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Economic Prospects for Central, East and Southeast Europe

Leon Podkaminer, Kazimierz Laski, Peter Havlik, Hermine Vidovic, Doris Hanzl-Weiss, Michael Landesmann et al.

**Fasting or Feasting? Europe – Old and New –
at the Crossroads**



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Executive summary

External determinants

There are two key factors affecting short and medium-term economic prospects of CESEE: the crisis in the euro area and movements in commodity prices. For Russia, Kazakhstan and Ukraine domestic developments will depend on trends relating to world-market prices of energy carriers, steel and other basic commodities. More recently global commodity prices have shown signs of weakness. But even a deep decline in commodity prices would not spell ruin for Russia and Kazakhstan, as both countries have sizeable foreign reserves. For most of the countries in Central and Southeast Europe, the strength of external demand for their manufacturing exports and their competitiveness tends to be much more important. The European Union constitutes a natural external environment for the CEE countries. Not only their mutual trade, capital and labour flows are important but also 'immaterial links' (e.g. formal regulations/directives enacted 'in Brussels'). At present, the economic crisis in the euro area is officially perceived as being primarily about possible insolvencies of a few peripheral euro area countries. Of course, the range of possibilities opened up by the insolvency of Greece (for example) is vast. However, a muddling-through scenario still seems to be the most realistic prospect - at least, for the time being.

Insistence that the 'problematic' euro area countries – but possibly also others in the EU (including the new member states) – should enact austerity measures in order to reduce public debt levels continues to set the tone throughout Europe. The recently designed Fiscal Compact epitomises this new 'spirit of austerity'. But were the Fiscal Compact to be actually obeyed, the euro area - and the EU as a whole, including the new member states – would plunge into an era of permanent stagnation with high and rising unemployment. The political and economic elites of Europe have yet to acknowledge the futility of 'fiscal austerity economics'.

Euro area enters recession, CESEE to follow?

Given the fiscal consolidation orientation followed in the EU it is not surprising that while the world economy recovers, the euro area returns to recession. Consolidation fever has spread to the new member states – including those that formally refused to subscribe to the Fiscal Compact such as the Czech Republic. Given the trend towards fiscal consolidation, it is natural to expect that the new member states will also slow down in 2012. Chances of faster growth in 2013 remain uncertain – both in the new and old member states. As is to be expected, the EU Spring forecast for 2012 is (cautiously) optimistic. Of course, that official optimism is predicated on further successful fiscal consolidation – and particularly on the return of ‘increased consumer and investor confidence’. Our forecasts for the new member states in 2013 are also cautiously optimistic. That optimism, however, is based on the assumption that the fiscal consolidation fever will abate perceptibly – both within the euro area and outside.

After the deep recession that beset almost all CESEE countries in 2009, most of them recorded a moderate recovery in 2010. However, on a quarterly basis, growth has been generally slowing down since the third quarter of 2011. In a number of countries the most recent quarterly GDP growth (first quarter of 2012) rates are already negative. The recent output contractions do not appear to be exceptions, but point to the possibility of more protracted periods of recession occurring in the CESEE region. Growth among the star-performers of 2011 (Turkey, the three Baltic countries and Kazakhstan) will also slow down, while Poland, Slovakia, Ukraine and Russia, all of which displayed steady growth in the biennium 2010-2011, are gradually losing steam.

External rebalancing is proving temporary

For the year as a whole, the values of merchandise exports of CESEE are generally expected to rise in 2012. This optimistic view reflects an assumption of a rather shallow and short-lived recession in the euro area. Should the recession in the euro area turn out to be more severe, CESEE exports would decline. The trade balance in a number of countries is expected to contribute negatively to GDP growth in 2012, despite relatively low growth in domestic demand. But in the Baltic countries, as well as in Romania, Bulgaria, Bosnia and Herzegovina and Ukraine, even with relatively slow growth in domestic demand, foreign trade will not be in a position to support overall GDP growth in 2012. The frailty of a proper industrial base capable of supplying higher value-added exports may be one reason for this. Furthermore, those countries’ real exchange-rates may also have started moving in the wrong direction once again (i.e. appreciating), adding to the deterioration in cost competitiveness. The return of a rise in trade deficits in the Baltic countries (and some other CEE countries) indicates that the ‘rebalancing’ of 2009 may have been a temporary phenomenon. That rebalancing involved adjustments in unit labour costs (through changes in wage rates relative to changes in labour productivity); they also meant downward adjustments in the scale of production in terms of both output and particularly employment. The adjustments in countries which had retained their own floating currencies also entailed some changes in their nominal exchange rates.

Analysis of unit labour cost adjustments over the longer term (and especially during the recent crisis) highlights the benefits to be gained from distinguishing between countries with floating and fixed

exchange rate regimes. The analysis argues that a flexible exchange-rate regime tends to be superior to a fixed rate regime in times of crisis because it allows for a less painful correction of excessive real appreciation via nominal exchange rate devaluation. Correction of excessive real appreciation in countries with fixed exchange rates (and, of course, in those countries that have adopted the euro as well) tends to be more painful (as it usually requires a palpable measure of wage deflation and employment cuts). The more recent data suggest that the real exchange rates tend to re-appreciate in fixed exchange rate countries, even if they had briefly depreciated in response to the impact of temporary deflation during the crisis. The negative experience that those countries had with currencies appreciating unduly in real terms may well repeat itself sooner or later.

The renewed accumulation of external imbalances in the Baltic countries may gain momentum gradually. Trade (and current account) deficits in those countries need to be covered by greater external funding. Given the relatively high levels of private external debt that some of the countries are shouldering, any providers of fresh external funding might well adopt a cautious attitude - at least initially. History has taught us, however, that initial reservations about the standing of potential borrowers do not last long, even if the latter's track record over the long term records is far from impeccable. Interestingly, the Western Balkan countries still run trade and current account deficits of a magnitude that would rightly provoke panic elsewhere. Nonetheless, the foreign capital needed to cover those deficits still pours in – and is expected to continue doing so in the near future. The relatively low level of gross external debt in most Balkan countries may be a factor facilitating their apparently easy access to foreign financing.

Household consumption and investment: steady on the 'fringes', sagging in the 'core'

In 2009, gross fixed investment declined throughout the region. In 2010, investment receded still further in most CESEE countries. That decline, however, morphed into growth on the eastern fringes of the CESEE region: in Turkey, Russia, Ukraine and Kazakhstan (and in Slovakia, the only 'core' CESEE country). In 2011, investment growth continued 'on the fringes', while also resuming in many new EU member states as well as in the Balkans. However, investment continued to contract in the Czech Republic, Bulgaria, Hungary, Slovenia, Croatia and Montenegro. On the other hand, gross fixed investment in the three Baltic countries increased at a rapid rate in 2011. Variations in recent investment performance cannot be explained in simple terms. For example, in the Czech Republic, Slovakia and Poland corporate debt is very low in relation to GDP and cannot possibly obstruct intentions to invest. In the same vein, corporate sector debt is very high in Estonia and Latvia, yet investment seems to be enjoying an explosive boom there. Of course, the corporate sector's balance-sheet problems may still be of some significance in countries with very high levels of corporate sector debt (Bulgaria, Hungary, Slovenia or Croatia). Similarly, the banks' balance-sheet problems may have some bearing on the availability of investment loans – and hence on investment performance. One never really knows how sound an individual bank is, yet it seems that the banking system in a number of countries (Poland, Slovakia and the Czech Republic) is in fairly good shape. Judging by the weight of non-performing loans, the banking systems of Kazakhstan, Serbia, Albania, Hungary, Latvia, Lithuania, and Romania are most fragile. Yet, this does not seem to interfere with investment growth in these countries. Conversely, robust banking in Poland, Slovakia and the Czech

Republic co-exists with stagnant or falling investment (despite moderate commercial interest rates on loans to business). Certainly, a rise in the share of non-performing loans may be of real importance, for example, in Hungary, Bulgaria, Croatia, Romania and Slovenia.

Investment growth in 2012 is expected to remain generally quite sluggish throughout the 'core' countries (while declining in some of them). Only in the period 2013-2014 is investment growth expected to recover across the new EU member states and in the Balkans. Investment growth is forecast to remain steady throughout 2012-2014 in Kazakhstan, Russia and Ukraine.

In 2010 household consumption stagnated or contracted across the geographical core of the CESEE region. On the region's fringes (Turkey, Kazakhstan, Ukraine and Russia) rapid consumption growth had already resumed in 2010. In 2011, household consumption continued to increase rapidly in the 'fringe' countries. In 2012, consumption growth will dip further in most new EU member states and across the Balkans. Even in the Baltic countries, consumption growth is expected to slow down. Consumer indicators everywhere point to overwhelmingly negative public expectations as to the future. The reason for consumption performance being much better in the 'fringe' countries than in their 'core' counterparts cannot simply be ascribed to differences in terms of their access to loans or tendencies to deleverage. Household sectors in Estonia and Latvia are highly indebted – but private consumption booms in these two countries. On the other hand, household debt in the Czech Republic and Romania is pretty low, but household consumption remains anaemic there. Furthermore, the link between the fragility of the banking systems and the expansion of consumption appears rather weak.

Differences in fiscal policies most likely to be pursued in 2012 may be of some importance, when seeking to explain differentials in the expected performance of household consumption across the CESEE. A policy of fiscal consolidation has been introduced in a number of countries. That policy not only stipulates cuts in public consumption and public investment (which indirectly affect employment, household incomes and consumption), but it also calls for cuts in social transfers and tax increases. The latter measures directly affect real disposable incomes – and thus effective consumer demand as well. Reliable quantitative estimates of the direct and indirect impact of fiscal consolidation on the dynamics of household consumption are, of course, hard to come by. Nonetheless, the fact that the new EU-member states feel obliged to introduce consolidation on this scale, whereas the 'fringe' countries can do as they please, may have a bearing on the differences in the dynamics of the household consumption in 2012 and beyond.

Fiscal consolidation for the sake of...fiscal consolidation

Only Russia and Kazakhstan – the two countries whose publicly owned financial reserves exceed their gross public debts – need not worry about the burden of public debt, at least not as long as demand (and prices) for oil and gas remains strong. However, countries with particularly high public debt levels (especially if denominated in foreign currencies) may have to consolidate, if only to reduce the burden of the high debt servicing costs. On that principle, fiscal consolidation is understandable in Hungary, the only CESEE country with a genuinely high level of public debt. Fiscal consolidation in Latvia and Lithuania may seem advisable too – despite the still relatively low public debt levels there.

The public debt situation of other countries is far better, even though the prospects may look a bit less favourable in Albania, Croatia and Slovenia. In those latter countries, fiscal policy consolidation may seem advisable, if not necessarily at this very moment in time. It seems particularly unfortunate that a few countries with really low levels of public debt (Bulgaria, the Czech Republic, Romania and Macedonia) have been attempting to introduce fiscal consolidation – precisely at a time when weaknesses in investment, household consumption and external demand have been revealed.

Threats and opportunities

For the CESEE countries, we expect 2012 to be a rather disappointing year in terms of GDP growth. In most of the countries, GDP growth will be pretty slow – at least when judged by their own past standards and the ambitions they harboured only a few years ago. Some of the CESEE countries will suffer a mild recession or come close to it. Although external imbalances will develop anew in some countries, those imbalances are not expected to culminate all that soon in a repetition of precipitate and disorderly rebalancing crises. Perhaps the imbalances, if allowed to widen, may come to a sticky end later – possibly beyond the horizon of our present forecast.

At present, the major and most realistic danger facing the majority of CESEE countries is that they will stick to their commitment to fiscal consolidation, even if investment, consumption and exports continue to weaken. For that threat to materialise, neither the euro area nor the EU as whole need necessarily plunge into some dramatic crisis or other. For that danger to become reality, it is sufficient for Europe to continue slowing down and for fiscal consolidation to still be demanded of its old, new or prospective members. Of course, some spectacular collapse of the euro area/EU (as we know it) could perhaps have truly devastating effects on most CESEE countries – via trade, capital flows, transfers and migration. Chaotic developments would then follow in its wake - with repercussions for the global economy at large. However, we may be unqualified to predict events, should chaos erupt.

A scenario more optimistic than that possible under the current practice of ‘muddling through’ may still be beyond the horizon. Even though muddling through is unlikely to yield satisfactory results no matter how long it lasts, desirable changes may eventually come about. Of course, such changes would have to begin in ‘high places’ in the leading EU countries and leading European institutions. Should the political and economic elites of Europe start acknowledging the futility of fiscal austerity economics, recognize the destructive character of structural policies that boil down to promoting still more laissez-faire and, last but not least, become aware of the need for an overhaul of EU institutions (including the ECB), things might start looking more promising for Europe as a whole – and hence for the CESEE countries as well. Whether the conclusions of the EU summit of June 2012 represent a step into the right direction remains to be seen.

Country summaries

Bulgaria’s economy kept losing steam in the first quarter of 2012 against the backdrop of weakening exports and weak domestic demand. The fiscal stance remains under the reigns of an austerity

strive in the absence of policy creativity. There is little chance of reversing this situation in the short run so current expectations are that the economy is likely to stagnate in 2012.

The **Czech** economy is entering a recession whose depth and duration will partly depend on the euro area developments. The recession may be moderated by the Czech currency's relative weakness. While the financial conditions and the monetary policy are essentially conducive to growth, the untimely – and actually unnecessary – fiscal consolidation implemented is the primary determinant of the overall poor performance of the real economy. The prospects for 2013 and 2014 may look better because by that time the fiscal consolidation will be either successfully completed – or discontinued.

Dwindling external demand remarkably reduces the **Estonian** growth expectations for 2012. However, the strong increase in employment of 2011 brings about real wage growth and hitherto domestic demand to back the business cycle. Thus, the current account turns into deficit again. An upswing of GDP growth in 2013 to 2014 is likely but depends strongly upon a revival in the Scandinavian region.

Given the decline in both consumption and investments and in view of the budget consolidation measures already introduced or still in the pipeline, recession looms large in **Hungary**. Positive contribution of net exports has not been enough to sustain economic growth. The question as to when (if at all) the government will conclude an agreement on the financial assistance package with the IMF and the EU that the economy so badly needs is still open, as is the question whether the government will be prepared to adjust its (economic and other) policies to comply with the international community's expectations.

Latvia is heading towards Eurozone accession and shall fulfil the Maastricht inflation and deficit criteria this year. However, the unemployment rate still amounts to more than 15% and the competitiveness of the industrial sector will remain a sore point of the Latvian economy. With sluggish export developments domestic demand is the trigger of GDP growth this year and 2013.

Last years' revival after the economic disaster of 2007 to 2010 allows **Lithuanian** households to gradually recuperate their consumption levels, thereby acting as the main growth driver in 2012. The parliamentary elections in October shall bring about a change in the government from centre-right to centre-left. However, the orientation of economic policies – austerity and the target to join the Eurozone in about 2015 – will remain the same.

Fiscal consolidation is likely to slow down growth in **Poland** in the coming years. The economy still benefits from its size, versatility and relative closeness – as well as from its exchange rate and labour market flexibility. The good financial standing of the business and banking sector should support growth. However, the ambitious nature of the incipient fiscal consolidation programme and the return of restrictive monetary policy will act as brakes on growth.

In **Romania** the new, centre-left government concentrates power and dilutes fiscal austerity. Controversy between government and president increases political uncertainty. The economy may come out of technical recession based on household demand and exports in the second half of the year.

Despite the EU crisis, export-led growth continued in **Slovakia** in the first quarter of 2012. The economy will expand by more than 2% this year. Growth will again be substantiated by the net exports, bolstered by still low unit labour costs and supported by the expansion of production in the automotive sector. The new government presumably will modestly stimulate private consumption. However, downward risks still prevail as resolution of the European debt crisis remains the crucial factor.

Given the economic deterioration in **Slovenia's** most important EU trading partners and the need of fiscal consolidation Slovenia will remain in recession in 2012 and rebound only slowly thereafter. The corporate and household sectors will continue to deleverage and asset quality of the ailing banking sector has to be strengthened. Returning recession will exert upward pressure on the unemployment rate not only in 2012 but probably in 2013 as well. Consequently household consumption growth will remain subdued.

Croatia is slipping again into recession in 2012 and should finally rebound in 2013 provided a strengthening of external demand and the picking up of investments. Households' disposable income being hit by high and persistent unemployment will keep domestic demand contracting. Reducing the budget deficit including structural reforms and servicing high foreign debt will remain the most challenging tasks for Croatian authorities. EU accession in 2013 may help to revive investments.

The short-term prospects point to some growth in **Macedonia** that should pick up speed over the next few years, unless the crisis in Greece deteriorates to such an extent that the Greeks will be forced to leave the eurozone. In the medium term, Macedonia should enjoy some measure of recovery, but the country's potential growth rate will hardly exceed 3% given the institutional and regional fundamentals.

In the short-term, prospect for growth in **Montenegro** is dim. Medium-term prospects are also not stellar. The start of negotiations with the EU should boost foreign investments: a helpful development. However, given the need to reduce still further the current account deficit and consolidate public finances, rapid recovery cannot be expected. The government stands ready to ward off political and social disaffection, but at some point a credible opposition will have to come to the fore in order to provide the much-needed impetus to democratic stability.

Three phenomena are topical features of the **Turkish** economy: relatively low real GDP growth after a spectacular growth bonanza in 2010-11; relatively high, albeit decelerating, inflation; and a somewhat diminished, though still high current account deficit. This deficit, which is of a structural nature, raises concerns about the long-term sustainability of high growth. This notwithstanding, growth may re-accelerate in 2013 and 2014, if external circumstances allow for this. In recent years, Turkey's exporters have been successful in selling to non-EU countries, and this is likely to continue during the next few years. Slow growth or stagnation in the EU has an impact on Turkey, but not necessarily an overwhelming one.

End-of-year balance of payments data for 2011 suggest that remittances from **Albanian** migrants (mostly located in crisis-shattered Greece and Italy) did not drop as much as expected; on the con-

trary, they increased slightly. The inflow of remittances thus accounted for about 8% of GDP, almost as much as the inflow of FDI. Given the positive developments in potentially weak areas of the Albanian economy, we have revised upwards our previous GDP growth rate estimate for 2011 by one percentage point to 2.9% and our GDP growth rate forecast for 2012 by 10 basis points to 2.3%.

Due to its specific export specialisation, the economy of **Bosnia and Herzegovina** is hit hard by the adverse international business climate. The current account gap has widened, and a widening gap between government revenues and expenditures is causing headache. It would be difficult to justify expectations of a quick recovery.

In **Serbia** recovery is unlikely this year and the prospects for the next two years will hinge on political stability and the economic policy pursued by the new government. The chances are that stagnation or slow growth is in the cards in the medium term.

The **Kazakh** economy will not have the capacity to reach the 7% real growth target officially set for 2012. That notwithstanding, growth will still be relatively strong: 6% year-on-year. In 2013-2014 the economy will continue to rely on the oil sector as a primary source of growth. Developments in the banking sector continue to suffer from the consequences of the 2008 crisis, as the share of non-performing loans in Kazakhstan remains high.

After a robust first quarter, **Russian** GDP growth has begun to slow down. wiiw forecasts unspectacular growth during 2012-2014, assuming no abrupt policy changes or severe external shocks. Export revenues will grow rather slowly due to stagnating volumes of exported oil and gas; imports are expected to grow at a faster rate as household consumption and investment will gradually pick up, both fuelled by the ongoing real currency appreciation. In the medium and long run, reforms and investment (including FDI) may be stimulated by WTO membership, while the attempted large scale modernisation will bring few of the desired benefits any time soon.

In **Ukraine**, a less buoyant domestic demand will likely result in a slowdown of economic growth to around 3% in 2012, with risks on the downside. Both fiscal and monetary policies have been relaxed recently, but may not generate sufficient demand in the environment of elevated uncertainties. While currency depreciation pressures have been so far largely counteracted, the high dependence on external funding will continue to remain a source of risk for the financial stability. The country's increased political isolation implies that the association and "deep" free trade agreements with the EU will not be signed at least until the October 2012 parliamentary elections.

Keywords: Central and East European new EU member states, Southeast Europe, financial crisis, future EU member states, Balkans, former Soviet Union, Turkey, economic forecasts, employment, foreign trade, competitiveness, debt, deleveraging, exchange rates, fiscal consolidation

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

Table I

Overview 2010-2011 and outlook 2012-2014

	GDP real change in % against previous year					Consumer prices change in % against previous year					Unemployment, based on LFS rate in %, annual average					Current account in % of GDP				
	2010	2011	2012	2013	2014	2010	2011	2012	2013	2014	2010	2011	2012	2013	2014	2010	2011	2012	2013	2014
	Forecast					Forecast					Forecast					Forecast				
NMS-10																				
Bulgaria	0.4	1.7	0.5	1.5	2	3.0	3.4	3	3	3	10.2	11.2	12	11	9	-1.0	0.9	-1.3	-2.4	-3.4
Czech Republic	2.7	1.7	-0.3	1.5	2.4	1.2	2.2	3.2	2	2	7.3	6.7	7.1	7	6.5	-3.9	-2.9	-2.4	-2.4	-2.1
Estonia	2.2	7.6	2.1	3.7	4.4	2.7	5.1	3.8	3.8	4	16.9	12.5	11	9.5	9	3.6	3.2	-4.7	-3.8	-4.0
Hungary	1.3	1.7	-1	1.5	2.5	4.7	3.9	5.5	4	3.7	11.2	10.9	11.5	10.5	10	1.2	1.4	1.8	1.6	1.0
Latvia	-0.3	5.4	2.7	3.3	3.8	-1.2	4.2	2.4	2.8	3.5	18.7	15.4	15.5	14.5	14	3.0	-1.2	-2.4	-2.7	-2.9
Lithuania	1.4	5.9	3	3.6	4	1.2	4.1	3	3	3.5	17.8	15.4	13.8	12.5	11.5	1.5	-1.6	-4.6	-4.3	-4.0
Poland	3.9	4.3	2.3	2.4	2.6	2.7	3.9	3.8	2.5	2.5	9.6	9.7	10	9.5	9	-4.6	-4.3	-4.0	-4.4	-4.3
Romania	-1.6	2.5	1	2.5	3	6.1	5.8	3.5	4	4	7.3	7.4	7.5	7	7	-4.4	-4.4	-4.6	-4.5	-4.9
Slovakia	4.2	3.4	2.2	3	4	0.7	4.1	3.5	3	3	14.4	13.5	14	13	12.5	-3.5	0.1	1.0	0.4	0.0
Slovenia	1.4	-0.2	-1.5	0.5	1.5	2.1	2.1	2	2	2	7.3	8.2	8.8	9	8.5	-0.8	-1.1	-0.6	-0.8	-1.1
<i>NMS-10¹⁾</i>	2.2	3.2	1.2	2.2	2.7	3.0	3.9	3.7	2.9	2.9	9.9	9.7	9.9	9.4	8.8	-3.1	-2.6	-2.7	-2.9	-3.1
<i>EA-17²⁾</i>	1.9	1.5	-0.3	1.0	.	1.6	2.7	2.4	1.8	.	10.1	10.2	11.0	11.0	.	0.4	0.5	.	.	.
<i>EU-27²⁾</i>	2.0	1.5	0.0	1.3	.	2.1	3.1	2.6	1.9	.	9.7	9.7	10.3	10.3	.	-0.2	0.2	.	.	.
Candidate countries																				
Croatia	-1.4	0.0	-1.5	1	2	1.1	2.3	2.5	2.4	2	11.8	13.5	14.5	14.5	13.5	-1.1	-1.0	-0.7	-1.1	-1.2
Macedonia	2.9	3.1	1.9	3	3.3	1.6	3.9	3	3	3	32.0	31.4	31	31	31	-2.1	-2.7	-5.7	-4.8	-4.5
Montenegro	2.5	2.0	1	2	3	0.5	3.1	3	3	3	19.6	19.7	20	20	19	-24.6	-19.2	-20.6	-22.2	-21.1
Turkey	9.0	8.5	3.5	5.0	5.0	8.6	6.5	9.1	9.0	8.0	10.7	8.8	10.1	10.2	9.9	-6.4	-10.0	-8.9	-9.1	-8.9
Potential candidate countries																				
Albania	3.0	2.9	2.3	2.8	3.3	3.5	3.5	1.5	4	4	13.7	14	15	14	13	-11.5	-12.5	-12.5	-13.8	-14.7
Bosnia and Herzegovina	0.7	2.2	-0.5	1.5	2.0	2.1	3.7	2	2	2	27.2	27.6	28	28	28	-5.7	-8.6	-8.9	-8.6	-8.3
Serbia	1.0	1.6	-1	1	2	6.8	11.0	6	5	5	19.2	23.0	27	27	26	-7.4	-9.6	-10.1	-11.2	-11.2
Kazakhstan	7.3	7.5	6	5	5.5	7.1	8.5	5.5	6	6	5.8	5.4	5.2	5	5	1.6	7.6	7.6	6.0	4.7
Russia	4.3	4.3	3.8	4.0	4.2	6.9	8.5	6	5	5	7.5	6.6	6.6	6.7	6.7	4.8	5.3	3.9	3.0	2.2
Ukraine	4.1	5.2	3.2	4	5	9.4	8.0	2	6	5	8.1	7.9	7.9	7.7	7.5	-2.2	-5.5	-4.7	-4.9	-4.8

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

1) wiw estimate. - 2) Current account data include transactions within the region .

Source: wiw (June 2012), Eurostat. Forecasts by wiw and European Commission (Spring Report, April 2012) for EU and euro area.

Table II

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

	Bulgaria	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	NMS-10 ¹⁾	EU-27 ²⁾
GDP in EUR at exchange rates, EUR bn	38.48	154.91	15.97	100.51	20.05	30.71	370.01	136.48	69.06	35.64	971.8	12629.8
GDP in EUR at PPP, EUR bn	83.32	210.84	22.94	162.66	30.00	49.53	618.43	253.29	102.00	43.01	1576.0	12629.8
GDP in EUR at PPP, EU-27=100	0.7	1.7	0.2	1.3	0.2	0.4	4.9	2.0	0.8	0.3	12.5	100.0
GDP in EUR at PPP, per capita	11300	20100	17700	16300	14500	16200	16200	13300	18900	21000	15900	25100
GDP in EUR at PPP per capita, EU-27=100	45	80	71	65	58	65	65	53	75	84	63	100
GDP at constant prices, 1990=100	129.6	148.1	146.1	126.6	105.4	127.1	196.3 ³⁾	133.5	168.2	156.4	166.1	146.0
GDP at constant prices, 2000=100	151.7	141.9	152.0	123.5	151.3	162.1	153.0	153.0	164.7	130.3	148.3	118.0
Industrial production real, 2000=100 ⁴⁾	150.5	156.2	195.3	149.6	156.3	182.0	187.0	133.1	199.7	119.8	166.0	105.0
Population - thousands, average	7348	10495	1296	9960	2064	3054	38230	19043	5397	2050	98937	502859
Employed persons - LFS, thousands, average	2950	4904	609	3812	971	1371	16131	9138	2351	936	43172	217169
Unemployment rate - LFS, in %	11.2	6.7	12.5	10.9	15.4	15.4	9.7	7.4	13.5	8.2	9.9	9.7
General gov. revenues, EU-def., in % of GDP	33.1	40.3	39.2	52.9	35.6	32.0	38.5	32.5	32.6	44.5	38.8	44.6
General gov. expenditures, EU-def., in % of GDP	35.2	43.4	38.2	48.7	39.1	37.5	43.6	37.7	37.4	50.9	42.4	49.1
General gov. balance, EU-def., in % of GDP	-2.1	-3.1	1.0	4.2	-3.5	-5.5	-5.1	-5.2	-4.8	-6.4	-3.6	-4.5
Public debt, EU def., in % of GDP	16.3	41.2	6.0	80.6	42.6	38.5	56.3	33.3	43.3	47.6	48.7	82.5
Price level, EU-27=100 (PPP/exch. rate)	46	73	70	62	67	62	60	54	68	83	62	100
Compensation per employee, monthly, in EUR ⁵⁾	482	1312	1152	1025	819	822	913	715	1164	2053	945	2856
Compensation per employee, monthly, EU-27=100	16.9	45.9	40.3	35.9	28.7	28.8	32.0	25.0	40.8	71.9	33.1	100.0
Exports of goods in % of GDP	52.6	64.3	75.7	76.6	42.9	65.7	37.6	33.0	81.7	58.0	51.3 ⁶⁾	33.1 ⁶⁾
Imports of goods in % of GDP	57.7	61.8	76.9	72.6	52.8	70.6	40.4	38.5	78.1	61.8	52.8 ⁶⁾	33.7 ⁶⁾
Exports of services in % of GDP	14.1	10.7	24.6	15.5	15.8	12.2	7.2	5.4	6.9	13.5	9.5 ⁶⁾	10.2 ⁶⁾
Imports of services in % of GDP	8.1	9.0	16.8	12.3	9.3	8.6	6.0	5.1	7.4	9.5	7.6 ⁶⁾	8.5 ⁶⁾
Current account in % of GDP	0.9	-2.9	3.2	1.4	-1.2	-1.6	-4.3	-4.4	0.1	-1.1	-2.6 ⁶⁾	0.2 ⁶⁾
FDI stock per capita in EUR, 2011	5026	9215	9861	6558	4550	3363	3716	2858	7401	5710	4846	10261 ⁷⁾

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

1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) 1989=100, which in the Polish case is the appropriate reference year. - 4) EU-27 working day adjusted. - 5) Gross wages plus indirect labour costs, according to national account concept. - 6) Data for NMS-10 and EU-27 include transactions within the region. - 7) For EU-27 year 2010.

Source: wiiw, Eurostat, AMECO.

Table III

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

	Croatia	Macedonia	Montenegro	Turkey	Albania	Bosnia and Herzegovina	Serbia	Kazakhstan	Russia	Ukraine	NMS-10 ¹⁾	EU-27 ²⁾
GDP in EUR at exchange rates, EUR bn	44.92	7.53	3.30	553.90	9.19	13.34	30.85	133.75	1335.59	118.70	971.8	12629.8
GDP in EUR at PPP, EUR bn	65.21	19.61	6.54	959.45	22.03	26.17	63.34	165.84	1912.73	264.82	1576.0	12629.8
GDP in EUR at PPP, EU-27=100	0.5	0.2	0.05	7.6	0.2	0.2	0.5	1.3	15.1	2.1	12.5	100.0
GDP in EUR at PPP, per capita	14800	9500	10500	13000	6800	6800	8700	10000	13500	5800	15900	25100
GDP in EUR at PPP per capita, EU-27=100	59	38	42	52	27	27	35	40	54	23	63	100
GDP at constant prices, 1990=100	109.9	121.2	.	230.5	201.5	.	.	165.3	112.1	69.2	166.1	146.0
GDP at constant prices, 2000=100	128.4	133.0	145.5	158.7	174.7	146.2	145.7	238.1	166.7	160.1	148.3	118.0
Industrial production real, 2000=100	121.2	103.8 ³⁾	80.9	159.8	258.0	204.0	106.8	213.3	155.4	166.3	166.0	105.0
Population - thousands, average	4402	2060	620	73950	3220	3840	7280	16558	142500	45706	98937	502859
Employed persons - LFS, thousands, average	1493	645	196	24099	1200	816	2253	8303	70732	20324	43172	217169
Unemployment rate - LFS, in %	13.5	31.4	19.7	8.8	14.0	27.6	23.0	5.4	6.6	7.9	9.9	9.7
General gov. revenues, nat. def., in % of GDP	34.7 ⁴⁾	29.6	33.9	46.4 ⁴⁾	25	44.0	41.9	19.7	38.4	30.3	38.8 ⁴⁾	44.6 ⁴⁾
General gov. expenditures, nat. def., in % of GDP	39.7 ⁴⁾	32.1	38.0	47.8 ⁴⁾	30	46.5	47.0	21.8	36.8	32.1	42.4 ⁴⁾	49.1 ⁴⁾
General gov. balance, nat. def., in % of GDP	-5.0 ⁴⁾	-2.5	-4.2	-1.4 ⁴⁾	-5	-2.5	-5.1	-2.1	1.6	-1.8	-3.6 ⁴⁾	-4.5 ⁴⁾
Public debt, nat. def., in % of GDP	46.0 ⁴⁾	35.0	44.0	37.9 ⁴⁾	60	39.0	45.0	16	9.2	35.9	48.7 ⁴⁾	82.5 ⁴⁾
Price level, EU-27=100 (PPP/exch. rate)	69	38	50	58	42	51	49	81	70	45	62	100
Average gross monthly wages, EUR at exchange rate	1049	497	722	568 ⁵⁾	292	649	512	440	576	237	945 ⁵⁾	2856 ⁵⁾
Average gross monthly wages, EU-27=100	36.7	17.4	25.3	19.9 ⁵⁾	10.2	22.7	17.9	15.4	20.2	8.3	33.1 ⁵⁾	100 ⁵⁾
Exports of goods in % of GDP	21.8	42.2	14.4	18.6	15.3	32.6	27.4	47.5	28.1	42.0	51.3 ⁶⁾	33.1 ⁶⁾
Imports of goods in % of GDP	35.9	64.5	54.0	30.2	39.7	59.8	45.2	22.1	17.4	50.4	52.8 ⁶⁾	33.7 ⁶⁾
Exports of services in % of GDP	20.1	10.6	25.7	5.1	19.0	6.9	9.8	2.4	2.9	11.8	9.5 ⁶⁾	10.2 ⁶⁾
Imports of services in % of GDP	5.8	9.3	9.6	2.7	17.5	2.8	9.3	5.9	4.8	8.8	7.6 ⁶⁾	8.5 ⁶⁾
Current account in % of GDP	-1.0	-2.7	-19.2	-10.0	-12.5	-8.6	-9.6	7.6	5.3	-5.5	-2.6 ⁶⁾	0.2 ⁶⁾
FDI stock per capita in EUR, 2011	5422	1699	7241	1482	933	1302	2435	4344	2807	1097	4846	10261 ⁷⁾

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

1) wiiw estimates. - 2) wiiw estimates and Eurostat. - 3) 2005=100. - 4) EU definition: expenditures and revenues according to ESA'95, excessive deficit procedure. - 5) Gross wages plus indirect labour costs, according to national account concept. - 6) Data for NMS-10 and EU-27 include transactions within the region. - 7) For EU-27 year 2010.

Source: wiiw, Eurostat, AMECO.

*Leon Podkaminer**

Fasting or feasting? Europe – old and new – at the crossroads

External environment: stable energy prices and the critical importance of extraordinary developments in the euro area

The current and future economic developments in Central, East and Southeast Europe are co-determined, to a varying degree, by the trends prevailing in the region's external environment. For Russia, Kazakhstan (assuming the country is considered part of an extended Eastern Europe) and (to a lesser extent) Ukraine, internal developments will heavily depend on short-to-medium-term trends relating to world-market prices of energy carriers, steel and other basic commodities. More recently, global commodity prices have shown signs of weakness. Looking ahead, the markets seem to expect that weakness to continue over the medium term.¹ The reasons for this development are not quite clear. Rumours abound about a current growth slowdown in China that may reduce the global demand for raw materials, while the increased volume and stability of global supplies may have played a role as well – for instance, through a reduced propensity to engage in speculative activities of the kind that provoked commodity price bubbles in earlier times. Of course, predicting the prices of commodities traded globally remains a truly risky business. None the less, some conclusions can be drawn as to the role of the external environment in shaping economic developments in Russia, Kazakhstan and Ukraine. First and foremost, current developments in those countries remain pretty much dependent on the whims of the global market place: economic forecasts for those countries continue to be rather uncertain. However, it may be recalled that even a deep – yet relatively short-lived – decline in commodity markets would result in growth slowdown yet not necessarily spell ruin for Russia and Kazakhstan, as both countries have sizeable foreign reserves (also in the form of sovereign wealth funds). Of course, things might be different for Ukraine, whose reserves are low in comparison. However, Ukraine could compensate lower prices for its steel exports with lower energy import bill. Finally, it may be assumed that the expected decline in the price of oil would still leave it at a fairly comfortable level as compared to levels observed in 2009-2010. Thus, on balance, the external environment should not give rise to strong impulses affecting the economic performance of Russia, Kazakhstan and Ukraine in either direction.

As for the countries in Central and Southeast Europe, were yet another hike in the prices of energy carriers not to materialise, it would, on the whole, be good news as the countries in question all are net energy-importers. However, the advantages to be gained from stable or even falling prices of energy imports must not be overrated because energy imports account for a relatively small share of those countries' total import bills. For most of them, the strength of external demand for their manu-

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¹ Oil (Brent) futures contracts for December 2013 are trading at below 95 USD/barrel – compared to close to 120 USD/barrel in the spot transactions at the beginning of May 2012.

facturing exports and their competitiveness tends to be much more important as far as overall economic developments are concerned. Moreover, to some extent their external financial relations (for example, those governing cross-border capital flows of various sorts) play a role. The European Union – and more precisely its euro-area core – constitutes a natural external environment, in which most countries in Central and Southeast Europe have to operate. Of course, the significance of trends evolving in the euro area varies across those countries. That significance may be relatively low for Turkey (whose economic and political attention seems to be gradually shifting from the EU to the Middle East and Central Asia) as well as for some Balkan countries (whose ties to the EU remain tenuous). The EU, however, is of crucial importance to the new EU member states – particularly for those that have already joined the euro area. Apart from the somewhat mechanical ties binding the countries of Central and Southeast Europe with the euro area (through trade, capital and labour flows, and – in the case of Slovenia, Slovakia and Estonia – via a common currency), certain ‘immaterial links’ also obtain in the guise of formal regulations/directives enacted ‘in Brussels’. Those regulations have some bearing on the economic decision-making processes in individual countries. The general thrust of economic policy evolving at the helm of the EU (which is even less tangible than the formal directives emanating ‘from Brussels’) can be of equally profound significance to the economic fates of the countries of Central and Southeast Europe. For this reason, we have to reflect, at least briefly, on those events of genuine importance happening in/to the euro area.

Not only is the euro area (and the EU itself) in recession, but it is also embroiled in a multi-faceted crisis: both economic and political (and soon probably social as well). At the present juncture, the *economic* crisis in the euro area is perceived as being primarily about possible insolvencies of a few peripheral euro area countries – and then about the possible fallout of such insolvencies, should they eventually come to pass. Of course, the range of possibilities opened up by the insolvency of Greece (for example) is vast. Hypothetically, in such an event much could happen – ranging from the complete disintegration of the EU and the reintroduction of national currencies to muddling through in some way – or ultimately to the formation of a more integrated, federalised Europe. However, it does not seem productive for us to dwell on Europe’s prospects, should developments take an extreme turn. First, it is an illusion to assume that regular research would be capable of envisioning the course of events, once unprecedented forces throw things far off the beaten track.² Secondly, a muddling-through scenario still seems to be the most realistic prospect – at least, for the time being. Our brief characterisation of the euro-area developments assumes a muddling through of some sort. Of course, even under that scenario, fascinating developments can unfold. The eventual outcome of muddling through, which can go on for some time, is of course uncertain. The chances are, however, that all muddling through will ultimately end well, with the euro area/EU reaching solid shores.

² The ‘debacle’ of the elaborate pre-1989 academic Sovietology, which was taken aback by the collapse of the Soviet Empire, is just one example of the difficulty inherent in predicting truly extreme socio-economic changes. Zygmunt Bauman, a prominent Polish-British sociologist recently remarked ‘I have witnessed many extraordinary social, economic and political transformations during my life. Nothing of consequence had ever been anticipated before it happened’. (Prof. Bauman was born in 1925).

The euro area public debt problem: serious but...

The prospect of approaching illiquidity or even potential insolvency of several highly indebted euro area member states has had a number of highly negative consequences. The costs at which some endangered euro area sovereigns could borrow funds from the private financial market institutions have risen sharply, with the spectre of sovereign insolvencies looming ever larger. Alternatively, some sovereigns may be completely cut off from private funding altogether. (The partial write-off of the Greek public debt entailed 'private sector participation', whereby *nolens volens* private holders of Greek debt had to swallow considerable losses. Given that lesson, prospective private buyers of the public debt of 'problematic' European sovereigns must be vigilant or demand appropriately high coupons). Secondly, given the impact of the high interest rates demanded by the financial markets, snowballing public debts have a potential to destabilise anew the very financial sector they are trying to bolster (as well as the banks still holding large portions of problematic public debt). Thirdly, policy has responded to the perceived dangers of runaway public debt. Some of the policy responses are generally considered helpful as they offer a temporary easing of tension. Two extraordinarily large tranches of long-term cheap loans extended by the European Central Bank (ECB) to the euro-area banks can be deemed to be two such 'soothing' operations. Although the money lent out does not really support commercial lending to the non-financial sector (and appears to be rather reluctant to support commercial banks acquiring public debt), it provides the banks with a protective liquidity buffer, thus containing chaotic urges to deleverage.³ Other steps taken by the ECB, such as lowering policy interest rates and mandatory reserve ratios or relaxing standards for collaterals accepted in ECB lending transactions, could also have strengthened the stability of the banking sector. However, the effectiveness of those non-standard or unorthodox monetary policy moves has been undermined somewhat by the tendency to impose on the European banks still more restrictive capital and safety requirements (Basel III). Last, but not least, much talk (and less action) has been devoted to the creation of 'firewalls': financial stability funds (of which the European Stability Mechanism (ESM) is the most recent incarnation). The effectiveness of successive 'firewalls' in containing the crisis has proven limited, to put things mildly. For instance, setting up the European Financial Stability Facility (EFSF) in May 2010 was swiftly followed by yields on government bonds issued by the 'endangered' euro area countries shooting up by several hundred basis points. The market has persistently responded in a similar manner to various other steps taken with the intention of bettering the situation. Worse still, there are some grounds for arguing that the very introduction of the ESM itself may in fact have been a destabilizing factor.⁴ More radical moves aimed at containing the sovereign debt crises in the euro area, such as the idea of common euro area debt bonds, have yet to take off. Other, still more unorthodox, moves such as explicitly authorising the ECB to engage in open monetisation of the debts accruing to the euro-area sovereigns are not even being officially mooted (although they are being considered by some far-sighted academics.⁵)

³ See the June 2012 issue of the *Monthly Bulletin of the ECB*, pp. 27-32 and 40-43.

⁴ See P. De Grauwe (2011): 'The Governance of a Fragile Eurozone', *CEPS Working Document No. 346 (May)*. De Grauwe even called the ESM 'a mechanism of self-destruction of the Eurozone'.

⁵ For example W.B. Buiter and E. Rahbari (2012): 'The ECB as Lender of Last Resort for Sovereigns in The Euro Area', *CEPR Discussion Paper No. 8974*.

... not really hopeless?

The combined gross public debts of the euro-area countries are forecast to reach 92% of the euro-area aggregate output in 2012 (EU Commission 2012 Spring Forecast). The same debt ratio will surpass 100% in the USA and the United Kingdom (and 220% in Japan). But none of those three countries really seems to suffer on account of its public debt. This is understandable because the interest rates on public debt in those countries are low (less than 1% in the case of Japan). Essentially, those countries' public debts are sustainable, even if their nominal GDP grow quite slowly. At low interest rates, those debts can be serviced indefinitely without an increase in the tax-to-GDP ratios. That the public debt level is not seen as a serious problem in those three countries is attested by the fact that all of them still run pretty high budgetary deficits – thereby raising still further their respective public debt levels (also in relation to their GDP).

The basic reason for public debt in Japan or the USA not being a serious problem, unlike the grave problem it poses for the euro area, is quite obvious. The fiscal authorities in the first two countries issue public debt, which, in the final instance, is always backed by their respective national central banks. The national banks can issue any reasonable amount of national currency needed to service the public debt (as long as it is denominated in the domestic currency). Conversely, gains or losses that can be made by the national banks of the truly sovereign countries are always absorbed in the books of their fiscal authorities. As long as the sovereign fiscal and monetary authorities cooperate, the effective interest rates on public debt can be modified pretty much irrespective of the moods prevailing on the private financial markets.

Of course, the euro area does not have one single fiscal authority that could cooperate with one single monetary authority, viz. the ECB. Were such cooperation permitted, it would boil down to the absorption of some member states' public debt in the ECB books. Under such circumstances, that cooperation would then create a potential (and possibly actual) liability or fiscal cost to be borne by *other* euro-area member states. Were it to take that route, the euro area would also become, through the back door so to speak, a *de facto* fiscal union. Moreover, such an arrangement could mean that cross-country fiscal transfers would be beyond the control of the 'donor' countries. The prospect of a 'fiscal union', however, is still unacceptable to certain EU member states – first and foremost Germany. Hence, the EU Treaties expressly prohibit any direct 'cooperation' between the ECB and the fiscal authorities of any euro-area member state. Admittedly, some of the ECB actions taken since 2008, usually presented as innocent (though 'unorthodox') monetary policy adjustments, smack of masked violation of the statutory prohibitions imposed on the ECB. Senior German officials serving at ECB headquarters have dutifully lodged protests against such violations that have also been denounced at the German Bundesbank.

While – as described above - various ECB actions have proven useful in temporarily attenuating the crisis to date, the scale of action has been deemed insufficient to make any lasting difference. It seems quite clear that as long as the letter of the law incorporated in the Union Treaties is respected, the ECB is not in a position to enter into the euro-area debt crisis with all the potentially effective means at its disposal. At the same time, since the idea of the 'well-off' euro-area sovereigns voluntar-

ily assuming the debt of their 'worse-off' counterparts would appear to be an unrealistic proposition, the euro-area debt crisis seems to have devolved into hopelessness. What makes matters even worse is the insistence that the 'problematic' euro area countries – but possibly also others in the EU (including the new member states) – should enact the austerity measures in order to reduce public debt levels. The recently designed Fiscal Compact (and the so-called 'six pack' proposed previously) epitomises this new 'spirit of austerity'. Briefly, the Fiscal Compact, signed in March 2012 by all EU Heads of State (except for the United Kingdom and the Czech Republic), envisages the mandatory introduction of a balanced budget rule and an automatically triggered correction mechanism at the national level, as well as a strengthening of the automaticity of the excessive deficit procedure within the Stability and Growth Pact. The Compact enshrines a numerical benchmark for debt reduction for those member states whose public debt exceeds 60% of their GDP.

The economic precepts propping up the Fiscal Compact (in general, the notion that adequately ruthless fiscal austerity would ultimately help solve the public debt problem) are fast falling out of favour with many leading economists. The original Keynesian concepts are enjoying a comeback – among them the idea that in times of recession, increased public deficits (and rising public debts) may well be preferable to fiscal austerity. For the adherents of the Keynesian school, fiscal consolidation in the midst of a recession (especially if subsequent to a financial crash) constitutes a grave policy error. It is argued that consolidation of that kind would not only deepen the recession, but also heighten the severity of the debt crisis.⁶ Were the Fiscal Compact to be actually obeyed, the euro area – and the EU as a whole, including the new member states – would plunge into an era of secular stagnation with high and rising unemployment. That is the very stagnation that could ultimately conjure up the prospects of Europe disintegrating in economic, political and social terms.

The political and economic elites of Europe have yet to acknowledge the futility of 'fiscal austerity economics' and its policy prescriptions. They should recognise the counterproductive character of certain 'structural' policies that are usually claimed to be supportive of successful fiscal austerity. (The policies in question boil down to promoting still more market liberalisation reforms, downsizing welfare-state institutions and, in particular, pressing for further labour market flexibility).

The outcome of the French presidential election (May 2012) may well signal the beginning of a process of genuine reassessment of the guiding paradigms of EU economic policy. It goes without saying that meaningful changes to those paradigms will be strongly opposed. The very core of the paradigm prevailing at present – a firm belief in the need for public finances to be more or less balanced over the longer term – will not be lightly cast aside. On the contrary, attempts will be made to suggest that fiscal austerity could somehow be usefully combined with certain 'growth promotion

⁶ For quite a long time, mainstream economics has claimed that fiscal austerity is 'good for growth'. That is the essence of the doctrine of 'expansionary fiscal contractions' still fully upheld at the European Commission and the ECB. Econometrics supporting the doctrine is quite shaky (and its underlying neo-liberal ideology is quite obvious). Recent rigorous empirical studies show that the opposite is true. The so-called Keynesian multipliers (which the mainstream claims to be about zero, if not negative) turn out to be far greater than unity (at least for the USA). See e.g. C.D. Romer and D.H. Romer (2010), 'The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks', *American Economic Review Macroeconomics* (June). There is no reason to believe that the EU is any different in this respect.

policies'. Presenting austerity as part and parcel of the 'growth strategy' has long been an EU tradition. After all, the original Stability and Growth Pact, which called for balanced public finances and strict adherence to its terms, also suggested – by its very name – that it was all about growth. The failed Lisbon Strategy (in 2000 announced with all pomp and circumstance as a '*Strategy for Growth and Jobs*') is yet another example of inexpensive publicity acting as a substitute for real content. In our opinion, combining 'fiscal responsibility' with more rapid economic growth borders on the impossible. Attempts to generate growth while trying to enforce austerity are unlikely to succeed in the euro area (and at the EU level), although of course they may make perfect sense to some smaller nation-states both within the EU and without.

A special section in this report (*Should the European Union strive to achieve permanently balanced public finances?*) presents a more specific (yet still fairly uncomplicated) analysis of the reasons why austerity policy precludes growth in the euro area/EU. Of course, it would be presumptuous to assume that our analysis (as many other analyses argue in much the same vein) can have any real (and immediate) impact. However, it is perhaps proper to end this section on the likely evolution of the EU economic paradigms on a more optimistic note. In practical terms, the present EU paradigms hinge critically on the opinions of Germany's ruling elite. Those opinions could change, once it becomes obvious that the paradigms no longer serve German interests. A similar change in opinion occurred back in the period 2003-2005, when the German government (allied at the time with the French) forced through a relaxation of the original Stability and Growth Pact. In this respect, history may repeat itself: strict subordination to fiscal austerity rules in the highly indebted euro-area countries will not only suppress those countries' growth, but it will also eventually hit Germany at full tilt. German exporters will have to downsize their productive activities while German creditors (public and private alike) holding huge amounts of unserviceable (public and private) debt of the highly indebted euro-area economies will have to swallow huge losses. Under such circumstances, the impossible can prove both necessary and acceptable, as has been the case in the past.

The world economy recovers - but the euro area returns to recession

Any expectations of a continuing recovery in Europe, that officially held sway as late as autumn 2011, have since proven too optimistic. GDP growth rates, primarily for the euro-area countries, have had to be revised substantially downwards. The latest European economic forecast (Spring 2012) prepared by the European Commission has reduced its growth rate forecasts for 2012 announced the previous autumn for almost all EU member countries. According to the Commission, euro area output overall is now expected to fall in 2012, if not all that much as yet. The EU economy as a whole is expected to remain stagnant. The second – still relatively mild - dip in Europe's economic growth (coming after the major recession of 2008-2009) will not be matched by recessions elsewhere.⁷ The euro-area recession notwithstanding, GDP growth is forecast to strengthen consid-

⁷ The 'first dip' of 2008-2009 initially developed in a pretty direct response to the sudden (revealed) deterioration of the financial sector institutions' balance sheets, primarily in the banking sector of the 'old' EU member states. The generalised banking crisis was contained throughout 2009 – very much to the detriment of the public finances of the countries concerned. The recovery in 2010 and the first half of 2011 proceeded quite steadily (albeit, of course, rather slowly, as is normally the case after major financial/banking crises). For characterisations of the post-2007 developments in Europe see Gligorov, Holzner, Landesmann et al.: *wiiw Current Analyses and Forecast*, issue 9, March 2012.

erably in the USA (and even in Japan). The global economy as a whole (excluding the EU) is not expected to slow down in 2012, according to the Spring 2012 European Commission forecast. Moreover, the tendency has been to revise upwards the forecasts for the rest of the world. The global economy is not really suffering on account of impaired financial sectors or unsustainable public finances, even though financial and fiscal conditions globally are still far from normal – and in many places they are in no better shape than in the euro area. Unlike in 2008, this time round the unfavourable developments in Europe cannot be interpreted as being the consequences of contagion of an illness that hatched out elsewhere. The current European weakness is genuinely indigenous. Moreover, should this weakness be allowed to develop further, it incurs the risk of poisoning the economic climate worldwide.

It is generally accepted that blame for the present European growth ‘dip’ that started to unfold in the second half of 2011 should be placed fairly and squarely on public debt developments in a number of the euro-area countries. None the less, public debt developments (their levels, structures and dynamic) in peripheral areas of the euro area could not, per se, affect overall growth throughout the incomparably larger euro-area economy. The reasons for the second dip in growth must be viewed in the context of the concerted attempts at fiscal consolidation throughout the euro area – and beyond. Strangely enough, whereas the EU Spring 2012 forecast (p. 45) puts the discretionary fiscal measures (by which the public sector deficits are cut) at 1.4% of the EU output in 2012 (following 2.2% in 2011), it fails to identify the ongoing fiscal consolidation as the main cause of flagging real growth.

Consolidation fever has spread to the new member states – including those that do not belong to the euro area – and also to the UK and the Czech Republic, both of which refused, for various reasons, to subscribe formally to the Fiscal Compact. Given the trend towards fiscal consolidation, it is quite natural to expect that the new member states will also slow down in 2012. Chances of faster growth in 2013 remain uncertain – both in the new and old member states. As is to be expected, the EU Spring forecast for 2012 is (cautiously) optimistic. Of course, that official optimism is predicated on further successful fiscal consolidation – and particularly on the return of ‘increased consumer and investor confidence’ and the effects of ‘structural reforms’. Our forecasts for the new member states in 2013 are also cautiously optimistic. That optimism, however, is based on the assumption that the fiscal consolidation fever will abate perceptibly – both within the euro area and outside.

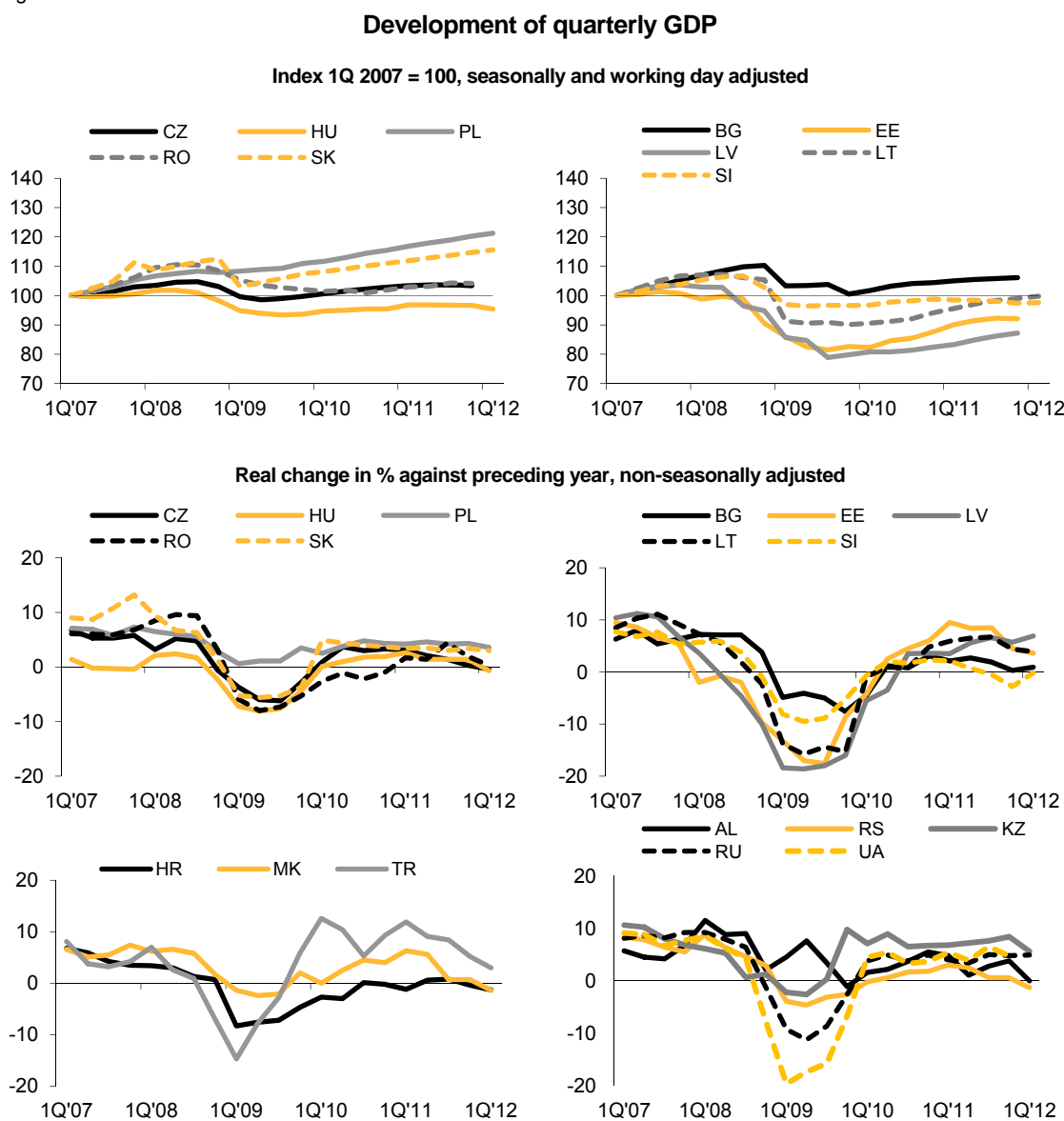
Here we go again! Growth slows down in Central, East and Southeast Europe

After the deep recession in 2009 that beset almost all countries in Central, East and Southeast Europe (CESEE), most of them recorded a moderate recovery in 2010. In general, that recovery became more pronounced in the course of 2011 (see Figure 1). With but a few exceptions (Slovakia, Albania), however, the recovery over the biennium (2010-2011) barely made up for the losses in output and employment suffered during the recession in 2009 (and before)⁸. Moreover, on a quar-

⁸ In most CESEE countries, the recession of 2009 represented a consequence of the financial and economic crisis which broke out in Western Europe in 2008. The West European crisis itself was triggered by developments in the USA. However, it may be recalled that full-scale crises erupted in the Baltic countries even earlier. In 2008 those countries were already in recession. Hungary also entered a period of stagnation prior to the outbreak of the 2008 crisis. Those earlier crises were largely domestic in character; they stemmed from faulty domestic policy (fiscal in the case of

terly basis, growth has been generally slowing down since the third quarter of 2011. The (still incomplete and otherwise provisional) data on GDP growth rates in the first quarter 2012 suggest that growth has continued to weaken. Moreover, in a number of countries the most recent quarterly GDP growth rates are already negative. The recent output contractions do not appear to be exceptions, but point to the possibility of more protracted periods of recession occurring in the CESEE region.

Figure 1



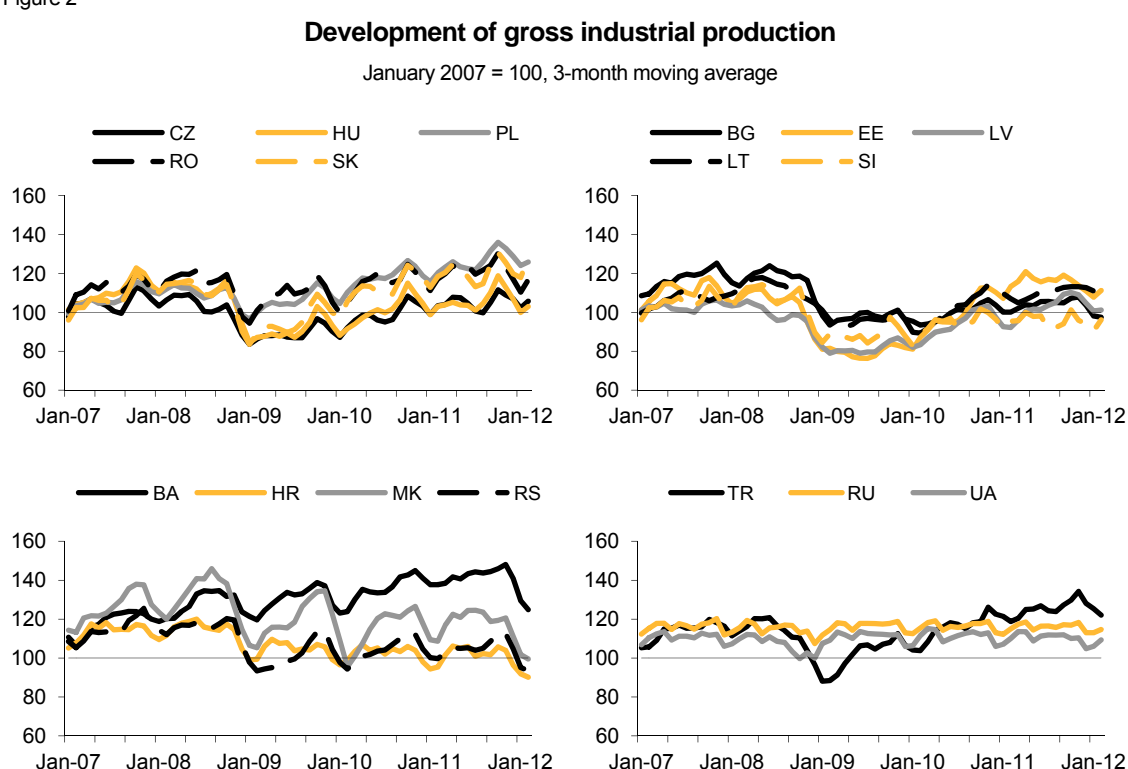
Source: Eurostat. and national statistics.

Hungary) or from inappropriate exchange rate regimes adopted much earlier and maintained for too long a period (in the case of the Baltic States). Of course, in 2009 the spillover from the global/West European crisis compounded the earlier domestic crises in the Baltic countries and Hungary.

