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Economic Prospects for Central, East and Southeast Europe

Peter Havlik, Mario Holzner et al.

Weathering the Global Storm, yet Rising Costs and Labour Shortages May Dampen Domestic Growth

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Please note:

This is the first issue of the new series **wiiw Current Analyses and Forecasts. Prospects for Central, East and Southeast Europe**, to replace the former wiiw Research Reports series **Special issue on economic prospects for Central, East and Southeast Europe**.

Contents

Tables and Figures

Summary

Part A

Part B

Part D

Tightening labour markets

Financial vulnerability and bubbles

Country reports

Appendix

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Executive summary

The world economy is facing serious challenges. The US subprime crisis has spread across the globe. A spillover into the real sector cannot be excluded as credit conditions have been generally tightened. A modest slowdown in GDP growth in the EU is likely, but the direct effects of such a slowdown on growth in the NMS should not be large; domestic factors are definitely more decisive in terms of their growth prospects. Still, the risks identified in the wiiw forecasts lie predominantly on the downside.

The majority of the ***new EU member states (NMS)*** *have been enjoying a period of robust economic growth. In 2007, the Czech and Slovak Republics reported the most 'balanced' growth with consumption, investments and net exports contributing positively to overall growth. In Poland and Slovenia, GDP growth was driven by investments and (household) consumption, while net exports reduced overall GDP growth. In Bulgaria, Romania and the Baltics, overall growth was dragged down by surging trade deficits. The Hungarian meagre GDP growth stemmed almost exclusively from the contribution of net exports.*

Household consumption will continue to play a decisive role as a growth driver in all NMS in the years to come. Also the vibrant investment activity is expected to continue. This forecast is based on a substantial increase in transfers from the EU budget, FDI inflows and the comfortable profits and liquidity situation of local companies. Forecasts of trade developments reckon with further double-digit growth in both NMS exports and imports (except for the Baltic States). Most NMS will continue to enjoy fairly high growth in industrial output, the projected average NMS industrial growth during 2008-2010 is above the countries' long-term average performance, and the majority of NMS will still benefit from huge cost advantages over Western Europe. Nevertheless, given the competition for production locations and new investment projects, there are some reasons for concern over the sustainability of these developments.

The recent upsurge in consumer prices will be only temporary and the average annual inflation will settle down again. Nominal appreciation of domestic currencies has been quite substantial over the past few years, especially in the Czech and Slovak Republics, as well as in Poland and (until mid-2007) Romania. Apart from potentially destabilizing capital flows – particularly in countries already suffering from high current account deficits such as Bulgaria, Romania and the Baltics – excessive real appreciation is detrimental to trade competitiveness. Government finances performed better than expected in the majority of NMS during 2007. Even Hungary's convergence programme reduced the budget deficit more than expected, but the price paid was economic stagnation and public unrest. Government deficits in the Czech Republic, Hungary and Poland will exceed the Maastricht threshold for another two years or so and accession to the eurozone will not feature on the agenda in the near future.

The situation on the labour market has changed dramatically and unemployment has started to decline rapidly. The economic growth in the NMS is no longer 'jobless'. On the contrary, in the period 2000-2007 (and essentially after 2004) more than 2.5 million new jobs were created in the NMS. Most countries in the region are now reporting labour shortages – especially of skilled workers – which could well become a serious constraint on their economic growth. Agriculture continues to shed labour in all NMS and industrial employment is growing modestly in Bulgaria, the Czech Republic and Slovakia, while the construction sector and the services sector in particular have recorded the fastest rate of employment growth. In most sectors, shortages of labour are being *reported and vacancies are difficult to fill owing to qualification mismatches, limited internal labour mobility and labour market rigidities.*

The NMS experienced another year of high economic growth in 2007 and easily maintained the speed at which they were catching up with the more advanced West European economies. The real per capita GDP in the NMS reached 56% of the EU-27 average – about 5 percentage points more than at the time of their EU accession in 2004. Slovenia, the Czech Republic and Estonia are now more affluent than Portugal; Slovenia may soon catch up with income levels in Greece. wiiw short- and medium-term growth forecasts for the region are moderately optimistic, expecting those countries to stay on their catching-up trajectory. The current turbulence on global financial markets is not going to hurt directly or seriously. Even the possible indirect effects should not be too excessive. GDP growth is projected to slow down from about 6% in 2007 to some 5% over the coming three years. Inflation will gradually decline, yet in most NMS it will stay above that of the eurozone. The unemployment rate may drop below that of the eurozone as early as next year (in fact only in Poland and Slovakia is unemployment still higher). Economic growth will be mainly driven by rising consumption (supported by rising labour incomes) and by investments (including FDI). The latter will be bolstered by much higher transfers from the EU budget. Foreign trade will continue to expand, yet the contribution of real net exports to GDP growth will gradually diminish. Except for Bulgaria, Romania and the Baltic States, all of which remain vulnerable to external shocks, current account deficits will not be excessively high. In sum, the NMS are expected to remain a region displaying dynamic growth in the years to come, maintaining their competitive advantages as attractive locations for both trading and investment purposes.

