large central budget deficits. In the Czech Republic the large increase in the deficit/GDP ratio in 2003 is attributed to a steep rise in expenditure not matched by a corresponding rise in revenue. The background of these developments is not yet quite clear. Nonetheless, the Czech authorities expect high deficits in the years to come, putting the blame on 'unproductive' social transfers, demography, 'difficulties in reforming public finances' etc. There is little doubt that in the short run all four countries have recently conducted 'unsound' (unbalanced) fiscal policies. But there are some other essential aspects of these policies which are worth discussing.

In Hungary and Slovakia the fiscal policies have often been misused for political purposes. They stipulated a co-ordination of lavish spending with the election calendar, and not so much with the business cycles, nor with the longer-term schedules of infrastructure investment. In due time the ensuing deficits are then trimmed (usually by means of indiscriminate cuts in spending), again without much concern for the actual needs of the moment. The Hungarian budget deficit registered in 2002 (8.8% of the GDP) is a clear example of politically, not economically calculated 'generosity' – which is being followed by emergency 'belts tightening'. The real harm inherent in such a style of fiscal policy conduct is indisputable.

The Polish situation is different. Really high budget deficits surfaced only in 2001. In so far as during 2001-2002 the Polish economy stagnated, these deficits may have even played a positive stabilizing role, preventing an outright recession. However, this is not the entire truth. Prior to 2001 Poland's fiscal policy was undergoing a radical structural change with a fairly constant (and low) deficit share. The change stipulated a steep fall in both budget revenue and spending. Spending fell from 29.6% of the GDP in 1995 to 22.1% in 2000. Revenues fell, respectively, from 27.2% to 19.8% and 18.9% of the GDP. The whole public sector revenues and expenditures followed similarly declining trajectories. The structural change contributed substantially to the slowdown of growth (1998-2000) and then stagnation. Cuts in taxation did not compensate, as far as total domestic demand is concerned, the cuts in spending. In particular, higher disposable (post-tax) income of the corporate sector failed to be transformed into higher investment. At the same time, once the falling tax revenue could no longer cover the statutory budgetary spending, high deficits emerged.

The Polish experience is of a more general significance. First, in some other countries (particularly Romania and also Slovakia) one observes a similar structural change in the fiscal policy. The ongoing tax competition among the accession countries is likely to force similar structural changes in other countries. That tax competition stipulates cuts in the corporate income tax rates, and in the tax rates applicable to high personal incomes. (Poland's fiscal structural change started precisely with such tax reductions.) Second, all acceding countries will be requested 'to do something' about their excessive (in terms of the EU Stability and Growth Pact) budget deficits. But, given their dedication to lowering taxation, that will imply the necessity to cut public consumption, investment, and social transfers.

Thus, should the provisions of the Stability and Growth Pact guide the EU fiscal policies in the future (no matter what opinion of these provisions one may have), the acceding countries will face rough times.[2] Falling spending, even if accompanied by falling taxation, will not be particularly conducive to higher growth (a growth slowdown will be at least equally probable). Of course, some social or political limits to cuts in spending may emerge – in which case high fiscal deficits would be either unavoidable, or requiring the reversal of the current trends in taxation. If, on the other hand, the social opposition to further cuts in spending is overruled, the social and long-run economic prospects of the acceding countries would not look much better than of those countries where balanced budgets mask mass poverty, degradation of human capital and disintegrating infrastructure.

Outlook: moderate growth acceleration in the acceding countries, moderate slowdown elsewhere

At the moment the least uncertain seem the prospects for Russia. World market prices for energy will most probably not rise any further in 2004 and 2005. Rather, they may stabilize, or even fall. Russia's GDP growth is therefore likely to slow down, though remaining quite high. Lower growth in Russia will also moderate growth in Ukraine. Both countries' current account surpluses will remain high.

[2] The EU Directorate-General for Economic and Financial Affairs projects substantial reductions in the general government deficits in the Czech Republic, Hungary and Slovakia. The ratios of those deficits (calculated in ESA 95 terms) to the GDP are projected to fall in the Czech Republic from 8% in 2003 to 6.3% in 2004 and 5.2% in 2005. For Hungary the respective ratios are 5.1%, 4.0% and 3.4% and for Slovakia 5.4%, 4.4% and 3.6%. (See *European Economy*, No 5/2003.) These projections do not yet have the status of 'recommendations' – but they may gain that status after 1 May 2004.

Moderate and quite stable growth is also expected in the transition countries not acceding to the EU in May 2004 (Bulgaria, Romania, Croatia, Macedonia and Serbia-Montenegro). However, all these countries will also be running very high current account deficits. This is rather unlikely to have significantly negative effects on their growth in 2004. Such effects may appear later on, possibly already in 2005. For that reason the margins of possible errors in our GDP forecasts for 2005 for these countries are considerably higher.

The forecasts for the five countries acceding the EU in May 2004 are much more uncertain – not only on account of the rather unpredictable effects of the accession itself. First, the acceding countries depend more than most others on the EU business climate. Although the long-awaited recovery in the EU is likely to materialize in 2004, it is still far from certain. Very likely the EU recovery will not be particularly impressive. The combined effects of the strong euro and restrictive monetary and fiscal policies may well delay, or weaken, the EU recovery. Then, the performance of individual acceding countries is likely to be quite strongly affected by internal developments whose course is hard to foresee. In Poland growth is likely to strengthen in 2004, provided the depreciation of the currency is not reversed abruptly, which is not unlikely. Also in Hungary much will depend on what kind of exchange rate stability (if any) will be achieved. In addition, in 2004 growth in that country may depend on the kind of upcoming re-orientation in fiscal/wage policies. In Slovakia some strengthening of growth in 2004 seems more certain, though it is far from obvious what effects the current radical reform of the tax system will have.

Apart from the country-specific factors that will have an uncertain bearing on the performance of the individual acceding countries in 2004, the effects of accession itself are also largely uncertain. Some quite certain effects (e.g. a rise in public spending on administrative tasks ensuing EU accession, or a rise in indirect taxes as required by the EU standards) will be of rather limited importance. On more substantial issues it is fair to say that not much is certain so far. The sizes of net transfers of funds from the EU will be determined by the efficiency of the acceding countries' administrations – and these have yet to learn to perform. (In any case those transfers are unlikely to be significant in 2004, and they are unlikely to have real impacts, e.g. on infrastructure investment.) While overall trade with the EU and FDI inflows are unlikely to be much affected in 2004 by the enlargement itself, there will be hard to assess, but probably significant, impacts of the implementation of specific EU rules and standards. Also, it is rather hard to say to what extent the acceding countries will be expected to reign in their public finances. But this may turn out to be a crucial issue as far as real growth in both 2004 and later on is concerned.

Table 15

Overview developments 2002-2003 and outlook 2004-2005

	GDP real change in % against previous year				Consumer prices change in % against previous year				Unemployment, based on LFS[1] rate in %, annual average				Current account in % of GDP			
	2002	2003	2004	2005	2002	2003	2004	2005	2002	2003	2004	2005	2002	2003	2004	2005
			forecast				forecast				forecast				forecast	
Czech Republic	2.0	2.9	3.3	4	1.8	0.1	3.5	2	7.3	8.1	8.2	8.0	-6.4	-6.4	-6.1	-6.1
Hungary	3.5	2.9	3.3	3.9	5.3	4.7	6.5	5	5.8	5.9	6	6	-4.0	-6.6	-5.7	-5.3
Poland	1.4	3.7	4	4	1.9	0.8	2	3	19.9	20.0	20	19	-3.6	-1.9	-2.5	-3.0
Slovak Republic	4.4	4.0	4.5	5	3.3	8.5	8	5	18.5	18.0	16	15	-8.0	-1.3	-1.5	-2.1
Slovenia	2.9	2.2	3.4	3.5	7.5	5.6	4	3.5	6.4	6.7	6.3	6	1.4	0.2	0.2	-0.4
CEEC-5	2.2	3.4	3.8	4.0					15.3	15.4	15.3	14.6	-4.2	-3.5	-3.6	-3.8
Estonia	6.0	4.4	5.6	5.1	3.6	1.3	4	4	10.3	10.0	10	10	-12.3	-14.6	-12.2	-8.5
Latvia	6.1	7.0	5.2	5.7	1.9	2.9	3	3	12.0	10.8	10	10	-7.6	-8.9	-9.5	-9.6
Lithuania	6.8	7.5	5.7	6.0	0.3	-1.2	2	3	13.8	12.7	12	11	-5.3	-5.7	-5.8	-5.9
CEEC-8	2.5	3.6	3.9	4.2					15.0	15.0	14.8	14.2	-4.4	-3.9	-4.0	-4.1
Bulgaria	4.8	4.5	4.5	4	5.8	2.4	5	3	17.8	14.5	14	13	-4.9	-8.9	-7.1	-6.2
Romania	4.9	4.7	4.5	4.5	22.5	15.3	11	8	8.4	8	8	7	-3.4	-6.2	-6.8	-6.4
CEEC-10	3.0	3.8	4.0	4.2					13.8	13.5	13.4	12.5	-4.3	-4.3	-4.4	-4.4
Croatia [2]	5.2	4.3	3.2	3.5	2.2	1.5	2	1.5	14.8	14	14	13.5	-8.5	-6.1	-5.1	-4.5
Macedonia [2]	0.3	2.8	4	4	1.4	2.4	3	2	31.9	36.7	36	35	-8.6	-6.0	-5.5	-5.3
Serbia & Montenegro [3]	4.0	1.0	2	3	16.5	9.4	8	8	13.8	14	15	15	-11.7	-8.8	-11.7	-11.7
Russia	4.7	6.8	4.5	4.1	16.0	13.6	10	8	8.0	8.5	8	9	8.5	9.0	7.5	6.0
Ukraine	5.2	8.5	6	6.5	0.8	5.2	7	5	10.1	9.5	9	8.5	7.5	6.5	5.3	3.5

Notes: 1) LFS - Labour Force Survey, refers to ILO definition. - 2) Consumer prices correspond to retail prices. - 3) Excluding Kosovo and Metohia.

Source: wiiw (February 2004); Baltic States forecasts: European Commission 2003.

For Slovenia (as opposed to the remaining acceding countries), fiscal consolidation will not be a major issue. Instead, unlike other countries, Slovenia is apparently keen on applying for membership in the ERM II mechanism in 2004. It is too early to judge the outcomes of Slovenia's application. However, there is little doubt that an eventual early ERM II participation may have destabilizing effects for that country.

Résumés for individual countries:

Czech Republic

Economic growth accelerated in the second half of 2003 and may reach over 3% in 2004 and about 4% in 2005. Balance of payments data point to improving international competitiveness of the tradable sector and at the same time to high current account deficits owing to high profits of foreign-owned companies. After zero inflation in 2003, government interventions will provoke significant price hikes in 2004. Strong exchange rate variations are not likely in the next few years, but in view of government deficits of about 5% of GDP the National Bank pleads for an introduction of the ERM II mechanism only in a few years' time.

Hungary

Recent data on economic growth, investment and exports are encouraging, but the weakening of the currency since the end of 2003 clearly signals that the populist economic policy, introduced by the previous conservative government in 2001 and continued by the socialist-liberal government after the 2002 elections, cannot be maintained any longer. Without a credible turn the confidence of the international markets cannot be restored.

Poland

The continuing strong devaluation of the currency supported the industrial and overall GDP recovery. Foreign trade and private consumption were the main sources of growth. High gains in industrial labour productivity and unit costs increased corporate profits, but did not have any positive impact on unemployment, which is stuck at a very high level. Fiscal deficits are high. At relatively low interest rates and some improvement in the standing of the banking system, conditions are good for a recovery of private investment. The upcoming EU accession carries many risks and uncertainties. Poland is not yet really prepared, institutionally and administratively, to receive the planned transfers from the EU.

Slovakia

Wide-ranging reforms have been implemented to provide pro-growth impulses and achieve a stabilization of public sector expenditures. Thanks to rising competitiveness, the Slovak economy has registered robust export-led growth for the past two years, resulting in a marked improvement in its external position. However, domestic demand (dominated by private consumption) stagnated in 2003. In the years to come the export performance will remain the main driving force behind GDP growth, but a gradual increase in domestic demand driven by pre-election demand incentives will support the economic expansion. The current account deficit will rise on account of growing domestic demand and repatriation of profits of FDI firms. After joining the EU, Slovakia intends to introduce the euro in 2008. In order to meet this ambitious target, Slovakia will have to significantly reduce its public budget deficit.

Slovenia

Despite an unchanged policy, stipulating close to balanced public finances and a roughly stable real exchange rate, GDP growth was not impressive in 2004. Industrial production stagnated and foreign trade performed disappointingly, with imports surging ahead of exports. Growth was driven by private consumption and public investment. Regardless of the relatively high inflation, the Slovenian authorities are keen on entering the ERM II system already in 2004.

Bulgaria

The Bulgarian economy continued to grow at a steady pace in 2003 and GDP is estimated to have grown by some 4.5% for the year as a whole. Manufacturing, construction, tourism and other services contributed most to the growth of aggregate output. The main factor behind this relatively sound performance is the ongoing process of restructuring in many sectors of economic activity, underpinned by several years of expansion of fixed investment. The solid output growth contributed to a notable improvement of the situation in the labour market in 2003. On the negative side, there was a rapid widening of the current account deficit, which has resurged as a source of policy concern. The short-term outlook remains generally positive and strong growth is expected to continue.

Romania

A sustained high rate of economic growth of about 4.5% as well as falling inflation are the main characteristics of the Romanian economy in 2004 and 2005. This wiiw forecast is more modest than the overambitious targets of the Romanian government. The current account deficit of 6-7% of GDP causes no problem for the country, as the economy is growing and investors' confidence is good.

Croatia

Strong growth driven by public investment and private consumption has been accompanied by a yawning trade deficit. Foreign debt, both by the private and the public sector, has soared, though part of its increase was due to exchange rate adjustments. Consumption growth will decelerate and the National Bank is likely to brake the rise in consumer credit. This is expected to slow down overall growth and the rise in the trade deficit in 2004.

Macedonia

The post-war recovery is under way. Continuing fiscal consolidation and restrictive monetary policy secure the stability of the exchange rate and low inflation. This is associated with extremely high, and rising, unemployment. Investment expansion and higher FDI inflows are hoped to sustain growth in the near future.

Serbia and Montenegro

The institutional stalemate has continued as the political events, including the assassination of the Prime Minister, absorbed the energies of the elite. Even privatization (including also FDI involvement), which had been quite intensive, practically stopped towards the end of 2003. The overall confusion about the future of the union of Serbia and Montenegro, and about the policies of each of those states is not promising for the economic prospects for the near future.

Russian Federation

GDP growth in 2003 was the second highest in Russia's recent economic history. Higher world market energy prices resulted in a resumption of net export growth; there was also a marked increase in investments. With the government budget in a sizeable surplus, foreign exchange reserves at a record level, and a modest decline in both inflation and unemployment, the Russian economy is now in its best shape since the beginning of transition. Putin's victory in the March 2004 presidential elections will guarantee political stability but not the speed of the reform process. There is a broad consensus that the current pace of economic growth is not sustainable unless the pace of structural, institutional and banking sector reforms increases substantially.

Ukraine

In 2003, the Ukrainian economy grew by an impressive 8.5%, largely due to booming investments and, to a lesser degree, domestic consumption. Short-term prospects remain favourable as well, although we expect growth rates to decline somewhat to 6% and 6.5% in 2004 and 2005, respectively. Inflation has been on the rise, reflecting first of all the poor grain harvest, but remains well below Russia's. The trade balance has declined and may turn negative already in 2004, but the current account will remain comfortably positive. Uncertainty regarding the outcome of the presidential elections in October 2004 persists. In addition, a constitutional reform is under way, which will convert the country into a parliamentary-presidential republic.

Appendix

Selected Indicators of Competitiveness

Table A/1

GDP per capita at current PPPs (EUR), from 2004 at constant PPPs

	1990	1995	1999	2000	2001	2002	2003	2004	2005	2006	2010	2015
									projection assuming 4% p.a. GDP growth and zero population growth p.a.			
Czech Republic	10319	11137	12701	12491	13248	14079	14211	14680	15268	15878	18575	22600
Hungary	7797	7844	10200	11032	12018	12845	13423	13866	14407	14983	17528	21326
Poland	4974	6177	8405	8955	9546	9902	10227	10636	11062	11504	13458	16374
Slovak Republic	6553	7114	9161	9914	10479	11329	12098	12642	13275	13805	16150	19650
Slovenia	9793	10240	13494	15044	15843	16597	16874	17448	18058	18781	21971	26731
Estonia	.	5500	7515	8492	9015	9661	10322	10900	11456	11915	13938	16958
Latvia	7815	4636	6440	7145	7791	8387	9219	9699	10251	10661	12472	15175
Lithuania	8059	5454	7312	7959	8690	9413	10287	10873	11526	11987	14023	17061
Cyprus	10173	13185	15815	17192	18189	18299	18749	19499	20279	21090	24673	30018
Malta	.	11134	14052	15062	15123	15479	15620	16244	16894	17570	20554	25008
Bulgaria	5078	4987	5117	5555	6079	6357	6898	7208	7497	7797	9121	11097
Romania	4739	4867	4982	5214	5700	6386	6926	7238	7563	7866	9202	11196
Croatia	5847	5184	7511	8047	8601	9263	9879	10195	10552	10974	12838	15620
Macedonia	3856	3747	5696	6010	5850	6116	6399	6655	6922	7199	8421	10246
Russia	7731	5740	5462	6126	6629	7156	7833	8186	8521	8862	10368	12614
Ukraine	5745	3304	3403	3686	4191	4563	5085	5390	5741	5970	6985	8498
									projection assuming 2% p.a. GDP growth and zero population growth p.a.			
Germany	18188	19064	21990	23117	23455	23957	24113	24595	25087	25589	27698	30581
Greece	10036	11519	13928	14952	15683	17045	17846	18203	18567	18938	20499	22633
Spain	11592	13974	17824	18899	19669	20711	21201	21625	22057	22498	24353	26888
Austria	16783	20245	24255	25921	26143	26689	26917	27455	28004	28565	30919	34137
Portugal	9578	11679	14976	15946	16504	17003	16788	17123	17466	17815	19284	21291
Turkey	3987	4808	5743	6260	5570	5918	6038	6159	6282	6408	6936	7658
USA	20276	24284	30189	32031	32416	33632	34209	34893	35591	36303	39296	43385
Japan	16570	19846	22612	23982	24371	24812	25439	25948	26467	26997	29222	32263
EU-15 average	15187	17683	21337	22664	23342	24055	24279	24765	25260	25765	27889	30792
EU-25 average	.	16454	19356	20563	21252	21959	22223	22667	23120	23583	25527	28184

European Union-25 average = 100

	1990	1995	1999	2000	2001	2002	2003	2004	2005	2006	2010	2015
Czech Republic	.	68	66	61	62	64	64	65	66	67	73	80
Hungary	.	48	53	54	57	58	60	61	62	64	69	76
Poland	.	38	43	44	45	45	46	47	48	49	53	58
Slovak Republic	.	43	47	48	49	52	54	56	57	59	63	70
Slovenia	.	62	70	73	75	76	76	77	78	80	86	95
Estonia	.	33	39	41	42	44	46	48	50	51	55	60
Latvia	.	28	33	35	37	38	41	43	44	45	49	54
Lithuania	.	33	38	39	41	43	46	48	50	51	55	61
Cyprus	.	80	82	84	86	83	84	86	88	89	97	107
Malta	.	68	73	73	71	70	70	72	73	75	81	89
Bulgaria	.	30	26	27	29	29	31	32	32	33	36	39
Romania	.	30	26	25	27	29	31	32	33	33	36	40
Croatia	.	32	39	39	40	42	44	45	46	47	50	55
Macedonia	.	23	29	29	28	28	29	29	30	31	33	36
Russia	.	35	28	30	31	33	35	36	37	38	41	45
Ukraine	.	20	18	18	20	21	23	24	25	25	27	30
Germany	.	116	114	112	110	109	109	109	109	109	109	109
Greece	.	70	72	73	74	78	80	80	80	80	80	80
Spain	.	85	92	92	93	94	95	95	95	95	95	95
Austria	.	123	125	126	123	122	121	121	121	121	121	121
Portugal	.	71	77	78	78	77	76	76	76	76	76	76
Turkey	.	29	30	30	26	27	27	27	27	27	27	27
USA	.	148	156	156	153	153	154	154	154	154	154	154
Japan	.	121	117	117	115	113	114	114	114	114	114	114
EU-15 average	.	107	110	110	110	110	109	109	109	109	109	109
EU-25 average		100	100	100	100	100	100	100	100	100	100	100

Note: EU(25) includes 8 acceeding countries from CEE plus Cyprus and Malta.

Sources: National statistics, Eurostat, wiiw estimates.

Table A/2

Indicators of macro-competitiveness, 1996-2003

EUR-based, annual averages

	1996	1997	1998	1999	2000	2001	2002	2003 prelim.
Czech Republic								
Producer price index, 1989=100	253.0	265.4	278.4	281.2	295.0	303.6	302.0	301.1
Consumer price index, 1989=100	301.0	326.6	361.6	369.2	383.6	401.6	408.8	409.7
GDP deflator, 1989=100	275.8	297.8	329.5	339.1	342.5	364.0	373.5	373.1
Exchange rate (ER), CZK/EUR	34.01	35.80	36.16	36.88	35.61	34.08	30.81	31.84
ER nominal, 1989=100	204.9	215.7	217.9	222.2	214.5	205.3	185.6	191.8
Real ER (CPI-based), 1989=100	88.1	86.9	80.3	81.2	76.9	71.8	65.1	68.5
Real ER (PPI-based), 1989=100	93.5	94.5	90.4	90.8	87.1	82.6	75.0	79.0
PPP, CZK/EUR	12.64	13.30	14.47	14.57	15.47	16.06	15.86	16.17
ERDI (EUR based)	2.69	2.69	2.50	2.53	2.30	2.12	1.94	1.97
Average monthly gross wages, CZK	9825	10802	11801	12797	13614	14793	15857	16935
Average monthly gross wages, EUR (ER)	289	302	326	347	382	434	515	532
Average monthly gross wages, EUR (PPP)	777	812	815	879	880	921	1000	1047
GDP nominal, bn CZK	1567.0	1679.9	1839.1	1902.3	1984.8	2175.2	2275.6	2340
Employed persons - LFS, th., average	4972.0	4936.5	4865.7	4764.1	4731.6	4750.2	4796.0	4777
GDP per employed person, CZK	315158	340306	377970	399297	419485	457926	474481	489866
GDP per empl. person, CZK at 1999 pr.	387489	387428	388931	399297	415355	426549	430781	445195
Unit labour costs, 1989=100	263.3	289.5	315.1	332.8	340.4	360.1	382.2	395.0
Unit labour costs, ER adj., 1989=100	128.5	134.2	144.6	149.8	158.6	175.4	205.9	205.9
Unit labour costs, PPP adj., Austria=100	25.39	27.63	30.08	30.72	32.53	35.71	41.52	40.75
Hungary								
Producer price index, 1989=100	349.2	420.4	467.9	491.8	548.8	577.3	567.0	580.6
Consumer price index, 1989=100	493.5	583.8	667.3	734.0	805.9	880.1	926.7	970.2
GDP deflator, 1989=100	422.8	500.7	563.9	611.4	670.9	728.6	793.8	843.0
Exchange rate (ER), HUF/EUR	191.15	210.93	240.98	252.80	260.04	256.68	242.97	253.51
ER, nominal 1989=100	293.8	324.2	370.3	388.5	399.6	394.5	373.4	389.6
Real ER (CPI-based), 1989=100	77.0	73.1	74.0	71.4	68.2	63.0	57.8	58.8
Real ER (PPI-based), 1989=100	97.1	89.7	91.4	90.8	87.2	83.4	80.4	83.2
PPP, HUF/EUR	80.52	92.93	102.93	109.11	116.74	121.29	128.32	134.78
ERDI (EUR based)	2.37	2.27	2.34	2.32	2.23	2.12	1.89	1.88
Average monthly gross wages, HUF	46837	57270	67764	77187	87645	103553	122482	137792
Average monthly gross wages, EUR (ER)	245	272	281	305	337	403	504	544
Average monthly gross wages, EUR (PPP)	582	616	658	707	751	854	955	1022
GDP nominal, bn HUF	6893.9	8540.7	10087.4	11393.5	13150.8	14849.6	16743.7	18300
Employed persons - LFS, th., average	3648.1	3646.3	3697.7	3811.5	3849.1	3859.5	3870.6	3922.0
GDP per employed person, HUF	1889723	2342292	2728020	2989243	3416591	3847545	4325867	4665987
GDP per empl. person, HUF at 1999 pr.	2732562	2859956	2957830	2989243	3113419	3228387	3331683	3383838
Unit labour costs, 1989=100	326.7	381.7	436.7	492.2	536.6	611.4	700.8	776.2
Unit labour costs, ER adj., 1989=100	111.2	117.8	117.9	126.7	134.3	155.0	187.7	199.2
Unit labour costs, PPP adj., Austria=100	22.87	25.23	25.53	27.05	28.66	32.85	39.39	41.04
Poland								
Producer price index, 1989=100	3189.0	3578.0	3839.6	4058.4	4375.0	4445.0	4489.4	4606.2
Consumer price index, 1989=100	4577.9	5260.0	5880.7	6309.9	6947.2	7329.3	7468.5	7528.3
GDP deflator, 1989=100	3176.3	3622.2	4050.3	4323.6	4629.5	4823.9	4885.7	4918.9
Exchange rate (ER), PLN/EUR	3.377	3.706	3.923	4.227	4.011	3.669	3.856	4.398
ER, nominal, 1989=100	2118.3	2324.1	2460.5	2651.1	2515.7	2300.9	2418.3	2758.3
Real ER (CPI-based), 1989=100	59.9	58.1	55.8	56.7	49.8	44.1	46.4	53.6
Real ER (PPI-based), 1989=100	76.6	75.5	74.0	75.1	68.9	63.2	65.7	74.2
PPP, PLN/EUR	1.4854	1.6499	1.8134	1.8933	1.9792	2.0353	2.0370	2.0600
ERDI (EUR based)	2.27	2.25	2.16	2.23	2.03	1.80	1.89	2.13
Average monthly gross wages, PLN *)	874	1066	1233	1697	1894	2045	2133	2193
Average monthly gross wages, EUR (ER)	259	288	314	401	472	557	553	499
Average monthly gross wages, EUR (PPP)	589	646	680	896	957	1005	1047	1065
GDP nominal, bn PLN	387.8	472.4	553.6	615.1	685.0	750.8	771.1	804.7
Employment total, th persons, average	15020.6	15438.7	15800.4	15373.5	15017.5	14923.6	14784.2	14468.6
GDP per employed person, PLN	25820	30595	35035	40011	45612	50309	52158	55617
GDP per empl. person, PLN at 1999 pr.	35146	36520	37398	40011	42599	45091	46158	48886
Unit labour costs, 1989=100	3619.4	4246.1	4795.7	6171.4	6468.1	6599.1	6724.3	6526.7
Unit labour costs, ER adj., 1989=100	170.9	182.7	194.9	232.8	257.1	286.8	278.1	236.6
Unit labour costs, PPP adj., Austria=100	32.60	36.32	39.15	46.11	50.92	56.39	54.15	45.22

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

(Table A/2 ctd.)