Overall, growth in 2012 is expected to be negative once more in the Czech Republic, Hungary, Slovenia (all new EU-member states), Croatia (soon to become an EU-member state) and Bosnia and Herzegovina, as well as Serbia (see Table I). In Bulgaria, GDP is expected to stagnate in 2012 (but given that country's proximity to Greece, GDP could end up contracting as well). It is expected that growth in all remaining CESEE countries will still be positive; in quantitative terms, however, it will be much more subdued than in 2011. Among the star-performers of 2011 (Turkey, the three Baltic countries and Kazakhstan), growth will slow down. Poland, Slovakia, Ukraine and Russia, all of which displayed rapid and steady growth in the biennium 2010-2011, are gradually losing steam.

Developments in gross industrial production (see Figure 2) confirm expectations of an overall GDP growth slowdown across the CESEE region, with some countries suffering definite recessions. In actual fact, gross industrial production fell by around 5% (or more) in the first quarter 2012 in a number of countries, including Serbia, Croatia, Macedonia, Bosnia and Herzegovina and Montenegro. Although in most of those countries industry is not the backbone of the national economy, the scale of industrial contraction recently observed does reveal something about the overall economic climate (as well as something about the construction sector and its reliance on supplies of domestically produced building materials). Industrial production has also contracted in the more industrialised countries in the region, such as Hungary, Bulgaria, Estonia and Romania. In the remaining CESEE countries, industrial production growth has decelerated – in some cases, to the point of stagnation.

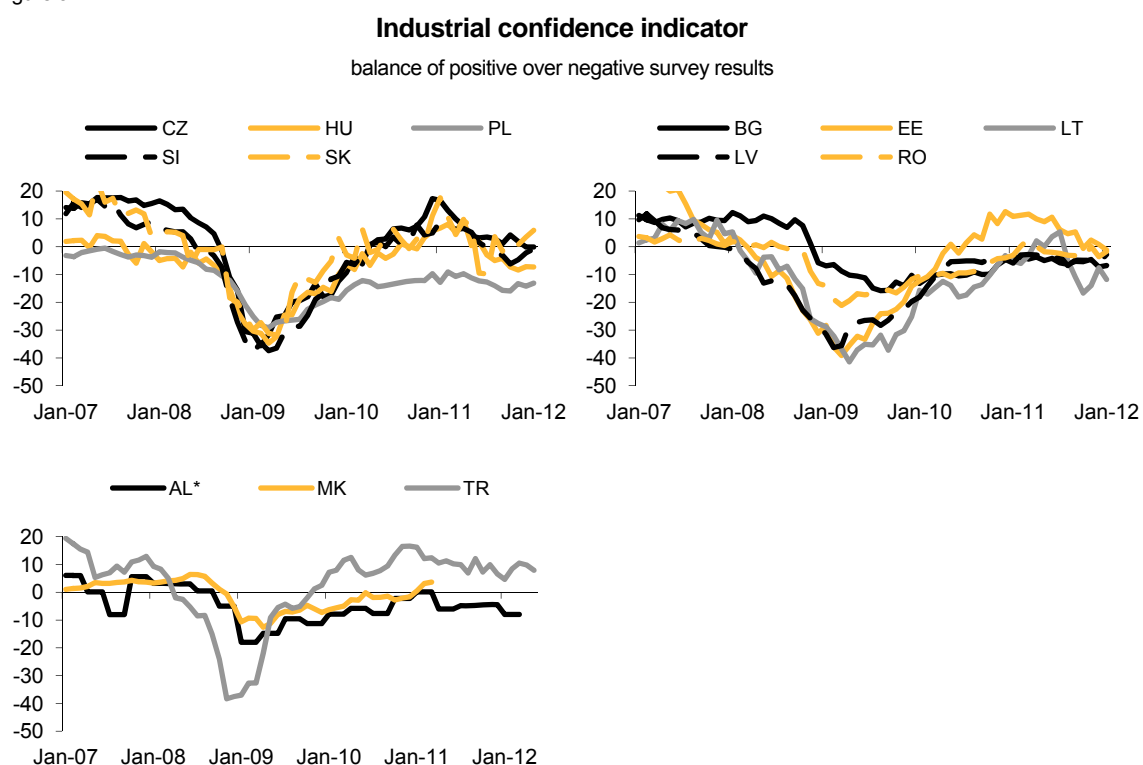
Figure 2



Source: wiw Monthly Database incorporating national and Eurostat statistics.

Recent information (where available) suggests that orders placed with industry will continue to weaken in the course of 2012. It is interesting to note that in many cases, the value of export orders placed with manufacturing industries has been less affected than the total value of orders. Domestic demand seems to be flagging more pronouncedly than external demand (which suggests that the major weakness emanates from the domestic, rather than external side of things). In any case, the present sorry overall state of industry is rather obvious. It is also reflected in the manner in which the industrial confidence indicators have developed over time (see Figure 3).

Figure 3



Remark: * AL: quarterly data.

Source: Eurostat, national statistics.

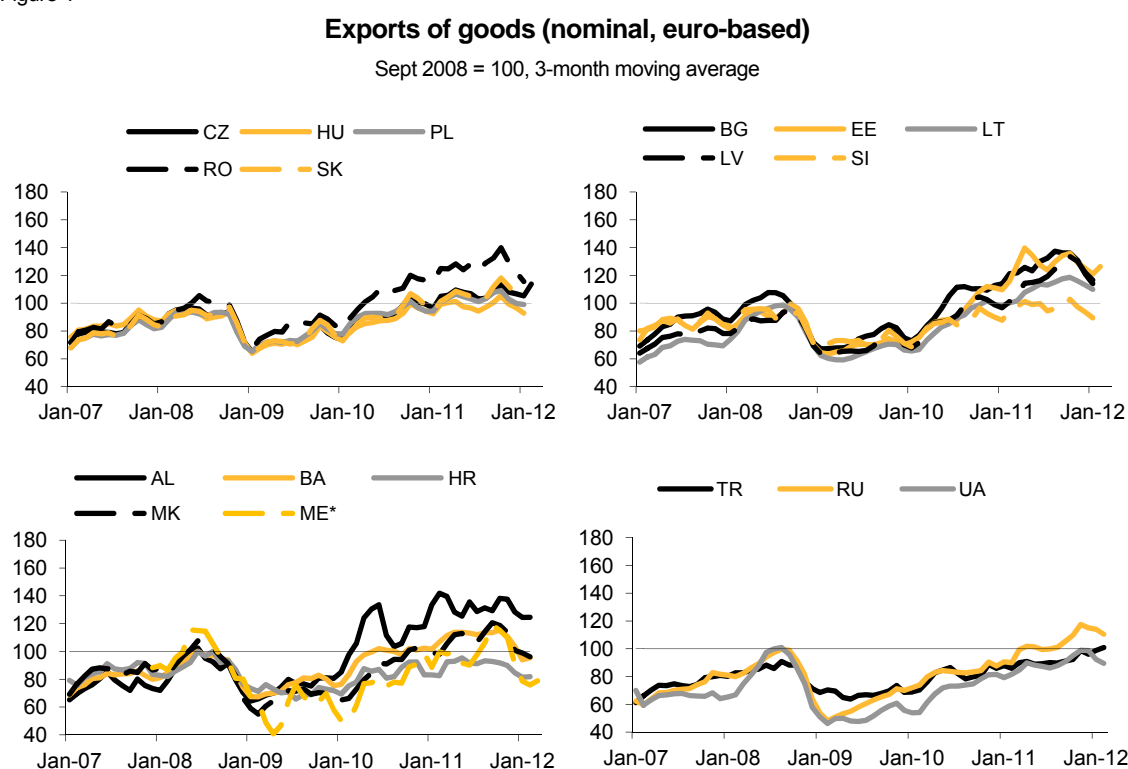
As can be seen, the confidence indicator tends downwards (or hovers within 'pessimism territory') in all countries (for which relevant statistics are available). The sole exception is Turkey where industrialists of an optimistic mind still outnumber (if not by a large margin) those of a pessimist bent.

To a large extent, industrial production developments correlate with those in exports. As can be seen (Figure 4) merchandise exports (in current euro terms), while following generally similar trajectories, vary quite significantly across groups of CESEE countries.

Generally speaking, merchandise exports from less industrialised CESEE countries (including the Western Balkans, shown in the left-hand side panel at the bottom of Fig. 4) are highly volatile (even

after being smoothed out by taking three-month moving averages). The recovery of exports after the major crash in 2009 has been delayed; the process is not yet complete in the Western Balkans. In terms of value, export recovery in Ukraine and Russia (the right-hand side panel at the bottom of Fig. 4) has also suffered a delay, but does not exhibit the volatility characteristic of the Western Balkan countries. The trajectories of export values in the new member states (the two top panels in Fig. 4) are broadly similar to each other. Common to the trajectories of all groups of countries is that they hint at the possibility of a further slowdown in export growth in terms of volume. It would seem that in the first quarter 2012 that very possibility has already materialised in certain countries (primarily in the Western Balkans, but in Romania and Bulgaria as well), where exports even declined in value terms. In the remaining countries, export values continued to increase in the first quarter 2012; however, the respective rates of growth are incomparably lower than a year ago. Clearly, the engine of export growth is beginning to stall throughout the region (Kazakhstan being the only exception). Weakening export growth certainly reflects the current stagnation of output in the euro area. However, the variations in the export performance of individual CESEE countries also reflect recent country-specific developments (such as the rate of domestic demand growth, the sectoral composition of growth and trends relating to real exchange rates and export prices, as well as the types of export specialisation).

Figure 4



Remark: * ME from 2008.

Source: wiiw Monthly Database incorporating national and Eurostat statistics.

For the year as a whole, the values of merchandise exports are generally expected to rise in 2012 compared to the previous year. This optimistic view reflects an assumption of a rather shallow and short-lived recession in the euro-area. In 2009, when output in the euro-area declined by more than 4%, the value of merchandise exports in the CESEE countries plummeted at double-digit rates. The value of Russian, Ukrainian and Kazakh exports fell most spectacularly - by more than 30% at the time (which reflected not only lower demand for their export commodities, but also the depressed world-market prices for the same). Of course, should the recession in the euro-area turn out to be more severe, CESEE exports would also decline again.

Trade in goods and services: diminishing impact on GDP growth in 2012

During the 2009 recession, imports of goods and non-factor services fell, in real terms, even more sharply than exports of the same. In effect, taken together (on both the export and import sides) the foreign trade developments helped to constrain overall GDP decline throughout the CESEE region. As documented in Table 1, the trade balance contributed positively to GDP growth everywhere in the region (except for Albania). The contribution was particularly large (in excess of 10 percentage points) in the three Baltic countries that were suffering a most spectacular recession at the time, accompanied by plummeting imports.

In most countries, the 2010-2011 recovery was also bolstered by trade developments. However, the contribution of the trade balance was generally much more modest than it had been in 2009. In some countries, the contribution of trade in the biennium 2010-2011 turned negative once more and re-assumed the pattern that had regularly prevailed (in the countries that suffered most in 2009) before the biennium 2007-2008 (i.e. during the run-up to the great recession of 2009).

The trade balance in a number of countries is expected to contribute negatively to GDP growth in 2012, despite relatively low growth in domestic demand. This development is no cause for concern as far as Russia is concerned: the country runs massive current account and trade surpluses (see Table 2). However, in the case of the Baltic countries, Romania, Bulgaria, Bosnia and Herzegovina, as well as Ukraine, the potentially disquieting fact is that even with relatively slow growth in domestic demand, foreign trade will not be in a position to support overall GDP growth in 2012. Moreover, as can be seen, this unwelcome trend may extend beyond 2012. The frailty of a proper industrial base capable of supplying higher-value exports and import-competitive commodities may be one reason for this trend. Furthermore, those countries' real exchange-rates may also have started moving in the wrong direction once again, adding to the deterioration in the cost competitiveness (see special section on unit labour cost adjustments).

Table 1

Contributions to the GDP growth rates
in percentage points¹⁾

	2007	2008	2009	2010	2011	2012	2013 Forecast	2014
Bulgaria								
GDP growth rate (%)	6.4	6.2	-5.5	0.4	1.7	0.5	1.5	2.0
Household final consumption	6.4	2.3	-5.0	0.0	-0.4	1.2	1.2	1.2
Government final consumption	0.0	-0.2	-1.0	0.3	0.1	0.2	0.2	0.2
Gross fixed capital formation	3.2	6.3	-5.8	-5.4	-2.2	0.0	0.6	1.2
Trade balance	-3.9	-1.6	9.8	6.5	2.0	-0.7	-0.6	-0.7
Czech Republic								
GDP growth rate (%)	5.7	3.1	-4.7	2.7	1.7	-0.3	1.5	2.4
Household final consumption	1.9	1.4	-0.2	0.3	-0.2	-0.3	0.2	0.5
Government final consumption	0.1	0.2	0.7	0.1	-0.3	-0.6	-0.2	0.0
Gross fixed capital formation	3.4	1.1	-3.1	0.0	-0.3	-0.2	0.5	1.4
Trade balance	-0.5	1.0	0.7	0.8	2.7	0.9	1.0	0.5
Estonia								
GDP growth rate (%)	7.5	-3.6	-14.3	2.2	7.6	2.1	3.7	4.4
Household final consumption	4.9	-3.5	-8.4	-0.9	2.2	1.3	1.5	1.9
Government final consumption	1.2	0.9	-0.3	-0.2	0.3	0.4	0.1	0.2
Gross fixed capital formation	3.3	-5.5	-12.0	-1.9	5.1	2.2	2.3	3.0
Trade balance	-2.8	5.7	11.1	2.9	0.5	-2.2	-0.4	-1.1
Hungary								
GDP growth rate (%)	0.1	0.9	-6.8	1.3	1.7	-1.0	1.5	2.5
Household final consumption	0.5	-0.3	-3.4	-1.1	0.0	-0.8	0.0	0.9
Government final consumption	-1.6	0.2	-0.1	-0.5	-0.1	-1.2	-0.4	-0.4
Gross fixed capital formation	0.8	0.7	-2.4	-2.0	-1.0	-0.2	0.3	0.5
Trade balance	1.6	0.3	3.7	1.7	2.2	1.2	1.5	1.4
Latvia								
GDP growth rate (%)	9.6	-3.3	-17.7	0.0	5.4	2.7	3.3	3.8
Household final consumption	9.9	-3.9	-13.7	0.3	2.7	2.0	1.9	2.2
Government final consumption	1.0	0.0	-1.8	-2.1	0.2	0.2	0.1	0.1
Gross fixed capital formation	2.6	-4.5	-11.4	-2.8	4.7	3.5	2.1	2.7
Trade balance	-6.2	8.5	13.1	-0.2	-4.3	-2.2	-1.3	-1.7
Lithuania								
GDP growth rate (%)	9.8	2.9	-14.8	1.4	5.9	3.0	3.6	4.4
Household final consumption	7.5	2.7	-11.3	-3.2	3.9	2.6	2.3	2.6
Government final consumption	0.2	0.0	-0.2	-0.7	0.0	0.2	0.1	0.2
Gross fixed capital formation	5.5	-1.4	-10.3	0.2	2.9	1.3	1.7	2.0
Trade balance	-5.4	-0.8	13.1	0.2	0.5	-0.8	-0.5	-0.4
Poland								
GDP growth rate (%)	6.8	5.1	1.6	3.9	4.3	2.3	2.4	2.6
Household final consumption	3.0	3.5	1.2	2.0	1.9	1.0	1.2	1.5
Government final consumption	0.7	1.3	0.4	0.8	-0.2	-0.4	-0.3	0.0
Gross fixed capital formation	3.5	2.1	-0.3	0.0	1.7	1.2	1.1	1.3
Trade balance	-2.0	-0.7	2.8	-0.8	0.7	0.3	-0.5	-0.3
Romania								
GDP growth rate (%)	6.3	7.3	-6.6	-1.6	2.5	1.0	2.5	3.0
Household final consumption	8.5	6.4	-6.9	-0.2	0.8	0.6	1.3	1.9
Government final consumption	0.0	1.1	0.5	-0.8	-0.6	-0.1	0.2	0.4
Gross fixed capital formation	8.0	4.9	-9.1	-0.5	1.5	0.7	1.3	1.6
Trade balance	-10.8	-1.5	7.0	-0.1	-0.9	-0.5	-0.4	-1.0
Slovakia								
GDP growth rate (%)	10.5	5.8	-5.0	4.2	3.4	2.2	3.0	4.1
Household final consumption	3.8	3.3	0.1	-0.5	-0.2	0.6	0.8	1.3
Government final consumption	0.0	1.0	1.1	0.2	-0.7	-0.1	-0.2	0.2
Gross fixed capital formation	2.4	0.3	-4.9	2.6	1.3	0.6	0.7	0.9
Trade balance	4.0	0.0	2.0	0.2	4.9	1.0	1.6	1.5

(Table 1 ctd.)

Table 1 (ctd.)

	2007	2008	2009	2010	2011	2012	2013 Forecast	2014
Slovenia								
GDP growth rate (%)	6.9	3.6	-8.0	1.4	-0.2	-1.5	0.5	1.4
Household final consumption	3.1	2.0	-0.1	-0.4	-0.1	0.3	-0.2	0.2
Government final consumption	0.1	1.1	0.5	0.3	-0.2	0.0	-0.4	0.1
Gross fixed capital formation	3.5	2.2	-6.7	-2.0	-2.2	-1.7	-0.2	0.7
Trade balance	-2.0	-0.6	2.2	1.3	1.5	0.1	0.7	0.5
Croatia								
GDP growth rate (%)	5.1	2.1	-6.9	-1.4	0.0	-1.5	1.0	2.0
Household final consumption	3.7	0.8	-4.4	-0.5	0.1	-0.3	0.3	0.6
Government final consumption	1.0	0.0	0.1	-0.3	-0.1	-0.3	0.0	0.1
Gross fixed capital formation	1.9	2.3	-4.0	-3.8	-1.5	-0.7	0.5	0.6
Trade balance	-1.5	-1.3	4.0	2.5	0.3	0.4	0.2	0.7
Macedonia								
GDP growth rate (%)	6.1	5.0	-0.9	2.9	3.1	1.9	3.0	3.3
Household final consumption	6.4	5.9	-3.7	1.0	3.0	0.0	1.5	1.5
Government final consumption	-0.1	1.8	0.1	0.0	-0.5	0.2	0.0	0.2
Gross fixed capital formation	2.9	1.1	-0.8	-0.5	1.9	0.0	0.8	0.8
Trade balance	-5.0	-3.7	2.3	2.6	-4.1	1.4	0.1	-0.1
Turkey								
GDP growth rate (%)	4.7	0.7	-4.8	9.0	8.5	3.5	5.0	5.0
Household final consumption	3.9	-0.2	-1.6	4.8	5.4	2.9	2.9	3.6
Government final consumption	0.8	0.2	1.0	0.3	0.6	0.0	0.0	0.0
Gross fixed capital formation	0.7	-1.4	-3.8	5.0	3.7	-0.2	2.0	2.1
Trade balance	-1.1	1.8	2.6	-4.4	-1.4	0.2	-0.2	-0.8
Albania								
GDP growth rate (%)	5.9	7.5	3.3	3.0	2.9	2.3	2.8	3.3
Household final consumption	8.1	5.4	2.4	2.0	2.4	1.6	3.2	4.0
Government final consumption	0.0	0.0	0.7	0.2	0.3	0.1	0.4	-0.1
Gross fixed capital formation	2.1	3.7	1.6	-2.7	1.6	0.7	1.3	2.0
Trade balance	-4.7	-0.1	-0.5	3.4	-1.4	-0.1	-2.2	-2.8
Bosnia and Herzegovina								
GDP growth rate (%)	6.1	5.6	-2.9	0.7	2.2	-0.5	1.5	2.0
Household final consumption	5.1	4.9	-3.1	-0.8	0.2	0.0	0.8	0.8
Government final consumption	0.4	0.6	0.1	0.4	0.1	0.0	0.0	0.0
Gross fixed capital formation	6.1	4.0	-6.1	-2.4	1.0	0.4	0.8	1.0
Trade balance	-3.6	-2.9	9.1	3.2	1.3	-0.9	-0.4	0.2
Russia								
GDP growth rate (%)	8.5	5.2	-7.8	4.3	4.3	3.8	4.0	4.2
Household final consumption	7.3	5.4	-2.6	2.5	3.6	2.6	2.6	2.7
Government final consumption	0.4	0.6	-0.1	-0.3	0.3	0.7	0.9	0.9
Gross fixed capital formation	4.1	2.2	-3.2	1.2	1.7	1.1	1.3	1.4
Trade balance	-4.1	-3.4	5.9	-2.0	-4.8	-1.6	-2.0	-2.2
Ukraine								
GDP growth rate (%)	7.9	2.3	-14.8	4.1	5.2	3.2	4.2	4.9
Household final consumption	10.6	8.4	-9.7	4.4	9.8	5.5	4.3	4.4
Government final consumption	0.3	0.0	-0.5	0.9	-0.6	0.1	0.0	0.0
Gross fixed capital formation	5.9	-0.3	-16.1	1.9	4.1	-2.4	1.5	1.5
Trade balance	-9.3	-6.9	12.3	-2.8	-7.6	0.0	-1.7	-1.1

1) Contributions of changes in inventories are not shown.

Source: wiiw estimates incorporating national and Eurostat statistics.

Table 2

Foreign financial position

in % of GDP

	Trade Balance (goods and services – BOP)							Current account							Gross external debt			
	2009	2010	2011 ¹⁾	1Q 12	2012	2013	2014	2009	2010	2011 ¹⁾	1Q 12	2012	2013	2014	2009	2010	2011 ¹⁾	1Q 12
	Forecast							Forecast										
Bulgaria	-8.2	-2.1	0.8	-9.0	-1.6	-8.2	-9.4	-8.9	-1.0	0.9	-4.3	-1.3	-2.4	-3.4	108.3	102.8	91.9	89.0
Czech Republic	4.3	3.4	4.2	9.0	6.5	7.5	7.8	-2.4	-3.9	-2.9	5.5	-2.4	-2.4	-2.1	43.8	47.2	46.9	.
Estonia	5.8	7.4	6.7	-2.2	0.9	-2.2	-6.1	3.7	3.6	3.2	-8.3	-4.7	-3.8	-4.0	124.3	114.7	97.1	93.4
Hungary	4.8	6.3	7.2	.	8.6	9.7	10.5	-0.1	1.2	1.4	.	1.8	1.6	1.0	150.0	142.4	130.8	.
Latvia	-1.1	-1.0	-3.4	-4.5	-4.8	-4.9	-6.5	8.6	3.0	-1.2	-3.0	-2.4	-2.7	-2.9	157.1	166.8	146.7	142.6
Lithuania	-1.3	-1.1	-1.3	-5.6	-2.4	-4.3	-7.7	4.4	1.5	-1.6	-8.0	-4.6	-4.3	-4.0	87.0	87.4	80.8	.
Poland	-0.6	-1.8	-1.6	-1.3	-1.6	-2.0	-2.0	-3.9	-4.6	-4.3	-4.1	-4.0	-4.4	-4.3	62.6	66.6	67.3	.
Romania	-6.1	-5.8	-5.2	-4.5	-6.0	-5.3	-5.8	-4.2	-4.4	-4.4	-2.2	-4.6	-4.5	-4.9	68.7	74.5	72.1	69.9
Slovakia	-0.1	-0.9	3.0	.	3.7	3.6	3.5	-2.6	-3.5	0.1	.	1.0	0.4	0.0	72.2	74.9	76.7	.
Slovenia	1.3	0.3	0.3	0.8	1.1	1.9	1.8	-1.3	-0.8	-1.1	-1.8	-0.6	-0.8	-1.1	114.1	114.9	116.6	119.5
Croatia	-3.4	0.0	0.1	.	0.7	1.4	1.6	-5.1	-1.1	-1.0	.	-0.7	-1.1	-1.2	97.7	103.6	101.8	.
Macedonia	-23.0	-20.1	-21.0	-23.9	-18.9	-19.7	-21.5	-6.8	-2.1	-2.7	-5.9	-5.7	-4.8	-4.5	56.4	58.6	63.7	.
Montenegro	-32.6	-27.6	-23.5	.	-24.1	-24.4	-25.0	-29.6	-24.6	-19.2	.	-20.6	-22.2	-21.1	23.5	29.4	30.3	.
Turkey	-1.2	-5.6	-9.2	-8.1	-8.6	-7.7	-7.1	-2.3	-6.4	-10.0	-9.0	-8.9	-9.1	-8.9	42.5	39.7	42.8	.
Albania	-24.4	-20.9	-22.9	.	-22.3	-21.9	-21.6	-15.3	-11.5	-12.5	.	-12.5	-13.8	-14.7	40.9	44.3	49.3	48.1
Bosnia and Herzegovina	-23.1	-21.2	-23.1	.	-24.1	-23.9	-23.5	-6.3	-5.7	-8.6	.	-8.9	-8.6	-8.3	21.8	25.6	25.5	25.6
Serbia	-17.6	-17.0	-17.4	.	-19.2	-19.2	-19.0	-7.2	-7.4	-9.6	-16.9	-10.1	-11.2	-11.2	77.7	84.9	78.2	77.6
Kazakhstan	7.9	14.6	21.9	27.0	20.1	18.9	17.1	-3.6	1.6	7.6	9.6	7.6	6.0	4.7	95.1	80.1	71.6	.
Russia	7.5	8.3	8.7	12.0	6.2	4.7	4.0	4.0	4.8	5.3	9.5	3.9	3.0	2.2	37.0	33.0	31.5	27.7
Ukraine	-1.7	-2.9	-5.4	-4.7	-5.7	-6.6	-7.7	-1.5	-2.2	-5.5	-3.3	-4.7	-4.9	-4.8	85.8	86.0	82.5	.

1) Preliminary and wiiw estimates.

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

‘Floaters’ vs. ‘fixers’: differential real exchange-rate developments

The return of a rise in trade deficits in the Baltic countries (and some other countries) indicates that the ‘rebalancing’ of 2009 may have been a temporary phenomenon. That rebalancing involved adjustments in unit labour costs (through changes in wage rates relative to changes in labour productivity); they also meant downward adjustments in the scale of production in terms of both output and particularly employment. However, it may be noticed that protracted external imbalances in the Baltic countries had skewed the structure of production – in favour of non-tradable sectors (see the *Special section on Structural distortions before adjustments and adjustment after the crisis: a GIIPS-NMS comparison*). Such structural distortions will take time and effort to correct.

The adjustments in countries, which had retained their own floating currencies, entailed – in addition to changes in wages – also some changes in their nominal exchange rates. (For more details, see the *Special section on unit labour cost adjustments in times of crisis*). As a rule, the nominal exchange rates of the free-floating countries tend to weaken, sometimes substantially, against the euro, whenever the mood on the ‘international financial markets’ takes a turn for the worse. On such occasions, the tendency is to embark on a ‘flight to safety’ – away from the CESEE securities and currencies. When the mood on the ‘international financial markets’ takes a turn for the better, the tendency is to return to the ‘emerging markets’ as they offer promise of higher gains. Of course, the markets’ swings in mood aid the larger CESEE countries in particular with their floating currencies.⁹ They affect their currencies in a countercyclical manner by weakening them when the overall external climate is bad and strengthening them when that climate is good.

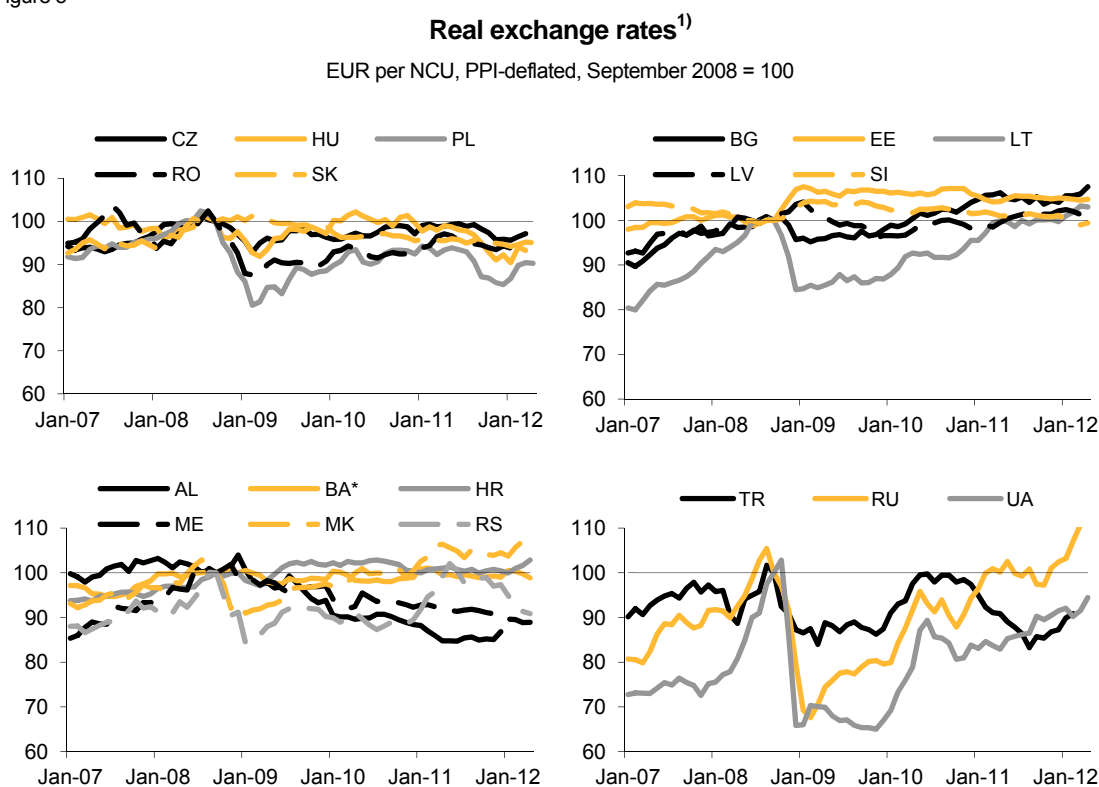
Analysis of unit labour cost adjustments over the longer term (and especially during the recent crisis), presented in the special section referred to above, bears out the benefits to be gained from distinguishing between countries with floating and fixed exchange-rate regimes. The analysis argues that a flexible-exchange-rate regime tends to be superior to a fixed-rate regime because it allows less painful correction of excessive real appreciation via nominal exchange-rate devaluation. Correction of excessive real appreciation in countries with fixed exchange rates (and, of course, in those countries that have adopted the euro as well) tends to be more painful (as it usually requires a palpable measure of wage and price deflation).

The more recent data suggest that the real exchange rates (deflated by the industrial producer price index) tend to re-appreciate in fixed exchange rate countries, even if they had briefly depreciated in response to the impact of temporary industrial producer price deflation¹⁰ during the crisis (see upper right-hand side panel in Figure 5).

⁹ The fluctuations in the value of the Polish currency are most pronounced among the NMS. Volatilities of the exchange rates of other floating CESEE currencies (Czech, Hungarian and Romanian) are much more subdued. The reasons for the singularity of the Polish currency seem quite obvious. The Polish capital and foreign exchange markets are comparatively large, deep, liquid, diversified and well-organised/supervised. The foreign exchange and capital rate markets of much smaller economies – even if otherwise attractive – may not possess the critical mass required for meaningful financial/foreign exchange operations.

¹⁰ A huge real exchange rate depreciation of the Lithuanian currency recorded at the end of 2008 (see Figure 5) reflects a specificity of the industrial sector of that small country which is dominated by a single (huge, by the local standards)

Figure 5



1) Values above 100 indicate appreciation relative to September 2008. - * BA: CPI-deflated.

Source: wiw Monthly Database incorporating national and Eurostat statistics.

Figure 5 convincingly documents the differential performance, in terms of real exchange rates, of the 'floaters' and the 'fixers'. The former managed to keep their currencies depreciated over quite a long period of time (and most recently as well). Significantly, Poland's currency has lost most in real terms, yet its economy has proved to be the most resilient to the unfavourable external developments (at least so far). Similarly, the large floating-exchange economies of Russia, Turkey and Ukraine have stood by their massively depreciated currencies for a longer period of time. No doubt this has been one factor determining their real performance in 2010-2011 (and the prospects for the future do not look all that bad). In contrast thereto, the fixed-exchange-rate countries find themselves unable to suppress the real exchange rate on a permanent basis. Only in Slovenia has there recently been some suppression of the real exchange rate appreciation. However, achieving that is associated with a deepening recession: something that can hardly be tolerated indefinitely. The experience of Slovakia (which joined the euro-area in January 2009) shows that given rapid labour-productivity growth, for example, on account of high investment dynamics (also on the part of foreign multinationals) in export-oriented manufacturing, it is possible to avoid undue real appreciation. The

petroleum refinery. Plummeting (at that time) prices of oil and oil-products translated into a strong (13.5%) decline in the overall industrial producer price index in 2009 and hence in real exchange rate depreciation. Per se, such a real depreciation of a currency cannot say much about the change in the country's external competitiveness.

risk associated with that kind of appreciation, however, is always real. As soon as the inflation of industrial producer prices accelerates unduly, real appreciation can return.¹¹ This is what seems to be happening now to a number of CESEE fixers: the Baltic countries, Slovenia (up until very recently), as well as to most of the Western Balkan countries. Most probably the real appreciation tendencies, now coming to the fore, bear out expectations of those countries' trade performance weakening. The negative experience that those countries had with currencies appreciating unduly in real terms may well repeat itself sooner or later.

Certainly, it is natural to assume that the renewed accumulation of external imbalances in the Baltic countries may gain momentum - albeit only gradually. Trade (and current account) deficits in those countries need to be covered by means of greater external funding. Given the relatively high levels of external debt that some of the countries are shouldering (and given the memories of the rather unpleasant experiences that those countries' foreign creditors went through during the crisis), any providers of fresh external funding might well adopt a fairly cautious attitude - at least initially. History has taught us, however, that initial reservations about the standing of potential borrowers do not last long, even if the latter's track record over the long term records is far from impeccable.

Interestingly enough, the rebalancing that took place in the Western Balkan was also very substantial. It was most extreme in Montenegro whose current account deficit tumbled from 50.6% of the GDP in 2008 to less than 30% in 2009. The Western Balkan countries, however, (be they floaters or fixers) still run trade and current account deficits of a magnitude that would rightly provoke panic elsewhere. None the less, the foreign capital needed to cover those deficits still pours in - and is expected to continue doing so in the near future. One portion of that capital may represent multilateral (aid) capital transfers of various sorts and another portion foreign direct investment, whereas the rest represents borrowing from abroad, primarily by the private sector (but not necessarily from the regular lending institutions).¹² The continuing relatively low (or relatively moderate) level of gross external debt in most Balkan countries may be a factor facilitating their apparently easy access to foreign financing. It should be recalled, however, that foreign capital had no compunctions about funding the Baltic countries' large and sustained current account deficits either. Lending to the Baltic countries also seemed safe at the time since their foreign debts were very low. As can be seen (Table 2), the foreign debt of the Baltic countries, mostly private, has in the meantime assumed rather menacing proportions. The same is likely to occur - if not necessarily anytime soon - to those Balkan countries (Serbia, Croatia) addicted to borrowing.

¹¹ Inflation in industrial producer prices may accelerate for many reasons. Accelerating growth in unit labour costs (be it due to a combination of higher growth of wages and slower growth in labour productivity) is only one of many possible reasons. A rise in profit mark-ups in industry is an equally possible reason, especially when wage-push is limited by high levels of unemployment.

¹² Political instabilities - also related to the region's primordial ethnic and religious animosities - periodically convulse the Balkans. Moreover the region's institutional development has been grossly retarded. All this should bear obvious ramifications for the assessments of the safety of the capital invested there. Given these facts, it remains a mystery of sorts as to what motivates those who supply huge amounts of capital to the region.

‘Absolute’ levels of over- and under-valuation of the region’s price levels

The dynamics of a country’s real exchange rates says something about a country’s changing external competitiveness – and hence about the likely performance of its foreign trade (and, indirectly, of its entire macro-economy). It must be remembered, however, that real (as opposed to nominal) exchange rates can be defined in many different ways. Various price indices (for consumer goods, producer goods, export goods, etc.) can be used to deflate the dynamics of nominal exchange rates. Alternatively, various cost indices (such as the index of unit labour costs in manufacturing) can serve as deflators. Last, but not least, the choice of the base year (or period) has a bearing on judgements as to likely foreign-trade performance, which heed the analyses of the trajectories of real exchange rates for specific groups of countries. The fact that real exchange rate dynamics can be defined in many different ways (which then can – and often do - suggest divergent conclusions relating to the evolution of external competitiveness) justifies the search for the right definition of (and the right *absolute* values for) the exchange rate that suit the economies best. That hunt has long been on the research agenda of much of the empirically oriented economics of international relationships. It is only fair to say that the quest has yielded a mind-boggling host of various specific measurement/definition proposals – and little agreement within the research community. The Holy Grail of the ‘equilibrium exchange rate’ has yet to be discovered.

Recent research conducted at our institute suggests a fairly new concept for ‘equilibrium price levels’ (and a concrete method of measuring them) in the EU member-countries. The concept is derived from the observation that a stable – and fairly close – relationship seems to exist between a country’s relative per capita GDP level (at current purchasing power parities PPP) and its price level (the ratio of the current PPP to the current exchange rate). Any deviations from that long-term universal relationship (or ‘locus’) that occur over time and space are interpreted as signs of a misalignment of the domestic price level and the exchange rate. It is shown that the movements involving reductions in the levels of over- or under-valuation tend to be associated with gains in relative GDP levels (hence with real convergence). Countries whose price levels move along the locus do not need to exhibit rapid growth – but in all likelihood their long-term performance will be relatively steady. In contrast thereto, countries with strongly overvalued price levels may occasionally perform quite well – only to land in trouble (recession) sooner or later. Countries with permanently undervalued price levels tend to exhibit growth stagnation over extended periods of time¹³.

Table 3 shows the actual price levels in relation to the values of the price levels consistent with the long-term locus (described above) for the new EU-member states, the EU-candidate countries (both current and potential), as well as Germany and Greece (representing two extreme euro area experiences).

¹³ For the extensive presentation of the concept see L. Podkaminer (2010): ‘Real Convergence and Price Levels: Long-Term Tendencies versus Short-Term Performance in the Enlarged European Union’, *Metroeconomica*, 4.

The locus in question is expressed mathematically as $P = \exp(3.435831 + 0.01047Y)$ where P is the relative price level (with the average P for the whole EU-27 normalized at 100); Y is the per capita GDP level (at PPP, again properly normalized) and exp stands for the exponential function. Both parameters in this formula, derived through OLS estimation from a sample with 416 observations, are significant at 10^{-5} level.

Table 3

**The ratios of actual price levels to the price levels consistent with the long-run locus,
for 1995, and 2000-2010**

	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Bulgaria	59.0	76.4	78.6	76.9	76.5	78.3	80.0	82.4	84.9	86.7	90.4	90.6
Czech Republic	54.8	70.3	72.9	81.6	75.1	75.7	80.8	84.7	83.6	100.8	95.2	101.7
Estonia	83.7	105.3	110.4	106.6	103.0	102.3	100.9	103.1	105.7	109.8	114.0	112.2
Latvia	77.5	113.1	111.8	105.4	98.1	97.3	100.9	108.5	119.3	128.8	128.7	121.0
Lithuania	60.7	100.0	98.7	97.7	90.6	91.4	95.0	96.7	99.6	106.9	112.8	105.8
Hungary	84.4	87.3	88.1	94.0	93.6	99.2	103.1	99.4	108.2	108.4	97.8	100.1
Poland	90.9	102.9	116.1	108.1	95.4	92.1	104.8	108.5	109.8	121.1	97.1	101.1
Romania	60.4	89.5	88.4	88.2	86.8	85.9	104.7	107.9	115.7	109.2	98.0	101.2
Slovakia	78.9	81.6	79.0	79.8	86.4	90.8	90.7	91.7	94.6	98.5	102.1	100.3
Slovenia	109.4	98.8	100.9	99.6	99.7	94.1	94.7	95.7	99.3	100.7	109.4	110.3
Croatia	.	.	109.1	110.4	108.8	109.5	112.0	114.7	109.5	111.7	113.7	118.8
Macedonia	.	.	94.2	95.2	93.7	89.8	85.1	85.8	88.0	87.7	85.0	85.7
Montenegro	.	.	.	.	.	.	97.8	90.1	90.9	94.4	102.3	104.0
Turkey	.	.	96.7	108.8	118.0	115.0	121.5	115.6	118.6	117.5	112.0	121.6
Albania	.	.	.	.	.	.	106.4	105.3	107.3	106.9	100.9	100.9
Bosnia and Herzegovina	.	.	.	.	.	.	108.8	108.7	110.7	116.2	117.1	115.9
Serbia	.	.	.	.	.	.	89.4	94.2	107.1	108.9	104.3	101.8
Germany	104.4	104.1	106.4	107.6	103.8	102.8	99.0	99.4	97.8	99.2	102.0	98.6
Greece	102.8	105.4	102.3	96.9	99.1	99.4	105.9	105.6	111.1	110.2	111.6	115.2

Note: The ratios close to 100 in Table 3 are interpreted as being indicative of the absence of both overvaluation and undervaluation of the domestic price level. At a ratio close to 100, the existing price level is 'about right', meaning that the country's purchasing power parity/exchange rate ratio is what it should be given the country's development (GDP) level. Such price levels could be termed 'equilibrium' price levels (and the corresponding exchange rates – the ratios' denominators – could be termed 'equilibrium exchange rates'). Ratios that fall significantly short of 100 suggest undervaluation, while those far in excess of 100 suggest overvaluation. For the former, the exchange rates are 'too weak' relative to the PPP; for the latter, they are 'too strong'.

Source: Own calculations based on Eurostat (June 2012) data.

Table 3 suggests that back in 1995 all CEE countries that later joined the EU had strongly undervalued price levels. Slovenia was the sole exception (the price level being some 10% above its 'equilibrium' level at the time). By 2000 the Slovene overvaluation had been eliminated. That was achieved by applying the crawling peg policy whereby domestic inflation was closely followed by an officially administered devaluation of the country's currency. That policy was discontinued prior to the country's joining the euro-area (in 2006). Since then there has been a steady move towards overvaluation. In 2010, Slovene price levels were again overvalued by 10%.

Adoption of a fixed exchange rate regime can lead to a very slow shift towards overvaluation, as shown by the data for Bulgaria, whose currency was still hugely undervalued in 2010: 15 years after the country adopted the currency-board regime. Similarly, the Slovak price level is still about 'right' despite that country's adoption of the euro. (However, Slovakia's has only been a member of the

euro-area for a relatively short period. Overvaluation of the Slovak price level can still develop in the future, although, of course, it does not have to.)

According to Table 3, despite being 'fixers', Slovakia – and Bulgaria even more so – still seem to dispose of some 'appreciation reserves'. As such, they perhaps do not need to fear (wage) competitiveness losses too much.¹⁴ The wage/income policies in both countries could perhaps be a wee bit more generous than has been the case in the past. Macedonia is another country with consistently depressed price levels. This outcome may have been yet another side effect of the stability-oriented policies traditionally pursued in that country (in addition to the sluggishness of its GDP growth).

According to Table 3, price levels in the floating-exchange rate countries (Poland, Hungary and Romania, as well as Albania and Serbia) are highly volatile (the Czech Republic is much more stable in this respect). However, after venturing far into the overvaluation zone in 2008, they quickly returned to normalcy in 2009. Of course, that was achieved primarily by devaluing nominal exchange rates. By 2010, the price levels in these countries were just about 'right' again. Their exchange rates were on the whole consistent with the values set for their purchasing power parities – and with the overall development levels achieved. The developments in 2011 do not seem to have changed the situation for the 'floaters' all that much.

In 2010, things were different in the three Baltic countries (especially in Latvia and Estonia, less so in Lithuania) as well as in Croatia, Turkey, Bosnia and Herzegovina and Slovenia – and not forgetting Greece. Their price levels were still highly overvalued in 2010. Moreover, they had generally failed to reduce the levels of overvaluation in 2009-2010 – despite often significant cuts in employment, nominal (and real) wages and unit labour costs (see also Appendix Table A/3). Given the price developments in 2011 (as well as expectations concerning inflation and GDP growth in 2012), all those countries are most likely to display even higher levels of overvaluation at the end of 2012. Further cuts in wages, employment and unit labour costs may generate an impression of improved competitiveness. However, as in the period 2010-2011, steps such as those do not necessarily reduce overvalued price levels. In Turkey (and possibly in Croatia) reducing overvaluation levels is feasible without having to take recourse to such draconian (and not really productive) measures – provided the nominal exchange rates are allowed to weaken. The latter option, however, is not considered (at least officially) in the fixed-exchange rate countries. Moreover, unless they re-introduce their own currencies, the euro-area countries will, of course, not have such an option either.

Growth of gross fixed-capital formation: marked revival in the Baltic countries and steady growth in the East - unimpressive elsewhere

In 2009, gross fixed investment declined throughout the region (Albania being the sole exception). In almost all cases, the decline was truly massive (see Table 4). In Ukraine, investment dropped by half in 2009; in the three Baltic countries it fell by close on 40%. The slump can be attributed to many

¹⁴ This finding is consistent with the fact that the Bulgarian unit labour costs (in absolute terms) are singularly low, even as compared with the ULC of other CESEE countries (see also Figure 11 in the special section on unit labour cost adjustments in times of crisis).

factors that affected various countries to varying degrees. Universally, the fairly pronounced decline in export demand may have initially triggered cutbacks in orders for capital goods and construction work. The initial triggering impulses were soon followed by the revelation of mass-scale balance-sheet problems troubling banks and their corporate clients. Leading, in turn, to a rush to deleverage, those balance-sheet problems further restricted the demand for and the supply of investment loans. Of course, once set in motion, a recession in investment feeds strongly on itself. The eventual investment decline observed may well be of a size and duration that is out of all proportion to the events that initially triggered it off. Pro-cyclical fiscal policy in the Baltic countries and Ukraine also contributed (for instance through massive cuts in public investment).

Table 4

Consumption and investment

real change in % against preceding year

	Household final consumption							Gross fixed capital formation						
	2009	2010	2011 ¹⁾	1Q 12	2012	2013	2014	2009	2010	2011 ¹⁾	1Q 12	2012	2013	2014
													Forecast	
NMS-10														
Bulgaria	-7.6	0.0	-0.6	2.0	2	2	2	-17.6	-18.3	-9.7	1.3	0	3	6
Czech Republic	-0.5	0.6	-0.4	-2.8	-0.6	0.5	1	-11.5	0.2	-1.2	1.2	-1	2	6
Estonia	-16.1	-1.7	4.4	3.2	2.8	3	4	-37.8	-9.1	26.8	17.2	10	10	12
Hungary	-6.4	-2.1	0.0	-0.2	-1.5	0	1.8	-11.0	-9.7	-5.5	-6.6	-1	2	3
Latvia	-22.8	0.7	4.6	5.6	3.5	3	3.5	-37.4	-18.1	27.9	39.0	15	8	10
Lithuania	-17.4	-5.0	6.1	6.8	4	3.5	4	-39.5	1.0	17.0	8.4	7	9	10
Poland	2.1	3.1	3.2	2.1	1.7	2	2.5	-1.3	-0.4	8.1	6.7	6	5	6
Romania	-10.4	-0.4	1.4	0.6	1	2	3	-28.1	-2.1	6.3	11.8	3	5	6
Slovakia	0.1	-0.8	-0.4	-0.1	1	1.5	2.5	-19.7	12.4	5.6	-3.9	2.5	3	4
Slovenia	-0.2	-0.6	-0.2	1.4	0.5	-0.3	0.4	-23.3	-8.3	-10.6	-10.9	-9	-1	4
NMS-10 ²⁾	-3.4	0.8	1.8	1.2	1.1	1.6	2.4	-13.5	-2.2	4.6	4.8	3.1	4.1	5.8
EA-17	-1.2	0.9	0.2	.	-0.6	0.5	.	-12.4	0.0	1.4	.	-1.5	1.9	.
EU-27	-1.8	1.0	0.1	.	-0.3	0.7	.	-12.7	0.2	1.4	.	-0.9	2.2	.
Candidate countries														
Croatia	-7.6	-0.9	0.2	-0.3	-0.5	0.5	1	-14.2	-15.0	-7.2	-2.8	-3.5	2.5	3
Macedonia	-4.7	1.3	4.0	0.7	0	2	2	-4.3	-2.7	10	.	0	4	4
Montenegro	-12.9	2.0	2.0	.	2	3	3	-30.1	-18.5	-5.0	.	2	5	5
Turkey	-2.3	6.7	7.7	.	4	4	5	-19.0	29.9	18.3	.	-1	10	10
Potential candidate countries														
Albania	3.0	2.5	3	.	2	4	5	5	-7	4.8	.	2	4	6
Bosnia and Herzegovina	-3.9	-1.0	0.2	.	0	1	1	-22.4	-11.1	5.4	.	2	4	5
Serbia ²⁾	-2	2	1	.	0	1	1	-5	-4	0	.	-1	3	3
Kazakhstan	0.7	10.0	8	.	5	4	4	-0.8	3.8	3.5	.	8	9	10
Russia	-5.1	5.2	6.8	.	5	5	5	-14.4	5.8	8.0	.	5	6	6
Ukraine	-14.9	7.1	15.0	9.8	8	6	6	-50.5	3.9	10.1	7.6	5	8	8

1) Preliminary and wiiw estimates. - 2) wiiw estimate.

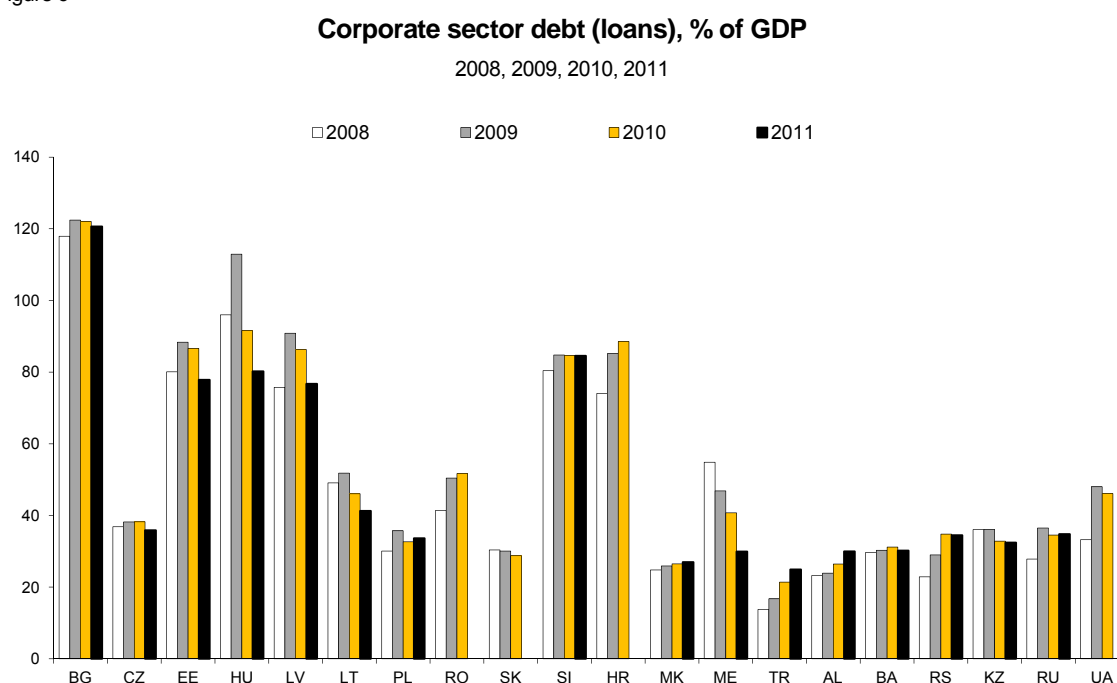
Source: wiiw Database incorporating national and Eurostat statistics. Forecasts by wiiw and European Commission (Economic Forecast, Spring 2012) for EU and euro area.

In 2010, investment receded still further – often with almost equal force – in most CESEE countries. That decline, however, morphed into growth on the eastern fringes of the CESEE region: in Turkey, Russia, Ukraine and Kazakhstan (and in Slovakia, the only ‘core’ CESEE country). In 2011, invest-

ment growth continued ‘on the fringes’, while resuming in many new EU-member states as well as in the Balkans. However, investment continued to contract in the Czech Republic, Bulgaria, Hungary, Slovenia, Croatia and Montenegro. On the other hand, gross fixed investment in the three Baltic countries increased at a rapid rate in 2011. In the first quarter 2012, investment expanded very strongly in the Baltic countries (and Romania), but investment growth slowed down or even declined rapidly in other new EU-member states.¹⁵

Variations in recent investment performance cannot be easily explained in simple terms. For instance, the deleveraging thesis, according to which the persistent balance-sheet problems of the corporate sector are responsible for stagnant or falling investment, does not seem to apply, for example, to the Czech Republic, Slovakia or Poland. In those three countries, corporate debt is very low in relation to GDP and cannot possibly obstruct intentions to invest (should there be any). In the same vein, corporate sector debt is very high in Estonia and Latvia, yet investment seems to be enjoying an explosive boom there (see Figure 6).

Figure 6



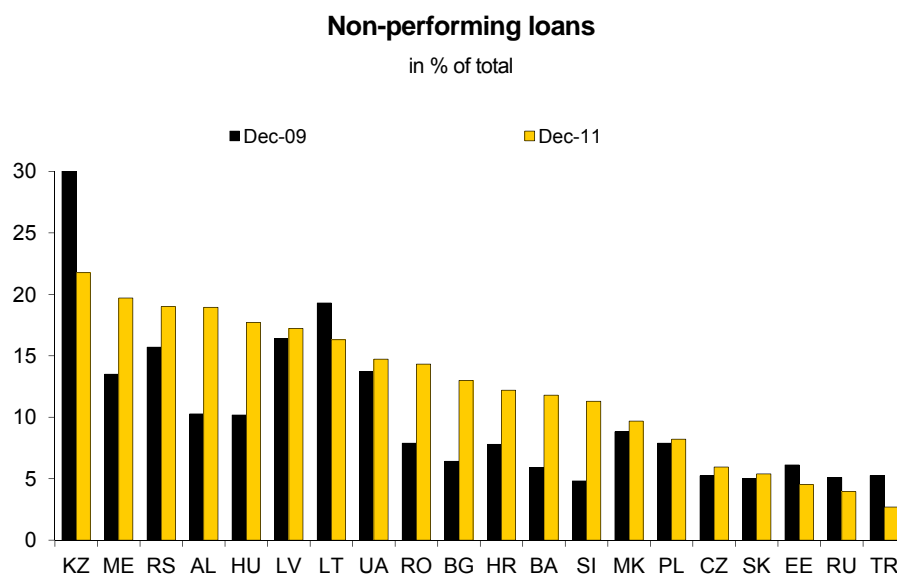
Note: Data in 2011 for BG, EE, CZ, LV, LT are estimated with national data. Data for MK, ME, TR, AL, BA, RS, KZ, RU, UA are based on various banking statistics reports.

Source: Eurostat, National Banks and wiw own calculations.

¹⁵ Data on the gross fixed investment for the first quarter of 2012 were not yet available for the remaining CESEE countries as this Report was completed.

Of course, the corporate sector's balance-sheet problems may still be of some significance in countries with very high levels of corporate sector debt (Bulgaria, Hungary, Slovenia or Croatia). Similarly, the banks' balance-sheet problems may have some bearing on the availability of investment loans – and hence on investment performance. One never really knows – with any certainty – how sound an individual bank is (and even less so, when it comes to assessing the soundness of a banking system), yet it seems that the banking system in a number of countries such as Poland, Slovakia and the Czech Republic is in fairly good shape. That assessment is borne out by a number of indicators, of which data on non-performing loans are but only one (see Figure 7).

Figure 7



Note: Non-performing loans defined as credits more than 90 days overdue or classified as sum of substandard (more than 90 days overdue), doubtful (more than 180 day overdue) and loss.

EE: loans more than 60 days overdue. HU: loans for corporate sector only. UA: doubtful and loss credits. RU: referring to debt service, therefore not fully comparable with other countries. For ME and HR data as of September 2011.

Source: National Bank of respective country.

Judging by the weight of non-performing loans, the banking systems of Kazakhstan, Serbia, Albania, Hungary, Latvia, Lithuania, and Romania are most fragile. Yet, as seen in Table 4, this does not seem to interfere with investment growth in those self-same countries. Conversely, robust banking in Poland, Slovakia and the Czech Republic co-exists with stagnant or falling investment (despite generally moderate commercial interest rates on loans to business). Certainly, a rise in the share of non-performing loans may be of real importance, for example, in Hungary, Bulgaria, Croatia, Romania and Slovenia.

Investment growth in 2012 is expected to slow down significantly wherever it boomed in the first quarter 2012. However, investment growth is expected to remain generally quite sluggish throughout the 'core' countries (while continuing to decline in some of them). Only in the period 2013-2014 is

investment growth expected to recover across the new EU member states and in the Balkans. Investment growth is forecast to remain steady – but not excessive - throughout the period 2012-2014 in Kazakhstan, Russia and Ukraine.

Three specific observations are worth making at this juncture. First, it may be recalled that corporate sector investment does not necessarily rely exclusively on banking loans for funding purposes. In most CESEE countries, retained earnings are of greater importance than bank loans. Furthermore, direct financing bypassing the banking system is important (especially for the domestic branches of foreign multinationals that can provide cover). Secondly, public investment, which is part of overall gross fixed investment, may be somewhat depressed at present on account of the fiscal consolidation policy being pursued in a number of the new EU-member states. To some degree this could depress overall investment growth in certain countries. Finally, the current investment boom in the Baltic countries must be seen in a longer-term perspective. The boom is not a sign of the strength to be expected from those economies' productive sectors. In 2011, fixed investment in Lithuania was still 32% below its 2007 level. For Estonia and Latvia, the respective figures are even more depressing: 39% and 44%.

Growth of private consumption: still quite strong in the East, but slowing down in the new EU member states and in the Balkans

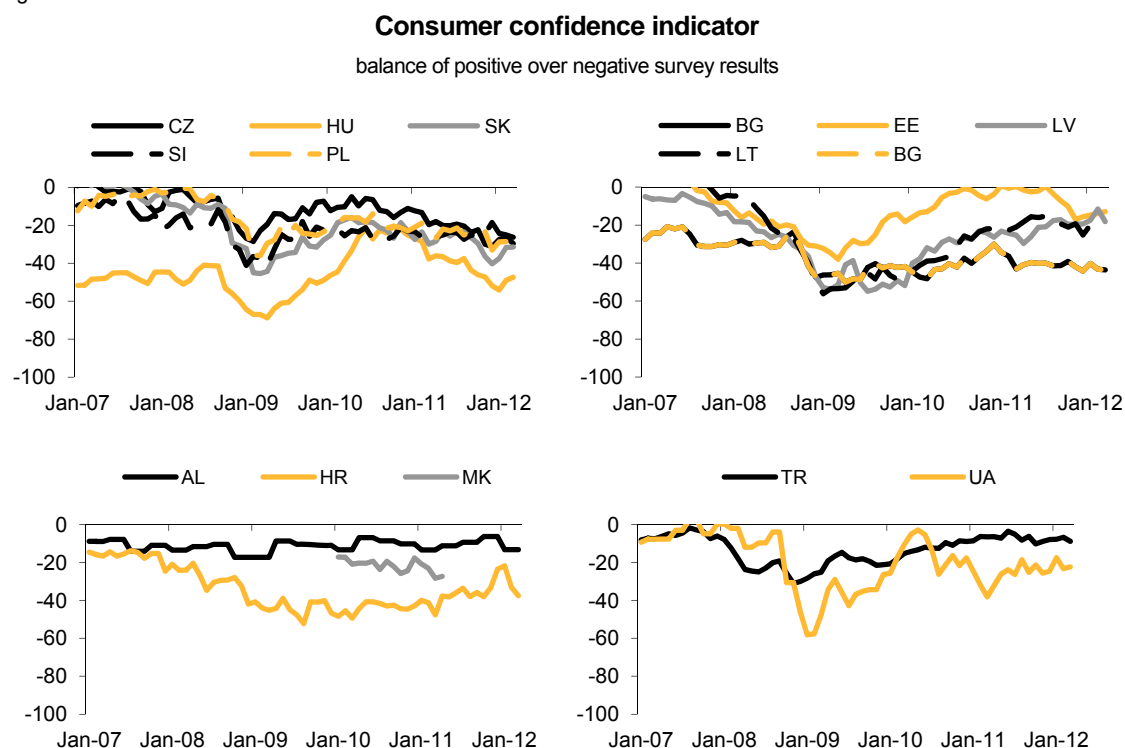
In 2009, household consumption fell in almost all CESEE countries (massively in the Baltic countries and Ukraine). In 2010, stagnation (or even further contraction) of household consumption continued across the geographical core of the CESEE region (see Table 4). On the region's fringes, in Turkey, Kazakhstan, Ukraine and Russia, rapid consumption growth had already resumed in 2010. In 2011, household consumption continued to increase rapidly in the 'fringe' countries. In the biennium 2013-2014, consumption is expected to continue growing quite strongly. By way of contrast, household consumption in the core countries did not really pick up speed in 2010. Moreover, in some of those countries, consumption declined anew in 2011. A certain measure of swifter consumption growth in 2011 was only recorded in the Baltic countries, which are emerging from the unprecedented consumption recession they suffered in the period 2008-2010. Even despite the consumption boom over the past two years, household consumption in Estonia in 2011 was still 20% below its 2007 level, in Lithuania 13% and in Latvia 23%.

In 2012, consumption growth will sag still more (even stopping or going into decline) in most new EU member states and across the Balkans. Even in the Baltic countries, consumption growth is expected to slow down. Consumer indicators everywhere point to overwhelmingly negative public expectations as to the future – even in the Baltic countries (see Figure 8).