The medium-term economic outlook for the ***countries of Southeast Europe*** *is favourable. Domestic demand remains the core growth driver. Remittances from family members working abroad in tandem with a credit boom are fuelling both consumption and imports. Higher investment activity has finally reached the region's ailing industrial sector. Given the exceptionally high world market prices for minerals and metals, some of the mining and metallurgical plants that lay idle have been re-activated. Nevertheless, the growth in 2008 will cool off slightly in the wake of the global slowdown, price turbulences and increased risk awareness. wiiw expects growth rates to rise from 4-5% to around 5-6% by the end of the three-year forecast horizon in 2010.*

wiiw forecasts that for several countries in the region gross industrial production will outstrip overall economic growth in the medium term. Except for Montenegro and Serbia, all the countries in the region will finally experience growth in employment. Construction and trade have proved to be the most dynamic sectors in terms of employment creation. In recent years international competitiveness of the region's economies has remained fairly stable. Two important exceptions are Serbia and Turkey. While in most countries the real exchange rate hovers around the level of early 2004, the Turkish lira and Serbian dinar began appreciating from mid-2006 onwards. In most countries, incipient reindustrialization and a more stable competitive environment have resulted in strong, double-digit export growth. However, the net export position remains weak. A fundamental reason for this is that the Southeast European countries still did not manage to attract enough FDI in general – and greenfield investment to manufacturing in particular.

The slowdown in global growth, the hikes in oil, metal and food prices on world markets, as well as the subprime crisis are expected to have only a minor impact on the region. With regard to Kosovo's declaration of independence, it will affect mainly the newborn state itself, assuming smooth and non-violent development. However, losing Kosovo, the Serbian government is trying to buy political stability in the country by sacrificing macroeconomic stability. At the moment, muddling through still

seems a possible option. If nationalist risks prevail and the Serbian economy jolts to a sudden stop, it could have a significant impact on the neighbouring countries as well. Nevertheless, with the change of government in France, the prospects of Southeast European countries joining the EU have greatly improved. However, this does not hold true for Turkey, which still lacks the support of the majority of incumbent EU members. Croatia could become EU member in 2011. The other Balkan countries could make it to the EU around 2015.

Kazakhstan, Russia and Ukraine are all expected to grow by more than 6% per year in the period 2008 2010 – also slightly slower than in the previous two years. A modest cooling down of growth is projected for China as well.

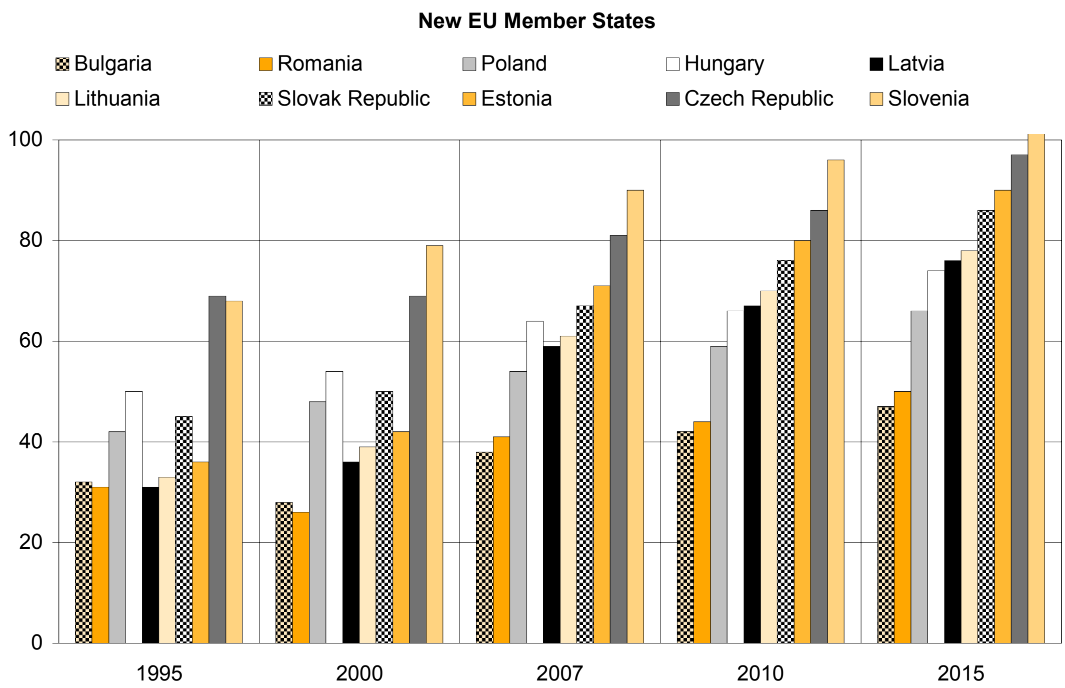
Keywords: *Central and East European new EU member states, Southeast Europe, Balkans, former Soviet Union, China, Turkey, GDP, industry, productivity, labour market, foreign trade, exchange rates, inflation, fiscal deficits, EU integration*