Table A/2 (ctd.)

	1996	1997	1998	1999	2000	2001	2002	2003 prelim.
Slovak Republic								
Producer price index, 1989=100	273.5	285.8	295.3	307.9	341.2	363.4	371.1	401.1
Consumer price index, 1989=100	317.8	337.2	359.8	397.9	445.6	477.2	493.0	532.4
GDP deflator, 1989=100	239.3	255.4	268.7	286.1	310.4	323.5	336.4	364.6
Exchange rate (ER), SKK/EUR	38.40	38.01	39.60	44.12	42.59	43.31	42.70	41.49
ER, nominal, 1989=100	231.4	229.0	238.6	265.8	256.6	260.9	257.3	249.97
Real ER (CPI-based), 1989=100	94.2	89.4	88.4	90.1	79.2	76.8	74.9	68.7
Real ER (PPI-based), 1989=100	97.6	93.2	93.3	99.2	90.0	87.7	84.6	77.3
PPP, SKK/EUR	15.26	15.86	16.41	17.08	17.45	17.91	17.99	18.98
ERDI (EUR based)	2.52	2.40	2.41	2.58	2.44	2.42	2.37	2.19
Average monthly gross wages, SKK	8154	9226	10003	10728	11430	12365	13511	14376
Average monthly gross wages, EUR (ER)	212	243	253	243	268	286	316	346
Average monthly gross wages, EUR (PPP)	534	582	610	628	655	690	751	757
GDP nominal, bn SKK	638.4	712.7	781.4	844.1	934.1	1009.8	1096.4	1235
Employed persons, -LFS, th., average	2224.9	2205.9	2198.6	2132.1	2101.7	2123.7	2127.0	2170
GDP per employed person, SKK	286956	323079	355425	395905	444440	475509	515460	569245
GDP per empl. person, SKK at 1999 pr.	343027	361950	378496	395905	409615	420561	438387	446615
Unit labour costs, 1989=100	234.9	251.9	261.2	267.8	275.8	290.6	304.6	318.1
Unit labour costs, ER adj., 1989=100	101.5	110.0	109.5	100.8	107.5	111.4	118.4	127.3
Unit labour costs, PPP adj., Austria=100	24.72	27.90	28.06	25.46	27.15	27.93	29.41	31.03
Slovenia								
Producer price index, 1989=100	5982.4	6347.2	6727.8	6869.0	7391.3	8048.9	8459.4	8670.8
Consumer price index, 1989=100	8635.7	9360.9	10100.5	10716.2	11670.2	12650.2	13598.9	14360.6
GDP deflator, 1989=100	7633.5	8303.1	8953.7	9542.1	10557.0	11522.3	12463.3	13173.7
Exchange rate (ER), SIT/EUR	169.51	180.40	186.27	193.63	205.03	217.19	226.22	233.70
ER, nominal, 1989=100	5253.6	5591.0	5772.9	6001.0	6354.5	6731.1	7011.3	7243.1
Real ER (CPI-based), 1989=100	78.7	78.6	76.2	75.5	74.9	74.8	74.0	73.8
Real ER (PPI-based), 1989=100	101.3	102.5	99.1	100.4	102.9	102.1	101.1	103.6
PPP, SIT/EUR	117.22	124.21	131.47	136.17	141.02	150.20	159.28	171.75
ERDI (EUR based)	1.45	1.45	1.42	1.42	1.45	1.45	1.42	1.36
Average monthly gross wages, SIT	129125	144251	158069	173245	191669	214561	235436	253565
Average monthly gross wages, EUR (ER)	762	800	849	895	935	988	1041	1085
Average monthly gross wages, EUR (PPP)	1102	1161	1202	1272	1359	1429	1478	1476
GDP nominal, bn SIT	2555.4	2907.3	3253.8	3648.4	4222.4	4740.1	5275.8	5700
Employment total, th persons, average	741.7	743.4	745.2	758.5	768.2	779.0	783.5	777.2
GDP per employed person, SIT	3445175	3910621	4366460	4810186	5496691	6084560	6733674	7333727
GDP per empl. person, SIT at 1999 pr.	4306585	4494177	4653422	4810186	4968290	5038879	5155425	5312050
Unit labour costs, 1989=100	4981.2	5332.5	5643.3	5983.5	6409.2	7074.2	7586.9	7930.2
Unit labour costs, ER adj., 1989=100	94.8	95.4	97.8	99.7	100.9	105.1	108.2	109.5
Unit labour costs, PPP adj., Austria=100	56.31	59.02	61.12	61.48	62.17	64.32	65.59	65.13
Estonia								
Producer price index, 1992=100	344.3	374.6	390.4	385.7	404.6	422.4	424.1	424.9
Consumer price index, 1992=100	445.2	495.1	535.7	553.3	575.5	608.9	630.8	639.0
GDP deflator, 1992=100	411.3	457.7	502.4	524.8	559.9	589.2	613.5	634.9
Exchange rate (ER), EEK/EUR	15.074	15.670	15.783	15.647	15.647	15.647	15.647	15.647
ER, nominal, 1992=100	94.8	98.5	99.2	98.4	98.4	98.4	98.4	98.4
Real ER (CPI-based), 1992=100	23.8	22.6	21.4	20.7	20.3	19.6	19.3	19.5
Real ER (PPI-based), 1992=100	29.8	28.7	27.6	27.5	27.4	26.7	26.6	27.0
PPP, EEK/EUR	6.179	6.699	7.230	7.384	7.513	7.961	8.230	8.360
ERDI (EUR based)	2.44	2.34	2.18	2.12	2.08	1.97	1.90	1.87
Average monthly gross wages, EEK	2985	3573	4125	4440	4907	5510	6144	6746
Average monthly gross wages, EUR (ER)	198	228	261	284	314	352	393	431
Average monthly gross wages, EUR (PPP)	483	533	571	601	653	692	747	807
GDP nominal, bn EEK	52.4	64.0	73.5	76.3	87.4	97.9	108.0	116.8
Employed persons - LFS, th., average	619.3	617.2	606.5	579.3	572.5	577.7	585.5	593
GDP per employed person, EEK	84648	103767	121250	131757	152626	169456	184498	197122
GDP per empl. person, EEK at 1999 pr.	108002	118978	126650	131757	143061	150929	157828	162925
Unit labour costs, 1992=100	456.6	496.1	538.0	556.7	566.6	603.1	643.1	684.0
Unit labour costs, ER adj., 1992=100	481.8	503.6	542.3	565.9	576.0	613.1	653.8	695.4
Unit labour costs, PPP adj., Austria=100	31.65	34.47	37.50	38.60	39.28	41.50	43.83	45.75

(Table A/2 ctd.)

Table A/2 (ctd.)

	1996	1997	1998	1999	2000	2001	2002	2003 prelim.
Latvia								
Producer price index, 1992=100	322.9	336.1	342.5	328.8	330.8	336.4	339.8	350.7
Consumer price index, 1992=100	417.9	453.0	474.3	485.7	498.3	510.8	520.5	535.6
GDP deflator, 1992=100	317.1	340.8	357.4	376.4	393.8	403.8	410.9	426.5
Exchange rate (ER), LVL/EUR	0.6900	0.6574	0.6614	0.6237	0.5600	0.5627	0.5826	0.6449
ER, nominal, 1992=100	79.5	75.7	76.2	71.9	64.5	64.8	67.1	74.3
Real ER (CPI-based), 1992=100	21.3	19.0	18.5	17.3	15.4	15.4	16.0	17.6
Real ER (PPI-based), 1992=100	26.7	24.6	24.1	23.6	21.9	22.1	22.6	24.7
PPP, LVL/EUR	0.2275	0.2382	0.2457	0.2529	0.2567	0.2623	0.2650	0.2708
ERDI (EUR based)	3.03	2.76	2.69	2.47	2.18	2.15	2.20	2.38
Average monthly gross wages, LVL	99	120	133	141	150	159	173	193
Average monthly gross wages, EUR (ER)	143	183	202	226	267	283	297	299
Average monthly gross wages, EUR (PPP)	434	504	543	557	583	606	653	711
GDP nominal, bn LVL	2.807	3.269	3.592	3.890	4.348	4.813	5.195	5.792
Employed persons - LFS, th., average	949.0	990.0	986.0	968.0	941.0	962.0	989.0	1008
GDP per employed person, LVL	2958	3303	3643	4018	4621	5003	5252	5747
GDP per empl. person, LVL at 1999 pr.	3511	3647	3836	4018	4416	4663	4811	5071
Unit labour costs, 1992=100	382.2	447.3	472.2	476.8	460.1	463.4	488.7	516.0
Unit labour costs, ER adj., 1992=100	480.8	590.5	619.7	663.6	713.2	714.8	728.1	694.5
Unit labour costs, PPP adj., Austria=100	24.10	30.84	32.71	34.53	37.10	36.92	37.25	34.87
Lithuania								
Producer price index, 1992=100	1064.8	1128.7	1079.0	1097.4	1273.0	1234.8	1200.2	1194.2
Consumer price index, 1992=100	1528.8	1664.9	1749.8	1763.8	1781.4	1804.6	1810.0	1788.3
GDP deflator, 1992=100	1132.7	1293.2	1362.6	1357.8	1369.9	1366.6	1367.4	1356.8
Exchange rate (ER), LTL/EUR	5.0118	4.5272	4.4924	4.2712	3.6990	3.5849	3.4605	3.4528
ER, nominal, 1992=100	218.0	196.9	195.4	185.8	160.9	155.9	150.5	150.2
Real ER (CPI-based), 1992=100	16.0	13.5	12.9	12.3	10.7	10.5	10.3	10.6
Real ER (PPI-based), 1992=100	22.2	19.1	19.7	18.3	14.2	14.5	14.4	14.6
PPP, LTL/EUR	1.4728	1.6382	1.6973	1.6534	1.6048	1.5701	1.5544	1.5436
ERDI (EUR based)	3.40	2.76	2.65	2.58	2.30	2.28	2.23	2.24
Average monthly gross wages, LTL	618	778	930	987	971	982	1034	1075
Average monthly gross wages, EUR (ER)	123	172	207	231	262	274	299	311
Average monthly gross wages, EUR (PPP)	420	475	548	597	605	626	665	696
GDP nominal, bn LTL	31.5	38.5	43.6	42.6	44.7	47.5	50.8	54.8
Employed persons - LFS, th., average	1620.4	1570.7	1597.6	1598.4	1397.8	1351.8	1405.9	1442
GDP per employed person, LTL	19458	24524	27262	26657	31977	35137	36104	38035
GDP per empl. person, LTL at 1999 pr.	23324	25748	27165	26657	31695	34909	35848	38062
Unit labour costs, 1992=100	1287.6	1468.1	1662.7	1799.4	1488.0	1367.0	1400.8	1372.1
Unit labour costs, ER adj., 1992=100	590.6	745.5	850.9	968.5	924.8	876.6	930.6	913.6
Unit labour costs, PPP adj., Austria=100	20.44	26.88	31.01	34.80	33.22	31.27	32.87	31.67
Bulgaria								
Producer price index, 1989=100	5645.0	60462.0	71789.8	73804.8	86741.7	90010.9	91073.6	94443.3
Consumer price index, 1989=100	12637.6	146392.9	173732.5	178203.6	196584.0	211052.2	223319.1	228567.4
GDP deflator, 1989=100	6399.9	67110.2	83015.2	86086.7	91854.7	98008.9	101733.2	105293.9
Exchange rate (ER), BGN/EUR	0.220	1.896	1.972	1.956	1.956	1.956	1.956	1.956
ER, nominal, 1989=100	23704.0	203894.4	212116.3	210349.5	210349.5	210349.5	210349.5	210349.5
Real ER (CPI-based), 1989=100	242.7	183.3	162.8	159.2	147.1	140.0	135.1	134.7
Real ER (PPI-based), 1989=100	484.5	392.2	341.2	327.5	290.4	285.4	281.8	276.1
PPP, BGN/EUR	0.0450	0.4589	0.5586	0.5662	0.5895	0.6176	0.6462	0.6505
ERDI (EUR based)	4.90	4.13	3.53	3.45	3.32	3.17	3.03	3.01
Average monthly gross wages, BGN	13	128	183	201	225	240	272	282
Average monthly gross wages, EUR (ER)	60	67	93	103	115	123	139	144
Average monthly gross wages, EUR (PPP)	294	279	328	355	381	389	421	434
GDP nominal, bn BGN	1.8	17.4	22.4	23.8	26.8	29.7	32.3	35
Employment total, th persons, average	3285.9	3157.4	3152.6	3087.8	2980.1	2968.1	2992.2	3052
GDP per employed person, BGN	536	5521	7112	7705	8977	10010	10803	11468
GDP per empl. person, BGN at 1999 pr.	7210	7082	7375	7705	8413	8792	9141	9376
Unit labour costs, 1989=100	5228.7	51394.5	70706.6	74239.8	75933.5	77680.7	84676.0	85589.9
Unit labour costs, ER adj., 1989=100	22.1	25.2	33.3	35.3	36.1	36.9	40.3	40.7
Unit labour costs, PPP adj., Austria=100	11.03	13.14	17.56	18.33	18.74	19.04	20.55	20.39

(Table A/2 ctd.)

Table A/2 (ctd.)

	1996	1997	1998	1999	2000	2001	2002	2003 prelim.
Romania								
Producer price index, 1989=100	14928.8	37725.0	50235.3	72589.7	111371.6	157085.7	195726.6	238786.5
Consumer price index, 1989=100	13643.6	34758.8	55300.0	80629.4	117450.2	157932.6	193467.4	223067.9
GDP deflator, 1989=100	15453.6	38220.3	58917.0	87060.2	125120.3	172536.9	213088.3	245051.5
Exchange rate (ER), ROL/EUR	3862.90	8090.92	9989.25	16295.57	19955.75	26026.89	31255.25	37555.87
ER, nominal, 1989=100	23482.7	49184.9	60724.9	99061.2	121311.6	158218.2	190001.5	228303.2
Real ER (CPI-based), 1989=100	222.7	186.2	146.4	165.7	142.0	140.8	140.9	149.8
Real ER (PPI-based), 1989=100	181.5	151.6	139.6	156.8	130.4	123.0	118.4	118.5
PPP, ROL/EUR	918.8	2212.7	3378.2	4877.9	6845.7	9138.4	10913.8	12395.1
ERDI (EUR based)	4.20	3.66	2.96	3.34	2.92	2.85	2.86	3.03
Average monthly grross wages, ROL	426610	846450	1357132	1957731	2876645	4282622	5452097	6760600
Average monthly gross wages, EUR (ER)	110	105	136	120	144	165	174	180
Average monthly gross wages, EUR (PPP)	464	383	402	401	420	469	500	545
GDP nominal, bn ROL	108920	252926	371194	545730	800773	1167243	1512257	1820000
Employed persons - LFS, th., average *)	10935.5	11050.0	10844.9	10775.6	10763.8	10696.9	9234.3	9244
GDP per employed person, th. ROL	9960.2	22889.2	34227.5	50645.0	74395.0	109119.7	163765.2	196894.4
GDP per empl. person, th. ROL at 1999 pr.	56112.2	52138.2	50577.2	50645.0	51765.0	55060.6	66908.6	69951.3
Unit labour costs, 1989=100	15896.6	33945.0	56104.5	80825.2	116193.1	162629.3	170377.3	202078.2
Unit labour costs, ER adj., 1989=100	67.7	69.0	92.4	81.6	95.8	102.8	89.7	88.5
Unit labour costs, PPP adj., Austria=100	22.44	23.84	32.25	28.09	32.96	35.12	30.34	29.39
Croatia								
Producer price index, 1989=100	370183.9	378698.3	374153.9	383881.7	421118.3	436278.3	434533.3	442789.4
Consumer price index, 1989=100	408679.1	423391.3	447530.6	466326.7	495238.8	519505.8	530935.2	538899.3
GDP deflator, 1989=100	320477.1	344066.9	373062.5	387324.9	405475.9	421771.6	427028.3	433433.7
Exchange rate (ER), HRK/EUR	6.80	6.96	7.14	7.58	7.63	7.47	7.41	7.56
ER, nominal, 1989=100	210895.8	215699.6	221182.2	234912.7	236628.2	231483.2	229555.6	234304.5
Real ER (CPI-based), 1989=100	66.8	67.0	65.9	68.0	65.7	62.6	62.0	63.6
Real ER (PPI-based), 1989=100	65.7	66.2	68.3	70.3	67.3	64.8	64.5	65.6
PPP, HRK/EUR	4.119	3.795	4.039	4.139	4.272	4.340	4.287	4.259
ERDI (EUR based)	1.65	1.83	1.77	1.83	1.79	1.72	1.73	1.78
Average monthly gross wages, HRK	3243	3668	4131	4551	4869	5061	5366	5618
Average monthly gross wages, EUR (ER)	477	527	579	600	638	678	724	743
Average monthly gross wages, EUR (PPP)	787	967	1023	1100	1140	1166	1252	1319
GDP nominal, bn HRK	108.0	123.8	137.6	141.6	152.5	165.6	176.4	186.8
Employment total, th persons, average	1329.5	1310.9	1384.8	1364.5	1341.0	1348.3	1359.0	1359.8
GDP per employed person, HRK	81219	94447	99364	103759	113739	122850	129821	137377
GDP per empl. person, HRK at 1999 pr.	98160	106322	103163	103759	108647	112817	117751	122762
Unit labour costs, 1989=100	252664.5	263840.3	306241.5	335438.2	342731.6	343080.8	348513.1	349997.2
Unit labour costs, ER adj., 1989=100	119.8	122.3	138.5	142.8	144.8	148.2	151.8	149.4
Unit labour costs, PPP adj., Austria=100	46.98	49.98	57.16	58.13	58.95	59.89	60.76	58.67
Macedonia								
Producer price index, 1989=100	170357.8	177512.8	184616.7	184429.3	204156.7	208245.3	206371.4	206371.4
Consumer price index, 1989=100	295385.2	303065.2	302769.8	300643.1	318070.8	335557.6	341583.4	345689.3
GDP deflator, 1990=100	43708.8	45429.8	46050.2	47329.3	51225.9	53075.7	54047.9	55399.1
Exchange rate (ER), MKD/EUR	50.08	56.20	61.07	60.62	60.73	60.91	60.98	61.5
ER, nominal, 1989=100	155515.9	174525.6	189641.9	188247.5	188584.8	189169.5	189371.4	190991.6
Real ER (CPI-based), 1989=100	68.1	75.8	83.5	84.5	81.5	79.2	79.5	80.8
Real ER (PPI-based), 1989=100	105.3	114.4	118.6	117.3	110.6	110.9	112.0	114.7
PPP, MKD/EUR	23.14	18.02	17.93	18.19	19.41	19.64	19.51	19.58
ERDI (EUR based)	2.16	3.12	3.41	3.33	3.13	3.10	3.12	3.14
Average monthly net wages, MKD	8817	9063	9394	9664	10193	10552	11279	11877
Average monthly net wages, EUR (ER)	176	161	154	159	168	173	185	193
Average monthly net wages, EUR (PPP)	381	503	524	531	525	537	578	607
GDP nominal, bn MKD	176.4	186.0	195.0	209.0	236.4	233.8	244.0	256.8
Employed persons - LFS, th., average	537.6	512.3	539.8	545.2	549.8	599.3	561.3	545.1
GDP per employed person, MKD	328212	363103	361231	383348	429919	390185	434620	471143
GDP per empl. person, MKD at 1999 pr.	355399	378285	371265	383348	397216	347941	380593	402513
Unit labour costs, 1996=100	100.0	96.6	102.0	101.6	103.4	122.2	119.5	118.9
Unit labour costs, ER adj., 1996=100	100.0	86.1	83.6	83.9	85.3	100.5	98.1	96.8
Unit labour costs, PPP adj., Austria=100	21.07	18.89	18.55	18.36	18.65	21.82	21.09	20.44

*) Methodological break in 2001/2002.

(Table A/2 ctd.)

Table A/2 (ctd.)

	1996	1997	1998	1999	2000	2001	2002	2003 prelim.
Russia								
Producer price index, 1989=100	1356086	1559505	1670224	2653986	3890743	4631930	5176181	5983666
Consumer price index, 1989=100	574672	659723	841807	1563235	1888388	2296280	2663684	3025945
GDP deflator, 1989=100	603989	694937	823777	1420080	1955429	2277726	2635376	3028046
Exchange rate (ER), RUB/EUR	6.63	6.54	11.06	26.24	26.03	26.13	29.65	34.55
ER, nominal, 1989=100	954960	941800	1592973	3778114	3747905	3762448	4268826	4974471
Real ER (CPI-based), 1989=100	215.0	187.9	252.3	326.1	272.8	230.2	229.9	240.5
Real ER (PPI-based), 1989=100	81.3	70.2	110.2	163.6	115.3	99.2	100.6	103.1
PPP, RUB/EUR	2.395	3.048	3.547	6.035	8.193	9.321	10.522	11.832
ERDI (EUR based)	2.77	2.15	3.12	4.35	3.18	2.80	2.82	2.92
Average monthly gross wages, RUB	790.2	950.2	1051.5	1522.6	2223.4	3240.4	4360.0	5512.0
Average monthly gross wages, EUR (ER)	119	145	95	58	85	124	147	160
Average monthly gross wages, EUR (PPP)	330	312	296	252	271	348	414	466
GDP nominal, bn RUB	2007.8	2342.5	2629.6	4823.2	7305.6	8943.6	10834.2	13300
Employment total, th persons, average	65950	64693	63812	63963	64327	64710	65650	65059
GDP per employed person, RUB	30445	36210	41209	75406	113570	138210	165030	204429
GDP per empl. person, RUB at 1999 pr.	71581	73993	71039	75406	82478	86169	88927	95872
Unit labour costs, 1989=100	462119	537565	619613	845250	1128463	1574172	2052390	2406698
Unit labour costs, ER adj., 1989=100	48.4	57.1	38.9	22.4	30.1	41.8	48.1	48.4
Unit labour costs, PPP adj., Austria=100	23.48	28.86	19.87	11.27	15.17	20.92	23.81	23.52
Ukraine								
Producer price index, 1989=100	30290361	32622718	36928917	48413810	58532296	63566073	65536621	70648477
Consumer price index, 1989=100	12229109	14172537	15674826	19233012	24656721	27615528	27836452	29283948
GDP deflator, 1989=100	12819488	15140086	16950568	21587839	26575880	29218423	30715221	32404558
Exchange rate (ER), UAH/EUR	2.322	2.113	2.768	4.393	5.029	4.814	5.030	6.024
ER, nominal, 1989=100	33408633	30401439	39821583	63212950	72357554	69260000	72375540	86682014
Real ER (CPI-based), 1989=100	353.5	282.3	338.7	443.4	403.4	352.4	373.0	433.1
Real ER (PPI-based), 1989=100	127.3	108.4	124.5	150.0	148.0	133.1	134.7	152.1
PPP, UAH/EUR	0.5201	0.5559	0.6110	0.7680	0.9321	1.0010	1.0266	1.0599
ERDI (EUR based)	4.46	3.80	4.53	5.72	5.39	4.81	4.90	5.68
Average monthly gross wages, UAH	126.0	143.0	153.0	177.5	230.1	311.1	376.4	462.6
Average monthly gross wages, EUR (ER)	54	68	55	40	46	65	75	77
Average monthly gross wages, EUR (PPP)	242	257	250	231	247	311	367	436
GDP nominal, bn UAH	81.5	93.4	102.6	130.4	170.1	204.2	225.8	257.7
Employment total, th persons, average	23231.8	22597.6	22348.7	21823.7	21268.5	20941.9	21378.6	21550
GDP per employed person, UAH	3509	4132	4591	5977	7996	9750	10562	11958
GDP per empl. person, UAH at 1999 pr.	5909	5891	5846	5977	6495	7204	7424	7967
Unit labour costs, 1989=100	12811424	14583936	15723252	17844302	21286399	25944340	30461300	34885945
Unit labour costs, ER adj., 1989=100	38.3	48.0	39.5	28.2	29.4	37.5	42.1	40.2
Unit labour costs, PPP adj., Austria=100	16.49	21.49	17.87	12.60	13.13	16.60	18.47	17.33
Austria								
Producer price index, 1989=100	104.8	105.2	104.7	103.7	107.9	109.6	109.2	110.9
Consumer price index, 1989=100	123.3	125.0	126.1	126.8	129.8	133.3	135.7	137.6
GDP deflator, 1989=100	122.0	123.1	123.7	124.5	126.3	128.4	130.1	132.5
Exchange rate (ER), ATS-EUR/EUR	0.9636	1.0017	1.0089	1.0000	1.0000	1.0000	1.0000	1.0000
PPP, ATS-EUR/EUR	1.0511	1.0386	1.0407	1.0165	0.9951	1.0121	1.0158	1.0278
ERDI (EUR based)	0.92	0.96	0.97	0.98	1.00	0.99	0.98	0.97
Average monthly gross wages, EUR	2239	2177	2225	2296	2355	2389	2438	2496
Average monthly gross wages, EUR (PPP)	2052	2099	2157	2259	2367	2360	2400	2429
GDP nominal, bn EUR-ATS	178.0	182.5	190.6	197.1	206.7	212.5	218.3	223.8
Employment total, th persons, average	3415.4	3424.5	3446.6	3478.8	3506.5	3522.5	3532.9	3540.0
GDP per employed person, EUR-ATS	52131	53289	55309	56647	58939	60330	61800	63218
GDP per empl. person, EUR-ATS at 1999 pr.	53199	53895	55667	56647	58099	58497	59121	59416
Unit labour costs, 1989=100	118.5	118.2	117.9	118.5	118.5	119.4	120.5	122.8
Unit labour costs, ER adj., 1989=100	130.2	124.9	123.7	125.4	125.4	126.3	127.6	130.0
Unit labour costs, PPP adjusted	0.51	0.49	0.49	0.49	0.49	0.50	0.50	0.51

ER = Exchange Rate, PPP = Purchasing Power Parity, ERDI = Exchange Rate Deviation Index (ER / PPP).
ATS-EUR: ATS divided by fixed parity before 1999 (1 EUR = 13.7603 ATS).
For accession countries PPPs are taken from Eurostat. For the rest of the countries PPPs have been estimated by wiiw using the OECD benchmark PPPs for 1996 and 1999 and extrapolated with GDP price deflators.

Sources: National statistics; WIFO; Eurostat; Benchmark results of the 1996 Eurostat-OECD comparison by analytical categories, OECD, 1999; Purchasing power parities and real expenditures, 1999 benchmark year, OECD 2002; wiiw estimates.