The decline in consumption in 2009 (and partly in 2010 as well) can be attributed to many causes. Without doubt, foreign-trade developments were important factors, as was the steep decline in gross fixed capital formation. Those developments quickly translated into losses in household income and increases in savings propensity. Also important was the dominant tendency at the time to deleverage (and to reduce lending to the household sector). The household sector in many countries (not

only in the Baltic countries, but also in Hungary and Romania) accrued a high level of debt denominated in foreign currencies. Serving that debt proved very costly (especially in Hungary and Romania, whose currencies were greatly devalued). Of course, a drop in private consumption feeds on itself via falling output and stagnant/falling employment¹⁶ and wages (and eventually via falling consumption that had previously been funded by wages).

Figure 8



Remark: AL: quarterly data.

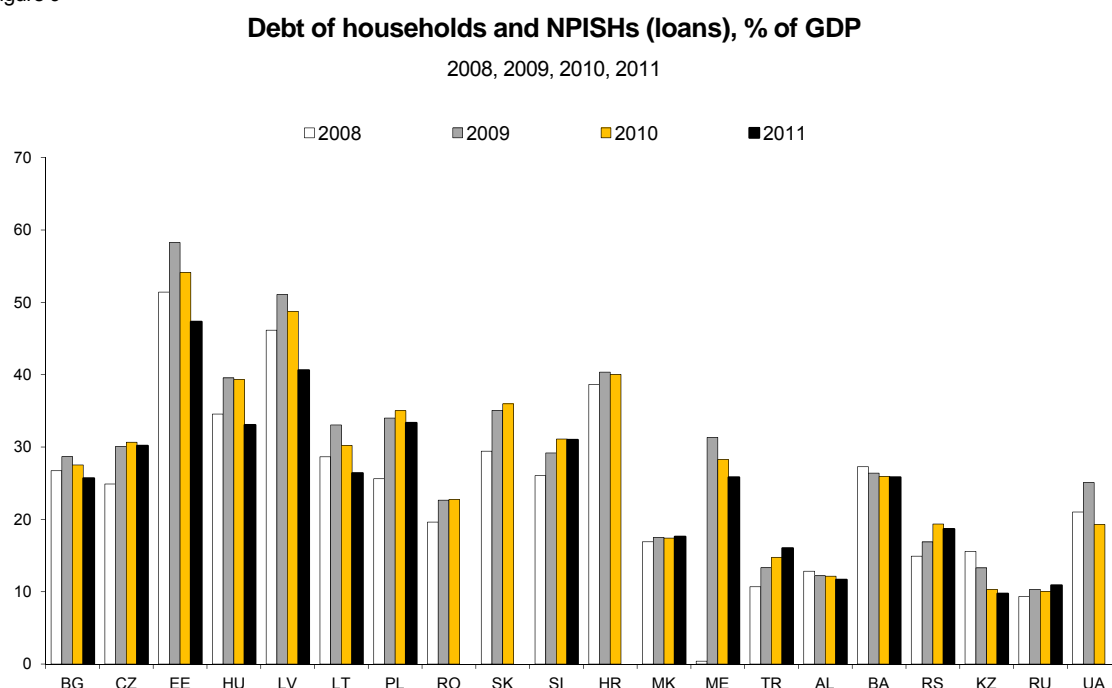
Source: Eurostat, national statistics.

The reason for consumption performance being much better in the 'fringe' countries than in their 'core' counterparts cannot be simply ascribed to differences in terms of their access to loans or tendencies to deleverage (see Figure 9). Household sectors in Estonia and Latvia are highly indebted – but private consumption booms again in those two very countries. On the other hand, household debt in Czech or Romania is pretty low, but household consumption remains anaemic there. Furthermore, the link between the fragility of the banking systems (see Figure 7) and the expansion of consumption appears rather weak.¹⁷

¹⁶ See the Special section on labour market developments and prospects.

¹⁷ For example, Figure 7 suggests e.g. that banks in Ukraine may be facing a pretty fragile situation while those in the Czech Republic, for example, look very solid on the whole. These facts, however, do not correlate at all with the developments expected in household consumption. (Similarly, banks in Hungary and Latvia exhibit similar levels of non-performing loans, yet very different trends in expected consumption growth).

Figure 9



Note: Data in 2011 for BG, EE, CZ, LV, LT are estimated with national data. Data for MK, ME, TR, AL, BA, RS, KZ, RU, UA are based on various banking statistics reports.

Source: Eurostat, National Banks and wiw own calculations.

Differences in the fiscal policies most likely to be pursued in 2012 (and beyond) may be of some importance, when seeking to explain the differentials in the expected performance of household consumption across the CESEE. A policy of fiscal consolidation (in brief, the introduction of systemic changes that will reduce public sector deficits or possibly eliminate them altogether) is being introduced in a number of countries. That policy not only stipulates cuts in public consumption and public investment (which indirectly affect employment, household incomes and consumption), but it also calls for cuts in social transfers and tax increases. The latter measures directly affect real disposable incomes in the household sector – and thus effective consumer demand as well. (Indeed, the whole point of fiscal consolidation is to reduce disposable income in the private sector – primarily, that of households). Reliable quantitative estimates of the direct and indirect impact of fiscal consolidation on the dynamics of household consumption are, of course, hard to come by (see below). None the less, the fact that the new EU-member states feel obliged to introduce consolidation on this scale, whereas the ‘fringe’ countries can do as they please in this respect, may have a bearing on the differences in the dynamics of the household consumption in 2012 and beyond.¹⁸

¹⁸ According to Table 1, the direct contribution of final government consumption to GDP growth is expected to be negative in a number of countries. In many others that contribution will be about zero. Only in Russia is that contribution expected to be of a meaningful (and positive) magnitude.

Fiscal consolidation for the sake of...fiscal consolidation

No CESEE country – not even Russia – enjoys the privilege of having at its disposal unlimited amounts of money that could potentially assume the role of a global reserve currency. Some of the CESEE countries do not even have their own sovereign currency. Given this fact and the free movement of capital and money typical of today's globalising world economy, it is obvious that the governments of the CESEE countries would be well advised to watch and control their countries' level of public debt and deficits. Only Russia and Kazakhstan – the two countries whose publicly-owned financial reserves exceed their *gross* public debts – need not worry about the burden of public debt, at least not as long as demand for oil and gas remains strong. However, countries with particularly high public debt levels (especially if denominated in foreign currencies) may have to consolidate, if only to reduce the burden of the high debt-servicing costs (interest on public debt). Applying that principle, fiscal consolidation seems quite understandable in Hungary (see Table 5). Hungary is the only CESEE country with a genuinely high level of public debt (of which a large chunk is also denominated in foreign currencies). Moreover, fiscal consolidation in Latvia and Lithuania may seem advisable – despite the still relatively low public debt levels there. The reason for considering fiscal consolidation is that the private sectors' gross external debts in those two countries are very high. Tranches of those private external debts may have to be 'nationalised' at some point in the future, as has happened in many euro-area countries. The public debts of both countries may increase rapidly. Otherwise, fiscal tightening is possibly the only instrument that the two countries can apply in order to cool down the next domestic (but foreign-financed) boom that may be already brewing there.

The public debt situation of other countries is far better, even though the prospects of debt may look a bit less favourable in Albania, Croatia and Slovenia. In those latter countries, fiscal policy consolidation may seem advisable, if not necessarily at this very moment in time. However, such a policy may well prove counterproductive. By stipulating cuts in public sector deficits, the policy may also undermine GDP growth. This may yield deficits higher than assumed, for example, through an unanticipated fall in tax revenue. Even if the deficits are not pushed upwards by the consolidation policies, GDP stagnation (or even recession) due to those policies may actually worsen the debt-to-GDP ratio.

It seems particularly unfortunate that a few countries with really low levels of public debt (Bulgaria, the Czech Republic, Romania and Macedonia) have been attempting to introduce fiscal consolidation – precisely at a time when weaknesses in investment, household consumption and external demand have been revealed.

Three observations are worth making at this juncture. First, the GDP growth-reducing effects of fiscal consolidation policies can only be approximately deduced from a simple arithmetical change in the fiscal balance. The devil is in the detail. Even if the balance does not change, the policy may be more or less contractionary, depending on whether it stipulates simultaneous offsetting cuts or increases in fiscal revenues and expenditures. Generally speaking, a policy that stipulates simultaneous cuts in revenues and expenditures is considered contractionary, whereas a policy that adheres to the 'tax and spend' maxim is considered expansionary, even if it leaves the balance unchanged. In Table 5 it can be seen that the recently introduced fiscal policies have been contractionary.

Table 5

Public finance overview

in % of GDP

	Revenues			Expenditures			Balance					Public debt				
	2009	2010	2011 ¹⁾	2009	2010	2011	2009	2010	2011 ¹⁾	2012	2013	2009	2010	2011 ¹⁾	2012	2013
										Forecast					Forecast	
Bulgaria	36.3	34.3	33.1	40.7	37.4	35.2	-4.3	-3.1	-2.1	-1.8	-1.5	14.6	16.3	16.3	18	18
Czech Republic	39.1	39.3	40.3	44.9	44.1	43.4	-5.8	-4.8	-3.1	-2.9	-2.5	34.4	38.1	41.2	43	45
Estonia	43.2	40.9	39.2	45.2	40.6	38.2	-2.0	0.3	1.0	-2.5	-1.0	7.2	6.7	6.0	10	11.5
Hungary	46.9	45.2	52.9	51.4	49.5	48.7	-4.5	-4.3	4.2 ²⁾	-3	-3	79.8	81.4	80.6	79	78
Latvia	34.7	35.7	35.6	44.4	43.9	39.1	-9.7	-8.1	-3.5	-2.6	-2.5	36.7	44.7	42.6	43.5	44.5
Lithuania	34.3	33.7	32.0	43.8	40.9	37.5	-9.4	-7.3	-5.5	-3.3	-2.8	29.4	38.0	38.5	40.5	41.0
Poland	37.2	37.5	38.5	44.5	45.4	43.6	-7.4	-7.9	-5.1	-3.5	-3.0	50.9	54.8	56.3	55	54
Romania	32.1	33.4	32.5	41.1	40.2	37.7	-9.0	-6.8	-5.2	-3.5	-3	23.6	30.5	33.3	34	34
Slovakia	33.5	32.4	32.6	41.5	40.0	37.4	-8.0	-7.7	-4.8	-5.0	-4.0	35.5	41.1	43.3	46	47
Slovenia	43.2	44.2	44.5	49.3	50.3	50.9	-6.1	-6.0	-6.4	-4.5	-4.0	35.3	38.8	47.6	54.0	58.0
NMS-10	37.7	37.7	38.8	44.7	44.2	42.4	-6.9	-6.4	-3.6	.	.	42.5	47.1	48.7	.	.
EA-17	44.8	44.8	45.3	51.2	51.0	49.4	-6.4	-6.2	-4.1	-3.2	-2.9	79.9	85.3	87.2	91.8	92.6
EU-27	44.2	44.1	44.6	51.1	50.6	49.1	-6.9	-6.5	-4.5	-3.6	-3.3	74.8	80.0	82.5	86.2	87.2
Croatia	36.4	35.0	34.7	40.5	39.9	39.7	-4.1	-4.9	-5.0	-4.5	-4.0	35.8	42.2	46.0	50	55
Macedonia	31.3	30.4	29.6	33.9	32.9	32.1	-2.7	-2.4	-2.5	-1	-1	31.7	34.8	35.0	34	33
Montenegro	45.8	40.9	33.9	49.4	43.9	38.0	-3.6	-3.0	-4.2	-1	-1	38.2	40.9	44.0	44	42
Turkey	33.5	36.7	38.0	40.4	39.4	39.4	-6.9	-2.7	-1.4	-1.6	-1.8	45.5	39.4	37.9	35	33
Albania	26.0	26.6	25	33.0	29.7	30	-7.0	-3.1	-5	-5	-8	59.7	58.2	60	62	66
Bosnia and Herzegovina	43.0	44.2	44.0	47.5	46.7	46.5	-4.5	-2.5	-2.5	-3.0	-2.5	35.3	38.9	39.0	41	42
Serbia	42.1	43.1	41.9	46.6	47.9	47.0	-4.5	-4.8	-5.1	-6	-4	34.8	42.9	45.0	49	50
Kazakhstan	20.6	19.7	19.7	23.5	22.1	21.8	-2.9	-2.4	-2.1	-2.5	-1.5	12.2	14.7	16	16	16
Russia	35.0	35.5	38.4	41.4	39.0	36.8	-6.3	-3.5	1.6	0	0	8.3	8.6	9.2	8	7
Ukraine	29.9	29.1	30.3	34.0	35.0	32.1	-4.1	-6.0	-1.8	-3.5	-3	34.8	39.1	35.9	35	34

1) Preliminary . - 2) Including one-off effects. Without those effects general government budget balance is estimated to have attained -4.6% of GDP .

Source: wiiw Database incorporating national and Eurostat statistics. Forecasts by wiiw and European Commission (Economic Forecast, Spring 2012) for EU and euro area.

This has not come about solely on account of the diminishing size of public-sector deficits, but also on account of the rapid decline in expenditures being accompanied by lower (or little) decline in taxation. This definitely compounded the effects of falling deficits. It is to be expected that the same trend will persist in the years to come (in the euro-area countries of Western Europe). Secondly, more detailed changes in the structure of taxation and public spending have generally favoured those segments of society that are better off and placed at a disadvantage those who are worse off, such as the recipients of social-security benefits.¹⁹ Given the differentials in savings propensities, detailed changes of this kind in taxation and public spending systems reduce – *ceteris paribus* – consumer demand and thus overall growth. Thirdly, the estimates concerning future public finance developments in the new EU member states tend to be based – with only limited adjustments – on the official budget plans of those countries. Drawing up those budget plans, however, has to conform to the format set by the European Commission. As such, they may underestimate the negative consequences that fiscal consolidation measures bear for the evolution of the debt-to-GDP ratios.²⁰ Adherence to the consolidation course may slow down output growth to a greater extent than claimed. In the ultimate analysis, the debt/GDP goals may be missed – despite all the sacrifices made.

Threats and opportunities

For the CESEE countries, we expect 2012 to be a rather disappointing year in terms of growth. In most of the countries, GDP growth will be pretty slow – at least when judged by their own past standards and the ambitions they harboured only a few years ago. Some of the CESEE countries will suffer a mild recession or come close to it. Although external imbalances will develop anew in some countries, those imbalances are not expected to culminate all that soon in a repetition of precipitate and disorderly rebalancing crises. Perhaps the imbalances, if allowed to widen, may come to a sticky end later – possibly beyond the horizon of our present forecast.

To a certain extent, the current state of at least some CESEE economies follows on naturally from the recession of 2009. Some effects of that recession (and of the developments that preceded it) do not seem to matter very much anymore. Deleveraging has already taken its toll and the domestic banking

¹⁹ Examples of reforms favouring the rich at the expense of those worse off abound. Introduction of a 'flat tax' on personal incomes combined with increases in indirect taxation burdening consumption of basic staples is just one instance of the tendency to make lives of the well-off even more pleasant. More recently in a number of CESEE countries (even in Slovakia which was among the pioneers of 'flat taxes'), the authorities seem to be having second thoughts about the economic rationale for and social fairness of 'flat taxes'.

²⁰ In its Spring 2012 economic forecast, the European Commission argues (pp. 45-47) that 'the improvement' (i.e. cut) in the EU-27 budget balance of 1.4% of the EU output envisioned for 2012 will leave the EU output almost unchanged (a cosmetic decline by 0.3% against the baseline scenario is quoted). This suggests a multiplier of $\frac{1}{4}$ – way off the likely $1\frac{1}{2}$. (1.52 is the average first-year instantaneous multiplier of fiscal stimulus for the EU, according to a recent paper jointly authored by 18 researchers that appeared in the January 2012 issue of *American Economic Journal: Macroeconomics* (<http://gesd.free.fr/coenen11.pdf>). Multipliers well in excess of 1 are also suggested for the new member states by the estimations conducted at our institute. The EU Commission's estimations come from a Dynamic Stochastic General Model. Models of that class used to be highly fashionable prior to the crisis of 2008-2009. More recently, they have been the object of ridicule (see e.g. J. Stiglitz (2011): Rethinking Macroeconomics: What Went Wrong and How to Repair It, *Journal of the European Economic Association*, August). It is very likely that the multipliers used in official consolidations plans in the new EU member states were close to those used by the European Commission.

sectors seem to have been strengthened. For example, the domestic banks' exposure to foreign banks has been reduced, without this perceptibly impairing the former's operations. On the other hand, the public debt that has increased steeply over the past few years is commonly considered a major threat to stability and prosperity in most of the CESEE countries. The fiscal consolidation measures currently under way in a number of countries constitute a response to the risks that excessive public debts supposedly pose. It is only fair to say that in many countries these dangers are more imagined than real. Moreover, in all the CESEE countries, whose governments have decided to become 'fiscally responsible', consolidation comes at a most inappropriate moment. Output growth has been losing momentum under the impact of an investment slowdown/recession and a weakening of external demand (the latter development is due to recessionary developments in the euro-area). Under such conditions, fiscal consolidation – even if otherwise desirable – should be postponed, unless the circumstances are truly critical (which is not the case, except perhaps in Hungary).

At present, the major and most realistic danger facing the majority of CESEE countries is that they will stick to their commitment to fiscal consolidation, even if investment, consumption and exports continue to weaken. For that threat to materialise, neither the euro area nor the EU as whole need necessarily plunge into some dramatic crisis or other. For that danger to become reality, it is sufficient for Europe to continue slowing down, while fiscal consolidation is still being demanded of its old, new or prospective members. Of course, some spectacular collapse of the euro area/EU (as we know it) could perhaps have truly devastating effects on most CESEE countries – via trade, capital flows, transfers and migration. (The world-market commodity prices would then be also affected, with obvious - negative - consequences for Russia, Kazakhstan and Ukraine). Chaotic developments would then follow in its wake - with repercussions for the global economy at large. However, for reasons spelled out earlier, we may be unqualified to predict specific events, should chaos erupt.

A scenario more optimistic than that possible under the current practice of 'muddling through' may still be beyond the horizon. Even though muddling through is unlikely to yield satisfactory results no matter how long it lasts, desirable changes may eventually come about. Of course, those changes would have to start in 'high places' in the leading EU countries and leading European institutions. Should the political and economic elites of Europe start acknowledging the futility of fiscal austerity economics, recognize the destructive character of structural policies that boil down to promoting still more laissez-faire and, last but not least, become aware of the need for an overhaul of EU institutions (including the ECB), things might start looking more promising for Europe as a whole – and hence for the CESEE countries as well.

Kazimierz Laski and Leon Podkaminer

Special Section I: Should the European Union strive to achieve permanently balanced public finances?

Balanced public finances are incompatible with private-sector demand for financial wealth

Looking at a national economy from both the income and expenditure sides, one gets the following identity:

$$YD + T + M = CP + IP + G + X \quad (1)$$

where YD denotes the disposable income of the private sector, T is the disposable income of the government (all taxes net of all monetary transfers to the private sector) and M is the income of the rest of the world (RoW) from imports of the national economy in question (the left-hand side of (1)). On the right-hand side of (1) we have private sector expenditures on consumption (CP) and that sector's gross investment (IP), government expenditure on goods and services (G), and RoW expenditure on the national economy's exports (X). By simple rearrangement, we get

$$[(YD - CP) - IP] = (G - T) + (X - M)$$

This is equivalent to:

$$(SP - IP) = (G - T) + (X - M)$$

or, finally:

$$NPS = D + E \quad (2)$$

In (2) we denote by $NPS = (SP - IP)$ the *net* private savings, by $D = (G - T)$ the budget deficit and by $E = (X - M)$ the RoW deficit (or the current account of the country concerned).

Ex post, the formula (2) always holds because it is an identity. However, even as an identity it points up interesting relationships between sectors, especially when statistical data covering longer periods are available. For the world as a whole, we obviously have $NPS = D$. This is an identity which links the financial balances of the private and government sectors aggregated globally. Budget surpluses ($D < 0$) and even balanced budgets ($D = 0$) do occur, albeit rarely; thus, for monetary economies worldwide, budget deficits ($D > 0$) seem to be the rule rather than an exception. This applies not only to times of war and disasters, but – at least for the industrial countries disposing of longer statistical records – also to periods of peace as well.²¹

The world public debt-to-GDP ratio has increased over the past 120 years from about 40% to about 70% and for advanced countries from about 50% to about 100% (IMF 2011)²². Although there were

²¹ See e.g. Laski (2008).

²² See IMF, Fiscal Affairs Department, Historical Public Debt Database, 2011

also periods when this ratio went into decline, its tendency to increase implies not only an increase in debt but also an increase ahead of GDP growth. In advanced industrial countries, the public-debt ratio increased from 30% to over 100% between the mid-1970s and the mid-2000s. Taking into account the fact that the rate of interest (on public debt) was – for extended periods of time - lower than the rate of growth of (nominal) GDP, this implies that the primary budget deficit in most countries must have been positive.

Given that for the world as a whole $E = 0$ by definition and $D > 0$ (as shown by long-term statistical records), we have, according to (2), $NPS > 0$. The private sector of the entire global economy thus displays a sustained tendency to save more than it invests. The same observation can be made with respect to the European Union (EU). The EU is a group of countries with negligible E . Almost all EU countries have consistently run budget deficits (very much in violation of the Maastricht Treaty); hence for the EU as a whole, we also have $D > 0$. In actual fact, the consolidated budget deficits for the entire euro area have been positive since at least 1995. It thus follows that the NPS for the EU as a whole is also positive. Last but not least, we observe that for $NPS = 0$ - which can be understood as a minimum requirement or something to that effect whereby the private sector should not incur outside debt - all countries with a passive current account ($E < 0$) must record budget deficits $D > 0$. Of course, all these observations are to be understood as referring to a trend and average values for longer periods – and not as a rule for each country and every year. We also observe that those countries, which happen to report budget surpluses ($D < 0$), very often (although not always) record high E . This must be the case if $E > NPS > 0$ (e.g. the case of Norway since becoming a major oil exporting country).

Within the private sector we have two subsectors: private households and firms. Correspondingly, private savings ($SP=YD-CP$) comprise household savings SH and profits retained by firms PR . It is normally assumed that for most of the time, firms invest more than they save (in the form of profits retained), hence incurring a flow of debt, the volume of which increases over time. This debt makes it possible to increase the firms' productive capacities beyond the levels funded from their own savings (i.e. profits retained). One also assumes that private households are net savers, whose financial assets increase over time. The assumption $NPS > 0$ is thus normally interpreted as a situation in which private households save in excess of the new debts that firms are prepared to incur.

The fact that as a rule (or mostly so) NPS is positive can be interpreted as reflecting the *desired* level of private savings (SP) being higher than the actual level of private investments. Positive ($D + E$) helps to narrow the gap between private savings and investments. Alternatively, it can be said that the positive NPS must be reflected in the sum $(D+E)$ being positive as well. However, NPS equal to $(D+E)$ is an identity; as such, it does not say anything about the direction of causality. In any event, positive NPS must be *counterbalanced* by the sum of government and foreign deficits. The private sector's desire to run a financial surplus ($NPS>0$) cannot be realized without the willingness of government and foreign sectors (taken together) to run a deficit. Similarly, the government and foreign sectors (once again taken together) cannot run financial surpluses ($D+E<0$) without the private sector's net dis-saving (NPS dropping below 0) i. e. without private sector savings falling short of private sector investment.

At present, the understandable trend throughout much of the industrialised world is for the private sector to increase net savings ($\Delta NPS > 0$). 'Deleveraging' should strengthen private sector balance sheets. Both households and firms (including those in the financial intermediation sector) feel they have incurred excessive debt. The deleveraging trend, however, actually clashes with the present overall orientation of fiscal policies. Those policies prescribe fiscal austerity – reducing budgetary deficits. Should austerity prevail, one would have $\Delta D < 0$. Should the private sector succeed in deleveraging, $\Delta NPS > 0$ would be the outcome. Clearly, the identity $\Delta NPS = \Delta D$ (for a while disregarding the change in current account, ΔE), would of necessity be violated. However, by their very nature, the identities hold under any circumstances. In reality, the identity $\Delta NPS = \Delta D$ will hold no matter what policy is pursued and irrespective of private-sector preferences. What kind of outcome will emerge out of the two conflicting tendencies or which of them will ultimately prevail is very much an open issue. In any case, that conflict is likely to incur some 'collateral damage' in the form of weaker growth and higher unemployment.

However, why do net private savings tend to be positive? In a 'textbook economy' (consisting solely of a private sector – without government and the rest of the world), NPS according to (2) would have to be zero. Indeed, in such an economy $D=E=0$, hence $NPS=0$. In such a 'textbook economy', investment is equal to savings (both are private) so that $SP-IP=0$. It must be understood that in such an economy, the private sector as a whole would be unable to accumulate *net* ('outside') financial wealth – simply because there would be no party other than the private sector to supply the financial debt that would constitute the private sector's financial wealth. Undoubtedly, economies that rule out accumulation of private sector *net* financial wealth are conceivable. In all probability, the early 'natural' economies would have fitted that description. However, it is hard to imagine (unless one adheres to the ideas of 'mainstream economics') a modern monetary economy without private sector accumulation of *net* financial wealth. In a modern economy the private sector accumulates *net* financial wealth – if not in the form of government bonds, then at least in the form of hoards of cash/flat money issued by the government's own central bank. To gain access to the money to be hoarded, the private sector would of its own free will have to supply the government with goods and services that it had produced on its own. (Thereby the government would have had to acquire such goods and services, without paying for them out of the proceeds of proper taxation levied on the private sector). Of course, the private sector's *net* financial wealth would have to be matched by the debt issued by the government²³ (plus, eventually, the debt issued by foreign parties that the private sector acquires).

Why does the private sector tend to accumulate outside debt (in particular, that of its own government)? The simplest answer is that the private sector greatly values such debt. For the private sector, public debt *must be* wealth – no matter what the proponents of '*Ricardian equivalence*' claim. Otherwise, the private sector would not trade valuable goods and services it produces for government 'paper'.

²³ See Wray (1998), Ch. 4

What kinds of benefits follow from the ownership of public debt? The opportunity to earn interest income on that debt may certainly be one motive. That motive alone, however, does not seem to be decisive. In many countries the rate of interest on public debt is purely symbolic. Japan with its soaring public debt has no difficulty in floating its massively expanding public deficits at interest rates of less than 1%. Interest rates on Switzerland's public debt gravitate towards zero. Essentially, public debt is in such great demand in the private sector for reasons of liquidity (as, of course, stressed by Keynes) or as a trusted store of value or as those necessary capital reserves that facilitate firms' access to capital markets (and thus private investment, as in Kalecki). In Laski and Podkaminer (2012) our hypothesis was that private sector demand for public debt is even likely to strengthen secularly. This will be due to private sector savings in general rising more rapidly than private investment. Changes observed in the structure of private sector income (with rising inequality in disposable incomes and the emergence of a super-rich class whose members derive their incomes from trade/speculation in various assets and financial instruments rather than from capital investment in productive capacities) is one of the factors contributing to the yawning gap between private sector savings and investment²⁴. The emergence of the super-rich is, of course, intimately linked to the ever-progressing financialisation/privatisation of services traditionally provided by the public sector (inter alia, health, education and old-age pensions). Financialisation/privatisation also induces a higher propensity to save for precautionary reasons – without the requisite rise in the propensity to invest productively. The flip side of financialisation of the services formerly provided by the public sector is the rise in private funds, such as pension funds²⁵. These funds may tend to acquire – especially in turbulent times – growing chunks of public debt. Ageing in a time of ever-increasing financialisation of the pension system may add strength to the private propensity to save. Moreover, technological change may be another factor. The productivity of fixed assets is likely to improve secularly owing to advances in technology – the investment of smaller amounts of real assets is capable of producing more output. This trend may be temporarily interrupted by major inventions (such as 'electricity' which called for high initial investment in the construction of power stations, transmission grids, etc.). In the long term, as the supply of goods produced by the private business sector can perhaps be expected to outstrip demand for the same, the desire to save could systematically outstrip the desire to invest.

Destructive fiscal consolidation

There is a basic difference between state debt and private debt. A private debtor can become insolvent, while the state, if indebted in its own fiat currency that is not linked to any commodity or any other

²⁴ The study of impacts of rising inequality on macroeconomic performance (GDP growth, current account developments, financial stability) has come to the fore of research interests recently (e.g. Rajan, 2010, Berg and Ostry, 2011). More research on links between rising inequality, rising net private savings and the overall growth slowdown is still needed. In particular, it remains to be examined whether the relatively rapid and balanced ($NPS \approx 0$, $D \approx 0$, $E \approx 0$) growth of major industrial countries in the 1950s and 1960s was not associated with rather low/falling levels of inequality prevailing at that time. Low/falling inequality may have produced reduced levels of household sector's savings and increased levels of consumer demand. Furthermore, the increased size of consumer goods markets may have induced large investments in firms that soaked up household's savings leading to relatively minor surpluses in the private sector financial balance as well as to relatively low budget deficits.

²⁵ See Toporowski, 2012.

currency via a fixed exchange rate, is always solvent, assuming that the central bank and public finance act in concert. Under those conditions, there are no exact limits to the level of the public debt-to-GDP and the deficit-to-GDP ratios as long as the economy's GDP remains below the potential output.

In the Economic and Monetary Union (EMU) monetary policy is supposed to be divorced from fiscal policy. While fiscal policy remains the responsibility of member states, monetary policy is the domain of the European Central Bank (ECB), which is politically independent with the prime task of maintaining price stability. From the very outset it excluded the possibility of the ECB bailing out countries that encounter difficulties in gaining access to financial markets. This is tantamount to a situation in which each EMU member country manages its fiscal policy in a foreign currency.

Godley (1997, p.2) noted this danger even before EMU had been created:

'If a government does not have its own central bank on which it can draw cheques freely, its expenditures can be financed only by borrowing in the open market in competition with business, and this may prove excessively expensive or even impossible, particularly under 'condition of extreme emergency'... The danger, then, is that the budgetary restraint to which governments are individually committed will impart a disinflationary bias that locks Europe as a whole into a depression it is powerless to lift'

The EMU supposed that the member states' fiscal policy could be constrained by numerical criteria on the maximum deficit-to-GDP and debt-to GDP ratios. Actually, the Stability and Growth Pact goes even further as it '*lays down the obligation for Member States to adhere to the medium-term objective for their budgetary positions of close to balance or in surplus...*'²⁶ The Fiscal Compact recently agreed upon by majority of EU leaders is designed to strengthen 'fiscal discipline' across the euro area (and beyond). Moreover, the Fiscal Compact imposes the obligation to *reduce* public debt/GDP ratios. In so doing, it actually may impose, on some euro-area countries, the obligation to run – on a long-term basis - budgetary surpluses. Taxation of the private sector (net of transfers to the same) should be persistently higher than income earned by the private sector on sales on goods and services to the government. The private sector in most euro-area countries will 'bleed' for many years to come – for the sake of 'healthy public finances'. The latter are deemed indispensable to the long-term robustness of the private sector itself. (An analogy to the mediaeval 'medical science' and the practice of bloodletting inevitably comes to mind). The economic and social costs of this austerity hysteria will no doubt be immense.

Supposing D is negative (as required by the Fiscal Compact), NPS (further disregarding possible changes in E) would have to be negative as well. Or (remembering that $NPS = SP - IP$) private sector savings would have to be consistently lower than private sector investment. The private sector's financial wealth would then have to drop: for example, via the government redeeming its debt to the private sector (with the proceeds then serving to finance private investment). It is at least debatable whether the private sector would be eager to engage in investment under such conditions. The fal-

²⁶ See Council Regulation No. 1055/2005 amending the Growth and Stability Pact. *Official Journal of the European Union*, 7 July 2005, L. 174/1. The same requirement features in the recent Fiscal Compact (Article 3, point 1(a)).

ling financial wealth and contracting domestic consumer demand might more likely induce falling investment and rising savings, thereby initiating spiralling recessionary adjustment.

The question worth asking is whether it will be possible at all – and under what conditions – to run a euro-area-wide policy, which in fact requires that the net private savings of the member states are persistently negative. Of course, the current account E (the changes of which we disregarded for a while) for some euro-area countries may, on occasion, be positive and high enough to render $\Delta(D+E)$ still positive. A small country (such as Luxembourg) can combine large budgetary surpluses with current account surpluses over extended periods of time – without this having a perceptible impact on its trading partners. A large country (such as Germany) is unlikely to persist indefinitely with high budgetary surpluses combined with massive current account surpluses, the reason being that Germany's current account surpluses are the current account deficits of its partners, such as Italy. The latter country's NPS would then have to be unambiguously negative – on account of both E and D being negative. Thus, any attempts to run budgetary surpluses in one (or more) euro-area countries can only be successful (via expansion of current account surpluses), if the same attempts fail in some other euro-area countries²⁷. Incidentally, under the present circumstances it is an illusion to expect that the EU as whole could become a major net exporter to the rest of the world. Germany and some other EU member countries can continue – at least for some time – to run mercantilist (and deflationary) policies which negatively affect other countries (also outside the EU). There are limits, however, to the beggar-thy-neighbour policies. Such policies will sooner or later provoke retaliatory reactions. The rest of the world (and the USA, in particular) is unlikely to remain passive, should the EU as a whole start recording gigantic trade surpluses (for example, matching those of China). Otherwise, the successful beggar-thy-neighbour policy is self-defeating because it implies accumulation of the foreign debt of those countries with persistent trade deficits. Once that debt is acknowledged to be unsustainable, growth in countries with persistent trade surpluses would inevitably flag as well. Moreover, the creditor countries would have to write off chunks of their 'bad assets'.

The idea of fiscal consolidation as a way out of the present difficulties is related to the diagnosis of the present crisis. Over the past few decades in the world as a whole – and especially in advanced countries – the debt-to-GDP ratio has increased, but private debt has increased more rapidly than government debt. The crisis started when the private household sector could no longer service its debt, which amounted to almost 100 per cent of GDP in the US (financial institution debt accounted for another 125 per cent, and the total debt ratio ran to 500 per cent of GDP). The fiscal interventions that had to be undertaken by governments in the US and Europe gave rise to a significant increase in public debt in relation to GDP; thus, the increase in government debt was the consequence of the crisis – not its cause. Hence, it is totally misleading to interpret the present crisis as a sovereign debt problem. It is more a case of a speculative financial bubble suddenly bursting, the dark side of which

²⁷ We describe in summary terms another difficulty that arises. A combination of current account surpluses with budgetary surpluses implies a shift in a country's private sector net financial wealth. To an ever increasing degree, that wealth would consist of foreign (private or public) debt. At the same time, the share/size of debt issued by that country's government would decline. It is doubtful whether the German private sector would actually be eager to substitute *bunds* for private/public Greek (or even Italian) debt.

is increasing debt and inequality.²⁸ Moreover, the term “balance sheet recession” introduced by Koo (2003) pinpoints the notion that the real cause of the present crisis is over-indebtedness of private households and firms that need to repair their balances via lower expenditures and higher savings; the latter are the real factors restricting demand.

Conclusions

However, the diagnosis prevailing in Europe politics is quite different. The reason for the crisis is seen to lie in too high a public debt and excessive Government spending, hence the suggestion that the essential solution lies in tightening fiscal discipline. Mr. Wolfgang Schäuble, Germany’s Minister of Finance, put it this way: ‘The main reason for the lack of demand is the lack of confidence; the main reason for the lack of confidence is the deficits and public debts which are seen as unsustainable’. On another occasion he said, ‘We won’t come to grips with economies deleveraging by having governments and central banks throwing – literally – even more money at the problem. You simply cannot fight fire with fire’²⁹

First, it just happens that fire can be - and is - used very effectively to fight forest fires. Breaks in the forests are back-burnt so as to prevent the spread of an uncontrollable wildfire. Secondly, and much more importantly, the question arises as to the intellectual basis of the ‘doctrine of expansionary austerity’. This is what Krugman (2012) calls the ‘confidence fairy tale’: the idea that confidence would enter the fray and reward policy-makers for their fiscal virtue. In actual fact, business confidence depends on many things – but surely profits earned are vital. Let us, therefore, take a look at the impact of fiscal consolidation on profits.

From (2) and taking into account that $SP = PR + SH$ (private sector’s savings consist of profits retained by firms and household savings) we get

$$PR = IP + D + E - SH \quad (3)$$

Remember that total profits P equal profits retained (PR) plus profits distributed (PD).

By adding PD to both sides of (3) we eventually get the following identity:

$$P = IP + CPD + D + E - SHW \quad (4)$$

In (4) CPD represents consumption out of profits and SHW household savings out of non-profit incomes.³⁰

In a closed economy without a government (4) reduces to the following identity:

$$P = IP + CPD - SHW \quad (5)$$

(5) is the famous profit equation due to Michal Kalecki. The equation says that in a closed economy without government, profits are equal to the sum of private investment and capitalist consumption

²⁸ See Papadimitriou and Wray (2012)

²⁹ Giles (2011)

³⁰ This implies that $(SH - SHW)$ denotes savings out of the distributed-profits income.

(i.e. consumption out of distributed profits) minus workers' savings. Equation (4) adds budget deficit D and trade surplus E to the items that increase, *ceteris paribus*, profits earned by firms. By virtue of being tied together in identities, profits P and other items on the right-hand side of (4) and (5) are simultaneous. There is no time lag between appearance of deficit spending and appearance of profits earned by firms. It is evident that policy actions successfully reducing budget deficits would, *ceteris paribus*, be matched by simultaneous a *reduction* in firms' profits. But firms suffering a loss in profits are highly unlikely to improve the sense of confidence essential to encouraging private firms to invest more. As a rule, large profits are a precondition for investment take-off. In other words, the negative D , as required by the Fiscal Pact, must be expected to be recessionary – all the more so, if at the same time the household sector attempts to accumulate more savings and the business sector does not invest enough.

Of course, recessionary adjustments could, ultimately, steer NPS into negative territory (consistent with the budgetary surpluses). That outcome, however, would feature low (falling) income and high (rising) unemployment levels. At a very low level of private savings, the requisite negative net private savings could eventually be achieved. However, even if economically imaginable, such an outcome would be unacceptable – both politically and socially. We doubt whether this is the outcome that the EU leaders actually desire. On the other hand, we deeply deplore the fact that the economic advisors to the EU heads of state apparently fail to grasp the actual consequences of the policies that they so doggedly advocate.

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Peter Havlik

Special Section II: Unit labour cost adjustments in times of crisis

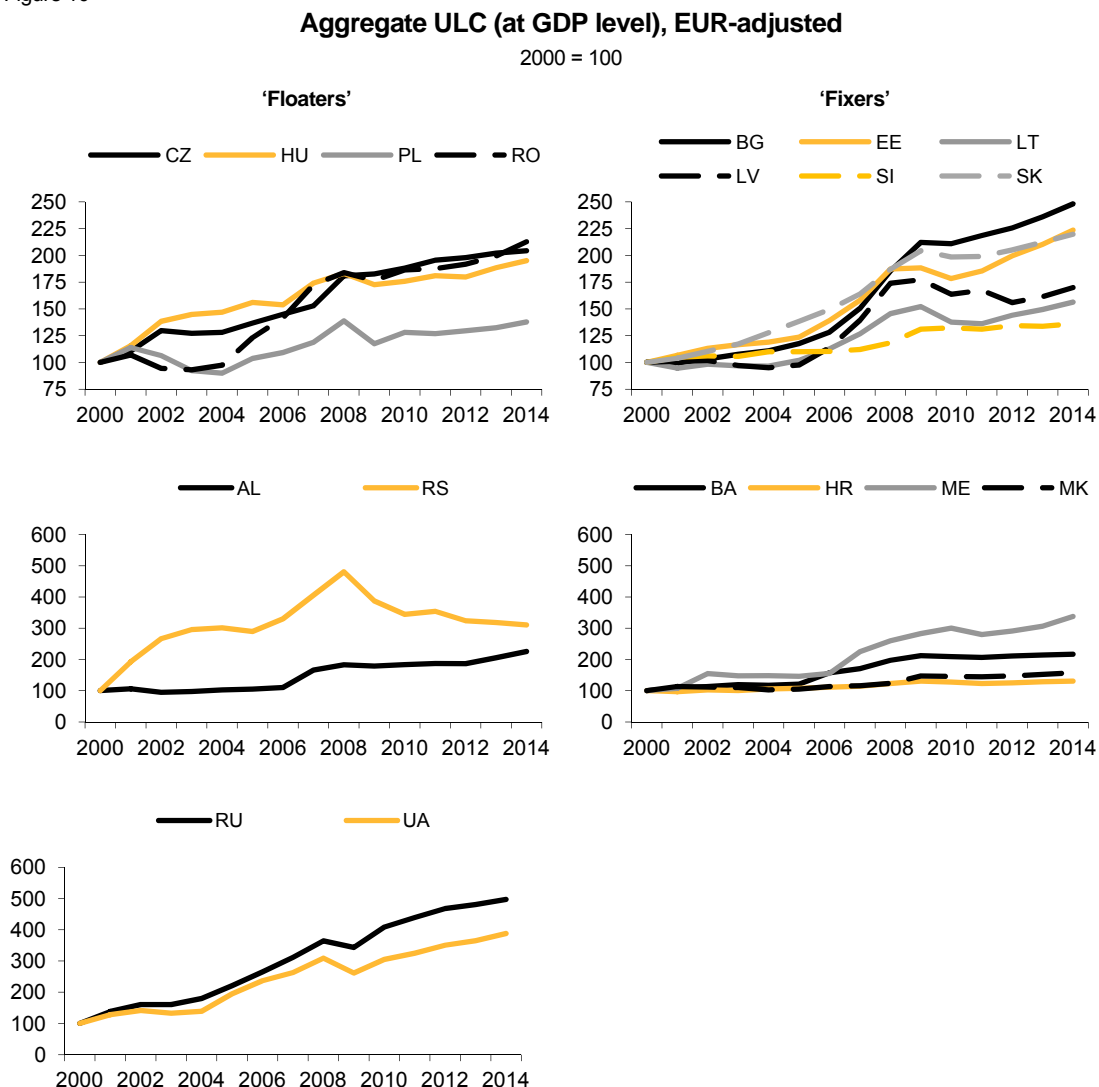
This section provides an analysis of recent developments relating to *Unit Labour Costs* (ULCs) in the countries of Central, East and Southeast Europe (CESEE) and an examination in greater detail of the key components of labour cost competitiveness. A summary is presented of the different responses to the crisis, productivity developments and the role of exchange rate regimes in terms of ULC adjustments ('external' as against 'internal' devaluations) in individual CESEE countries. Our estimates show that a country with a flexible exchange rate can achieve a downward ULC adjustment of up to 20 percentage points in the course of a single year (viz. Serbia in 2009), while even a country with a fixed exchange rate can achieve a remarkable adjustment of up to 10 percentage points over a similar period (viz. Lithuania in 2010). However, these adjustments turned out to be only temporary and the growth of ULC resumed again (except Serbia).

Prior to the recent crisis, rapidly rising ULCs (and fast deteriorating cost competitiveness) were a characteristic feature of developments in most CESEE countries. In the majority of those countries, aggregate ULCs (at the GDP level adjusted for the EUR exchange rate – see Box 1 for definitions) more or less doubled during the decade leading up to the crisis. In the period 2005-2008, ULCs had on average been increasing at double-digit annual rates in most CESEE countries (the exceptions being Croatia, Hungary, Macedonia and Slovenia – see Figure 10 based on Annex Table A/3). At that time, ULC growth was most rapid in Russia and Ukraine (about 20% per year on average). In contrast thereto, average ULC growth in Austria was a mere 2.7% over the same period, implying that the relative cost position (= labour cost competitiveness) of all CESEE countries in relation to Austria (with the sole exception of Slovenia) had markedly deteriorated. Two key factors that contributed to the decline in competitiveness in the CESEE countries during that period were: (i) rapidly increasing nominal wages; and (ii) currency appreciation in a number of countries with flexible exchange rates, such as the Czech Republic, Poland and Slovakia (see Figure 12). Obviously, developments such as those cannot be sustained, even though ULC levels in the CESEE countries still remain relatively low - according to our estimates, they amount to less than 50% of the level in Austria (with the exception of Slovenia and Croatia - see Figure 11).

The recent crisis brought about an abrupt change in these trends and an uneven pattern of ULC adjustments (both across countries and in terms of time). In a number of CESEE countries, ULCs fell markedly over the period 2009-2011 and it proved possible to bolster competitiveness. The pattern of adjustments over time in individual countries differed: a not insignificant determinant factor being the countries' exchange rate regimes. In a number of countries with *floating exchange rates* commonly known as 'floaters' (Czech Republic, Hungary, Poland, Romania, Russia, Serbia and Ukraine), ULCs dropped in 2009 compared to 2008 (by close to 20% in Serbia and by about 15% in both Poland and Ukraine). These downward adjustments were partly the result of national currencies having depreciated, but they were also the outcome of productivity improvements (see Annex Table A/3 and Figure 12 for decomposition of ULCs). On the other hand, countries with *fixed ex-*

change rates commonly known as ‘fixers’ (either those countries with a currency board regime such as Bulgaria, Estonia, Latvia and Lithuania or those already in the eurozone such as Austria, Slovakia and Slovenia) have been deprived of the ‘external’ devaluation option. In 2009 that lack of exchange rate flexibility initially led to an increase in ULC levels (by as much as 15% in Bulgaria and Macedonia, 10% in Slovakia and Slovenia, 5.6% in Austria); GDP and aggregate labour productivity (GDP per employed person) dropped, while average wages (except those in the Baltic States) rose. Only during the biennium 2010-2011 was competitiveness (a reduction in ULC) partially restored. Whereas ULC adjustments among the ‘fixers’ (Croatia, Estonia, Latvia, Lithuania, Montenegro and Slovakia) were largely the outcome of cutbacks in employment, the majority of ‘floaters’ were confronted with a renewed increase in ULCs as exchange rates appreciated and productivity growth remained unimpressive.

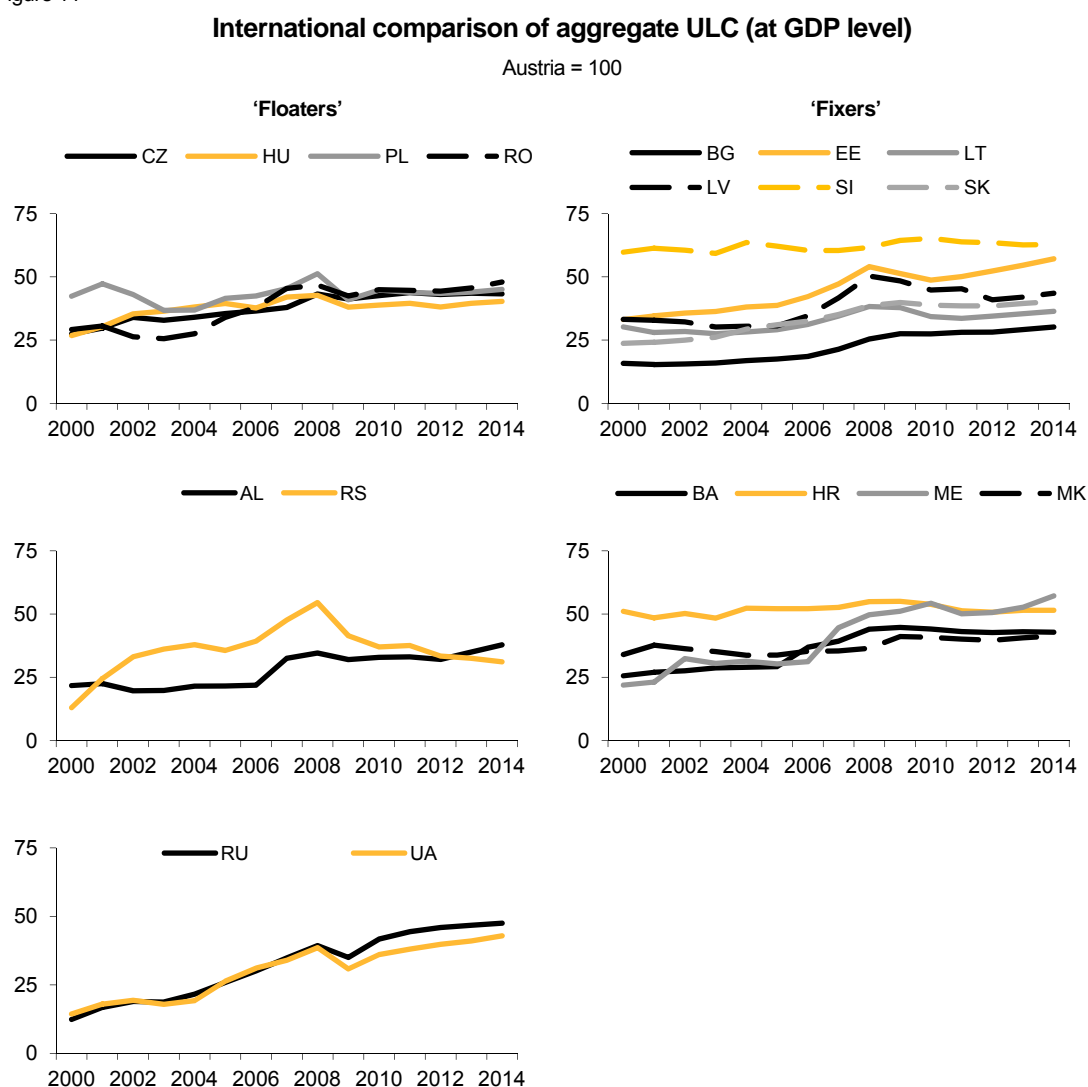
Figure 10



Source: wiw Database incorporating national and Eurostat statistics; forecasts: wiw.

The variance in the spatial and time dimensions of ULC adjustments between ‘floaters’ and ‘fixers’ illustrates the power of exchange rate flexibility as compared to relative wage-rigidity (apart from exchange rates, other key ULC components are wages and labour productivity, the latter decomposed into changes in output and employment – see Box 1 for details). As mentioned above, countries with flexible exchange rates managed to reduce their ULCs in 2009 mostly by means of exchange-rate adjustments. Invariably, the latter adjustments more than offset the adverse effects of the decline in labour productivity in the crisis period when labour productivity lapsed owing to the drop in GDP, while employment cutbacks were initially kept in check. ‘Competitive’ devaluations even permitted a modest increase in nominal wages in some countries (extreme examples being Poland and Ukraine where devaluations captured most of the ULC adjustment in 2009 – see Figure 12, ‘floaters’).

Figure 11



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

Box 1

Definition of Unit Labour Costs (ULC)³¹

Assuming that individual ULC components are defined on a comparable basis (in time and across countries/industries, respectively, or both), ULC can be defined as follows:

$$\text{ULC} = \text{LC} / \text{LP}$$

where LC are labour costs or gross wages (per employed person) and the labour productivity (LP) is defined as real output per employed person:

$$\text{LP} = \text{OUT} / \text{EMP}$$

Thus, unit labour costs can be rewritten as:

$$\text{ULC} = \text{LC}/\text{LP} = \text{LC} / (\text{OUT} / \text{EMP}) \quad (1)$$

Accordingly, any change (Δ) in unit labour costs (ΔULC , measured either in logarithm or per cent) can be decomposed in the following way (time or country subscripts are omitted):

$$\Delta\text{ULC} = \Delta\text{LC} - \Delta\text{LP} = \Delta\text{LC} - \Delta\text{OUT} + \Delta\text{EMP} \quad (2)$$

ULC will rise (that is, labour cost competitiveness will decline) when the increase in labour costs is higher than the corresponding increase in productivity and *vice versa*. In turn, productivity changes are determined by the relative growth rates of output and employment: For instance, LP will increase if (real) output growth outstrips employment growth. And, with given labour costs, this will lower ULC and increase the cost competitiveness of the respective country or industry. Formula (2) is basically valid for comparisons in both time (ULC growth rates) and across countries (ULC levels).³² In practice, it is much easier to compare growth rates rather than levels (productivity level comparisons in particular are problematic), since the available statistical data tend to be more consistent over time than across countries.³³ In international ULC comparisons over time, the 'national' ULC in formula (2) are frequently adjusted to the relative movements of exchange rates (ER). Labour costs in national currencies are therefore converted into euros (at current exchange rates) and fluctuations of exchange rates also have an impact on ULCs.³⁴ The exchange-rate effect has been substantial – see the variances in ULC performance of 'floaters' and 'fixers'.

On the other hand, by definition 'fixers' lack the exchange rate tool for restoring ULC competitiveness and have to resort to other policy instruments: either cutting nominal wages or reducing employment in order to offset the drop in output (so-called 'internal devaluation'). As Figure 12 relating

³¹ See P. Havlik (2005), 'Unit Labour Costs in the New EU Member States, *wiiw Statistical Reports*, No. 1, for details.

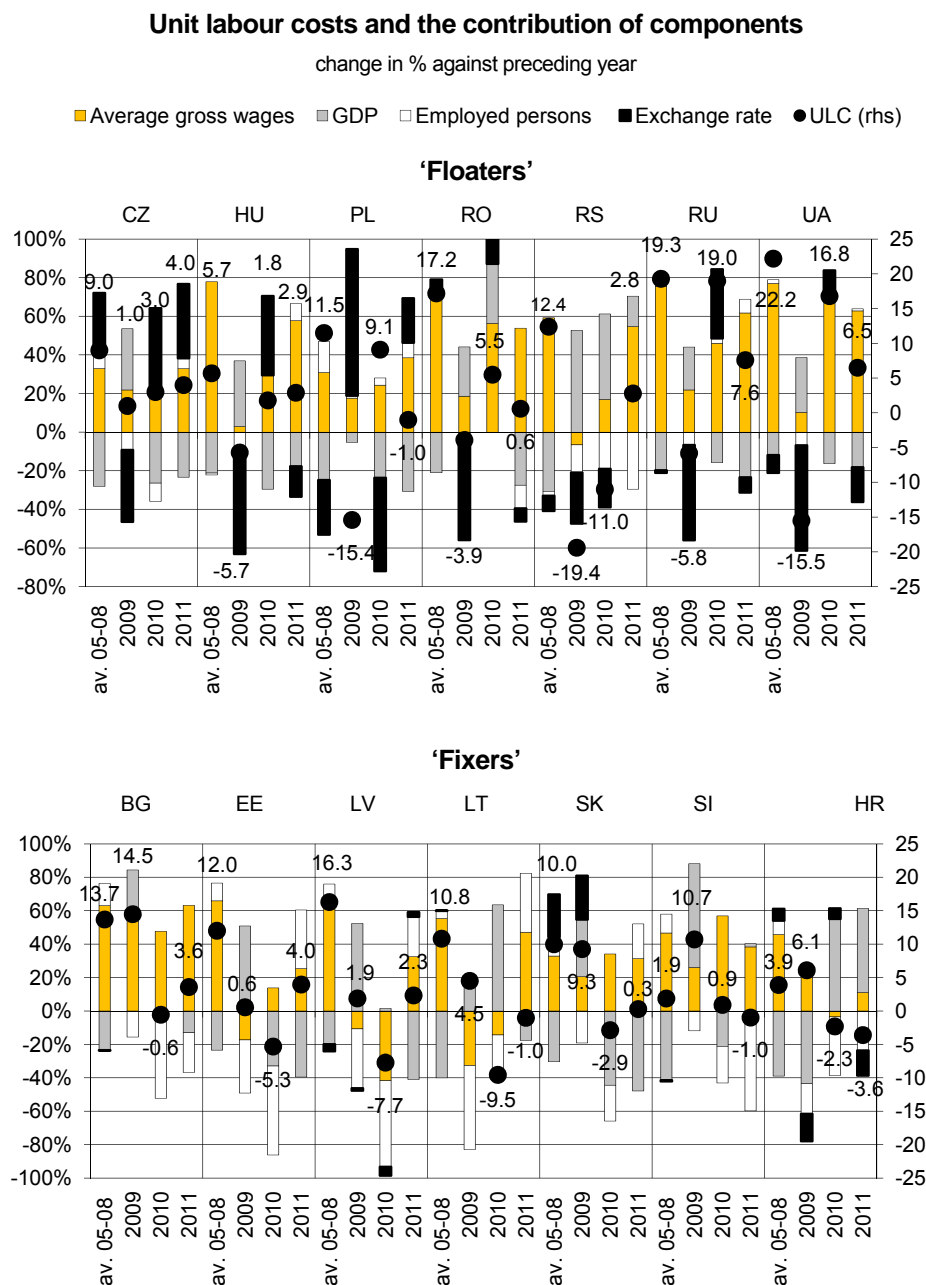
³² Changes in time (Δ) can be replaced by differences among countries.

³³ The NMS have witnessed sweeping changes in their statistical reporting methodology over recent years and the time consistency of their data is thus often problematic in comparisons over time as well.

³⁴ Currency appreciation will push up labour costs expressed in euros and thus ULCs as well; currency depreciation ('competitive devaluation') will lower labour costs in euros and thus reduce the ULCs of the respective country. Alternatively, if one is interested in the (domestic) purchasing power of wages, PPPs can be used for the conversion of LC instead of ER. In the absence of branch-specific unit value ratios, productivity levels are usually compared after conversion from national currency using PPPs.

to 'fixers' shows, employment usually bears the brunt of restoring ULC competitiveness in the absence of exchange-rate flexibility (in the Baltic States, nominal wages have been cut as well).

Figure 12



Source: wiiw Database incorporating national and Eurostat statistics.

Last but not least, the crucial factors are not ULC changes alone, but their levels as well (which, admittedly, are much more difficult to measure, especially on a country- or industry-wide basis – see

Box 1). wiiw estimates show that in most CESEE countries aggregate ULCs (at the country GDP level) are 50% lower than those in Austria (with the exception of Slovenia – see Figure 11).

In summary, it can be seen that flexible exchange rates not only permit more rapid ULC adjustment by restoring competitiveness in times of crisis (N.B. ‘floaters’ were already able to reduce their ULCs in 2009), but they also enable countries to secure that adjustment with far fewer adverse effects in terms of employment.³⁵ However, the recent downward ULC adjustments turned out to be only temporary and the growth of ULC quickly resumed as wages continue to outpace productivity and exchange rates tend to appreciate (with a notable exception of Serbia).

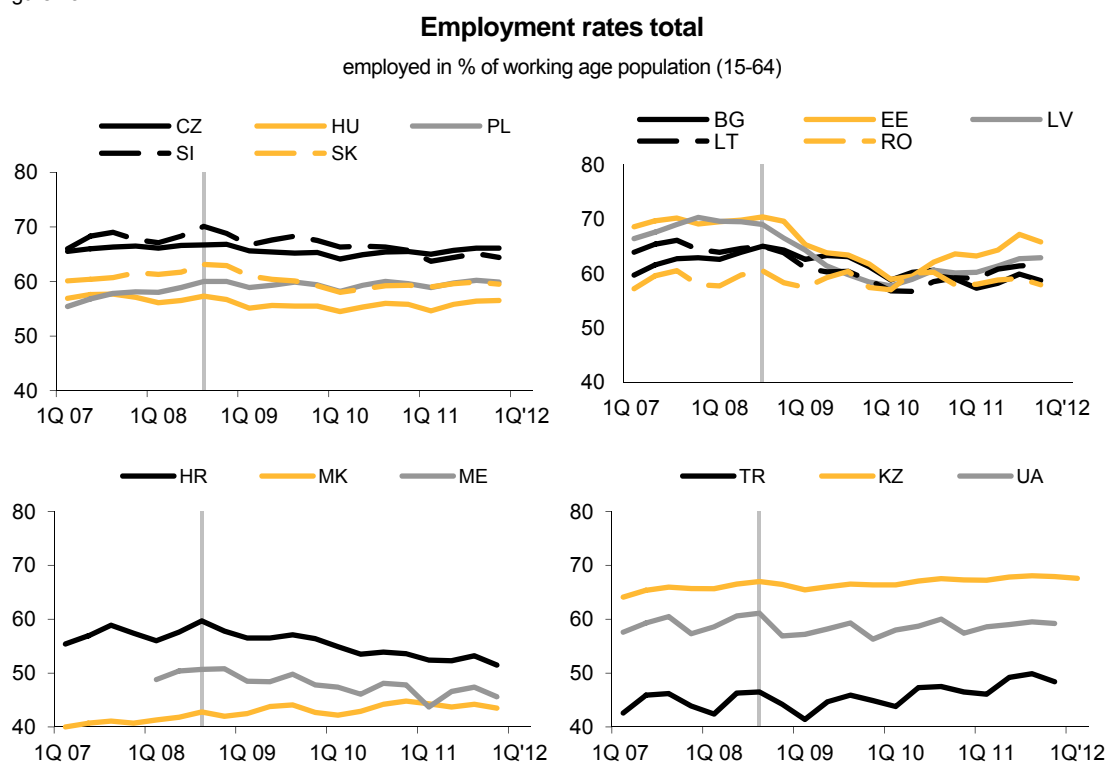
³⁵ This is one of the reasons why it is argued that flexible exchange rates turned out to be the preferable exchange-rate regime option (and countries with this option should not rush to abandon it) in times of crisis - see K. Laski and L. Podkaminer (2010), ‘Long-term growth prospects in Central and Eastern Europe hinge on changes in the basic paradigms of EU economic policy-making’, in: V. Astrov, M. Holzner, K. Laski, L. Podkaminer et al., ‘Will Exports Prevail over Austerity?’, *wiiw Current Analyses and Forecasts*, No. 6, July 2010, pp. 1-22.

Hermine Vidovic

Special Section III: Labour market developments and prospects

Following a subdued recovery in 2011, employment in several countries in the CESEE region continued to rise moderately, but developments varied to a remarkable degree across countries. In the first quarter 2012, notable rises of up to 4% were reported for Estonia, Turkey and Kazakhstan compared with the first quarter 2011, whereas employment continued to decline in Bosnia and Herzegovina, Bulgaria and Slovenia. It also declined in Serbia (albeit more moderately than in previous years), yet remained almost stagnant in the Czech Republic.