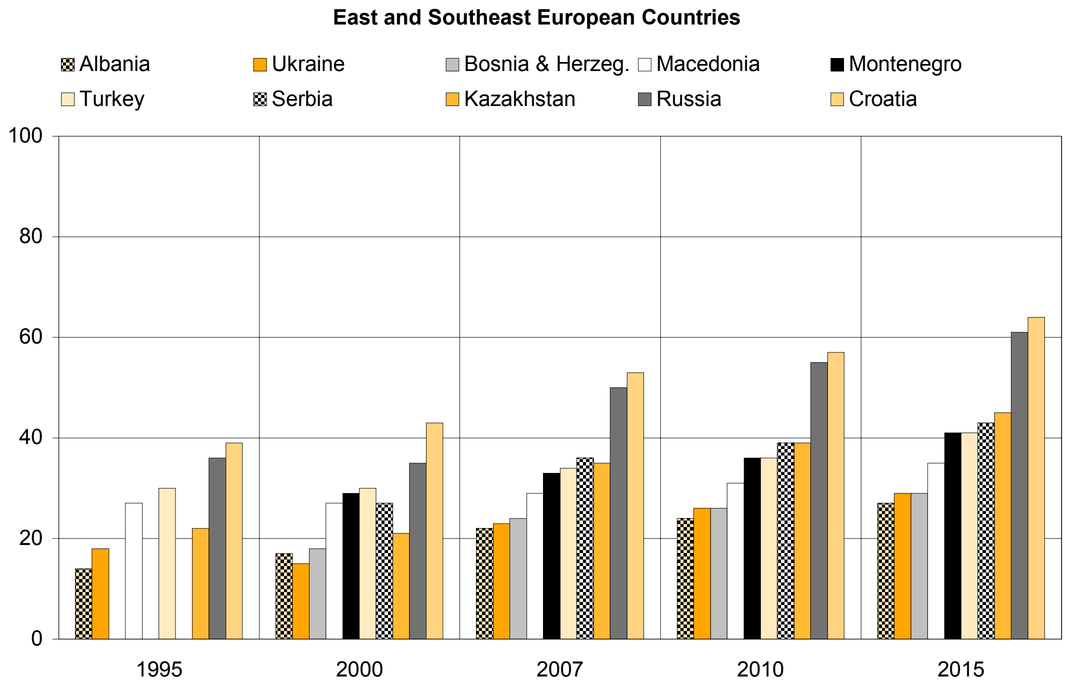
JEL classification: *O52, O57, P24, P27, P33, P52*

Figure I

Real per capita GDP in transition countries, at PPP

European Union (27) average = 100





Remark: Projection assuming a 3 percentage points growth differential with respect to the EU-15 after 2007

Source: National statistics, Eurostat, wiiw estimates..