Table A/3

Indicators of macro-competitiveness, 1996-2003

annual changes in %

	1996	1997	1998	1999	2000	2001	2002	2003 prelim.	1996-03 average
Czech Republic									
GDP deflator	8.8	8.0	10.6	2.9	1.0	6.3	2.6	-0.1	3.9
Exchange rate (ER), CZK/EUR	-0.9	5.3	1.0	2.0	-3.4	-4.3	-9.6	3.3	-0.8
Real ER (CPI-based)	-6.7	-1.3	-7.6	1.1	-5.3	-6.6	-9.3	5.2	-3.1
Real ER (PPI-based)	-4.9	1.2	-4.4	0.5	-4.1	-5.1	-9.2	5.3	-2.1
Average gross wages, CZK	18.3	9.9	9.2	8.4	6.4	8.7	7.2	6.8	7.3
Average gross wages, real (PPI based)	13.0	4.8	4.1	7.4	1.4	5.6	7.7	7.1	4.8
Average gross wages, real (CPI based)	8.7	1.3	-1.3	6.2	2.4	3.8	5.3	6.6	3.0
Average gross wages, EUR (ER)	19.3	4.4	8.2	6.3	10.2	13.5	18.6	3.3	8.0
Employment total	0.2	-0.7	-1.4	-2.1	-0.7	0.4	1.0	-0.4	-0.5
GDP per empl. person, CZK at 1999 pr.	4.1	0.0	0.4	2.7	4.0	2.7	1.0	3.3	1.8
Unit labour costs, CZK at 1999 prices	13.6	10.0	8.8	5.6	2.3	5.8	6.1	3.3	5.4
Unit labour costs, ER (EUR) adjusted	14.6	4.4	7.7	3.6	5.9	10.5	17.4	0.0	6.2
Hungary									
GDP deflator	21.2	18.4	12.6	8.4	9.7	8.6	8.9	6.2	9.5
Exchange rate (ER), HUF/EUR	17.5	10.3	14.2	4.9	2.9	-1.3	-5.3	4.3	3.8
Real ER (CPI-based)	-2.6	-5.1	1.3	-3.5	-4.5	-7.6	-8.2	1.6	-3.3
Real ER (PPI-based)	-3.0	-7.6	1.9	-0.7	-4.0	-4.3	-3.7	3.5	-1.9
Average gross wages, HUF	20.4	22.3	18.3	13.9	13.5	18.2	18.3	12.5	15.0
Average gross wages, real (PPI based)	-1.1	1.6	6.3	8.4	1.7	12.3	20.4	9.9	7.4
Average gross wages, real (CPI based)	-2.6	3.4	3.5	3.6	3.4	8.2	12.3	7.5	5.2
Average gross wages, EUR (ER)	2.5	10.8	3.6	8.6	10.4	19.7	25.0	7.8	10.5
Employment total	-0.8	0.0	1.4	3.1	1.0	0.3	0.3	1.3	0.9
GDP per empl. person, HUF at 1999 pr.	3.1	4.7	3.4	1.1	4.2	3.7	3.2	1.6	2.7
Unit labour costs, HUF at 1999 prices	16.8	16.8	14.4	12.7	9.0	13.9	14.6	10.8	11.8
Unit labour costs, ER (EUR) adjusted	-0.6	5.9	0.1	7.4	6.0	15.4	21.1	6.2	7.6
Poland									
GDP deflator	18.8	14.0	11.8	6.7	7.1	4.2	1.3	0.7	5.9
Exchange rate (ER), PLN/EUR	7.7	9.7	5.9	7.7	-5.1	-8.5	5.1	14.1	3.4
Real ER (CPI-based)	-8.0	-2.9	-4.1	1.6	-12.2	-11.4	5.3	15.4	-1.3
Real ER (PPI-based)	-3.7	-1.4	-2.0	1.4	-8.3	-8.2	4.0	12.9	-0.4
Average gross wages, PLN *)	26.5	21.9	15.7	10.6	11.6	8.0	4.3	2.8	9.8
Average gross wages, real (PPI based)	12.6	8.6	7.8	30.3	3.5	6.3	3.3	0.2	7.3
Average gross wages, real (CPI based)	5.5	6.1	3.5	28.3	1.3	2.4	2.4	2.0	5.5
Average gross wages, EUR (ER)	17.4	11.1	9.2	27.8	17.6	18.1	-0.8	-9.9	8.8
Employment total	1.9	2.8	2.3	-2.7	-2.3	-0.6	-0.9	-2.1	-0.5
GDP per empl. person, PLN at 1999 pr.	4.0	3.9	2.4	7.0	6.5	5.9	2.4	5.9	4.2
Unit labour costs, PLN at 1999 prices	21.7	17.3	12.9	28.7	4.8	2.0	1.9	-2.9	8.1
Unit labour costs, ER (EUR) adjusted	12.9	6.9	6.7	19.4	10.5	11.5	-3.1	-14.9	4.3
Slovak Republic									
GDP deflator	4.3	6.7	5.2	6.5	8.5	4.2	4.0	8.4	5.4
Exchange rate (ER), SKK/EUR	-0.1	-1.0	4.2	11.4	-3.5	1.7	-1.4	-2.8	1.0
Real ER (CPI-based)	-3.3	-5.1	-1.1	2.0	-12.2	-3.0	-2.6	-8.2	-3.8
Real ER (PPI-based)	-3.6	-4.5	0.1	6.3	-9.2	-2.6	-3.5	-8.7	-2.9
Average gross wages, SKK	13.3	13.1	8.4	7.2	6.5	8.2	9.3	6.4	7.6
Average gross wages, real (PPI based)	8.8	8.3	5.0	2.8	-3.8	1.6	7.0	-1.6	2.4
Average gross wages, real (CPI based)	7.1	6.6	1.6	-3.0	-4.9	1.0	5.8	-1.5	0.7
Average gross wages, EUR (ER)	13.5	14.3	4.1	-3.7	10.4	6.4	10.8	9.5	6.5
Employment total	3.6	-0.9	-0.3	-3.0	-1.4	1.0	0.2	2.0	-0.3
GDP per empl. person, SKK at 1999 pr.	2.5	5.5	4.6	4.6	3.5	2.7	4.2	1.9	3.4
Unit labour costs, SKK at 1999 prices	10.6	7.2	3.7	2.5	3.0	5.4	4.8	4.4	4.0
Unit labour costs, ER (EUR) adjusted	10.8	8.3	-0.5	-8.0	6.7	3.6	6.3	7.5	3.0
Slovenia									
GDP deflator	11.1	8.8	7.8	6.6	10.6	9.1	8.2	5.7	7.2
Exchange rate (ER), SIT/EUR	10.7	6.4	3.3	4.0	5.9	5.9	4.2	3.3	4.2
Real ER (CPI-based)	3.2	-0.2	-3.1	-0.8	-0.9	-0.1	-1.1	-0.2	-0.8
Real ER (PPI-based)	4.2	1.1	-3.3	1.3	2.5	-0.8	-1.0	2.4	0.3
Average gross wages, SIT	15.3	11.7	9.6	9.6	10.6	11.9	9.7	7.7	9.0
Average gross wages, real (PPI based)	8.0	5.3	3.4	7.3	2.8	2.8	4.4	5.1	3.9
Average gross wages, real (CPI based)	4.9	3.1	1.6	3.3	1.6	3.3	2.1	2.0	2.1
Average gross wages, EUR (ER)	4.1	5.0	6.1	5.4	4.5	5.7	5.3	4.3	4.5
Employment total	-0.5	0.2	0.2	1.8	1.3	1.4	0.6	-0.8	0.6
GDP per empl. person, SIT at 1999 pr.	4.0	4.4	3.5	3.4	3.3	1.4	2.3	3.0	2.7
Unit labour costs, SIT at 1999 prices	10.9	7.1	5.8	6.0	7.1	10.4	7.2	4.5	6.1
Unit labour costs, ER (EUR) adjusted	0.1	0.6	2.5	2.0	1.2	4.2	3.0	1.2	1.8

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

(Table A/3 ctd.)

Table A3 (ctd.)

	1996	1997	1998	1999	2000	2001	2002	2003 prelim.	1996-03 average
Estonia									
GDP deflator	23.3	11.3	9.8	4.5	6.7	5.2	4.1	3.5	5.9
Exchange rate (ER), EEK/EUR	1.7	4.0	0.7	-0.9	0.0	0.0	0.0	0.0	0.5
Real ER (CPI-based)	-15.4	-4.9	-5.7	-2.9	-2.0	-3.4	-1.4	0.7	-2.4
Real ER (PPI-based)	-11.0	-3.7	-4.0	-0.2	-0.7	-2.3	-0.5	1.4	-1.2
Average gross wages, EEK	25.7	19.7	15.4	7.6	10.5	12.3	11.5	9.8	11.3
Average gross wages, real (PPI based)	9.5	10.0	10.8	8.9	5.4	7.6	11.1	9.6	8.0
Average gross wages, real (CPI based)	2.1	7.6	6.7	4.2	6.3	6.1	7.6	8.4	5.9
Average gross wages, EUR (ER)	23.6	15.1	14.6	8.6	10.5	12.3	11.5	9.8	10.6
Employment total	-2.2	-0.3	-1.7	-4.5	-1.2	0.9	1.4	1.2	-0.5
GDP per empl. person, EEK at 1999 pr.	6.3	10.2	6.4	4.0	8.6	5.5	4.6	3.2	5.3
Unit labour costs, EEK at 1999 prices	18.2	8.7	8.5	3.5	1.8	6.4	6.6	6.4	5.4
Unit labour costs, ER (EUR) adjusted	16.2	4.5	7.7	4.4	1.8	6.4	6.6	6.4	4.8
Latvia									
GDP deflator	16.2	7.5	4.9	5.3	4.6	2.5	1.8	3.8	3.9
Exchange rate (ER), LVL/EUR	1.2	-4.7	0.6	-5.7	-10.2	0.5	3.5	10.7	-0.8
Real ER (CPI-based)	-11.9	-10.6	-2.7	-6.8	-10.8	0.2	3.7	9.7	-2.2
Real ER (PPI-based)	-10.5	-7.7	-2.0	-2.3	-7.0	0.8	2.4	9.0	-0.9
Average gross wages, LVL	10.3	21.6	11.1	5.8	6.1	6.3	8.8	11.3	9.0
Average gross wages, real (PPI based)	-3.0	16.8	9.0	10.2	5.4	4.6	7.7	7.8	7.5
Average gross wages, real (CPI based)	-6.2	12.2	6.1	3.3	3.4	3.7	6.8	8.2	5.3
Average gross wages, EUR (ER)	9.0	27.6	10.4	12.2	18.1	5.8	5.1	0.5	9.9
Employment total	-2.5	4.3	-0.4	-1.8	-2.8	2.2	2.8	1.9	0.7
GDP per empl. person, LVL at 1999 pr.	6.3	3.9	5.2	4.7	9.9	5.6	3.2	5.4	4.7
Unit labour costs, LVL at 1999 prices	3.8	17.0	5.6	1.0	-3.5	0.7	5.5	5.6	3.9
Unit labour costs, ER (EUR) adjusted	2.5	22.8	4.9	7.1	7.5	0.2	1.9	-4.6	4.8
Lithuania									
GDP deflator	21.5	14.2	5.4	-0.4	0.9	-0.2	0.1	-0.8	2.6
Exchange rate (ER), LTL/EUR	-3.1	-9.7	-0.8	-4.9	-13.4	-3.1	-3.5	-0.2	-4.5
Real ER (CPI-based)	-20.4	-15.6	-4.4	-4.5	-12.6	-2.2	-1.7	3.0	-4.5
Real ER (PPI-based)	-16.4	-14.1	3.1	-7.0	-22.2	1.9	-0.8	1.9	-4.7
Average gross wages, LTL	28.6	25.9	19.5	6.2	-1.7	1.2	5.2	4.0	7.9
Average gross wages, real (PPI based)	10.3	18.7	25.0	4.4	-15.2	4.3	8.3	4.5	5.9
Average gross wages, real (CPI based)	3.2	15.6	13.7	5.4	-2.7	-0.1	4.9	5.3	5.1
Average gross wages, EUR (ER)	32.7	39.3	20.4	11.7	13.5	4.4	9.0	4.2	13.5
Employment total	-0.7	-3.1	1.7	0.1	-12.6	-3.3	4.0	2.6	-1.4
GDP per empl. person, LTL at 1999 pr.	5.4	10.4	5.5	-1.9	18.9	10.1	2.7	6.2	6.4
Unit labour costs, LTL at 1999 prices	21.9	14.0	13.3	8.2	-17.3	-8.1	2.5	-2.0	1.1
Unit labour costs, ER (EUR) adjusted	25.8	26.2	14.1	13.8	-4.5	-5.2	6.2	-1.8	6.3
Bulgaria									
GDP deflator	120.9	948.6	23.7	3.7	6.7	6.7	3.8	3.5	55.6
Exchange rate (ER), BGN/EUR	153.8	760.2	4.0	-0.8	0.0	0.0	0.0	0.0	46.3
Real ER (CPI-based)	17.3	-24.5	-11.2	-2.2	-7.6	-4.8	-3.5	-0.3	-7.8
Real ER (PPI-based)	10.9	-19.0	-13.0	-4.0	-11.3	-1.7	-1.3	-2.0	-7.1
Average gross wages, BGN	74.4	865.6	43.3	9.7	11.7	6.9	13.3	3.7	56.2
Average gross wages, real (PPI based)	-24.2	-9.9	20.7	6.7	-5.0	3.0	12.0	0.0	3.4
Average gross wages, real (CPI based)	-21.3	-16.6	20.7	6.9	1.2	-0.4	7.1	1.3	2.6
Average gross wages, EUR (ER)	-31.3	12.3	37.7	10.6	11.7	6.9	13.3	3.7	11.1
Employment total	0.1	-3.9	-0.2	-2.1	-3.5	-0.4	0.8	2.0	-0.9
GDP per empl. person, BGN at 1999 pr.	-9.5	-1.8	4.1	4.5	9.2	4.5	4.0	2.6	3.4
Unit labour costs, BGN at 1999 prices	92.8	882.9	37.6	5.0	2.3	2.3	9.0	1.1	53.0
Unit labour costs, ER (EUR) adjusted	-24.1	14.3	32.2	5.9	2.3	2.3	9.0	1.1	7.5
Romania									
GDP deflator	45.3	147.3	54.2	47.8	43.7	37.9	23.5	15.0	45.5
Exchange rate (ER), ROL/EUR	46.9	109.5	23.5	63.1	22.5	30.4	20.1	20.2	36.6
Real ER (CPI-based)	8.4	-16.4	-21.4	13.2	-14.3	-0.9	0.1	6.3	-5.0
Real ER (PPI-based)	-1.5	-16.5	-7.9	12.3	-16.8	-5.7	-3.7	0.1	-5.2
Average gross wages, ROL	51.7	98.4	60.3	44.3	46.9	48.9	27.3	24.0	45.3
Average gross wages, real (PPI based)	1.2	-21.5	20.4	-0.2	-4.2	5.6	2.2	1.6	-0.2
Average gross wages, real (CPI based)	9.3	-22.1	0.8	-1.1	0.9	10.7	3.9	7.5	-0.7
Average gross wages, EUR (ER)	3.2	-5.3	29.9	-11.6	20.0	14.1	6.0	3.2	6.3
Employment total *)	-1.9	1.0	-1.9	-0.6	-0.1	-0.6	.	0.1	.
GDP per empl. person, ROL at 1999 pr.	6.0	-7.1	-3.0	0.1	2.2	6.4	21.5	4.5	2.7
Unit labour costs, ROL at 1999 prices	43.1	113.5	65.3	44.1	43.8	40.0	4.8	18.6	41.0
Unit labour costs, ER (EUR) adjusted	-2.6	1.9	33.9	-11.7	17.4	7.3	-12.8	-1.3	3.4

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

(Table A/3 ctd.)

Table A3 (ctd.)

	1996	1997	1998	1999	2000	2001	2002	2003 prelim.	1996-03 average
Croatia									
GDP deflator	3.6	7.4	8.4	3.8	4.7	4.0	1.2	1.5	3.9
Exchange rate (ER), HRK/EUR	0.7	2.3	2.5	6.2	0.7	-2.2	-0.8	2.1	1.3
Real ER (CPI-based)	-0.4	0.4	-1.7	3.1	-3.3	-4.7	-0.9	2.6	-0.6
Real ER (PPI-based)	-0.2	0.8	3.1	3.0	-4.3	-3.7	-0.5	1.8	0.0
Average gross wages, HRK	12.3	13.1	12.6	10.2	7.0	3.9	6.0	4.7	7.3
Average gross wages, real (PPI based)	10.8	10.6	14.0	7.4	-2.5	0.3	6.5	2.7	4.9
Average gross wages, real (CPI based)	8.5	9.2	6.5	5.7	0.7	-0.9	3.7	3.2	3.6
Average gross wages, EUR (ER)	11.6	10.6	9.8	3.7	6.2	6.3	6.9	2.6	5.9
Employment total	-6.2	-1.4	5.6	-1.5	-1.7	0.5	0.8	0.1	0.3
GDP per empl. person, HRK at 1999 pr.	12.9	8.3	-3.0	0.6	4.7	3.8	4.4	4.3	3.0
Unit labour costs, HRK at 1999 prices	-0.5	4.4	16.1	9.5	2.2	0.1	1.6	0.4	4.2
Unit labour costs, ER (EUR) adjusted	-1.2	2.1	13.2	3.1	1.4	2.3	2.4	-1.6	2.8
Macedonia									
GDP deflator	2.9	3.9	1.4	2.8	8.2	3.6	1.8	2.5	3.0
Exchange rate (ER), MKD/EUR	1.9	12.2	8.7	-0.7	0.2	0.3	0.1	0.9	2.6
Real ER (CPI-based)	2.0	11.2	10.2	1.2	-3.5	-2.8	0.4	1.7	2.2
Real ER (PPI-based)	2.7	8.6	3.7	-1.1	-5.7	0.3	0.9	2.5	1.1
Average net wages, MKD	2.8	2.8	3.7	2.9	5.5	3.5	6.9	5.3	3.8
Average net wages, real (PPI based)	3.1	-1.4	-0.3	3.0	-4.7	1.5	7.9	5.3	1.3
Average net wages, real (CPI based)	0.5	0.2	3.8	3.6	-0.3	-1.9	5.0	4.0	1.8
Average net wages, EUR (ER)	0.9	-8.4	-4.6	3.6	5.3	3.2	6.8	4.4	1.2
Employment total	.	-4.7	5.4	1.0	0.8	9.0	-6.3	-2.9	0.2
GDP per empl. person, MKD at 1999 pr.	.	6.4	-1.9	3.3	3.6	-12.4	9.4	5.8	1.8
Unit labour costs, MKD at 1999 prices	.	-3.4	5.6	-0.4	1.8	18.2	-2.3	-0.4	2.5
Unit labour costs, ER (EUR) adjusted	.	-13.9	-2.8	0.4	1.6	17.8	-2.4	-1.3	-0.5
Russia									
GDP deflator	45.8	15.1	18.5	72.4	37.7	16.5	15.7	14.9	23.2
Exchange rate (ER), RUB/EUR	12.6	-1.4	69.1	137.2	-0.8	0.4	13.5	16.5	22.9
Real ER (CPI-based)	-22.0	-12.6	34.3	29.3	-16.3	-15.6	-0.1	4.6	1.8
Real ER (PPI-based)	-25.0	-13.6	56.8	48.5	-29.5	-14.0	1.4	2.4	3.5
Average gross wages, RUB	48.4	20.2	10.7	44.8	46.0	45.7	34.6	26.4	28.7
Average gross wages, real (PPI based)	-1.6	4.6	3.3	-8.9	-0.4	22.4	20.4	9.4	5.9
Average gross wages, real (CPI based)	0.4	4.7	-13.3	-22.0	20.9	19.9	16.0	11.3	3.6
Average gross wages, EUR (ER)	31.8	21.9	-34.6	-38.9	47.2	45.2	18.6	8.5	4.4
Employment total	-0.7	-1.9	-1.4	0.2	0.6	0.6	1.5	-0.9	-0.2
GDP per empl. person, RUB at 1999 pr.	-2.9	3.4	-4.0	6.1	9.4	4.5	3.2	7.8	3.7
Unit labour costs, RUB at 1999 prices	52.8	16.3	15.3	36.4	33.5	39.5	30.4	17.3	24.0
Unit labour costs, ER (EUR) adjusted	35.8	18.0	-31.9	-42.5	34.6	39.0	14.9	0.6	0.7
Ukraine									
GDP deflator	66.2	18.1	12.0	27.4	23.1	9.9	5.1	5.5	13.7
Exchange rate (ER), UAH/EUR	20.4	-9.0	31.0	58.7	14.5	-4.3	4.5	19.8	12.4
Real ER (CPI-based)	-31.6	-20.1	20.0	30.9	-9.0	-12.7	5.8	16.1	3.6
Real ER (PPI-based)	-20.4	-14.8	14.9	20.5	-1.3	-10.1	1.3	12.9	2.7
Average gross wages, UAH	72.6	13.5	7.0	16.0	29.6	35.2	21.0	22.9	18.9
Average gross wages, real (PPI based)	13.5	5.4	-5.5	-11.5	7.2	24.5	17.4	14.0	5.9
Average gross wages, real (CPI based)	-4.2	-2.1	-3.3	-5.4	1.1	20.7	20.0	16.8	5.5
Average gross wages, EUR (ER)	43.3	24.7	-18.3	-26.9	13.3	41.2	15.8	2.6	5.5
Employment total	-2.1	-2.7	-1.1	-2.3	-2.5	-1.5	2.1	0.8	-0.9
GDP per empl. person, UAH at 1999 pr.	-8.1	-0.3	-0.8	2.2	8.7	10.9	3.1	7.3	3.8
Unit labour costs, UAH at 1999 prices	87.8	13.8	7.8	13.5	19.3	21.9	17.4	14.5	14.8
Unit labour costs, ER (EUR) adjusted	55.9	25.1	-17.7	-28.5	4.2	27.3	12.4	-4.4	2.0
Austria									
GDP deflator	1.3	0.9	0.5	0.6	1.4	1.7	1.4	1.8	1.0
Exchange rate (ER), ATS-EUR/EUR	1.7	4.0	0.7	-0.9	0.0	0.0	0.0	0.0	0.5
Real ER (CPI-based)	2.2	4.4	1.1	-0.3	-0.4	-0.5	0.3	0.6	0.6
Real ER (PPI-based)	2.2	4.4	0.5	-0.4	0.1	0.4	0.3	0.0	0.7
Average gross wages, ATS-EUR	0.8	1.1	3.0	2.3	2.6	1.4	2.1	2.4	1.8
Average gross wages, real (PPI based)	0.8	0.7	3.4	3.3	-1.4	-0.2	2.4	0.8	1.1
Average gross wages, real (CPI based)	-1.1	-0.2	2.0	1.7	0.2	-1.2	0.2	1.0	0.5
Average gross wages, EUR (ER)	-0.9	-2.8	2.2	3.2	2.6	1.4	2.1	2.4	1.4
Employment total	-0.7	0.3	0.6	0.9	0.8	0.5	0.3	0.2	0.4
GDP per empl. person, ATS-EUR at 1999 pr.	2.7	1.3	3.3	1.8	2.6	0.7	1.1	0.5	1.4
Unit labour costs, ATS-EUR at 1999 prices	-1.9	-0.2	-0.3	0.5	0.0	0.7	1.0	1.9	0.4
Unit labour costs, ER (EUR) adjusted	-3.6	-4.0	-1.0	1.4	0.0	0.7	1.0	1.9	0.0

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

Sources: National statistics and wiiw estimates.

COUNTRY REPORTS

Josef Pöschl

Czech Republic: international competitiveness strengthening

GDP growth, year-on-year at constant prices, was an impressive 3.4% in the third quarter of 2003. The seasonally adjusted growth rate was slightly lower, at 3.2%. A 7.3% rise in private household consumption was the main growth impetus; another boost came from an upsurge in gross fixed investment. Each of these two factors had a side effect on demand for imported goods: the balance of trade – including non-factor services, at constant prices – deteriorated correspondingly and affected GDP growth adversely.

2003 data for exports and imports of goods – in euro terms at current prices – confirm the continuation of a long-term trend towards an improvement of the trade balance. Starting from mid-2001, year-on-year quarterly data depicted a continuous decline of the trade deficit. Export revenues covered over 95% of import expenditures in 2003 compared to roughly 90% in 2000. In 2003, exports covered 112% of imports in trade with the EU-15 and 108% in that with Germany. The EU-15 absorbed 70% of Czech exports, Germany alone 37%. Over time, the deficit in the balance of goods may disappear. Given that the economy of the Czech Republic grew significantly faster than that of its main trading partners, the improving trade performance most likely reflects increasing international competitiveness of the tradable sector. In 2003, the year-on-year growth rates were 5.8% for exports and 5.3% for imports, and growth accelerated in the course of the year. Czech exports to the EU grew more than 11% in spite of the rather chilly EU business climate. The export share of machinery and transport equipment surpassed the 50% mark. It would be wrong to interpret the continuous deficit on the current account, which has always been close to 6% of GDP in recent years, as a sign of low international competitiveness of Czech producers of tradable goods.

The trade balance has improved in recent years, but the current account deficit has remained high. The reason was a shrinking surplus in the balance of services together with a widening gap in the balance of income. In the first quarter of 2003, the current account deficit amounted to EUR 3.3 billion as a result of a EUR 1.1 billion trade deficit, a 2.8 billion deficit in the balance of income and a 0.3 billion surplus in both services and transfers. In the same period of 2000 – and of 2001 as well – the trade deficit had been over EUR 2 billion, the surplus in services over 1 billion and the deficit in the income account 1 billion (2 billion in 2001). The high deficits in the balance of income reflect mainly the profits earned by foreign-owned Czech enterprises, which are to a large extent repatriated to the firms' mother companies; the remaining marginal part is reinvested within the country or abroad. The volume of those profits is relatively high, as the Czech Republic is the regional leader in terms of foreign direct investment per capita. Foreign-owned companies are the engine of the country's strong dedication to foreign trade.

In 2002, the improvement in the trade balance took place in spite of a 10% nominal currency appreciation against the euro. A close to 9% decline in export prices helped to avoid price increases of Czech products on international markets. In 2003, the Czech koruna depreciated by some 3% against the euro, whereas export prices remained roughly constant (-0.3%), so that on international markets the prices of Czech products tended to fall.

On the import side the Czech koruna's appreciation against the US dollar, by approximately 15% in both 2002 and 2003, played a major role. This was of particular relevance for imports of fuels and raw materials, whereas for imported semi-finished and finished goods mainly the exchange rate against the euro was of relevance. Import prices fell close to 7% in 2002 and rose slightly in 2003. In 2002 in particular, the change in the import price index was modest compared to the alteration of exchange rates.

The absence of significant price changes, especially in 2003, was not restricted to exports and imports alone. It was also observable for consumer prices and industrial producer prices. The average rate of consumer price inflation was only marginally above zero (0.1%) in 2003. This was the net outcome of stagnating non-regulated prices and of regulated prices rising by 0.6%. From another point of view, the price stability was a net outcome of a decline with regard to goods – especially food – and a rise with regard to services. Housing, health, financial services and insurance became significantly more expensive.