Figure 13



Working age population in Kazakhstan 15+, in Ukraine 15-70.

Source: Eurostat, national statistics.

Over the period 2008 - 2011, almost one million jobs were lost in the new member states (NMS). Poland was the only country to report any increases in employment during that period. Serbia is an exceptional case reporting a loss of 570,000 jobs or a contraction of 20% over the same three-year period. As shown in Figure 13, despite embarking on an upward trend after the (sharp) declines throughout the crisis, the majority of CESEE countries report employment rates that are still well below their pre-crisis levels. For all the substantial improvements in the three Baltic States, the em-

ployment rate in Latvia in the fourth quarter 2011 was 7 percentage points lower than in the same quarter 2007, with both Lithuania and Estonia reporting rates that were 3 percentage points lower. Sharp declines were also recorded elsewhere. Croatia dropped by 6 percentage points and Bulgaria by 4 percentage points, while Slovenia and Montenegro slipped by some 3 percentage points each. Only in five countries - Poland, Macedonia, Kazakhstan, Ukraine and Turkey - did employment rates exceed pre-crisis levels, growth being most pronounced in Turkey (plus 4.5 percentage points). The rate of employment in almost all Western Balkan countries, Bulgaria and Slovenia still continues to drop.

Over the past few years, experience has shown that unemployment displays a high degree of diversity in the CESEE region as whole and in the individual countries. Three NMS (Czech Republic, Romania and Slovenia) and three-CIS countries (Kazakhstan, Russia and probably so in Ukraine) started out in 2012 with unemployment rates below the EU-average of 10.2%.³⁶ Most of the (potential) EU-candidate countries, however, report unemployment rates of close to 30%. Only in Croatia and Albania are the rates lower: some 15%.

The past few years have also seen the plight of young people, who had been hit hard by unemployment even before the crisis, going from bad to worse. As illustrated in Figure 14 youth unemployment rates are more than double the average rate. In Bosnia and Herzegovina and Macedonia, youth unemployment is only slightly below the 60% mark, in Serbia it hovers around 50% and in Montenegro it stands at 40%. Of the NMS, youth unemployment is lowest in Slovenia (16%) - albeit ratcheting steadily upwards - and the Czech Republic (18%) in 2011. In Russia and Kazakhstan unemployment among the young decreased from 2010 onwards, whereas it increased in Ukraine. For the past three years, the rate of unemployment among the young in Kazakhstan has been even lower than the average EU-rate: it stood at about 5% in 2011.

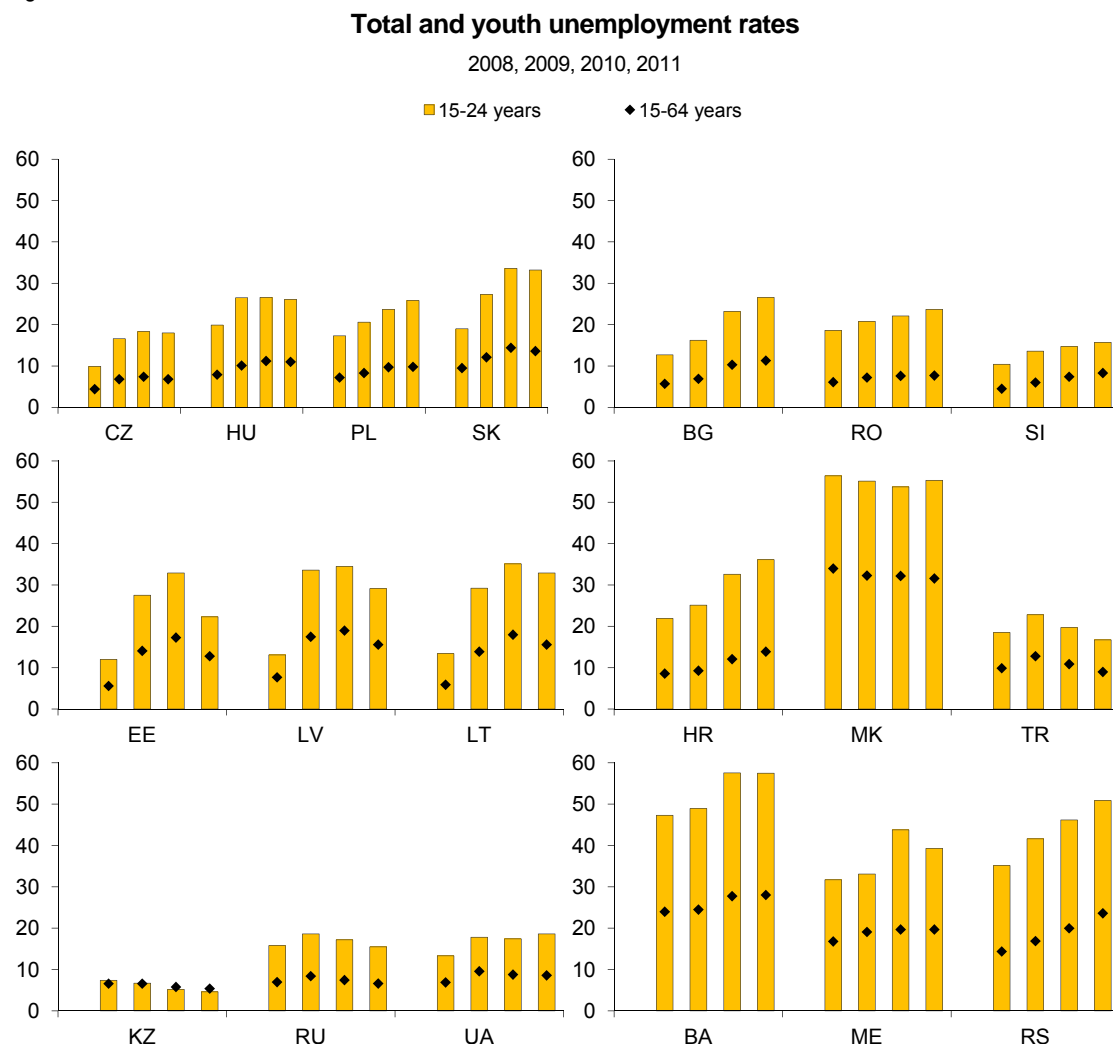
Apart from being threatened by the spectre of high unemployment, young people also invariably face poorer working conditions. Young workers aged 15-24 are being increasingly employed in non-standard jobs in ever-increasing numbers. In 2011, for example, 75% of the young employees in Slovenia and 66% of the young people working in Poland only had temporary contracts³⁷; the highest rates in the EU (see Figure 15). In Poland, the proportion of temporary jobs to total employees is also the highest in Europe (27%). In both Slovenia and Poland, switching from a temporary assignment to a permanent contract is considered a relatively difficult procedure. Over the past few years also in Croatia and Macedonia, temporary jobs have taken on increasing importance for those aged 15-24, accounting for 43% and 35% respectively of all employment arrangements in that age group. The share of young people in temporary employment has also increased in most other countries, albeit starting from lower levels. The most pronounced increases were reported in the Czech Republic, Slovakia and Turkey: 6 percentage points each. Temporary workers in Poland are particularly hard done by. Three factors weigh heavily against them: (i) they can be served a mere week's no-

³⁶ Unemployment rates in the first quarter of 2012: Czech Republic 7%, Romania 7.7%, Slovenia 8.6%, Kazakhstan 5.4% and Russia 6.5%.

³⁷ According to the LFS definition temporary employment includes fixed-term contracts, seasonal work and non-permanent temporary agency work.

tice; (ii) as temporary employees, they have no claim to social security or the minimum wage; and (iii) their situation is similar to that of day-labourers.³⁸

Figure 14



Remark: Unemployment rate in KZ refers to 15+, in Russia 15-72.

Source: Eurostat, national statistics.

The rise in temporary employment is the outcome of the reforms pertaining to legislation on employment protection (i.e. hire-and-fire regulations) that a number of EU-member states and certain accession states at the time have adopted over the past few decades.³⁹ Having introduced flexibility 'at the margin', the reforms paved the way for deregulation of the use of temporary contracts and the

³⁸ V. Trappmann, Precarious work in Poland – a legacy of transition or an effect of European Integration? <http://www.emecon.eu/current-issue/second/vera-trappmann/>

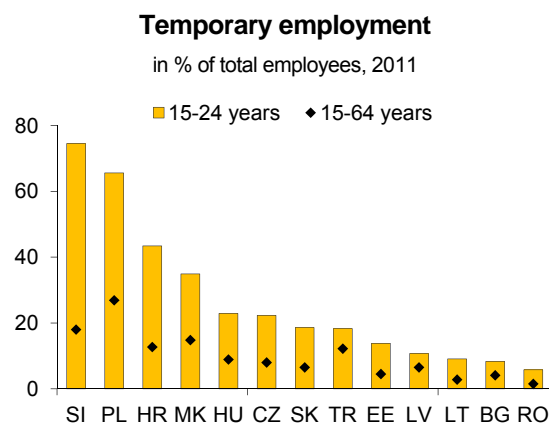
³⁹ This paragraph is based on Employment in Europe 2010, Chapter 3, Youth and segmentation in EU labour markets, pp. 117

maintenance of strict regulations governing the dismissal of workers on permanent contracts. This asymmetric reform strategy has resulted in the emergence of two distinct labour markets: one for permanently protected employees (insiders) and the other for temporary employees (outsiders) who enjoy little or no protection and whose career and wage prospects are extremely limited.

Even before the crisis, the concept of temporary employment bore an appeal for employers across a number of EU-countries (not only Sweden, Finland, Spain and Portugal, but also Poland and Slovenia) as it provided them with a means of circumventing strict rules and regulations pertaining to the dismissal of workers on permanent contracts. Temporary employment was also liberalized to a significant extent in Croatia and Macedonia. Overall, it has transpired that this particular type of contract has proven particularly effective in instances where young workers are involved. The crisis seems to have reinforced that trend.

Temporary workers and young workers, two groups that often overlap, bore the brunt of employment losses during the crisis. At the same time, however, the sectoral structure of the economy also played an important role. For example, countries with a high exposure to construction and tourism (often a breeding ground for temporary jobs) or manufacturing were more affected than others.

Figure 15



Source: Eurostat, national statistics.

Prospects

Fiscal consolidation and cuts in public-sector employment in a number of countries will exert still more pressure on the labour market. The slowdown in GDP growth and a return of recession in some countries suggest a rise in unemployment in the majority of CESEE countries in 2012. The greatest increase is expected in Serbia, the Western Balkan country hit hardest by the crisis. Only in Estonia, Lithuania, Macedonia and Kazakhstan does wiiw expect a decline in unemployment in the current year. In 2013, a moderate rise in GDP should translate into a slight decline in unemployment in the NMS (the exception being Slovenia), as well as in Kazakhstan and Ukraine. On the other hand, unemployment will remain unchanged in most Western Balkan countries and Turkey. From 2014 onwards a more sustained labour-market recovery is expected for almost all CESEE countries.

Doris Hanzl-Weiss and Michael Landesmann

Special section IV: Structural distortions before and adjustments after the crisis: a GIIPS-NMS comparison

With all the attention currently focused on the GIIPS countries (Greece, Ireland, Italy, Portugal, Spain) as representing the weak – and crisis-prone – part of the European Union, what about New EU Member States (NMS)? In this short note we select one aspect to compare the performances of NMS economies with the GIIPS countries: The GIIPS countries were judged to have followed a distorted pattern of economic development prior to the crisis, leading to a strong bias towards non-tradable activities (construction, various services sectors) to the detriment of strengthening the tradable sector (particularly manufacturing but also some tradable service activities). This went along with strong deteriorations of trade and current accounts in these economies. The global financial crisis then led to a drying out of the means to finance large deficits on the current accounts and countries which had built up external disequilibria were forced to adjust their economies. We shall examine this particular aspect using industry-level data (value added at constant prices and employment) to see to which extent the GIIPS pattern of ‘structural distortions’ is also prevalent in the NMS economies and which patterns of adjustment characterised the different groups of economies following the impact of the crisis.

We base our analysis on Figures 16 and 17 which show the contributions of different sectors of the economy to economy-wide GDP growth (Figure 16) and to economy-wide employment growth (Figure 17).⁴⁰ Only selected sectors are shown in order not to overload the text:⁴¹ manufacturing (C) as the classic tradable goods sector, construction (F) and wholesale and retail (G) sectors as important non-tradable sectors, and a range of ‘other market services’ activities (H-N) which include both tradable service activities (such as ‘accommodation and food services’ which would be particularly important for economies with a large tourism industry, or ‘financial and insurance activities’, all of which however still overwhelmingly cater for the domestic market) as well as non-tradable activities (such as real estate services).

Looking at the pattern in the pre-crisis period in Figure 16 we see indeed quite a different picture for the GIIPS countries⁴² on the one hand and the NMS economies on the other hand, although there also important differences amongst these as well: What is evident is the very poor contribution of the manufacturing sector to GDP growth in the pre-crisis period in the GIIPS economies. We can see that manufacturing hardly contributed to GDP growth in these economies in the pre-crisis period (or contributed negatively) and GDP growth relied almost entirely on one or the other of the services sectors (G or H-N) or on construction (F) (Spain).

⁴⁰ Contributions are calculated by multiplying the share of the selected industry by its growth rate.

⁴¹ Based on the NACE rev. 2 classification scheme.

⁴² Ireland is here excluded as there were no constant price value added figures available.

This is in contrast to the NMS economies where we see a more balanced picture of the different sectors' contributions to GDP growth with manufacturing playing a very important role in quite a few economies (particularly in Czech Republic, Slovakia), but was also important in the other economies where construction and services activities were more dominant in GDP growth. Hence one can speak of a ***more balanced structural development pattern between the tradable and non-tradable sectors in the NMS economies as compared to the GIIPS economies in the pre-crisis period.***

Nonetheless we want to point out that also in some of the NMS economies, as we come closer to the crisis period (see the sub-division of the overall pre-crisis period into the sub-periods 2001-2004 and 2005-2008), there is evidence that the contribution to growth of manufacturing declined quite strongly (Estonia, Latvia, Lithuania, Hungary) while that of construction and other market services increased significantly (see Baltics and also Slovenia). These economies seem to have experienced a strong shift in spending towards services and construction in the period immediately before the crisis (also Slovakia experienced such a shift, but manufacturing still played a very strong role in GDP growth).

If we now come to ***developments in the wake of the crisis***, we can see a sharp contraction of activity in the construction industry in the GIIPS countries and also in those NMS economies which experienced an accelerated expansion of this industry in the period immediately prior to the crisis (a 'construction boom') – the Baltics, but also Slovenia and Bulgaria.

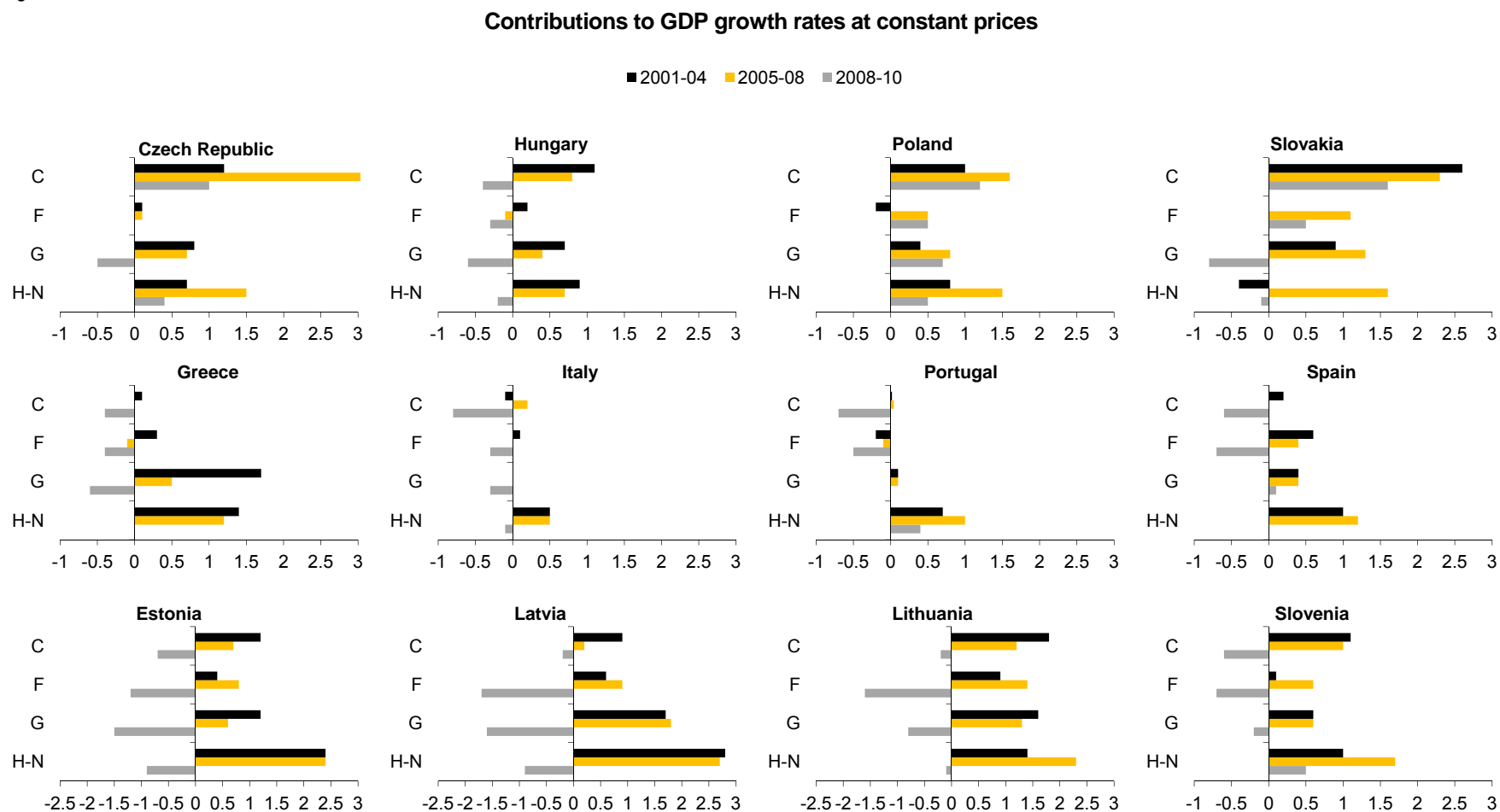
Looking at employment developments (Figure 17) we observe very dramatic employment contraction during the crisis in construction especially in Spain and Ireland, but also in the Baltics, Slovenia and Bulgaria. As to the other industries, it is interesting to note that also manufacturing has been deeply affected – especially in employment terms – in most of the economies, also in those which have a strong record in this sector (such as the Central European economies).

Particularly problematic is a strong contraction of tradable activities in those economies where these were weak already in the period prior to the crisis. This would indicate that the structural re-adjustment which is required in these economies to escape from strong longer-term positions of external imbalances has not so far taken place and might even have moved in the wrong direction. This seems to have been the case in quite a few of the GIIPS countries where spending on some of the services sectors (G, H-N) has held up better than spending on manufacturing. This is less the case for the NMS economies.

In sum, one can say that there are distinct differences between GIIPS and NMS economies in the build-up of structural distortions before the crisis, in that the move away from manufacturing prior to the crisis was much more pronounced in the GIIPS economies, while the growth pattern was more balanced in the NMS economies. Nonetheless, sub-groups of NMS economies (Baltics, Slovenia) experienced a strong shift away from manufacturing in the period just before the outbreak of the crisis. In these economies the underlying dynamic favouring non-tradables over tradables which accompanies real exchange rate appreciations, increases in unit labour costs and the loss of com-

petitiveness, led to severe current account problems. As to the adjustment in the wake of the crisis, we pointed out that manufacturing was also strongly negatively affected in many countries and hence a process of re-adjustment (favouring the tradable sector) has hardly started. This is particularly worrisome for those economies which entered the crisis with a very weak tradable sector, chronic current accounts problems and high external debt.

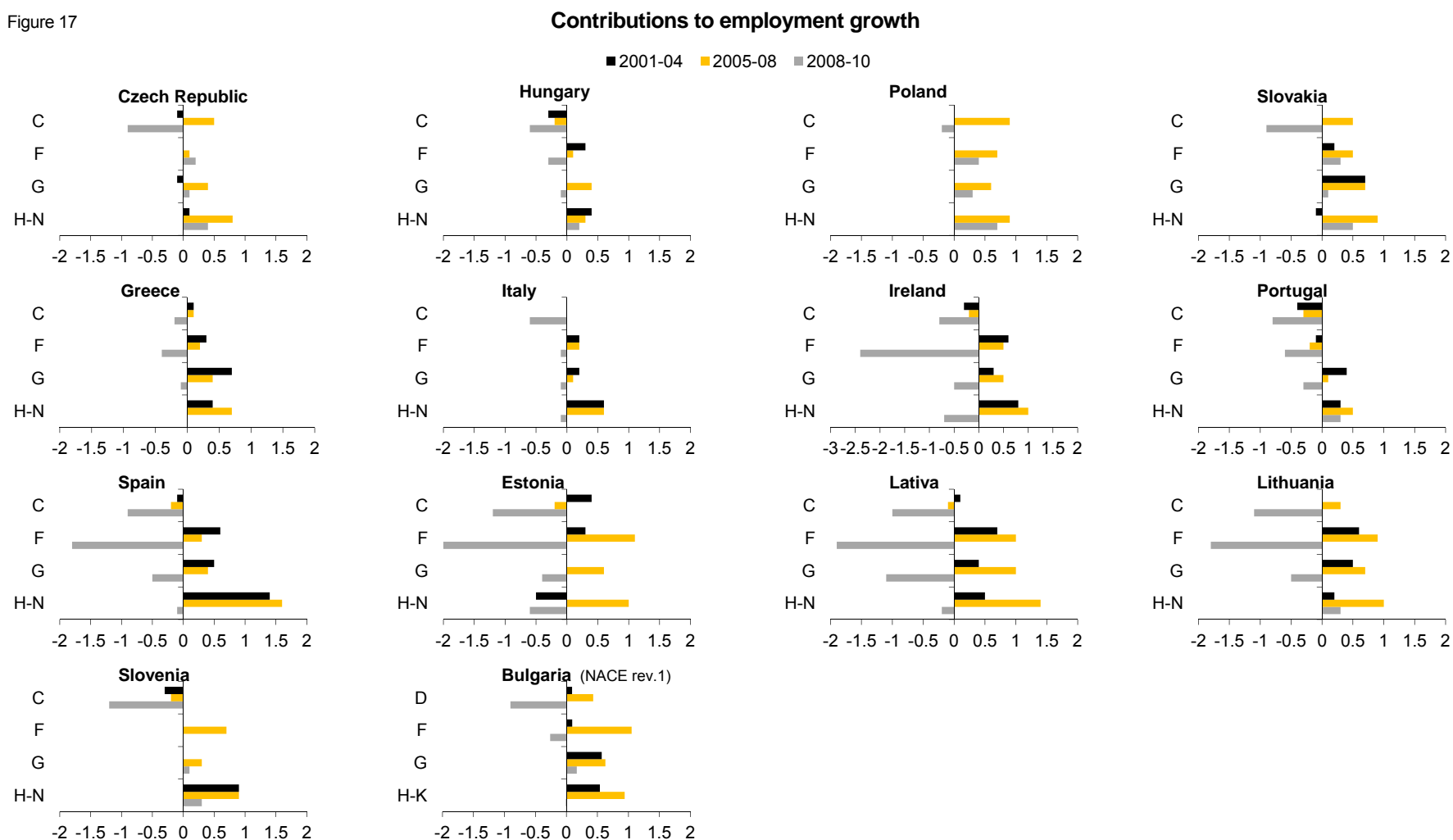
Figure 16



Notes: Based on NACE rev. 2 classification scheme: C (Manufacturing), F (Construction), G (Wholesale and retail trade), H-N (Other market services). Contributions are calculated by multiplying the share in total GDP at current prices by real growth at preceding year prices.

Source: wiw Database incorporating national and Eurostat statistics.

Figure 17



Notes: Based on NACE rev. 2 classification scheme: C (Manufacturing), F (Construction), G (Wholesale and retail trade), H-N (Other market services). Bulgaria: Based on NACE rev. 1 classification scheme: D (Manufacturing), F (Construction), G (Wholesale and retail trade), H-K (Other market services).

Source: wiw Database incorporating national and Eurostat statistics.



Anton Mihailov

Bulgaria: Economy at the freezing point

Bulgaria's economy failed to sustain a recovery course in the environment of an enduring debt debacle in Europe and a lasting instability in international financial markets. The weakening of economic activity which could be observed in the final months of 2011 continued in 2012 as well. The main factor behind this was the sharp deterioration in export performance which in itself mirrored weak demand in Europe. Consequently net exports made a negative contribution to GDP growth in the first quarter, reversing the situation prevailing in the period 2009-2011. By contrast, domestic demand made a positive contribution to GDP growth in the first quarter, mostly thanks to a modest upturn in private consumption.

Overall, it is difficult to draw far-reaching conclusions from these facts as the economy remains close to the freezing point, with quarterly GDP growing by a 0.9% year on year according to preliminary statistics. However, the preliminary national accounts data tend to be rather unreliable. For example, these data suggest that real aggregate value added produced in the Bulgarian economy in the first quarter dropped by 0.9% from the same period of 2011. The reported positive GDP figure was exclusively due to a large positive contribution of FISIM (financial intermediation services indirectly measured), which is an adjustment item in the System of National Accounts. Moreover, different short-term indicators point to different directions of recent trends that are in some case the opposite of those implied by the quarterly national accounts data. Thus real retail sales in the first quarter were on the decline year-on-year while national accounts point to an increase in private consumption. Similarly, national accounts suggest a year-on-year increase in value added produced in construction, while according to monthly data quarterly gross construction production fell from the same period of 2011.

The most disappointing recent development has been the weakening in export performance which had kept the economy afloat during the past couple of years. In the first quarter of 2012, the growth of merchandise exports was negative (albeit slightly) both in nominal and in real terms for the first time since 2009. In this period, the biggest retrenchment was recorded in exports to the EU while exports to third parties were less affected. Mirroring this, manufacturing output also went into the red in the first quarter. By contrast, after almost two years of decelerating import growth, imports started picking up speed in the first months of 2012.

The divergent trends in export and import performance affected the dynamics of Bulgaria's external balances and since the beginning of 2012 the current account has been in the negative territory. Overall, net capital outflow continued in the first months of 2012, mostly due to the ongoing amortization of loans borrowed externally by commercial banks and very little, if any at all, new such borrow-

Table BG

Bulgaria: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012 Forecast	2013	2014
Population, th pers., average ²⁾	7623.4	7585.1	7534.3	7348.4	.	.	7330	7300	7270
Gross domestic product, BGN mn, nom.	69295	68322	70511	75265	15971	15705	77900	81400	85500
annual change in % (real)	6.2	-5.5	0.4	1.7	2.1	0.9	0.5	1.5	2.0
GDP/capita (EUR at exchange rate)	4600	4600	4800	5200	.	.	.	.	.
GDP/capita (EUR at PPP)	10900	10300	10700	11300	.	.	.	.	.
Consumption of households, BGN mn, nom.	45766	42942	43990	45386	9981	10725	.	.	.
annual change in % (real)	3.4	-7.6	0.0	-0.6	-3.1	2.0	2	2	2
Gross fixed capital form., BGN mn, nom.	23283	19724	16077	15743	3637	3093	.	.	.
annual change in % (real)	21.9	-17.6	-18.3	-9.7	-2.4	1.3	0	3	6
Gross industrial production ³⁾									
annual change in % (real)	0.6	-17.4	1.1	5.8	12.0	-2.6	-4	2	5
Gross agricultural production (EAA)									
annual change in % (real)	33.0	-1.6	-6.0	-2.1	.	.	.	.	.
Construction industry ⁴⁾									
annual change in % (real)	12.2	-14.4	-14.5	-12.9	-15.1	-1.6	.	.	.
Employed persons - LFS, th, average ⁵⁾	3360.7	3253.6	3052.8	2949.6	2904.4	2853.2	2920	2950	3000
annual change in %	3.3	-3.2	-6.2	-3.4	.	-1.8	-1.0	1.0	1.6
Unemployed persons - LFS, th, average ⁵⁾	199.7	238.0	348.0	372.3	402.0	421.4	.	.	.
Unemployment rate - LFS, in %, average ⁵⁾	5.6	6.8	10.2	11.2	12.2	12.9	12	11	9
Reg. unemployment rate, in %, end of period ²⁾	6.3	9.1	9.2	10.4	9.5	11.5	.	.	.
Average gross monthly wages, BGN	544.8	609.1	648.1	706.5	671.7	731.0	.	.	.
annual change in % (real, gross)	12.6	8.8	3.9	4.6	3.8	6.8	.	.	.
Consumer prices (HICP), % p.a.	12.0	2.5	3.0	3.4	4.5	1.9	3	3	3
Producer prices in industry, % p.a.	10.9	-6.5	8.6	9.4	13.2	3.9	.	.	.
General governm.budget, EU-def., % GDP									
Revenues	40.0	36.3	34.3	33.1	35.4	.	.	.	.
Expenditures	38.3	40.7	37.4	35.2	36.7	.	.	.	.
Net lending (+) / net borrowing (-)	1.7	-4.3	-3.1	-2.1	-1.3	.	-1.8	-1.5	-1.5
Public debt, EU-def., in % of GDP	13.7	14.6	16.3	16.3	15.5	.	18	18	19
Central bank policy rate, % p.a., end of period ⁶⁾	5.77	0.55	0.18	0.22	0.18	0.15	.	.	.
Current account, EUR mn	-8182	-3116	-375	362	-87	-346	-500	-1000	-1500
Current account in % of GDP	-23.1	-8.9	-1.0	0.9	-1.1	-4.3	-1.3	-2.4	-3.4
Exports of goods, BOP, EUR mn	15203	11699	15562	20228	4784	4626	19300	19800	21200
annual growth rate in %	12.5	-23.0	33.0	30.0	57.7	-3.3	-5	3	7
Imports of goods, BOP, EUR mn	23802	15874	18326	22202	4985	5429	22200	23200	25300
annual growth rate in %	14.7	-33.3	15.4	21.2	35.5	8.9	0	5	9
Exports of services, BOP, EUR mn	5355	4916	5164	5409	829	803	5400	5600	6000
annual growth rate in %	12.5	-8.2	5.0	4.7	15.1	-3.1	0	4	7
Imports of services, BOP, EUR mn	4045	3617	3148	3121	690	723	3150	3300	3600
annual growth rate in %	12.8	-10.6	-13.0	-0.9	-0.3	4.8	1	5	9
FDI inflow, EUR mn	6728	2438	1208	1341	-42	237	1000	1300	1500
FDI outflow, EUR mn	522	-68	174	137	44	21	.	.	.
Gross reserves of NB excl. gold, EUR mn	11928	11943	11612	11788	10918	11594	.	.	.
Gross external debt, EUR mn	37246	37816	37051	35385	36464	35274	.	.	.
Gross external debt in % of GDP	105.1	108.3	102.8	91.9	94.8	88.6	.	.	.
Average exchange rate BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.956	1.956	1.956
Purchasing power parity BGN/EUR	0.8355	0.8712	0.8729	0.9033	.	.	.	.	.

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

1) Preliminary. - 2) From 2011 according to census February 2011. - 3) Enterprises with 10 and more employees. - 4) All enterprises in public sector, private enterprises with 5 and more employees. - 5) Quarterly data according to census February 2011. - 6) Base interest rate. This is a reference rate based on the average interbank LEONIA rate of previous month (Bulgaria has a currency board).

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

ing. Consequently, gross foreign debt also continued to fall. At the same time, there have been no signs of an invigoration of FDI inflows.

The negative shocks experienced during the crisis have largely been transmitted to the labor market which acted as one of the main shock absorbers in the Bulgarian economy. With some lags, these negative effects continue to pass through and, given the failure of the economy to embark on a path of sustained recovery, net job destruction still prevails as a trend. Hence, unemployment was on the rise in the first months of 2012 although seasonal factors may reverse this in the summer months.

Another worrisome development has been the continuing deterioration in commercial banks' portfolios due to a persistent rise in substandard loans. Overall, credit activity remains very subdued and selective, both due to the uncertain economic prospects and the liquidity constraints that banks themselves are facing: with the drying up of external funding, savings in bank deposits have become the main source of new funds. Against this backdrop, the share of non-performing and restructured loans kept rising in the opening months of 2012 and reached 18.6% of total loans in April, up from 15.2% a year earlier and an average of 16.2% for 2011 as a whole.

Nevertheless, the banking system as a whole remains relatively stable thanks to its high degree of capitalization as required by local regulations which are considerably tougher than Basle-2 requirements. Thus, at the end of 2011, the average capital adequacy ratio of the commercial banking system in Bulgaria was 17.5% which allowed most banks facing bad loans problems to provision heftily without suffering a serious burden. Anyway, 10 out of 31 commercial banks in Bulgaria reported a loss for 2011 as a whole.

Fiscal policy remains as one of the most controversial aspects of macroeconomic management in Bulgaria. In terms of its fiscal balance, Bulgaria can appear as one of the "star performers" in the EU as, with the exception of the years 2009-2010 it has not only been within the 3 per cent deficit range but actually had been reporting fiscal surpluses from 2004 to 2008. However, the rationale of Bulgaria's fiscal policy has often been disputed. The two questions that have been posed most often are: 1) Whether the degree of fiscal austerity in Bulgaria was really justified? and 2) Whether the allocation of public spending within the targeted fiscal position was efficient?

The answers to both questions are not straightforward. While there were good reasons to maintain a fiscal surplus during the boom years (in line with the structural fiscal balance), the degrees of fiscal austerity during the crisis years are probably more difficult to justify, moreover given the very low level of public debt in the country. Targeted one-off policy measures during this period could probably have helped for a certain dampening of the negative external shocks. In this sense, the unduly tight fiscal stance has probably resulted in growth and employment sacrifices in this period.

What is even more debatable is the internal adjustment of public spending within the targeted overall balance. In the first place, fiscal policy in recent years has suffered from very low transparency. Thus the current government (in power since 2009) never declared its concrete policy priorities during its mandate (especially, during the crisis) and how these would translate into public spending. In addi-

tion, the government has throughout its term in office avoided unpopular large-scale fiscal measures and therefore major structural reforms have continuously been put on hold. By contrast, on several occasions, the government did retreat into populist moves under pressure from the streets. Thus de facto public spending – and spending cuts – have been a reflection of what the government could commit within a generally austere fiscal stance with least resistance from the public.

The fiscal policy stance implied by the 2012 budget and currently being executed by the government follows the same paradigm. The main victim of this political economy has been public investment financed from national sources which has suffered continuous subsequent cuts since 2009. A certain increase in the absorption of EU investment funds in 2010 and 2011 could not compensate for the cutbacks in local financing. In this sense, the government de facto abandoned one of the few instruments available at its disposal for providing support to economic activity in the country, adding to the growth and employment sacrifices attributable to economic policy.

In the present circumstances, most factors point to continuing sluggishness in economic activity in the short run. Exports keep losing their momentum while there are no signs pointing towards a more proactive domestic policy stance. Investor sentiment remains subdued. The possible modest recovery in private consumption will hardly be sufficient to act as a visible growth driver. Adding to that the prevailing overall economic weakness in Europe, most likely Bulgaria's economy will be close to stagnation in 2012 taken as a whole. In the absence of more pro-active policy measures it is also difficult to expect a notable amelioration in the labor market situation.

This course of economic performance in an environment of persistent uncertainties in Europe also implies lower than earlier expected growth performance in 2012 and 2013. Under the currency board straightjacket, Bulgaria's economy – and its growth prospects – are largely a hostage of capital inflows and these are unlikely to materialize in the coming years. Therefore the most likely medium-term scenario is probably the switch to a rather moderate growth path.



Leon Podkaminer

The Czech Republic: The second dip materialises

Throughout 2011, GDP growth had been slowing down much more than originally reported (dropping to a mere 0.6% in the last quarter of the year, year-on-year). Defying an official forecast of 0.2% growth for the first quarter of 2012 issued by the Finance Ministry in April 2012, GDP (adjusted for seasonal and calendar effect) fell by 0.7% according to the provisional estimate released by the central statistical. As is usual practice, the latter estimate will probably be revised downwards. In all likelihood, foreign trade will have contributed positively to GDP growth in the first quarter of 2012 (primarily on account of very weak import growth). However, both domestic consumption and investments will, of necessity, have dropped steeply. Output in the construction sector contracted by over 7% in the first quarter, while industry's domestic sales fell in real terms (export sales, however, still rose, albeit not to any marked degree). The volume of new orders placed with industry does not look promising either: in quantitative terms, both domestic and export orders have been contracting quite rapidly. The most recent official forecasts for GDP growth in 2012 (a symbolic +0.2% according to the Finance Ministry's forecast published in April and 0% according to the forecast announced by the Czech National Bank in May)⁴³ look increasingly unrealistic.

One generally advanced explanation for the ongoing (since the first quarter of 2011) unanticipated and swift deceleration of growth throughout 2011 places the blame on the unexpected weakening of growth in the main Czech export markets. This explanation is plausible, yet it cannot be accepted uncritically. First, growth has not been slowing down all that much in Germany, Slovakia and Poland (which jointly absorb about half of the Czech merchandise exports). Secondly, Czech exports did not perform perceptibly worse than anticipated in 2011. At the beginning of 2011 (i.e. prior to the Czech growth slowdown), it was assumed that exports (of both goods and services) would grow by 12% over the year. In actual fact, they rose 11%. Moreover, the contribution of foreign trade to the GDP growth rate in 2011 reached 2.6 percentage points (p.p.) rather than the 1.8 p.p. expected).⁴⁴

While a more serious weakening of exports (owing to a sudden deterioration in the business climate in key export markets) is still a real eventuality, the actual problem facing the Czech economy has much more to do with the fiscal consolidation fever that has befallen the country's current ruling elite. The liberal-conservative government of Mr Necas (in power since mid-2010) has persisted in the

⁴³ The EU Commission Spring 2012 Forecast also envisages economic stagnation in the Czech Republic in 2012 (thereby revising its own autumn forecast by -0.7 percentage points).

⁴⁴ Similarly, the current (April 2012) Finance Ministry's forecast envisaged an external balance of trade in goods and services of 56 billion CZK in the first quarter of 2012. The actual surplus was over 80 billion KCZ (about 8% of the GDP). This is not exactly a sign of external weaknesses affecting the overall GDP growth.

Table CZ

Czech Republic: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012 Forecast	2013	2014
Population, th pers., average	10424	10487	10520	10495	.	.	10580	10610	10640
Gross domestic product, CZK bn, nom.	3848.4	3739.2	3775.2	3809.3	884.1	898.9	3870	3980	4130
annual change in % (real)	3.1	-4.7	2.7	1.7	3.1	-0.4	-0.3	1.5	2.4
GDP/capita (EUR at exchange rate)	14800	13500	14200	14700	.	.	.	.	.
GDP/capita (EUR at PPP)	20200	19300	19400	20100	.	.	.	.	.
Consumption of households, CZK bn, nom.	1856.7	1852.5	1871.8	1897.2	448.3	451.6	.	.	.
annual change in % (real)	3.0	-0.5	0.6	-0.4	-0.6	-2.8	-0.6	0.5	1
Gross fixed capital form., CZK bn, nom.	1031.2	927.5	923.0	911.1	193.7	197.5	.	.	.
annual change in % (real)	4.1	-11.5	0.2	-1.2	-1.7	1.2	-1	2	6
Gross industrial production									
annual change in % (real)	-1.9	-13.6	10.3	6.9	12.3	2.2	2	4	6
Gross agricultural production (EAA)									
annual change in % (real)	6.8	-3.6	-7.0	7.1	.	.	.	.	.
Construction industry									
annual change in % (real)	-0.2	-0.8	-7.1	-3.5	5.9	-10.1	-5	2	3
Employed persons - LFS, th, average	5002.5	4934.3	4885.2	4904.0	4864.4	4868.5	4900	4910	4930
annual change in %	1.6	-1.4	-1.0	0.4	0.7	0.1	0.0	0.2	0.5
Unemployed persons - LFS, th, average	229.8	352.2	383.5	353.6	376.2	368.0	.	.	.
Unemployment rate - LFS, in %, average	4.4	6.7	7.3	6.7	7.2	7.0	7.1	7	6.5
Reg. unemployment rate, in %, end of period	6.0	9.2	9.6	8.6	9.2	8.9	.	.	.
Average gross monthly wages, CZK ²⁾	22592	23344	23864	24436	23281	24126	.	.	.
annual change in % (real, gross)	1.4	2.3	0.7	0.5	0.7	-0.1	0.5	1	2
Consumer prices (HICP), % p.a.	6.3	0.6	1.2	2.2	1.9	4.0	3.2	2	2
Producer prices in industry, % p.a.	0.4	-1.5	0.1	3.7	3.2	3.8	.	.	.
General governm. budget, EU-def., % GDP									
Revenues	38.9	39.1	39.3	40.3	.	.	.	.	.
Expenditures	41.1	44.9	44.1	43.4	.	.	.	.	.
Net lending (+) / net borrowing (-)	-2.2	-5.8	-4.8	-3.1	.	.	-2.9	-2.5	-2.5
Public debt, EU-def., in % of GDP	28.7	34.4	38.1	41.2	.	.	43	45	46
Central bank policy rate, % p.a., end of period ³⁾	2.25	1.00	0.75	0.75	0.75	0.75	0.75	1.0	1.5
Current account, EUR mn	-3297	-3428	-5894	-4453	932	1967	-3700	-3800	-3500
Current account in % of GDP	-2.1	-2.4	-3.9	-2.9	2.6	5.5	-2.4	-2.4	-2.1
Exports of goods, BOP, EUR mn	84845	70983	86083	99580	24800	26606	110000	123000	139000
annual growth rate in %	9.3	-16.3	21.3	15.7	27.8	7.3	10	12	13
Imports of goods, BOP, EUR mn	83811	67684	83991	95755	23418	23879	102000	113000	128000
annual growth rate in %	10.4	-19.2	24.1	14.0	28.6	2.0	7	11	13
Exports of services, BOP, EUR mn	14910	13924	15812	16598	3929	4087	17000	19000	21000
annual growth rate in %	17.9	-6.6	13.6	5.0	11.4	4.0	3	10	10
Imports of services, BOP, EUR mn	11949	11126	12839	13895	3147	3572	15000	17000	19000
annual growth rate in %	13.7	-6.9	15.4	8.2	19.3	13.5	8	10	10
FDI inflow, EUR mn	4467	2082	4644	3868	710	977	3000	4000	4000
FDI outflow, EUR mn	2964	685	882	827	172	230	1300	1300	1300
Gross reserves of NB excl. gold, EUR mn	26386	28556	31357	30675	29435	31742	.	.	.
Gross external debt, EUR mn	60511	61940	70498	72583	69854	.	.	.	.
Gross external debt in % of GDP	39.2	43.8	47.2	46.9	45.1	.	.	.	.
Average exchange rate CZK/EUR	24.95	26.44	25.28	24.59	24.37	25.08	25.00	24.75	24.75
Purchasing power parity CZK/EUR	18.24	18.46	18.47	18.07	.	.	.	.	.

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

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

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

pursuit of fiscal consolidation policies. Active measures taken to restrict public sector deficit-amounted to about 2.2% of the GDP in 2010. According to the Finance Ministry's *Convergence Programme of the Czech Republic* (April 2012)⁴⁵, further measures to be implemented in 2011 amounted to another 1.6% of the GDP to be followed by further extraordinary measures amounting to another 0.7% in 2012. Previous consolidation programmes assumed a reduction in the general government deficit to 3.5% of the GDP in 2012. However, as proudly stated in the *Convergence Report 2012* (p.3) *'...the vigour of consolidation measures accompanied by responsible budgetary behaviour in 2011...resulted in the deficit being significantly lower. The target for 2012 was therefore improved by 0.5 p.p. to 3% of the GDP.'*

It is a pity that the vigour of fiscal consolidation appears to be associated with a definite flagging of vigour in terms of capital formation (that has also dropped on account of cuts in government investment programmes) and consumption (that has also been reduced directly through cuts in public sector employment and wage rates, and indirectly lessened by hikes in the VAT rates). Indeed, it transpires that the 'over-fulfilment' of the fiscal consolidation programmes has fused with a more pronounced growth slowdown than initially assumed. The 2011 Convergence Programme (setting less ambitious deficit targets) assumed high GDP growth (2.3%) in 2012 (with private consumption rising close to 2% and the gross fixed capital formation increasing by over 2%). According to the current Convergence Programme, both items are projected to drop in 2012 – by 0.4% and close to 4%, respectively. Of course, the eventual rates of decline in both items, however, are likely to be much higher because the real disposable income of the private sector is likely to fall by some 1-2% in 2012. The Czech consolidation overkill has not escaped the attention of the IMF Staff Report on the Czech Republic (dated April 2012)⁴⁶ The report tactfully suggested *'...that procyclical tightening in addition to the already ambitious consolidation would unnecessarily undermine short-term growth...and that the Czech Republic has the fiscal space to allow automatic stabilisers to work...the Czech Republic will still be able to meet the budget target in 2012 without further expenditure cuts...'* The IMF suggestions fell on deaf ears: *'...while mindful of staff arguments, the authorities disagreed...they stressed that reducing the fiscal deficit below 3% in 2013...was critically important for preserving market confidence...and noted that the government had been elected on a platform of fiscal rectitude...'* (p.7)

Even if inflation (driven by hikes in both indirect tax rates and prices of imported energy carriers) surpasses its 2% target, the Czech National Bank will keep the policy rate at 0.75%. There is still some way to go before hitting 'zero-bound'. The interest rate on the three-month interbank loans has remained stable at close to 1.2%, thus showing that the money market conditions are not only more or less normal, but, in fact, they are over-liquid. Interest rates on loans to non-financial corporations are still quite low (recently 3.1% on average), while interest rates on lending to households are fairly low, especially on mortgage loans (for example, the average interest rate on new mortgage loans extended for 5 to 10 years was 4.8% in March 2012). The financial standing of the banking sector

⁴⁵ The substance and goals of the Czech government's fiscal consolidation programme were described in detail in *wiiw Current Analyses and Forecasts*, Issue 8 (July 2011).

⁴⁶ <http://www.imf.org/external/pubs/ft/scr/2012/cr12115.pdf>

remains very strong, with the most recent Capital Adequacy Ratio standing at 15.2% (as at end 2011). Non-performing loans (recently 5.2% of the stock of loans to households, 8.8% of the stock of loans to corporations) have been creeping upwards. However, even under the 'second dip' scenario – and making allowances for more stringent regulatory standards – the stability of the banking sector as a whole would not in any way – be seriously jeopardised – according to the recent stress tests carried out by the Czech National Bank in February 2012. The sector should retain its ability to perform its functions vis-à-vis the real economy, even if its profits are squeezed.⁴⁷ However, the risk of excessive support being lent by the Czech banks to their foreign parent organisation may have to be contained, by way of some additional regulations (for example, by limiting exposure to foreign parent organisations).

Low nominal interest rates and a strong banking sector have not led to monetary expansion. Money supply (M3) stock rose 4.7% in the year ending March 2012, with the stock of loans to households rising by 5.5% and those to the corporate sector by 5.4%. Neither households nor the corporate (non-financial) sector are over-indebted in any way (while the stock of financial sector's debt falls short of 55% of the GDP). Stagnant demand for loans reflects expectations of negative income growth in both the household and corporate sectors.

By now, it is quite certain that, even if the euro area continues to 'muddle through' and avert deep recession in 2012, the Czech economy will not escape recession. That recession may be moderated somewhat, should the Czech currency remain relatively weak against the euro (which is probable). None the less, some weakening of exports would then follow. A euro-area recovery in 2013 and beyond would naturally (by way of stronger exports) help speed up growth in the Czech Republic once again. Furthermore, by that time the fiscal consolidation measures will have become less intense (also on account of the next regular parliamentary elections to be held in 2014, at the latest). The good financial standing of the banking and corporate sectors, the relatively low level of household debt, combined with the competent policy pursued by the Czech National Bank (which is determined to keep its policy in a highly relaxed mode even in the face of temporary hikes in inflation) should also help accelerate growth – initially growth in investments followed by growth in private consumption and overall GDP. Political instabilities (that can become acute anytime, given the fragility of the ruling coalition that is dogged by ample evidence of widespread corruption in high places) are unlikely to affect the course of economic events. It is an open question whether other ('structural') reforms (pertaining to labour market flexibilisation, 'leaner' social welfare systems, partial privatisation of the pension system, limitation of corruption, etc.) would then help to speed up growth. Our guess is that, even if those reforms were implemented and ultimately yielded desirable results (which by no means can be guaranteed), the results could only materialise in a very long-term perspective – certainly not within the next 2-3 years.

⁴⁷ In the first quarter of 2012 banks' profits rose nominally some 8% over the same period of 2011. Profitability (return on equity) approaches 20%.



Sebastian Leitner

Estonia: Domestic demand reinforces growth

Over the past two years, the upswing in external demand has spurred economic activity throughout the Baltics, especially in Estonia. In 2012, however, the most recent Europe-wide decline in industrial production also came to bear on Estonia's small open economy. Fortunately, the previous year's improvement in labour market conditions continues to support overall economic growth via an increase in household demand.

Growth in the exports of goods, which had already started to decline in the second half of 2011, continued slowing down in the first months of 2012. In particular, the business cycle downturn in Sweden, Estonia's main trading partner, dragged down the country's export performance. The electronics sector, in particular, was hit hard, with industrial production in the first quarter 2012 even declining by 1.8% year-on-year. Forecasts for Scandinavia for the next two years, however, are fuelling expectations that export growth will recover in 2013. Elcoteq, formerly the largest exporter of electronic equipment in Estonia, whose parent company went bankrupt in October 2011, has been taken over by Eolane, a French-owned company. The product range will be broadened to include medical equipment and there are plans to increase the workforce.

Weakening external demand has already affected the Estonian labour market. Whereas in 2011 economic recovery led to substantial employment growth (6.7%), by the end of 2011 and at the beginning of 2012 job creation had already ground to a halt, especially in the industrial sectors. The unemployment rate, which also increased slightly to 11.5% in the first quarter 2012 owing to seasonal fluctuations over the past six months, is now only expected to drop gradually over the rest of the current year and the years thereafter. That notwithstanding, the remarkable recovery in 2011 brought about an increase in average real net wages for the first time since 2008. A growth rate of 2% is to be expected for 2012 as a whole.

Domestic demand can thus be seen to be boosting economic growth in Estonia. Household consumption remained resilient in the first quarter 2012. However, retail figures and consumer surveys indicate that in the months to come, the growth rate of domestic consumption will start slowing down. Households and enterprises alike are still in the process of deleveraging, which will also reduce the country's gross external debt.

In addition to household demand, gross fixed capital investment, particularly in the area of construction and refurbishment of buildings, is also driving growth. Public investment will increase over the current year as well as in 2013 on account of the government having committed itself to investing the

Table EE

Estonia: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012 Forecast	2013	2014
Population, th pers., average ²⁾	1340.7	1340.3	1340.2	1295.5	.	.	1287	1281	1274
Gross domestic product, EUR mn, nom.	16304	13840	14305	15973	3617	3876	16900	18200	19800
annual change, % (real)	-3.6	-14.3	2.2	7.6	9.5	3.6	2.1	3.7	4.4
GDP/capita (EUR at exchange rate)	12200	10300	10700	12100	.	.	.	.	.
GDP/capita (EUR at PPP)	17300	14900	15700	17700	.	.	.	.	.
Consumption of households, EUR mn, nom.	8657	7201	7235	7917	1915	2057	.	.	.
annual change in % (real)	-6.4	-16.1	-1.7	4.4	3.7	3.2	2.8	3	4
Gross fixed capital form., EUR mn, nom.	4847	2973	2694	3434	691	799	.	.	.
annual change in % (real)	-15.1	-37.8	-9.1	26.8	20.6	17.2	10	10	12
Gross industrial production									
annual change in % (real)	-5.2	-24.0	23.6	16.8	29.9	-1.8	1	8	10
Gross agricultural production (EAA)									
annual change in % (real)	-1.2	2.8	-4.0	3.0	.	.	.	.	.
Construction industry									
annual change in % (real)	-13.3	-29.8	-8.5	26.7	34.4	27.9	.	.	.
Employed persons - LFS, th, average	656.5	595.8	570.9	609.1	591.3	614.3	625	640	655
annual change in %	0.2	-9.2	-4.2	6.7	6.8	3.9	3	2	2
Unemployed persons - LFS, th, average	38.4	95.1	115.9	86.8	99.3	79.6	.	.	.
Unemployment rate - LFS, in %, average	5.5	13.8	16.9	12.5	14.4	11.5	11	9.5	9
Reg. unemployment rate, in %, end of period	4.6	13.3	10.1	7.3	10.2	7.5	.	.	.
Average gross monthly wages, EUR	825	784	792	831	792	847	.	.	.
annual change in % (real, gross)	3.2	-4.9	-1.8	-0.1	-0.8	2.4	2	.	.
Consumer prices (HICP), % p.a.	10.6	0.2	2.7	5.1	5.2	4.6	3.8	3.8	4
Producer prices in industry, % p.a.	8.0	0.7	3.2	4.3	4.9	3.6	.	.	.
General governm. budget, EU-def., % GDP									
Revenues	36.5	43.2	40.9	39.2	35.4	.	39.0	39.0	39.0
Expenditures	39.5	45.2	40.6	38.2	37.5	.	41.5	40.0	39.0
Net lending (+) / net borrowing (-)	-2.9	-2.0	0.3	1.0	-2.1	.	-2.5	-1.0	0.0
Public debt, EU-def., in % of GDP	4.5	7.2	6.7	6.0	6.5	.	10	11.5	11
Central bank policy rate, % p.a., end of period ³⁾	7.02	2.83	0.92	1.00	1.00	1.00	.	.	.
Current account, EUR mn	-1577	513	513	506	-53	-323	-800	-700	-800
Current account in % of GDP	-9.7	3.7	3.6	3.2	-1.5	-8.3	-4.7	-3.8	-4.0
Exports of goods, BOP, EUR mn	8542	6551	8777	12095	2752	2987	13000	14500	16500
annual growth rate in %	5.0	-23.3	34.0	37.8	54.6	8.5	7	12	14
Imports of goods, BOP, EUR mn	10664	7109	9028	12277	2865	3210	13850	15900	18800
annual growth rate in %	-1.0	-33.3	27.0	36.0	49.9	12.0	13	15	18
Exports of services, BOP, EUR mn	3537	3174	3422	3936	774	863	4300	4800	5500
annual growth rate in %	7.5	-10.3	7.8	15.0	10.6	11.5	9	12	15
Imports of services, BOP, EUR mn	2293	1815	2109	2681	565	724	3300	3800	4400
annual growth rate in %	2.0	-20.8	16.2	27.1	21.5	28.2	23	15	16
FDI inflow, EUR mn	1181	1323	1162	130	419	261	.	.	.
FDI outflow, EUR mn	761	1115	100	-1046	224	94	.	.	.
Gross reserves of NB excl. gold, EUR mn ⁴⁾	2814	2758	1904	150	155	202	.	.	.
Gross external debt, EUR mn	19025	17204	16402	15504	16238	15784	.	.	.
Gross external debt in % of GDP	116.7	124.3	114.7	97.1	101.7	93.4	.	.	.
Purchasing power parity EUR/EUR	0.7020	0.6922	0.6808	0.6962	.	.	.	.	.

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

1) Preliminary. - 2) From 2011 according to census March 2012. - 3) From 2011 official refinancing operation rates for euro area (ECB), TALIBOR one-month interbank offered rate before (Estonia had a currency board). - 4) From January 2011 (Euro introduction) only foreign currency reserves denominated in non-euro currencies.

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

revenues accruing from the sale of CO2 emission certificates in 2011. Moreover, real estate prices bottomed out in 2011; they have since started to rise again, indicating that the housing market has shifted out of the trough. Real growth in the construction sector is thus expected to remain relatively lively in 2012.

Rising wages have brought about an increase in core inflation in Estonia. However, at present the only additional drivers of consumer prices are oil-related products, the effect of which will fade in the second half of the year. Consumer inflation, which still stood at 4.6% in the first quarter 2012, is thus expected to slow down on average to 3.8% for 2012 as a whole.

After two years of balanced budgets, the Estonian government will end the fiscal year 2012 with a deficit of about 2.5% of GDP. Aside from the government's commitment to invest the revenue from the trade in CO2 emissions, the deficit will also accrue on account of the restoration of the public contributions to the second pillar pension fund, which had been suspended during the economic crisis. Since both are one-off factors, the deficit will decline substantially in 2013, although public wages are expected to rise more perceptibly next year.

The medium-term economic outlook for 2013 and 2014, however, is rife with uncertainty. First of all, the Estonian economy depends heavily on the business cycle in Scandinavia. The forecast rise in the real GDP growth to 3.7% in 2013 and 4.4% in 2014 is, however, predicated on a recovery in exports to Sweden and Finland. Given the improvements in the labour market, household demand will also continue to drive growth in Estonia. Furthermore, we expect the deleveraging process in the household sector to come to a halt by 2013; that should lend further momentum to household consumption and investment activities. One outcome of the more rapid growth in domestic demand that has already become apparent this year is the return of current account deficits. Once again, they will rise to a level between 4% and 5% of GDP in both the current year and the two following years.

Table HU

Hungary: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012 Forecast	2013	2014
Population, th pers., average	10038	10023	10000	9960	9973	9953	9940	9920	9900
Gross domestic product, HUF bn, nom.	26546	25623	26748	28080	6228	6498	29000	30300	32000
annual change in % (real)	0.9	-6.8	1.3	1.7	2.5	-0.7	-1	1.5	2.5
GDP/capita (EUR at exchange rate)	10500	9100	9700	10100	.	.	.	.	.
GDP/capita (EUR at PPP)	16000	15200	15800	16300	.	.	.	.	.
Consumption of households, HUF bn, nom.	13985	13568	13854	14471	3398	3585	.	.	.
annual change in % (real)	-0.5	-6.4	-2.1	0.0	-0.6	-0.2	-1.5	0	1.8
Gross fixed capital form., HUF bn, nom.	5760	5295	4806	4710	851	820	.	.	.
annual change in % (real)	2.9	-11.0	-9.7	-5.5	-1.5	-6.6	-1	2	3
Gross industrial production									
annual change in % (real)	-0.2	-17.6	10.5	5.4	12.6	-0.1	3	4	8
Gross agricultural production (EAA)									
annual change in % (real)	27.7	-10.3	-11.5	10.1	.	.	.	.	.
Construction industry									
annual change in % (real)	-5.2	-4.4	-10.4	-7.7	-6.6	-11.3	-6	3	8
Employed persons - LFS, th, average	3879.4	3781.8	3781.2	3811.9	3732.5	3791.3	3810	3830	3850
annual change in %	-1.2	-2.5	0.0	0.8	0.4	1.6	0	0.5	0.5
Unemployed persons - LFS, th, average	329.1	420.7	474.8	467.9	489.8	504.1	.	.	.
Unemployment rate - LFS, in %, average	7.8	10.0	11.2	10.9	11.6	11.7	11.5	10.5	10
Reg. unemployment rate, in %, end of period	10.9	13.6	13.3	12.5	14.7	13.3	.	.	.
Average gross monthly wages, HUF ²⁾	198741	199837	202525	213054	209908	219212	.	.	.
annual change in % (real, net)	0.8	-2.3	1.8	2.4	-1.0	-3.9	.	.	.
Consumer prices (HICP), % p.a.	6.0	4.0	4.7	3.9	4.3	5.6	5.5	4	3.7
Producer prices in industry, % p.a.	4.6	4.5	6.3	2.5	5.2	6.4	.	.	.
General governm.budget, EU-def., % GDP									
Revenues	45.5	46.9	45.2	52.9	.	.	.	.	.
Expenditures	49.2	51.4	49.5	48.7	.	.	.	.	.
Net lending (+) / net borrowing (-) ³⁾	-3.7	-4.5	-4.3	4.2	.	.	-3	-3	-3
Public debt, EU-def., in % of GDP	73.0	79.8	81.4	80.6	.	.	79	78	77
Central bank policy rate, % p.a., end of period ⁴⁾	10.00	6.25	5.75	7.00	6.00	7.00	.	.	.
Current account, EUR mn	-7728	-112	1185	1442	338	.	1800	1700	1100
Current account in % of GDP	-7.3	-0.1	1.2	1.4	1.5	.	1.8	1.6	1.0
Exports of goods, BOP, EUR mn	72043	57397	68964	76979	19308	.	83100	92200	102300
annual growth rate in %	6.2	-20.3	20.2	11.6	23.6	.	8	11	11
Imports of goods, BOP, EUR mn	73233	55028	65749	72931	17973	.	78300	86500	95800
annual growth rate in %	6.9	-24.9	19.5	10.9	21.7	.	7.4	10.5	10.8
Exports of services, BOP, EUR mn	13804	13305	14634	15578	3447	.	16500	18200	20000
annual growth rate in %	9.8	-3.6	10.0	6.5	3.8	.	6	10	10
Imports of services, BOP, EUR mn	12287	11319	11704	12355	2991	.	12800	13800	14900
annual growth rate in %	9.4	-7.9	3.4	5.6	11.7	.	4	8	8
FDI inflow, EUR mn	4225	1518	1708	3033	-100	.	.	.	.
FDI outflow, EUR mn	1503	1440	998	3097	97	.	.	.	.
Gross reserves of NB, excl. gold, EUR mn	23807	30648	33667	37242	35601	34697	.	.	.
Gross external debt, EUR mn	123454	137125	138222	131511	139985	.	.	.	.
Gross external debt in % of GDP	117.0	150.0	142.4	130.8	139.3	.	.	.	.
Average exchange rate HUF/EUR	251.51	280.33	275.48	279.37	272.46	296.76	295	290	290
Purchasing power parity HUF/EUR	165.55	168.29	169.20	172.63	.	.	.	.	.