Table I

Overview developments 2006-2007 and outlook 2008-2010

	GDP real change in % against previous year					Consumer prices change in % against previous year					Unemployment, based on LFS [1)] rate in %, annual average					Current account in % of GDP				
	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010
			Forecast					Forecast					Forecast					Forecast		
Czech Republic	6.4	6.6	4.5	5	5	2.5	2.8	5.0	2.8	2.5	7.1	5.3	5.5	5	4.5	-3.1	-3.2	-3.3	-3.5	-3.5
Hungary	3.9	1.3	3.0	4.1	4.3	3.9	8.0	5.5	3.2	2.9	7.5	7.4	7.5	7.5	7.5	-6.5	-4.6	-4.2	-3.8	-3.5
Poland	6.2	6.5	5.5	5.3	5	1.0	2.5	2.5	3.5	2.6	13.9	11.0	9	8	7	-3.2	-4.0	-4.8	-5.5	-6.0
Slovak Republic	8.5	9	8	7	6	4.5	2.8	2.8	3	2.5	13.3	11	10	9	8.5	-7.0	-4.7	-4.0	-4.0	-5.0
Slovenia	5.7	6	4.7	4.5	4.8	2.5	3.6	3.9	3.5	3	6.0	5.2	4.9	4.7	4.6	-2.8	-4.8	-3.9	-3.1	-2.6
NMS-5 [2)3)]	*6.0*	*5.9*	*5.1*	*5.2*	*5.0*	*2.1*	*3.5*	*3.6*	*3.3*	*2.6*	*11.5*	*9.3*	*8.3*	*7.5*	*6.7*	*-4.0*	*-4.1*	*-4.3*	*-4.6*	*-4.8*
Bulgaria	6.1	6	5.5	6	6.2	7.3	8.4	10	6	5	9.0	6.9	6.0	5.6	5.2	-15.7	-21.6	-18.8	-17.0	-15.6
Romania	7.8	6.0	5.5	5	6	6.6	4.8	8	7	5	7.3	6.5	6.5	6.5	6	-10.4	-14.3	-14.9	-14.4	13.6
Estonia	11.2	7.0	6	5.5	6	4.4	6.3	6	4	3	5.9	4.7	4.5	4	4	-15.5	-16.2	-14	-13	-12
Latvia	11.9	10.8	8	7	6	6.5	9.7	9	6.5	5	6.8	6.1	5.5	5.5	6	-22.3	-23.4	-21	-18	-17
Lithuania	7.7	8.7	8	7	6.5	3.7	5.5	6	5	4	5.6	4.2	3.5	3.5	4	-10.8	-12.3	-13	-12	-10
NMS-10 [2)3)]	*6.5*	*6.1*	*5.4*	*5.3*	*5.3*	*3.2*	*4.2*	*4.8*	*4.1*	*3.2*	*10.0*	*8.2*	*7.4*	*6.9*	*6.4*	*-6.1*	*-7.1*	*-7.2*	*-7.2*	*-7.2*
EU-15 [3)]	*2.8*	*2.7*	*1.8*	.	.	*2.2*	*2.0*	*2.6*	.	.	*7.7*	*7.0*	*7.0*	*6.9*	*6.8*	*-0.23*	*-0.35*	.	.	.
EU-25 [2)3)]	*3.1*	*3.0*	*2.1*	.	.	*2.2*	*2.2*	*2.8*	.	.	*8.2*	*7.3*	*7.1*	*6.9*	*6.8*	*-0.49*	*-0.63*	.	.	.
EU-27 [2)3)]	*3.2*	*3.1*	*2.2*	.	.	*2.3*	*2.2*	*2.9*	.	.	*8.2*	*7.2*	*7.1*	*6.9*	*6.7*	*-0.61*	*-0.81*	.	.	.
Croatia	4.8	6	4.8	4.5	5	3.2	2.9	5	4	3.5	11.1	10	9.8	9.4	9	-7.7	-7.5	-7.1	-7.3	-7.3
Macedonia	3.8	5	5	6	6	3.2	2.3	3	3	3	36.0	35.2	35	34	33	-0.9	-0.9	-1.7	-2.4	-2.2
Turkey	6.1	4.2	4.0	5	6	9.6	8.8	9.0	7	6	9.9	9.9	11	10	9	-8.2	-7.9	-6.9	-6.5	-5.9
Albania [4)]	5.5	5.6	5.8	6.1	6.2	2.4	2.9	3.2	3.1	3.0	13.6	14	13	12	11	-7.4	-8.9	-6.5	-7.1	-8.0
Bosnia & Herzegovina	6.2	5	4.5	5	6	6.2	1.5	5.5	2	2	31.1	29.0	29	28	27	-9.9	-13.4	-11.7	-10.6	-9.8
Montenegro	8.3	7	6	6	6	3.0	4.2	3	3	3	29.6	30	30	28	27	-26.0	-40	-30	-25	-25
Serbia	5.7	7.5	5	5	5	11.7	7.0	6	4	3	20.9	21.2	23	23	23	-11.5	-15.7	-13.6	-12.7	-12.0
Kazakhstan	10.6	8.7	6.5	7.5	8	8.6	10.8	13	10	9	7.8	7.0	6.8	6.5	6	-2.2	-6.6	-6.3	-3.9	-2.0
Russia	7.4	8.1	6.4	6	5.5	9.7	9.1	10	9	8	6.8	6.2	5.8	5.5	5.5	9.8	5.9	2.4	0.4	-1.1
Ukraine	7.1	7.3	6.5	6	6	9.1	12.8	14.5	12	10	6.8	6.4	6.4	6.6	6.8	-1.5	-2.5	-4.3	-4.8	-5.2
China [5)]	11.1	11.4	9.5	9.7	10	1.5	4.8	5	4	3	4.1	4.0	4.3	4.3	4.2	9.4	10.8	9.6	8.6	7.9

Note: NMS: The New EU Member States.

1) LFS: Labour Force Survey. - 2) wiiw estimate. - 3) Current account data include flows within the region. - 4) Unemployment rate by registration, end of period. - 5) Urban unemployment rate (registered).

Source: wiiw (February 2008), Eurostat; forecasts: wiiw, European Commission (February 2008) for EU-15.

Table II

Central and East European new EU member states (NMS-10): an overview of economic fundamentals, 2007