The stagnation or slight fall in the prices of consumer goods was predominantly cost-induced. In December 2003, the industrial producer price index was exactly at the level it had reached at the beginning of 2002. The fluctuations in between were marginal. A moderate rise up until April 2002 was followed by a nearly continuous, slight decline, and only in the second half of 2003 did that trend reverse. The average rate of PPI inflation was negative in both 2002 and 2003 (-0.5% and -0.3% respectively). The background was a decline in unit labour costs thanks to an increase in industrial labour productivity in excess of the rise in gross nominal wages: In the period January to October 2003 labour productivity was 9.3% higher, whereas wages were only 5.4% higher as against the same period in 2002. The decline in unit labour costs in tandem with the stagnation or decline of import prices supported the fall or stability of producer prices.

As for future developments, the Czech koruna is not too likely to strengthen against the euro in the first half of 2004. In 1999, the Czech currency had entered an appreciation path, and with some time lag expectations had adapted. The Czech National Bank, at ease about the fulfilment of its inflation target, showed its willingness to fight appreciation and proved remarkably successful in this respect. The CNB-controlled interest rates are below ECB levels. The Czech koruna has become weaker, a fact that the authorities may welcome: entering the phase of exchange rate stabilization, as projected in the course of

EU accession, with an overvalued exchange rate would be a disadvantage for the real sector. The financial markets' expectations have adjusted to the depreciation tendency; a wait-and-see stance is feasible until EU accession has actually taken place. A renewed appreciation tendency may follow after EU accession and may continue in 2005.

Consumer prices will rise by up to 3.5% in 2004 – not pushed by market forces, but owing to higher VAT rates and increases in the limits for regulated prices. These measures are at least partly EU accession-related. In 2005, inflation will calm down again, to about 2%. Producer price inflation will remain modest.

The economy grew by about 2.9% in 2003 thanks to a strong increase in private consumption and construction expenditures. In 2004 it will grow by up to 3.5%. It could be more, but in 2003 private consumption rose mainly on account of an over 6% increase in gross monthly wages and a strong expansion of consumer credits. The latter cannot go on forever, and the rise of real wages will be dampened in 2004 by the hike in consumer prices. Investment growth will probably remain modest in the first half of 2004. It may accelerate in the second half of the year, when it has become clear that the EU accession has passed without trouble. Export growth should strengthen thanks to an improving business climate in the EU. In 2005, GDP growth may climb to 4%.

The question of the best date for introducing the euro has become a much-discussed topic in the Czech Republic as well. The main hindrance to a fast introduction of the euro is the budget deficit, no matter that fears expressed in advance usually exceed *ex post* reality in the Czech case. The somewhat higher rate of inflation in 2004 as well as accession-related tax hikes and higher GDP growth could ease the budget problems at least to a certain extent. In any case, the National Bank and the government share the opinion that the country should enter ERM II only when macroeconomic indicators meet the Maastricht requirements, and that the ERM II episode should be kept as short as possible. The population's confidence in the domestic currency is strong, and the degree of euroization is lower than in comparable countries. This may add to the cautious attitude towards euro introduction.

The coalition government has so far survived in spite of its tiny majority in parliament, and also in spite of its weak leadership that triggers a lot of avoidable discussions, such as those on the new VAT rates or the future Czech EU commissioner.

Table CZ

Czech Republic: Selected Economic Indicators

	1997	1998	1999	2000	2001	2002	2003 1)		2004	2005
									forecast	
Population, th pers., mid-year 2)	10303.6	10294.9	10282.8	10272.5	10224.2	10189.4	.		.	.
Gross domestic product, CZK bn, nom.	1679.9	1839.1	1902.3	1984.8	2175.2	2275.6	2340		2500	2650
annual change in % (real)	-0.8	-1.0	0.5	3.3	3.1	2.0	2.9		3.3	4
GDP/capita (EUR at exchange rate)	4554	4940	5016	5426	6242	7248	7220		.	.
GDP/capita (EUR at PPP - wiiw)	12260	12340	12700	12490	13250	14080	14210		.	.
Gross industrial production										
annual change in % (real)	4.5	1.6	-3.1	5.4	6.5	4.8	5.5		5.5	6
Gross agricultural production										
annual change in % (real)	-5.1	0.7	0.6	-4.5	2.5	-4.4	.		.	.
Goods transport, mn t-kms	62460	53591	54620	57343	57777	61350	46500	I-IX	.	.
annual change in %	.	-14.2	1.9	5.0	0.8	6.2	1.3	I-IX	.	.
Gross fixed capital form., CZK bn, nom.	514.5	535.5	528.3	561.5	603.3	599.3	.		.	.
annual change in % (real)	-2.9	0.7	-1.0	5.4	5.5	0.6	2.2		4	6
Construction industry										
annual change in % (real)	-3.9	-7.0	-6.5	5.3	9.6	2.5	9.0	I-XI	.	.
Dwellings completed, units	16757	22183	23734	25207	24759	27291	16853	I-IX	.	.
annual change in %	15.7	32.4	7.0	6.2	-1.8	10.2	-3.0	I-IX	.	.
Employed persons total - LFS, th, avg 3)	4936.5	4865.7	4764.1	4731.6	4750.2	4764.9	4733.2		.	.
annual change in % 3)	-0.7	-1.4	-2.1	-0.7	0.4	0.8	-0.7		.	.
Employed pers. in industry - LFS, th, avg 3)	1550.4	1519.9	1468.7	1429.4	1470.6	1463.1	1424.7		.	.
annual change in % 3)	-3.0	-2.0	-3.4	-2.7	2.9	-0.1	-2.6		.	.
Reg. unemployed, th pers, end of period	268.9	386.9	487.6	457.4	461.9	514.4	542.4		.	.
Reg. unemployment rate in %, end of period	5.2	7.5	9.4	8.8	8.9	9.8	10.3		10.2	10.1
LFS - unemployment rate in %, average 3)	4.8	6.5	8.7	8.8	8.1	7.3	8.1		8.2	8.0
Average gross monthly wages, CZK 4)	10802	11801	12797	13614	14793	15857	16321	I-IX	.	.
annual change in % (real, gross)	1.3	-1.4	6.2	2.4	3.8	5.3	6.9	I-IX	.	.
Retail trade turnover, CZK bn	.	.	.	.	.	.	.		.	.
annual change in % (real)	-0.4	-6.8	3.0	4.3	4.5	3.0	4.9	I-XI	.	.
Consumer prices, % p.a.	8.5	10.7	2.1	3.9	4.7	1.8	0.1		3.5	2.0
Producer prices in industry, % p.a.	4.9	4.9	1.0	4.9	2.9	-0.5	-0.3		1.1	0.5
Central government budget, CZK bn										
Revenues	509.0	537.4	567.3	586.2	626.2	705.0	699.6		.	.
Expenditures	524.7	566.7	596.9	632.3	693.9	750.8	808.7		.	.
Deficit (-) / surplus (+)	-15.7	-29.3	-29.6	-46.1	-67.7	-45.7	-109.1		.	.
Deficit (-) / surplus (+), % GDP	-0.9	-1.6	-1.6	-2.3	-3.1	-2.0	-4.7		.	.
Money supply, CZK bn, end of period										
M1, Money	418.9	404.0	447.8	497.7	583.6	692.3	782.7	Nov	.	.
M2, Money + quasi money	1177.8	1241.4	1337.5	1412.3	1596.0	1647.3	1723.0	Nov	.	.
Discount rate, % p.a., end of period	13.0	7.5	5.0	5.0	3.8	1.8	1.0		.	.
Current account, EUR mn	-3157	-1120	-1372	-2945	-3652	-4691	-4700		-4800	-5200
Current account in % of GDP	-6.7	-2.2	-2.7	-5.3	-5.7	-6.4	-6.4		-6.1	-6.1
Gross reserves of NB incl. gold, EUR mn	8857	10756	12771	14159	16400	22614	21341		.	.
Gross external debt, EUR mn	19588	20757	22765	23285	25368	25067	24367	Sep	.	.
Exports total, fob, EUR mn 5)	19811.2	23067.9	24639.6	31482.7	37251.2	40711.2	43067.7		46500	51500
annual change in %	12.0	16.4	6.8	27.8	18.3	9.3	5.8		8	11
Imports total, cif, EUR mn 5)	24013.6	25286.6	26386.0	34875.7	40674.8	43026.0	45303.3		48500	53400
annual change in %	8.2	5.3	4.3	32.2	16.6	5.8	5.3		7	10
Average exchange rate CZK/USD	31.71	32.27	34.60	38.59	38.04	32.74	28.21		.	.
Average exchange rate CZK/EUR (ECU)	35.80	36.16	36.88	35.61	34.08	30.81	31.84		32.0	31.0
Purchasing power parity CZK/USD, wiiw	12.61	13.78	14.08	14.14	14.32	14.77	14.55		.	.
Purchasing power parity CZK/EUR, wiiw	13.30	14.47	14.57	15.47	16.06	15.86	16.17		.	.

Notes: 1) Preliminary. - 2) From 2001 based on census March 2001. - 3) From 2002 weighted according to census 2001. - 4) Enterprises with more than 20 employees, from 1998 including part of the Ministry of Defence and the Ministry of the Interior. - 5) Converted from the national currency to EUR at the official exchange rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Sándor Richter

Hungary: in need of credibility

A weakening of the forint in the last weeks of 2003 clearly signalled that the populist economic policy introduced by the previous conservative government in 2001 and continued by the incoming socialist-liberal government after the 2002 elections has arrived at a critical point: without a credible turn, the results achieved following the painful stabilization in 1995 are endangered.

The 2003 volatility of the forint/euro exchange rate originates in the interplay of three factors: specific structural features of the Hungarian public debt, policy mistakes resulting in loss of confidence and, finally, the deterioration of some (but not all) key macroeconomic indicators.

At the end of 2003 public debt amounted to 56.6% of the GDP. Government securities denominated in forint made up 76% of the public debt; the rest was denominated in foreign currencies. Of the forint-denominated government securities, 34% was in foreign ownership. The foreign ownership structure is highly centralized; transactions of a small number of big investors have decisive influence on the market and on the exchange rate.

The problems over the weak forint in the second half of 2003 were in sharp contrast to the concerns of economic policy in the first half of the year, when the forint was too strong. In January 2003 the central bank had to intervene through purchasing EUR 5 billion within a few days, in order to ease the revaluation pressure on the Hungarian currency. The first weakening of the forint in June 2003 unfortunately coincided with the devaluation of the middle of the intervention band. The decision on the latter had been made prior to the forint's weakening, and was then thought to be a prophylactic measure against the strong forint problem that was extrapolated to remain a concern for a longer period.

The second weakening of the forint started at the end of November 2003. A fraction of the stock of the foreign-owned, forint-denominated government securities were sold, and these transactions pushed the forint from the central bank's informally set target band of 250-260 HUF/EUR. In reaction to the forint's weakening the Monetary Council raised the prime rate of the central bank from 9.5% to 12.5%. This measure was the beginning of a series of unsuccessful steps to get the exchange rate back below 260 HUF/EUR. Later on, the government announced that the state support on housing credits would be reduced and measures would be taken to ensure that the targeted improvement in the budget in 2004 would really be achieved. In the first days of 2004 the Minister of Finance was sacked because the 2003 general government deficit had amounted to 5.6% of GDP, instead of 5.2% as predicted by the minister only a few weeks earlier. The new Minister of Finance announced that the planned date for introducing the euro (2008) would be reconsidered and initiated a further cut in government expenditures to regain credibility of the economic policy. This latter cut, together with those announced in December, amounts to HUF 155 billion, equalling 0.7% of the GDP. The continued weakness of the forint (ranging between 261 and 272 HUF/EUR in December and January) signals that no remedy has been found as yet to the shaken confidence of the markets.

The failure to stabilize the exchange rate with the above measures hints at a dual crisis of credibility in Hungary – that of the economic policy in general and that of the monetary policy in particular.

As described in earlier wiiw reports[3], the populist policy before and after the 2002 elections derailed the Hungarian economy from its earlier export-led growth path. In 2001-2003 household consumption expanded by 25% while GDP increased by 10% only. The consequences were a 9% budget (general government) deficit in 2002, failure in observing the 4.5% budget deficit target in 2003 and a serious deterioration of the current account (6.6% of the GDP) in 2003.

Although last year the government made some half-hearted attempts at improving fiscal balances, it stuck to the fiction of its main election campaign message: if elected, the socialist-liberal government's mission would fundamentally change the Hungarian welfare system to the better. Also, the government has remained hostage to another promise. In the 2002 election campaign, the conservative parties had demonized the 'Bokros package' (the 1995 austerity programme introduced by the socialist-liberal government in office then) claiming that if the socialists and the liberals were to win the elections, they would introduce a new edition of the Bokros package. The socialists, instead of proudly taking over the responsibility for the then unavoidable stabilization measures which cleared the way for the highly successful growth performance in the second half of the 1990s, chose the tactic of endlessly repeating that there would be no second 'Bokros package' should they return to government. This is the political background to the persistent denial of the need for action in the economic policy and the hesitation to address the towering problems by otherwise excellent economists such as Prime Minister Peter Medgyessy and former Minister of Finance Csaba László. A radical turn in the economic policy would have been seen as a break of the election promises. Accordingly, the government's strategy was to initiate small corrective measures thought to have a less devastating PR effect than one

[3] S. Richter, 'Hungary: the election year is over, repair of damages may begin', in L. Podkaminer et al., 'Transition Countries Resist Global Slowdown: Productivity Gains Offset Effects of Appreciation', *wiiw Research Reports*, No. 293, February 2003. pp. 70-74; S. Richter, 'Hungary: corrective measures to stop drifting', in P. Havlik et al., 'Transition Economies in 2003: Reforms and Restructuring Keep Global Economic Slowdown at Bay', *wiiw Research Reports*, No. 297, July 2003, pp. 61-64.

resolute adjustment. These corrective measures were insufficient to solve the problems but left the impression of weakness and indecision in foreign and domestic observers.

The other scenery of the credibility crisis is the monetary policy. Since 2001 the monetary policy has followed inflation targeting. The HUF/EUR exchange rate has an allowed volatility of ± 15% within the 240-325 HUF/EUR band. Within this band the central bank has had a much narrower informally targeted band for the forint (most recently 250-260 HUF/EUR). This 'wishful' rate appears again and again in the central bank's communications, leaving no doubt that the central bank would intervene through changing the interest rates if the exchange rate were to get out of the informally targeted narrow band. International experience shows that this practically dual targeting (inflation and exchange rate) with principally one instrument applied (interest rate) makes the system an attractive target for speculation. In the wake of the previous episode of forint weakening in June 2003 the government, in agreement with the central bank, announced the planned date (2008) of the euro's introduction in Hungary. This step, in other circumstances, could have been an important confidence-raising event. In this particular case however the government made this announcement instead of undertaking the badly needed measures to consolidate the budget, with exactly the opposite outcome on confidence. The monetary policy did not meet its primary target, the CPI inflation, either. At the end of 2003 the latter amounted to 5.7%, well beyond the targeted range of 3.5 ± 1%.

What is the relation between the forint's weakening and the macroeconomic 'fundamentals'? The populist economic policy, the fragility of the fiscal policy targets and the deterioration of the current account were well known in the first half of 2003 when the main concern was still about the strength of the forint. In the days of the critical weakening of the forint at the end of 2003, news about the accelerating growth and improving export performance should have had the opposite effect on the exchange rate. All in all, the 'fundamentals' alone do not serve as an explanation to the exchange rate development in Hungary in the past 14 months.

Recent data on the state of the economy are encouraging. The third-quarter GDP in 2003 increased by 2.9%, more rapidly than in the first and second quarters. Output of the manufacturing industry expanded by 5.9% year on year in the first eleven months of 2003. The expansion of the most modern sectors of industry, machinery and equipment, amounted to 14.7% in the same period. Growth in industry is nearly fully export-driven, export sales of industry increased by 9.5% in January-November. New orders in October 2003 were 22.8% higher, of which export orders 26.6% higher than in the respective month of 2002. Investment in the manufacturing industry increased by 12.7% in January-October. Employment may have increased by about 1% in 2003.

The record deficit of the current account in 2003 (about EUR 4.8 billion) reflects two tendencies: first, the 'outphasing' consumer rush triggered by the hike in real earnings related to the 2002 elections and second, the growing import-sucking effect due to the economy's take-off. Lower incomes from tourism also contributed to the deterioration of the current account balance. Exceptionally unfavourable was the balance of non-debt generating financing. In earlier years a considerable surplus of this position had been able to partly compensate the current account deficit, keeping the economy's external position sustainable. In 2003 this positive effect was missing because outward FDI from Hungary (according to data of the first eleven months) was higher than the amount of inward FDI; this was primarily due to two major Hungarian acquisitions abroad: INA in Croatia (acquired by the national oil and gas company MOL) and the second largest Bulgarian commercial bank, DSK (acquired by OTP Bank).

The general government deficit, as already mentioned, was substantially higher than planned. The government has contradicting aims for 2004: The deficit target (4.6% of GDP) should be observed to regain the confidence of the international markets; the programmes to stimulate the economy, primarily those in highway construction, should be continued or stepped up; co-financing for projects supported by the EU Structural Actions will have to be provided; further, the election promise 'there will be no "Bokros package" again' should not be broken. As of the beginning of the year, it is yet unclear which of these aims will be dropped, or which mix with what weights of these aims will be opted for.

The most likely scenario for 2004 foresees a modest acceleration of economic growth, based on an expansion of industrial exports. The forint/euro exchange rate will remain moderately volatile around 260 HUF/EUR, which will please exporters, but less so central bankers. As real earnings of households will hardly increase this year, the current account will slightly improve and fall below 6% of the GDP. CPI inflation will be between 6% and 7% due to price changes related to the EU accession. The latter will have no immediate impact on the economy except for the budget where the uncertainty due to major changes related to the in- and outflow of transfers will be much higher than in earlier years. It is assumed that the consolidation of the budget will begin, and the deficit/GDP ratio might be brought down below 5%. The financing of the budget will be restructured, with a considerably increasing share of euro-denominated bonds relative to forint-denominated government securities. As of now, no predictions can be made on the monetary policy. Giving up the exchange rate targeting parallel to the inflation targeting would allow for a lowering of the prime rate. Should the dual targeting prevail, this would probably leave interest rates high for a longer period and put a brake on the beginning recovery. Postponing the date of entry of the ERM II (which is planned to occur immediately upon Hungary's accession to the EU in May) by at least half a year would provide more manoeuvring room for the government and the central bank to regain confidence through a newly designed coherent economic and monetary policy.

Table HU

Hungary: Selected Economic Indicators

	1997	1998	1999	2000	2001	2002	2003 [1]		2004 forecast	2005 forecast
Population, th pers., end of period	10280	10253	10222	10200	10175	10142	10115		10085	10065
Gross domestic product, HUF bn, nom. [2]	8540.7	10087.4	11393.5	13150.8	14849.6	16743.7	18300		21000	21900
annual change in % (real) [2]	4.6	4.9	4.2	5.2	3.8	3.5	2.9		3.3	3.9
GDP/capita (EUR at exchange rate)	3935	4077	4402	4953	5679	6784	7140		.	.
GDP/capita (EUR at PPP - wiiw)	8930	9550	10200	11030	12020	12840	13420		.	.
Gross industrial production										
annual change in % (real)	11.1	12.5	10.4	18.1	3.6	2.7	6.4		8.5	10
Gross agricultural production										
annual change in % (real)	-3.3	0.7	0.4	-6.5	15.8	-4.1	.		.	.
Goods transport, mn t-kms [3]	24789	27144	26339	26399	26240	25816	19159	I-IX	.	.
annual change in %	-0.3	9.5	-3.0	0.2	-0.6	-1.6	5.9	I-IX	.	.
Gross fixed capital form., HUF bn, nom.	1898.9	2384.6	2724.5	3179.8	3508.4	3844.5	.		.	.
annual change in % (real)	9.2	13.3	5.9	7.7	3.5	7.2	3.5		5	6
Construction industry										
annual change in % (real)	8.1	15.3	9.0	7.9	7.7	17.5	0.1	I-XI	.	.
Dwellings completed, units	28130	20323	19287	21583	28054	31511	15408	I-IX	.	.
annual change in %	-0.4	-27.8	-5.1	11.9	30.0	12.3	-2.1	I-IX	.	.
Employed persons total - LFS, th, avg [4]	3646.3	3697.7	3811.5	3849.1	3859.5	3870.6	3922.0		.	.
annual change in % [4]	0.0	0.7	3.1	1.0	0.3	0.1	1.3		0	.
Reg. employees in industry, th pers., avg [5]	783.5	795.9	834.0	844.8	833.9	817.9	801.2	I-XI	.	.
annual change in %	-0.7	1.6	0.8	1.3	-1.3	-1.9	-2.2	I-XI	.	.
Reg. unemployed pers, th, end of period	464.0	404.1	404.5	372.4	342.8	344.9	339.6	Oct	.	.
Reg. unemployment rate in %, end of period [6]	11.0	9.6	9.4	8.6	8.0	8.0	7.9	Oct	8	8
LFS - unemployment rate in %, average	8.7	7.8	7.0	6.4	5.7	5.8	5.9		6	6
Average gross monthly wages, HUF [5]	57270	67764	77187	87645	103553	122482	133660	I-XI	.	.
annual change in % (real, net)	4.9	3.6	2.5	1.5	6.4	13.6	10.1	I-XI	.	.
Retail trade turnover, HUF bn [7]	2949.1	3682.8	4329.7	4822.0	5396.1	6108.5	4260.3	I-XI	.	.
annual change in % (real) [7]	-1.6	12.3	7.9	2.0	5.4	10.7	8.4	I-XI	.	.
Consumer prices, % p.a.	18.3	14.3	10.0	9.8	9.2	5.3	4.7		6.5	5
Producer prices in industry, % p.a.	20.4	11.3	5.1	11.6	5.2	-1.8	2.4		.	.
Central government budget, HUF bn [8]										
Revenues	2364.6	2624.4	3227.6	3681.0	4068.0	4357.3	4939.5		.	.
Expenditures	2703.1	3176.6	3565.8	4049.7	4470.9	5826.9	5667.4		.	.
Deficit (-) / surplus (+)	-338.5	-552.2	-338.1	-368.7	-402.9	-1469.6	-728.0		.	.
Deficit (-) / surplus (+), % GDP	-4.0	-5.5	-3.0	-2.8	-2.7	-8.8	-4.0		.	.
Money supply, HUF bn, end of period [9]										
M1, Money	1528.4	1991.4	2362.1	2653.9	3113.3	3655.0	4028.5		.	.
Broad money	4036.3	4590.4	5192.4	6129.6	7177.7	7858.5	8782.7		.	.
Refinancing rate, % p.a., end of period	20.5	17.0	14.5	11.0	9.8	8.5	12.5		.	.
Current account, EUR mn	-578.5	-1976.6	-2301.2	-3151.5	-1966.9	-2770.8	-4800		-4600	-4500
Current account in % of GDP	-1.4	-4.7	-5.1	-6.2	-3.4	-4.0	-6.6		-5.7	-5.3
Reserves total, excl. gold, EUR mn	7613.1	7976.8	10845.3	12038.4	12163.7	9887.4	10108.9		.	.
Gross external debt, EUR mn	22108.9	23368.1	28915.0	32513.5	37568.4	38578.6	42998	Sept	.	.
Exports total, fob, EUR mn [10]	16910.1	20476.8	23491.0	30544.5	34082.0	36522.9	37070		39700	43300
annual growth rate in %	35.1	21.1	14.7	30.0	11.6	7.2	1.5		7	9
Imports total, cif, EUR mn [10]	18779.5	22871.2	26287.8	34856.3	37654.1	39939.5	41860		44400	47900
annual growth rate in %	29.9	21.8	14.9	32.6	8.0	6.1	4.8		6	8
Average exchange rate HUF/USD	186.75	214.45	237.31	282.27	286.54	258.00	224.44		.	.
Average exchange rate HUF/EUR (ECU)	210.93	240.98	252.80	260.04	256.68	242.97	253.51		262	260
Purchasing power parity HUF/USD, wiiw	83.39	92.76	99.85	108.60	111.76	118.63	124.24		.	.
Purchasing power parity HUF/EUR, wiiw	92.93	102.93	109.11	116.74	121.29	128.32	134.78		.	.

Notes: 1) Preliminary. - 2) Methodological break 2000/2001. - 3) From 2002 methodological break in road transport. - 4) From 1998 new sample; from 2002 according to census 2001 and excluding conscripts. - 5) Enterprises with more than 10, from 1999 more than 5 employees. - 6) From 2001 wiiw estimate. - 7) From 2003 excluding sale, maintenance and repair of motor vehicles (NACE 52). - 8) Excluding privatization revenues. - 9) From 1998 revised data according to ECB methodology. - 10) Converted from the national currency to EUR at the official exchange rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Leon Podkaminer

Poland: the power of a weak currency

In the course of 2003 the Polish currency devalued by close to 15% vs. the euro, from 4.02 to 4.72 PLN/EUR. The zloty's weakening was not affected by capital inflows, whose size was not much lower than in 2002. Basically, the weakness of the Polish currency reflects the relatively low (by Polish standards) interest rates. The long downward slide in the National Bank's leading interest rates that started in February 2001 has continued. The NBP rediscount rate fell from 7.5% to 5.25% during 2003 (for reference, that rate was over 20% from November 1999 through June 2001). The weakening of the zloty has worsened the financial position of firms and financial intermediaries which happened to have accumulated large debts denominated in euro. Nonetheless, net profits of the banking system, as reported for the first three quarters of 2003, improved quite strongly. Moreover, with a rather meagre (2.4%) rise in banks' assets, there has been some improvement in their quality. (In September the share of 'problematic' credits was still quite high at over 21% though.)

Gross profits of the non-financial corporate sector almost doubled during the first three quarters of 2003 (vs. the same period of 2002) – and nearly trebled in manufacturing. Much of the growth in gross profits in manufacturing comes from the motor vehicle and transport equipment branches, which in 2003 managed to cut their enormous losses recorded in 2002. In all probability the net losses (close to PLN 2 billion) suffered by the corporate sector in 2002 will be replaced by handsome net profits in 2003.

Sales of industrial firms (corporate sector) rose 8.7% in real terms. With falling employment the industrial labour productivity increased by some 12%. As the average wage in industry rose 3% in 2003 and industrial producer prices by 2.6%, unit labour costs declined by about 8% (and the real unit labour cost indicator fell by 10%). No doubt, lower labour costs have improved profits.

The growth of private (household) consumption, at 2.6% in 2003, does not correspond to the real growth rate of the purchasing power of the entire wage bill (which was slightly negative). There was however a 4% rise in the real purchasing power of retirement payments. Besides, consumer demand has been undoubtedly supported by spending out of rising profits and incomes of employers. This is consistent with the fact that gross fixed capital formation was declining throughout the year.

Foreign trade played an important role in generating growth in 2003. In euro terms, exports rose strongly while imports stagnated. Of course these developments reflected the exchange rate and industrial labour cost tendencies, both stipulating quite massive real depreciation and significantly improving external competitiveness.