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

1) Preliminary. - 2) Enterprises with 5 and more employees. - 3) In 2011 including one-off effects. Without those effects general government budget balance is estimated to have attained -4.6% of GDP (Source: Porfolio.hu). - 4) Base rate (two-week NB bill).

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

*Sándor Richter*

Hungary: Sliding into recession

In economic terms, everything points to an upcoming recession. In the first quarter of 2012, Hungary's GDP declined by 0.7%; however, once adjusted for seasonal and calendar effects, actual contraction was twice as great. The value added by the traditional driver of economic growth, the vibrant export-oriented industry, stagnated in the first quarter. Of Hungary's two major industrial sectors, the manufacture of transport equipment and the production of electronic equipment, the first sector performed well, while low external demand for computers, electronic and optical devices led to an appreciable drop in the volume of exports in this sector. In the construction sector, value-added has come close to free fall. Agricultural performance also recorded a decline, partly owing to the fact that the sector's performance in the previous year provided a strong basis for comparison. Value-added in the services sector stagnated. In terms of GDP distribution, consumption declined, mainly because the government's consolidation measures started to 'bite'. The high cost of borrowing, deleveraging in the banking sector and flat domestic demand are reflected in the unrelenting contraction of investment activities. The only positive contribution to the shift in GDP came from net exports (+2.2 percentage points). Although the growth rate of both exports and imports diminished substantially compared to the period 2010-2011, the large gap of more than 2 percentage points in favour of the export growth rate saved Hungary from lurching into a much deeper slump.

Throughout the spring season, Hungary fought three battles on various sectors of one and the same front. The first engagement involved an attempt to get out from under the EU excessive debt procedure: a battle into which the country had been locked for the past eight consecutive years and where defeat bore the threat of the 2013 Cohesion Fund transfers being suspended - to the tune of EUR 500 million. The second skirmish was related to the launching of negotiations with the IMF-EU tandem on a precautionary financial support package. The third struggle was a foray to secure acknowledgement of the legitimacy of a whole clutch of new Hungarian laws that were suspected of contravening EU laws. All three issues are closely interrelated. Furthermore, in all three cases the European Union has been the main counterpart, although, where the latter two issues are concerned, the implications extend beyond the European context. By early summer 2012, however, Hungary had scored partial success in all the three sectors.

On the first front, the European Commission (EC) acknowledged that in terms of its economic policy, the government had indeed moved towards consolidating the country's fiscal balances for both 2012 and 2013. The EC deemed the measures announced in the "Széll Kálmán Plan 2.0" package and the up-dated convergence programme sufficient to nudge the general government deficit below the 3% Maastricht threshold in both 2012 and 2013. On 30 May 2012, the EC thus recommended that the Economic and Financial Affairs Council lift the sanctions that suspended part of the Cohesion

Fund transfers to Hungary. This recommendation was approved on 22. June. That notwithstanding, despite the progress being acknowledged, it is still not enough to permit a decision to release Hungary from the excessive deficit procedure. That decision may follow early next year, as it will be conditional upon the Hungarian economic policy being positively evaluated in terms of sustainability.

On the second front, negotiations with the IMF and EU have come closer to getting started than they have ever been since the government announced its intention to embark on such an undertaking in late 2011. Nevertheless, the controversial law pertaining to the central bank remains an open issue. Furthermore, uncertainty rules given the government's bombastic statements, alternating between outright hostility and plain indulgence, on the content of the negotiations, the IMF and EU against a backdrop of the government's propaganda machine urging a 'fight for freedom' against all foreign influences of any kind. Amidst all the international turbulences related to Greece, the vulnerable Hungarian economy is in dire need of a protective umbrella that an agreement with the IMF/EU would afford; however, neither a quick start nor a successful conclusion can be guaranteed. Meanwhile an exchange rate close to 300 HUF/€ and yields on long term government bonds over 8%, both closely related to the uncertainties concerning the IMF/EU financial package, cause painful losses for the budget, on one hand, and for households tackling with the high debt service after their foreign currency loans, on the other hand.

On the third front, the conflict over the controversial Hungarian laws is also far from being resolved, despite the government having scored a minor victory inasmuch as the EU gave a conditional go-ahead for the start of negotiations with the IMF-EU tandem on the financial assistance package. Once negotiations begin with the tandem, economic policy issues may well be topped by the emergence of other issues of paramount importance, viz. the independence of the Central Bank, curtailment of the rights of the Constitutional Court and the licence granted to the Fiscal Council.

Fiscal policy has been, and will remain, the focal point in both the international and domestic policy context. Successive Hungarian governments have done battle with the grave consequences of the lax fiscal policies pursued in the period between mid-2001 - mid-2006 as well as the lack of reforms in public spending that have long been outstanding. In 2010, the newly elected Orbán government toyed with the idea of a return to stimulating the economy by deficit spending. However, given the unfavourable external circumstances and for want of the growth effects that it had hoped for, the government was compelled in less than a year thereafter to revert to the disagreeable practice of fiscal consolidation, even though Orbán's flagship project, the 16% 'flat' income tax, which alone led to a gap in budget revenue equivalent to 1.8% of GDP, was introduced. The Orbán government's fiscal consolidation has been 'unorthodox' in the sense that instead of restrictive measures hitting the population head on, the financial sector (in the form of a bank levy) and primarily multinational enterprises in the energy, wholesale, telecom sectors (in the form of sectoral levies) bore the brunt of consolidation. Moreover, the second, mandatory private pillar of the pension scheme was nationalized, the aim being twofold: reduction of both the fiscal deficit and public debt. All those steps, coupled with a propaganda campaign against multinational companies and the financial markets, was successfully sold to large segments of the population in Hungary. That notwithstanding, though designed to step up budget revenues from unconventional sources, the measures proved inadequate

to the task; they failed to reduce the fiscal deficit to below the 3% threshold. Furthermore, as they were mostly of a temporary nature, they left the issue of medium-term sustainability unresolved. Only the increasing confrontation with the EC (see above) compelled the government to launch a second wave of economic-policy measures designed to diminish the budget deficit to well below 3% of the GDP. More importantly, they should be able to replace the temporary sector-specific taxes and reduce the bank levy by half, with promises of everything being phased out next year.

Although uncertainties abound in terms of the details, the main features of the forthcoming wave of fiscal consolidation will be: new taxes on financial transactions and telecom services; electronic road pricing; a modified tax on the energy sector and insurance companies; reduced subsidies for pharmaceutical products; reverse VAT charges in the agriculture sector; reduced government spending on research and innovation; and further cuts in expenditure in central government. The government aim is to reduce the fiscal deficit to 2.5% of GDP in 2012 - and 2.2% in 2013.

As for Hungary's poor track record in terms of fiscal balances, high public debt and the external pressure for fiscal consolidation, it is out of the question that economic growth over the next few years can be stimulated by way of deficit spending. Other means of fostering growth should be sought. One such growth resource would be an increase in inflow of FDI. Currently, FDI-inflows are focused on a limited number of major projects in the automotive cluster. The government encourages 'productive' FDI projects (in selected manufacturing branches), yet discourages them in communal services and agriculture. Even more important, trust in the rule of law has been seriously undermined by the manner in which sectoral levies, the nationalization of pension funds and the scheme for the early repayment of foreign currency mortgage loans were introduced, not to speak of the often hostile government rhetoric about the presence and influence of foreigners in Hungary. All this has effectively put the brakes on new projects and proven a disincentive for the local reinvestment of profits generated.

One alternative growth strategy would be to improve and broaden financial intermediation. Most countries are intent on keeping the central bank policy rate low in order to offset the negative impact of fiscal restrictions on growth. This is no simple task in Hungary, which boasts one of the highest policy rates (7%) in the EU-27 and has but limited manoeuvring space for introducing substantial cuts in the immediate future. The stock of business sector credits has dropped unabated in real terms since 2009. This is one explanation for the decline in investment activity, especially in the typically domestic-owned medium and small enterprises, which, unlike foreign-owned companies, do not enjoy access to intra-firm credits from a parent company abroad. Moreover, stagnating domestic markets and the high costs of borrowing diminish the readiness of firms to raise credits. Loans to households have also been contracting.

Banks are certainly key players where the future of financial intermediation is concerned. Whereas banks were highly profitable ventures in Hungary over the past decade, the Orbán government 'discovered' them first as a source of an inordinate bank levy, then as the main donors to the reduction of the costs associated with the early repayment of foreign currency mortgage loans at preferential rates. The government also announced that the banks were to bear the costs of the financial trans-

action tax that it was about to introduce. 2011 was a year of severe losses for Hungarian banks. Amidst the pressure for deleveraging the banks are finding themselves compelled to pursue a conservative or even restrictive lending policy.

The Orbán government's original plan to foster growth via domestic consumption has not taken off. A series of improvised economic policy measures over the past twelve months appear to have finally managed to consolidate the budget for this year and the next year - or at least to keep the budget deficit below or close to the 3% threshold. Nevertheless no coherent medium run economic policy is in sight. The politically motivated centralization introduced in undue haste in every possible segment of the economy and society excludes any reasonable reconciliation of interests. In fact, it even distorts any appropriate government initiatives.

The wiiw expects a 1% decline in GDP this year, contrary to the marginal growth forecast by the government. The wiiw reckons with fiscal consolidation having a greater negative impact on both consumption and investments. The positive net-exports position at a later juncture will prove incapable of offsetting that impact. Given the probable release of Hungary from the excessive debt procedure and the agreement with the IMF-EU tandem being concluded by the end of the year at the latest, the external pressure on Hungary may ease up in 2013, thus leading to cheaper financing of external debt. A modest upturn in investment, a check in decline in consumption and a positive net-exports position at a later juncture will make for a 1.5% expansion of the economy in 2013. Despite flat domestic demand, inflation will remain a matter of concern over the next two years. The current account will show a considerable surplus, albeit diminishing as of next year, when imports take off - coupled with a modest recovery of economic growth. While this is the baseline scenario for Hungary, the downward risks are considerable. In view of the country's high external debt and the vulnerability so induced, Prime Minister Orbán's confrontational course poses a serious risk. However, there is no reason to expect any change at the present juncture.



Sebastian Leitner

Latvia: Eurozone within reach

In the first quarter of 2012, Latvia recorded the highest GDP growth rate in the EU-27 (6.9% year-on-year), although external demand had slowed down to a remarkable degree. The level of capital investments, which had dropped in 2009 to half of the pre-crisis level, has continued to rebound strongly. Furthermore, the gradual upswing in employment has triggered growth in domestic consumption.

Growth in the export of goods continued to decline over the first few months of 2012. In particular, external demand among Latvia's trading partners in Western European slowed down perceptibly. However, in the course of the past two years Latvian exporters were able to improve their competitive position and, in turn, their market shares in their main export markets as well. Moreover, on looking at detailed trade figures, we can see that the range of export products has broadened over the past two years. The relative importance of wood products has declined, while metal products and machinery have assumed greater importance. Moreover, Latvian producers, in particular in the food industry, have managed to increase substantially the volume of exports to Russia.

Subsequent to the slump in export growth rates, imports of intermediary goods also lost momentum. However, imports of goods continue to record nominal growth rates surpassing those of exports on account of strong domestic demand. The current account deficit will thus record gradual growth in 2012 and the two years thereafter.

In contrast to the second half of 2011, the volume of retail trade in the first months of 2012 experienced rapid growth again, reflecting rising consumer confidence in the wake of improvements in the labour market situation. Subsequently, private household consumption increased by 5.6% in real terms year-on-year in the first quarter 2012. Owing to the modest rise in real wages and the inflow of remittances, household consumption will continue to drive GDP growth throughout the year. Nevertheless, private households and the corporate sector keep on deleveraging.

The growth rate of gross fixed capital investment strongly increased in the first quarter of 2012, the main driver being public expenditures on the construction of roads and other transport infrastructure. Owing to the cloudy outlook in terms of exports and industrial production in the months to come, investment in machinery will also be restrained during the rest of 2012.

Compared to the previous year, employment in the service sector continued to grow slightly in the first quarter 2012. The recalculation of population figures in line with the findings of 2011 census

Table LV

Latvia: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012 Forecast	2013	2014
Population, th pers., average ²⁾	2266.1	2254.8	2239.0	2064.1	.	.	2047	2037	2027
Gross domestic product, LVL mn, nom.	16085	13070	12739	14161	3046	3385	14900	15800	17000
annual change in % (real)	-3.3	-17.7	-0.3	5.4	3.5	6.9	2.7	3.3	3.8
GDP/capita (EUR at exchange rate) ²⁾	10100	8200	8000	9700	.	.	.	.	.
GDP/capita (EUR at PPP) ²⁾	14100	12000	12500	14500	.	.	.	.	.
Consumption of households, LVL mn, nom.	9904	7889	7908	8682	1991	2188	.	.	.
annual change in % (real)	-5.8	-22.8	0.7	4.6	3.5	5.6	3.5	3	3.5
Gross fixed capital form., LVL mn, nom.	4770	2820	2330	3045	471	692	.	.	.
annual change in % (real)	-13.7	-37.4	-18.1	27.9	31.4	39.0	15	8	10
Gross industrial production ³⁾									
annual change in % (real)	-3.2	-18.1	14.9	9.0	10.7	9.8	7	8	10
Gross agricultural production (EAA)									
annual change in % (real)	0.2	-0.7	-2.4	1.3	.	.	.	.	.
Construction industry									
annual change in % (real)	-3.1	-34.9	-23.4	12.4	-15.1	28.5	.	.	.
Employed persons - LFS, th, average ⁴⁾	1124.5	983.1	940.9	970.5	835.9	857.6	880	890	900
annual change in %	0.6	-12.6	-4.3	3.1	3.1	2.6	2	1	1
Unemployed persons - LFS, th, average ⁴⁾	90.5	203.2	216.1	176.4	178.9	166.7	.	.	.
Unemployment rate - LFS, in %, average ⁴⁾	7.5	17.1	18.7	15.4	17.6	16.3	15.5	14.5	14
Reg. unemployment rate, in %, end of period	7.0	16.0	14.3	11.5	14.4	11.7	.	.	.
Average gross monthly wages, LVL	479	461	445	464	450	466	.	.	.
annual change in % (real, net)	6.2	-5.6	-6.5	0.3	0.1	0.2	.	.	.
Consumer prices (HICP), % p.a.	15.2	3.3	-1.2	4.2	3.8	3.3	2.4	2.8	3.5
Producer prices in industry, % p.a.	11.4	-4.6	2.8	7.4	8.2	5.9	.	.	.
General government budget, EU-def., % GDP									
Revenues	34.9	34.7	35.7	35.6	36.6	.	35.9	37.0	37.5
Expenditures	39.1	44.4	43.9	39.1	38.8	.	38.5	39.5	39.5
Net lending (+) / net borrowing (-)	-4.2	-9.7	-8.1	-3.5	-2.3	.	-2.6	-2.5	-2.0
Public debt, EU-def., in % of GDP	19.8	36.7	44.7	42.6	43.9	.	43.5	44.5	45.5
Central bank policy rate, % p.a., end of period ⁵⁾	6.0	4.0	3.5	3.5	3.5	.	.	.	.
Current account, EUR mn	-3014	1598	535	-241	28	-143	-500	-600	-700
Current account in % of GDP	-13.2	8.6	3.0	-1.2	0.6	-3	-2.4	-2.7	-2.9
Exports of goods, BOP, EUR mn	6531	5253	6813	8598	1924	2146	9500	10600	12100
annual growth rate in %	8.5	-19.6	29.7	26.2	41.8	11.5	10	12	14
Imports of goods, BOP, EUR mn	10603	6575	8084	10586	2295	2713	12200	13600	15700
annual growth rate in %	-4.3	-38.0	23.0	31.0	40.4	18.2	15	11	15
Exports of services, BOP, EUR mn	3088	2747	2763	3176	663	772	3700	4100	4500
annual growth rate in %	14.1	-11.0	0.6	14.9	8.5	16.4	16	11	10
Imports of services, BOP, EUR mn	2169	1625	1666	1856	383	418	2000	2200	2450
annual growth rate in %	9.9	-25.1	2.5	11.4	8.2	9.1	8	10	11
FDI inflow, EUR mn	869	68	284	1108	270	101	.	.	.
FDI outflow, EUR mn	169	-44	16	64	21	-10	.	.	.
Gross reserves of NB excl. gold, EUR mn	3514	4572	5472	4665	4997	5067	.	.	.
Gross external debt, EUR mn	29763	29097	29978	29405	29082	29983	.	.	.
Gross external debt in % of GDP	130.0	157.1	166.8	146.7	145.1	142.6	.	.	.
Average exchange rate LVL/EUR	0.7027	0.7057	0.7087	0.7063	0.7048	0.7048	0.71	0.71	0.71
Purchasing power parity LVL/EUR	0.5051	0.4814	0.4543	0.4720	.	.	.	.	.

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

1) Preliminary. - 2) From 2011 according to census March 2011. - 3) Enterprises with 20 and more employees. - 4) Quarterly data according to census March 2011. - 5) Refinancing rate of National Bank.

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

yielded an upward revision of unemployment rates by 1 percentage point. Throughout 2012, the deceleration of external demand will allow for only a slight reduction in unemployment, while employment in manufacturing will even go into decline. A persistent problem in the Latvian labour market is the pronounced divergence between urban and rural regions, as well as between the western and eastern regions of the country. Whereas in the Riga area the registered unemployment rate has dropped to less than 10%, it stands at almost 25% in the Latgale region in the south-east part of the country.

Although gross wages have continued to rise (by 3.7% in the first quarter of 2012), average real net wages have remained stagnant. Whereas consumer inflation will drop over the rest of the current year, households will experience a slight increase in their purchasing power towards the end of 2012.

The most important goal in Latvian economic policy remains the attainment of the Maastricht criteria so that country can join the Eurozone in 2014. During the first months of 2012, consumer inflation rates declined constantly. However, the previously forecast CPI-rate of 2.8% for 2012 gave rise to concern over the possibility of the country not meeting the inflation criterion, should the euro-crisis lead to still more recession and hence to a decline of inflation rates in Southern Europe. Aware of the situation, the Latvian government decided in May 2012 to lower VAT from 22% to 21% from 1 July 2012 onwards. That move should lower the annual inflation rate for 2012 by about 0.5 percentage points.

The severe austerity measures introduced during the economic crisis had already led to a drop in the general government deficit to 3.5% of GDP in 2011. Since many of the spending cuts are more of a permanent nature extending over the medium term, such as staff cutbacks in the public sector as well as cuts in both public wages levels and social transfers, the government deficit will continue to fall given every expectation of tax revenues increasing as mentioned above. The resolve to reduce the rate of VAT will prevent the budget deficit from dropping close to 2%; however the deficit will hold at about 2.6% of GDP in 2012. Assuming a gradual upswing in economic activities, the budget deficit will decline further over the next two years.

Assuming a recovery of external demand dynamics across Western Europe, we expect GDP growth in 2013 and 2014 to pick up speed once again: rising to 3.3% in 2013 and 3.8% in 2014. Public investment is likely to remain at a high level in the current year and the year thereafter, since a large portion of EU-funds for the period 2007-2013 remained unspent up to now. Moreover, assuming that the slowdown in GDP growth to 2.7% in 2012 will still allow for a slight reduction in unemployment, we also expect real wages to start rising somewhat more rapidly in the two years to come. Accordingly, household demand is also likely to increase over the next two years. Weighing in at about 3% in real terms year-on-year, it will thus remain an important driver of GDP growth.

Table LT

Lithuania: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012 Forecast	2013	2014
Population, th pers., average ²⁾	3358.1	3339.5	3286.8	3053.8	.	.	3023	3008	2993
Gross domestic product, LTL mn, nom.	112084	91914	95074	106019	23234	25249	112500	120000	129400
annual change in % (real)	2.9	-14.8	1.4	5.9	5.9	3.9	3	3.6	4
GDP/capita (EUR at exchange rate)	9700	8000	8400	9500	.	.	.	.	.
GDP/capita (EUR at PPP)	15400	12800	14000	16200	.	.	.	.	.
Consumption of households, LTL mn, nom.	73406	63309	60994	67378	15147	16761	.	.	.
annual change in % (real)	4.2	-17.4	-5.0	6.1	5.5	6.8	4	3.5	4
Gross fixed capital form., LTL mn, nom.	28370	15808	15489	18651	3202	3589	.	.	.
annual change in % (real)	-5.2	-39.5	1.0	17.0	45.7	8.4	7	9	10
Gross industrial production (sales)									
annual change in % (real)	5.5	-14.6	6.7	7.4	14.5	3.9	4.5	6	7
Gross agricultural production (EAA)									
annual change in % (real)	8.8	1.0	-7.2	6.5	.	.	.	.	.
Construction industry									
annual change in % (real)	4.0	-48.5	-7.7	22.2	15.9	11.7	.	.	.
Employed persons - LFS, th, average	1520.0	1415.9	1343.7	1370.9	1340.4	1365.9	1390	1405	1420
annual change in %	-0.9	-6.8	-5.1	2.0	0.9	1.9	1.4	1.1	1.1
Unemployed persons - LFS, th, average	94.3	225.1	291.1	248.8	277.6	230.9	.	.	.
Unemployment rate - LFS, in %, average	5.8	13.7	17.8	15.4	17.2	14.5	13.8	12.5	11.5
Reg. unemployment rate, in %, end of period ³⁾	4.4	12.5	14.4	11.0	13.6	11.8	.	.	.
Average gross monthly wages, LTL	2151.7	2056.0	1988.1	2042.0	2071.6	2138.1	.	.	.
annual change in % (real, net)	10.1	-7.2	-4.3	-1.5	-1.4	-0.5	.	.	.
Consumer prices (HICP), % p.a.	11.1	4.2	1.2	4.1	3.2	3.6	3	3	3.5
Producer prices in industry, % p.a.	18.2	-13.5	10.3	13.9	15.4	8.5	.	.	.
General govern.budget, EU-def., % GDP									
Revenues	33.9	34.3	33.7	32.0	31.6	.	33.5	33.2	34.0
Expenditures	37.2	43.8	40.9	37.5	39.2	.	36.8	36.0	36.5
Net lending (+) / net borrowing (-)	-3.3	-9.4	-7.3	-5.5	-7.6	.	-3.3	-2.8	-2.5
Public debt, EU-def., in % of GDP	15.5	29.4	38.0	38.5	39.2	.	40.5	41.0	40.0
Central bank policy rate, % p.a., end of period ⁴⁾	7.84	1.57	1.07	1.24	1.10	.	.	.	.
Current account, EUR mn	-4194	1182	410	-481	-74	-586	-1500	-1500	-1500
Current account in % of GDP	-12.9	4.4	1.5	-1.6	-1.1	-8.0	-4.6	-4.3	-4.0
Exports of goods, BOP, EUR mn	16077	11797	15651	20169	4571	5112	22300	25500	29000
annual growth rate in %	28.5	-26.6	32.7	28.9	50.0	11.8	11	14	14
Imports of goods, BOP, EUR mn	20280	12648	16921	21678	4999	5652	24000	28000	33000
annual growth rate in %	20.8	-37.6	33.8	28.1	49.5	13.1	11	17	18
Exports of services, BOP, EUR mn	3240	2657	3115	3761	777	748	3800	4200	4700
annual growth rate in %	10.5	-18.0	17.2	20.7	24.1	-3.7	1.0	11	12
Imports of services, BOP, EUR mn	2835	2140	2141	2650	537	619	2900	3200	3600
annual growth rate in %	14.7	-24.5	0.0	23.8	23.4	15.3	9	10	13
FDI inflow, EUR mn	1341	47	568	875	150	300	.	.	.
FDI outflow, EUR mn	229	157	60	118	-7	52	.	.	.
Gross reserves of NB excl. gold, EUR mn	4458	4472	4788	6120	4738	5755	.	.	.
Gross external debt, EUR mn	23009	23163	24071	24813	23976	.	.	.	.
Gross external debt in % of GDP	70.9	87.0	87.4	80.8	78.1	.	.	.	.
Average exchange rate LTL/EUR	3.4528	3.4528	3.4528	3.4528	3.45	3.45	3.45	3.45	3.45
Purchasing power parity LTL/EUR	2.1710	2.1498	2.0621	2.1405	.	.	.	.	.

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

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

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



Sebastian Leitner

Lithuania: Above-average growth

Export growth declined gradually in the few first months of 2012. Surprisingly, however, exports to Lithuania's trading partners in the EU remained quite nimble, whereas external demand in Russia, its most important trading partner, even declined in nominal terms at the beginning of 2012. A mix of higher oil prices and vigorous domestic demand saw import growth rates consistently exceeding export growth rates. Thus, in the first quarter 2012 the current account deficit leapt once again to 8% of GDP. For 2012 as a whole, we expect import growth to weaken somewhat. That notwithstanding, current account deficits are back on the books since over the medium term Lithuania as its Baltic neighbours will continue to enjoy more rapid growth than their trading partners.

The country's economy continues to be driven by domestic demand. Although credit growth remains stagnant in both the household and corporate sectors, mitigation of conditions in the labour market has brought about a marked increase in household consumption (after a fall of more than 25% in 2008 – 2010), which should remain resilient throughout the year. Owing to rising real wages, we expect the propensity to consume to remain high throughout 2013 and 2014 as well.

In particular, investment in machinery and equipment continued to rise in the manufacturing sector. However, given the downturn in external demand, producer confidence dropped. Entrepreneurs started to reduce stocks in the last quarter 2011 and in the first quarter 2012, thus gross capital formation continued declining year-on-year in real terms.

The economic revival of 2011 brought about an increase in employment, particularly in industry. In the first quarter 2012, the rate of unemployment dropped to 14.5%: a figure still far above the EU-27 average. The likely flattening of the business cycle over the next six months will generate only a meagre number of jobs. We thus expect the average unemployment rate to decline only slightly to 13.8% in 2012. The still strained situation in the labour market has caused average real wages to drop still further in Lithuania. However, towards the end of the current year the effect of lower import prices on domestic inflation shall bring about a rise in real wages for the first time since the onset of the economic crisis. Moreover, in May the government suggested raising the Lithuanian minimum wage to € 260 to enter into effect in January 2013: a measure that the opposition parties also support. Thus, the resultant stronger wage growth should also bolster consumption dynamics in 2013.

On account of the lower import prices and their impact on inflation, the increase in the prices of consumer goods dropped gradually over the first few months of 2012. Given the likelihood of a drop in oil prices, a resource on which Lithuania is now more dependent than ever following the closure of the Ignalina nuclear power plant, we expect the CPI-rate to drop to 3% on average in 2012.

The revival of external demand over the past two years allowed the Lithuanian government to pursue its severe austerity policy and to cut the budget deficit. The current year's fiscal deficit will be reduced to slightly above 3% of GDP. Although the government has maintained a strict policy of restraint where public wages, pensions and public expenditures are concerned, it is discussing various forms of tax cuts for households in order to secure public support for the upcoming parliamentary elections.

Scheduled to be held in October 2012, the elections will most probably bring about a change in government with the ruling centre-right coalition ceding to a centre-left coalition. The strongest opposition parties, the Labour Party led by Viktor Uspaskich, the Social Democratic Party and the Order and Justice Party headed by Rolandas Paksas are front-runners in the opinion polls, while the Homeland Union chaired by Prime Minister Kubilius is the only right-wing party that, were elections to be held today, would clear the 5 per cent barrier regulating representation in parliament. The opposition parties mentioned above recently reached an agreement on joining forces after the elections in order to form a coalition government. The Social Democrats held the post of the prime minister in the penultimate parliamentary term (2004 – 2008). No radical changes are to be expected from the parties most likely to coalesce, since they lean more to the centre as well as being more inclined towards the business sector than the left wing. One issue that the opposition parties are mooting is a switch from the present flat-tax system to a progressive income tax scheme. Not only has the flat-tax system had detrimental distributional consequences, but Lithuania is also currently the country with the lowest government revenue-to-GDP ratio. Slovakia has also very recently decided to abandon the flat-tax system that it introduced in 2004 in order to alleviate the budget's chronic revenue shortage. In an era when sovereign debt crises abound, progressive taxation seems to be enjoying a revival.

Driven by a decline in external demand, but displaying stable household consumption, 2012 will see a slowdown in GDP growth to 3% in real terms. In 2013 and 2014, with the exports of goods gradually recovering, a slight increase in corporate investments will re-emerge. The probable increase in both minimum and average real wages should provide for stable household consumption. We thus expect GDP to grow at a swifter pace: 3.6% in 2013 and 4.2% in 2014.



Leon Podkaminer

Poland: Soft landing ahoy

In the wake of decelerating growth in private consumption (and a decline in the volume of public consumption), overall GDP growth slowed down in the first quarter of 2012. The first quarter's GDP growth rate was the lowest recorded over the past two years, despite the continuing palpable expansion of gross fixed investment and the marked increase in inventories. Foreign trade developments were also favourable; although the volume of both exports and imports grew at a slower rate than in 2011, export growth outstripped that of imports. Net exports contributed positively - by 0.7 percentage points (p.p.) - to overall GDP growth in the first quarter of 2012. Both gross fixed investment and the increase in inventories contributed 0.8 p.p. each, while private consumption contributed 1.4 p.p. The increase in gross value-added, (GVA), [the volume of which rose by 3.2% in toto] was particularly pronounced in the construction sector (close to 10%). GVA in industry increased by 3.4%.

The enterprise sector (non-financial firms operating outside agriculture and employing 49 persons or more) performed quite well in the first quarter of 2012. Although the sector's liquidity and profitability indicators worsened slightly, its net profits overall reached PLN 23.6 billion (roughly equivalent to EUR 5.7 billion): 7% more than the year before. Exporting enterprises performed better than their non-exporting counterparts. Although exports grew at a much lower rate than the year previous (in terms of both volume and value), they yielded higher profits. No doubt this reflects the relative weakness of the Polish currency as well as the current gains in unit labour costs (repressed growth in wages). The growth slowdown in the euro area has not yet affected Polish exporters, one factor being that hitherto growth in Germany, Poland's most important export market, has not overly slowed down. In 2011, the enterprise sector's attitude towards the expansion of productive capacities changed. After some two years of pre-emptive accumulation of idle cash balances, the sector started to expand its fixed asset investments quite forcefully. That trend continued during the first quarter of 2012. The sector's outlays for fixed investment (PLN 17.6 billion) rose by more than 12% in real terms over the same period in 2011. The upswing in the propensity to invest is especially visible in mining, market services and manufacturing, yet that same propensity is fast receding in the construction sector. The latter development marks a response to the gradual reduction in public-sector infrastructural (chiefly transportation) investment that has been planned for the next few years⁴⁸. Purchases of machinery and equipment, as well as means of transport, account for close to two thirds of the total investment outlay.

⁴⁸ The GDP share of the publicly-funded investment rose from 4% in 2006 to 5.8% in 2011. From 2012 that ratio will be progressively reduced, to 2.8% in 2015. Much of the investment in question is directly related to the UEFA European Football Championships (organized jointly by Poland and Ukraine) in June 2012.

Table PL

Poland: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012 Forecast	2013 Forecast	2014
Population, th pers., average ²⁾	38126	38152	38184	38230	38204	38207	38217	38204	38185
Gross domestic product, PLN bn, nom.	1275.4	1344.4	1416.4	1524.7	349.4	370.5	1620	1700	1790
annual change in % (real)	5.1	1.6	3.9	4.3	4.6	3.5	2.3	2.4	2.6
GDP/capita (EUR at exchange rate)	9500	8100	9300	9700	.	.	.	.	.
GDP/capita (EUR at PPP)	14100	14300	15300	16200	.	.	.	.	.
Consumption of households, PLN bn, nom.	773.8	809.7	856.2	921.9	233.6	247.6	.	.	.
annual change in % (real)	5.7	2.1	3.1	3.2	3.2	2.1	1.7	2	2.5
Gross fixed capital form., PLN bn, nom.	283.9	284.6	281.3	307.9	42.3	46.6	.	.	.
annual change in % (real)	9.7	-1.3	-0.4	8.1	4.0	6.7	6	5	6
Gross industrial production (sales) ³⁾									
annual change in % (real)	2.6	-3.7	11.1	6.9	9.1	4.7	4	5	6
Gross agricultural production (EAA)									
annual change in % (real)	0.4	5.9	23.9	1.2	.	.	.	.	.
Construction industry ³⁾									
annual change in % (real)	9.8	4.7	3.9	15.5	18.7	13.8	.	.	.
Employed persons - LFS, th, average	15799.8	15868.0	15960.5	16130.5	15875.0	15981.0	16210	16370	16530
annual change in %	3.7	0.4	0.6	1.1	1.9	0.7	0.5	1	1
Unemployed persons - LFS, th, average	1210.7	1411.1	1699.3	1722.6	1771.0	1883.0	.	.	.
Unemployment rate - LFS, in %, average	7.1	8.2	9.6	9.7	10.0	10.5	10	9.5	9
Reg. unemployment rate, in %, end of period	9.5	11.9	12.3	12.5	13.3	13.3	13	13	12.5
Average gross monthly wages, PLN ⁴⁾	2942.2	3101.7	3224.1	3399.5	3478.9	3668.5	3560	3690	3900
annual change in % (real, gross) ⁴⁾	5.9	2.0	1.4	1.2	0.4	1.3	1	1	3
Consumer prices (HICP), % p.a.	4.2	4.0	2.7	3.9	3.6	4.2	3.8	2.5	2.5
Producer prices in industry, % p.a.	2.4	3.9	2.3	7.5	7.7	5.8	4	3	2.5
General governm.budget, EU-def., % GDP									
Revenues	39.5	37.2	37.5	38.5	.	.	.	.	.
Expenditures	43.2	44.5	45.4	43.6	.	.	.	.	.
Net lending (+) / net borrowing (-)	-3.7	-7.4	-7.9	-5.1	.	.	-3.5	-3.0	-3
Public debt, EU-def., in % of GDP	47.1	50.9	54.8	56.3	.	.	55	54	53.5
Central bank policy rate, % p.a., end of period ⁵⁾	5.0	3.5	3.5	4.5	3.8	4.5	4.5	4.3	4.0
Current account, EUR mn ⁶⁾	-23818	-12153	-16486	-15914	3134	-3623	-15500	-18000	-18700
Current account in % of GDP ⁶⁾	-6.6	-3.9	-4.6	-4.3	3.5	-4.1	-4.0	-4.4	-4.3
Exports of goods, BOP, EUR mn ⁶⁾	120953	101715	124998	139209	33780	35900	149600	160800	173700
annual growth rate in %	14.2	-15.9	22.9	11.4	16.7	6.3	7.5	7.5	8
Imports of goods, BOP, EUR mn ⁶⁾	141896	107140	133893	149317	35673	37973	160500	173300	187200
annual growth rate in %	18.5	-24.5	25.0	11.5	17.4	6.4	7.5	8	8
Exports of services, BOP, EUR mn ⁶⁾	24207	20717	24718	26573	5754	5905	27900	30100	32500
annual growth rate in %	15.2	-14.4	19.3	7.5	19.2	2.6	5	8	8
Imports of services, BOP, EUR mn ⁶⁾	20729	17294	22381	22233	4901	4965	23300	25600	27600
annual growth rate in %	17.9	-16.6	29.4	-0.7	11.8	1.3	5	10	8
FDI inflow, EUR mn ⁶⁾	10135	9339	6699	10333	3829	-2770	.	.	.
FDI outflow, EUR mn ⁶⁾	3071	3331	4149	3723	1983	-1186	.	.	.
Gross reserves of NB excl. gold, EUR mn	42299	52734	66253	71028	71720	70626	.	.	.
Gross external debt, EUR mn	173736	194396	236018	249072	245344	.	.	.	.
Gross external debt in % of GDP	47.8	62.6	66.6	67.3	66.3	.	.	.	.
Average exchange rate PLN/EUR	3.5121	4.3276	3.9947	4.1206	3.9435	4.2322	4.15	4.15	4.15
Purchasing power parity PLN/EUR	2.3746	2.4703	2.4247	2.4654	.	.	.	.	.

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

1) Preliminary. - 2) From 2011 according to census March 2011. - 3) Enterprises with 10 and more employees. - 4) Quarterly data refer to enterprises with 10 and more employees. - 5) Reference rate (7-day open market operation rate). - 6) Including Special Purpose Entities (SPEs).

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

The financial standing of the banking system remains comparatively strong. The capital adequacy ratio (CAR) stood at 13% at the end of November 2011. Although CAR is forecast to decline slightly in 2012, it will surely suffice, even if macroeconomic and/or financial conditions deteriorate quite radically. The share of 'endangered' credits in the total stock of credits (7.5% at the end of September 2011) has dropped (from 7.9% the year previous). During the first quarter of 2012 the banking sector accrued net profits close to PLN 4.3 billion (12% up on the same period in 2011). The high profits earned are likely to continue to increase the banks' own capital base, thereby reinforcing their resilience.

During the first four months of 2012, the stock of loans to the non-financial sector remained flat. In real terms, stock contracted (because the stock of foreign-exchange denominated loans was inflated as a result of the weakening PLN). The sluggishness of lending reflects: (i) the entrenched risk awareness on both sides of the loan market; and (ii) the fact that a large share of the corporate sector does not rely on bank credits at all. On average, the sector's financial means exceeds its needs. Of course, access to credit is still a matter of concern to small and medium enterprises, especially those that have just started up. The sluggishness is also a reflection of the stagnation (both actual and anticipated) of real purchasing power that the economy-wide wage-bill and social benefits have also encountered.

Of course, the relatively high interest rates administered by the National Bank of Poland (NBP), which were raised yet again in May 2012,⁴⁹ keep market rates at elevated levels: a further disincentive to expand lending. At the end of March 2012, the average interest rate on loans to firms stood at 6.4% and the average interest on PLN-denominated housing credit (to households) at 7.4%. Given the recent hikes in official rates, commercial interest rates on new loans are likely to follow suit.

Despite the overall good standing of the banking system, some risks persist. At the end of April 2012, the banks' foreign-exchange assets accounted for 24.7% of their balance sheets, whereas their foreign-exchange liabilities accounted for only 17%. This continuing and ever-growing misalignment that is partly due to the weakening PLN points to a more profound structural problem. The non-financial (domestic) sector's deposits in domestic banking at present cover merely 85.5% of the banks' loans and credits to the domestic non-financial sector. The remaining 15.5% of the backing of the banks' stock of loans come from the financial sector – primarily from foreign parent-organisations. An abrupt withdrawal of a sizeable portion of those foreign resources would certainly affect the domestic banks' stability. However, the likelihood of that happening does not seem very high, given the high profit margins (offering over 15% return on equity) still to be earned on banking activities in Poland. More likely, some foreign banking groups facing difficulties outside Poland may have to sell off their local 'daughters' to other parties – including 'native' Polish banks or other financial groups. In any event, the authorities (both the National Bank of Poland and the Financial Supervision Office) are well aware of the potential fragility created by the lack of balance between the stocks of domestic loans and deposits and the presence of foreign-owned banks.

⁴⁹ The NBP reference rate currently stands at 4.75% and its deposit rate at 3.25%. The National Bank has resumed its old deplorable habit of combating inflation due to higher indirect taxes and the increase in the cost of imported crude oil by raising interest rates.

The budget law for 2012 lays down some new restrictions on public-sector spending (especially in relation to social expenditures and local government outlays on the public health service). Public spending on infrastructural investment is already starting to contract. Taxation (mainly in the form of a 2 percentage-point hike in social security contributions that employers have had to absorb, as well as higher indirect tax rates on certain items) has also gone up. Overall, the additional measures introduced by the government should draw in extra budgetary revenues of about 1.5% of the GDP in 2012 (and reduce spending by 0.6% of the GDP). In effect, the fiscal deficit should drop from about 5.1% of the GDP in 2011 to less than 3% in 2012. Fiscal consolidation will continue throughout 2013 and beyond. However, the changes currently legislated will shift the proportions between increases in revenues and cuts in expenditures, since cuts in spending in 2013 will be greater than increases in revenues. In 2015 revenues should account for 37.6% of the GDP (down from about 38.5% in 2011) and expenditures for 38.6% (as against 43.6% in 2011)⁵⁰. In 2015 the public sector deficit should drop to less than 1% of the GDP. The ratio of public sector debt to GDP should fall from 56.4% in 2011 to less than 50% in 2015. The share of debt denominated in foreign currencies will remain unchanged at about 30% of the total, while the average effective interest on the public debt thus reduced will none the less remain constant at slightly over 5% per annum.

The ambitions of the current fiscal consolidation measures extend well beyond 2015. The government is launching a major reform of the pension system, whereby the age of retirement will be progressively (up until 2040) raised to 67 for both sexes; in 2011 men could still retire at the age of 65 and women at the age of 60. According to the government, the pension system reform will not only stabilise the share of public spending on senior citizens (at a level of less than 20% of the GDP) up until at least 2060, it is also expected to contribute to a higher level of overall employment - and hence to more rapid economic growth. Of course, it is rather hard to square expectations of higher employment among an ever-larger number of older people intent upon finding jobs with such manifest empirical facts as the persistently high overall rate of unemployment among the elderly. The rate of unemployment for persons aged 50 or more is 23% - twice the overall unemployment rate. Furthermore, the assumption that output growth will accelerate given a higher rate of employment among senior citizens borders closely on wishful thinking. Of course, increasing the retirement age is not irrational on purely fiscal grounds, as it will obviously permit 'economisation' in terms of pension expenses being covered from the public purse (possibly through higher tax levies on income-earners in the future). Those fiscal gains, however, will be secured at the cost of impoverishing large segments of the future professionally inactive (or unemployed) population. Unable to find any work, older women, will be singularly hard hit⁵¹.

⁵⁰ According to the Governmental Convergence Programme, dated April 2012 (accessible, for example, on the website of the Polish Finance Ministry).

⁵¹ The actual consequences of the pension reforms will, sooner or later, be well understood by the young (especially those unable to find any work). It will then be fully rational for them to seek residence outside the country – i.e. in places where they can find work now and look forward to something better than outright misery in old age. The unfavourable demographic trend (ageing) is the primary justification for the reform put forward by the government. Ironically, the reform could strengthen that very trend by inducing a higher rate of emigration among the young and able.

During the global financial crisis, the Polish economy performed well, despite adverse external and internal circumstances (massive floods and other disasters). The country's GDP rose by 15.6% cumulatively over the period 2007 - 2011, without recording a single quarter with negative growth. In comparison, the cumulative change in output for the entire EU-27 was negative (-0.6%). No other EU country managed to escape deep and prolonged recession of varying degrees. This success had many sources, some certainly beyond governmental control. Governmental inaction, however, may well have been a decisive factor. During its first term, the Tusk government launched but one reform worth mentioning (yet it only entered into effect in 2011). More importantly perhaps, for all its hawkish rhetoric, the government did not address the issue of a rising public-sector deficit as much as it could have. On the contrary, despite continuing GDP growth, public-sector revenues fell from 40.3% of the GDP in 2007 to 37.2% in 2009. Public spending, however, rose from 42.2% to 44.5% over the same period. Consequently, the public sector deficit rose from 1.9% of the GDP to 7.4% in 2009. As was to be expected, the public debt rose from 45% of the GDP in 2007 to 56.3% in 2011. Arguably, the increase in public debt was the price paid for maintaining growth which otherwise could have been negative – as was the case throughout the rest of Europe. By allowing the automatic stabilisers to take effect during the difficult period, the Polish economy has sailed through dangerous waters with flying colours. It is quite possible that the reverse process now being set in motion – that of fiscal consolidation with expectations of the debt/GDP ratios being swiftly reduced – will also bolster Poland's growth. Such a providential outcome, however, need not necessarily materialise. It is much more likely that fiscal consolidation – especially as currently executed under generally worsening external conditions – might slow down growth. That growth slowdown is then likely to result in failure to reach the fiscal consolidation targets envisaged.

Certainly, even if fiscal consolidation proceeds as planned in 2012-13 and generates the usual Keynesian recessionary impulses, the country can still continue growing, albeit at a somewhat slower pace. In the near term, private export-oriented investment (sustained by prospects of handsome profits to be made) can still drive overall growth. Later on, that role could be passed on to net exports (the dynamics of which could be supported by further gains in unit labour costs owing to depressed wages and depreciating currency). Of course, this moderately positive scenario for Poland assumes reasonably stable developments in the euro area – most particularly in Germany.

Table RO

Romania: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012 Forecast	2013	2014
Population, th pers., average ²⁾	21514	21480	21438	19043	.	.	19000	18950	18900
Gross domestic product, RON mn, nom.	514700	501139	522561	578552	105129	109722	619400	673100	728300
annual change in % (real)	7.3	-6.6	-1.6	2.5	1.7	0.5	1	2.5	3
GDP/capita (EUR at exchange rate)	6500	5500	5800	7200	.	.	.	.	.
GDP/capita (EUR at PPP)	11700	11000	11400	13300	.	.	.	.	.
Consumption of households, RON mn, nom.	327928	304667	327562	351206	71254	73688	.	.	.
annual change in % (real)	9.0	-10.4	-0.4	1.4	-1.2	0.6	1	2	3
Gross fixed capital formation, RON mn, nom.	164279	122442	125227	142094	17988	21008	.	.	.
annual change in % (real)	15.6	-28.1	-2.1	6.3	-2.1	11.8	3	5	6
Gross industrial production ³⁾									
annual change in % (real)	2.6	-5.5	5.5	5.6	11.4	-0.4	3	5	5
Gross agricultural production (EAA)									
annual change in % (real)	21.2	-2.2	1.0	11.4	.	.	.	.	.
Construction industry ³⁾									
annual change in % (real)	26.7	-15.0	-13.2	2.8	-4.5	-1.1	.	.	.
Employed persons - LFS, th, average	9369.1	9243.5	9239.4	9137.7	9068.7	.	9150	9150	9200
annual change in %	0.2	-1.3	0.0	-1.1	1.5	.	0.1	0	0.5
Unemployed persons - LFS, th, average	575.5	680.7	725.1	730.2	740.6	747	.	.	.
Unemployment rate - LFS, in %, average	5.8	6.9	7.3	7.4	7.6	7.7	7.5	7	7
Reg. unemployment rate, in %, end of period	4.4	7.8	7.0	5.1	6.0	5.1	.	.	.
Average gross monthly wages, RON ⁴⁾	1761	1845	1902	1995	1988	2059	.	.	.
annual change in % (real, net)	16.5	-1.5	-3.7	-0.9	-7.3	0.9	.	.	.
Consumer prices (HICP), % p.a.	7.9	5.6	6.1	5.8	7.5	2.7	3.5	4	4
Producer prices in industry, % p.a.	15.3	1.8	6.3	8.9	10.7	5.6	.	.	.
General governm.budget, EU-def., % GDP									
Revenues	33.6	32.1	33.4	32.5	.	.	.	.	.
Expenditures	39.3	41.1	40.2	37.7	.	.	.	.	.
Net lending (+) / net borrowing (-)	-5.7	-9.0	-6.8	-5.2	.	.	-3.5	-3	-3
Public debt, EU-def., in % of GDP	13.4	23.6	30.5	33.3	.	.	34	34	34
Central bank policy rate, % p.a., end of period ⁵⁾	10.25	8.00	6.25	6.00	6.25	5.25	.	.	.
Current account, EUR mn	-16178	-4938	-5499	-6007	-967	-543	-6500	-7000	-8500
Current account in % of GDP	-11.6	-4.2	-4.4	-4.4	-3.9	-2.2	-4.6	-4.5	-4.9
Exports of goods, BOP, EUR mn	33656	29091	37340	45031	11045	10998	46800	52400	58700
annual growth rate in %	13.9	-13.6	28.4	20.6	39.7	-0.4	4	12	12
Imports of goods, BOP, EUR mn	52729	35959	44931	52541	12035	12165	55700	61300	69300
annual growth rate in %	11.3	-31.8	25.0	16.9	25.8	1.1	6	10	13
Exports of services, BOP, EUR mn	8751	7061	6622	7352	1470	1652	7900	8700	9400
annual growth rate in %	27.1	-19.3	-6.2	11.0	4.3	12.4	7	10	8
Imports of services, BOP, EUR mn	8091	7352	6216	6979	1490	1624	7400	8100	8900
annual growth rate in %	25.0	-9.1	-15.5	12.3	2.9	9.0	6	10	10
FDI inflow, EUR mn	9501	3490	2227	1940	473	425	.	.	.
FDI outflow, EUR mn	186	-61	-12	22	-29	25	.	.	.
Gross reserves of NB excl. gold, EUR mn	25977	28249	32606	33166	32767	34605	.	.	.
Gross external debt, EUR mn	72354	81206	92458	98425	94803	98425	.	.	.
Gross external debt in % of GDP	51.8	68.7	74.5	72.1	69.5	69.9	.	.	.
Average exchange rate RON/EUR	3.6826	4.2399	4.2122	4.2391	4.2234	4.3533	4.4	4.3	4.2
Purchasing power parity RON/EUR	2.0425	2.1125	2.1445	2.2841	.	.	.	.	.

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

1) Preliminary. - 2) From 2011 according to census October 2011. - 3) Enterprises with 4 and more employees. - 4) Quarterly data refer to enterprises with 4 and more employees. - 5) One-week repo rate.

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



Gábor Hunya

Romania: New government relaxing the budget

A change in political leadership a few months ahead of the general elections has caused a politico-economic upheaval in Romania. In a vote of no confidence, parliament tossed out the centre-right coalition government led by the Democratic Liberal Party (PDL) after several MPs had switched allegiance to the centre-left opposition, the Social Liberal Union (USL). After being sworn in on 7 May, the new government got off to a dynamic start. It amended the election law that will enter into effect in time for the November elections and within a matter of weeks it replaced all the senior officials in various public bodies. For good measure, it also initiated wage-hikes in the public sector. The new government's popularity was resoundingly confirmed in the local elections held on 10 June and they are currently clear favourites in the upcoming general elections in November. As they can apparently draw on some fiscal reserves and count on the goodwill of both the IMF and the EU, they will apparently be in a position to fund popular expenditures.

The economy grew by a modest 0.5% in the first quarter of 2012 year-on-year, whereas for the second time in a row negative rates were recorded in comparison to the previous quarter. Modest private consumption, deteriorating export performance and fiscal austerity were the main causes of the current economic stagnation. On the positive side, investments picked up and the inflow of EU funds improved.

Data for the first four months show that industrial production flattened in comparison to the previous year. Shrinking internal and external demand for durable consumer goods and the closure of the Nokia production facility in Cluj have had a lasting effect. Driven by sales of food and fuel, retail trade turnover rose by 3.4% in the first four months of 2012, whereas sales of other industrial goods stagnated at the same level as the previous year. Inflation dropped to its lowest level for decades: to 1.8% in May 2012 as against the same month in the previous year. Administered prices recorded almost no increases and food prices stabilised in the wake of the previous year's bumper harvest. Unemployment stood at 7.7% in the first quarter of 2012, practically at the level of the previous year. In May business sentiment improved across all sectors of the economy with the (widely anticipated) change in government bumping up optimism in general.

The banking sector continued to be soundly capitalized; deleverage does not seem to have posed any problems in Romania. The National Bank reported robust credit expansion. At the end of April 2012, non-government loans edged up year-on-year by 9.8% (7.9% in real terms), including a 3.3% increase in RON-denominated loans (1.4% in real terms) and 13.9% in foreign currency-denominated loans expressed in RON (5.5% in nominal EUR terms). At the same time, the share of non-performing loans rose and companies complained of the increase in credit costs. Insolvency is

expected to rise among larger companies which, until recently, benefited from rescheduling facilities that helped them survive and funded their current operations in the first few years of the crisis. At present, companies are increasingly unable to abide by the terms set for credit rescheduling; their cash reserves are dwindling and banks are no longer willing to reschedule bad loans.

The current account deficit shrank compared to the first quarter of 2011. The trade balance, however, deteriorated with exports contracting marginally and imports rising in a like manner. In that context, due account should be taken of the extraordinarily high import and export growth in the first quarter of 2011 that subsequently dropped. Consequently, the base-effect may well diminish during the year and both exports and imports may well grow again; it all depends on external demand. Following a significant boost, the current transfers surplus offset the trade deficit. In that context, remittances increased a jot or two, while general government transfers recorded a threefold increase. The latter item and the tenfold increase in capital transfers received by the general government indicate that access to EU financing has improved.

While policies determining economic growth will need more time to take shape, the left-leaning government is in a position to introduce some immediate changes on the fiscal front. It has agreed with the IMF and the European Commission to keep the general government deficit (as per ESA95) below 3% of GDP, while permitting the cash deficit to increase from 1.9% to 2.2% of GDP. Public-sector wages will rise by 8% as of 1 June 2012; pensions will go up as well. This will be followed by another wage-hike prior to the elections, thereby providing compensation for the reductions introduced in the context of the austerity package launched mid-2010.

There is every expectation that public finances will be less austere than in previous years. Budget implementation in 2011 was better than planned. The cash deficit declined to 4.2% of GDP, while the ESA95 deficit fell from 6.8% in the previous year to 5.2% on account of a series of one-off expenditures (such as social security contributions that had been drawn down pensions in breach of the national constitution). Despite relatively agreeable economic growth of 2.5% in 2011, fiscal revenues diminished moderately by 0.9 percentage points to 32.5% of GDP - mainly on account of privatization plans that failed. Expenditures fell by 2.5 percentage points to 37.7% of GDP. For two years, expenditures on both wages and subsidies had been curtailed, whereas those on interest payments and investments, including the co-financing of EU projects, increased.

The budgetary programme for 2012 maintains the austerity policy in line with the agreements reached with the IMF and the EU Commission; a deficit of 2.8% of GDP has been set as the target on the assumption that real GDP growth will reach either 1.7% as envisaged by the government or 1.4% as predicted by the EU Commission. The general taxation framework, including flat tax, has been maintained and a number of minor taxes and fees are to be consolidated. Revenues are to be restored to 33.4% of GDP, their level in 2010, without increasing taxes by relying on improved tax collection. Expenditures should decline by 1.5 percentage points to 36.2% of GDP. Whereas the EC and the government do not contest the above figures, the two institutions appear to have quite different views on the structure of expenditures. The Commission's recommendations would shift the structure of expenditures away from wages and social security payments to higher fixed capital for-

mation. The former government's priority laid down in the Convergence Programme of April 2012 was quite the opposite. The new government's public wage policy may give rise to even more shifts away from investments. The government is also harbouring exaggerated hopes of increasing public-sector efficiency and absorbing more EU funds that would then enhance investments. Unrealistic expectations for the revenue side and new commitments for expenditures mean fiscal relaxation even if not openly admitted.

The new government has not yet adopted a clear stance on the structural reform chapter of the IMF treaty that lists a series of measures to be taken in order to: (i) reduce losses and arrears in the public sector; and (ii) increase the transparency and efficiency of funding in the energy, health and transport sectors. In general, the new government is in favour of transparency and efficiency, but progress in that respect has always been sluggish. In the context of energy sector reform, the previous government agreed with the IMF to eliminate regulated electricity prices and social tariffs in a series of stages over the period 2013-2015. Special prices granted to major clients will be re-negotiated as their introduction in the past was often based on favouritism. The elimination of gas price subsidies has been postponed yet again; a new deadline for stepwise implementation has been set for the period 2015-2017. However, regulated tariffs for industrial consumers are to be phased out by the end of 2013. It should be noted that for energy-intensive industries, low electricity and gas prices are critical competitive factors. Among the EU-27, Romania applies the lowest gas prices and the second lowest electricity prices (after Bulgaria) for both household and industrial consumers.

A long-standing political controversy is raging in Romania over the privatisation of state-owned enterprises. The USL has declared that the privatisation steps included in the current IMF agreement 'are detrimental to the Romanian interests'. In fact, the outgoing coalition was equally unenthusiastic and the delay in taking steps towards privatisation proved to be a main stumbling block on the path to fulfilling the terms of the IMF agreement. It is unlikely that the interim government will contradict the IMF, but further delays or slow responses will become the norm. As happened several times before in the case of restructuring the energy sector, the IMF may relax the deadlines.

Developments in early 2012 are in line with the wiiw annual GDP growth forecast of 1%. Pessimism on our part is supported by the emergence of: (i) growing difficulties where exports to stagnating West European markets are concerned; (ii) continuing sluggish domestic demand; (iii) a probable drop in agricultural production; (iv) a slowdown of credit expansion owing to Greek and Austrian banks restructuring their balance sheets and aligning them with new provisioning requirements. The wiiw forecast has already taken account of some fiscal relaxation in the election year. The public-sector wage increases may not have a major positive effect on growth; they will stimulate demand, but they may also lead to a further deterioration of net exports.

The medium-term wiiw forecast for Romania is based on a standard external environment and no shocks. It is assumed that external demand and capital inflows will consolidate and fiscal austerity will not drag down domestic demand. In the medium-term, all these conditions will be less favourable than before the crisis. We thus forecast an average GDP growth of 3% instead of 5%, the pre-crisis rate. A severe downside risk to this forecast is the probability of a protracted European crisis.

Table SK

Slovakia: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012	2013	2014
							Forecast		
Population, th pers., average ²⁾	5406.6	5418.6	5430.1	5397.3	.	.	5410	5430	5440
Gross domestic product, EUR mn, nom.	66842	62795	65744	69058	15853	16556	73000	77400	82900
annual change in % (real)	5.8	-5.0	4.2	3.4	3.4	3.0	2.2	3	4
GDP/capita (EUR at exchange rate)	11900	11600	12100	12700	.	.	13500	14300	15200
GDP/capita (EUR at PPP)	18100	17000	17900	18900	.	.	.	.	.
Consumption of households, EUR mn, nom.	37573	37640	37740	39018	9480	9897	.	.	.
annual change in % (real)	6.0	0.1	-0.8	-0.4	-0.2	-0.1	1	1.5	2.5
Gross fixed capital form., EUR mn, nom.	16576	13025	14616	15477	3564	3420	.	.	.
annual change in % (real)	1.0	-19.7	12.4	5.6	1.6	-3.9	2.5	3	4
Gross industrial production									
annual change in % (real)	3.1	-14.1	18.3	7.2	12.1	8.0	5	6	7
Gross agricultural production (EAA)									
annual change in % (real)	10.6	-12.3	-8.2	8.0	.	.	.	.	.
Construction industry									
annual change in % (real)	11.9	-11.2	-4.6	-1.8	-2.5	-9.2	.	.	.
Employed persons - LFS, th, average ³⁾	2433.7	2366.3	2317.5	2351.4	2296.1	2324.7	2360	2400	2440
annual change in %	3.2	-2.8	-2.1	1.5	.	1.2	0.5	1.5	1.5
Unemployed persons - LFS, th, average ³⁾	255.7	323.5	389.2	368.3	372.2	380.3	.	.	.
Unemployment rate - LFS, in %, average ³⁾	9.5	12.0	14.4	13.5	13.9	14.1	14	13	12.5
Reg. unemployment rate, in %, end of period	8.4	12.7	12.5	13.6	13.1	13.7	13.5	13	12.5
Average gross monthly wages, EUR	723	745	769	786	746	770	.	.	.
annual change in % (real, gross)	3.3	1.4	2.2	-1.6	-0.4	-0.6	.	.	.
Consumer prices (HICP), % p.a.	3.9	0.9	0.7	4.1	3.5	4.0	3.5	3	3
Producer prices in industry, % p.a.	2.5	-6.6	0.1	4.4	5.3	2.5	3	3	3
General government budget, EU-def., % GDP									
Revenues	32.8	33.5	32.4	32.6	.	.	.	.	.
Expenditures	34.9	41.5	40.0	37.4	.	.	.	.	.
Net lending (+) / net borrowing (-)	-2.1	-8.0	-7.7	-4.8	.	.	-5	-4	-3
Public debt, EU-def., in % of GDP	27.8	35.5	41.1	43.3	.	.	46	47	47
Central bank policy rate, % p.a., end of period ⁴⁾	2.5	1.0	1.0	1.0	1.0	1.0	.	.	.
Current account, EUR mn	-4021	-1627	-2278	38	156	388 ^{I-II}	700	300	0
Current account in % of GDP	-6.2	-2.6	-3.5	0.1	1.0	2.3 ^{I-II}	1.0	0.4	0.0
Exports of goods, BOP, EUR mn	49521	39721	48791	56408	13304	9156 ^{I-II}	60000	65000	70000
annual growth rate in %	17.2	-19.8	22.8	15.6	26.7	9.5 ^{I-II}	7	9	8
Imports of goods, BOP, EUR mn	50280	38775	48652	53967	12850	8509 ^{I-II}	57000	62000	67000
annual growth rate in %	17.2	-22.9	25.5	10.9	27.6	4.5 ^{I-II}	5.5	8	8
Exports of services, BOP, EUR mn	6001	4342	4398	4750	1066	821 ^{I-II}	5100	5700	6600
annual growth rate in %	16.8	-27.6	1.3	8.0	8.4	17.5 ^{I-II}	8	12	15
Imports of services, BOP, EUR mn	6488	5367	5140	5121	1194	803 ^{I-II}	5400	5900	6700
annual growth rate in %	36.6	-17.3	-4.2	-0.4	-5.2	3.8 ^{I-II}	5	10	14
FDI inflow, EUR mn	3323	-4	335	1541	309	803 ^{I-II}	1000	.	.
FDI outflow, EUR mn	376	652	250	353	42	-95 ^{I-II}	.	.	.
Gross reserves of NB excl. gold, EUR mn ⁵⁾	12674	481	541	659	573	612	.	.	.
Gross external debt, EUR mn	37286	45338	49262	52934	51641	53891 ^{Feb}	.	.	.
Gross external debt in % of GDP	57.9	72.2	74.9	76.7	74.8	73.8	.	.	.
Average exchange rate EUR/EUR	1.0377	1.0000	1.0000	1.0000	1.0000	1.0000	1	1	1
Purchasing power parity EUR/EUR	0.6813	0.6810	0.6758	0.6770	.	.	.	.	.