	Bulgaria	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Romania	Poland	Slovak Republic	Slovenia	*NMS-10* [1]	*EU-15*	*EU-27* [2]
GDP in EUR at exchange rates, EUR bn	28.63	127.51	15.48	101.87	20.06	28.00	118.15	305.93	54.78	33.40	*833.8*	*11,418.2*	*12,272.7*
GDP in EUR at PPP, EUR bn	71.91	207.30	23.72	159.58	33.10	50.64	218.40	513.51	90.28	45.09	*1,413.5*	*10,876.8*	*12,272.7*
GDP in EUR at PPP, EU-27=100	0.6	1.7	0.2	1.3	0.3	0.4	1.8	4.2	0.7	0.4	*11.5*	*88.6*	*100.0*
GDP in EUR at PPP, per capita	9,390	20,080	17,680	15,870	14,540	15,000	10,140	13,470	16,720	22,330	*13,840*	*27,740*	*24,860*
GDP in EUR at PPP per capita, EU-27=100	38	81	71	64	58	60	41	54	67	90	*56*	*112*	*100*
GDP at constant prices, 1990=100	117.9	139.8	165.6	140.3	129.0	124.3	127.1	168.8 [3]	155.1	161.3	*152.5*	*142.1*	*143.7*
GDP at constant prices, 2000=100	145.5	136.3	181.8	130.0	183.8	170.5	151.1	131.5	150.5	133.9	*139.2*	*114.4*	*116.8*
Industrial production real, 1990=100	96.3	131.1	119.1	233.9	73.8	70.9	82.1	204.0 [3]	149.9	117.7	*161.8*	*129.0*	*132.9*
Industrial production real, 2000=100	181.6	161.4	182.5	154.6	157.0	183.9	141.3	157.4	160.1	131.3	*156.4*	*112.5*	*117.5*
Population - thousands, average	7,660	10,326	1,342	10,056	2,276	3,375	21,538	38,115	5,399	2,019	*102,105*	*392,130*	*495,430*
Employed persons - LFS, thousands, average	3,270	4,922	655	3,926	1,115	1,540	9,560	15,250	2,350	980	*43,568*	*176,497*	*220,613*
Unemployment rate - LFS, in %	6.9	5.3	4.7	7.4	6.1	4.2	6.5	11.0	11.0	5.2	*8.2*	*7.0*	*7.2*
General gov. expenditures, EU-def., in % of GDP	36.7	43.0	34.6	50.2	37.0	36.4	36.8	43.5	35.9	43.6	*41.7*	*46.2*	*45.9*
General gov. revenues, EU-def., in % of GDP	39.7	41.1	37.2	44.5	37.5	35.5	33.9	40.2	33.2	43.0	*39.8*	*45.3*	*44.9*
Price level, EU-27=100 (PPP/exch. rate)	40	62	65	64	61	55	54	60	61	74	*59*	*105*	*100*
Compensation per employee [4], monthly, in EUR	299	1,069	1,037	1,129	797	773	764	794	856	1,793	*851*	*3,318*	*2,851*
Compensation per employee, monthly, EU-27=100	10.5	37.5	36.4	39.6	27.9	27.1	26.8	27.8	30.0	62.9	*29.9*	*116.4*	*100.0*
Exports of goods in % of GDP	46.8	69.8	51.7	67.3	26.9	44.6	24.9	35.4	78.5	59.6	*47.7* [5]	*29.1* [5]	*30.3* [5]
Imports of goods in % of GDP	72.8	66.7	67.2	66.0	49.3	58.6	42.3	37.8	78.5	64.2	*52.8* [5]	*29.2* [5]	*30.8* [5]
Exports of services in % of GDP	15.8	9.4	20.7	12.1	12.0	10.4	6.4	6.4	9.7	12.3	*8.9* [5]	*9.0* [5]	*9.1* [5]
Imports of services in % of GDP	12.3	7.8	14.2	10.7	8.5	8.2	6.2	5.7	8.6	9.3	*7.6* [5]	*8.1* [5]	*8.1* [5]
Current account in % of GDP	-21.6	-3.2	-16.2	-4.6	-23.4	-12.3	-14.3	-4.0	-4.7	-4.8	*-7.1* [5]	*-0.3* [5]	*-0.8* [5]
FDI stock per capita in EUR	3,000	6,200	9,000	6,700	3,500	3,300	1,900	2,900	5,600	4,000	*3,700*	.	.

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

1) wiiw estimates. - 2) wiiw estimates, except: budget and compensation per employee. - 3) 1989=100, which in the Polish case is the appropriate reference year. - 4) Gross wages plus indirect labour costs, whole economy, national account concept. - 5) NMS-10, EU-15 and EU-27 data include flows within the region.

Source: wiiw, AMECO, Eurostat.