While conducive to a much better foreign trade performance, the productivity and labour cost improvements did not have any positive effect on the unemployment front. The unemployment rate is stuck at 20% – which is one of the reasons why the present government fares extremely badly in all public opinion polls.

The government has been unsuccessful in reigning in the very high public sector deficits. The central budget deficit planned for 2004 will again be quite high. The longer-term fiscal consolidation programme currently worked out envisages major cuts in the deficits only later on (when the presently ruling coalition will most probably be out of power). As elsewhere, the current approach to fiscal consolidation stipulates quite decisive cuts in public consumption and social transfers, coupled with cuts in corporate income taxes and reductions in personal income tax rates (primarily on higher incomes). Whether this approach, followed already since 1995, will be successful in reducing the public sector deficit is debatable. What is more certain is that it will have unwelcome social and also macroeconomic side effects. Similarly, there are good grounds to doubt the effects of the policies aimed at inducing higher labour market flexibility (e.g. through further cuts in unemployment benefits, or further relaxation of the provisions of the Labour Code).

The positive foreign trade developments are likely to continue in 2004, provided the zloty does not strengthen too much. At this moment the chances are fairly good that the zloty will stay rather weak. As inflation is low – though likely to rise moderately in 2004-2005 – the NBP will probably be reluctant to raise interest rates significantly. (Overall, the new Monetary Policy Council, which will be deciding the interest rate levels from March 2004, is going to be dominated by 'doves' – in contrast to the outgoing one, which proved fairly 'hawkish'). Despite this a strengthening of the zloty cannot be ruled out. In the closing months of 2003 prices of government debt fell significantly (not without active involvement of the London-based financial institutions). Higher yields on the government debt may induce higher capital inflows and possibly reverse the PLN/EUR trend. Besides, it is hard to assess the prospects of further export expansion. On the foreign demand side, one does not really know yet what kind of recovery will take place in the EU, and how this will relate to the sales of the specific products dominating Poland's export offer. On the supply side, little is known about the levels of capacity utilization in the export-oriented firms and branches. After a protracted (and strong) decline in gross fixed capital formation in recent years, the current export acceleration may sooner or later be braked by e.g. production bottlenecks.

Fixed assets investment is likely to be decisive for growth in 2004. By the end of 2003 the decline of investments seems to have stopped. It is natural to expect investment to start rising in 2004: rising profits (and profitability), relatively low interest rates, improved stance of the banking sector, all seem conducive to rising investment. But it is too early to assess the actual size of investment growth in the coming quarters. Investors, both domestic and foreign, may wish to learn more about the conditions likely to take shape after Poland's accession to the EU on 1st May 2004. It would be quite rational for them to adopt a wait-and-see approach and thus delay investment decisions until at least some uncertainties are dispelled.

The upcoming EU accession is fraught with some other uncertainties as well. For example, Poland is not yet ready, institutionally, to receive funds from the EU to which it is theoretically entitled already in 2004. It is therefore quite possible that the funds disbursed in 2004 will be smaller than planned. Other impacts of the accession, likely to materialize in 2004, include some additional inflation (due e.g. to higher costs of adopting some EU standards, regulations and indirect tax rates) and possibly some negative supply responses (e.g. over the closures of some production facilities – primarily in food processing – not meeting the EU standards). Mutual trade with the 'old' EU is unlikely to be much affected by the accession itself. But, some negative effects will follow from the adoption of the common external EU tariffs (which for many items, such as textiles, are lower than the current national ones). Also, the 'suitcase foreign trade' with Ukraine and Belarus (right now generating huge surpluses) may be reduced. Revenues of the central government will be diminished as the customs collected will no longer be appropriated nationally. In addition, one should expect higher administrative costs of managing the everyday communication with the EU authorities. It is also far from clear what size of labour migration to expect – especially as the EU countries are currently reconsidering their earlier decisions on opening their labour markets to workers from the acceding countries. Last, but not least, it remains to be seen what fiscal adjustments will be requested from the Polish government by the EU Commission.

All in all, the year 2004 is going to be quite turbulent for Poland. Only when the dust caused by accession settles down, a more reliable evaluation of the prospects for 2005 and beyond will be possible.

Table PL

Poland: Selected Economic Indicators

	1997	1998	1999	2000	2001	2002	2003 [1]	2004 forecast	2005 forecast
Population, th pers., end of period [2]	38660	38667	38654	38644	38632	38215	38197 XI	.	.
Gross domestic product, PLN mn, nom. [3]	472350	553560	615115	684982	750786	771113	804700	850000	910000
annual change in % (real)	6.8	4.8	4.1	4.0	1.0	1.4	3.7	4	4
GDP/capita (EUR at exchange rate)	3298	3649	3765	4419	5296	5231	4790	.	.
GDP/capita (EUR at PPP - WIIW)	7410	7890	8410	8960	9550	9920	10230	.	.
Gross industrial production (sales)									
annual change in % (real)	11.5	3.5	3.6	6.7	0.6	1.4	6	7	7
Gross agricultural production									
annual change in % (real)	-0.2	5.9	-5.2	-5.6	5.8	-1.8	.	.	.
Goods transport, mn t-kms	329737	317052	310698	282559	253269	248685	.	.	.
annual change in %	6.6	-3.8	-2.0	-9.1	-10.4	-1.8	.	.	.
Gross fixed capital form., PLN mn, nom.	110853	139205	156690	170430	157209	148338	.	.	.
annual change in % (real)	21.7	14.2	6.8	2.7	-8.8	-5.8	-0.9	5	6
Construction output total									
annual change in % (real)	16.5	12.4	6.2	1.0	-6.4	-0.9	-5.9 [4]	.	
Dwellings completed, units	73706	80594	81979	87789	105967	97595	163578	.	.
annual change in %	18.6	9.3	1.7	7.1	20.7	-7.9	67.6	.	.
Employment total, th pers., average	15438.7	15800.4	15373.5	15017.5	14923.6	14784.2	14468.6	.	.
annual change in %	2.8	2.3	-2.7	-2.3	-0.6	-0.9	-2.1	.	.
Employees in industry, th pers., average	3433.4	3378.7	3138.4	2955.0	2820.6	2735.9	2409.0 [4]	.	.
annual change in %	-0.1	-1.6	-7.1	-5.8	-4.5	-3.0	-2.9 [4]	.	.
Reg. unemployed, th pers, end of period	1826.4	1831.4	2349.8	2702.6	3115.1	3217.0	3175.7	.	.
Reg. unemployment rate in %, end of period	10.3	10.4	13.1	15.1	17.5	18.1	18.0	17	17
LFS - unemployment rate in %, average	11.2	10.6	13.9	16.1	18.2	19.9	20.0	20	19
Average gross monthly wages, PLN [5]	1065.8	1232.7	1697.1	1893.7	2045.1	2133.2	2341.5 [4]	.	.
annual change in % (real, net) [6]	7.3	4.5	4.7	1.0	2.5	0.7	2.0 [4]	.	.
Retail trade turnover, PLN mn	258166	291197	323687	360318	375438	385287	.	.	.
annual change in % (real)	6.8	2.6	4.0	1.0	0.2	1.8	6.8 [4]	.	.
Consumer prices, % p.a.	14.9	11.8	7.3	10.1	5.5	1.9	0.8	2	3
Producer prices in industry, % p.a.	12.2	7.3	5.7	7.8	1.6	1.0	2.6	3	3
Central government budget, PLN mn									
Revenues	119772	126560	125922	135664	140527	143520	152176	.	.
Expenditures	125675	139752	138401	151055	172885	182922	189165	.	.
Deficit (-) / surplus (+)	-5903	-13192	-12479	-15391	-32358	-39403	-36989	.	.
Deficit (-) / surplus (+), % GDP	-1.2	-2.4	-2.0	-2.2	-4.3	-5.1	-4.6	.	.
Money supply, PLN mn, end of period									
M1, Money	79240	89920	111384	106456	118297	136611	158065	.	.
M2, Money + quasi money	179378	223678	268701	300424	328198	320183	337814	.	.
Discount rate of NB % p.a., end of period	24.5	18.2	19.0	21.5	14.0	7.5	5.8	.	.
Current account, EUR mn	-3769	-5946	-10926	-10672	-7992	-7188	-3514	-4800	-6000
Current account in % of GDP	-3.0	-4.2	-7.5	-6.2	-3.9	-3.6	-1.9	-2.5	-3.0
Gross reserves of NB incl. gold, EUR mn	19376	24209	27179	29524	30067	28450	26942	.	.
Gross external debt, EUR mn	44945	50632	65043	74672	81380	80502	79936 Sep	.	.
Exports total, fob, EUR mn [7]	22798.4	25145.4	25729.3	34382.6	40374.7	43400.2	46400	49200	52200
annual growth rate in %	17.0	10.3	2.3	33.6	17.4	7.5	7	6	6
Imports total, cif, EUR mn [7]	37484.2	41539.3	43151.2	53121.9	56222.7	58307.4	59500	61300	65500
annual growth rate in %	26.3	10.8	3.9	23.1	5.8	3.7	2	3	7
Average exchange rate PLN/USD	3.28	3.49	3.97	4.35	4.09	4.08	3.89	.	.
Average exchange rate PLN/EUR (ECU)	3.71	3.92	4.23	4.01	3.67	3.86	4.40	4.5	4.6
Purchasing power parity PLN/USD, WIIW	1.48	1.63	1.73	1.84	1.88	1.88	1.87	.	.
Purchasing power parity PLN/EUR, WIIW	1.65	1.81	1.89	1.98	2.04	2.04	2.06	.	.

Notes: 1) Preliminary. - 2) 2002 according to census May 2002. - 3) From 2001 new methodology. - 4) Enterprises with more than 9 employees. - 5) From 1999 including mandatory premium for social security. - 6) From 1999 real gross wages. - 7) Converted from the national currency to EUR at the official exchange rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Zdenek Lukas

Slovakia: comprehensive reforms and export-led growth

The coalition government, in power since October 2002, is pushing through an economic programme that is first of all targeted at the stabilization of public sector expenditures. In a first step towards reforming the healthcare scheme, the rules for qualification for full social benefits and the maximum amount of allowance were tightened. Further (impending) reform steps are to reorganize the financing and management of the health system such (public hospitals and private pharmacies). As for the pension system, in 2003 the Slovak parliament approved a new act to increase the statutory retirement age and create privately managed personal-pension accounts, into which workers will pay half of their compulsory contributions. The resulting shortfall in the pay-as-you-go state pension system is to be covered, over a transition period, by privatization revenues. Securing the latter, however, is uncertain given that the privatization of the big companies in Slovakia has been completed.

To step up budgetary revenues, the government further deregulated (i.e. raised) prices of housing, energy, water and public transport at the beginning of 2003. In August taxes on fuels, beer and tobacco were raised as well. At the beginning of 2004 Slovakia introduced a single 19% tax rate for personal income, corporate profits, and all other types of income. The flat tax for personal income coupled with the higher tax-free income replaced the progressive five-rate system ranging from 10% to 38%. In the entrepreneurial sector, the 19% tax rate on corporate profits replaced the earlier rate of 25%. The expected decline in revenues is to be compensated by unifying the earlier two-tier value added tax at a rate of 19% on all goods (also staples) and services. The supporters of this wide-ranging tax reform expect more effective tax collection, more FDI, stronger economic growth and a stabilization of budgetary revenues. However, opponents emphasize the unfairness inherent in any flat-tax system, with most of the benefits of lower taxation going to the rich, while the low- and medium-income groups are asked to pay actually higher taxes. Thus corporations located in Slovakia will benefit from both the lower tax rate and cost savings related to book-keeping and administration. On the other hand, the flat VAT rate will raise prices for consumers mostly in retail trade, restaurants and other services.

Despite slow growth in the EU, the Slovak economy has been growing strongly for the past two years: rising competitiveness, based on decreasing unit labour costs in industry and a shift towards higher value-added products, has opened the door to international markets. Foreign sales are increasing continuously; they are in fact the sole driving force behind the economic expansion. Car exports (VW Bratislava), soaring by around 70% and accounting for 30% of total exports, dominate this development. The Slovak GDP grew by 4% in the first nine months of 2003. Exports (goods and services) rose by 22% (GDP concept).

Following a strong expansion in 2002, total domestic demand (dominated by private consumption) stagnated in 2003; hikes in regulated prices and in some excise taxes fuelled inflation and eroded real household incomes. Gross fixed capital formation and government consumption stagnated.

On the supply side, gross industrial production expanded by 5.3% in 2003; labour productivity rose by more than 6%, real wages fell by 3%. As a result, unit labour costs were declining. Import prices stagnated; at the same time exporters were able to sell larger quantities at higher prices. The major contributors to the industrial expansion were the transport equipment industry (VW Bratislava) with a production growth of 30%, followed by rubber & plastic products (18%) and electrical and optical equipment (11%). On the other hand, output of the mining and energy sector declined. Mostly due to maintenance and activities abroad, output of the construction sector rose by more than 5% in 2003. The construction of new buildings however has increased only marginally as investors remain hesitant.

Demand for labour is rising and consequently unemployment is on the decline. The registered unemployment rate fell to 15.6% at year-end compared to 17.5% at the end of 2002. At least part of the decline went on account of more rigorous registration rules. In order to comply with the EU *acquis,* the labour act was first revised in April 2002 and several amendments came into force in July 2003. The new legislation should improve the flexibility on the labour market and finally result in a further lowering of the unemployment rate. Besides, the government hopes that the rising foreign green-field investments will gradually create more new jobs. Unfortunately, investors are mainly targeting the rich western regions and disregarding the poor regions with high unemployment in the rest of the country. As a result, the anyhow massive regional disparities are even increasing.

The higher inflation in 2003 (consumer prices rose by 8.5%) was home-made as the administrative measures accounted for more than 75% of the total price increase. Another domestic factor was the acceleration of the food price dynamics. External factors dampened the price level as the strengthening of the Slovak koruna, in particular vis-à-vis the US dollar, pushed down prices of imported fuels and some consumer goods. The central government's deficit fell slightly (by 0.3 percentage points) and accounted for 4.5% of GDP in 2003 as the growth of budgetary expenditures decelerated and revenues rose due to increases in regulated prices and taxes.

After a record level of EUR 4 billion in 2002, the FDI inflow dropped to about EUR 0.5 billion in 2003. It is however anticipated to recover in the years to come because of the envisaged green-field investment by the French carmaker PSA Peugeot Citroen (EUR 0.7 billion by 2006) and other projects expected due to the low corporate flat-tax. As a result of the export expansion and depressed domestic demand, the current account deficit fell strongly, to less than 2% of GDP, as compared to 8% in the year 2002.

In 2004 the export performance will again be the main driving force of economic growth; GDP will grow by about 4.5%. In 2005 GDP growth may accelerate to 5%, supported by exports and recovering domestic demand driven by pre-election demand stimulation. The price and tax adjustments will keep the inflation rate high, at 8% this year and 5% in 2005. After a historical low in 2003, the current account deficit will be rising slightly in the coming years as export growth will decelerate and the repatriation of profits of FDI companies will gradually increase. Besides, the expected real appreciation of the Slovak koruna will support imports.

After joining the EU, the greatest challenge for the Slovak economy will be to master the accession to the European Monetary Union. The Slovak Central Bank and the government envisage to enter the ERM II as soon as conditions have been created to introduce the euro. This implies that Slovakia intends to stay in the ERM II for as brief a period as possible, i.e. just two years. In order to achieve this goal, the Maastricht criteria will have to be met already at the beginning of joining the ERM II. The Slovak administration believes that it will be able to fulfil these criteria by 2006. Thus, Slovakia intends to introduce the euro in 2008. However, there are some serious obstacles on the way to this ambitious target. Reducing the public budget deficit (currently at 5% of GDP) by 2 percentage points already in 2006 will be a tough challenge, in particular in view of the envisaged reforms. Assuming less revenue from the low corporate taxes coupled with less revenue from the reformed pension system, the budget deficit may even increase in the future. In addition, fiscal stability in the coming years may be undermined by liabilities (mostly state guaranties), altogether accounting for some 10% of GDP. Last but not least, the target of significantly cutting the inflation rate will be confronted with considerable upward adjustments in various relative prices, which were delayed in the election year 2002. Despite the progress in price deregulation in 2003, further adjustment steps are needed and the election year 2006 is approaching.

Table SK

Slovak Republic: Selected Economic Indicators

	1997	1998	1999	2000	2001	2002	2003 [1]		2004	2005
									forecast	
Population, th pers., mid-year	5383.2	5390.7	5395.3	5400.7	5379.8	5378.6	5378.8		.	.
Gross domestic product, SKK bn, nom.	712.7	781.4	844.1	934.1	1009.8	1096.4	1235		1390	1525
annual change in % (real)	4.6	4.2	1.5	2.0	3.8	4.4	4.0		4.5	5
GDP/capita (EUR at exchange rate)	3483	3661	3546	4061	4334	4774	5530		.	.
GDP/capita (EUR at PPP - wiiw)	8350	8830	9160	9910	10480	11330	12100		.	.
Gross industrial production										
annual change in % (real) [2]	2.7	5.0	-2.7	8.6	6.9	6.5	5.3		6	7
Gross agricultural production										
annual change in % (real)	-1.0	-5.9	-2.5	-12.3	8.2	5.5	.		.	.
Goods transport, mn t-kms	17672	17808	19996	19829	18501	18182	12723	I-IX	.	.
annual change in %	-5.9	0.8	12.3	-0.8	-6.7	-1.7	-5.3	I-IX	.	.
Gross fixed capital form., SKK bn, nom.	243.5	281.8	249.8	242.3	291.0	300.6	.		.	.
annual change in % (real)	15.0	11.0	-19.6	-7.2	13.9	-0.9	-0.5		2	5
Construction industry										
annual change in % (real)	9.2	-3.5	-25.8	-0.4	0.8	4.1	5.4	I-X	.	.
Dwellings completed, units	7172	8234	10745	12931	10321	14213	8261	I-IX	.	.
annual change in %	14.6	14.8	30.5	20.3	-20.2	37.7	-3.0	I-IX	.	.
Employed persons total - LFS, th, avg	2205.9	2198.6	2132.1	2101.7	2123.7	2127.0	2162.5	I-IX	.	.
annual change in %	-0.9	-0.3	-3.0	-1.4	1.0	0.2	2.0	I-IX	.	.
Employed pers. in industry - LFS, th, avg	665.8	662.5	630.3	615.3	628.8	640.9	634.6	I-IX	.	.
annual change in %	-3.5	-0.5	-4.9	-2.4	2.2	1.9	-0.8	I-IX	.	.
Reg. unemployed, th pers, end of period	347.8	428.2	535.2	506.5	533.7	504.1	452.2		.	.
Reg. unemployment rate in %, end of period	12.5	15.6	19.2	17.9	18.6	17.5	15.6		14	13
LFS - unemployment rate in %, average	11.8	12.5	16.2	18.6	19.2	18.5	18.0		16	15
Average gross monthly wages, SKK	9226	10003	10728	11430	12365	13511	13757	I-IX	.	.
annual change in % (real, gross)	6.5	1.7	-2.8	-4.5	0.8	5.8	-1.7	I-IX	.	.
Retail trade turnover, SKK bn [3]	328.8	379.4	442.1	481.1	301.1	328.0	287.1	I-XI	.	.
annual change in % (real)	4.8	8.6	9.8	2.3	4.5	5.8	-5.8	I-XI	.	.
Consumer prices, % p.a.	6.1	6.7	10.6	12.0	7.1	3.3	8.5		8	5
Producer prices in industry, % p.a.	4.5	3.3	4.3	10.8	6.5	2.1	8.1		7	4
Central government budget, SKK bn										
Revenues	180.8	177.8	216.7	213.5	205.4	220.4	233.1		.	.
Expenditures	217.8	197.0	231.5	241.1	249.7	272.0	289.0		.	.
Deficit (-) / surplus (+)	-37.0	-19.2	-14.8	-27.6	-44.4	-51.6	-56.0		.	.
Deficit (-) / surplus (+), % GDP	-5.2	-2.5	-1.8	-3.0	-4.5	-4.8	-4.5		.	.
Money supply, SKK bn, end of period										
M1, Money	166.1	147.2	153.9	187.2	228.5	246.8	264.2	Nov	.	.
M2, Money + quasi money	453.5	466.1	523.6	601.5	680.3	713.8	740.3	Nov	.	.
Discount rate, % p.a., end of period	8.8	8.8	8.8	8.8	8.8	6.5	6.0		.	.
Current account, EUR mn	-1596	-1764	-920	-761	-1950	-2059	-400		-500	-800
Current account in % of GDP	-8.5	-8.9	-4.8	-3.5	-8.4	-8.0	-1.3		-1.5	-2.1
Gross reserves of NB incl. gold, EUR mn [4]	2978	2493	3410	4391	4748	8824	9717		.	.
Gross external debt, EUR mn [5]	9699	10146	10470	11637	12516	12655	13474	Sep	.	.
Exports total, fob, EUR mn [6]	7299.0	9540.6	9602.2	12879.5	14115.4	15270.1	19440		22200	25800
annual growth rate in %	3.6	11.9	0.6	34.1	9.6	8.2	27		14	16
Imports total, fob, EUR mn [6]	9119.0	11634.7	10627.7	13859.8	16487.8	17517.4	19730		22900	26800
annual growth rate in %	2.7	12.3	-8.7	30.4	19.0	6.2	13		16	17
Average exchange rate SKK/USD	33.62	35.24	41.42	46.20	48.35	45.34	36.77		.	.
Average exchange rate SKK/EUR (ECU)	38.01	39.60	44.12	42.59	43.31	42.70	41.49		40.5	40.0
Purchasing power parity SKK/USD, wiiw	14.23	14.79	15.63	16.23	16.51	16.63	17.78		.	.
Purchasing power parity SKK/EUR, wiiw	15.86	16.41	17.08	17.45	17.91	17.99	18.98		.	.

Notes: 1) Preliminary. - 2) From 1999 according to EU methodology. - 3) From 2001 according to NACE, excluding VAT. - 4) From January 2002 new valuation of gold. - 5) In 2003 original data in EUR. - 6) Converted from the national currency to EUR at the official exchange rate; from 1998 new methodology.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Hermine Vidovic

Slovenia: net FDI exporter

Economic growth was dampened noticeably by a decline in foreign demand in 2003. GDP grew by 2.2% (compared with an average rate of 3.8% over the past five years) backed by household consumption and investments. Industrial production rose by a mere 1.4%: only a few sub-sectors recorded an output increase, such as manufacture of electrical and optical equipment, chemicals, transport equipment and coke and nuclear fuels. Activity was particularly depressed in a number of labour-intensive branches such as the leather and textile industries and the wood industry. Employment fell in most branches, facilitating a modest productivity increase.

Inflation was reduced by about 2 percentage points as against a year earlier: in 2003 consumer prices rose by 5.6% on average, the December-to-December inflation rate was 4.6%. In line with the recently adopted programme for the (early) entry into ERM II, the government has decided that the rise in administered prices – their share in the CPI was 16% in 2003 – may not exceed 3.4% in 2004 and 2.3% in 2005 (rates relate to December/December values). These price increases are below the recently announced inflation forecasts of 3.6% in 2004 and 2.9% in 2005.

The labour market trends prevailing in the first months of 2003 continued for the rest of the year. In November the number of registered job seekers was about 4% lower than in December 2002, but that resulted mainly from methodological changes in the coverage of unemployed. After years of moderate growth, employment reported a slight overall decrease, with the decline of self-employed and farmers contributing most to this result.

Although declining gradually, nominal (lending) interest rates remained high and stood at 10.7% in December for long-term loans. Therefore it is no surprise that foreign currency loans soared significantly (by 31.7% in real terms) in the first ten months of the year whereas tolar loans were up by only 4.1%. A further reduction of nominal interest rates is the declared target of the Bank of Slovenia in order to stabilize the exchange rate by the end of 2004 – the date of the envisaged entry into ERM II.

In contrast to preceding years when export growth exceeded import growth, in 2003 imports, measured in current euro terms, grew at a higher rate (5%) than exports (3%). In the first eleven months the trade deficit widened substantially, by about 70%, as against the same period in 2002. Stagnating exports to the European Union as a whole and the contraction of exports to Germany (-4%) and France (-16%) in particular could only partly be offset by increasing deliveries to CEFTA countries and Russia. Furthermore, services trade reported a smaller surplus than a year earlier, mainly caused by the deteriorating balance in construction and other business services. Based on these results, wiiw expects the current account to end up balanced or slightly negative in 2003 as a whole (2002: EUR 330 million surplus). The existing free trade agreements between Slovenia and other successor states of former Yugoslavia (Croatia, Bosnia and Herzegovina and Macedonia) will lose validity after EU accession. Slovenia's authorities have expressed fears that this might entail some disadvantages for Slovenia as agreements between the EU and these countries are less favourable.

After inward FDI had reached an all-time record level in 2002, Slovenia became a net exporter of FDI in 2003. In the period January-November investments abroad, in particular in the successor states of Yugoslavia, were reported at some EUR 234 million whereas inward FDI stood at a meagre EUR 132 million. By the end of December Renault acquired the remaining shares (one third) of Revoz and became the sole owner of the country's only car producer and biggest exporting company. Foreign debt increased continuously: in November it was about EUR 1.5 billion higher than at the end of 2002, mainly due to long-term international borrowing by commercial banks abroad.

The consolidated general government deficit for 2003 is in line with the anticipated 1.5% of the GDP. In December Slovenia's parliament approved the amended budget for 2004 and the budget bill for 2005, envisaging deficit to GDP ratios of 1.5% and 1.7% respectively. Both budgets foresee a cut in expenditures on public sector salaries and goods and services and an increase in subsidies and investments (e.g. to attract foreign investors).

In November 2003 the government and the Bank of Slovenia presented a 'Joint Programme for the ERM II Entry and Adoption of the Euro'. Accordingly Slovenia wants to enter the ERM II as soon as possible, i.e. by the end of 2004, which would allow to adopt the euro in 2007. In order to bring down inflation – still high by acceding countries' standards – the Bank of Slovenia will pursue a policy that will gradually cut interest rates. The Bank is confident that stabilizing the tolar exchange rate will be possible despite the interest rate cuts. The government, on the other hand, committed itself to gradually reducing the structural deficit in public finance and reducing the cost pressures in administered prices and tax increases. In addition a further de-indexation of wages in the public sector is envisaged.

GDP may grow by 3.4% in 2004, supported by investments (motorway construction programme) and the release of funds from a government-sponsored savings scheme for the purchase of new housing. This will however depend on an improvement in the business cycle in the European Union (in particular Germany). Inflation will continue to slow down and reach some 4% on average in 2004 and 3.5% in 2005. Due to the envisaged changes in the exchange rate policy the current account might slightly deteriorate.