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

1) Preliminary. - 2) From 2011 according to Census May 2011. - 3) Quarterly data according to Census May 2011. - 4) From 2009 official refinancing operation rates for euro area (ECB), two-week repo rate of NB before. - 5) From January 2009 (euro introduction) foreign currency reserves denominated in non-euro currencies only.

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



Doris Hanzl-Weiss

Slovakia: Export-led growth despite the EU crisis

After a successful 2011, Slovak gross domestic product continued to grow in the first months of 2012 as well. Whereas GDP stagnated in the EU, growth in Slovakia in the first quarter 2012 was quite robust, reaching 3% year-on-year and 0.7% quarter-on-quarter. Slovakia thus recorded the fourth highest growth rate in the EU behind the Baltic countries and bucked the negative trend in the European Union. As in 2011, growth came primarily from net exports, with exports of goods and services increasing by about 2.6%, while imports declined by 1.3%. Exports to Slovakia's main trading partners – Germany and the Czech Republic – expanded most. In terms of export products, motor-car exports increased considerably. Consumption of households stagnated, while that of government increased slightly by 0.4%. Gross capital formation as well as gross fixed capital were negative (-4%, -3.9%) and thus did not contribute to GDP growth.

Industrial production grew by 8% in the first quarter of 2012 and that of manufacturing even more: 10%. The main Slovak sector, the automotive industry, which provides 27% of manufacturing output, expanded rapidly as well and displayed a growth rate of 25%. Two smaller sectors, textiles and leather, as well as electrical equipment, grew by 14% and 11%, respectively, while two other important branches, machinery and equipment and basic metals, expanded by 9.8% and 4.4%, respectively. On the other hand, output in the food, the wood-processing and pharmaceuticals industries declined during the period concerned. Apart from industry, small contributions to growth came also from services, while value added of agriculture and construction declined in the first quarter 2012.

In 2011 inflation rose to 4.1%: one of the highest rates in the EU. In the first quarter 2012, inflation still ran high at 4% year-on-year, but it is expected to decline over the course of the year.

Whereas the situation on the labour market deteriorated towards the end of 2011, it showed mixed results at the beginning of 2012. On the one hand, employment increased in the first quarter by 1.2% year-on-year; on the other hand, unemployment rose to 14.1%. The main problems are: (i) the high share of long-term unemployed, accounting for 67.7% of all unemployed (fourth quarter 2011); and (ii) the youth unemployment rate of 34.4%, which is well above the EU-average (23%, first quarter 2012). These problems are related to large regional disparities, with unemployment rates being higher in the eastern parts of Slovakia. The cabinet now plans to reshuffle funds of EU-supported operational programmes in favour of programmes tackling youth unemployment and boosting economic growth. Money will come from the operational programmes for the informatisation of society, education and transportation. Funds will also be forthcoming from the Ministry of Labour, Social Affairs and Family.

Public debt levels in the previous year rose more slowly than in the two years prior thereto, peaking at 43.3% which was well below the EU average. The budget deficit was reduced from about 8% in both 2009 and 2010 to 4.8% in 2011. This was a direct outcome of the consolidation programme introduced under the previous government headed by Iveta Radičová, which had set a deficit target of 4.9%. The difficulty of complying with that goal was however compounded by having to include the debts outstanding of both state-owned railway company and hospitals for the period 2008-2010. The main features of the budget consolidation programme included: (i) a temporary rise in VAT to 20%; (ii) an increase in selected excise taxes (e.g. tobacco); (iii) a reduction in the public wage bill; and (iv) a decline in government consumption of goods and services. The interim government still managed to pass the budget for 2012, in which the deficit is officially projected to reach 4.6% of GDP. A bank levy was introduced at the beginning of 2012.

Responsibility for continuing fiscal consolidation now falls on the new government formed by Robert Fico, whose leftist SMER party won the elections on 10 March 2012. Over the next four years, Slovakia will have a social democratic government that is bent on improving the living conditions of the disadvantaged segments of society. However, Fico has also announced that he would abide by EU-rules and pursue a pro-European course, including a reduction in the fiscal deficit to less than 3% in 2013. Although concrete measures are still missing, the new government's proposed measures will focus mainly on revenues. The flat tax of 19% will be modified and higher personal income taxes will be introduced for people with high incomes. Corporate income tax will be increased to 23% and the taxable base for the bank levy will be extended, its rate will probably be raised. Further measures include a shift of contributions from the second pension pillar in favour of the first "pay as you go" system, as well as a special levy for certain companies in 2012 and 2013 equivalent to 4.2% of their earnings. The companies affected will encompass telecom companies, postal services and the energy sector. Apart from adhering to EU-rules, the new government programme includes somewhat broader topics ranging from mitigating the effects of the crisis to combating joblessness and improving social standards. It is now up to the government to put these agreeable ideas into practice and address the issue of structural reforms.

Foreign direct investment inflows recovered strongly in 2011 after the slump over the period 2008-2009; they amounted to EUR 1.5 billion. However, Slovakia still received less than half of the inflows it enjoyed in 2008. The three automotive companies in Slovakia – Volkswagen in Bratislava, PSA Peugeot-Citroën in Trnava and Kia in Žilina – recorded a successful year, with automotive production increasing by 14% to a total of 639,760 vehicles. Slovakia thus remained the number one car producer per capita in Europe. In 2011 investments were directed towards the manufacture of new models or the expansion of engine production (KIA) and in 2012 all three companies added a third shift: KIA introduced a third shift in January 2012; Volkswagen in March and PSA followed suit ahead of schedule in May (instead of June). Possible production numbers for 2012 range between 780,000 and 925,000 vehicles. While the news from the car manufacturers is positive, the number of newly announced greenfield projects declined significantly in the first quarter of the current year. Uncertainties about Fico's policies and imponderables related to the crisis in Europe might delay new investment decisions.

Overall, wiiw has revised its growth forecasts upwards for the current year as the earlier negative scenarios it had previously assumed failed to materialize and the figures for the first quarter 2012 have been rather positive. We have thus reverted to our previous growth forecast of 2.2% for 2012. Growth will be again substantiated by the net exports, bolstered by still low unit labour costs and supported by the expansion of production in the automotive sector. Furthermore, private consumption might well start contributing, albeit modestly, to some GDP growth later in the year. The government might stimulate private consumption by cutting expenditures to a lesser extent than originally planned. That might yield greater growth and thus more tax revenues. Fico announced that his government would set priority on large-scale infrastructure projects, including the construction of motorways and the faster completion of the Mochovce nuclear power plant. Stimulation of household consumption seems now more probable and even strengthened by the outcome of the presidential election in France. However, downward risks still prevail since Slovakia is dependent on developments in Germany and the Czech Republic, its main trading partners which together account for 36.5% of Slovakia's exports. Resolution of the European debt crisis will be the crucial factor. The wiiw reckons with an acceleration of growth to 3% in 2013 and about 4% in 2014, backed by growth in private consumption and investment, as well as supported by net exports.

Table SI

Slovenia: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012 Forecast	2013	2014
Population, th pers., average	2021.3	2039.7	2048.6	2050.0	2050.2	2055.5	2050	2050	2050
Gross domestic product, EUR mn, nom.	37280	35311	35416	35639	8362	8406	35810	36710	38010
annual change in % (real)	3.6	-8.0	1.4	-0.2	2.1	-0.2	-1.5	0.5	1.5
GDP/capita (EUR at exchange rate)	18400	17300	17300	17400	.	.	17500	17900	18500
GDP/capita (EUR at PPP)	22700	20500	20700	21000	.	.	.	.	.
Consumption of households, EUR mn, nom.	19544	19434	19577	19966	4495	4686	.	.	.
annual change in % (real)	3.9	-0.2	-0.6	-0.2	0.1	1.4	0.5	-0.3	0.4
Gross fixed capital form., EUR mn, nom.	10730	8268	7651	6941	1632	1476	.	.	.
annual change in % (real)	7.8	-23.3	-8.3	-10.6	-8.2	-10.9	-9	-1	4
Gross industrial production									
annual change in % (real)	2.4	-17.3	6.2	1.3	7.7	0.7	1.5	2	3
Gross agricultural production (EAA)									
annual change in % (real)	-1.9	0.0	-0.3	-0.7	.	.	.	.	.
Construction industry ²⁾									
annual change in % (real)	15.5	-20.9	-16.9	-25.6	-25.3	-19.9	.	.	.
Employed persons - LFS, th, average	996	981	966	936	928	927	930	920	930
annual change in %	1.1	-1.5	-1.5	-3.1	-3.8	-0.1	-1	-1	1
Unemployed persons - LFS, th, average	46	61	75	83	86	87	.	.	.
Unemployment rate - LFS, in %, average	4.4	5.9	7.3	8.2	8.5	8.6	8.8	9	8.5
Reg. unemployment rate, in %, end of period	7.0	10.3	11.8	12.1	12.2	12.0	13	13	12
Average gross monthly wages, EUR	1391	1439	1495	1525	1505	1529	.	.	.
annual change in % (real, net)	2.0	2.5	2.1	0.3	1.6	-0.8	.	.	.
Consumer prices (HICP), % p.a.	5.5	0.9	2.1	2.1	2.2	2.5	2	2	2
Producer prices in industry, % p.a.	3.9	-1.4	2.0	4.6	5.7	1.3	1.5	2	3
General governm.budget, EU-def., % GDP									
Revenues	42.4	43.2	44.2	44.5	.	.	44.2	44.0	43.0
Expenditures	44.2	49.3	50.3	50.9	.	.	48.5	48.0	46.5
Net lending (+) / net borrowing (-)	-1.9	-6.1	-6.0	-6.4	.	.	-4.5	-4.0	-3.5
Public debt, EU-def., in % of GDP	21.9	35.3	38.8	47.6	.	.	54.0	58.0	60.0
Central bank policy rate, % p.a., end of period ³⁾	2.5	1.0	1.0	1.0	1.0	1.0	.	.	.
Current account, EUR mn	-2574	-455	-297	-385	-91	-153	-200	-300	-400
Current account in % of GDP	-6.9	-1.3	-0.8	-1.1	-1.1	-1.8	-0.6	-0.8	-1.1
Exports of goods, BOP, EUR mn	20032	16167	18387	20688	5018	5157	21300	22200	23500
annual growth rate in %	1.2	-19.3	13.7	12.5	19.4	2.8	3	4	6
Imports of goods, BOP, EUR mn	22681	16871	19591	22023	5329	5457	22500	23200	24600
annual growth rate in %	5.7	-25.6	16.1	12.4	21.3	2.4	2	3	6
Exports of services, BOP, EUR mn	4956	4347	4634	4820	1049	1093	5000	5200	5500
annual growth rate in %	19.5	-12.3	6.6	4.0	7.0	4.2	4	4	6
Imports of services, BOP, EUR mn	3533	3182	3325	3387	732	722	3400	3500	3700
annual growth rate in %	14.0	-9.9	4.5	1.9	6.1	-1.4	0	3	5
FDI inflow, EUR mn	1330	-470	274	791	72	157	800	.	.
FDI outflow, EUR mn	983	174	-59	40	20	22	.	.	.
Gross reserves of NB excl. gold, EUR mn	623	671	695	642	656	583	.	.	.
Gross external debt, EUR mn	39234	40294	40699	41444	42798	42787	.	.	.
Gross external debt in % of GDP	105.2	114.1	114.9	116.3	120.1	119.5	.	.	.
Purchasing power parity EUR/EUR	0.8114	0.8451	0.8339	0.8286	.	.	.	.	.

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

1) Preliminary. - 2) Enterprises with 20 and more employees and output of some non-construction enterprises.- 3) Official refinancing operation rates for euro area (ECB).

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



Hermine Vidovic

Slovenia: Returning recession

Slovenia's GDP continued to shrink in the first quarter of 2012 year-on-year, down by 0.2% owing to a decline in domestic demand. Gross fixed capital formation dropped by about 11%; household consumption rose by 1.4% and government consumption growth was slightly positive after three quarters of steady decline. Only foreign trade contributed positively to GDP growth. The slump in investments was felt primarily in the construction sector, where output continued to decline dramatically (about 20%). Future prospects for the construction sector are also gloomy, since the market is swamped by an enormous stock of unsold flats and large infrastructural projects are in short supply owing to fiscal consolidation.

Along with the slowdown in foreign demand, industrial production growth lost momentum as of mid-2011 and rose by only 0.7% in the first quarter of 2012. In the automotive sector, one of Slovenia's major export industries, the output of vehicles fell by 12%, while output in the furniture industry dropped by 15%. Remarkable increases in production were reported in the manufacture of wearing apparel and leather and related products.

Foreign trade weakened remarkably in the first quarter of 2012: in nominal terms, exports and imports of goods were up 2.8% and 2.4%, respectively. The trade deficit remained almost unchanged compared to a year earlier. Owing to a rising deficit in both the income balance and current transfers along with a stagnating surplus in the trade of services, the current account closed with a higher deficit than in the first three months of 2011. The inflow of FDI was more than double the amount in the first quarter of 2011, yet remained at a comparatively low level (EUR 157 million).

The labour market situation has deteriorated slightly compared to the first quarter of 2011. Based on labour force survey data, employment stagnated in the first quarter of 2012; the unemployment rate rose slightly to 8.6%, but is still below the EU-average. Unemployment based on registration data remained unchanged at 12% compared to March 2011. This was due to fewer people losing their jobs and more people being struck from the register on account of their either neglecting certain duties or participating in public work programmes. In March amendments to the unemployment compensation system were announced. The entitlement period will now be limited to 18 months; the replacement rate will be reduced from 80% to 70% (unemployment benefit as a percentage of a person's gross wage in the last eight months) in the first two months and 60% thereafter; and the maximum unemployment benefit will be cut to around EUR 850 (down from EUR 1,050).⁵²

⁵² European Employment Observatory EEO, Quarterly Reports, April 2012, p. 8.

According to the Bank of Slovenia, the losses suffered by the Slovene banking system totalled EUR 436 million in 2011 (as against EUR 98.1 million in 2010). By the end of March 2012, the share of non-performing loans in total loans had reached 11.8%. All major Slovene banks - Nova Ljubljanska Banka (NLB), Nova Kreditna Banka Maribor and Abanka Vipava - are in need of fresh capital. Having received a capital injection of EUR 250 million last year, the NLB had to raise equity capital of EUR 381 million by the end of June to meet the 9% core Tier 1 capital requirement set by the European Banking Authority (EBA). The government, holding the majority in NLB, will purchase EUR 320 million of contingent convertible bonds (CoCo) by using deposits it has in local banks in order not to increase its debt, while KBC the second largest investor will buy EUR 61 million in shares. The government wants to cut its NLB holding to 25% plus one share by the end of this year.

On several occasions since last year, all the major credit rating agencies have downgraded their ratings of the three Slovene banks, the determinant factors being the drop in asset quality and the banks' weak loss-absorption capacity. Slovene banks – for the most part domestically owned – are over-exposed to highly indebted companies in the construction and real estate sectors.

According to the final figures, the general government deficit in 2011 stood at 6.4% of GDP. Part of the deficit (EUR 459 million or 1.5% of GDP) is due to ongoing capital transfers such as the recapitalisation of both the NLB (EUR 243 million) and Adria Airways (EUR 49 million). The state has also assumed Slovene Rail's liabilities totalling EUR 119 million. The dynamics of public-debt growth, although still lower than in a number of other eurozone countries, has become a matter of major concern over the past few years, having risen from 22% in 2008 to 47.6% in 2011. In autumn 2011, the yield of a ten-year Slovene government bond broke the psychological barrier of 7%. Since the beginning of 2012 things have cooled off slightly with the yield on Slovene government bond returning to 5.27% in April. In May 2012, the Slovene parliament adopted the revised 2012 budget, as well as a package of austerity measures aimed at stabilising public finances and cutting the public deficit. Accordingly, the general government deficit should drop to 3.5 - 4% of GDP in the current year and meet the Maastricht threshold of 3% in 2013. The supplementary budget envisages a cut in expenditures of EUR 800 million, mainly by rationalising public-sector operations and welfare activities. Given the unfavourable economic environment, it is likely that in the course of the current year, GDP will decline more pronouncedly than the Slovene authorities anticipated. It will increase, if at all, only slightly next year, with the debt to GDP ratio possibly coming close to the 60% mark as early as 2013.

The austerity package envisages an 8% reduction in public-sector wages as of June 2012. However, civil-service wage cuts will vary widely owing to a harmonisation of the public-sector wage system being launched at the same time. Furthermore, public investment expenditures will be slashed by 22%. In 2012 the bulk of funds will be earmarked for improving road and rail infrastructure, managing natural resources and building an environmental infrastructure. Over and above that, expenditures related to the labour market, health care and social security will also be cut. Even before the austerity package was approved, the Slovene government had reached an agreement with all the major trade unions that they would not block the measures by calling for a referendum (In

2011, four laws were repealed via national referenda, including a bill on raising the retirement age, which ultimately led to the ousting of the former government).

Given the economic downturn among Slovenia's most important trading partners in the EU and the Western Balkan countries (which absorb about 14% of the country's exports) and in view of the need to secure fiscal consolidation, Slovenia will re-enter the recession mode in 2012 and rebound only slowly thereafter. wiiw expects the GDP to decline by 1.5% in 2012 (a more pronounced contraction than we previously forecast). Stagnation or even further contraction is likely in 2013 as a consequence of the continued drop in domestic demand. The corporate and household sectors will continue to deleverage and asset quality of the ailing banking sector will have to be strengthened. The return of recession will exert upward pressure on the unemployment rate not only in 2012, but probably in 2013 as well. Consequently, household consumption growth will remain subdued owing to an expected decline in disposable income.

Table HR

Croatia: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012	2013	2014
							Forecast		
Population, th pers., mid-year	4434.5	4429.1	4417.8	4401.9	4401.9	.	4435	4435	4435
Gross domestic product, HRK mn, nom.	343412	328672	326980	333956	75813	75716	337200	348700	362800
annual change in % (real)	2.1	-6.9	-1.4	0.0	-1.2	-1.3	-1.5	1	2
GDP/capita (EUR at exchange rate)	10700	10100	10200	10200	.	.	10100	10500	11000
GDP/capita (EUR at PPP - wiiw)	15800	14600	14500	14800	.	.	.	.	.
Consumption of households, HRK mn, nom.	197936	188859	189314	194318	46005	46557	.	.	.
annual change in % (real)	1.3	-7.6	-0.9	0.2	-0.1	-0.3	-0.5	0.5	1
Gross fixed capital form., HRK mn, nom.	93930	80367	67254	62746	14322	13975	.	.	.
annual change in % (real)	8.7	-14.2	-15.0	-7.2	-6.9	-2.8	-3.5	2.5	3
Gross industrial production ²⁾									
annual change in % (real)	1.2	-9.2	-1.4	-1.2	-3.6	-5.3	-4	2.5	3
Gross agricultural production									
annual change in % (real)	8.0	-0.8	-8.2	.	.	.	.	.	.
Construction output ²⁾									
annual change in % (real)	11.8	-6.5	-15.9	-9.1	-8.5	-12.0	.	.	.
Employed persons - LFS, th, average	1636	1605	1541	1493	1476	.	1480	1480	1490
annual change in %	1.3	-1.8	-4.0	-3.2	-5.6	.	-1	0	1
Unemployed persons - LFS, th, average	149	160	206	232	246	.	.	.	.
Unemployment rate - LFS, in %, average	8.4	9.1	11.8	13.5	14.3	.	14.5	14.5	13.5
Unemployment rate, reg., in %, end of period	13.7	16.7	18.8	18.7	19.3	20.0	20	19.5	18
Average gross monthly wages, HRK	7544	7711	7679	7796	7672	7835	7750	7800	7850
annual change in % (real, net)	0.8	0.2	-0.5	-0.4	-0.4	0.1	.	.	.
Consumer prices, % p.a.	6.1	2.4	1.1	2.3	2.2	1.5	2.5	2.4	2
Producer prices in industry, % p.a. ³⁾	8.3	-0.4	4.3	6.3	6.3	6.1	4	3	3
General governm.budget, EU-def., % GDP ⁴⁾									
Revenues	39.1	36.4	35.0	34.7	.	.	34.5	35.5	35.5
Expenditures	40.4	40.5	39.9	39.7	.	.	39.0	39.5	39
Deficit (-) / surplus (+)	-1.4	-4.1	-4.9	-5.0	.	.	-4.5	-4.0	-3.5
Public debt, EU-def., in % of GDP ⁴⁾	29.3	35.8	42.2	46.0	.	.	50	55	58
Central bank policy rate, % p.a., end of period ⁵⁾	6.0	6.0	6.0	6.0	6.0	6.0	.	.	.
Current account, EUR mn	-4258.1	-2292.5	-472.2	-446.3	-1644.0	.	-300	-500	-600
Current account in % of GDP	-9.0	-5.1	-1.1	-1.0	-16.0	.	-0.7	-1.1	-1.2
Exports of goods, BOP, EUR mn	9752.7	7674.5	9063.6	9784.2	2238.7	.	9900	10300	10900
annual growth rate in %	6.5	-21.3	18.1	8.0	10.3	.	1	4	6
Imports of goods, BOP, EUR mn	20607.8	15090.1	15054.3	16142.8	3774.3	.	16100	16600	17400
annual growth rate in %	10.6	-26.8	-0.2	7.2	13.8	.	0	3	5
Exports of services, BOP, EUR mn	10090.6	8640.2	8649.3	9016.5	761.7	.	9200	9500	10000
annual growth rate in %	10.7	-14.4	0.1	4.2	-7.3	.	2	3	5
Imports of services, BOP, EUR mn	3016.0	2754.5	2662.7	2607.8	596.2	.	2700	2550	2700
annual growth rate in %	9.7	-8.7	-3.3	-2.1	-9.5	.	2	2	6
FDI inflow, EUR mn	4218.6	2414.8	295.3	1048.4	341.2	.	1500	.	.
FDI outflow, EUR mn	970.2	888.2	-112.9	25.8	-295.5	.	.	.	.
Gross reserves of NB excl. gold, EUR mn	9121	10376	10660	11195	11424	11340	.	.	.
Gross external debt, EUR mn ⁶⁾	39764	43745	46496	45733	47485	45751 ^{Feb}	.	.	.
Gross external debt in % of GDP ⁶⁾	83.6	97.7	103.6	101.8	105.7	.	.	.	.
Exchange rate HRK/EUR, average	7.2232	7.3396	7.2862	7.4339	7.4003	7.5552	7.5	7.5	7.45
Purchasing power parity HRK/EUR	4.9004	5.0664	5.0929	5.1216	.	.	.	.	.

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

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

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



Hermine Vidovic

Croatia: Waiting for the turnaround

Having stagnated in 2011 after two years of economic downturn, Croatia's GDP dropped by 1.3% during the first quarter of 2012 owing to a decline in domestic demand. Gross fixed capital formation, which has been on the decline since 2009 continued to drop for yet another year. Both government and household consumption has declined due to fiscal consolidation and restricted access to credits, as well as high and ever-increasing unemployment. The contraction in investments was felt primarily in the construction sector, where output continued to decline (12%). The slowdown in industrial production in 2012 has become even more pronounced than in the two preceding years, with output dropping by 6.5% over the first four months of the year. In the manufacturing category more than half of all sectors recorded a decline in production; the worst drop in output (30%) occurred in the machinery and equipment sector, followed by the manufacture of fabricated metal products and the manufacture of basic metals, both of which registered a drop of about 20% each. On the positive side, the shipbuilding industry, Croatia's single most important exporter, increased production by 17%. During the first four months of 2012, labour productivity in industry was 4% lower than the year previous.

Based on customs statistics, external trade dynamics were low during the first quarter of the year imports of goods rose modestly by 2% and exports declined by 1%. The resultant trade deficit increased by about EUR 100 million to EUR 1.7 billion compared to a year earlier. Taking into account the rising trade deficit and assuming no significant change in the trade surplus in the services sector, the current account deficit can be seen to have increased slightly. At the end of January 2012, foreign debt stood at EUR 47.7 billion, thus remaining unchanged compared to December 2011.

In response to the continued downward pressure on the kuna against the euro and in an endeavour to support the domestic currency, the Croatian National Bank (CNB) intervened repeatedly on the foreign exchange market throughout 2011. It has already had to intervene four times in a like manner during the first few months of 2012. Having raised the minimum reserve requirement for banks from 14% to 15% in January 2012, the CNB reduced the same requirement to 13.5% only three months later. The latter step was designed to ease matters for the banks by releasing HRK 4.1 billion from the kuna component and EUR 110 million from the foreign exchange component of the reserve requirement. It is envisaged that the funds so released will be used in cooperation with the Croatian Bank for Reconstruction and Development (HBOR) to stimulate economic recovery.

Croatia's labour market deteriorated further during the first quarter of 2012. Data from the Croatian Pension Institute (HZMO) indicate that the number of employed fell by 1%. This decline is also confirmed by information obtained from the Statistical Office: based on those data, the number of em-

employees contracted most markedly in the construction sector (-3.9%), while increases in employment were to be observed in agriculture and administrative support services, as well as in the non-market services sectors, such as education, health and social work. Registered unemployment leapt to 19.1% at the end of April. Final labour force survey data for 2011 indicate an unemployment rate of 14.3%, with youth unemployment standing at 35%. In the EU only Spain and Greece have higher rates than that. In response to the high rate of youth unemployment, the Minister of Labour proposed extending measures to support young people in their attempts to acquire work experience in the enterprise sector. Hitherto those initiatives had been limited to civil service institutions: now young unemployed are to be offered an opportunity to work in an enterprise for a year. Over that period, participants in the programme will be entitled to health and pension insurance, as well as a monthly allowance of about EUR 200.

According to final data, the general government deficit in 2011 amounted to 5% of the GDP. As for 2012, the deficit target is 3.8% based on a 0.8% growth of GDP. After years of steady expansion, the budget anticipates a reduction in expenditures, particularly in subsidies to agriculture and Croatian Rail, as well as in terms of public-sector wages. The assumptions underlying the budget (for example, a GDP growth rate of 0.8%) are far too optimistic, since all the forecasts published by international organizations and banks, as well as the Croatian National Bank and the country's main economic research institute EIZ, predict a GDP decline for 2012. Thus, achieving a decline in the deficit as set in the budget appears unrealistic.

At the end of 2011 the ratio of non-performing loans to total loans increased to 12.2% from 11.2% in December 2010. Working on the assumption that the economy will not recover in 2012, the Croatian National Bank estimates that the share of non-performing loans may rise to 17% by the end of the year.

Until the country joins the EU on 1 July 2013, the European Commission will closely monitor Croatia's implementation of the commitments it has entered into, particularly those relating to the judiciary, competition (shipyards) and freedom of movement. Accordingly the Commission will issue six-monthly assessments up to the projected date of accession. The first report published on 24 April 2012 covering the period 1 September 2011 - 29 February 2012 concludes that 'overall, Croatia's preparations for EU membership are on track'. However, the Commission 'has identified a limited number of issues requiring further efforts'. In terms of competition policy, the report concentrates on the steel and shipbuilding sectors. With respect to the steel mill, CMS Sisak, the plant will have to reimburse the financial aid it received from the state; the steel mill has since been closed and is to be sold. As for the other steel mill, Zeljezara Split, the commercial court in Split initiated bankruptcy proceedings in 2011. As for the heavily subsidised shipbuilding industry, which has suffered losses over the past 20 years, a first round of decisions was taken in March 2012. Of the five shipyards, only Uljanik is profitable and is to be sold to the employees and management. The Croatian government accepted a bid for the shipyard Brodosplit tendered by the Split-based DIV group, but rejected bids for the shipyards Kraljevica and Brodotrogir. A bid for the shipyard 3.Maj was withdrawn by the bidder. The government decided to initiate bankruptcy proceedings for Kraljevica and seek new privatisation and restructuring arrangements for the 3.Maj and Brodotrogir shipyards by July

2012. In April the government announced the takeover of the government-backed credit liabilities of the three shipyards (3. Maj, Brodotrogir and Brodosplit), which amount to EUR 245 million. The sum will be transferred to public debt.

Based on the results for the first months of the year, wiiw has revised its previous GDP forecast for 2012 downwards to minus 1.5% (from -1%); we expect a slight recovery in 2013. Prospects have been dampened by the poor economic outlook in the EU (particularly in Italy, one of Croatia's most important trading partners, but also in Slovenia). It will have a negative effect not only on Croatia's exports of goods but also on its services sector, tourism in particular. Household consumption will remain flat as a consequence of high unemployment and weak credit activity; joining the EU in mid-2013 may help to boost foreign investor confidence. Employment will continue to contract along with a decline in GDP in 2012 and stabilise, if at all, in 2013. At the same time the unemployment rate established in the labour force survey is expected to remain at around 14.5% and will only decrease slowly from 2014 onwards. The current account deficit will remain within moderate limits. Fiscal consolidation and structural reforms against the background of high unemployment and servicing foreign debt will remain the major challenge for the years to come.

Table MK

Macedonia: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012 Forecast	2013	2014
Population, th pers., mid-year	2046.9	2050.7	2055.0	2060	.	.	2065	2070	2075
Gross domestic product, MKD mn, nom. ²⁾	411728	410734	434112	463393	103000	103951	486400	516000	549000
annual change in % (real) ²⁾	5.0	-0.9	2.9	3.1	6.3	-1.4	1.9	3	3.3
GDP/capita (EUR at exchange rate)	3300	3300	3400	3700	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	8400	8500	8900	9500	.	.	.	.	.
Consumption of households, MKD mn, nom. ²⁽³⁾	330399	314376	321524	345410	80093	81709	.	.	.
annual change in % (real) ²⁽³⁾	7.4	-4.7	1.3	4.0	4.5	0.7	0	2	2
Gross fixed capital form., MKD mn, nom. ²⁾	86403	81872	82968	94800	.	.	.	.	.
annual change in % (real) ²⁾	5.4	-4.3	-2.7	10	.	.	0	4	4
Gross industrial production ⁴⁾									
annual change in % (real)	5.1	-8.7	-4.8	3.3	13.8	-8.4	-2	3	5
Gross agricultural production (EAA)									
annual change in % (real)	5.4	-2.3	8.0	.	.	.	.	.	.
Construction output, hours worked									
annual change in % (real)	-9.6	-2.1	5.8	14.2	12.7	-13.1	5	5	5
Employed persons - LFS, th, average	609.0	629.9	637.9	645.1	649.6	643.7	650	660	670
annual change in %	3.2	3.4	1.3	1.1	5.5	-0.9	0.8	1.5	1.5
Unemployed persons - LFS, th, average	310.4	298.9	300.4	295.0	294.6	297.4	.	.	.
Unemployment rate - LFS, in %, average	33.8	32.2	32.0	31.4	31.2	31.6	31	31	31
Unemployment rate, reg., in %, end of period	.	.	.	.	.	.	.	.	.
Average gross monthly wages, MKD ⁵⁾	26229	29922	30225	30602	30383	30634	.	.	.
real growth rate, % (net wages) ⁵⁾	1.9	25.0	1.4	-2.4	-2.1	-1.5	.	.	.
Consumer prices, % p.a.	8.3	-0.8	1.6	3.9	4.1	2.5	3	3	3
Producer prices in industry, % p.a. ⁶⁾	10.1	-7.2	8.7	11.1	13.6	5.1	.	.	.
General governm. budget, nat.def., % GDP ⁷⁾									
Revenues	33.1	31.3	30.4	29.6	30.5	30.6	.	.	.
Expenditures	34.1	33.9	32.9	32.1	34.1	34.9	.	.	.
Deficit (-) / surplus (+)	-0.9	-2.7	-2.4	-2.5	-3.6	-4.4	-1	-1	-1
Public debt, nat.def., in % of GDP	27.9	31.7	34.8	35	.	.	34	33	32
Central bank policy rate, %, p.a., end of period ⁸⁾	7.00	8.50	4.11	4.00	4.00	4.00	4	4	4
Current account, EUR mn	-862.2	-457.1	-150.4	-201.1	-200.3	-99.7	-450	-400	-400
Current account in % of GDP	-12.8	-6.8	-2.1	-2.7	-12.0	-5.9	-5.7	-4.8	-4.5
Exports of goods, BOP, EUR mn	2692.6	1932.6	2492.8	3178.9	712.4	693.5	3340	3670	4220
annual growth rate in %	8.9	-28.2	29.0	27.5	47.7	-2.7	5	10	15
Imports of goods, BOP, EUR mn	4455.1	3492.2	3960.7	4860.5	1174.0	1088.5	4860	5350	6150
annual growth rate in %	21.9	-21.6	13.4	22.7	50.7	-7.3	0	10	15
Exports of services, BOP, EUR mn	692.0	617.6	693.8	799.9	177.3	171.0	840	924	1016
annual growth rate in %	15.9	-10.8	12.3	15.3	31.6	-3.6	5	10	10
Imports of services, BOP, EUR mn	682.8	601.1	644.4	702.5	158.0	180.8	773	850	952
annual growth rate in %	20.0	-12.0	7.2	9.0	21.2	14.4	10	10	12
FDI inflow, EUR mn	399.9	145.0	159.1	303.5	202.0	59.8	200	250	300
FDI outflow, EUR mn	-9.5	8.1	1.4	1.6	0.3	0.6	0	0	0
Gross reserves of NB, excl. gold, EUR mn	1361.0	1429.4	1482.7	1801.9	1678.3	1796.4	.	.	.
Gross external debt, EUR mn	3304.2	3780.4	4133.8	4800.0	4496.0	.	.	.	.
Gross external debt in % of GDP	49.2	56.4	58.6	63.7	59.7	.	.	.	.
Exchange rate MKD/EUR, average	61.27	61.27	61.52	61.53	61.51	61.50	61.5	61.5	61.5
Purchasing power parity MKD/EUR	23.93	23.59	23.83	23.63	.	.	.	.	.

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

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

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



Vladimir Gligorov

Macedonia: The Greek shadow

Any expectations of this year seeing moderate growth will be dashed. The first quarter recorded a GDP decline of 1.5%. Over the same period, industrial production plummeted by more than 8% and activities in the construction sector dropped by more than 13%. Similarly, imports went into decline, as did exports - albeit to a somewhat lesser degree. Foreign investments performed worse than last year, but that has never really been the strong side of the Macedonian economy. Wages dipped slightly in line with inflation, which has remained low. The prospects for 2012 hint at some rebound in the second half of the year; it may suffice to nudge growth into positive territory. However, the risks are significant owing to the crisis unfolding in neighbouring Greece.

Macedonia is a landlocked country. It depends to a very large extent on its immediate neighbours, two of which, Serbia and Greece, are not faring well. Moreover, the latter country is a partner of some importance as the National Bank of Greece owns the largest Macedonian bank, Stopanska banka, in addition to being a major investor in other sectors of the economy. Serbia is a major export market and the drop in demand in that country has certainly hurt Macedonia. Bulgaria and Albania are less prominent partners; Kosovo, however, is the only neighbouring country enjoying a positive economic development of some substance for Macedonia.

The turbulent developments in Greece undoubtedly exert a major influence, even though their impact is not easy to quantify. In addition to a general rise in uncertainty, there is every risk that the Greek banking sector will be reduced to bankruptcy – with significant consequences for the Macedonian financial system. Neither the central bank of Macedonia nor the government can do much to change things.

The influence of Greece extends still further. Regardless of the political turmoil and the shifts in government, Greece has continued to block Macedonian accession to NATO and the EU. The European Commission has repeatedly recommended that negotiations be taken up with Macedonia, yet the European Council is unable to override the Greek veto. Matters proceed in very much the same vein in NATO, thus hardly contributing to Macedonia's political and economic stability.

The short-term prospects point to some growth that should pick up speed over the next few years, unless the crisis in Greece deteriorates to such an extent that the Greeks will be forced to leave the eurozone. In the medium term, Macedonia should enjoy some measure of recovery, but the country's potential growth rate will hardly exceed 3% given the institutional and regional fundamental characteristics.

Table ME

Montenegro: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012 Forecast	2013	2014
Population, th pers., mid-year ²⁾	628.8	631.5	618.8	620.0	.	.	621	622	623
Gross domestic product, EUR mn, nom. ³⁾	3085.6	2981.0	3103.9	3300	.	.	3400	3600	3800
annual change in % (real) ³⁾	6.9	-5.7	2.5	2	.	.	1	2	3
GDP/capita (EUR at exchange rate)	4900	4700	5000	5300	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	10700	9700	10100	10500	.	.	.	.	.
Consumption of households, EUR mn, nom. ³⁾	2814.8	2503.7	2550.7	2680	.	.	.	.	.
annual change in % (real) ³⁾	12.1	-12.9	2.0	2	.	.	2	3	3
Gross fixed capital form., EUR mn, nom. ³⁾	1180.2	797.6	655.1	640	.	.	.	.	.
annual change in % (real) ³⁾	27.3	-30.1	-18.5	-5	.	.	2	5	5
Gross industrial production ⁴⁾									
annual change in % (real)	-2.0	-32.2	17.5	-10.3	-0.5	-14.7	-10	5	5
Net agricultural production	.	.	.	.	.	.	.	.	.
annual change in % (real)	10.0	3.0	2.0	2	.	.	.	.	.
Construction output ⁵⁾
annual change in % (real)	20.7	-19.2	-7.4	5	.	.	5	5	5
Employed persons - LFS, th, average	218.8	212.9	208.2	196.0	.	.	196	198	210
annual change in %	0.6	-2.7	-2.2	-5.8	.	.	0	1	6
Unemployed persons - LFS, th, average	45.3	50.9	50.9	48.1	.	.	.	.	.
Unemployment rate - LFS, in %, average	17.2	19.3	19.6	19.7	.	.	20	20	19
Unemployment rate, reg., %, average	14.4	15.1	16.9	15.8	17.1	16.3	17	17	16
Average gross monthly wages, EUR	609	643	715	722	749	741	.	.	.
real growth rate, % (net wages)	14.6	7.6	3.0	-2.0	5.2	-3.8	.	.	.
Consumer prices, % p.a.	7.4	3.4	0.5	3.1	2.5	2.8	3	3	3
Producer prices in industry, % p.a. ⁶⁾	14.0	-3.9	-0.9	3.2	4.3	-1.0	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	49.1	45.8	40.9	33.9	.	.	.	.	.
Expenditures	47.5	49.4	43.9	38.0	.	.	.	.	.
Deficit(-)/Surplus(+)	1.7	-3.6	-3.0	-4.2	.	.	-1	-1	-1
Public debt, nat. def., in % of GDP	29.0	38.2	40.9	44.0	.	.	44	42	41
Central bank policy rate, % p.a., end of period ⁷⁾	8.81	8.85	8.98	10.00	9.00	9.00	9	9	8
Current account, EUR mn	-1560.7	-881.3	-764.2	-633.8	-186.9	-216.7	-700	-800	-800
Current account in % of GDP	-50.6	-29.6	-24.6	-19.2	.	.	-20.6	-22.2	-21.1
Exports of goods, BOP, EUR mn	450.4	296.3	356.6	476.6	115.7	89.2	450	500	550
annual growth rate in %	-6.8	-34.2	20.4	33.6	91.7	-22.9	-5	10	10
Imports of goods, BOP, EUR mn	2475.7	1617.9	1623.8	1782.6	345.3	367.2	1910	2100	2310
annual growth rate in %	22.1	-34.6	0.4	9.8	13.1	6.3	7	10	10
Exports of services, BOP, EUR mn	750.6	680.5	747.0	847.2	61.3	82.4	970	1070	1180
annual growth rate in %	11.5	-9.3	9.8	13.4	21.4	34.6	15	10	10
Imports of services, BOP, EUR mn	404.9	331.0	336.8	316.8	65.8	73.6	330	350	370
annual growth rate in %	45.7	-18.3	1.8	-5.9	-11.4	11.9	5	5	5
FDI inflow, EUR mn	655.7	1099.4	574.2	401.4	113.7	72.3	500	800	1000
FDI outflow, EUR mn	73.7	32.9	22.1	12.3	-2.4	18.3	20	20	50
Gross reserves of NB, excl. gold, EUR mn ⁸⁾	216.6	172.8	164.6	170.8	164.0	169.6	.	.	.
Gross external public debt, EUR mn	481.7	699.9	912.4	1000	.	.	.	.	.
Gross external public debt in % of GDP	15.6	23.5	29.4	30.3	.	.	.	.	.
Purchasing power parity EUR/EUR ⁹⁾	0.4596	0.4884	0.4964	0.5047	.	.	.	.	.

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

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



Vladimir Gligorov

Montenegro: Anger and EU Integration

Despite the extent of its pre-crisis external imbalances, Montenegro has weathered the crisis somewhat better than expected. Furthermore, the decision to call a snap election in early 2009 ensured the renewal of the government's legitimacy. A government reshuffle in the midst of the crisis with the prime minister stepping down contributed to maintaining political stability. However, prolonged stagnation, a series of complicated banking issues and problems with a major aluminium plant, a major domestic industrial enterprise and important exporter, have worn the patience of society thin and fuelled political polarization. That notwithstanding, the general expectation that the European Council will decide to open membership negotiations with Montenegro in June should prove a stabilizing factor.

Economic developments were not encouraging in the first quarter of the current year. GDP has probably shifted into negative territory, albeit perhaps only just. Decline in industrial production has been rather pronounced; that, however, is a reflection of problems that have re-surfaced in the aluminium plant. The government is facing the probability of having to meet its obligations of well over 100 million euro, which it entered into under a guaranty scheme with the owner, Mr. Oleg Deripaska: an enormous sum for a small economy. The decline in the plant's output is reflected in the poor performance reported for the industrial sector.

That having been said, industrial production does not contribute all that much to Montenegro's economy, which depends on its services sector, mainly in the field of tourism. The export of services has more than recovered since the beginning of the crisis; it is expected to continue to exhibit healthy growth both this year and in the medium term. Foreign investments are still flowing in, although certainly not on the same scale as in the years prior to the crisis.

The outburst of protests is partly attributable to the government's fiscal policy. Revenues and expenditures alike have plummeted. Expenditures declined by almost 10 per cent of GDP, while revenues decreased still more and in 2011 they stood at only 34% of GDP. The government has decided to embark on a policy of increasing taxes, initially on mobile phones and similar services, but more is sure to come. Moreover, the representatives of the corporate sector are not subscribing to the government's commitment to free market economic policy. Requests have been made for greater government intervention, in terms of both financial and industrial policies.

The same party, indeed the same person or persons, have run Montenegro since the onset of the transition process more than twenty years ago. It thus comes as no surprise that widespread allegations abound hinting at government corruption and the lack of democratic governance. By way of

contrast, the country has managed to speed up its progress along the path to the EU: Montenegro is now the prime candidate for the distinction of being the first country to join the EU after Croatia.

Medium-term prospects are not stellar. The start of negotiations with the EU should boost foreign investments: a helpful development. However, given the need to reduce still further the current account deficit and consolidate public finances, rapid recovery cannot be expected. The government stands ready to ward off political and social disaffection, but at some point a credible opposition will have to come to the fore in order to provide the much-needed impetus to democratic stability.



Josef Pöschl

Turkey: Growth and inflation – mutual slowdown

Three phenomena are topical features of the Turkish economy: relatively low real GDP growth, relatively high inflation and a somewhat diminished, though still high current account deficit.

In some European countries, a real annual GDP growth rate in the current year ranging between 3 and 4 per cent would be a dream statistic. In the case of Turkey, it would represent a major slowdown after the country's having recorded growth rates of over 10% not so long ago (peaking at 11.9% in the first quarter of 2011). The deceleration is the outcome of slower growth in private consumption, whereas private investment growth has remained quite substantial. Exports continued to grow in the first quarter 2012, whereas imports, compared to the first quarter 2011, declined - at least in real terms. Households continued consuming domestic products in greater quantities, but economized on items from abroad. In contrast thereto, the share of imports in purchases of investment goods increased. Growth in the construction sector slowed down considerably. The domestic sales of motorcars and light commercial vehicles in the period January-May 2012 (some 270,000 units) was some 20% below the figure for the same period in 2011. At the same time, the number of vehicles exported increased.

The Turkish economy has created a large number of new employment opportunities in recent years. In the service sector, the increase in the number of employees was especially pronounced. As yet, the deceleration of GDP growth has not had a strong adverse impact on employment growth, but this may change during the next few months.

Inflation leapt to over 10% year-on-year in December 2011 and stood at 11.1% in April 2012. The subsequent decline to 8.3% in May 2012 came as a relief. Price increases had been highest for alcoholic beverages and tobacco. Over the past ten years, the greatest price increases have been in food and housing (rent, water and energy); these items have more weight in the budgets of poorer households, and they suffered more from inflation than wealthier families. A rate of inflation in excess of 10% would offer the central bank little comfort. Inflation pressure is likely to weaken further in the course of the next few months. Austerity measures, especially in their conventional form, do not feature prominently in the Turkish political landscape. Moreover, on the fiscal side of things, austerity was not a first priority over the past few years. During the slump in 2009, the government increased the government expenditures-to-GDP ratio, but refrained from reducing it to the pre-crisis level thereafter. That notwithstanding, the budget-deficit-to-GDP ratio is better than in most of the EU 27 member states.

Table TR

Turkey: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012 Forecast	2013	2014
Population, th pers., average	71095	72050	73003	73950	.	.	75200	76100	77000
Gross domestic product, TRY bn, nom.	950.5	952.6	1098.8	1294.9	288.0	323.0	1460	1670	1890
annual change in % (real)	0.7	-4.8	9.0	8.5	11.9	3.0	3.5	5.0	5.0
GDP/capita (EUR at exchange rate)	7000	6100	7500	7500	.	.	7800	7800	8200
GDP/capita (EUR at PPP - wiiw)	11700	10900	11900	13000	.	.	15400	18300	20500
Consumption of households, TRY bn, nom.	663.9	680.8	787.8	920.8	217.4	.	.	.	.
annual change in % (real)	-0.3	-2.3	6.7	7.7	11.9	.	4	4	5
Gross fixed capital form., TRY bn, nom.	189.1	160.7	207.8	283.2	64.1	.	.	.	.
annual change in % (real)	-6.2	-19.0	29.9	18.3	33.9	.	-1	10	10
Gross industrial production									
annual change in % (real)	-0.6	-9.7	13.1	8.9	14.4	2.8	4	7	8
Gross agricultural production									
annual change in % (real)	.	.	.	.	.	.	.	.	.
Construction industry									
annual change in % (real)	-7.6	-16.3	17.5	11.8	16.3	.	5	7	9
Employed persons - LFS, th, avg.	21193	21271	22593	24099	22802	23700	24100	24650	25800
annual change in %	2.1	0.4	6.2	6.7	7.2	3.9	0.0	2.3	4.7
Unemployed persons - LFS, th, average	2279	3053	2696	2324	2637	2500	2700	2800	2850
Unemployment rate - LFS, in %, average	9.8	12.6	10.7	8.8	10.4	9.5	10.1	10.2	9.9
Reg. unemployment rate, in %, average	.	.	.	.	.	.	.	.	.
Average gross monthly wages, manuf.ind., TRY	1590	.	.	.	.	.	.	.	.
annual change in % (real)	0	.	.	.	.	.	.	.	.
Consumer prices (HICP), % p.a.	10.4	6.3	8.6	6.5	4.3	10.5	9.1	9.0	8.0
Producer prices in industry, % p.a. ²⁾	13.0	1.0	6.2	12.4	10.1	9.9	8	7	7
General governm. budget, EU-def., % GDP ³⁾									
Revenues	32.0	33.5	36.7	38.0	.	.	.	.	.
Expenditures	34.8	40.4	39.4	39.4	.	.	.	.	.
Deficit (-) / surplus (+)	-2.8	-6.9	-2.7	-1.4	.	.	-1.6	-1.8	-2.5
Public debt, EU-def., in % of GDP ³⁾	39.5	45.5	39.4	37.9	.	.	35	33	31
Central bank policy rate, %, p.a., end of period ⁴⁾	17.50	9.00	6.50	5.75	6.25	5.75	5.75	5.75	5.75
Current account, EUR mn	-28108	-9551	-35135	-55375	-15810	-12341	-52000	-54000	-56000
Current account in % of GDP	-5.6	-2.2	-6.4	-10.0	-11.8	-9.0	-8.9	-9.1	-8.9
Exports of goods, BOP, EUR mn	95484	78616	91292	103154	24289	28642	112000	128000	147000
annual change in %	13.7	-17.7	16.1	13.0	20.7	17.9	9	14	15
Imports of goods, BOP, EUR mn	131095	96145	133986	167238	39376	41327	177000	191000	210000
annual change in %	11.0	-26.7	39.4	24.8	48.2	5.0	6	8	10
Exports of services, BOP, EUR mn	23928	24251	26604	28221	4598	4952	30000	33000	36000
annual growth rate in %	13.3	1.3	9.7	6.1	25.7	7.7	8	9	9
Imports of services, BOP, EUR mn	12186	12024	14759	15201	3542	3386	15000	16000	18000
annual growth rate in %	6.8	-1.3	22.7	3.0	21.2	-4.4	0	6	12
FDI inflow, EUR mn	13217	6085	6805	11476	3089	3483	10000	8000	112000
FDI outflow, EUR mn	1707	1110	1108	1789	689	1744	1500	1500	1600
Gross reserves of CB, excl. gold, EUR mn	51022	49088	60411	60637	61094	60010	.	.	.
Gross external debt, EUR mn	202201	187157	218740	236920	236920	.	.	.	.
Gross external debt in % of GDP	40.6	42.5	39.7	42.8	42.8	.	.	.	.
Average exchange rate TRY/EUR	1.9064	2.1631	1.9965	2.3378	2.1576	2.3551	2.50	2.80	3.00
Purchasing power parity TRY/EUR	1.1385	1.2171	1.2605	1.3496	.	.	1.26	1.2	1.2

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

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

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

The main concern is over the current account deficit. It had clambered up to 10% of GDP in 2011 (rising close to 12% in the first quarter 2011). Today, given the impact of decelerated growth, it may have fallen below 9%. In that context, the good news is that initial estimates of export revenues for the first five months of 2012 point to an accrual of about EUR 45 billion: up by 10.3% year-on-year. In any event, the current account deficit is still disquieting. In the Baltic countries the deficit ratio used to be just as high (and sometimes even higher for extended periods), and most observers became quite accustomed to it. Ultimately, however, it became a source of vulnerability; clearing up the situation proved a costly undertaking for most of the parties involved. Indeed, the question is whether the protracted current account deficit could sooner or later prove a major setback for Turkey, although it is impossible to say exactly when or if this might occur.

Turkey remains attractive to foreign direct investors. FDI, however, may not reach the uppermost pre-crisis level, further to which the inflow covers only a minor portion of the current account deficit. A substantial share of that deficit is covered by categories of capital inflows ('errors and omissions') that have not been fully identified. Low savings are frequently suspected of being the culprit for high current account deficits, but it may well be a case of reverse causality. A high net-imports-to-GDP ratio always implies a low savings-to-GDP ratio. The best way out is to enhance the competitiveness of domestic producers. Temporarily at least, a change in the exchange rate could prove supportive. A side effect of lira depreciation would be a boost to inflation: something that the central bank would prefer not to see happen.

It is difficult to exclude the possibility of a sudden setback. Were it to occur, however, rapid recovery might be the likely response. Turkey has developed a strong business sector; its decision-makers are trained to think in dynamic terms. The sector can rely on a sound infrastructure and a well-educated labour force. There is every will to make full use of the opportunities offered by industrial modernisation. Moreover, the country disposes of labour reserves, as is visible from the low participation of females in the labour market. Assuming no sudden setback, GDP growth is likely to rise to 5% in 2013. It could climb even higher in 2014, were a global recovery to set in. Alas, nobody knows whether this will be the case.

At the technical level, preparations for Turkey's accession to the EU continue. EU funds for Turkey will supposedly add up to EUR 5 billion by the end of 2013. In the second half of 2012, contacts between the EU and Turkey may well turn distinctly chilly when Cyprus assumes the EU presidency.

Table AL

Albania: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012 Forecast	2013	2014
Population, th pers., average	3182.0	3194.4	3210	3220	.	.	3240	3260	3280
Gross domestic product, ALL bn, nom. ²⁾	1089.3	1151.0	1220	1290	.	.	1340	1430	1540
annual change in % (real) ²⁾	7.5	3.3	3.0	2.9	4.8	.	2.3	2.8	3.3
GDP/capita (EUR at exchange rate)	2800	2700	2800	2900	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	6400	6500	6600	6800	.	.	.	.	.
Consumption of households, ALL bn, nom. ²⁾	861.9	910	970	1030	.	.	.	.	.
annual change in % (real) ²⁾	6.7	3	2.5	3	.	.	2	4	5
Gross fixed capital form., ALL bn, nom. ²⁾	415.1	430	400	420	.	.	.	.	.
annual change in % (real) ²⁾	9.5	5	-7	4.8	.	.	2	4	6
Gross industrial production ³⁾									
annual change in % (real)	8.7	7.2	20	10	15.7	.	3	4	7
Gross agricultural production ⁴⁾									
annual change in % (real)	7.1	2.0	6	3	3.4	.	4	2	3
Construction output total ³⁾									
annual change in % (real)	10.9	0.4	-25	1	5.4	.	1	5	4
Employed persons - LFS, th ⁵⁾	1123.3	1160.5	1200	1200	.	.	1180	1200	1220
annual change in %	-6.2	3.3	3.4	0	.	.	-2	2	2
Employment reg. total, th pers., end of period	974.1	899.3	916.9	928.1	920.4	933.3	920	930	950
annual change in %	3.7	-7.7	2.0	1.2	2.2	1.4	-1	1	2
Unemployed persons - LFS, th ⁵⁾	168.6	185.0	190	200	.	.	210	200	190
Unemployment rate - LFS, in % ⁵⁾	13.0	13.8	13.7	14	.	.	15	14	13
Unemployment rate, reg., in %, end of period	12.7	13.9	13.5	13.3	13.5	13.3	14	13	12
Average gross monthly wages, ALL ⁶⁾	34277	36075	38492	41030	45500	48800	.	.	.
annual change in % (real, gross) ⁶⁾	21.2	2.9	3.1	3.0	4.1	6.1	6	8	4
Consumer prices, % p.a.	3.4	2.3	3.5	3.5	4	1.1	1.5	4	4
Producer prices in industry, % p.a.	6.5	-1.6	0.3	2.5	3.1	2.5	2	4	4
General government budget, nat. def., % GDP									
Revenues	26.7	26.0	26.6	25	.	.	26	27	28
Expenditures	32.3	33.0	29.7	30	.	.	31	35	34
Deficit (-) / surplus (+)	-5.5	-7.0	-3.1	-5	.	.	-5	-8	-6
Public debt, nat. def., in % of GDP ⁷⁾	55.2	59.7	58.2	60	.	.	62	66	67
Central bank policy rate, % p.a., end of period ⁸⁾	6.25	5.25	5.00	4.75	5.30	4.25	4.00	3.75	4.25
Current account, EUR mn	-1381.2	-1329.8	-1018.5	-1145.4	-220.9	-259.2	-1200	-1450	-1700
Current account in % of GDP	-15.6	-15.3	-11.5	-12.5	.	.	-12.5	-13.8	-14.7
Exports of goods, BOP, EUR mn	917.5	750.7	1171.5	1405.5	370.6	325.8	1330	1400	1600
annual growth rate in %	16.7	-18.2	56.1	20.0	45.4	-12.1	-5	5	14
Imports of goods, BOP, EUR mn	3348.9	3054.4	3254.2	3647.1	779.1	791.2	3610	3850	4300
annual growth rate in %	15.9	-8.8	6.5	12.1	15.6	1.6	-1	7	12
Exports of services, BOP, EUR mn	1687.8	1771.4	1750.7	1747.4	312.3	293.8	1750	1850	2050
annual growth rate in %	18.7	5.0	-1.2	-0.2	15.3	-5.9	0	6	11
Imports of services, BOP, EUR mn	1618.3	1597.5	1518.8	1612.7	329.3	285.4	1600	1700	1850
annual growth rate in %	15.4	-1.3	-4.9	6.2	20.9	-13.3	-1	6	9
FDI inflow, EUR mn	665.2	716.9	793.3	741.9	83.3	185.9	700	800	900
FDI outflow, EUR mn	55.4	28.2	4.8	30.1	4.7	4.1	20	30	40
Gross reserves of NB excl. gold, EUR mn ⁹⁾	1626.1	1607.8	1842.1	1853.1	1733.7	1825.3	.	.	.
Gross external debt, EUR mn	3313.5	3567.5	3919.1	4534.0	3993.4	4600.5	.	.	.
Gross external debt in % of GDP	37.4	40.9	44.3	49.3	43.4	48.1	.	.	.
Exchange rate ALL/EUR, average	122.80	132.06	137.79	140.33	139.46	139.23	140	136	133
Purchasing power parity ALL/EUR ¹⁰⁾	53.48	55.39	57.83	58.55	.	.	.	.	.

1) Preliminary. - 2) According to ESA'95 (including non-observed economy, real growth rates based on previous year prices). - 3) Gross value added. - 4) Gross value added of agriculture, forestry and fishing. - 5) Survey once a year (June or September-October), wiiw estimate in 2010 and 2011. - 6) Quarterly data refer to public sector. - 7) Based on IMF data. - 8) One-week repo rate. - 9) From 2009 international reserves (foreign assets of NB before). - 10) wiiw estimates based on the 2005 International Comparison Project benchmark and wiiw Eurostat.

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



Mario Holzner

Albania: High heels sans Achilles

Customs trade-data for the first four months of 2012 reveal that a surprising trend continues unabated. While overall exports denominated in Albanian leks are even falling slightly, exports to crisis-shattered Italy, Greece and Spain are increasing on average by about 20%. The latter group of countries are among Albania's most important trading partners and were thus deemed to be the country's Achilles heel, yet similarly high growth rates for exports to those very same countries were also recorded throughout 2011. The main items exported to that group of countries were textiles and footwear. The key reason for this strange trade development might be the substitution of low-priced Albanian goods for high-priced domestic textiles and footwear in Italy, Greece and Spain, as well as a further outsourcing of production to Albania.

Similarly, end-of-year balance of payments data for 2011 suggest that remittances from Albanian migrants (mostly located in Greece and Italy) did not drop as much as expected; on the contrary, they increased slightly. The inflow of remittances thus accounted for EUR 700 million (8% of GDP), almost as much as the inflow of FDI. Given the positive developments in potentially weak areas of the Albanian economy, we have revised upwards our previous GDP growth rate estimate for 2011 by one percentage point to 2.9% and our GDP growth rate forecast for 2012 by 10 basis points to 2.3%.

However, positive developments in an unexpected segment of the economy have been unable to prevent the overall deceleration of economic growth since 2008. Should both exports and imports continue to decline throughout 2012, neither foreign nor domestic private-sector demand will lend the Albanian economy any substantial growth impetus. In the first quarter of 2012, Albania's overall economic sentiment indicator recorded its lowest value since the all-time low in the first quarter of 2009. The construction confidence indicator, in particular, has hit rock bottom. Despite displaying a negative trend, consumer confidence is still close to the long-term average. Retail data for the fourth quarter of 2011 confirm this trend; they show complete stagnation as compared to the same period in the previous year. However, one forward-looking indicator, the sale, maintenance and repair of motor vehicles, increased by more than 30% year-on-year (but dropped by about 10% as against the previous quarter).

In the light of the lower demand for credit and an ever-higher share of non-performing loans (20% in the first quarter 2012 as against 15% a year earlier), banks have continued to tighten their lending standards, especially for households and large enterprises. This has led to a deceleration in the growth rate of total new loans to the economy to 8% for the first quarter 2012 as compared to the same period a year earlier. New loans to households slumped by almost a quarter, while new loans to businesses increased by 15%. However, the latter growth was quite unevenly distributed. New

loans to the manufacturing (-33%) and construction sectors (-18%) dropped markedly. On the other hand, loans to trade and repair services increased palpably (53%), as did those to business services (294%).

Despite some disconcerting signals, the financial sector appears to be pretty sound. Return-to-assets as well as return-to-equity figures (although at low levels) are improving, as is the capital adequacy ratio, which stood as high as 16% in the first quarter 2012. Provided the inflation rate continues to drop, the Bank of Albania is expected to reduce its policy rate to about 4% or even less. This should help to dampen the deleveraging process and to avert appreciation of the domestic currency.

For want of momentum in the private sector, a continuation of government deficit spending will be of crucial importance to economic growth. Whereas data for the first quarter 2012 show both government revenues and expenditures increasing in equal measure, a mere one percentage point (year on year) each, the dynamics of the situation will in all likelihood pick up speed by the end of the year. The main reason for the acceleration is the parliamentary election scheduled for 2013. The government has announced that the major road works on the Tirana-Elbasan motorway will be completed by May 2013 - just before the parliamentary elections.

The Albanian election cycle is expected to keep economic growth rates at a level ranging between 2% and 3% for both 2012 and 2013. This will most likely be achieved at the expense of violating the legal limit set for public debt: 60% of GDP. This is a relatively high value compared to other countries in Central, East and South-east Europe. However, Albania's external debt levels are very low; short-term external debt is almost non-existent. This makes Albania less vulnerable to speculative financial forays and bolsters the government's confidence in pursuing its pro-growth investment activity that is of such vital significance for a country with enormous gaps in its public infrastructure.

As for domestic politics, the performance of Prime Minister Sali Berisha's conservative government is small-minded and could well jeopardise Albania's European integration ambitions. Political infighting is hampering the selection of a compromise candidate for the current presidential election that requires a two-thirds majority in parliament. This, in tandem with the persistent delay in adopting an electoral bill that meets European standards, is the main reason for Albania most likely celebrating its centenary of independence (from the Ottoman Empire) without, however, acquiring EU candidate status this autumn.