Table III

Southeast Europe: an overview of economic fundamentals, 2007

	Croatia	Macedonia	Turkey	Albania	Bosnia and Herzegovina	Montenegro	Serbia	*NMS-10* [1]	*EU-15*	*EU-27* [2]
GDP in EUR at exchange rates, EUR bn	37.25	5.43	364.99	7.85	10.43	2.20	30.53	*833.8*	*11,418.2*	*12,272.7*
GDP in EUR at PPP, EUR bn	58.53	14.56	559.60	16.86	23.10	5.11	66.56	*1,413.5*	*10,876.8*	*12,272.7*
GDP in EUR at PPP, EU-27=100	0.5	0.1	4.6	0.1	0.2	0.04	0.5	*11.5*	*88.6*	*100.0*
GDP in EUR at PPP, per capita	13,180	7,120	8,440	5,350	6,010	8,180	8,950	*13,840*	*27,740*	*24,860*
GDP in EUR at PPP per capita, EU-27=100	53	29	34	22	24	33	36	*56*	*112*	*100*
GDP at constant prices, 1990=100	120.2	106.6	193.9	171.1	479.8 [3]	.	.	*152.5*	*142.1*	*143.7*
GDP at constant prices, 2000=100	140.3	116.9	136.5	148.3	140.4	130.5	146.6	*139.2*	*114.4*	*116.8*
Industrial production real, 1990=100	89.9	56.6	215.4	.	.	.	.	*161.8*	*129.0*	*132.9*
Industrial production real, 2000=100	140.0	107.2	140.5	176.1	173.2	115.5	115.9	*156.4*	*112.5*	*117.5*
Population - thousands, average	4,440	2,045	70,586	3,150	3,846	625	7,435	*102,105*	*392,130*	*495,430*
Employed persons - LFS, thousands, average	1,600	590	22,700	935	850	175	2,600	*43,568*	*176,497*	*220,613*
Unemployment rate - LFS, in %	10.0	35.2	9.9	14.0 [4]	29.0	30.0	21.2	*8.2*	*7.0*	*7.2*
General gov. expenditures, nat. def., in % of GDP	47.0 [6]	34.5	31.1 [5]	28.5 [6]	42	30	42.6 [6]	*41.7* [5]	*46.2* [5]	*45.9* [5]
General gov. revenues, nat. def., in % of GDP	44.8 [6]	34.0	30.4 [5]	25.3 [6]	44	35	41.2 [6]	*39.8* [5]	*45.3* [6]	*44.9* [5]
Price level, EU-27=100 (PPP/exch. rate)	64	37	65	47	45	43	46	*59*	*105*	*100*
Average gross monthly wages, EUR at exchange rate	958	391	692 [7]	277 [8]	480	497	484 [9]	*851* [7]	*3,318* [7]	*2,851* [7]
Average gross monthly wages, EUR at PPP	1,505	1,048	1,061 [7]	595 [8]	1,064	1,155	1,055 [9]	*30* [7]	*116* [7]	*100* [7]
Exports of goods in % of GDP	25.0	45.5	22.5	10.2	29.7	30.9	21.1	*47.7* [10]	*29.1* [10]	*30.3* [10]
Imports of goods in % of GDP	49.7	62.7	32.1	35.7	70.9	95.5	42.1	*52.8* [10]	*29.2* [10]	*30.8* [10]
Exports of services in % of GDP	24.4	10.7	6.2	16.6	9.6	31.4	6.9	*8.9* [10]	*9.0* [10]	*9.1* [10]
Imports of services in % of GDP	7.4	10.1	2.8	16.6	4.1	10.6	7.2	*7.6* [10]	*8.1* [10]	*8.1* [10]
Current account in % of GDP	-7.5	-0.9	-7.9	-8.9	-13.4	-39.5	-15.7	*-7.1* [10]	*-0.3* [10]	*-0.8* [10]
FDI stock per capita in EUR	7,200	1,200	1,400	800	1,300	4,000	1,300	*3,700*	.	.

Note: 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, Macedonia, Montenegro, Serbia.

1) wiiw estimates. - 2) wiiw estimates, except: budget and compensation per employee. - 3) 1995=100. - 4) Employment and unemployment by registration, end of year. - 5) EU definition: expenditures and revenues according to ESA'95, excessive deficit procedure. - 6) Year 2006; for Serbia year 2004. - 7) Gross wages plus indirect labour costs, whole economy, national account concept. - 8) Public sector. - 9) Including various allowances. - 10) NMS-10, EU-15 and EU-27 data include flows within the region.

Source: wiiw, AMECO, Eurostat.

Medium-term economic outlook for Central, East and Southeast Europe

Part A: The new EU member states

*Peter Havlik**

Modest growth slowdown with higher downside risks

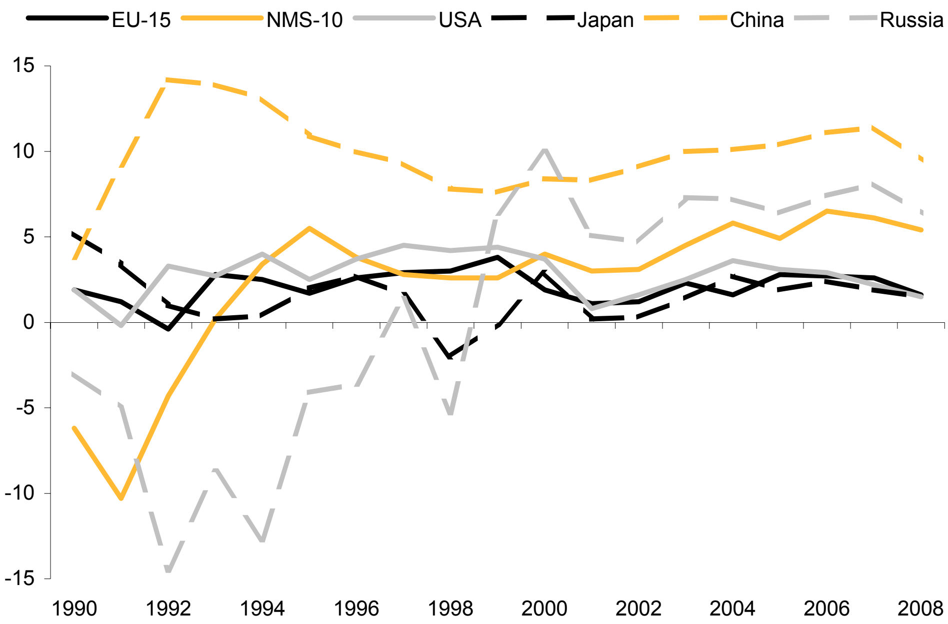
Rising global uncertainties

The world economy is facing serious challenges. After several years of robust growth accompanied by rising household consumption and current account deficits, the US economy was hit by a subprime credit crisis in the second half of 2007. The subprime crisis resulted in banks and investment funds suffering huge losses; in the meantime, the crisis has spread across the globe. Despite large injections of liquidity into the troubled banking sector and radical cuts in interest rates, the threat of recession in the USA remains real; a slowdown in GDP growth is almost certain. At the same time, the US dollar has dropped sharply in value, in particular against the euro; inflation has increased and the oil price briefly hit USD 100 a barrel at the end of 2007.