Table SI

Slovenia: Selected Economic Indicators

	1997	1998	1999	2000	2001	2002	2003 [1)]	2004	2005
								forecast	
Population, th pers., mid-year	1986.8	1982.6	1985.6	1990.3	1992.0	1995.7	1996.8	.	.
Gross domestic product, SIT bn, nom.	2907.3	3253.8	3648.4	4222.4	4740.1	5275.8	5700	6150	6600
annual change in % (real)	4.6	3.8	5.2	4.6	2.9	2.9	2.2	3.4	3.5
GDP/capita (EUR at exchange rate)	8111	8811	9490	10352	10957	11690	12400	.	.
GDP/capita (EUR at PPP - wiiw)	11780	12480	13490	15040	15840	16600	16870	.	.
Gross industrial production									
annual change in % (real)	1.0	3.7	-0.5	6.2	2.9	2.4	1.4	2	2.5
Gross agricultural production									
annual change in % (real)	0.0	2.2	-1.3	2.4	.	.	.	.	.
Goods transport, mn t-kms [2)]	37859	36733	40041	37003	41317	36287	29775 [I-X]	.	.
annual change in %	0.1	-3.0	9.0	-7.6	2.9	-12.2	-2.0 [I-X]	.	.
Gross fixed capital form., SIT bn, nom.	679.5	800.6	999.2	1085.9	1136.8	1193.2	.	.	.
annual change in % (real)	11.6	11.3	19.1	0.2	-0.4	1.3	5.5	6	6
Construction output, in effect. working time									
annual change in % (real)	-5.2	1.7	10.2	-1.2	-2.1	-3.4	-1.7 [I-X]	.	
Dwellings completed, units	6085	6518	5142	6460	6421	.	.	.	
annual change in %	-2.3	7.1	-21.1	25.6	-0.6	.	.	.	
Employment total, th pers., average	743.4	745.2	758.5	768.2	779.0	783.5	777.5 [I-XI]	.	
annual change in %	0.2	0.2	1.8	1.3	1.4	0.6	-0.8 [I-XI]	.	
Employees in industry, th pers., average	248.5	246.2	242.8	241.6	243.5	246.1	242.3 [I-X]	.	
annual change in %	-2.1	-0.9	-1.4	-0.5	0.8	1.1	-1.6 [I-X]	.	
Reg. unemployed, th pers, end of period	128.6	126.6	114.3	104.6	104.3	99.6	96.0	.	
Reg. unemployment rate in %, end of period	14.8	14.6	13.0	12.0	11.8	11.3	11.0	10	9.8
LFS - unemployment rate in %, average	7.4	7.9	7.6	7.0	6.4	6.4	6.7	6.3	6
Average gross monthly wages, SIT	144251	158069	173245	191669	214561	235436	250943 [I-XI]	.	.
annual change in % (real, net)	2.9	1.5	3.0	1.4	3.1	2.1	1.9 [I-XI]	.	.
Retail trade turnover, SIT bn [3)]	1290.0	1346.7	1555.0	1557.4	1684.8	.	.	.	.
annual change in % (real) [4)]	1.0	2.1	2.9	7.4	7.8	4.7	5.0 [I-X]	.	.
Consumer prices, % p.a.	8.4	7.9	6.1	8.9	8.4	7.5	5.6	4	3.5
Producer prices in industry, % p.a.	6.1	6.0	2.1	7.6	8.9	5.1	2.5	.	.
General government budget, SIT bn									
Revenues	1222.6	1397.9	1590.0	1726.7	1967.8	2083.9	1927.1 [I-X]	.	.
Expenditures	1256.7	1423.5	1613.3	1781.4	2031.0	2239.9	1974.1 [I-X]	.	.
Deficit (-) / surplus (+)	-34.1	-25.6	-23.3	-54.7	-63.2	-156.0	-47.0 [I-X]	.	.
Deficit (-) / surplus (+), % GDP	-1.2	-0.8	-0.6	-1.3	-1.3	-3.0	.	.	.
Money supply, SIT bn, end of period									
M1, Money	347.4	428.2	507.8	549.8	648.1	720.1	768.8 [Nov]	.	.
Broad money	1547.8	1832.7	2055.7	2370.6	3040.6	3600.7	3777.7 [Nov]	.	.
Discount rate % p.a., end of period [5)]	10.0	10.0	8.0	10.0	7.8	7.3	5.0	.	.
Current account, EUR mn	43.1	-107.9	-664.2	-583.0	38.0	329.7	50	50	-100
Current account in % of GDP	0.3	-0.6	-3.5	-2.8	0.2	1.4	0.2	0.2	-0.4
Gross reserves of NB excl. gold, EUR mn	3003.0	3104.5	3159.2	3435.8	4907.5	6701.5	6798.2	.	.
Gross external debt, EUR mn	6165	6459	8012	9490	10403	11482	12988 [Nov]	.	.
Exports total, fob, EUR mn [6)]	7413.4	8051.9	8037.0	9505.1	10348.7	10965.9	11250	11800	12400
annual growth rate in %	11.6	8.6	-0.2	18.3	8.9	6.0	3	5	5
Imports total, cif, EUR mn [6)]	8289.7	8999.4	9482.0	10995.7	11345.4	11577.8	12200	12900	13400
annual growth rate in %	10.0	8.6	5.4	16.0	3.2	2.0	5	6	4
Average exchange rate SIT/USD	159.69	166.13	181.77	222.68	242.75	240.24	207.11	.	.
Average exchange rate SIT/EUR (ECU)	180.40	186.27	193.63	205.03	217.19	226.22	233.70	238	242
Purchasing power parity SIT/USD, wiiw	112.09	119.33	124.62	130.79	138.65	148.37	157.51	.	.
Purchasing power parity SIT/EUR, wiiw	124.21	131.47	136.17	141.02	150.20	159.28	171.75	.	.

Notes: 1) Preliminary. - 2) From 2001 new methodology in road transport. - 3) Including turnover tax; goods transport services, maintenance and repair of motor vehicles are not covered. - 4) Excluding turnover tax; maintenance and repair of motor vehicles are included. - 5) From 2001 main refinancing rate. - 6) Converted from the national currency to EUR at the official exchange rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Anton Mihailov

Bulgaria: accelerated restructuring is revitalizing the economy

Compared to other Central and Eastern European countries, the Bulgarian economy fared relatively well in 2003. Throughout the year the economy continued to grow at a steady pace: in January-September GDP increased by 4.2% year on year and a rate of some 4.5% is expected for the year as a whole. In 2003 manufacturing, for the first time since the start of economic transformation, became the most dynamic sector of the economy, making a major contribution to GDP growth. Growth in the services sector also remained solid while agriculture was badly affected by the severe and prolonged droughts and subtracted from the growth of aggregate output.

The main factor behind this relatively sound performance (against the background of a continuing economic weakness in Western Europe) is an ongoing process of economic restructuring. Its effect has been especially pronounced in manufacturing. The surge in investment (including FDI) after 1998 has resulted in the setting-up of numerous new (mostly small and medium-sized) production facilities and has contributed to the gradual upgrading and modernization of existing privatized firms. Most of the new manufacturing capacity is export-oriented and is often part of some form of international partnership; new types of international industrial cooperation such as outsourcing and subcontracting have supplemented the more traditional ones such as outward processing. In 2003 Bulgaria's gross industrial output rose by some 14% and manufacturing exports also registered a solid growth.

But the fruits of active restructuring are also evident in other sectors of the economy. There is an ongoing investment boom in the tourist industry, mostly along the Black Sea coast but also in the mountain ski resorts. The number of tourists in 2003 rose some 18% over the previous year, reaching more than 3.5 million persons. Tourism makes an important and growing contribution to the country's balance of payments: tourism revenues amounted to more than EUR 1 billion. Residential construction in large cities is also booming; an evidence of the growing demand for housing is the fact that in 2003 real estate prices jumped on average by some 20%. The retail trade sector has undergone a complete overhaul, mostly thanks to massive investment by several international supermarket chains.

The process of investment-led restructuring has been greatly facilitated by improved financial intermediation thanks to the renaissance in the banking system. With the sale in 2003 of Bank DSK (the former state savings bank) to the Hungary's OTP, the Bulgarian banking system has been fully privatized, with the overwhelming share of assets being held by foreign banks. The financial rehabilitation of the privatized banks, the improving expectations of consumers and investors and the growing competition in the banking sector have given rise to a genuine boom in credit activity. Credit expansion accelerated sharply in 2003: during the year credit to the non-government sector grew on average by 47%, after increasing by 20% in 2002. The most dynamic segment of the credit market has been household credit, which rose by more than 75% in 2003. The resurgence in both consumer credit (facilitated by the rapid proliferation of credit cards) and mortgage loans gave an important boost to final consumer demand and residential construction. Easier access to credit has in general been an important support to fixed investment in the country which grew by close to 20% in 2003.

The continuing robust recovery has contributed to a notable improvement of the situation in the Bulgarian labour market. According to preliminary data, the total number of employed persons in the third quarter of 2003 was 4.6% higher than a year earlier while employment in industry grew by almost 2% during the same period. In turn, unemployment fell sharply in 2003 and the rate in December (13.5%) was almost 3 percentage points lower than that a year earlier. Apart from the growing labour demand in the business sector, active labour market policies (including public works) also contributed to this improvement.

During most of the year, inflation remained low and in October the CPI index pointed to a price increase of just 1.9% compared to December 2002. However, consumer prices rose fast in the last two months, bringing the year-on-year inflation rate to 5.6% in December. This acceleration was mostly due to increases in the prices of some basic foods (such as bread) related to the exceptionally poor grain harvest. In average annual terms, CPI inflation remained low at 2.4% but the effects of the latest price increases will be carried forward into 2004.

On the negative side, the most alarming development in 2003 has been the rapid (and quite unexpected) deterioration in the current account balance. The current account deficit has been widening and is expected to reach almost 9% of GDP for 2003 as a whole. The most important factor for the worsening of the external balance has been the unexpected surge in the demand for merchandise imports which outpaced the (rather high) growth of merchandise exports. Although the balance on the services account improved in 2003 (thanks to higher tourism revenues), this could not offset the rapidly expanding gap in the balance on goods trade. The credit expansion has also contributed to the widening of the current account deficit.

The widening current account deficit has been a source of concern for the authorities but they have fairly limited policy instruments to address this problem. The currency board arrangement precludes the conduct of an independent monetary policy. Besides, one specific feature of the present situation is that the deficit is rooted in the private, not in the public sector: in the past several years, public finances have been close to balance.

Hence, while further fiscal tightening could lead to some improvement in the current account balance, it is difficult to expect that fiscal measures alone could bring about its radical reversal. In fact, as part of the latest deal negotiated with the IMF, the Bulgarian government undertook to target a zero deficit in the consolidated general government fiscal balance in 2003 in return for the IMF agreement to a somewhat higher fiscal deficit in 2004. Another policy measure that is due to come into effect in 2004 is a change in the capital adequacy requirements of commercial banks which would mandate them to set aside larger provisions (and hence would put certain brakes on their credit expansion).

Nevertheless, while the current account deficit is indeed quite large, it probably does not entail very serious problems for the Bulgarian economy at present. The additional resources mobilized abroad seem to be directed mainly into productive activity. They provide additional support to the ongoing economic restructuring and will boost the future growth potential of the country. In addition, the deficit is closely associated with the acceleration of inward FDI: in the period January-November, the inflow of FDI covered almost 100% of the current account deficit in this period. Bulgaria has regained access to international financial markets and can raise additional funds from abroad to finance the deficit, if necessary.

In general, the prospects for 2004 remain positive. The government's official GDP growth target for the year is 5.3%; while this may be somewhat optimistic, most likely economic activity will remain buoyant. After the expiration in February 2004 of the current stand-by agreement with the IMF, the authorities intend to seek a new two-year agreement, but of a 'precautionary' type (in which funds will be allocated but in general will not be expected to be drawn). The government plans to maintain a relatively tight fiscal stance in 2004 (the budget deficit target for the year finally agreed upon with the IMF is 0.7%), despite the lowering of some taxes (as of January 2004, the basic corporate income tax has been lowered from 23.5% to 19.5% and the taxation of the lower ranges of personal income has also been reduced). It is envisaged that higher tax revenue from other sources such as excises and customs duties (partly thanks to further improvements in tax collection) will more than offset the reduced revenue from corporate and personal taxation. Average annual inflation will likely be somewhat higher than in 2003: apart from the carry-over effects of the recent price increases, some regulated prices (fuels, cigarettes) were also raised in January, in line with the gradual harmonization of excise duties with the EU.

Table BG

Bulgaria: Selected Economic Indicators

	1997	1998	1999	2000	2001	2002	2003 [1)]	2004 forecast	2005 forecast
Population, th pers., end of period	8283.2	8230.4	8190.9	8149.5	7891.1	7845.8	.	.	.
Gross domestic product, BGN mn, nom.	17432.6	22421.1	23790.4	26752.8	29709.2	32323.7	35000	38400	41000
annual change in % (real)	-5.6	4.0	2.3	5.4	4.1	4.8	4.5	4.5	4
GDP/capita (EUR at exchange rate)	1106	1377	1481	1674	1920	2100	2290	.	.
GDP/capita (EUR at PPP - wiiw)	4570	4860	5120	5550	6080	6360	6900	.	.
Gross industrial production									
annual change in % (real)	-5.4	-7.9	-8.0	8.2	1.6	0.6	14	10	8
Gross agricultural production									
annual change in % (real)	13.7	-1.5	2.7	-9.4	-0.1	4.1	.	.	.
Goods transport, public, mn t-kms [2)]	92021	84308	88538	88136	81937	76377	.	.	.
annual change in % [2)]	15.2	-8.4	5.0	.	-7.0	-6.8	.	.	.
Gross fixed capital form., BGN mn, nom.	1913.5	2919.8	3600.5	4206.0	5415.2	5858.9	.	.	.
annual change in % (real)	-20.9	35.2	20.8	15.4	23.3	9.3	18	.	.
Construction output total									
annual change in % (real)	-4.4	-0.2	8.0	8.1	12.8	-22.3	.	.	.
Dwellings completed, units	7452.0	4942.0	9824.0	8795.0	5937.0	6153.0	.	.	.
annual change in %	-8.0	-33.7	98.8	-10.5	-32.5	3.6	.	.	.
Employment total, th pers., average	3157.4	3152.6	3087.8	2980.1	2968.1	2992.2	.	.	.
annual change in %	-3.9	-0.2	-2.1	-3.5	-0.4	0.8	.	.	.
Employees in industry, th pers., average	838.7	802.5	722.5	662.0	658.4	649.1	.	.	.
annual change in %	-2.7	-4.3	-10.0	-8.4	-0.5	-1.4	.	.	.
Reg. unemployed, th pers, end of period	523.5	465.2	610.6	682.8	662.3	602.5	500.7	480	460
Reg. unemployment rate in %, end of period	13.7	12.2	16.0	17.9	17.3	16.3	13.5	13	12.5
LFS - unemployment rate in %, average	14.4	14.1	15.7	16.9	19.7	17.8	14.5	14	13
Average gross monthly wages, BGN	127.9	183.3	201.0	224.5	240.0	272.0	282	.	.
annual change in % (real, gross)	-16.6	20.7	6.9	1.3	-0.5	7.1	1.2	.	.
Retail trade turnover, BGN mn	5469.3	7214.2	8023.3	9725.9	10867.8	11642.0	.	.	.
annual change in % (real)	-34.8	18.6	12.3	12.7	4.8	1.6	.	.	.
Consumer prices, % p.a.	1058.4	18.7	2.6	10.3	7.4	5.8	2.4	5	3
Producer prices in industry, % p.a.	971.1	18.7	2.8	17.5	3.8	1.2	3.7	.	.
Central government budget, BGN mn									
Revenues	3143.5	4449.5	5199.3	6120.9	6525.3	7289.4	8441.6	.	.
Expenditures	3769.7	4156.0	4736.8	6304.8	7189.5	7286.0	8552.2	.	.
Deficit (-) / surplus (+)	-626.3	293.6	462.5	-183.8	-664.2	3.4	-110.6	.	.
Deficit (-) / surplus (+), % of GDP	-3.6	1.3	1.9	-0.7	-2.2	0.0	-0.3	.	.
Money supply, BGN mn, end of period [3)]									
M1, Money	2433.1	2960.7	3305.2	3976.0	4883.2	5542.3	6801.0	.	.
Broad money	5947.5	6646.7	7535.6	9856.6	12421.5	13966.8	16822.2	.	.
Base rate of NB % p.a., end of period	6.8	5.2	4.5	4.7	4.7	3.4	2.9	.	.
Current account, EUR mn	925.2	-28.5	-586.9	-761.4	-928.4	-812.4	-1600	-1400	-1300
Current account in % of GDP	10.1	-0.3	-4.8	-5.6	-6.1	-4.9	-8.9	-7.1	-6.2
Gross reserves of NB excl. gold, EUR mn [4)]	1899.4	2290.9	2878.7	3390.6	3734.0	4247.1	4981.0	.	.
Gross external debt, EUR mn [5)]	9362.9	9295.0	10863.9	12038.5	12046.0	10750.0	10600	.	.
Exports total, fob, EUR mn [4)6)]	4368.3	3841.2	3733.8	5253.1	5714.2	6062.8	6600	7100	7500
annual change in %	12.0	-12.1	-0.4	40.7	8.8	6.1	9	8	6
Imports total, cif, EUR mn [4)6)]	4361.4	4475.8	5139.9	7084.9	8127.8	8411.2	9500	10000	10500
annual change in %	7.8	2.6	16.4	37.8	14.7	3.5	13	6	5
Average exchange rate BGN/USD	1.677	1.760	1.838	2.124	2.185	2.077	1.733	1.7	.
Average exchange rate BGN/EUR (ECU)	1.896	1.972	1.956	1.956	1.956	1.956	1.956	1.956	1.956
Purchasing power parity BGN/USD, wiiw	0.414	0.507	0.518	0.547	0.570	0.602	0.597	.	.
Purchasing power parity BGN/EUR, wiiw	0.459	0.559	0.566	0.590	0.618	0.646	0.651	.	.

Notes: 1) Preliminary. - 2) From 2000 new methodology. - 3) According to International Accounting Standards. - 4) Converted from the national currency to EUR at the official exchange rate. - 5) Up to 2001 converted from USD to NCU, and from NCU to EUR at the official exchange rates. - 6) From 1999 new methodology.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Gábor Hunya

Romania: growth and disinflation continue

The high rate of economic growth was again the main positive feature of Romania's economic development. Economic growth in 2003 was supported by the expansion of private demand and fixed investment. But stocks increased rapidly as well, illustrating the persistent commodity mismatch between supplies and demands.

Much of the popular policies that would have been expected for the election year 2004 took already place last year. Living standards increased more rapidly than in any of the past five years, even if unequally distributed across the population. Real wages rose by some 9% and fuelled the increase in retail sales. The number of dwellings completed rose by 12%, that of cars sold by 25%. Fortunately, investments went also into infrastructure and the modernization of manufacturing companies. Consumer credits expanded significantly for the first time in Romanian history. Private demand pulled growth, generating at the same time increasing imports that were not matched by exports.

Imports rose by 11.6% and exports by 6.2%, based on customs statistics. Particularly high rates of import growth were registered for durable consumer goods, cars and building materials. Among the export commodities, the share of textiles and clothing was still high (at more than 20%) but decreasing, while the share of machinery and transport equipment exceeded 22%. The upgrading process of the export structure was to a great extent due to the increase in FDI. The inflow of direct investment has probably reached EUR 1.4 billion, 20% more than the year before. This sum does not even include the EUR 200 million to be received from EBRD and IFC for shares in the BCR bank.

The current account deficit of 6-7% of GDP causes no problem for the country, as the economy is growing and investors' confidence is good. The credit risk is expected to improve further, interest margins are shrinking and external financing is becoming cheaper. Gross external debt increased to about EUR 16 billion, still only 33% of GDP. International reserves reached EUR 6.4 billion by the end of the year, equalling 3.6 months of imports. The exposure to short-term capital flows is low.

In 2003 the Romanian leu devalued by an average 20% against the euro, while consumer price inflation was 15% and the increase in industrial producer prices in the range of 22%. This suggests a neutral exchange rate policy. The managed floating system functioned without any significant turbulences. Active participation of the National Bank on the currency market was necessary in the second half of the year to curb the pressure towards depreciation. Government-controlled prices were increased several times in the last quarter of the year, thus also contributing to inflation in 2003. Yet the inflation target was missed by just a narrow margin.

The restructuring of state-owned firms and privatization have continued to proceed but slowly. For the largest commercial bank an interim solution with the involvement of EBRD and IFC was found, practically postponing privatization. The tenders of gas distribution companies also meet with delays. But the privatization of loss-making manufacturing companies proceeded quite rapidly. As a result, inter-enterprise payment arrears should diminish and also tax-payment discipline improve.

In the last quarter of 2003, the government started to take measures curtailing domestic demand and limiting the soaring current account deficit. The National Bank gradually increased the reference interest rate from 17.4% in April 2003 to 21.25% in January 2004. It also warned commercial banks to better assess the creditworthiness of private customers. Commercial credit rates are sluggish to follow and there is no sign of the public losing interest in further borrowing. The question is how long this course can be maintained in view of the local elections in June and the parliamentary and presidential elections in December this year.

The 2004 budget envisages cutting the deficit from 2.7% to 2.5% of GDP and attaining economic growth of 5.5% while bringing down inflation to below 10% and curtailing the current account deficit to less than 6% of GDP. It goes without saying than these plans are over-ambitious and also contradictory. The wiiw forecast reflects the problems related to slow restructuring and low competitiveness. Economic growth at a similar rate as in 2003 would certainly be not a bad result. Also disinflation may continue, albeit at a slower pace. FDI – which is rather low as compared to the size of the country – will grow, and may finance the current account deficit to an even larger extent than in the previous year. To keep the economy on a healthy growth path, exports should rise more rapidly and imports benefit more from the modernization of production. To this end, some curtailment of private consumption is necessary. The export performance may improve due to increasing European demand, but the tax incentives for exporters will expire. A serious slippage in the budgetary policy is not very likely, even if the restrictive course may not be followed.

Some consumption restriction will not harm the ruling party's popularity and there is a good chance for the present Social-Democratic Party government to continue even f Adrian Nastase should resign as prime minister and run for presidency. The opposition has started forming a coalition with the aim to bring the Social Democrats to fall, but may be too late to come up with attractive alternatives.

Table RO

Romania: Selected Economic Indicators

	1997	1998	1999	2000	2001	2002	2003 [1]	2004	2005
								forecast	
Population, th pers., mid-year	22545.9	22502.8	22458.0	22435.2	22408.4	21698.2	.	.	.
Gross domestic product, ROL bn, nom.	252926	371194	545730	800773	1167243	1512257	1820000	2110000	2382000
annual change in % (real)	-6.1	-4.8	-1.2	2.1	5.7	4.9	4.7	4.5	4.5
GDP/capita (EUR at exchange rate)	1387	1651	1491	1789	2001	2230	2290	.	.
GDP/capita (EUR at PPP - wiiw)	5070	4880	4980	5210	5700	6390	6930	.	.
Gross industrial production									
annual change in % (real)	-7.2	-13.8	-2.4	7.1	8.4	3.1	3	4	4
Gross agricultural production									
annual change in % (real)	3.4	-7.5	4.0	-14.8	22.7	-6	.	.	.
Goods transport, mn t-kms [2]	87590	62364	45988	42131	40647	47334	.	.	.
annual change in % [2]	-18.0	.	-26.3	-8.4	-3.5	16.5	.	.	.
Gross fixed capital formation, ROL bn, nom.	53540.1	68111.6	96630.4	151947.2	238977.5	319645.1	.	.	.
annual change in % (real)	1.7	-5.7	-4.8	5.5	9.2	8.3	8	7	7
Construction output total									
annual change in % (real)	-24.4	-0.5	-0.2	2.8	9.0	5.9	5.7 I-IX	.	.
Dwellings completed, units	29921	29692	29517	26376	27041	27722	17495 I-IX	.	.
annual change in %	1.6	-0.8	-0.6	-10.6	2.5	2.5	12.1 I-IX	.	.
Employed persons total - LFS, th, avg. [3]	11050.0	10844.9	10775.6	10763.8	10696.9	9234.3	9119.0 I-VI	.	.
annual change in %	1.0	-1.9	-0.6	-0.1	-0.6	-13.7	0.1 I-VI	.	.
Reg. employees in industry, th pers., avg.	2443.0	2272.0	1991.0	1873.0	1901.0	1884.0	1784.3 I-X	.	.
annual change in %	-5.5	-7.0	-12.4	-5.9	1.5	-0.9	-1.8 I-X	.	.
Reg. unemployed, th pers, end of period	881.4	1025.1	1130.3	1007.1	826.9	760.6	655.4 Nov	.	.
Reg. unemployment rate in %, end of period	8.9	10.4	11.8	10.5	8.8	8.1	7.2 Nov	7	7
LFS - unemployment rate in %, average [3]	6.0	6.3	6.8	7.1	6.6	8.4	8	8	7
Average gross monthly wages, ROL	846450	1357132	1957731	2876645	4282622	5452097	6620445 I-XI	.	.
annual change in % (real, net) [4]	-22.6	3.4	-3.8	4.6	4.9	3.7	8.7 I-XI	.	.
Retail trade turnover, ROL bn	83035	125513	160137	213569	287278	.	.	.	.
annual change in % (real)	-12.1	20.6	-6.4	-7.0	1.9	0.8	4.7 I-X	.	.
Consumer prices, % p.a.	154.8	59.1	45.8	45.7	34.5	22.5	15.3	11	8
Producer prices in industry, % p.a.	152.7	33.2	44.5	53.4	41.0	24.6	22	15	10
Central government budget, ROL bn									
Revenues	43835	67216	93240	120342	148203	179206	214156 Oct	.	.
Expenditures	52897	77617	106887	149168	184012	226824	225285 Oct	.	.
Deficit (-) / surplus (+)	-9062	-10401	-13647	-28826	-35809	-47618	-11129 Oct	.	.
Deficit (-) / surplus (+), % GDP	-3.6	-2.8	-2.5	-3.6	-3.1	-3.1	.	-2.5	.
Money supply, ROL bn, end of period									
M1, Money	18731	22110	29669	46331	64309	88305	99413 Nov	.	.
M2, money + quasi money	62150	92530	134123	185060	270512	373713	425654 Nov	.	.
Discount rate, % p.a., end of period [5]	40.0	35.0	35.0	35.0	35.0	20.4	20.4	.	.
Current account, EUR mn [6]	-1864	-2592	-1352	-1494	-2488	-1623	-3000	-3500	-3500
Current account in % of GDP	-6.0	-7.0	-4.0	-3.7	-5.5	-3.4	-6.2	-6.8	-6.4
Gross reserves of NB excl. gold, EUR mn	1984.7	1177.3	1520.0	2654.8	4445.3	5876.8	6399.3	.	.
Gross external debt, EUR mn [7]	7767.2	7983.4	8734.3	11043.5	13501.9	14622.8	15542.0 Oct	.	.
Exports total, fob, EUR mn [8]	7434.4	7412.4	7977.0	11273.3	12722.0	14674.9	15600	16700	17900
annual growth rate in %	16.6	-0.3	7.6	41.3	12.9	15.4	6	7	7
Imports total, cif, EUR mn [8]	9946.3	10569.3	9927.2	14235.4	17383.3	18880.8	21100	23200	24600
annual growth rate in %	10.3	6.3	-6.1	43.4	22.1	8.6	12	10	6
Average exchange rate ROL/USD	7167.9	8875.6	15332.9	21692.7	29060.9	33055.5	33200.1	.	.
Average exchange rate ROL/EUR (ECU)	8090.9	9989.3	16295.6	19955.8	26026.9	31255.3	37555.9	41000	43500
Purchasing power parity ROL/USD, wiiw	1996.8	3066.4	4464.1	6349.2	8435.7	10166.6	11367.5	.	.
Purchasing power parity ROL/EUR, wiiw	2212.7	3378.2	4877.9	6845.7	9138.4	10913.8	12395.1	.	.