Josef Pöschl

Bosnia and Herzegovina: An economy under attack

Given their country's past history, entrepreneurs in Bosnia and Herzegovina (BiH) are accustomed to a harsh business environment. None the less, even for many of them, the current situation poses a real challenge. During the first four months of 2012, industrial production was down by 8.5% year-on-year. The manufacture of machinery, admittedly only a wee part of the whole, slumped by more than 50%. The production of capital goods, in general, dropped by a third, consumer durables by a quarter and textiles by a fifth. Food production stagnated. In the business section of the newspapers, reports of losses or reduced profits abound. Minor foreign investment projects are presented as good news, yet at the same time foreign businesses are reported to be checking out, Turkish Airlines allegedly being one of them.

Aluminium Mostar, one of the country's main exporters, has been hit hard by the adverse international business climate. Aluminium prices have fallen yet again – albeit not as steeply as in May 2009 – and energy is an increasingly expensive resource. Conditions have also worsened for the steel company, Arcelor Mittal Zenica, another leading exporter.

Not surprisingly, in the first quarter of 2012, export revenues were down by 9.6% year-on-year. Imports remained at the level they were a year ago; hence, for 2012 we have to reckon with a still wider gap in the current account. In 2011 the CA deficit already amounted to 8.6% of GDP: a figure that is uncomfortably and perhaps unsustainably high. The currency board arrangement, an important stability factor, means that the current account gap can only narrow, if the producers of tradeables increase their level of competitiveness. Reaching an effective level calls for investment in the real sector, but investors, especially foreign investors, are rare on the ground. Under the present circumstances, the financial sector can survive, but it will hardly flourish.

After 1995, society engaged quite successfully in reconstructing the country and its economy. Today BiH is a normal European post-transition country. No doubt, it could have attained better results, had economic activities enjoyed continuous public sector support in terms of appropriate regulations and institutional arrangements. Parts of the public sector are functioning well, but given its size it bears distinct traits of parasitism.

Most hopes are placed in the IMF renewing its support. It would improve preconditions for a bridging of the gap between fiscal revenues and expenditures, which is likely to widen substantially in 2012. At the same time, fears are being voiced about the conditionality of that support. Structural reforms in times of recession mean hardship for large segments of the society. Even now, only a fraction of the population has a regular job. This situation may well not change soon, since GDP growth will be at best moderate in both 2013 and 2014.

Table BA

Bosnia and Herzegovina: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012 Forecast	2013	2014
Population, th pers., mid-year	3842.3	3843.0	3843.1	3839.7	.	.	3843	3842	3842
Gross domestic product, BAM mn, nom. ²⁾	24759	24051	24584	26100	.	.	26500	27400	28500
annual change in % (real) ²⁾	5.6	-2.9	0.7	2.2	.	.	-0.5	1.5	2.0
GDP/capita (EUR at exchange rate)	3300	3200	3300	3500	.	.	3500	3600	3800
GDP/capita (EUR at PPP - wiiw)	6700	6400	6600	6800	.	.	.	.	.
GDP by expend. approach, BAM mn, nom. ²⁾	28116	27895	27955	.	.	.	.	.	.
Consumption of households, BAM mn, nom. ²⁾	22468	21631	21828	22700	.	.	.	.	.
annual change in % (real) ²⁾	6.0	-3.9	-1.0	0.2	.	.	0	1	1
Gross fixed capital form., BAM mn, nom. ²⁾	7565	5952	5344	5800	.	.	.	.	.
annual change in % (real) ²⁾	16.1	-22.4	-11.1	5.4	.	.	2	4	5
Gross industrial production ³⁾									
annual change in % (real)	7.3	1.5	3.7	5.6	11.2	-9.4	-5	5	7
Gross agricultural production									
annual change in % (real)	9.1	3.9	-7.1	.	.	.	.	.	.
Construction output total ⁴⁾									
annual change in % (real)	16.9	-7.2	-12.4	.	.	.	.	.	.
Employed persons - LFS, th, April	890.2	859.2	842.8	816.0	.	.	810	810	812
annual change in %	4.8	-3.5	-1.9	-3.2	.	.	-0.7	0.0	0.2
Employees total - reg., th, average	705.6	697.6	688.2	693.3	695.3	688.3	682	685	685
annual change in %	2.9	-1.1	-1.3	0.7	-0.7	-1.0	-1.6	0.4	0.0
Unemployed persons - LFS, th, April	272.0	272.3	315.1	310.9	.	.	315	313	312
Unemployment rate - LFS, in %, April	23.4	24.1	27.2	27.6	.	.	28	28	28
Unemployment rate, reg., in %, end of period	40.6	42.4	42.7	43.8	43.3	44.1	44	44	44
Average gross monthly wages, BAM	1113	1204	1217	1270	1249	1284	1280	1300	1350
annual change in % (real, net)	8.4	5.6	-1.1	-1.4	-1.0	-0.5	.	.	.
Consumer prices, % p.a.	7.5	-0.4	2.1	3.7	3.3	2.3	2	2	2
Producer prices in industry, % p.a. ⁵⁾	8.6	-3.2	0.9	3.7	4.3	1.1	2	2	2
General government budget, nat. def., % GDP									
Revenues	44.0	43.0	44.2	44.0	.	.	43.5	43.5	44.0
Expenditures	46.2	47.5	46.7	46.5	.	.	46.5	46.0	46.5
Deficit (-) / surplus (+)	-2.2	-4.5	-2.5	-2.5	.	.	-3.0	-2.5	-2.5
Public debt, nat. def., in % of GDP ⁶⁾	30.7	35.3	38.9	39.0	.	.	41	42	43
Central bank policy rate, % p.a., end of period ⁷⁾
Current account, EUR mn ⁸⁾	-1771.3	-777.7	-719.3	-1141.9	-163.1	.	-1200	-1200	-1200
Current account in % of GDP	-14.0	-6.3	-5.7	-8.6	.	.	-8.9	-8.6	-8.3
Exports of goods, BOP, EUR mn ⁸⁾	3522.0	2920.2	3761.9	4347.2	1035.3	936.1	4200	4500	5000
annual growth rate in %	13.9	-17.1	28.8	15.6	25.1	-9.6	-3	7	11
Imports of goods, BOP, EUR mn ⁸⁾	8344.6	6330.1	6994.1	7976.0	1746.9	1750.4	8000	8400	9000
annual growth rate in %	15.4	-24.1	10.5	14.0	23.3	0.2	0	5	7
Exports of services, BOP, EUR mn ⁸⁾	1132.0	1024.9	974.5	922.3	168.9	.	920	950	1000
annual growth rate in %	6.6	-9.5	-4.9	-5.4	-4.7	.	0	3	5
Imports of services, BOP, EUR mn ⁸⁾	467.7	461.8	407.4	378.6	65.6	.	390	400	420
annual growth rate in %	10.8	-1.3	-11.8	-7.1	3.0	.	3	3	5
FDI inflow, EUR mn ⁸⁾	683.8	180.5	173.6	313.0	83.7	.	320	330	340
FDI outflow, EUR mn ⁸⁾	11.3	4.4	31.7	14.2	-3.1	.	2	3	3
Gross reserves of NB excl. gold, EUR mn ⁹⁾	3218.9	3143.8	3267.6	3207.0	3108.8	3046.0	3150	3200	3200
Gross external public debt, EUR mn	2168.0	2676.2	3215.4	3405.3	3188.9	3466.0	3700	4000	4000
Gross external debt in % of GDP	17.1	21.8	25.6	25.5	23.9	25.6	27.4	28.6	27.5
Exchange rate BAM/EUR, average	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.96	1.96	1.96
Purchasing power parity BAM/EUR ¹⁰⁾	0.9658	0.9842	0.9742	0.9972	.	.	.	.	.

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

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



Vladimir Gligorov

Serbia: Post-election crisis

Similar to other Balkan economies, Serbia recorded negative GDP growth for the first quarter 2012: – 1.3%. Furthermore, industrial production declined rather strongly by 6.2% over the same period and future prospects are not encouraging. Driven by pre-election government munificence, imports increased and exports declined, while employment continued to fall. The outlook for the year as a whole has steadily worsened. The chances now are that growth this year will be negative: hovering, it is hoped, around – 1%.

This year's economic developments have been heavily influenced by pre-election politics. Presidential, general and local elections were held at the beginning of May. In the run-up to the same, the government put the IMF programme on hold and increased spending significantly. Indeed, almost everything else was held in abeyance. The outcome has been mixed. Whereas the incumbent president, Mr. Boris Tadic, was not re-elected, the governing coalition won enough seats to continue in office. Moreover, the incumbent parties fared pretty well in the local elections, especially in the major cities and the province of Vojvodina. Serbia is a parliamentary democracy, which hitherto has been run as though it were a presidential system. The lost presidential elections may thus cast a shadow on the new-cum-old coalition, which may ultimately prove to be less than stable and effective.

The new government will inherit a stagnant economy entailing risks to the country's macroeconomic stability. In the aftermath of the elections, the Fiscal Council, an independent body legally authorised to monitor fiscal sustainability, has issued a warning about the public debt increasing rapidly and a crisis looming large - with every risk of default perhaps just six months or so away. The projected fiscal deficit for the current year now stands at over 6% and the public debt is expected to come close to 50% of GDP by the end of the year. The recommendation is to embark on decreasing expenditures and increasing value-added tax from 18% to 22%.

As for the background, it should be recalled that public expenditures dropped from around 46% of GDP in 2008 to 44% in 2011. However, public revenues also declined from 44% to 39% of GDP over the same period. This year, public expenditure may well reach 48% of GDP owing to the pre-election spending spree and dismal GDP growth. The Fiscal Council recommends that expenditures be cut and a revenue-neutral tax reform set in motion. The idea is to engineer fiscal devaluation by cutting taxes on labour and increasing levies on consumption, viz. VAT. The corporate sector rejects the latter proposal because of the weak demand it is facing. For their part, however, the unions and the pensioners' party, which is part of the current government, refuse to countenance lower taxes on

Table RS

Serbia: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012 Forecast	2013	2014
Population, th. pers., mid-year	7350.2	7320.8	7291.4	7280.0	.	.	7250	7220	7200
Gross domestic product, RSD bn, nom. ²⁾	2661.4	2720.1	2881.9	3175.0	.	.	3300	3500	3700
annual change in % (real) ²⁾	3.8	-3.5	1.0	1.6	3.0	-1.3	-1	1	2
GDP/capita (EUR at exchange rate)	4400	4000	3800	4200	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	9000	8400	8400	8700	.	.	.	.	.
Consumption of households, RSD bn, nom. ²⁾	2023.6	2143.2	2282.8	2600	.	.	.	.	.
annual change in % (real) ³⁾	6	-2	2	1	.	.	0	1	1
Gross fixed capital form., RSD bn, nom. ²⁾	632.4	510.2	512.3	700	.	.	.	.	.
annual change in % (real) ³⁾	8	-5	-4	0	.	.	-1	3	3
Gross industrial production									
annual change in % (real)	1.4	-12.6	2.5	2.1	5.7	-6.2	-3	3	4
Gross agricultural production									
annual change in % (real)	13.7	1.3	1.0	0.8	.	.	2	3	3
Construction output ⁴⁾									
annual change in % (real)	4.7	-19.7	-7.1	7.7	.	.	3	3	3
Employed persons - LFS, th, average ⁵⁾	2821.7	2616.4	2396.2	2253.2	.	.	2150	2100	2100
annual change in %	.	-7.3	-8.4	-6.0	.	.	-5	-2	0
Unemployed persons - LFS, th, average ⁵⁾	445.4	503.0	568.7	671.1	.	.	.	.	.
Unemployment rate - LFS, in %, average ⁵⁾	13.6	16.1	19.2	23.0	.	.	27	27	26
Unemployment rate, reg., in %, end of period	24.0	25.9	26.7	27.2	26.8	28.5	30	30	30
Average gross monthly wages, RSD ⁶⁾	45674	44147	47450	52733	48803	54153	.	.	.
real growth rate, % (net wages) ⁶⁾	3.9	0.2	0.7	0.2	-2.3	5.9	.	.	.
Consumer prices, % p.a.	13.5	8.6	6.8	11.0	12.8	4.8	6	5	5
Producer prices in industry, % p.a. ⁷⁾	12.4	5.6	12.7	14.2	18.2	6.3	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	43.0	42.1	43.1	41.9	.	.	.	.	.
Expenditures	45.6	46.6	47.9	47.0	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-2.6	-4.5	-4.8	-5.1	.	.	-6	-4	-4
Public debt, nat.def., in % of GDP	29.2	34.8	42.9	45.0	.	.	49	50	52
Central bank policy rate, % p.a., end of period ⁸⁾	17.75	9.50	11.50	9.75	12.3	9.5	8	6	5
Current account, EUR mn	-7054.1	-2084.4	-2082.0	-2967.8	-760.3	-1159.4	-2900	-3280	-3240
Current account in % of GDP	-21.6	-7.2	-7.4	-9.6	-11.8	-16.9	-10.1	-11.2	-11.2
Exports of goods, BOP, EUR mn	7416.0	5977.8	7402.5	8437.8	1954.8	1852.3	9000	9900	11100
annual growth rate in %	16.2	-19.4	23.8	14.0	32.5	-5.2	7	10	12
Imports of goods, BOP, EUR mn	15917.2	11096.3	12175.8	13951.5	3268.9	3394.7	14600	15600	16700
annual growth rate in %	18.3	-30.3	9.7	14.6	22.9	3.8	5	7	7
Exports of services, BOP, EUR mn	2741.4	2500.0	2667.1	3032.2	631.4	676.0	3300	3600	4000
annual growth rate in %	19.0	-8.8	6.7	13.7	17.6	7.1	10	10	10
Imports of services, BOP, EUR mn	2926.1	2481.7	2661.9	2871.5	603.9	638.2	3200	3500	3900
annual growth rate in %	14.1	-15.2	7.3	7.9	8.8	5.7	10	10	10
FDI inflow, EUR mn	2017.5	1410.1	1003.1	1948.9	325.4	-353.0	800	1000	1000
FDI outflow, EUR mn	193.1	37.6	143.0	122.0	18.8	18.5	100	100	100
Gross reserves of NB, excl. gold, EUR mn	7939	10278	9555	11497	9490	10492	.	.	.
Gross external debt, EUR mn	21088	22487	23786	24125	22672	24068	.	.	.
Gross external debt in % of GDP	64.6	77.7	84.9	78.2	73.5	77.6	.	.	.
Exchange rate RSD/EUR, average	81.47	93.94	102.90	102.93	103.99	108.11	115	120	128
Purchasing power parity RSD/EUR ⁹⁾	40.16	44.35	46.92	50.13	.	.	.	.	.

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

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

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

labour because it would mean lower contributions to the pension fund. This is all tied up with a proposal for reforming the pension scheme, which would result in lower pensions and a longer working life. The government will probably have little choice but to accept some version of these recommendations. It has to renew its programme with the IMF, whose members will certainly insist on reforms as one of the pre-conditions for their continuing to lend financial support.

Given the sharp depreciation of the dinar against the euro, the need for that support would appear most urgent. Although foreign financial inflows were quite significant, considering the circumstances prevailing throughout the previous year, they have practically stalled this year. The central bank has been drawing down funds to purchase dinars, yet it has failed to adjust interest rates adequately to the slowdown in inflation and so stabilize the foreign exchange market. Its efforts at stabilisation have not met with success to date. The stand-by agreement with the IMF thus seems inevitable.

The key problem is that exports have levelled off and industrial production has gone into decline. The ongoing depreciation of the domestic currency may help reverse the trend as far as foreign trade is concerned; however, investments are essential, if industrial output is to recover. Recovery is unlikely this year and the prospects for the next two years will hinge on political stability and the economic policy pursued by the new government. The chances are that stagnation or slow growth is on the cards in the medium term.

Table KZ

Kazakhstan: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012 Forecast	2013	2014
Population, th pers., average ²⁾	15674	16093	16323	16558	16475	16717	16700	16800	16900
Gross domestic product, KZT bn, nom.	16053	17008	21816	27301	4910	5838	31400	35300	39500
annual change in % (real)	3.3	1.2	7.3	7.5	6.6	5.6	6	5	5.5
GDP/capita (EUR at exchange rate)	5800	5100	6800	8100	.	.	9600	10600	11500
GDP/capita (EUR at PPP - wiiw)	8900	8500	9300	10000	.	.	.	.	.
Consumption of households, KZT bn, nom.	6871	7913	9721	11390	.	.	12620	13910	15330
annual change in % (real)	6.3	0.7	10.0	8	.	.	5	4	4
Gross fixed capital form., KZT bn, nom.	4309	4727	5307	6590	.	.	7830	9130	10650
annual change in % (real)	1.0	-0.8	3.8	3.5	.	.	8	9	10
Gross industrial production									
annual change in % (real)	2.1	2.7	10.0	3.5	6	2.9	4	5	7
Gross agricultural production									
annual change in % (real)	-6.4	13.9	-11.7	26.7	1.8	-5.1	2	8	5
Construction industry									
annual change in % (real)	1.9	-3.2	1.0	2.7	3.1	-0.7	5	8	8
Employed persons - LFS, th, average	7857.2	7903.4	8114.2	8302.8	8134.5	8462.5	8390	8470	8550
annual change in %	3.0	0.6	2.7	2.3	1.3	4.0	1	1	1
Unemployed persons - LFS, th, average	557.8	554.5	496.5	473.1	475.9	478.5	.	.	.
Unemployment rate - LFS, in %, average	6.6	6.6	5.8	5.4	5.5	5.4	5.2	5	5
Reg. unemployment rate, in %, end of period	0.7	0.6	.	.	.	.	.	.	.
Average gross monthly wages, KZT	60734	67639	77565	89887	80195	93947	.	.	.
annual change in % (real, gross)	-2.6	3.8	7.0	7.2	9	11.5	.	.	.
Consumer prices, % p.a.	17.1	7.3	7.1	8.5	8.7	5	5.5	6	6
Producer prices in industry, % p.a.	36.8	-22.0	25.2	20	23	9.8	10	7	6
General government budget, nat. def., % GDP									
Revenues and grants	25.1	20.6	19.7	19.7	.	.	.	.	.
Expenditures and net lending	27.2	23.5	22.1	21.8	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-2.1	-2.9	-2.4	-2.1	.	.	-2.5	-1.5	-1.0
Public debt, nat. def., in % of GDP	8.3	12.2	14.7	16	.	.	16	16	15
Central bank policy rate % p.a., end of period ³⁾	10.5	7.0	7.0	7.5	7.5	7.0	.	.	.
Current account, EUR mn ⁴⁾	4298	-2950	1814	10136	1680	2896	12300	10600	9200
Current account in % of GDP	4.7	-3.6	1.6	7.6	6.8	9.6	7.6	6.0	4.7
Exports of goods, BOP, EUR mn ⁴⁾	48905	31504	46376	63551	12251	16815	76300	83600	88600
annual growth rate in %	38.5	-35.6	47.2	37.0	24.7	37.3	20.1	9.6	6.0
Imports of goods, BOP, EUR mn ⁴⁾	26128	20769	24786	29601	5382	7432	37700	43200	47900
annual growth rate in %	7.5	-20.5	19.3	19.4	31.3	38.1	27.4	14.6	10.9
Exports of services, BOP, EUR mn ⁴⁾	3007	3038	3203	3239	677	786	3790	4000	4080
annual growth rate in %	15.5	1.0	5.4	1.1	3.8	16.0	17.0	5.5	2.0
Imports of services, BOP, EUR mn ⁴⁾	7556	7200	8534	7845	1370	2054	10000	10760	11410
annual growth rate in %	-11.8	-4.7	18.5	-8.1	-19.1	50.0	27.5	7.6	6.0
FDI inflow, EUR mn ⁴⁾	9732	9497	8109	9274	3058	3546	10600	11400	10800
FDI outflow, EUR mn ⁴⁾	818	2266	5902	3254	1409	342	3977	4355	4317
Gross reserves of NB excl. gold, EUR mn	12630	14352	19044	19474	22762	20390	.	.	.
Gross external debt, EUR mn	76278	78674	89261	95811	87450	.	.	.	.
Gross external debt in % of GDP	84.1	95.1	80.1	71.6	65.4	.	.	.	.
Average exchange rate KZT/EUR	177.04	205.68	195.67	204.11	199.91	194.12	195	198	203
Purchasing power parity KZT/EUR, wiiw ⁵⁾	115.30	123.85	143.49	164.71	.	.	.	.	.

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

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



Olga Pindyuk

Kazakhstan: Banking sector problems still to be solved

After remarkable results in 2011 (7.5% growth of real GDP), economic growth in Kazakhstan slowed down in the first quarter 2012 to 5.6% year-on-year: 1 p.p. lower than in the first quarter 2011. The main reason for this slowdown in growth lay in the decline in the extraction of oil: 2.3% in real terms. At the same time, oil exports increased during the first quarter 2012 by 13.1% in real terms. The decline in total production can thus be attributed to lower domestic sales. Preliminary investment data show that in the oil sector, fixed capital investment dropped during the first quarter 2012. In the manufacturing sector, however, investment outlays increased over that same period by a hefty 25.1% year-on-year in real terms; output in the manufacturing sector increased by 7.8% year-on-year in real terms during the first quarter 2012.

We believe that the oil sector's sluggish performance is merely a temporary matter. In the course of the current year production will pick up, as will investment given the sector's investment plans, especially those for the Kashagan project⁵³. Other sectors will also step up investment. In particular, investment in construction will enjoy a boost thanks to sizeable state-funded infrastructure projects.

Although no data on consumption in the first quarter of 2012 are available, the rapid wage rise in real terms over that period (11.5% against 9% in the first quarter 2011) leads us to assume that household consumption remained strong throughout the first quarter 2012. However, we do not believe that household consumption can keep growing at the same high rate as it did in 2011, since real wages are unlikely to continue growing as rapidly as in 2011. We thus envisage growth in household consumption being slower than that of gross fixed capital formation during the forecast period.

Exports are expected to rise rapidly this year on the back of the high oil prices: in the first quarter 2012, merchandise exports increased by 31.7%, in particular owing to a 13.1% increase in the Brent crude oil price (USD 118.6 per barrel as against USD 104.9). We do not expect oil prices to change dramatically in the biennium 2013-2014. Export growth will thus to a large extent be more in terms of volume - and hence at a more moderate rate. The current account balance will gradually decrease, yet remain positive and relatively high. That will allow the National Bank to accumulate more foreign exchange reserves. The tenge/USD exchange rate will remain virtually stable over the forecast period. The National Bank is expected to allow somewhat greater exchange rate fluctuations, but de facto will continue to keep the exchange rate fixed to the USD.

⁵³ Karachaganak is an oil field discovered in 2000, which is estimated to have commercial reserves of 9 to 16 bn barrels of oil – the largest field found during the last 30 years. In February 2012, USD 45bn funding was approved by Kazakhstan to develop the field.

We forecast that the Kazakh economy will not have the capacity to reach the 7% real growth target set for 2012 by the country's President. That notwithstanding, growth will still be relatively strong: 6% year-on-year. In the biennium 2013-2014, the economy will continue to rely on the oil sector as a primary source of growth. Although the manufacturing sector will register rapid growth, it will remain relatively small in volume terms compared to the oil sector. With price developments on the global oil market expected to be less favorable for Kazakhstan over the period 2013-2014, the country's real GDP will grow at a somewhat slower rate: 5-5.5% year-on-year. An inherent risk in that forecast lies in the prolonged recession in the eurozone, Kazakhstan's major oil market; it could well have a significant negative impact on global oil prices.

In the first quarter 2012 inflation dropped to 5% year-on-year. That reflects the impact of the slow-down in international food prices, a record bumper harvest and the administrative measures launched to limit price increases for fuel and dietary staples. Those factors will continue to have an impact; by the end of 2012, CPI is expected to reach only 5.5% annually – 3 p.p. lower than in 2011. Moderate levels of inflation of about 6% have also been forecast for the biennium 2013-2014.

Developments in the banking sector continue to suffer from the consequences of the 2008 crisis. On the one hand, the banking system's performance shows signs of noticeable improvement. For example, the stock of loans started to grow in 2011. In April 2012, growth gained speed: up to 16.9% year-on-year as against 2.3% year-on-year in April 2011. The bulk of newly issued loans over the period January-April 2012 was directed towards trade (37.5% of the newly issued loans), purchases of consumer goods by households (14.3%) and manufacturing (10.5%). Mortgage loans accounted for only 2% of the newly issued loans during that period, whereas their share in the total stock of loans in April 2012 was 9.5%. On the other hand, the share of non-performing loans in Kazakhstan has remained high. In the narrowest sense of the term, the share of non-performing loans stood at 22.5% in April 2012, while another 22% of the total loans stock are considered doubtful. The reason for the latter share being so high lies in the Kazakh banking practice of restructuring many of the banks' non-performing loans by simply extending their maturity date.

In an attempt to deal with the non-performing loans issue, the government recently set up an impaired assets fund; it is to be independently managed and financed via pension funds, banks and the National Bank. However, the fund's efficiency will be limited, as it is not allowed to purchase loans related to real estate that account for about 90% of all non-performing loans. In order to deal with real-estate issues, it is envisaged that banks will set up their own special-purpose vehicles in the form of companies tasked to manage distressed assets. The process has just started and no concrete steps have been undertaken to date. Under those circumstances, resolution of the non-performing loans issue is likely to be a protracted affair.

Another potential problem facing the banking sector in Kazakhstan is that of liquidity constraints. Up until recently, rapidly growing deposits were the major source of funding for the banks (88% of total liabilities in April 2012). Furthermore, as deposits grew faster than loans, the banks enjoyed ample liquidity. By the beginning of 2012, however, growth in loans had outstripped growth in deposits. Moreover, deposits have proven to be quite a risky source of financing on account of their volatility.

By their very nature, corporate deposits are volatile, and current regulations allow withdrawal of household deposits (which account for more than a half of total deposits) at any time – thus term deposits are virtually non-existing in the country. Kazakh banks will thus have to search actively for additional sources of funding: a difficult proposition considering the still limited scope for foreign borrowing after the sudden stop in banks international funding in 2008..

None the less, banking sector issues will continue to have but a limited impact on the real economy of Kazakhstan, as most investment is financed either by companies drawing down their own funds (49% of total investment in 2011), by foreign funding (21% - primarily in the oil sector) or by government resources (19.5%). In the period January-April 2012, the share of the companies' own funds in investment outlays further increased to 55%. Loans accounted only for 10.6% of fixed capital financing in 2011, their share decreasing a further 1.1 p.p. over the period January-April 2012.

There have been developments in the foreign trade policy of Kazakhstan: the country has completed all the bilateral negotiations necessary for accession to the WTO. The one final step remaining is that of concluding the round of multilateral negotiations: something that might be accomplished within a year. Russia, one of Kazakhstan's partners in the Customs Union, is expected to join the WTO by September 2012. It is expected that Russia will have to change its import tariffs and the other members of the Customs Union will have to adopt those changes - in particular, the changes relating to lowering the level of protection in the automotive industry. That particular sector in Kazakhstan was one of those most profoundly affected when the Customs Union was set up. Import duties were increased significantly, and where second-hand cars were concerned, the levies were prohibitive. In less than a year after the introduction of the new import tariffs in Kazakhstan in July 2011, the car market has changed dramatically. Cars produced in Russia secured the lion's share of the market (in particular, Lada and Hyundai of Russian assembly), while locally assembled cars increased their market share as well (in particular, assembly lines of Chevrolet, UZ-Daewoo, and Ssang Young) – mostly to the detriment of new and used cars from Asia.

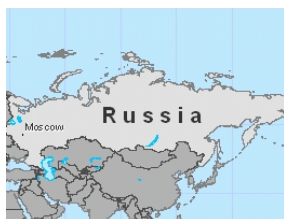
Table RU

Russia: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012 Forecast	2013	2014
Population, th pers., average ²⁾	141956	141902	142938	142500	.	.	142000	141500	141000
Gross domestic product, RUB bn, nom. ³⁾	41277	38807	45173	54586	11680	13491	62600	70000	78000
annual change in % (real) ³⁾	5.2	-7.8	4.3	4.3	4.0	4.9	3.8	4.0	4.2
GDP/capita (EUR at exchange rate)	8000	6200	7800	9400	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	13100	11900	12600	13500	.	.	.	.	.
Consumption of households, RUB bn, nom. ³⁾	19967	20986	23482	27229	6049	.	.	.	.
annual change in % (real) ³⁾	10.6	-5.1	5.2	6.8	6.1	.	5	5	5
Gross fixed capital form., RUB bn, nom. ³⁾	9201	8536	9829	11620	1524	.	.	.	.
annual change in % (real) ³⁾	10.6	-14.4	5.8	8.0	-0.6	.	5	6	6
Gross industrial production ⁴⁾									
annual change in % (real)	2.1	-9.3	8.2	4.7	5.9	4.0	6	5	6
Gross agricultural production									
annual change in % (real)	10.8	1.4	-11.3	22.1	0.7	4.0	.	.	.
Construction output									
annual change in % (real)	12.8	-13.2	3.5	5.1	1.6	5.2	6	5	6
Employed persons - LFS, th, average	70965.1	69284.9	69804.0	70732.0	69426.7	69895.0	70500	70000	70000
annual change in %	0.6	-2.4	0.7	1.3	2.1	0.7	-0.3	-0.7	0.0
Unemployed persons - LFS, th, average	4791.5	6372.8	5636.0	5020.0	5617.3	4869.7	5000	5000	5000.0
Unemployment rate - LFS, in %, average	6.3	8.4	7.5	6.6	7.5	6.5	6.6	6.7	6.7
Unemployment rate, reg., in %, end of period	2.0	2.9	2.1	1.7	2.2	1.8	.	.	.
Average gross monthly wages, RUB	17290.1	18637.5	20952.0	23532.0	21340.7	24423.0	.	.	.
annual change in % (real, gross)	11.0	-3.0	5.2	3.5	0.5	11.7	.	.	.
Consumer prices, % p.a.	14.1	11.8	6.9	8.5	9.5	3.9	6	5	5
Producer prices in industry, % p.a. ⁵⁾	21.4	-7.2	12.2	19.0	21.3	10.8	10	9	8
General governm.budget, nat.def., % GDP									
Revenues	38.8	35.0	35.5	38.4	37.6	37.8	.	.	.
Expenditures	33.9	41.4	39.0	36.8	30.6	34.0	.	.	.
Deficit (-) / surplus (+), % GDP	4.9	-6.3	-3.5	1.6	7.0	3.9	0	0	0
Public debt, nat.def., in % of GDP ⁶⁾	5.7	8.3	8.6	9.2	7.5	8.0	8	7	6
Central bank policy rate, % p.a., end of period ⁷⁾	13.00	8.75	7.75	8.00	8.00	8.00	.	.	.
Current account, EUR mn ⁸⁾	70642	34961	53861	70976	22519	32256	60000	50000	40000
Current account in % of GDP	6.2	4.0	4.8	5.3	7.7	9.5	3.9	3.0	2.2
Exports of goods, BOP, EUR mn ⁸⁾	321792	218221	303580	374872	82792	102717	410000	445000	480000
annual growth rate in %	24.3	-32.2	39.1	23.5	20.9	24.1	9	9	8
Imports of goods, BOP, EUR mn ⁸⁾	199148	137960	188404	232553	47580	55896	280000	320000	360000
annual growth rate in %	22.0	-30.7	36.6	23.4	39.5	17.5	20	14	13
Exports of services, BOP, EUR mn ⁸⁾	34921	29918	34085	38797	7735	8922	45000	49000	53000
annual growth rate in %	21.8	-14.3	13.9	13.8	7.1	15.3	16	9	8
Imports of services, BOP, EUR mn ⁸⁾	51495	44185	55834	64612	12397	14946	80000	95000	100000
annual growth rate in %	21.2	-14.2	26.4	15.7	10.5	20.6	24	19	5
FDI inflow, EUR mn ⁸⁾	51177	26254	32802	37973	.	.	45000	50000	55000
FDI outflow, EUR mn ⁸⁾	37934	31407	39800	48318	.	.	45000	40000	35000
Gross reserves of CB, excl. gold, EUR mn	291916	290432	335191	350786	330657	348683	.	.	.
Gross external debt, EUR mn	340688	325697	369458	421258	362040	423250	.	.	.
Gross external debt in % of GDP	30.1	37.0	33.0	31.5	27.1	27.7	.	.	.
Exchange rate RUB/EUR, average	36.43	44.14	40.30	40.87	40.03	39.67	41	42	43
Purchasing power parity RUB/EUR, wiiw ⁹⁾	22.13	22.91	25.00	28.54	.	.	.	.	.

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

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



Peter Havlik

Russian Federation: Few changes after the tandem shuffle

After nearly 5% growth in the first quarter of 2012, Russian GDP growth is currently slowing down and the growth forecast for the year as a whole has been revised downwards accordingly (to less than 4%). Falling oil prices and the lack of progress in diversification are the main culprits; the worsened growth outlook may be aggravated by the crisis in the eurozone. The current rate of GDP growth results from a robust recovery of fixed investment and also from growing consumer expenditures. The contribution of net exports to GDP growth remains negative because import volumes are growing faster than those of exports. On the supply side, industry remains sluggish (growth of just 3.4% in Jan-May 2012 against the same period of the previous year. Last year's strong upturn in agricultural output (+22%) will definitely not be repeated. Agriculture not only helped GDP growth in 2011 however, but was also instrumental in the reduction of consumer price inflation, an effect which spilled over to 2012. These developments together with a slight increase in employment (and the related drop in unemployment) and last year's fiscal surplus have been the positive economic developments in the past 12 months.

Positive economic news has been overshadowed by the popular disillusionment related to the alleged falsification of Duma and presidential elections however, especially among the middle class intelligentsia in Moscow and St. Petersburg. Disillusionment has been escalating since the Medvedev-Putin tandem shuffle. The formation of a new government in May 2012 revealed Prime Minister Medvedev's weakness: many former ministers switched to Putin's presidential administration and were replaced in the government by their previous deputies. The influential "spin doctor" V. Surkov will head and 'supervise' the government apparatus; the former Deputy Prime Minister I. Sechin will head the leading state energy company Rosneft. On the more positive side, some political reforms (such as the reintroduction of regional governors' elections and an easier registration of political parties) have been introduced as well.

Inflation has calmed down since the end of 2011, in part thanks to the absence of food price hikes following last year's favourable harvest. Another factor mitigating inflationary pressures has been the nominal rouble appreciation – a by-product of surging export revenues. In real terms (deflated with the consumer price index), the rouble appreciated by more than 20% against the euro between January 2009 and May 2012. Nevertheless, the volatility of the rouble exchange rate has been considerable: after a short-lived but sharp nominal and real depreciation at the turn of 2009, and the period of real appreciation during 2011 and early 2012; since May 2012 the rouble has been weakening again. That notwithstanding, foreign exchange reserves are being replenished (they exceeded USD 510 billion in mid-2012), despite sizeable capital flight: the outflow of capital from Russia exceeded USD 85 billion in 2011; another USD 40 bn is estimated to have left the country in the first

half of 2012. These outflows are partly linked to genuine outward FDIs, and partly due to lasting political uncertainties. Corruption and the hostile domestic investment climate have also played an important role.

The banking sector is slowly consolidating, with credits to both households (including housing mortgages) and enterprises growing sharply again (+30% at the end of March 2012 compared with the end of March 2011). Still, investment growth is clearly insufficient and much more investment is needed, especially for the envisaged modernization and diversification. According to Putin's announcement at the recent St. Petersburg Economic Forum, the share of investment in GDP is planned to increase from the current rate of 20% to 27% by the year 2018. With this target in mind, a substantial improvement in the investment climate is required. To foster this new privatization plans have been announced.⁵⁴ Unfortunately (as mentioned repeatedly in our previous assessments), the recent years have not been used for launching economic restructuring and institutional reforms which would bring about the badly needed improvements in the business climate. Russia is as dependent on exports of commodities as ever: oil and gas account for about two thirds of export revenues. Restructuring, modernization and the 'innovation development' preached by the authorities over a number of years have so far remained empty slogans.

The elements of Putin's future policies have been made public over the last couple of months. In his first programmatic declaration in October 2011, Mr. Putin underlined the importance of Euroasian (EurAz) integration of the post-Soviet space.⁵⁵ Another Putin's article praised the macroeconomic stability achieved under his rule as well as own leadership qualities.⁵⁶ Finally, the economic programme of Putin's forthcoming presidency was made public in a lengthy article published under the heading 'We Need a New Economy' in January 2012.⁵⁷ All these programmatic theses were reiterated by President-elect Putin in his welcoming address at the above mentioned St. Petersburg Economic Forum in June 2012. Besides – apart from WTO accession which will be completed in the coming months – Putin also expressed the hope that Russia will join the OECD in 2014.

All the rhetoric notwithstanding, we basically stick to the previous assessment regarding the reform outlook and are convinced that any significant breakthrough is unlikely in the near future. Uncertainties have increased and Mr. Putin's current presidency is assumed to be much weaker than the previous one. External risks have also increased: a more pronounced recession in Europe and a slowdown in the global economy may result in lower oil prices. The wiiw baseline forecast scenario assumes that oil prices will stay at or slightly below USD 100 per barrel in 2012 and thereafter. The

⁵⁴ The government has announced ambitious plans to privatize - either fully or by selling minority stakes in a number of state owned companies such as Sovkomflot (sea transport), Sberbank, Rosnano, Russian Railways, Aeroflot, Sheremetyevo Airport, Transneft, etc.

⁵⁵ The Customs Union of Belarus, Kazakhstan and Russia was launched in 2010. According to plans, this will be expanded to include Kyrgyzstan and Tajikistan, with the ultimate Russian aim to eventually get Ukraine on board also. The Customs Union was upgraded to a Common Economic Space in January 2012.

⁵⁶ See *Izvestiya*, 16 January 2012. Indeed, inflation dropped to record low levels (below 4%) in Jan-May 2012 (producer price inflation to 10% in the same period).

⁵⁷ See *Vedomosti*, 30 January 2012.

'horror scenario' (for Russia), with oil prices falling below USD 70 per barrel and the resulting severe consequences for Russian export and fiscal revenues is unlikely – although the government allegedly makes plans based on a scenario which assumes oil prices falling to USD 60 per barrel.⁵⁸

In the current baseline scenario, the wiiw has revised the GDP growth forecast for 2012 downwards (below 4%), but continues to forecast an accelerating yet unspectacular growth rate of GDP during 2013-2014. This scenario assumes no abrupt policy changes or external shocks and is charged with substantial downside risks. In particular, a more severe recession in Europe would have serious consequences, largely via falling export (and fiscal) revenues.⁵⁹ In the baseline scenario, export revenues will grow slowly due to stagnating volumes of exported oil and gas in the forecasting period, while there will be not much else to export since progress in export diversification will be limited. Simultaneously, import volumes are expected to grow at a faster rate as household consumption and investment gradually pick up, both fuelled by the ongoing real currency appreciation. In the medium and long run, economic reforms and investment (including FDI) may be stimulated by WTO membership. In summary, we stick to this relatively optimistic scenario which implies another negative contribution of real net exports to GDP growth in the coming years and, in nominal terms, gradual reductions of the trade and current account surpluses. With some luck the annual CPI inflation will gradually drop below 5% and the budget deficit will remain balanced.

⁵⁸ The baseline assumption for the 2013 budget plan regarding the oil price is USD 90 per barrel. Each 1 USD/bbl lower oil price costs the Russian budget Rbl 60 bn in foregone revenues; the non-oil budget deficit is expected to reach 10.6% of GDP in 2012 – see *Vedomosti*, 21 June 2012.

⁵⁹ Some analysts are fairly upbeat claiming that nowadays Russia is much better prepared to face the challenges which would stem from a crisis in Europe – see, for example, the analysis of the Gaidar Institute published in *Vedomosti*, 19 October 2011. Indeed, Mr Putin argued on a similar stroke in the above quoted speech stressing the USD 510 bn Forex reserves.

Table UA

Ukraine: Selected Economic Indicators

	2008	2009	2010	2011 ¹⁾	2011 1st quarter	2012	2012 Forecast	2013	2014
Population, th pers., average	46258	46053	45871	45706	45751	45611	45600	45500	45400
Gross domestic product, UAH bn, nom.	948.1	913.3	1082.6	1316.6	261.9	297.0	1390	1530	1690
annual change in % (real)	2.3	-14.8	4.1	5.2	5.4	2.0	3.2	4	5
GDP/capita (EUR at exchange rate)	2700	1800	2200	2600	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	6000	5100	5400	5800	.	.	.	.	.
Consumption of households, UAH bn, nom.	582.5	581.7	686.1	857.3	182.2	211.0	.	.	.
annual change in % (real)	13.1	-14.9	7.1	15.0	13.8	9.8	8	6	6
Gross fixed capital form., UAH bn, nom.	250.2	167.6	195.9	247.9	37.7	47.6	.	.	.
annual change in % (real)	-1.2	-50.5	3.9	10.1	2.1	7.6	5	8	8
Gross industrial production									
annual change in % (real)	-5.2	-21.9	11.2	7.3	10.3	0.9	2	4	6
Gross agricultural production									
annual change in % (real)	17.1	-1.8	-1.5	17.5	5.3	0.5	.	.	.
Construction output									
annual change in % (real)	-15.8	-48.2	-5.4	11.1	6.8	-2.7	.	.	.
Employed persons - LFS, th, average	20972.3	20191.5	20266.0	20324.2	20108.2	.	20300	20350	20400
annual change in %	0.3	-3.7	0.4	0.3	0.1	.	0	0.2	0.2
Unemployed persons - LFS, th, average	1425.1	1958.8	1785.6	1732.7	1924.9	.	.	.	.
Unemployment rate - LFS, in %, average	6.4	8.8	8.1	7.9	8.7	.	7.9	7.7	7.5
Unemployment rate, reg., in %, end of period ²⁾	3.0	1.9	2.0	1.8	2.2	1.9	.	.	.
Average gross monthly wages, UAH ³⁾	1806.3	1905.9	2239.2	2633.0	2388.7	2814.7	.	.	.
annual change in % (real, gross)	6.8	-9.0	9.7	8.9	11.3	14.5	.	.	.
Consumer prices, % p.a.	25.2	15.9	9.4	8.0	7.7	2.9	2	6	5
Producer prices in industry, % p.a. ⁴⁾	35.5	6.5	20.9	19.0	20.0	8.5	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	31.4	29.9	29.1	30.3	32.2	33.2	.	.	.
Expenditures	32.8	34.0	35.0	32.1	32.5	33.4	.	.	.
Deficit (-) / surplus (+) ⁵⁾	-1.5	-4.1	-6.0	-1.8	-0.3	-0.2	-3.5	-3	-2.5
Public debt, nat.def., in % of GDP	20.0	34.8	39.1	35.9	34.1	34.5	35	34	33
Central bank policy rate, % p.a., end of period ⁶⁾	12.00	10.25	7.75	7.75	7.75	7.50	.	.	.
Current account, EUR mn ⁷⁾	-8721	-1242	-2274	-6469	-981	-926	-6000	-6500	-7000
Current account in % of GDP	-7.1	-1.5	-2.2	-5.5	-4.1	-3.3	-4.7	-4.9	-4.8
Exports of goods, BOP, EUR mn ⁷⁾	46274	28958	39321	49865	11401	12537	54900	63100	72600
annual growth rate in %	27.2	-37.4	35.8	26.8	51.3	10.0	10	15	15
Imports of goods, BOP, EUR mn ⁷⁾	57270	32046	45641	59782	13660	14641	65800	75700	87100
annual growth rate in %	29.9	-44.0	42.4	31.0	62.1	7.2	10	15	15
Exports of services, BOP, EUR mn ⁷⁾	12228	9936	12856	13954	3028	3138	14700	16200	17500
annual growth rate in %	18.3	-18.8	29.4	8.5	16.7	3.6	5	10	8
Imports of services, BOP, EUR mn ⁷⁾	11039	8248	9538	10444	2291	2372	11000	12500	14500
annual growth rate in %	28.8	-25.3	15.6	9.5	19.0	3.5	5	14	16
FDI inflow, EUR mn ^{7) 8)}	7457	3453	4893	5177	641	1107	5000	6000	7000
FDI outflow, EUR mn ⁷⁾	690	116	555	138	-3	.	.	.	.
Gross reserves of NB excl. gold, EUR mn	21847	17825	25096	23593	24960	22283	.	.	.
Gross external debt, EUR mn	72109	72113	88363	97940	85667	.	.	.	.
Gross external debt in % of GDP	58.6	85.8	86.0	82.5	72.2	.	.	.	.
Exchange rate UAH/EUR, average	7.708	10.868	10.533	11.092	10.849	10.435	11	11.5	11.5
Purchasing power parity UAH/EUR, wiiw ⁹⁾	3.417	3.921	4.361	4.972	.	.	.	.	.

1) Preliminary. - 2) In % of working age population. - 3) Excluding small enterprises. - 4) Domestic output prices. - 5) wiiw projections include transfers to Naftohaz. - 6) Discount rate of NB. - 7) Converted from USD with the average exchange rate. - 8) In first quarter 2012 FDI net. - 9) wiiw estimates based on the 2005 International Comparison Project benchmark.

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



Vasily Astrov

Ukraine: Social spending spree

Until recently, Ukraine's economy had proven relatively resilient amid the global and European economic woes. However, in the first quarter 2012 economic growth slowed down to a mere 2% year-on-year (after 4.6% in the fourth quarter 2011) and turned slightly negative on the seasonally adjusted quarterly basis. Across sectors, only mining and services recorded solid growth, whereas manufacturing and agriculture were close to stagnant and construction output declined. Above all else, the stagnating manufacturing output reflects a decline in metals, textile and the oil-processing industry – the latter on account of the Lisichansk refinery being shut down.

The slowdown of economic growth has been fully due to the weakening of domestic demand, representing largely a less buoyant private consumption and a marked decline in inventories.⁶⁰ The deceleration of household consumption growth from the extraordinarily high pace recorded last year (+15%) may not come as a surprise: even at the current pace, it continues to thrive. In January-May 2012, retail trade turnover soared 15.5% in real terms, facilitated by impressive growth in nominal wages and marked disinflation (see below). Fixed capital investments have also performed strongly (+8% in the first quarter 2012), primarily driven by factors other than the government-sponsored infrastructure projects ahead of the 2012 European football championship, most of which have been largely completed. In fact, most regions hosting championship games have recorded a below-average rise in investments.

In turn, the external sector can be hardly blamed for the recent growth slowdown. In real terms, the dynamics of both exports and imports (of goods and services) in the first quarter 2012 turned negative. However, they declined at a similar pace, so that net exports have been less of a drag on GDP growth than in 2011, when imports surged well ahead of exports. In nominal terms, the export dynamics have been marginally positive (+4.8% in January-May 2012), but exports of metals declined by 7%, reflecting primarily lower global prices. On the other hand, exports of agricultural products and machinery (the latter mostly to Russia) continued to perform well. Growth in nominal imports has been extremely weak, too (+6.4% over the same period), and is likely to remain so in the months to come, as the rising gas prices (mirroring the peak in oil prices in the first quarter 2012) should be at least partly offset by the expected decline in oil prices. In addition, it is still quite possible that Ukraine will succeed in re-negotiating the infamous gas contract with Russia. As a result, further deterioration of the current account deficit beyond 4-5% of GDP can probably be avoided.

⁶⁰ The latter may be attributed to the high statistical base in the first quarter 2011 due to large-scale purchases of gas by Naftohaz in order to compensate RosUkrEnergo following the ruling of the Stockholm Arbitration Court.

Consumer price growth is still being dampened by last year's exceptional harvest. By May 2012, food prices had declined by 4.2% on an annual basis, resulting in consumer price deflation of 0.5% and making a case in favour of softening monetary policy. In March 2012 in a move to revive domestic lending (particularly in the household segment), the National Bank lowered the discount rate from 7.75% to 7.5%. It also eased the reserve requirements on hryvnia deposits, although it simultaneously raised those on foreign currency deposits. The National Bank's purchases of foreign exchange in March and April 2012 in response to the receding depreciation pressure on the hryvnia also contributed to the expansion of the monetary base and, at least in theory, to that of the money supply. However, judging by the stagnant credit dynamics, the effectiveness of those measures has at best been limited. The interest rates for loans demanded by banks have even increased and currently stand on average at 18%. In most cases, they are prohibitively high, especially in an environment marked by lower inflation. Credit expansion is also being constrained by the ongoing deleveraging of the Ukrainian subsidiaries of European banks (which still account for around 25% of the banking sector). The latter are freezing their lending operations or even withdrawing funds so as to be able to comply with stricter capital adequacy requirements.

Confronted by low ratings on the eve of the upcoming parliamentary elections on 28 October 2012, the Yanukovych administration, which had otherwise been known for its fiscal prudence, has splurged out on social spending. The recently enacted budget amendments envisage for 2012 extra expenditures of UAH 33 billion (an estimated 2.4% of GDP). Of that amount, UAH 18 billion is to be used for social payments such as pensions, children's allowances and disability benefits. Another UAH 6 billion is to be channelled to compensate the depositors of the former Soviet Sberbank, whose savings were effectively gobbled up by hyperinflation in the 1990s.⁶¹ Before the end of 2012, those eligible are to receive a lump-sum compensation of UAH 1,000 (some EUR 100) and their heirs will receive UAH 500 (EUR 50). Finally, UAH 1 billion has been allocated to the subsidized mortgage programme. Of the 16% interest rate that banks charge for household mortgages, some 13-14 p.p. are to be covered from the state budget. It is hoped that the move will boost mortgage loans (as well as provide a comfortable source of revenue for the banks participating).

These extra expenditures are to be financed largely by improving tax collection. The latter is expected to yield UAH 21 billion, while the bulk of the remaining UAH 12 billion should come in the form of state signature bonuses from production-sharing agreements on offshore hydrocarbon exploration activities. In the first quarter 2012, fiscal performance was indeed encouraging. Despite the slowdown in economic growth, the revenues of consolidated budget went up by 13.5% in real terms. However, the optimistic projection of tax collection for the current year is still based on the official forecasts of 3.9% real GDP growth and 7.9% consumer price inflation, both of which look increasingly unreal. This hints at the budget deficit in 2012 possibly exceeding the current target of 1.8% of GDP (excluding transfers to Naftohaz). Should the government find a way to finance the higher deficit either via extra borrowing or from some other sources (such as higher privatization proceeds), the recent social initiatives should offset the recent slowdown of economic growth. However, if deficit

⁶¹ The deposit compensation programme was initially launched by the Tymoshenko government back in 2008, but stalled during the economic crisis.

financing proves problematic, compelling the government to cut expenditures elsewhere (most likely on public investments), the economic benefits of the government initiatives may be less apparent.

Given the sluggish GDP growth in the first quarter of 2012, wiiw has lowered its forecast for the year as a whole to 3.2%, with risks on the downside. The authorities will probably avoid taking unpopular measures, such as raising residential energy tariffs or allowing the hryvnia to depreciate - at least not until the parliamentary elections are over. Taking into account the traditional food-price stability over the summer months, inflationary pressures are likely to stay reasonably low in the months to come. However, should the eurozone crisis escalate any further, the repercussions for the financial markets in the emerging economies, including Ukraine, may be severe and potentially jeopardize the viability of the current exchange rate peg of 8 UAH/USD even before the October elections.

EU concerns over what it views as the selective use of Ukraine's judicial system to political ends (first and foremost, but not solely, the 'Tymoshenko case') have resulted in the country's growing political isolation. One manifestation of this has been the boycott of the European football championship in Ukraine by a number of European leaders. After a protracted delay, the Association Agreement with the EU was finally initialled on 30 March 2012. However, the related Deep and Comprehensive Free Trade Agreement was initialled only partly; it is to undergo final verification over the months to come. Meanwhile, further criminal charges have been filed against Ms. Tymoshenko, making it highly unlikely that she will be released or any agreements signed with the EU before the elections in October. Furthermore, recent Ukrainian opinion polls suggest a shift in public sentiment away from EU integration: it is now less popular than e.g. Ukraine's joining a Customs Union with Russia.

Appendix

Selected indicators of competitiveness

Table A/1 GDP per capita at current PPPs (EUR), from 2011 at constant PPPs and population

	1991	1995	2000	2005	2007	2008	2009	2010	2011	2012	2013	2014
Bulgaria	4400	4600	5400	8200	10000	10900	10300	10700	11300	11300	11400	11700
Cyprus	10600	12800	16700	20300	23100	24700	23500	24200	24600	24400	24500	25500
Czech Republic	8800	11200	13500	17800	20600	20200	19300	19400	20100	20200	20700	21400
Estonia	5500	5300	8600	13900	17500	17300	14900	15700	17700	18000	18700	19600
Hungary	6800	7500	10300	14200	15400	16000	15200	15800	16300	16100	16400	16900
Latvia	6500	4600	6900	10800	13900	14100	12000	12500	14500	14800	15300	15800
Lithuania	7100	5200	7500	11900	14800	15400	12800	14000	16200	16500	17100	17800
Malta	9500	12700	16200	17600	19000	19700	19300	20100	20700	20900	21300	22200
Poland	4500	6200	9100	11500	13600	14100	14300	15300	16200	16700	17400	18100
Romania	4000	4800	5000	7900	10400	11700	11000	11400	13300	13400	13800	14200
Slovakia	5800	7000	9600	13500	16900	18100	17000	17900	18900	19200	19800	20600
Slovenia	8500	10900	15300	19700	22100	22700	20500	20700	21000	20800	21100	21400
NMS-12	5400	6500	8600	11800	14100	14700	14200	14900	16000	16200	16700	17300
Croatia	7000	6700	9500	12800	15200	15800	14600	14500	14800	14600	14700	15000
Macedonia	4300	4000	5100	6600	7700	8400	8500	8900	9500	9700	10000	10400
Montenegro	.	.	5600	6900	10000	10700	9700	10100	10500	10600	10800	11100
Turkey	3800	4400	8000	9500	11300	11700	10900	11900	13000	13400	14100	14800
Albania	1400	2000	3500	5000	5800	6400	6500	6600	6800	6900	7100	7300
Bosnia & Herzeg.	.	.	3900	5200	6300	6700	6400	6600	6800	6800	6900	7000
Serbia	.	.	5000	7100	8200	9000	8400	8400	8700	8700	8800	9000
Kazakhstan	.	3100	4200	7300	8800	8900	8500	9300	10000	10600	11100	11700
Russia	7600	5300	6600	10000	12500	13100	11900	12600	13400	14000	14600	15200
Ukraine	4700	2600	2800	4700	5800	6000	5100	5400	5800	6000	6300	6600
Austria	18700	19700	25100	28200	30900	31100	29300	30800	32100	32400	33000	33700
Germany	18200	18900	22400	26000	28900	29000	27200	28800	30100	30300	30800	31400
Greece	12200	12300	16000	20400	22500	23100	22100	21900	20700	19700	19700	20100
Ireland	12400	15200	25100	32600	36900	33300	30000	31100	31700	31900	32500	33200
Italy	16800	17800	22400	23700	26000	26100	24300	24600	24900	24600	24700	25200
Portugal	10600	11300	15500	17900	19600	19500	18800	19600	19500	18900	19000	19400
Spain	12800	13400	18500	22900	26200	25900	24200	24500	25000	24600	24500	25000
USA	21400	23300	30600	35700	37700	36700	34200	36100	37000	37700	38500	39300
EU-27 average	13700	14700	19000	22500	25000	25000	23500	24400	25200	25200	25500	26100
European Union (27) average = 100												
	1991	1995	2000	2005	2007	2008	2009	2010	2011	2012	2013	2014
Bulgaria	32	31	28	36	40	44	44	44	45	45	45	45
Cyprus	77	87	88	90	92	99	100	99	98	97	96	98
Czech Republic	64	76	71	79	82	81	82	80	80	80	81	82
Estonia	40	36	45	62	70	69	63	64	70	71	73	75
Hungary	50	51	54	63	62	64	65	65	65	64	64	65
Latvia	47	31	36	48	56	56	51	51	58	59	60	61
Lithuania	52	35	39	53	59	62	54	57	64	65	67	68
Malta	69	86	85	78	76	79	82	82	82	83	84	85
Poland	33	42	48	51	54	56	61	63	64	66	68	69
Romania	29	33	26	35	42	47	47	47	53	53	54	54
Slovakia	42	48	51	60	68	72	72	73	75	76	78	79
Slovenia	62	74	81	88	88	91	87	85	83	83	83	82
NMS-12	39	44	45	52	56	59	60	61	63	64	65	66
Croatia	51	46	50	57	61	63	62	59	59	58	58	57
Macedonia	31	27	27	29	31	34	36	36	38	38	39	40
Montenegro	.	.	29	31	40	43	41	41	42	42	42	43
Turkey	28	30	42	42	45	47	46	49	52	53	55	57
Albania	10	14	18	22	23	26	28	27	27	27	28	28
Bosnia & Herzeg.	.	.	21	23	25	27	27	27	27	27	27	27
Serbia	.	.	26	32	33	36	36	34	35	35	35	34
Kazakhstan	.	21	22	32	35	36	36	38	40	42	44	45
Russia	55	36	35	44	50	52	51	52	53	56	57	58
Ukraine	34	18	15	21	23	24	22	22	23	24	25	25
Austria	136	134	132	125	124	124	125	126	127	129	129	129
Germany	133	129	118	116	116	116	116	118	119	120	121	120
Greece	89	84	84	91	90	92	94	90	82	78	77	77
Ireland	91	103	132	145	148	133	128	127	126	127	127	127
Italy	123	121	118	105	104	104	103	101	99	98	97	97
Portugal	77	77	82	80	78	78	80	80	77	75	75	74
Spain	93	91	97	102	105	104	103	100	99	98	96	96
USA	156	159	161	159	151	147	146	148	147	150	151	151
EU-27 average	100	100	100	100	100	100	100	100	100	100	100	100

Note: From 2011 data may be affected by new population census data.

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

Table A/2

Indicators of macro-competitiveness, 2005-2014

EUR based, annual averages

	2005	2008	2009	2010	2011	2012	2013	2014
							Forecast	
Bulgaria								
Producer price index, 2005=100	100.0	133.8	125.1	135.9	148.6	153.1	157.6	162.3
Consumer price index, 2005=100	100.0	129.4	132.6	136.6	141.2	145.4	149.8	154.3
GDP deflator, 2005=100	100.0	126.6	132.0	135.7	142.5	146.7	151.1	155.6
Exchange rate (ER), NC/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2005=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2005=100	100.0	119.3	121.1	122.2	122.5	123.0	124.3	125.5
Real ER (PPI-based), 2005=100	100.0	117.7	115.0	120.7	125.0	126.3	127.7	129.0
PPP, NC/EUR	0.7156	0.8355	0.8712	0.8729	0.9033	0.91	0.92	0.93
Price level, EU27 = 100	37	43	45	45	46	47	47	48
Average monthly gross wages, NC	324	545	609	648	707	740	780	820
Average monthly gross wages, EUR (ER)	166	279	311	331	361	380	400	420
Average monthly gross wages, EUR (PPP)	452	652	699	742	782	810	840	880
GDP nominal, NC mn	45484	69295	68322	70511	75265	77900	81400	85500
Employed persons - LFS, th., average	2982	3361	3254	3053	2950	2920	2950	3000
GDP per employed person, NC	15253	20619	20999	23097	25517	26700	27600	28500
GDP per empl. person, NC at 2000 pr.	12001	12815	12514	13390	14090	14300	14400	14400
Unit labour costs, NC, 2005=100	100.0	157.6	180.5	179.5	185.9	191.9	200.8	211.1
Unit labour costs, ER adj., 2005=100	100.0	157.6	180.5	179.5	185.9	191.9	200.8	211.1
Unit labour costs, PPP adj., Austria=100	17.5	25.4	27.5	27.4	28.1	28.2	29.2	30.2
Czech Republic								
Producer price index, 2005=100	100.0	103.2	101.6	101.7	105.5	107.5	108.9	110.4
Consumer price index, 2005=100	100.0	111.7	112.4	113.7	116.2	119.9	122.3	124.8
GDP deflator, 2005=100	100.0	105.8	107.9	106.0	105.2	107.2	108.7	110.1
Exchange rate (ER), NC/EUR	29.78	24.95	26.44	25.28	24.59	25	24.75	24.75
ER nominal, 2005=100	100.0	83.8	88.8	84.9	82.6	83.9	83.1	83.1
Real ER (CPI-based), 2005=100	100.0	123.0	115.6	119.8	122.1	120.8	122.1	122.1
Real ER (PPI-based), 2005=100	100.0	108.4	105.2	106.4	107.4	105.7	106.2	105.5
PPP, NC/EUR	17.10	18.24	18.46	18.47	18.07	18.1	18.0	17.9
Price level, EU27 = 100	57	73	70	73	73	72	73	72
Average monthly gross wages, NC	18344	22592	23344	23864	24436	25100	25700	26500
Average monthly gross wages, EUR (ER)	616	906	883	944	994	1000	1040	1070
Average monthly gross wages, EUR (PPP)	1073	1238	1265	1292	1352	1390	1430	1480
GDP nominal, NC bn	3116	3848	3739	3775	3809	3870	3980	4130
Employed persons - LFS, th., average	4764	5003	4934	4885	4904	4900	4910	4930
GDP per employed person, NC	654084	769298	757803	772791	776776	789800	810600	837700
GDP per empl. person, NC at 2000 pr.	581925	647012	624734	648314	656616	655200	663700	676800
Unit labour costs, NC, 2005=100	100.0	110.8	118.5	116.8	118.1	121.5	122.8	124.2
Unit labour costs, ER adj., 2005=100	100.0	132.2	133.5	137.5	143.0	144.8	147.8	149.5
Unit labour costs, PPP adj., Austria=100	35.5	43.2	41.2	42.6	43.8	43.0	43.5	43.3
Estonia								
Producer price index, 2005=100	100.0	121.7	122.6	126.6	132.0	136.7	142.0	148.0
Consumer price index, 2005=100	100.0	123.3	123.6	127.0	133.4	138.5	143.7	149.5
GDP deflator, 2005=100	100.0	127.9	126.6	127.9	132.8	137.6	142.9	148.9
Exchange rate (ER), NC/EUR	1.000	1.000	1.000	1.000	1.0	1.0	1.0	1.0
ER, nominal, 2005=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2005=100	100.0	113.7	112.8	113.5	115.7	117.1	119.3	121.6
Real ER (PPI-based), 2005=100	100.0	107.1	112.6	112.5	111.0	112.9	115.1	117.6
PPP, NC/EUR	0.5997	0.7020	0.6922	0.6808	0.6962	0.71	0.72	0.74
Price level, EU27 = 100	60	70	69	68	70	71	72	74
Average monthly gross wages, NC	516	825	784	792	831	890	950	1030
Average monthly gross wages, EUR (ER)	516	825	784	792	831	890	950	1030
Average monthly gross wages, EUR (PPP)	860	1176	1132	1164	1193	1260	1320	1400
GDP nominal, NC mn	11182	16304	13840	14305	15973	16900	18200	19800
Employed persons - LFS, th., average	607.4	656.5	595.8	570.9	609.1	625	640	655
GDP per employed person, NC	18409	24835	23229	25057	26224	27000	28400	30200
GDP per empl. person, NC at 2000 pr.	14326	15116	14277	15242	15372	15300	15500	15800
Unit labour costs, NC, 2005=100	100.0	151.6	152.4	144.3	150.1	161.5	170.2	181.0
Unit labour costs, ER adj., 2005=100	100.0	151.6	152.4	144.3	150.1	161.5	170.2	181.0
Unit labour costs, PPP adj., Austria=100	38.7	54.0	51.3	48.7	50.1	52.3	54.6	57.1

(Table A/2 ctd.)