Figure 1

GDP growth rates, 1990-2008

year-on-year, growth in %



Source: wiiw Annual Database incorporating national statistics, Eurostat, IMF (January 2008).

In marked contrast, economic growth in the EU picked up speed in 2006; for the first time in many years, growth in the eurozone in 2007 even outpaced that of the USA. GDP growth was particularly

* The research on this overview was completed on 21 February 2008. V. Gligorov, M. Landesmann, K. Laski as well as the authors of individual country reports (all wiiw) provided useful comments on the earlier draft.

strong in Germany (as well as in Austria) which enjoyed a rising trade surplus – the strong euro notwithstanding. The economies of France, Italy and Portugal performed below the EU average. Emerging market economies grew by nearly 8% per year in the period 2006-2007; the Chinese economy has been constantly accelerating ever since the turn of the century and it expanded by more than 11% in 2007 (Figure 1).

More recently, the US crisis spilt across the whole financial sector, resulting in huge losses for several major players in the money markets. The effects are gradually being felt in the real sector, with a negative impact on consumption and investment. The crisis has also had an impact on credit markets in Western Europe, given the close integration among liberalized global financial markets and complex links in the derivatives business. Quite recently, financial markets in Asia and Eastern Europe also began recording losses; volatility remains high everywhere. A spillover into the real sector in Europe and Asia cannot be excluded either. Credit conditions have been generally tightened – even for borrowers in good standing; conditions for funding via capital markets are also less favourable than before. The European corporate sector, however, particularly in the NMS, relies more on its own resources; financing investment projects via bank loans or capital markets is less common. Stock markets will remain volatile for some time to come (at least several weeks, perhaps even months), although the direct effects of that volatility on the NMS should be limited.

The situation in the energy and food markets could relax, were growth in the United States and/or global demand to slow down. Nonetheless, the fact that inflation in the eurozone is higher than the ECB target (close to, yet still below 2%) could prevent interest rates being cut. The widening interest rate differential will affect the EUR/USD exchange rate and the euro may appreciate further. In the longer run, we have to reckon with an upward trend in energy and food prices owing to (a) higher demand in emerging markets and (b) supply constraints (Middle East and Russia). Recession in the United States appears possible – even likely: with energy prices feasibly dropping in response. The rise in food prices, however, would probably slow down only if China, Russia, India, Brazil and elsewhere suffered a marked growth slowdown. That is rather unlikely.

With the euro strengthening against the US dollar, eurozone exports are losing their competitiveness. Hitherto, however, the effects appear to have been limited (the eurozone, especially Germany, recorded a trade surplus in 2007 not only with the USA but overall; trade deficits were registered with China, Japan and Russia). More euro appreciation would harm West European exports and import competition on EU markets may become fiercer (even Germany may suffer). However, exports to the USA do not account for a large share in overall EU trade (only 10% of overall EU-27 exports go to the USA, less than 3% go to China) as intra-EU trade accounts for more than half of EU exports. Furthermore, a stronger euro would cushion the impact of rising energy prices denominated in US dollars.

Consequently, a modest slowdown in GDP growth in the EU is likely, but nobody expects outright recession in Europe.[1] Here again – as will be discussed below – the direct effects of such a

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1 The latest IMF World Economic Outlook update (from 29 January 2008) projects a deceleration of global growth from 4.9% in 2007 to 4.1% in 2008 with risks tilted to the downside. The US economy will slow down to 1.5% in 2008 (from 2.2% in 2007), the eurozone to 1.6% (from 2.6%) and Central and Eastern Europe to 4.6% (from 5.5%). The projected fourth-quarter 2007 to fourth-quarter 2008 growth slowdown is even more pronounced – see IMF, World Economic Outlook Update, 29 January 2008.

slowdown on GDP growth in the NMS should be even less pronounced; domestic factors are definitely more decisive in terms of their growth prospects.