Notes: 1) Preliminary. - 2) From 1998 new methodology in road transport. - 3) From 2002 break in methodology and according to census March 2002. - 4) From 2000 excluding various social security contributions of employees. - 5) Reference rate of NB from February 2002. - 6) Up to 1998 wiiw calculated from USD. - 7) Medium- and long-term. - 8) Up to 1998 converted from USD to EUR using the ECB EUR/USD foreign exchange reference rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Hermine Vidovic

Croatia: sky-rocketing foreign debt

GDP growth lost momentum in the third quarter of 2003 (slowing down to 3.9%) mainly due to lower pace of growth of household consumption; the average rate for the first nine months of the year was 4.6%. Investment activities remained strong (+18.5%), due to motorway and housing projects, whereas government consumption growth was again negative. Thus, for the year as a whole, wiiw expects GDP to grow at some 4.3%. In line with overall developments industrial production growth slowed down gradually in the course of the year. Output of manufacturing rose by 4.5%, with publishing and printing, manufacture of fabricated metal products and manufacture of electrical machinery and apparatus registering the highest growth rates.

Retail trade growth decelerated steadily, to just 3.8% in real terms in the period January-November, as against a 12.5% increase in 2002. This was mainly a consequence of the credit squeeze imposed by the National Bank at the beginning of the year. Retail price inflation increased by 1.5% on average in 2003, the lowest value since the country gained independence. In its first session the new government fulfilled one of its election commitments and decided to reduce the VAT from currently 22% to 20%. The new regulation will become effective from 1 January 2005 as some amendments to the law still have to undergo the parliamentary procedure. Following the Slovak example, the introduction of a uniform 20% tax rate has been announced, to come into force in 2006.

The relatively high GDP growth has had little lasting impact on the creation of new jobs over recent years. Thanks to stricter registration criteria and active labour market policy measures, the number of registered unemployed fell until September, but started to increase again thereafter. However, the final figure for December 2003 indicates a remarkable improvement against December 2002, with the jobless rate down to about 19% from almost 21%. Nevertheless, the rate remains one of the highest among the more advanced transition countries.

Altogether Croatia's external position has deteriorated substantially in the course of 2003. Foreign trade performed once again disappointingly. With imports up by some 10% in euro terms, exports grew by only 6%, resulting in a record trade deficit. The coverage of imports by exports was just 44%. Thanks to a remarkable increase in trade with Italy – Croatia's most important trading partner – trade with the EU developed above average, whereas trade with the successors of former Yugoslavia remained below expectations. Despite the high deficit in commodity trade, the current account may close with a lower deficit than in 2002, when it stood at 8.5% of GDP according to the latest revisions. The improved 2003 result is mainly due to significantly higher earnings from tourism – in the third quarter alone they were more than double than a year earlier.

Croatia's main concern, however, is its soaring foreign indebtedness. According to the Minister of Finance the country's foreign debt reached an estimated USD 22.8 billion by December 2003, which is nearly 50% more than by the end of 2002 – and accounts for more than 80% of the GDP. Almost one third of the debt increase expressed in US dollar is to be attributed to the exchange rate adjustment (about 70% of total debt is denominated in euro). The major part of the debt increase stems from banks borrowing from parent banks abroad, followed by the state and companies. The 2004 debt service is estimated at USD 3.7 billion; the bulk of it falls due in the second half of the year. Most of the debt service will have to be borne by enterprises, about one third by the state and only a minor share by banks; the latter share is projected to increase in the coming two years. In 2004 the National Bank will be focusing on a further reduction of the current account deficit and the slowing down of external borrowing. In accordance with the IMF the Bank has announced to eliminate administered credit ceilings and replace them by a more orthodox monetary policy framework, by starting open market operations in the second half of 2004.

FDI inflows totalled USD 1.2 billion during the first nine months of 2003, which is significantly more than in the same period a year earlier (USD 680 million). Out of this, more than half relates to retained and/or reinvested profits (e.g. in the cases of Croatian Telekom, Pliva and banks). As the partial sale of the oil company INA to the Hungarian MOL, worth USD 505 million, is still excluded from that amount (the transaction materialized only in the final quarter of the year), the full year 2003 will register a record FDI inflow. Croatian investments abroad (USD 42 million) were mainly concentrated on projects in Bosnia and Herzegovina as well as in Serbia and Montenegro.

The fiscal outcome of 2003 was subject to embittered debates between representatives of the new and old governments. According to Mr. Suker, the new Minister of Finance, the consolidated general government closed with a 6.9% deficit relative to the GDP whereas his predecessor Mr. Crkvenac insists on the deficit being in line with the targeted 4.5% agreed upon with the IMF. Meanwhile these debates have been suspended to wait for the actual final results. Discussions on the 2004 budget – aiming at a 'further reduction' of the deficit – will start from mid-February.

Following the parliamentary elections in November, a new centre-right government, headed by Ivo Sanader from the Croatian Democratic Union, was approved on 24 December 2003. It is supported by most representatives of the ethnic minorities, pensioners, the peasants party and the Liberal Party (HSLS). In view of the main strategic goals of the new government – EU and NATO membership – the new prime minister announced to speed up reforms and fulfil the conditions for accession. Croatia submitted its application for EU membership in February 2003, aspiring to enter the EU together with Bulgaria and Romania in 2007. Croatia expects a positive opinion from the Commission in spring and gaining the candidate status by June 2004. Thus negotiations on accession could start in late 2004 or early 2005. One of the preconditions set by the Union is Croatia's willingness to fully cooperate with the International Tribunal in the Hague; other requirements the country has to meet are the return of refugees, judicial reforms, but also resolving its protracted territorial disputes with Slovenia over their common sea border. In contrast to the government's ambitions of an early EU entry, Enlargement Commissioner Verheugen has recently stated that 'the government should not have too high expectations to join the EU in 2007'.

The weakening of Croatia's economic performance observed in the final quarter of 2003 will continue during the first months of 2004: wiiw expects GDP growth to slow down to about 3% as a consequence of the further dwindling of private consumption. Investment activities are expected to remain strong due to the motorway construction programmes. The current account deficit will remain at high levels, however, credit restrictions should help to lower imports and consequently reduce the trade deficit. Substantial improvements on the labour market are not in sight. The National Bank will continue its policy of price and exchange rate stabilization, while details of the new government's policy priorities will be known only in the coming weeks.

Table HR

Croatia: Selected Economic Indicators

	1997	1998	1999	2000	2001	2002	2003 [1]		2004	2005
									forecast	
Population, th pers., mid-year [2]	4573	4501	4554	4437	4437	4443	.		.	.
Gross domestic product, HRK mn, nom.	123811	137604	141579	152519	165640	176429	186800		196600	206500
annual change in % (real)	6.8	2.5	-0.9	2.9	4.4	5.2	4.3		3.2	3.5
GDP/capita (EUR at exchange rate)	3891	4284	4102	4502	4998	5361	5570		.	.
GDP/capita (EUR at PPP - wiiw)	7130	7570	7510	8050	8700	9210	.		.	.
Gross industrial production [3]										
annual change in % (real)	6.8	3.7	-1.4	1.7	6.0	5.4	4.1		3.5	3
Gross agricultural production										
annual change in % (real)	4.0	10.2	-3.5	-10.0	8.4	7.4	.		.	.
Goods transport, public, mn t-kms [4]	203428	170107	146302	143839	142265	139313	102681	I-IX	.	.
annual change in %	-4.6	-16.4	-14.0	-1.7	-1.0	-2.1	0.9	I-IX	.	.
Gross fixed capital form., HRK mn, nom.	29935.6	32065.6	33025.0	33280.9	36984.2	43674.0	.		.	.
annual change in % (real)	26.4	2.5	-3.9	-3.8	7.1	10.1	17.5		10	7
Construction industry, hours worked [3]										
annual change in % (real)	16.7	0.7	-7.7	-9.1	3.6	12.8	22.8	I-XI	.	.
Dwellings completed, units	12516	12557	12175	12187	18088	19549	.		.	.
annual change in %	-0.9	0.3	-3.0	0.1	48.4	8.1	.		.	.
Employment total, th pers., average [5]	1310.9	1384.8	1364.5	1341.0	1348.3	1359.0	1359.8		.	.
annual change in % [5]	-1.4	0.4	-1.5	-1.7	0.5	0.8	0.1		.	.
Employees in industry, th pers., average	319.7	308.9	299.5	291.9	287.2	281.0	273.5		.	.
annual change in %	-6.4	-3.4	-3.0	-2.5	-1.6	-2.2	-2.6		.	.
Reg. unemployed, th pers, end of period	287.1	302.7	341.7	378.5	395.1	366.2	318.7		.	.
Reg. unemployment rate in %, end of period	17.6	18.1	20.4	22.3	23.1	21.3	19.1		18.5	18
LFS - unemployment rate in %, average	9.9	11.4	13.6	16.1	15.9	14.8	14.0		14	13.5
Average gross monthly wages, HRK	3668	4131	4551	4869	5061	5366	5608	I-XI	.	.
annual change in % (real, net)	12.3	6.0	10.1	3.4	1.6	3.1	3.9	I-XI	.	.
Retail trade turnover, HRK mn	34736.1	.	.	.	.	.	.		.	.
annual change in % (real)	14.9	0.1	-3.5	10.0	9.5	12.5	3.8	I-XI	.	.
Retail prices, % p.a.	3.6	5.7	4.2	6.2	4.9	2.2	1.5		2	1.5
Producer prices in industry, % p.a.	2.3	-1.2	2.6	9.7	3.6	-0.4	1.9		.	.
Central government budget, HRK mn [6]										
Revenues	33846	43809	46356	44636	53504	69869	61273	I-X	.	.
Expenditures	35006	42552	48879	50744	57813	73370	65770	I-X	.	.
Deficit (-) / surplus (+)	-1160	1257	-2523	-6108	-4309	-3501	-4497	I-X	.	.
Deficit (-) / surplus (+), % GDP	-0.9	0.9	-1.8	-4.0	-2.6	-2.0	.		.	.
Money supply, HRK mn, end of period										
M1, Money	13731	13531	13859	18030	23704	30870	33889		.	.
Broad money	50742	57340	56659	73061	106071	116142	128893		.	.
Discount rate % p.a., end of period	5.9	5.9	7.9	5.9	5.9	4.5	4.5		.	.
Current account, EUR mn	-2224.0	-1295.0	-1312.0	-498.0	-810.0	-2025.0	-1500		-1300	-1200
Current account in % of GDP	-12.5	-6.7	-7.0	-2.5	-3.7	-8.5	-6.1		-5.1	-4.5
Gross reserves of NB excl. gold, EUR mn	2303.7	2400.2	3012.6	3783.2	5333.6	5651.3	6553.8	Nov	.	.
Gross external debt, EUR mn	6760.7	8254.3	9937.2	11865.2	12830.6	14797.5	17987.2	Nov	.	.
Exports total, fob, EUR mn [7]	3665.8	4046.2	4027.3	4818.0	5210.4	5187.3	5500		5700	5900
annual growth rate in %	1.8	10.4	-0.5	18.9	8.1	-0.4	6		4	4
Imports total, cif, EUR mn [7]	8059.7	7476.9	7324.1	8588.5	10232.4	11324.8	12400		13100	13900
annual growth rate in %	29.6	-7.2	-2.0	16.8	19.1	10.7	10		6	6
Average exchange rate HRK/USD	6.16	6.36	7.11	8.28	8.34	7.86	6.70		.	.
Average exchange rate HRK/EUR (ECU)	6.96	7.14	7.58	7.63	7.47	7.41	7.56		7.7	7.8
Purchasing power parity HRK/USD, wiiw	3.46	3.71	3.80	3.90	3.96	3.96	3.97		.	.
Purchasing power parity HRK/EUR, wiiw	3.80	4.04	4.14	4.27	4.34	4.29	4.26		.	.

Notes: 1) Preliminary. - 2) From 2000 according to census March 2001. - 3) Enterprises with more than 20 employees. - 4) From 2001 new methodology. - 5) Including persons employed at the Ministry of Defence and Ministry of Internal Affairs. - 6) Methodological changes in June 2001 and January 2002 with respect to the stepwise inclusion of extrabudgetary funds. - 7) From 2000 new method of statistical processing. Converted from the national currency to EUR at the official exchange rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Vladimir Gligorov

Macedonia: EU perspective sought

After the near civil war that had caused a significant decrease of growth and fiscal destabilization, with a sharp increase in the public deficit in 2001 and stagnation in 2002, growth returned in 2003. GDP was growing, perhaps at an accelerated pace in the second half, by close to 3% for the year as a whole. Industrial production increased as well, by about 5%. Exports were rising, while imports declined. These positive developments were accompanied by a significant fiscal adjustment, as public expenditures were more than 10% lower than in the previous year.

The cost has been an increase in unemployment. This has been very high for a very long time and the unemployment rate has now reached 37% according to the labour survey. The increase is mostly due to the contraction of public employment. Fiscal adjustment is to continue in the coming years, so more loss of public employment can be expected. The expansion of the private sector may compensate for that, but the inevitable lag may prove to be politically and socially stressful.

The monetary policy is still rather cautious, after it had to be tightened significantly during the 2001-2002 crisis in order to prevent a collapse of the exchange rate. Macedonia has a fixed exchange rate regime – the denar is pegged to euro – and the main worry was that fiscal destabilization would lead to a destabilization of the monetary policy and eventually to a sharp depreciation of the currency. To prevent these developments, the central bank hiked interest rates quite considerably. Last year, those have started to go down, albeit slowly. Thus, the money market interest rates are around 15% while inflation is around 1-2%. Producer prices were in fact falling for most of the year. Clearly, there is room for a more relaxed monetary policy and it is expected that the adjustment will continue in the next couple of years.

Foreign direct investments have also been slow in coming back. In the period before the crisis in 2001, FDI inflows had been steadily increasing. Last year, less than USD 50 million of FDI was recorded. There are signs that this year there will be more FDI and certainly the government is expecting that. Indeed, an increase in investments is the key element in the government's economic policy for the current year. There is a sense of urgency because further growth of unemployment may threaten the still fragile stability of the country.

As the recovery has started, the prospect for its sustainability is crucial. GDP growth of about 4% is expected in the next couple of years and it is not impossible that it will in fact be higher. The main sources of growth will be increased investments and exports.

Consumption cannot grow all that much, though wages are rising, but employment is not. Public consumption will continue to decrease, as fiscal adjustment will continue and perhaps also because there will be some increase in public investments.

Export prospects depend also on the regional economic developments. Though the EU is Macedonia's main trading partner, and neighbouring Greece takes a growing share, Serbian and Kosovo markets are also quite important. The developments in these countries or territories are not encouraging, and that may affect Macedonian foreign trade negatively. Other countries in the region are less important, though that may change over time. This is constantly a problem for Macedonia, as it is very vulnerable to external shocks. Thus, continuing stabilization of the region and its economic reconstruction and recovery are very important for the sustainability of growth in Macedonia itself.

Since its independence, Macedonia has been struggling with internal stability. It has relied on outside help to achieve it. Especially important have been its relations with the EU. At the moment, Macedonia has a stabilization and association agreement with the EU, which is yet to be ratified by all EU member states. So far, this agreement has had limited impact on political developments in the country. More important is the growing feeling in the political public that Macedonia is being left behind in the process of EU integration. There is no doubt that the prospect of integration is crucial for the stability and economic development of this country. After Croatia has submitted its application for membership last year, Macedonia has decided to do the same at the end of February this year. A constructive response from the EU would be helpful both politically and economically. It would structure the political agenda in the country and would help improve investment sentiment domestically and, more importantly, abroad.

Table MK

Macedonia: Selected Economic Indicators

	1997	1998	1999	2000	2001	2002	2003 [1]	2004 forecast	2005 forecast
Population, th pers., mid-year	1996.9	2007.5	2017.1	2026.4	2034.9	2044.0	.	.	.
Gross domestic product, MKD mn, nom.	186018	194979	209010	236389	233841	243970	256820	275000	292000
annual change in % (real)	1.4	3.4	4.3	4.5	-4.5	0.3	2.8	4	4
GDP/capita (EUR at exchange rate)	1658	1590	1709	1921	1887	1917	2040	.	.
GDP/capita (EUR at PPP - wiiw)	5170	5420	5700	6010	5850	6120	6400		
Gross industrial production									
annual change in % (real) [2]	1.6	4.5	-2.6	3.6	-3.0	-5.3	5	5	5
Gross agricultural production									
annual change in % (real)	1.1	4.3	1.0	1.0	-9.8	-5.2	.	.	.
Goods transport, mn t-kms [3]	1175	1302	1219	1303	2773	.	.	.	.
annual change in % [3]	10.1	10.8	-6.4	6.9	112.8	.	.	.	.
Gross fixed capital form., MKD mn, nom.	32236	33982	34710	38332	34716	.	.	.	.
annual change in % (real)	-4.3	-2.6	-1.4	-3.2	-8.6	.	.	.	.
Construction output, value added									
annual change in % (real)	0.2	7.7	10.4	-1.1	-14.4	-7.5	.	.	.
Dwellings completed, units	4300	3253	4479	5316	4431	.	.	.	.
annual change in %	-19.5	-24.3	37.7	18.7	-16.6	.	.	.	.
Employment persons total - LFS, th. avg	512.3	539.8	545.2	549.8	599.3	561.3	545.1	.	.
annual change in %	-4.7	5.4	1.0	0.8	9.0	-6.3	-2.9	.	.
Employees in industry, th pers., average [2]	117.6	113.6	119.8	114.4	122.5	110.9	108.3 I-VIII	.	.
annual change in % [2]	-7.9	-3.4	5.5	-4.5	-4.8	-9.5	.	.	.
Reg. unemployed, th pers, end of period	257.7	258.9	354.7	366.2	360.3	374.1	.		
Reg. unemployment rate in %, end of period	42.1	.	.	.	.	.	.		
LFS - unemployment rate in %, average	36.0	34.5	32.4	32.2	30.5	31.9	36.7	36	35
Average net monthly wages, MKD	9063	9394	9664	10193	10552	11279	11811 I-X	.	.
annual change in % (real, net)	0.2	3.8	3.6	-0.3	-1.9	5.0	4.3 I-X	.	.
Retail trade turnover, MKD mn [4]	32482.8	33215.6	38247.9	50208.6	45975.8	48882.3	40859.1 I-IX	.	.
annual change in % (real, calc.)	4.1	1.5	16.4	12.1	-13.0	4.7	10.9 I-IX	.	.
Retail prices, % p.a.	4.4	0.8	-1.1	10.6	5.2	1.4	2.4	3	2
Producer prices in industry, % p.a.	4.2	4.0	-0.1	10.7	2.0	-0.9	0.0 I-XI	2	2
Central government budget, MKD mn									
Revenues	41398	42655	50478	63097	63109	67571	54728 I-XI	.	.
Expenditures	41393	42623	49761	57689	68885	71692	54468 I-XI	.	.
Deficit (-) / surplus (+)	4	32	717	5408	-5776	-4121	260 I-XI	.	.
Deficit (-) / surplus (+), % GDP	0.0	0.0	0.3	2.3	-2.5	-1.7	.	.	.
Money supply, MKD mn, end of period									
M1, Money	13983	15178	19694	22388	25324	26406	24862 Nov	.	.
M2, Money + quasi money	22724	26003	33720	41957	69785	64222	72696 Nov	.	.
Discount rate, % p.a., end of period	8.9	8.9	8.9	7.9	10.7	10.7	6.5 Sep	.	.
Current account, EUR mn [5]	-254.0	-240.0	-30.0	-79.0	-272.0	-345.0	-250	-250	-250
Current account in % of GDP	-7.7	-7.5	-0.9	-2.0	-7.1	-8.8	-6.0	-5.5	-5.3
Gross reserves of NB, excl. gold, EUR mn	232.6	260.5	428.0	461.5	845.5	692.8	.	.	.
Gross external debt, EUR mn [6]	1023.8	1190.3	1431.9	1545.2	1638.3	1486.3	1438.4 Sep	.	.
Exports total, fob, EUR mn [7]	1090.6	1170.2	1116.7	1431.4	1292.3	1180.6	1200	1300	1350
annual change in %	20.5	7.3	-4.6	28.2	-9.7	-8.6	1	8	4
Imports total, cif, EUR mn [7]	1568.3	1709.5	1664.9	2266.1	1890.8	2111.5	2030	2200	2300
annual change in %	22.2	9.0	-2.6	36.1	-16.6	11.7	-4	8	5
Average exchange rate MKD/USD	49.83	54.45	56.90	65.89	68.04	64.73	55.25 I-IX	.	.
Average exchange rate MKD/EUR (ECU)	56.20	61.07	60.62	60.73	60.91	60.98	61.27 I-IX	61	62
Purchasing power parity MKD/USD, wiiw	16.45	16.48	16.70	17.70	17.91	18.04	18.24	.	.
Purchasing power parity MKD/EUR, wiiw	18.02	17.93	18.19	19.41	19.64	19.51	19.58	.	.

Notes: 1) Preliminary. - 2) Excluding small enterprises; from 2001 according to NACE. - 3) Excluding air, from 2001 new methodoloy. - 4) From 2000 according to NACE. - 5) Including grants. - 6) Medium - and long-term. - 7) Converted from USD to EUR using the ECB EUR/USD foreign exchange reference rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Vladimir Gligorov

Serbia and Montenegro: new year, new crisis

The end of last year saw parliamentary elections being held in Serbia. Rather than resolving problems, they deepened the existing crisis. The Radical Party headed by Vojislav Šešelj, currently facing war crimes charges in the Hague Tribunal, came ahead with about 27% of the votes cast. Five other parties got between 7% and 18% of the votes. Four of those are considered to be democratic, while the fifth is the Socialist Party headed by Slobodan Miloševic, the former president of Serbia and Yugoslavia who is currently on trial in the Hague on charges of genocide and other war crimes. So far, the parties were unable to agree on the composition and the programme of the new government.

This new crisis is being played out against the background of a worsened economic situation and general dissatisfaction with reforms and transition. Industrial production dropped by about 3% in Serbia (about 2.7% in Serbia and Montenegro as a whole).[4] Agricultural production decreased by as much as 10%, GDP nearly stagnated. Unemployment continued to grow, though the labour market data are not reliable. Real wages also grew much faster than output, though, again, that information is not very reliable. Exports in euro have declined and the trade deficit is well above 20% of GDP. The only positive result is the increase in foreign direct investments, which have probably reached close to USD 1 billion in 2003.

The increase in foreign direct investment comes mostly from the sale of the tobacco industry. Most other privatizations did not bring all that much money (thousand companies were sold by the end of 2003). Also, the dissatisfaction with privatization is quite widespread. Except for the Democratic Party, which is the backbone of the outgoing government, no party is happy with it and all have called for one or the other type of revision of the actual privatizations and of the privatization law as well. A report by the anti-corruption council has also severely criticized the process of privatization as have some of the trade unions. At the moment, the process has been practically stopped.

The outgoing Serbian government was unable to secure the passage of the law of the budget, so the current financing is on the same level as that of the previous year. This will not contribute to overall consumption in the current year. Unlike the fiscal policy, the monetary policy has become somewhat more lax last year. The nominal exchange rate

4 Increasingly, the data released by the statistical offic e of Serbia and Montenegro cover Serbia only. When Montenegrin data are included, those are for the most part quite different from those published by Montenegrin sources. As Montenegro is a very small economy, the data for Serbia and Montenegro do not differ significantly from the ones for Serbia only. There is clearly the need to treat these two states separately when it comes to statistics, but that is not always possible because the statistical institutions have yet to be reformed to provide reliable and internationally comparable data.

has depreciated faster than inflation, though only by few percentage points. Also, monetary aggregates have started to grow, after falling sharply in the first three quarters of last year. This has not had a significant impact on either production or foreign trade so far – nor on inflation, which has continued to slow down.

Institutional transformation was practically paused last year. Even before the assassination of the then prime minister Zoran Djindjic in March 2003, the process of reforms was at a standstill. Thereafter, a lot of energy was wasted on the new law of the central bank and on the change of the leadership in that institution. Rather than settling the disputes between the finance ministry and the central bank, the sacking of the old governor and the election of the new one caused an even greater political crisis. That took the second part of the year. The government was unable to introduce the VAT at the end of 2003, as planned. Indeed, most of the structural targets agreed with the IMF have been missed.

It is fair to say that the reform that started with the political change in October 2000 have now come to an end with only a few important changes being accomplished. At the moment, Serbia has hardly any functioning institution of public governance. This will change once the government is elected and the presidential elections are held. It is, however, not clear what the new government's programme will be. All parties want to revive production and create jobs – but it is not set out how they plan to go about doing that. Perhaps one idea appears more often than others: reliance on the budget rather than on private, especially foreign, investments. Given that this is exactly the opposite of that which is possible, it is clear that the failure of the reforms so far has increased the confusion rather than doing anything else. Thus, it is anybody's guess what the new government will actually do if and when it is elected. Chances are that early elections are unavoidable in about a year.

In Montenegro, political stability is not threatened, though the current government lacks enough support for the realization of its main goal – the referendum on independence. The opposition parties also lack the ability to challenge the government effectively. The emerging third political force, called the Group for Change, may eventually play a significant role, but at the moment the political scene is basically frozen.

The government of Montenegro reports encouraging developments, with industrial and GDP growth returning and inflation remaining relatively low. The public, however, is not persuaded and points towards the problems with the fiscal sustainability. The data are not very transparent despite the fact that Montenegro has introduced the treasury system of controlling expenditures and has also introduced the VAT in the first half of last year. In many ways, Montenegro is ahead of Serbia in reforms in a number of areas, it is difficult to assess how transformed the economy and public governance are.

The common state union of Serbia and Montenegro has practically stopped functioning in the second half of 2003. The parties that are most likely to form the new Serbian coalition government are committed to preserving this union. That may be so on paper, but it is hard to see the union gaining some practical life. It will remain in existence because the EU is committed to it and for the lack of an alternative. In reality, the union is just the army, which is in fact Serbian but answers to the parliament of the union. This position of the army is quite tricky, as it can be a way to diminish its political influence and also the democratic control over it.

Prospects for the economies of Serbia and Montenegro are not very promising in the next couple of years. Most of the current year will be lost on political conflicts and confusion in Serbia. Montenegro, on the other hand, will continue to muddle through because the country is almost evenly divided over the issue of independence. Finally, international support and investment are rather uncertain, because the transparency of the transition in Serbia and Montenegro has been lost.