(Table A/2 ctd.)

	2005	2008	2009	2010	2011	2012	2013	2014
							Forecast	
Hungary								
Producer price index, 2005=100	100.0	111.9	116.9	124.3	127.4	132.9	136.8	141.0
Consumer price index, 2005=100	100.0	119.1	123.9	129.7	134.8	142.2	147.9	153.4
GDP deflator, 2005=100	100.0	114.9	119.0	122.6	126.7	132.1	136.0	140.2
Exchange rate (ER), NC/EUR	248.05	251.51	280.33	275.48	279.37	295	290	290
ER, nominal 2005=100	100.0	101.4	113.0	111.1	112.6	118.9	116.9	116.9
Real ER (CPI-based), 2005=100	100.0	108.3	100.1	104.5	103.8	101.1	105.0	106.7
Real ER (PPI-based), 2005=100	100.0	97.1	95.1	99.5	95.1	92.3	94.9	95.8
PPP, NC/EUR	153.62	165.55	168.29	169.20	172.63	176.8	178.7	180.5
Price level, EU27 = 100	62	66	60	61	62	60	62	62
Average monthly gross wages, NC	158343	198741	199837	202525	213054	221400	230300	243100
Average monthly gross wages, EUR (ER)	638	790	713	735	763	750	790	840
Average monthly gross wages, EUR (PPP)	1031	1200	1187	1197	1234	1250	1290	1350
GDP nominal, NC bn	22018	26546	25623	26748	28080	29000	30300	32000
Employed persons - LFS, th., average	3902	3879	3782	3781	3812	3810	3830	3850
GDP per employed person, NC	5643543	6842720	6775310	7073855	7366490	7611500	7911200	8311700
GDP per empl. person, NC at 2000 pr.	4113370	4341828	4151538	4205622	4238487	4198200	4238900	4322300
Unit labour costs, NC, 2005=100	100.0	118.9	125.0	125.1	130.6	137.0	141.1	146.1
Unit labour costs, ER adj., 2005=100	100.0	117.3	110.6	112.6	115.9	115.2	120.7	125.0
Unit labour costs, PPP adj., Austria=100	39.5	42.7	38.0	38.8	39.5	38.1	39.5	40.3
Latvia								
Producer price index, 2005=100	100.0	142.7	136.2	140.0	150.4	154.1	158.2	164.0
Consumer price index, 2005=100	100.0	135.2	139.6	137.9	143.7	147.2	151.3	156.6
GDP deflator, 2005=100	100.0	151.7	149.9	146.5	154.5	158.3	162.5	168.4
Exchange rate (ER), NC/EUR	0.6962	0.7027	0.7057	0.7087	0.7063	0.71	0.71	0.71
ER, nominal, 2005=100	100.0	100.9	101.4	101.8	101.5	102.0	102.0	102.0
Real ER (CPI-based), 2005=100	100.0	123.6	125.8	121.2	122.9	122.0	123.1	124.9
Real ER (PPI-based), 2005=100	100.0	124.4	123.4	122.2	124.7	124.7	125.7	127.8
PPP, NC/EUR	0.3607	0.5051	0.4814	0.4543	0.4720	0.47	0.48	0.49
Price level, EU27 = 100	52	72	68	64	67	67	67	68
Average monthly gross wages, NC	246	479	461	445	464	490	520	560
Average monthly gross wages, EUR (ER)	353	682	653	628	657	690	730	790
Average monthly gross wages, EUR (PPP)	681	948	958	979	983	1030	1090	1150
GDP nominal, NC mn	9000	16085	13070	12739	14161	14900	15800	17000
Employed persons - LFS, th., average	1034	1125	983	941	971	880	890	900
GDP per employed person, NC	8707	14304	13295	13539	14591	16900	17800	18900
GDP per empl. person, NC at 2000 pr.	6776	7339	6903	7190	7351	8300	8500	8700
Unit labour costs, NC, 2005=100	100.0	180.0	184.1	170.6	174.0	162.8	168.7	177.5
Unit labour costs, ER adj., 2005=100	100.0	178.3	181.7	167.6	171.6	159.6	165.4	174.0
Unit labour costs, PPP adj., Austria=100	30.6	50.3	48.4	44.8	45.3	40.9	42.0	43.5
Lithuania								
Producer price index, 2005=100	100.0	135.7	117.3	129.5	147.5	151.9	156.4	162.2
Consumer price index, 2005=100	100.0	122.0	127.1	128.6	133.9	137.9	142.1	147.0
GDP deflator, 2005=100	100.0	127.1	122.4	124.8	131.4	135.4	139.4	144.5
Exchange rate (ER), NC/EUR	3.453	3.453	3.453	3.453	3.453	3.45	3.45	3.45
ER, nominal, 2005=100	100.0	100.0	100.0	100.0	100.0	99.9	99.9	99.9
Real ER (CPI-based), 2005=100	100.0	112.5	116.1	115.0	116.2	116.7	118.0	119.7
Real ER (PPI-based), 2005=100	100.0	119.4	107.8	115.0	124.0	125.5	126.9	129.0
PPP, NC/EUR	1.776	2.171	2.150	2.062	2.141	2.16	2.19	2.23
Price level, EU27 = 100	51	63	62	60	62	63	63	64
Average monthly gross wages, NC	1276	2152	2056	1988	2042	2190	2330	2510
Average monthly gross wages, EUR (ER)	370	623	595	576	591	630	680	730
Average monthly gross wages, EUR (PPP)	719	991	956	964	954	1010	1060	1130
GDP nominal, NC mn	72402	112084	91914	95074	106019	112500	120000	129400
Employed persons - LFS, th., average	1474	1520	1416	1344	1371	1390	1405	1420
GDP per employed person, NC	49123	73739	64916	70756	77336	80900	85400	91100
GDP per empl. person, NC at 2000 pr.	45400	53629	49030	52412	54385	55200	56600	58300
Unit labour costs, NC, 2005=100	100.0	142.7	149.2	134.9	133.6	141.1	146.4	153.2
Unit labour costs, ER adj., 2005=100	100.0	142.7	149.2	134.9	133.6	141.3	146.6	153.3
Unit labour costs, PPP adj., Austria=100	29.1	38.3	37.8	34.3	33.6	34.5	35.4	36.4

(Table A/2 ctd.)

(Table A/2 ctd.)

	2005	2008	2009	2010	2011	2012	2013	2014
							Forecast	
Poland								
Producer price index, 2005=100	100.0	106.4	110.5	113.1	121.6	126.4	130.2	133.5
Consumer price index, 2005=100	100.0	108.3	112.6	115.6	120.1	124.7	128.4	131.6
GDP deflator, 2005=100	100.0	108.7	112.8	114.4	118.1	122.6	125.7	129.0
Exchange rate (ER), NC/EUR	4.023	3.512	4.328	3.995	4.121	4.15	4.15	4.15
ER, nominal, 2005=100	100.0	87.3	107.6	99.3	102.4	103.2	103.2	103.2
Real ER (CPI-based), 2005=100	100.0	114.4	95.6	104.1	101.7	102.2	103.3	103.8
Real ER (PPI-based), 2005=100	100.0	107.2	94.4	101.2	99.8	101.2	102.3	102.8
PPP, PLN/EUR	2.233	2.375	2.470	2.425	2.465	2.51	2.53	2.55
Price level, EU27 = 100	56	68	57	61	60	61	61	61
Average monthly gross wages, NC	2361	2942	3102	3224	3400	3560	3690	3900
Average monthly gross wages, EUR (ER)	587	838	717	807	825	860	890	940
Average monthly gross wages, EUR (PPP)	1057	1239	1256	1330	1379	1420	1460	1530
GDP nominal, NC bn	983	1275	1344	1416	1525	1620	1700	1790
Employed persons - LFS, th., average	14116	15800	15868	15961	16131	16210	16370	16530
GDP per employed person, NC	69661	80725	84723	88747	94521	99900	103800	108300
GDP per empl. person, NC at 2000 pr.	61375	65417	66190	68320	70538	71800	72800	74000
Unit labour costs, NC, 2005=100	100.0	116.9	121.8	122.7	125.3	128.9	131.8	137.0
Unit labour costs, ER adj., 2005=100	100.0	133.9	113.3	123.6	122.3	125.0	127.8	132.8
Unit labour costs, PPP adj., Austria=100	41.5	51.2	40.9	44.8	43.8	43.5	44.0	45.0
Romania								
Producer price index, 2005=100	100.0	135.7	138.2	147.0	160.1	169.7	179.9	189.0
Consumer price index, 2005=100	100.0	120.7	127.4	135.2	143.0	148.0	154.0	160.1
GDP deflator, 2005=100	100.0	144.7	150.8	159.9	172.8	183.1	194.2	204.0
Exchange rate (ER), NC/EUR	3.621	3.683	4.240	4.212	4.239	4.3	4.3	4.2
ER, nominal, 2005=100	100.0	101.7	117.1	116.3	117.1	118.8	118.8	116.0
Real ER (CPI-based), 2005=100	100.0	109.5	99.4	103.9	106.0	105.4	107.6	112.3
Real ER (PPI-based), 2005=100	100.0	117.5	108.4	112.3	115.0	117.9	122.8	129.5
PPP, NC/EUR	1.700	2.042	2.113	2.144	2.284	2.38	2.47	2.55
Price level, EU27 = 100	47	55	50	51	54	55	58	61
Average monthly gross wages, NC	968	1761	1845	1902	1995	2090	2220	2380
Average monthly gross wages, EUR (ER)	267	478	435	452	471	490	520	570
Average monthly gross wages, EUR (PPP)	569	862	873	887	873	880	900	930
GDP nominal, NC mn	288955	514700	501139	522561	578552	619400	673100	728300
Employed persons - LFS, th., average	9115	9369	9244	9239	9138	9150	9150	9200
GDP per employed person, NC	31702	54936	54215	56558	63315	67700	73600	79200
GDP per empl. person, NC at 2000 pr.	11733	14054	13308	13092	13564	13700	14000	14400
Unit labour costs, NC, 2005=100	100.0	151.9	168.0	176.1	178.3	184.9	192.2	200.3
Unit labour costs, ER adj., 2005=100	100.0	149.3	143.5	151.4	152.3	155.7	161.8	172.7
Unit labour costs, PPP adj., Austria=100	34.0	46.8	42.4	44.9	44.7	44.3	45.6	47.9
Slovakia								
Producer price index, 2005=100	100.0	104.1	97.2	97.3	101.6	104.6	107.8	111.0
Consumer price index, 2005=100	100.0	110.4	111.4	112.2	116.8	120.9	124.5	128.2
GDP deflator, 2005=100	100.0	107.1	105.8	106.3	108.0	112.5	115.8	119.3
Exchange rate (ER), NC/EUR	1.2813	1.0377	1.0	1.0	1.0	1.0	1.0	1.0
ER, nominal, 2005=100	100.0	81.0	78.0	78.0	78.0	78.0	78.0	78.0
Real ER (CPI-based), 2005=100	100.0	125.7	130.4	128.6	129.8	131.0	132.4	133.7
Real ER (PPI-based), 2005=100	100.0	113.1	114.4	110.8	109.4	110.7	111.9	113.0
PPP NC/ EUR	0.6761	0.6813	0.6810	0.6758	0.6770	0.69	0.70	0.71
Price level, EU27 = 100	53	66	68	68	68	69	70	71
Average monthly gross wages, NC	573	723	745	769	786	820	860	910
Average monthly gross wages, EUR (ER)	448	697	745	769	786	820	860	910
Average monthly gross wages, EUR (PPP)	848	1061	1093	1138	1161	1180	1230	1290
GDP nominal, NC mn	49314	66842	62795	65744	69058	73000	77400	82900
Employed persons - LFS, th., average	2215	2434	2366	2318	2351	2360	2400	2440
GDP per employed person, NC	22262	27465	26537	28368	29369	30900	32300	34000
GDP per empl. person, NC at 2000 pr.	17881	20604	20150	21426	21836	22100	22400	22900
Unit labour costs, NC, 2005=100	100.0	109.4	115.2	111.9	112.3	115.7	119.7	123.9
Unit labour costs, ER adj., 2005=100	100.0	135.1	147.6	143.4	143.8	148.2	153.4	158.8
Unit labour costs, PPP adj., Austria=100	31.0	38.6	39.9	38.8	38.5	38.5	39.5	40.2

(Table A/2 ctd.)

(Table A/2 ctd.)

	2005	2008	2009	2010	2011	2012	2013	2014
							Forecast	
Slovenia								
Producer price index, 2005=100	100.0	110.9	109.4	111.5	116.6	118.4	120.7	124.4
Consumer price index, 2005=100	100.0	112.3	113.3	115.6	118.0	120.4	122.8	125.3
GDP deflator, 2005=100	100.0	110.7	114.1	112.8	113.7	115.4	116.6	118.9
Exchange rate (ER), NC/EUR	0.9997	1.0	1.0	1.0	1.0	1.0	1.0	1.0
ER, nominal, 2005=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2005=100	100.0	103.5	103.4	103.4	102.4	101.8	101.9	101.9
Real ER (PPI-based), 2005=100	100.0	97.6	100.4	99.1	98.0	97.7	97.8	98.8
PPP, NC/EUR	0.7306	0.8114	0.8451	0.8339	0.8286	0.83	0.82	0.82
Price level, EU27 = 100	73	81	85	83	83	83	82	82
Average monthly gross wages, NC	1157	1391	1439	1495	1525	1560	1590	1630
Average monthly gross wages, EUR (ER)	1157	1391	1439	1495	1525	1560	1590	1630
Average monthly gross wages, EUR (PPP)	1584	1715	1703	1793	1840	1890	1940	1990
GDP nominal, NC mn	28722	37280	35311	35416	35639	35810	36710	38010
Employed persons - LFS, th., average	949	996	981	966	936	930	920	930
GDP per employed person, NC	30259	37425	36006	36662	38071	38500	39900	40900
GDP per empl. person, NC at 2000 pr.	23366	26099	24377	25094	25846	25800	26400	26600
Unit labour costs, NC, 2005=100	100.0	107.7	119.2	120.3	119.1	122.1	121.6	123.7
Unit labour costs, ER adj., 2005=100	100.0	107.6	119.2	120.3	119.1	122.1	121.6	123.7
Unit labour costs, PPP adj., Austria=100	62.1	61.6	64.4	65.2	63.8	63.5	62.6	62.7
Croatia								
Producer price index, 2005=100	100.0	115.1	114.6	119.5	127.1	132.2	136.2	140.3
Consumer price index, 2005=100	100.0	112.7	115.4	116.6	119.3	122.3	125.2	127.7
GDP deflator, 2005=100	100.0	114.4	117.7	118.8	121.3	124.4	127.4	129.9
Exchange rate (ER), NC/EUR	7.400	7.223	7.340	7.286	7.434	7.5	7.45	7.45
ER, nominal, 2005=100	100.0	97.6	99.2	98.5	100.5	101.4	100.7	100.7
Real ER (CPI-based), 2005=100	100.0	106.5	106.2	106.0	103.0	102.0	103.2	103.2
Real ER (PPI-based), 2005=100	100.0	103.8	106.2	107.9	106.4	107.7	109.6	110.7
PPP, NC/EUR	4.677	4.900	5.066	5.093	5.122	5.15	5.18	5.18
Price level, EU27 = 100	63	68	69	70	69	69	70	70
Average monthly gross wages, NC	6248	7544	7711	7679	7796	7950	8180	8430
Average monthly gross wages, EUR (ER)	844	1044	1051	1054	1049	1060	1100	1130
Average monthly gross wages, EUR (PPP)	1336	1539	1522	1508	1522	1540	1580	1630
GDP nominal, NC mn	266652	343412	328672	326980	333956	337200	348700	362800
Employed persons - LFS, th., average	1573	1636	1605	1541	1493	1480	1480	1490
GDP per employed person, NC	169518	209974	204742	212159	223756	227800	235600	243500
GDP per empl. person, NC at 2000 pr.	140854	152464	144541	148436	153226	152200	153700	155800
Unit labour costs, NC, 2005=100	100.0	111.5	120.3	116.6	114.7	117.8	120.0	122.0
Unit labour costs, ER adj., 2005=100	100.0	114.3	121.3	118.4	114.2	116.2	119.2	121.2
Unit labour costs, PPP adj., Austria=100	52.1	54.9	55.0	53.8	51.3	50.7	51.5	51.5
Macedonia								
Producer price index, 2005=100	100.0	120.5	111.9	121.6	135.1	139.2	143.3	147.6
Consumer price index, 2005=100	100.0	114.3	113.4	115.2	119.7	123.3	127.0	130.8
GDP deflator, 2005=100	100.0	119.3	120.1	123.3	127.7	131.5	135.5	139.5
Exchange rate (ER), NC/EUR	61.30	61.27	61.27	61.52	61.53	61.5	61.5	61.5
ER, nominal, 2005=100	100.0	100.0	100.0	100.4	100.4	100.3	100.3	100.3
Real ER (CPI-based), 2005=100	100.0	105.5	103.6	102.7	103.5	103.9	105.0	106.1
Real ER (PPI-based), 2005=100	100.0	106.1	102.8	107.6	113.2	114.5	115.8	116.9
PPP, NC/EUR	21.97	23.93	23.59	23.83	23.63	23.9	24.2	24.4
Price level, EU27 = 100	36	39	38	39	38	39	39	40
Average monthly gross wages, NC ¹⁾	21330	26229	29922	30225	30602	31500	33100	34800
Average monthly gross wages, EUR (ER)	348	428	488	491	497	510	540	570
Average monthly gross wages, EUR (PPP)	971	1096	1269	1268	1295	1320	1370	1430
GDP nominal, NC mn	295052	411728	410734	434112	463393	486400	516000	549000
Employed persons - LFS, th., average	545.3	609.0	629.9	637.9	645.1	650	660	670
GDP per employed person, NC	541129	676056	652061	680581	718344	748300	781800	819400
GDP per empl. person, NC at 2000 pr.	481346	504256	482973	490827	500379	506000	513300	522300
Unit labour costs, NC, 2005=100	100.0	117.4	139.8	139.0	138.0	140.5	145.5	150.4
Unit labour costs, ER adj., 2005=100	100.0	117.4	139.9	138.5	137.5	140.0	145.0	149.9
Unit labour costs, PPP adj., Austria=100	33.8	36.5	41.1	40.8	40.1	39.6	40.6	41.3

1) From 2009 including allowances for food and transport.

(Table A/2 ctd.)

(Table A/2 ctd.)

	2005	2008	2009	2010	2011	2012	2013	2014
							Forecast	
Montenegro								
Producer price index, 2005=100	100.0	128.1	123.1	122.0	125.9	128.5	133.4	136.7
Consumer price index, 2005=100	100.0	115.3	119.2	119.8	123.5	127.2	131.0	135.0
GDP deflator, 2005=100	100.0	132.3	135.5	137.7	143.5	146.4	152.0	155.8
Exchange rate (ER), EUR/EUR	1	1	1	1	1	1	1	1
Real ER (CPI-based), 2005=100	100.0	106.3	108.8	107.1	107.1	107.6	108.7	109.8
Real ER (PPI-based), 2005=100	100.0	109.5	114.4	114.2	112.7	112.4	113.3	112.8
PPP, NC/EUR	0.4199	0.4596	0.4884	0.4964	0.5047	0.51	0.52	0.52
Price level, EU27 = 100	42	46	49	50	50	51	52	52
Average monthly gross wages, NC	326	609	643	715	722	760	810	860
Average monthly gross wages, EUR (PPP)	777	1325	1316	1440	1431	1500	1570	1660
GDP nominal, NC mn	1815.0	3085.6	2981.0	3103.9	3300	3400	3600	3800
Employed persons - LFS, th., average	178.8	218.8	212.9	208.2	196.0	196	198	210
GDP per employed person, NC	10150	14102	14002	14912	16837	17300	18200	18100
GDP per empl. person, NC at 2000 pr.	6846	7187	6968	7303	7911	8000	8100	7800
Unit labour costs, NC, 2005=100	100.0	177.7	193.5	205.3	191.4	199.2	209.7	231.2
Unit labour costs, PPP adj., Austria=100	30.3	49.7	51.1	54.3	50.1	50.6	52.7	57.2
Albania								
Producer price index, 2005=100	100.0	111.1	109.2	109.5	112.2	114.5	119.1	123.8
Consumer price index, 2005=100	100.0	108.9	111.4	115.3	119.4	121.2	126.0	131.1
GDP deflator, 2005=100	100.0	111.4	114.0	117.3	120.5	122.4	127.0	132.4
Exchange rate (ER), NC/EUR	124.2	122.8	132.1	137.8	140.3	140	136	133
ER, nominal, 2005=100	100.0	98.9	106.3	111.0	113.0	112.7	109.5	107.1
Real ER (CPI-based), 2005=100	100.0	101.6	95.7	93.0	91.7	90.9	95.5	99.6
Real ER (PPI-based), 2005=100	100.0	98.8	94.4	87.7	83.5	83.8	88.1	91.9
PPP, NC/EUR	52.13	53.48	55.39	57.83	58.55	58.4	59.5	60.8
Price level, EU27 = 100	42	44	42	42	42	42	44	46
Average monthly gross wages, NC	19993	34277	36075	38492	41030	42500	46000	50200
Average monthly gross wages, EUR (ER)	161	279	273	279	292	300	340	380
Average monthly gross wages, EUR (PPP)	384	641	651	666	701	730	770	830
GDP nominal, NC bn	815	1089	1151	1220	1290	1340	1430	1540
Employed persons - LFS, th., Oct ²⁾	932	1123	1161	1200	1200	1180	1200	1220
GDP per employed person, NC	874565	969738	991831	1016667	1075000	1135600	1191700	1262300
GDP per empl. person, NC at 2000 pr.	746612	742980	742889	739965	761418	792100	800800	813600
Unit labour costs, NC, 2005=100	100.0	172.3	181.3	194.3	201.2	200.4	214.5	230.4
Unit labour costs, ER adj., 2005=100	100.0	174.2	170.5	175.1	178.1	177.7	195.9	215.1
Unit labour costs, PPP adj., Austria=100	21.6	34.6	32.0	32.9	33.1	32.1	35.0	37.8
Bosnia and Herzegovina								
Producer price index, 2007=100	.	102.4	99.1	100.0	103.7	105.8	107.9	110.0
Consumer price index, 2005=100	100.0	115.9	115.4	117.8	122.2	124.6	127.1	129.7
GDP deflator, 2005=100	100.0	121.1	121.2	123.0	127.8	130.4	132.8	135.5
Exchange rate (ER), NC/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2005=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2005=100	100.0	106.9	105.4	105.4	106.0	105.4	105.5	105.5
Real ER (PPI-based), 2007=100	.	96.4	97.4	95.1	93.3	93.4	93.6	93.6
PPP, NC/EUR	0.8579	0.9658	0.9842	0.9742	0.9972	1.00	1.00	1.00
Price level, EU27 = 100	44	49	50	50	51	51	51	51
Average monthly gross wages, NC	796	1113	1204	1217	1270	1300	1340	1380
Average monthly gross wages, EUR (ER)	407	569	615	622	649	660	690	710
Average monthly gross wages, EUR (PPP)	928	1152	1223	1249	1274	1300	1340	1380
GDP nominal, NC mn	17218	24759	24051	24584	26100	26500	27400	28500
Employed persons - LFS, th., April ³⁾	641.5	890.2	859.2	842.8	816.0	810	810	812
GDP per employed person, NC	26839	27812	27992	29168	31984	32700	33800	35100
GDP per empl. person, NC at 2000 pr.	22653	19377	19491	20014	21123	21200	21500	21900
Unit labour costs, NC, 2005=100	100.0	163.4	175.6	172.9	171.0	174.4	177.3	179.2
Unit labour costs, ER adj., 2005=100	100.0	163.4	175.6	172.9	171.0	174.4	177.3	179.2
Unit labour costs, PPP adj., Austria=100	29.2	44.0	44.7	44.1	43.1	42.7	43.0	42.8

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

(Table A/2 ctd.)

(Table A/2 ctd.)

	2005	2008	2009	2010	2011	2012	2013	2014
							Forecast	
Serbia								
Producer price index, 2005=100	100.0	134.9	142.3	160.4	183.2	192.3	202.0	209.3
Consumer price index, 2005=100	100.0	135.7	147.3	157.4	174.7	185.1	194.4	204.1
GDP deflator, 2005=100	100.0	139.5	147.8	155.0	168.1	176.5	185.3	192.0
Exchange rate (ER), NC/EUR	82.91	81.47	93.94	102.90	102.93	115	120	128
ER, nominal, 2005=100	100.0	98.3	113.3	124.1	124.2	138.7	144.7	154.4
Real ER (CPI-based), 2005=100	100.0	127.3	118.7	113.4	122.0	112.9	111.4	107.6
Real ER (PPI-based), 2005=100	100.0	120.8	115.4	114.9	124.1	114.5	113.1	107.8
PPP, NC/EUR	31.73	40.16	44.35	46.92	50.13	51.7	53.3	54.1
Price level, EU27 = 100	38	49	47	46	49	45	44	42
Average monthly gross wages, NC	25514	45674	44147	47450	52733	55900	59280	62870
Average monthly gross wages, EUR (ER)	308	561	470	461	512	490	490	490
Average monthly gross wages, EUR (PPP)	804	1137	995	1011	1052	1080	1110	1160
GDP nominal, NC bn	1683	2661	2720	2882	3175	3300	3500	3700
Employed persons - LFS, th., average	2733	2822	2616	2396	2253	2150	2100	2100
GDP per employed person, NC	615891	943178	1039614	1202670	1409113	1534900	1666700	1761900
GDP per empl. person, NC at 2000 pr.	182488	200289	208429	229904	248420	257700	266500	271800
Unit labour costs, NC, 2005=100	100.0	163.1	151.5	147.6	151.8	155.2	159.1	165.4
Unit labour costs, ER adj., 2005=100	100.0	166.0	133.7	118.9	122.3	111.9	109.9	107.2
Unit labour costs, PPP adj., Austria=100	35.6	54.5	41.4	37.0	37.6	33.4	32.5	31.1
Russia								
Producer price index, 2005=100	100.0	155.7	144.5	162.1	192.8	212.1	231.2	249.7
Consumer price index, 2005=100	100.0	136.7	152.8	163.4	177.2	187.9	197.3	207.1
GDP deflator, 2005=100	100.0	154.7	157.7	176.1	204.0	225.4	242.4	259.2
Exchange rate (ER), NC/EUR	35.26	36.43	44.14	40.30	40.87	41	42	43
ER, nominal, 2005=100	100.0	103.3	125.2	114.3	115.9	116.3	119.1	121.9
Real ER (CPI-based), 2005=100	100.0	122.0	111.5	127.8	132.7	136.6	137.4	138.2
Real ER (PPI-based), 2005=100	100.0	132.6	106.0	126.0	139.9	150.6	157.3	162.7
PPP, NC/EUR	15.06	22.13	22.91	25.00	28.54	31.0	32.7	34.3
Price level, EU27 = 100	43	61	52	62	70	75	78	80
Average monthly gross wages, NC	8555	17290	18638	20952	23532	26190	28870	31830
Average monthly gross wages, EUR (ER)	243	475	422	520	576	640	690	740
Average monthly gross wages, EUR (PPP)	568	781	814	838	825	850	880	930
GDP nominal, NC bn	21610	41277	38807	45173	54586	62600	70000	78000
Employed persons - LFS, th., average	68169	70965	69285	69804	70732	70500	70000	70000
GDP per employed person, NC	317003	581650	560111	647137	771725	887900	1000000	1114300
GDP per empl. person, NC at 2000 pr.	144318	171217	161674	167311	172209	179300	187800	195700
Unit labour costs, NC, 2005=100	100.0	170.4	194.5	211.3	230.5	246.4	259.3	274.4
Unit labour costs, ER adj., 2005=100	100.0	164.9	155.4	184.8	198.9	211.9	217.7	225.0
Unit labour costs, PPP adj., Austria=100	25.9	39.3	35.0	41.7	44.4	45.9	46.7	47.5
Ukraine								
Producer price index, 2005=100	100.0	177.5	189.0	228.5	271.9	285.0	304.9	320.1
Consumer price index, 2005=100	100.0	154.1	178.6	195.4	211.0	221.5	237.0	248.9
GDP deflator, 2005=100	100.0	181.1	204.7	232.9	269.5	282.4	302.2	317.3
Exchange rate (ER), NC/EUR	6.389	7.708	10.868	10.533	11.092	11	11.5	11.5
ER, nominal, 2005=100	100.0	120.6	170.1	164.9	173.6	172.2	180.0	180.0
Real ER (CPI-based), 2005=100	100.0	117.8	95.9	106.0	105.4	108.8	109.3	112.5
Real ER (PPI-based), 2005=100	100.0	129.4	102.1	123.2	131.7	136.6	137.3	141.4
PPP, NC/EUR	1.9861	3.4175	3.9206	4.3614	4.9716	5.11	5.37	5.53
Price level, EU27 = 100	31	44	36	41	45	46	47	48
Average monthly gross wages, NC	806	1806	1906	2239	2633	2930	3350	3730
Average monthly gross wages, EUR (ER)	126	234	175	213	237	270	290	320
Average monthly gross wages, EUR (PPP)	406	529	486	513	530	570	620	670
GDP nominal, NC mn	441452	948056	913345	1082569	1316600	1434900	1612100	1777300
Employed persons - LFS, th., average	20680	20972	20192	20266	20324	20300	20350	20400
GDP per employed person, NC	21347	45205	45234	53418	64780	70700	79200	87100
GDP per empl. person, NC at 2000 pr.	11942	13960	12362	12828	13446	14000	14700	15400
Unit labour costs, NC, 2005=100	100.0	191.7	228.4	258.6	290.1	310.0	337.6	358.8
Unit labour costs, ER adj., 2005=100	100.0	158.9	134.2	156.8	167.1	180.0	187.5	199.3
Unit labour costs, PPP adj., Austria=100	26.4	38.6	30.8	36.1	38.0	39.8	41.0	42.9

(Table A/2 ctd.)

(Table A/2 ctd.)

	2005	2008	2009	2010	2011	2012	2013	2014
							Forecast	
Austria								
Producer price index, 2005=100	100.0	114.0	105.5	110.8	120.0	122.2	124.0	125.9
Consumer price index, 2005=100	100.0	107.1	107.6	109.6	113.2	116.0	118.3	120.8
GDP deflator, 2005=100	100.0	105.8	106.9	108.8	111.1	113.1	114.8	116.6
Real ER (CPI-based), 2005=100	100.0	98.7	98.3	98.1	98.2	98.1	98.2	98.2
Real ER (PPI-based), 2005=100	100.0	100.3	97.0	98.5	100.9	100.8	100.5	100.1
PPP, NC/EUR	1.0589	1.0904	1.1226	1.1077	1.1148	1.108	1.104	1.099
Price level, EU27 = 100	106	109	112	111	111	111	110	110
Average monthly gross wages, EUR	2790	3087	3154	3200	3290	3390	3470	3560
Average monthly gross wages, EUR (PPP)	2635	2831	2809	2889	2951	3059	3145	3240
GDP nominal, NC mn	245243	282746	274818	286200	300200	308500	318200	329700
Employed persons - LFS, th., average	3824	4090	4078	4100	4140	4180	4190	4240
GDP per employed person, NC	64126	69131	67395	69800	72500	73800	75900	77800
GDP per empl. person, NC at 2000 pr.	59243	60389	58263	59284	60291	60300	61100	61700
Unit labour costs, NC, 2005=100	100.0	108.5	115.0	114.6	115.9	119.4	120.6	122.5
Unit labour costs, PPP adjusted	0.59	0.64	0.67	0.67	0.68	0.70	0.71	0.72

From 2012 employment data and related indicators (e.g. Unit labour costs) may be affected by new population census data.

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

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

Real exchange rates: Increasing values mean real appreciation.

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

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

Table A/3

Indicators of macro-competitiveness, 2005-2014

annual changes in %

	2005	2008	2009	2010	2011	2012	2013 Forecast	2014	2005-08 average
Bulgaria									
GDP deflator	7.3	8.4	4.3	2.8	5.0	3.0	2.9	3.0	8.0
Exchange rate (ER), EUR/NC	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	3.6	8.0	1.5	0.9	0.3	0.4	1.1	1.0	5.4
Real ER (PPI-based)	3.4	4.4	-2.3	5.0	3.5	1.1	1.1	1.0	5.0
Average gross wages, NC	10.7	26.5	11.8	6.4	9.0	4.7	5.4	5.1	16.8
Average gross wages, real (PPI based)	2.6	14.1	19.5	-2.0	-0.4	1.7	2.4	2.1	6.6
Average gross wages, real (CPI based)	4.4	13.0	9.1	3.3	5.4	1.7	2.3	2.1	8.0
Average gross wages, EUR (ER)	10.6	26.5	11.8	6.4	9.0	5.2	5.3	5.0	16.8
Employed persons (LFS)	2.0	3.3	-3.2	-6.2	-3.4	-1.0	1.0	1.7	3.6
GDP per empl. person, NC at 2000 prices	4.3	2.8	-2.3	7.0	5.2	1.5	0.7	0.0	2.7
Unit labour costs, NC at 2000 prices	6.2	23.1	14.5	-0.6	3.6	3.2	4.7	5.1	13.7
Unit labour costs, ER (EUR) adjusted	6.0	23.1	14.5	-0.6	3.6	3.2	4.7	5.1	13.7
Czech Republic									
GDP deflator	-0.3	1.9	2.0	-1.7	-0.8	1.9	1.3	1.3	1.3
Exchange rate (ER), EUR/NC	7.1	11.3	-5.6	4.6	2.8	-1.6	1.0	0.0	6.3
Real ER (CPI-based)	6.5	14.1	-6.0	3.6	1.9	-1.1	1.1	0.0	7.0
Real ER (PPI-based)	3.3	5.2	-3.0	1.2	0.9	-1.6	0.5	-0.7	2.9
Average gross wages, NC	5.0	7.8	3.3	2.2	2.4	2.7	2.4	3.1	6.6
Average gross wages, real (PPI based)	4.5	7.4	4.9	2.1	-1.3	0.8	1.1	1.8	5.7
Average gross wages, real (CPI based)	3.3	1.4	2.7	1.1	0.2	-0.5	0.4	1.1	3.3
Average gross wages, EUR (ER)	12.5	20.0	-2.5	6.9	5.3	0.6	4.0	2.9	13.4
Employed persons (LFS)	1.2	1.6	-1.4	-1.0	0.4	-0.1	0.2	0.4	1.5
GDP per empl. person, NC at 2000 prices	5.4	1.5	-3.4	3.8	1.3	-0.2	1.3	2.0	4.0
Unit labour costs, NC at 2000 prices	-0.3	6.2	7.0	-1.5	1.1	2.9	1.1	1.1	2.5
Unit labour costs, ER (EUR) adjusted	6.7	18.2	1.0	3.0	4.0	1.3	2.1	1.1	9.0
Estonia									
GDP deflator	6.1	5.3	-1.0	1.0	3.8	3.6	3.8	4.2	7.9
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	1.9	6.7	-0.8	0.6	1.9	1.2	1.9	2.0	3.7
Real ER (PPI-based)	-2.3	1.7	5.2	-0.2	-1.3	1.7	2.0	2.2	1.1
Average gross wages, NC	10.8	13.9	-5.0	1.1	4.9	7.1	6.7	8.4	15.4
Average gross wages, real (PPI based)	8.9	5.4	-5.7	-2.1	0.6	3.4	2.8	4.0	9.4
Average gross wages, real (CPI based)	6.4	3.0	-5.2	-1.6	-0.2	3.2	2.8	4.3	8.4
Average gross wages, EUR (ER)	10.8	13.9	-5.0	1.1	4.9	7.1	6.7	8.4	15.4
Employed persons (LFS)	2.0	0.2	-9.2	-4.2	6.7	2.6	2.4	2.3	2.5
GDP per empl. person, NC at 2000 prices	6.7	-3.8	-5.5	6.8	0.9	-0.5	1.3	1.9	3.0
Unit labour costs, NC at 2000 prices	3.9	18.5	0.6	-5.3	4.0	7.6	5.4	6.4	12.0
Unit labour costs, ER (EUR) adjusted	3.9	18.5	0.6	-5.3	4.0	7.6	5.4	6.4	12.0
Hungary									
GDP deflator	2.5	5.3	3.6	3.1	3.3	4.3	2.9	3.0	4.2
Exchange rate (ER), EUR/NC	1.5	-0.1	-10.3	1.8	-1.4	-5.3	1.7	0.0	0.0
Real ER (CPI-based)	2.7	2.2	-7.6	4.4	-0.6	-2.6	3.8	1.7	2.7
Real ER (PPI-based)	0.4	-1.6	-2.1	4.6	-4.3	-3.0	2.8	1.0	-0.6
Average gross wages, NC	8.8	7.4	0.6	1.3	5.2	3.9	4.0	5.6	8.1
Average gross wages, real (PPI based)	5.5	2.7	-3.8	-4.7	2.6	-0.4	1.1	2.4	4.3
Average gross wages, real (CPI based)	5.1	1.3	-3.3	-3.2	1.2	-1.5	0.0	1.8	2.6
Average gross wages, EUR (ER)	10.4	7.3	-9.8	3.1	3.7	-1.7	5.3	6.3	8.1
Employed persons (LFS)	0.0	-1.2	-2.5	0.0	0.8	0.0	0.5	0.5	-0.1
GDP per empl. person, NC at 2000 prices	3.9	2.1	-4.4	1.3	0.8	-1.0	1.0	2.0	2.3
Unit labour costs, NC at 2000 prices	4.7	5.2	5.2	0.0	4.4	4.9	3.0	3.5	5.6
Unit labour costs, ER (EUR) adjusted	6.3	5.1	-5.7	1.8	2.9	-0.6	4.8	3.5	5.7
Latvia									
GDP deflator	10.1	12.9	-1.2	-2.2	5.4	2.5	2.7	3.7	13.7
Exchange rate (ER), EUR/NC	-4.5	-0.4	-0.4	-0.4	0.3	-0.5	0.0	0.0	-1.4
Real ER (CPI-based)	-0.1	10.7	1.8	-3.7	1.4	-0.7	0.9	1.5	5.4
Real ER (PPI-based)	-1.0	4.5	-0.8	-1.0	2.0	0.1	0.8	1.6	5.4
Average gross wages, NC	16.5	20.5	-3.8	-3.5	4.3	5.6	6.1	7.7	22.8
Average gross wages, real (PPI based)	7.9	8.1	0.9	-6.1	-2.9	3.1	3.4	3.9	10.2
Average gross wages, real (CPI based)	9.0	4.5	-6.8	-2.3	0.0	3.1	3.2	4.1	12.0
Average gross wages, EUR (ER)	11.3	20.0	-4.2	-3.9	4.6	5.0	5.8	8.2	21.1
Employed persons (LFS)	1.6	0.6	-12.6	-4.3	3.1	-9.3	1.1	1.1	2.5
GDP per empl. person, NC at 2000 prices	8.5	-3.8	-5.9	4.2	2.2	12.9	2.4	2.4	4.1
Unit labour costs, NC at 2000 prices	7.4	25.2	2.3	-7.3	2.0	-6.5	3.6	5.2	17.9
Unit labour costs, ER (EUR) adjusted	2.6	24.8	1.9	-7.7	2.3	-7.0	3.6	5.2	16.3

(Table A/3 ctd.)

Table A/3 (ctd.)

	2005	2008	2009	2010	2011	2012	2013 Forecast	2014	2005-08 average
Lithuania									
GDP deflator	6.6	9.7	-3.7	2.0	5.3	3.0	3.0	3.7	7.9
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Real ER (CPI-based)	0.5	7.1	3.1	-0.9	1.0	0.5	1.1	1.5	3.1
Real ER (PPI-based)	7.2	11.2	-9.7	6.7	7.8	1.2	1.1	1.7	6.4
Average gross wages, NC	11.0	19.4	-4.4	-3.3	2.7	7.2	6.4	7.7	17.0
Average gross wages, real (PPI based)	-0.5	1.0	10.5	-12.4	-9.8	4.1	3.3	3.9	5.4
Average gross wages, real (CPI based)	8.2	7.5	-8.3	-4.4	-1.4	4.1	3.3	4.1	10.6
Average gross wages, EUR (ER)	11.0	19.4	-4.4	-3.3	2.7	6.5	7.9	7.4	17.0
Employed persons (LFS)	2.6	-0.9	-6.8	-5.1	2.0	1.4	1.1	1.1	1.4
GDP per empl. person, NC at 2000 prices	5.1	3.9	-8.6	6.9	3.8	1.5	2.5	3.0	5.5
Unit labour costs, NC at 2000 prices	5.7	14.9	4.5	-9.5	-1.0	5.7	3.8	4.6	10.8
Unit labour costs, ER (EUR) adjusted	5.7	14.9	4.5	-9.5	-1.0	5.8	3.8	4.6	10.8
Poland									
GDP deflator	2.6	3.1	3.7	1.5	3.2	3.9	2.5	2.6	2.8
Exchange rate (ER), EUR/NC	12.5	7.7	-18.8	8.3	-3.1	-0.7	0.0	0.0	6.6
Real ER (CPI-based)	12.5	8.3	-16.5	8.9	-2.3	0.5	1.1	0.5	6.5
Real ER (PPI-based)	8.5	3.9	-12.0	7.2	-1.4	1.4	1.1	0.5	3.8
Average gross wages, NC	3.8	10.1	5.4	3.9	5.4	4.7	3.7	5.7	6.7
Average gross wages, real (PPI based)	3.4	7.5	1.5	1.6	-1.9	0.7	0.6	3.1	4.9
Average gross wages, real (CPI based)	1.7	5.6	1.4	1.2	1.5	0.9	0.6	3.1	4.0
Average gross wages, EUR (ER)	16.8	18.6	-14.4	12.6	2.2	4.2	3.5	5.6	13.6
Employed persons (LFS)	2.3	3.7	0.4	0.6	1.1	0.5	1.0	1.0	3.5
GDP per empl. person, NC at 2000 prices	1.3	1.4	1.2	3.2	3.2	1.8	1.4	1.6	1.9
Unit labour costs, NC at 2000 prices	2.5	8.6	4.2	0.7	2.1	2.9	2.2	4.0	4.6
Unit labour costs, ER (EUR) adjusted	15.4	16.9	-15.4	9.1	-1.0	2.2	2.2	4.0	11.5
Romania									
GDP deflator	12.2	15.2	4.2	6.0	8.1	6.0	6.0	5.0	12.9
Exchange rate (ER), EUR/NC	11.9	-9.4	-13.1	0.7	-0.6	-1.4	0.0	2.4	2.4
Real ER (CPI-based)	19.4	-5.8	-9.2	4.6	2.0	-0.6	2.1	4.4	6.9
Real ER (PPI-based)	16.1	-1.7	-7.7	3.5	2.4	2.6	4.1	5.4	8.1
Average gross wages, NC	18.3	26.1	4.8	3.1	4.9	4.8	6.2	7.2	21.1
Average gross wages, real (PPI based)	9.4	9.4	2.9	-3.1	-3.7	-1.2	0.2	2.1	10.0
Average gross wages, real (CPI based)	8.4	16.9	-0.8	-2.8	-0.9	1.2	2.1	3.1	13.1
Average gross wages, EUR (ER)	32.3	14.2	-9.0	3.8	4.2	4.1	6.1	9.6	24.0
Employed persons (LFS)	-0.5	0.2	-1.3	0.0	-1.1	0.1	0.0	0.5	0.6
GDP per empl. person, NC at 2000 prices	4.6	7.2	-5.3	-1.6	3.6	1.0	2.2	2.9	5.8
Unit labour costs, NC at 2000 prices	13.0	17.7	10.6	4.8	1.2	3.7	3.9	4.2	14.5
Unit labour costs, ER (EUR) adjusted	26.5	6.6	-3.9	5.5	0.6	2.2	3.9	6.7	17.2
Slovakia									
GDP deflator	2.4	2.9	-1.2	0.5	1.6	4.1	2.9	3.0	2.3
Exchange rate (ER), EUR/NC	3.7	8.0	3.8	0.0	0.0	0.0	0.0	0.0	6.4
Real ER (CPI-based)	4.3	8.3	3.7	-1.4	1.0	0.9	1.1	1.0	7.0
Real ER (PPI-based)	2.9	4.2	1.2	-3.2	-1.2	1.1	1.1	1.0	3.9
Average gross wages, NC	9.2	8.1	3.0	3.3	2.2	4.3	4.9	5.8	8.3
Average gross wages, real (PPI based)	5.6	5.5	10.3	3.2	-2.1	1.3	1.8	2.7	6.3
Average gross wages, real (CPI based)	6.2	4.0	2.0	2.6	-1.8	0.8	1.8	2.7	4.9
Average gross wages, EUR (ER)	13.2	16.8	6.9	3.3	2.2	4.3	4.9	5.8	15.2
Employed persons (LFS)	2.1	3.2	-2.8	-2.1	1.5	0.4	1.7	1.7	2.9
GDP per empl. person, NC at 2000 prices	4.5	2.5	-2.2	6.3	1.9	1.2	1.4	2.2	4.8
Unit labour costs, NC at 2000 prices	4.5	5.5	5.3	-2.9	0.3	3.1	3.5	3.5	3.4
Unit labour costs, ER (EUR) adjusted	8.3	14.0	9.3	-2.9	0.3	3.1	3.5	3.5	10.0
Slovenia									
GDP deflator	1.6	4.1	3.0	-1.1	0.8	1.5	1.0	2.0	3.0
Exchange rate (ER), EUR/NC	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1
Real ER (CPI-based)	0.1	1.8	-0.1	0.0	-1.0	-0.6	0.1	0.0	0.9
Real ER (PPI-based)	-2.4	-2.2	2.9	-1.4	-1.1	-0.4	0.2	1.0	-1.2
Average gross wages, NC	3.6	8.3	3.4	3.9	2.0	2.3	1.9	2.5	5.7
Average gross wages, real (PPI based)	1.7	4.3	4.9	1.9	-2.5	0.8	-0.1	-0.5	2.5
Average gross wages, real (CPI based)	1.1	2.6	2.5	1.8	-0.1	0.3	-0.1	0.5	2.0
Average gross wages, EUR (ER)	3.4	8.3	3.4	3.9	2.0	2.3	1.9	2.5	5.6
Employed persons (LFS)	0.7	1.1	-1.5	-1.5	-3.1	-0.7	-1.1	1.1	1.4
GDP per empl. person, NC at 2000 prices	3.3	2.5	-6.6	2.9	3.0	-0.2	2.3	0.8	3.7
Unit labour costs, NC at 2000 prices	0.3	5.6	10.7	0.9	-1.0	2.5	-0.4	1.7	1.9
Unit labour costs, ER (EUR) adjusted	0.1	5.6	10.7	0.9	-1.0	2.5	-0.4	1.7	1.9

(Table A/3 ctd.)

Table A/3 (ctd.)

	2005	2008	2009	2010	2011	2012	2013 Forecast	2014	2005-08 average
Croatia									
GDP deflator	3.3	5.7	2.9	0.9	2.2	2.5	2.4	2.0	4.3
Exchange rate (ER), EUR/NC	1.3	1.6	-1.6	0.7	-2.0	-0.9	0.7	0.0	0.9
Real ER (CPI-based)	2.4	3.9	-0.2	-0.3	-2.7	-1.0	1.2	0.0	2.2
Real ER (PPI-based)	-0.2	3.5	2.3	1.6	-1.4	1.2	1.8	1.0	0.9
Average gross wages, NC	4.4	7.1	2.2	-0.4	1.5	2.0	2.9	3.1	6.0
Average gross wages, real (PPI based)	1.7	-1.1	2.7	-4.5	-4.5	-1.9	-0.1	0.1	1.6
Average gross wages, real (CPI based)	1.0	0.9	-0.2	-1.5	-0.8	-0.5	0.5	1.0	2.0
Average gross wages, EUR (ER)	5.7	8.7	0.6	0.3	-0.5	1.1	3.8	2.7	6.9
Employed persons (LFS)	0.7	1.3	-1.8	-4.0	-3.2	-0.8	0.0	0.7	1.1
GDP per empl. person, NC at 2000 prices	3.6	0.8	-5.2	2.7	3.2	-0.7	1.0	1.4	2.9
Unit labour costs, NC at 2000 prices	0.8	6.2	7.8	-3.0	-1.7	2.7	1.9	1.7	3.0
Unit labour costs, ER (EUR) adjusted	2.1	7.9	6.1	-2.3	-3.6	1.8	2.6	1.7	3.9
Macedonia									
GDP deflator	3.8	7.5	0.7	2.7	3.5	3.0	3.0	3.0	5.5
Exchange rate (ER), EUR/NC	0.1	-0.1	0.0	-0.4	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	-1.6	4.3	-1.8	-0.9	0.7	0.4	1.1	1.0	0.9
Real ER (PPI-based)	-0.9	3.5	-3.1	4.7	5.1	1.2	1.1	1.0	1.3
Average gross wages, NC ¹⁾	2.7	8.7	9.0	1.0	1.2	2.9	5.1	5.1	6.0
Average gross wages, real (PPI based)	-0.5	-1.3	17.5	-7.1	-8.9	-0.1	2.0	2.1	0.4
Average gross wages, real (CPI based)	2.2	0.3	9.9	-0.6	-2.5	-0.1	2.0	2.1	2.4
Average gross wages, EUR (ER)	2.8	8.5	9.0	0.6	1.2	2.5	5.9	5.6	6.0
Employed persons (LFS)	4.3	3.2	3.4	1.3	1.1	0.8	1.5	1.5	3.9
GDP per empl. person, NC at 2000 prices	0.1	1.7	-4.2	1.6	1.9	1.1	1.4	1.8	1.2
Unit labour costs, NC at 2000 prices	2.6	6.9	13.8	-0.6	-0.7	1.8	3.6	3.3	4.8
Unit labour costs, ER (EUR) adjusted	2.7	6.7	13.8	-1.0	-0.7	1.8	3.6	3.3	4.8
Montenegro									
GDP deflator	4.3	7.7	2.4	1.6	4.2	2.0	3.8	2.5	8.4
Real ER (CPI-based)	0.1	3.6	2.4	-1.6	0.0	0.4	1.1	1.0	1.6
Real ER (PPI-based)	0.0	-2.1	4.4	-0.2	-1.4	-0.2	0.9	-0.5	2.3
Average gross wages, NC	7.8	22.5	5.6	11.2	1.0	5.3	6.6	6.2	19.1
Average gross wages, real (PPI based)	5.6	7.5	9.9	12.2	-2.1	3.2	2.7	3.6	11.3
Average gross wages, real (CPI based)	5.4	14.1	2.1	10.6	-2.1	2.2	3.5	3.1	14.3
Employed persons (LFS)	-4.5	0.6	-2.7	-2.2	-5.8	0.0	1.0	6.1	4.0
GDP per empl. person, NC	13.9	14.4	-0.7	6.5	12.9	2.8	5.2	-0.5	12.2
GDP per empl. person, NC at 2000 prices	9.1	6.2	-3.0	4.8	8.3	1.1	1.3	-3.7	3.5
Unit labour costs, NC at 2000 prices	-1.2	15.3	8.9	6.1	-6.8	4.1	5.3	10.3	15.1
Unit labour costs, ER (EUR) adjusted	-1.2	15.3	8.9	6.1	-6.8	4.1	5.3	10.3	15.1
Albania									
GDP deflator	2.6	4.7	2.3	2.9	2.8	1.5	3.8	4.3	3.4
Exchange rate (ER), EUR/NC	2.8	0.7	-7.0	-4.2	-1.8	0.2	2.9	2.3	1.0
Real ER (CPI-based)	3.0	0.3	-5.8	-2.8	-1.4	-0.8	5.1	4.3	1.1
Real ER (PPI-based)	3.5	1.0	-4.5	-7.1	-4.8	0.4	5.1	4.3	0.6
Average gross wages, NC	5.0	25.3	5.2	6.7	6.6	3.6	8.2	9.1	15.8
Average gross wages, real (PPI based)	0.1	17.7	7.0	6.4	4.0	1.6	4.1	4.9	11.5
Average gross wages, real (CPI based)	2.6	21.2	2.9	3.1	3.0	2.1	4.1	4.9	12.7
Average gross wages, EUR (ER)	8.0	26.2	-2.1	2.3	4.7	2.6	13.3	11.8	17.0
Employed persons (LFS) ²⁾	0.3	-6.2	3.3	3.4	0.0	-1.7	1.7	1.7	-1.0
GDP per empl. person, NC at 2000 prices	5.4	14.6	0.0	-0.4	2.9	4.0	1.1	1.6	7.2
Unit labour costs, NC at 2000 prices	-0.3	9.3	5.3	7.1	3.6	-0.4	7.1	7.4	8.0
Unit labour costs, ER (EUR) adjusted	2.5	10.1	-2.1	2.7	1.7	-0.2	10.2	9.8	9.1
Bosnia and Herzegovina									
GDP deflator	4.0	7.4	0.1	1.5	3.9	2.0	1.9	2.0	5.9
Exchange rate (ER), EUR/NC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	0.8	3.7	-1.4	0.0	0.6	-0.6	0.1	0.0	1.9
Real ER (PPI-based)	.	-3.6	1.1	-2.4	-1.9	0.1	0.2	0.0	.
Average gross wages, NC	6.5	16.7	8.1	1.1	4.4	2.4	3.1	3.0	10.4
Average gross wages, real (PPI based)	.	7.4	11.7	0.2	0.7	0.4	1.1	1.0	.
Average gross wages, real (CPI based)	3.4	8.5	8.6	-1.0	0.7	0.4	1.1	1.0	5.7
Average gross wages, EUR (ER)	6.5	16.7	8.1	1.1	4.4	2.4	3.1	3.0	10.4
Employed persons (LFS) ³⁾	0.5	4.8	-3.5	-1.9	-3.2	-0.7	0.0	0.2	2.8
GDP per empl. person, NC at 2000 prices	3.3	0.8	0.6	2.7	5.5	0.4	1.4	1.9	2.5
Unit labour costs, NC at 2000 prices	3.0	15.8	7.5	-1.6	-1.1	2.0	1.6	1.1	7.7
Unit labour costs, ER (EUR) adjusted	3.0	15.8	7.5	-1.6	-1.1	2.0	1.6	1.1	7.7

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

(Table A/3 ctd.)

Table A/3 (ctd.)

	2005	2008	2009	2010	2011	2012	2013 Forecast	2014	2005-08 average
Serbia									
GDP deflator	15.7	12.6	5.9	4.9	8.4	5.0	5.0	3.6	12.7
Exchange rate (ER), EUR/NC	-12.5	-1.8	-13.3	-8.7	0.0	-10.5	-4.2	-6.3	-2.9
Real ER (CPI-based)	-0.5	7.5	-6.7	-4.5	7.6	-7.5	-1.3	-3.5	6.1
Real ER (PPI-based)	-4.1	3.9	-4.4	-0.5	8.0	-7.8	-1.2	-4.7	3.7
Average gross wages, NC	24.1	17.9	-3.3	7.5	11.1	6.0	6.0	6.1	22.1
Average gross wages, real (PPI based)	8.7	4.9	-8.4	-4.6	-2.7	1.0	1.0	2.3	9.6
Average gross wages, real (CPI based)	6.8	3.9	-11.0	0.6	0.1	0.0	1.0	1.0	9.0
Average gross wages, EUR (ER)	8.6	15.7	-16.2	-1.9	11.1	-4.4	0.0	0.0	18.6
Employed persons (LFS)	-6.7	6.3	-7.3	-8.4	-6.0	-4.6	-2.3	0.0	-0.9
GDP per empl. person, NC at 2000 prices	13.0	-2.3	4.1	10.3	8.1	3.7	3.4	2.0	5.5
Unit labour costs, NC at 2000 prices	9.8	20.6	-7.1	-2.6	2.9	2.2	2.5	4.0	15.7
Unit labour costs, ER (EUR) adjusted	-3.9	18.4	-19.4	-11.0	2.8	-8.5	-1.7	-2.5	12.4
Russia									
GDP deflator	19.3	18.0	2.0	11.6	15.9	10.5	7.5	6.9	16.5
Exchange rate (ER), EUR/NC	1.6	-3.9	-17.5	9.5	-1.4	-0.3	-2.4	-2.3	-0.4
Real ER (CPI-based)	11.8	5.8	-8.7	14.7	3.8	3.0	0.6	0.5	8.1
Real ER (PPI-based)	17.7	9.9	-20.0	18.8	11.0	7.6	4.5	3.4	11.8
Average gross wages, NC	26.9	27.2	7.8	12.4	12.3	11.3	10.2	10.3	26.6
Average gross wages, real (PPI based)	5.2	4.8	16.1	0.2	-5.6	1.2	1.1	2.1	8.1
Average gross wages, real (CPI based)	12.8	11.5	-3.6	5.2	3.5	5.0	5.0	5.0	13.7
Average gross wages, EUR (ER)	28.9	22.3	-11.0	23.1	10.8	11.2	7.8	7.2	26.0
Employed persons (LFS)	1.3	0.6	-2.4	0.7	1.3	-0.3	-0.7	0.0	1.3
GDP per empl. person, NC at 2000 prices	5.0	4.6	-5.6	3.5	2.9	4.1	4.7	4.2	5.6
Unit labour costs, NC at 2000 prices	20.9	21.6	14.2	8.6	9.1	6.9	5.2	5.8	19.8
Unit labour costs, ER (EUR) adjusted	22.8	16.9	-5.8	19.0	7.6	6.6	2.7	3.3	19.3
Ukraine									
GDP deflator	24.5	28.6	13.0	13.8	15.7	4.8	7.0	5.0	22.5
Exchange rate (ER), EUR/NC	3.5	-10.3	-29.1	3.2	-5.0	0.8	-4.3	0.0	-3.8
Real ER (CPI-based)	14.9	8.4	-18.6	10.6	-0.5	3.2	0.4	2.9	7.9
Real ER (PPI-based)	15.9	14.5	-21.1	20.6	6.9	3.7	0.5	2.9	10.7
Average gross wages, NC	36.7	33.7	5.5	17.5	17.6	11.3	14.3	11.3	32.3
Average gross wages, real (PPI based)	17.2	-1.3	-0.9	-2.8	-1.2	6.2	6.9	6.0	10.3
Average gross wages, real (CPI based)	20.5	6.8	-9.0	7.4	8.9	6.0	6.9	6.0	15.0
Average gross wages, EUR (ER)	41.5	20.0	-25.2	21.2	11.7	13.7	7.4	10.3	27.3
Employed persons (LFS)	1.9	0.3	-3.7	0.4	0.3	-0.1	0.2	0.2	0.8
GDP per empl. person, NC at 2000 prices	0.8	2.0	-11.4	3.8	4.8	4.1	5.0	4.8	4.2
Unit labour costs, NC at 2000 prices	35.6	31.1	19.2	13.2	12.2	6.9	8.9	6.3	27.0
Unit labour costs, ER (EUR) adjusted	40.3	17.7	-15.5	16.8	6.5	7.8	4.2	6.3	22.2
Austria									
GDP deflator	2.0	1.8	1.0	1.8	2.1	1.8	1.5	1.6	1.9
Real ER (CPI-based)	0.1	-0.5	-0.5	-0.2	0.2	-0.2	0.1	0.1	-0.3
Real ER (PPI-based)	-2.0	0.2	-3.3	1.5	2.5	-0.1	-0.3	-0.4	-0.4
Average gross wages, NC	2.6	3.4	2.2	1.5	2.8	3.0	2.4	2.6	3.2
Average gross wages, real (PPI based)	0.5	-2.8	10.3	-3.4	-5.1	1.2	0.9	1.0	-0.6
Average gross wages, real (CPI based)	0.3	0.2	1.7	-0.4	-0.5	0.6	0.4	0.5	0.9
Employed persons (LFS)	2.1	1.5	-0.3	0.5	1.0	1.0	0.2	1.2	2.2
GDP per empl. person, NC at 2000 prices	0.2	-0.1	-3.5	1.8	1.7	0.0	1.3	1.0	0.5
Unit labour costs, NC at 2000 prices	2.4	3.6	5.9	-0.3	1.1	3.0	1.0	1.6	2.7
Unit labour costs, ER (EUR) adjusted	2.4	3.6	5.9	-0.3	1.1	3.0	1.0	1.6	2.7

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

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