Table CS

Serbia and Montenegro: Selected Economic Indicators *)

	1997	1998	1999	2000	2001	2002	2003 [1]	2004	2005
								forecast	
Population, th pers., mid-year	10600.1	10616.9	8372.7	8342.5	8326.4	8304.7	.	.	.
Gross domestic product, CSD mn, nom.	112355	148371	191099	381661	771800	1006900	1113000	1226000	1364000
annual change in % (real) [2]	7.4	2.5	-18.0	5.0	5.5	4.0	1.0	2	3
GDP/capita (EUR at exchange rate)	1635	1336	1945	2990	1558	1996	.	.	.
Gross industrial production [3]									
annual change in % (real)	9.5	3.6	-23.1	11.1	0.0	2.0	-2.7	0	2
Gross agricultural production									
annual change in % (real)	7.3	-3.2	-1.0	-12.9	17.2	-2.1	.	.	.
Goods transport, mn t-kms	38164	45601	32978	32852	17456	5503	.	.	.
annual change in %	31.8	19.5	.	-0.4	-46.9	-68.5	.	.	.
Gross fixed investment, CSD mn, nom.	13525.3	17893.2	24867.8	59315.5	80002.8	.	.	.	.
annual change in % (real)	0.8	-2.2	-26.3	13.3	.	.	.	.	.
Construction output, value of work done									
annual change in % (real)	6.9	-0.8	-9.9	14.4	.	.	.	.	.
Dwellings completed, units	14768	13096	13123	12732	12156	12776	.	.	.
annual change in %	-2.6	-11.3	.	-3.0	-4.5	5.1	.	.	.
Employment total, th pers., average [4]	2332	2504	2298	2238	2243	2201	.	.	.
annual change in %	-1.5	-0.1	.	-2.6	0.2	-1.9	.	.	.
Employees in industry, th pers., average	864.1	887.0	804.5	764.7	744.0	684.0	.	.	.
annual change in %	-3.4	2.6	.	-5.0	-2.7	-8.1	.	.	.
Reg. unemployed, th pers, end of period	793.8	849.4	774.3	812.4	860.5	980.8	.	.	.
Reg. unemployment rate in %,end of period [5)6)]	25.5	25.4	25.5	26.7	27.9	31.2	34.4 Oct	32	32
LFS - unemployment rate in %, average	13.8	13.7	13.7	12.6	12.9	13.8	14	15	15
Average net monthly wages, CSD [6]	803	1063	1309	2588	5545	9113	12254 I-XI	.	.
annual change in % (real, net)	21.2	2.0	-15.0	6.5	13.3	24.6	.	.	.
Retail trade turnover, CSD mn	35433	48748	57697	119522	252134	321386	.	.	.
annual change in % (real, calc.)	11.8	3.9	-13.5	10.2	11.6	9.4	.	.	.
Consumer prices, % p.a.	21.6	29.9	44.9	86.0	88.9	16.5	9.4	8	8
Producer prices in industry, % p.a.	19.5	25.5	43.4	106.5	85.1	8.7	4.6	5	5
General government budget, CSD mn									
Revenues	47455	61360	79321	138749	320475	507008	490677 I-XI	.	.
Expenditures	55315	70739	.	.	.	.	.	.	.
Deficit (-) / surplus (+)	-7860	-9379	.	.	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-7.0	-6.1	.	.	.	.	.	.	.
Money supply, CSD mn, end of period									
M1, Money [7]	9148.0	10807.3	14779.0	27051.0	58287.0	93996.0	98368.0 Oct	.	.
Broad money [7)8)]	38948.4	62352.0	24941.0	65302.0	125805.0	192598.0	231055.0 Oct	.	.
Discount rate, % p.a., end of period	33.7	33.7	26.3	26.3	16.4	9.5	9.0 Nov	.	.
Current account, EUR mn [6)9)]	-1128	-589	-672	-382	-728.7	-1828	-1500	-2000	-2000
Current account in % of GDP	-11.2	-7.6	-13.3	-3.9	-5.4	-11.0	-8.8	-11.7	-11.7
Gross reserves of NB, excl. gold, EUR mn [9]	245.2	167.7	157.9	429.9	1138.6	2076.8	3900 Nov		.
Gross external debt, EUR mn [9)10)]	9509	9856	12422	12292	13306	11352	15847 Oct		
Exports total, fob, EUR mn [11]	2360.0	2517.7	1391.1	1808.2	2097.0	2399.0	2270	2360	2480
annual growth rate in %	48.2	6.7	-44.0	30.0	16.0	14.4	-5	4	5
Imports total, cif, EUR mn [11]	4245.2	4283.5	3080.8	3892.1	5390.7	6647.5	6440	6400	6400
annual growth rate in %	30.6	0.9	-26.4	26.3	38.5	23.3	-3	0	0
Average exchange rate CSD/USD	5.72	9.34	11.01	16.69	66.84	64.19	57.44		
Average exchange rate CSD/EUR (ECU)	6.48	10.46	11.74	15.30	59.44	60.79	65.26	72	80

Notes: *) CSD: New international currency-code for Dinar. From 1999 excluding Kosovo and Metohia. - 1) Preliminary. - 2) Up to 1998 based on GMP. - 3) Excluding private enterprises. - 4) Employees plus own account workers, excluding individual farmers. - 5) In % of unemployed plus employment. - 6) From 2003 Serbia only. - 7) From 1999 Serbia only. - 8) From 1999 excluding frozen foreign currency saving deposits. - 9) Converted from USD. - 10) In 2003 including a part of Montenegrin foreign debt. - 11) Converted from the national currency to EUR at the official exchange rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Peter Havlik

Russian Federation: high GDP growth and rising investment

The Russian GDP grew by nearly 7% in 2003 – significantly more than most forecasters (including wiiw) had expected. Last year's GDP growth turned out to be the second highest in Russia's recent economic history (topped only by the 10% growth rate in the year 2000); since the 1998 financial crisis the GDP has expanded by more than 35%. Higher world market energy prices resulted in a resumption of net export growth; there was also a marked increase in investments. Both private consumption and real household incomes continue to expand as well. With the government budget in a sizeable surplus, foreign exchange reserves at a record level, a slightly appreciating exchange rate and a modest decline in both inflation and unemployment, the Russian economy is now in its best shape since the beginning of transition.

Export revenues were up by more than 25% in USD terms compared to a year earlier, largely thanks to higher energy revenues (crude oil, products and gas make up 55% of the total). Imports increased by more than 20%, partly also due to price and exchange rate effects. The foreign trade surplus exceeded EUR 50 billion and the current account surplus reached 9% of GDP. The growth of export revenues will most likely bottom out this year while imports, fuelled by strong consumer and investment demand, will continue to grow. Though the trade and current account surpluses will remain large, their contribution to GDP growth will diminish. The main pillar of growth in the current year of presidential elections will be private consumption, yet investment is expected to increase moderately as well. In 2005, lower growth of consumption is likely while investment may accelerate again. However, we do not expect any marked upturn in FDI inflows (in 2003 there was a net outflow of FDI from Russia) as the investment climate – especially for foreigners – will stay rough. The recent attacks on the 'oligarchs' may even discourage the return of flight capital.

Last year's investment recovery can be explained by several factors, both internal (domestic) and external. First, favourable prices have facilitated high revenues and profits in the Russian energy and metals sectors (and revenues of the state budget) which together account for about two thirds of total investment. Second, the global economic weakness, low interest rates and depressed yields on international bond and stock markets have made investments in Russia more attractive. The inflow of foreign direct investment was up by about 50% in the first half of 2003 while Russian investments abroad (and the capital flight) have diminished. These encouraging developments have stopped, or even reversed, during the past months, partly as a reaction to the Yukos affair and pre-election rhetoric. For the medium- and long-term outlook it will be crucial not only to restore investors' confidence, but also to diversify investment flows from extracting to manufacturing industries.

Despite the largely positive economic indicators, a sustainable development is still uncertain considering the lagging implementation of administrative reforms, legal regulations and, last but not least, growing structural distortions in the economy. The new Russian parliament (Duma) is dominated by pro-Putin forces; his victory in the March 2004 presidential elections is certain. Political stability is thus guaranteed, but the speed (and in particular the efficiency) of the reform process is not. Neither the recent murky affairs related to privatization deals (Yukos, Gazprom, Novoye Vremya) nor the announcement to form a 'Common Economic Space' together with Belarus, Kazakhstan and Ukraine are likely to have a significant economic impact on Russia. Despite the recent favourable developments, wiiw expects that Russian GDP growth will drop below 5% in 2004 since no additional growth stimulus can be identified. There is a broad consensus that the current pace of economic growth is not sustainable in the medium- and long-run unless the pace of structural, institutional and banking sector reforms increases substantially. This may well be the case after President Putin's re-election, yet not earlier than 2005.

Table RU

Russia: Selected Economic Indicators

	1997	1998	1999	2000	2001	2002	2003 1)	2004 forecast	2005 forecast
Population, th pers., end of period	147105	146693	145925	145185	144317	143467	143500	143000	142700
Gross domestic product, RUB bn, nom.	2342.5	2629.6	4823.2	7305.6	8943.6	10834.2	13300	15300	17200
annual change in % (real)	1.4	-5.3	6.4	10.0	5.1	4.7	6.8	4.5	4.1
GDP/capita (EUR at exchange rate)	2431	1618	1256	1928	2365	2540	2680	2820	2940
GDP/capita (EUR at PPP - wiiw)	5220	5050	5460	6130	6630	7160	7830	8300	8860
Gross industrial production									
annual change in % (real)	1.9	-5.2	11.0	11.9	4.9	3.7	7.0	5	4
Gross agricultural production									
annual change in % (real)	1.5	-13.2	4.1	7.7	7.5	1.7	1.5	.	.
Goods transport, bn t-kms	3256	3147	3315	3480	3755	3976	4269	.	.
annual change in %	-3.4	-3.3	5.3	5.0	7.9	5.9	7.4	.	.
Gross fixed investment, RUB bn, nom.	408.8	407.1	670.4	1165.2	1504.5	1758.7	2183.3	.	.
annual change in % (real)	-5.0	-12.0	5.3	17.7	8.7	2.6	12.5	9	9
Construction output total									
annual change in % (real)	-6.0	-5.0	6.0	17.0	9.9	2.7	14.4	.	.
Dwellings completed, th units	430.3	387.7	389.8	373.4	381.6	396.4	423.2	.	.
annual change in %	-10.6	-9.9	0.5	-4.2	2.2	3.9	6.8	.	.
Employment total, th pers., average	64693	63812	63963	64327	64710	65650	65482 I-XI	.	.
annual change in %	-1.9	-1.4	0.2	0.6	0.6	1.5	-0.9 I-XI	.	.
Employment in industry, th pers., average	14905	14162	14297	14543	14692	14768	.	.	.
annual change in %	-8.9	-5.0	1.0	1.7	1.0	0.5	.	.	.
Reg. unemployed, th pers, end of period	1998.7	1929.0	1263.4	1037.0	1122.7	1500.0	1638.0	.	.
Reg. unemployment rate in %, end of period	2.7	2.7	1.7	1.4	1.6	2.1	2.3	.	.
LFS - unemployment rate in %, average 2)	12.0	13.5	13.0	10.5	9.1	8.0	8.5	8	9
Average gross monthly wages, RUB	950.2	1051.5	1522.6	2223.4	3240.4	4360.0	5512.0	.	.
annual change in % (real, gross)	4.7	-13.3	-22.0	20.9	19.9	16.2	10.4	.	.
Retail trade turnover, RUB bn	883.3	1078.7	1855.9	2430.4	3176.3	3898.1	4483.5	.	.
annual change in % (real)	4.7	-3.3	-6.1	9.0	10.8	9.0	8.0	.	.
Consumer prices, % p.a.	14.8	27.6	85.7	20.8	21.6	16.0	13.6	10	8
Producer prices in industry, % p.a.	15.0	7.1	58.9	46.6	19.1	11.8	15.6	12	10
Central government budget, RUB bn									
Revenues	343.4	325.9	615.5	1132.1	1590.7	2202.2	2341.9 I-XI	.	.
Expenditures	436.6	472.2	666.9	1029.2	1325.7	2046.0	2025.8 I-XI	.	.
Deficit (-) / surplus (+)	-93.2	-146.3	-51.4	102.9	265.0	156.2	316.1 I-XI	.	.
Deficit (-) / surplus (+), % GDP	-4.0	-5.6	-1.1	1.4	3.0	1.4	.	.	.
Money supply, RUB bn, end of period									
M1, Money	298.3	342.8	526.8	879.3	1192.6	1498.1	1899.0 Nov	.	.
M2, Money + quasi money	457.2	628.6	984.9	1560.0	2122.7	2842.5	3618.0 Nov	.	.
Refinancing rate of NB % p.a., end of per.	28	60	55	25	25	21	16	.	.
Current account, EUR mn	-71	192	23100	50619	37729	31217	34600	30000	25000
Current account in % of GDP	0.0	0.1	12.6	18.0	11.0	8.5	9.0	7.5	6.0
Gross reserves of NB, excl. gold, EUR mn	11567	6650	8387	26139	37026	42290	58531	.	.
Gross external debt, EUR mn	117330	161282	177091	173872	171578	146011	138549 Nov	.	.
Exports total, fob, EUR mn 3)	76623	66467	70820	113672	113748	113558	120000	121000	126000
annual change in %	8.3	-13.3	6.5	60.5	0.1	-0.2	6	1	4
Imports total, fob, EUR mn 3)	63474	51798	37061	48552	60025	64521	66400	70000	76000
annual change in %	18.2	-18.4	-28.5	31.0	23.6	7.5	3	6	8
Average exchange rate RUB/USD	5.79	9.71	24.62	28.13	29.17	31.35	30.57	32	34
Average exchange rate RUB/EUR (ECU)	6.54	11.06	26.24	26.03	26.13	29.65	34.55	38	41
Purchasing power parity RUB/USD, wiiw	2.78	3.26	5.54	7.47	8.50	9.73	11.02	11.9	12.6
Purchasing power parity RUB/EUR, wiiw	3.05	3.55	6.04	8.19	9.32	10.52	11.83	12.9	13.6

Notes: 1) Preliminary. - 2) In 1998 data refer to October. - 3) Based on balance of payments statistics, including estimate of non-registered trade. Converted from USD to EUR using the ECB EUR/USD foreign exchange reference rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Vasily Astrov

Ukraine: parliamentary crisis against the background of strong economic performance

According to preliminary figures, in 2003 Ukraine's GDP grew by 8.5% in real terms – a clear improvement against the previous year (5.2%, according to a recent revision), and well above most forecasts. Indeed, this corresponds to the second-best result in the country's post-Soviet history (only in 2001 was Ukraine's economic growth higher). Measured in value added, among the best-performing sectors were construction (+23.0%), manufacturing (+18.2%), and wholesale and retail trade (+14.4%). Both construction and manufacturing benefited from a strong pick-up in domestic investment – the major engine of growth. In the first nine months of the year, gross fixed capital investment reportedly soared by 32.5% (against 8.9% in 2002 as a whole), fuelled by a favourable external market situation for the major Ukrainian export commodities and improved access to funds. In turn, the booming trade (retail trade turnover went up by 19.4%) reflected rising private consumption, driven by a marked improvement in real wages, which were 16.9% higher than a year before. Still, with an average wage of some USD 100 per month, Ukraine stands at just half of the Russian level and a quarter of that in its western neighbours: Poland, Slovakia and Hungary. The contribution of net exports to GDP growth appears to have been negative, as the growth of merchandise exports (+7.1% in euro terms in January-November) was over-compensated by a 12.6% increase in imports.

Industrial output has grown by a healthy 15.8% (7% in 2002), although nearly half of industrial enterprises are reportedly still loss-making. Within manufacturing, machine-building did particularly well (+35.8%), with production of transport vehicles rising by 62.1%. Production of metals grew by 14.3%, as Ukraine was increasingly establishing itself in the new export markets in Asia and the Middle East. Chemical (including petrochemical) and food processing industries expanded strongly as well, by 16.8% and 20.0% respectively, and goods transport increased by 9.6%. However, agricultural output declined by 10.2%, largely because of the losses of winter cereal crops, which were only partially offset by a fairly good harvest of spring crops. As a result, the 2003 cereal harvest in Ukraine was only half of the 2002 level.

The lax monetary policy of the National Bank certainly contributed to the impressive growth of the economy. Fixing *de facto* the nominal exchange rate against the US dollar implied a real depreciation of the hryvnia against the currencies of its main trading partners, Russia and the EU (due to higher inflation in the former and the strengthening of the euro against the dollar in nominal terms). This ensured the competitiveness of Ukrainian products and helped maintain a positive (though smaller than in the previous year) trade balance. The current account surplus approaching EUR 3 billion (nearly 7% of GDP) translated into a further accumulation of official foreign reserves, whose stock reached EUR 5.7 billion by the end of October – an all-time high. Consequently, the monetary base expanded strongly, and so did money supply. However, because of the healthy rise in money demand, any inflationary impact was kept within limits. Producer prices in industry increased on average by 7.8% and consumer prices by just 5.2%, although the latter was also due to the price controls for bread imposed in many regions in response to the bad grain harvest. Nevertheless, the end-year consumer inflation stood at 8.2%, and more price spill-over is expected in 2004.

In contrast, fiscal policy has been fairly restrictive: while the economic upswing and improved tax collection have inflated budget revenues (the revenues of the consolidated budget grew by 15.3% in real terms), expenditure items have been almost invariably under-financed. Also, the government has accumulated huge arrears of VAT refunds to exporters, which will be partially converted into bonds. As a result, according to preliminary data, the consolidated budget has recorded a deficit of only 0.2% of GDP, instead of the 0.8% deficit planned originally. The 2004 draft budget signed into law at the end of November targets a deficit of 1.2% of GDP. Budget revenues are projected to fall somewhat following the introduction of a flat 13% personal income tax and the reduction of corporate profit tax from 30% to 25% – both effective since January 2004. However, in the medium run, the measure is intended to broaden the tax base by raising tax compliance. Meanwhile, the share of the shadow economy in Ukraine may stand, according to some estimates, at 50% of official GDP.

While the prospects of both domestic consumption and exports remain good, investors' sentiment may be negatively affected in the short run by the political turmoil ahead of the October 2004 presidential elections. The unpopular incumbent President Leonid Kuchma will be unlikely to run, despite the recent ruling of the Constitutional Court providing him with such an option. So far, the 'centrist' elite close to Kuchma has not been able to compromise on a single successor candidate, and the leader of the right-wing opposition party 'Our Ukraine' Viktor Yushchenko has the best chances to win. However, the powers of the next president might be severely curbed as a result of the constitutional amendments initiated by the pro-Kuchma forces, who are looking for a tool to retain power after October 2004. Essentially, the bill drafted by the presidential administration converts Ukraine from a presidential-parliamentary into a parliamentary-presidential republic. According to the bill, the president elected in 2004 will remain in office for one and a half years only; starting from 2006 (the date of the next parliamentary elections), he will be elected by the Rada (parliament) rather than by popular vote. In turn, the Rada itself will be elected on a proportional basis, thus giving advantage to the communists, who are supporting the bill as well. On 24 December 2003, the amendments received preliminary approval by the Rada in a highly controversial voting which was obstructed by the right-wing opposition factions. The latter dubbed the voting as anti-constitutional and have been blocking the work of the parliament ever since. Nonetheless, the bill has been forwarded to the Constitutional Court for consideration. If approved, its second (and final) reading is due to take place in March, with a two-thirds Rada majority required to enact the changes.

In its foreign and foreign economic policy, Ukraine has been increasingly seeking a further rapprochement with Russia, while those governmental officials critical of the 'new course', including economy minister Khoroshkovskiy, have had to resign. Presidents Kuchma and Putin have finally signed a framework agreement on the joint use of Azov Sea, thus putting an end to the recent conflict over Tuzla island in the Kerch strait. Also, Ukraine has allowed Russia's electricity monopoly RAO UES to participate in the partial privatization of its energy complex. Although an agreement has been reached on extending the Odessa-Brody oil pipeline to the Polish town of Plock, the final decision as to the direction in which the pipeline is to be used has not been taken so far. Given Ukraine's participation in the newly established Common Economic Space (with Russia, Belarus and Kazakhstan), prospects of a WTO accession by 2005, as envisaged before, appear rather unrealistic.

The partial 're-orientation' of the country towards Russia has to a certain extent been facilitated by the position of the EU, which still hesitates to give Ukraine the 'carrot' of possible EU membership. In addition, the incidence of anti-dumping measures against some important items of Ukrainian exports (such as steel) may increase following the EU's enlargement in May 2004 due to the lobbying efforts of the new member countries. Three of these countries – Poland, Slovakia and Hungary – are bordering Ukraine, whereas another three – Lithuania, Latvia and Estonia – enjoy free trade agreements with it, which will be scrapped in the wake of EU accession. Also, the exports of Ukrainian agricultural products to the new member states will face tougher sanitary and phytosanitary standards. As a result – and despite the fact that Ukraine will benefit from the lower nominal import tariffs adopted by the accession countries (the latter will reportedly fall from 9% to 4% on average) – the Ukrainian side estimates the likely losses for domestic producers in 2004-2005 at some USD 350-370 million per year, corresponding to more than 1% of Ukrainian exports.

Table UA

Ukraine: Selected Economic Indicators

	1997	1998	1999	2000	2001	2002	2003 [1]	2004 forecast	2005 forecast
Population, th pers., end of period [2]	50499.9	50105.6	49710.8	49291.2	48457.1	48003.5	47615.8	47350	.
Gross domestic product, UAH mn, nom.	93365	102593	130442	170070	204190	225810	257700	292300	326900
annual change in % (real)	-3.0	-1.9	-0.2	5.9	9.2	5.2	8.5	6	6.5
GDP/capita (EUR at exchange rate)	872	737	595	683	872	931	900	.	.
GDP/capita (EUR at PPP - wiiw)	3310	3340	3400	3690	4190	4560	5090	.	.
Gross industrial production									
annual change in % (real)	-0.3	-1.0	4.0	12.4	14.2	7.0	15.8	8	9
Gross agricultural production									
annual change in % (real)	-1.8	-9.6	-6.9	9.8	10.2	1.2	-10.2	.	.
Goods transport, bn t-kms	402.3	391.7	388.0	394.1	394.0	411.3	450.7	.	.
annual change in %	-10.7	-2.6	-0.9	1.6	0.0	4.4	9.6	.	.
Gross fixed investment, UAH mn, nom.	12437.0	13958.0	17552.0	23629.0	32573.0	37177.9	50100	.	.
annual change in % (real)	-8.8	6.1	0.4	14.4	20.8	8.9	25	15	15
Construction output total									
annual change in % (real)	-9.9	2.7	-8.0	9.1	16.7	-0.7	23.1	.	.
Dwellings completed, units	80000	70000	73000	62600	65000	64000	.	.	.
annual change in %	-9.2	-12.5	4.3	-14.2	3.8	-1.5	23.3 I-XI	.	.
Employment total, th pers., average	22597.6	22348.7	21823.7	21268.5	20941.9	21378.6	.	.	.
annual change in %	-2.7	-1.1	-2.3	-2.5	-1.5	2.1	.	.	.
Employees in industry, th pers., average [3]	4273.0	4142.0	3932.0	3445.0	3806.0	3578.1	.	.	.
annual change in %	-7.9	-3.1	-5.1	-12.4	-6.1	-6.0	.	.	.
Reg. unemployed, th pers, end of period	637.1	1003.2	1174.5	1155.2	1008.1	1034.2	988.9	.	.
Reg. unemployment rate in %, end of period	2.3	3.7	4.3	4.2	3.7	3.8	3.6	3.5	3.5
LFS - unemployment rate in %, average	8.9	11.3	11.9	11.7	11.1	10.1	9.5	9	8.5
Average gross monthly wages, UAH [3]	143.0	153.0	177.5	230.1	311.1	376.4	462.6	.	.
annual change in % (real, gross)	-2.1	-3.2	-5.4	1.1	20.7	20.0	16.9	.	.
Retail trade turnover, UAH mn	18933	19317	22151	28757	34417	39691	48914	.	.
annual change in % (real)	0.2	-6.6	-7.1	8.1	13.7	15.0	19.4	.	.
Consumer prices, % p.a.	15.9	10.6	22.7	28.2	12.0	0.8	5.2	7	5
Producer prices in industry, % p.a.	7.7	13.2	31.1	20.9	8.6	3.1	7.8	5	5
General government budget, UAH mn									
Revenues	28112.0	28915.8	32876.4	49117.9	54934.6	61954.3	75165.4	60702.4 [4]	.
Expenditures	34313.0	31195.7	34820.9	48148.6	55528.0	60318.9	75655.3	64192.2 [4]	.
Deficit (-) / surplus (+)	-6201.0	-2279.9	-1944.5	969.3	-593.4	1635.4	-489.9	-3489.8 [4]	.
Deficit (-) / surplus (+), % GDP	-6.6	-2.2	-1.5	0.6	-0.3	0.7	-0.2	-1.2 [4]	.
Money supply, UAH mn, end of period									
M0, Currency outside banks	6132	7158	9583	12799	19465	26434	33100	.	.
Broad money	12541	15705	22070	32252	45755	64870	95000	.	.
Refinancing rate of NB % p.a., end of period	34.8	60.0	45.0	27.0	12.5	7.0	7.0	.	.
Current account, EUR mn [5]	-1176	-1147	1559	1602	1565	3360	2800	2400	1800
Current account in % of GDP	-2.7	-3.1	5.2	4.7	3.7	7.5	6.5	5.3	3.5
Gross reserves of NB excl. gold, EUR mn [5][6]	2121	650	1042	1453	3353	4088	5705 Oct		.
Gross external debt, EUR mn [5]	8657	9806	12381	11123	13730	9830	12324 Sep		.
Exports total, fob, EUR mn [7]	12550	11283	10856	15771	18159	19004	20500	22350	23700
annual change in %	10.5	-10.1	-3.8	45.3	15.1	4.7	8	9	6
Imports total, cif, EUR mn [7]	15103	13103	11104	15104	17612	17967	20000	22400	24200
annual change in %	8.8	-13.2	-15.3	36.0	16.6	2.0	11	12	8
Average exchange rate UAH/USD	1.862	2.450	4.130	5.440	5.372	5.327	5.333	5.3	5.3
Average exchange rate UAH/EUR (ECU)	2.113	2.768	4.393	5.029	4.814	5.030	6.024	6.4	6.4
Purchasing power parity UAH/USD, wiiw	0.507	0.561	0.705	0.850	0.913	0.949	0.987	.	.
Purchasing power parity UAH/EUR, wiiw	0.556	0.611	0.768	0.932	1.001	1.027	1.060	.	.

Notes: 1) Preliminary. - 2) In 2001 according to census 5 Dec 2001. - 3) Excluding small enterprises. - 4) Budget passed by Parliament end November 2003. - 5) Converted from USD to NCU, and from NCU to EUR at the official exchange rates. - 6) Useable. - 7) Exports and imports of goods according to customs statistics, adjusted for oil, gas and non-declarable goods. Converted from USD to EUR using the ECB EUR/USD foreign exchange reference rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

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