External factors and their effects on GDP growth in the NMS

- *Influence via exports:* Less demand (or lower demand growth) in the USA and Western Europe may result in lower export growth in the NMS. As past experience suggests, this effect need not be dramatic (it may be compensated, if the NMS increase their market shares). Thanks to the progress achieved in restructuring, NMS products have become more competitive in terms of both price and quality and thus remain attractive on foreign markets. However, as suppliers in cheaper price segments, the NMS have to compete with East Asia (especially China); in that context, international competition could increase, were domestic demand growth in East Asia to lessen and/or the flow of Asian exports to switch from the USA to Europe. The latter shift would also have an immediate impact on export and GDP growth in the NMS.
- *Influence via imports*: World market prices for food will remain above the level of the previous year. Inflation rates in both the eurozone and the NMS will be higher than they were in 2007. This will slow down real growth of private consumption. On the other hand, a recession in the USA could lead to less demand for oil – and hence to lower energy prices.
- *Influence via exchange rate variation*: Interest rates in the eurozone will be higher than in the USA; in all probability GDP growth in the EU will also outstrip GDP growth in the USA. These are two reasons why the euro is likely to appreciate still further against the US dollar. If that happens, extra-EU exports may suffer, while EU imports will experience a boost. In this way, the EU will contribute positively to the US business climate (and export employment) and help to alleviate substantial US external imbalances. For the NMS this should not cause too much trouble, as their trade is mainly within the EU (70% of NMS exports), and their euro peg will not change. In fact, the nominal and real appreciation of their currencies against the euro could pose a more serious problem. On the other hand, a stronger euro (or domestic currency) mitigates the adverse effects of higher energy prices on imports.
- *Influence via a more cautious lending policy in the banking sector:* Credit growth will undoubtedly slow down in Western Europe; in the NMS perhaps to a lesser degree. More cautious lending practices will exacerbate conditions for non-financial companies planning investments (purchases of machinery or increases in stocks of production material). Consumers will be also more reluctant to borrow (or take out housing mortgages) and face more severe borrowing conditions. However, lower credit growth could reduce the risk of overheating that is currently looming in some NMS.
- *Influence via changes in the behaviour of financial investors and lasting volatility*: Here, the uncertainties are particularly high. If the EU were able to show some degree of resistance to the crisis, European financial markets could become more attractive and the euro might appreciate. Furthermore, emerging markets (including the NMS and Russia) could become more attractive. However, one thing is sure: financial investors will be nervous and alert to any kind of anomalies or early warning indicators; they may well overreact. Countries with high external imbalances and/or excessive private debt levels that are already vulnerable (such as Bulgaria, Romania and the Baltics) could suffer external shocks.

Global threats manageable, domestic factors crucial

The impact of the above-mentioned factors differs from country to country; the difference in the overall outcome between Bulgaria, Russia and Turkey, for example, may be huge. Moreover, some of these factors have counterbalancing effects (such as the appreciating EUR/USD exchange rate and rising energy prices; less consumer credit mitigating overheating in the housing market; and higher inflation dampening consumption, while generating more budget revenues). In fact, the summary impact on overall GDP growth in the NMS may be relatively small, yet most factors tend to have a negative effect. The risks identified in our forecasts thus lie predominantly on the downside (for individual factors and the direction of their expected effects on GDP and its components see Box 1). However, this survey and the individual country reports argue that domestic factors will continue to dominate the economic performance of the NMS for years to come.

Box 1

External factors and their potential impact on GDP growth and its components

Impact (+ / –) or none (?)	**GDP growth**	**Private consumption**	**Investments**	**Government consumption**	**Exports**	**Imports**
Financial markets crisis, volatility	**–**	**?** (possibly negative)	**–** credit crunch uncertainty	**–** higher bond spreads	**?** (possibly negative)	**?** (possibly negative)
External price shocks	**? / –**	**–**	**? / –**	**?**	**?**	**?**
Euro appreciation	**?**	**+**	**?**	**?**	**?** (possibly negative)	**+** cheaper oil imports
Lower EU growth	**–**	**?**	**–** lower demand	**?**	**–** lower EU demand	**+** more competition

Note: For Russia and other energy-producing countries, the impact of higher energy prices on exports will be positive; in their case, we might have to put a + under exports. For food exporters (Poland, Romania, Ukraine, Serbia, etc.), higher food prices will have a positive impact on export revenues.

Good starting conditions: robust growth, driven by private consumption and booming investments

The majority of NMS have been enjoying a period of robust (6% and more per year) economic growth – at least since their accession to the EU. That rapid GDP growth also continued in 2007, albeit at a slightly slower pace than in 2006 (NMS-10 grew on average by 6.1% in 2007 as compared to 6.5% the year before – see Table I). In fact, the preliminary figures indicate that the Czech Republic, Slovakia and Slovenia achieved record economic growth during 2007, while Bulgaria and Poland continued to grow at a strong (6% and more) rate. A moderate growth slowdown in Romania, Estonia and Latvia (down to a still respectable figure of 6-11%) was largely attributable to one-time effects (such as the poor harvest in Romania in the wake of a drought or the housing market cooling down in Estonia). Only Hungary stepped out of the line in more recent times; the austerity package adopted in 2006 brought the economy close to stagnation in 2007 (the estimated GDP growth of just 1.3% was even lower than expected owing to a bad harvest).

Growth drivers and the contributions of individual components to overall GDP growth have been changing not only over time, but they have also differed in individual NMS. In this respect, the NMS can be roughly divided into three groups. In 2007, wiiw preliminary estimates suggest that the Czech and Slovak Republics enjoyed the most ‘balanced’ growth with consumption, investments and net exports (the latter including suspiciously large changes in stocks) contributing positively to overall GDP growth (Figure 2). In Poland and Slovenia, GDP growth was driven by investments and (household) consumption, while net exports reduced overall GDP growth by less than 1 percentage

Figure 2

Drivers of GDP growth

contributions of main components to GDP growth, in %

Note: *Net exports including change in stocks and statistical discrepancies.

Source: wiiw Annual Database incorporating national statistics.

point. In Bulgaria and Romania, overall GDP growth in 2007 – in both countries about 6% – was dragged down by surging trade deficits.[2] Last but not least, the Hungarian (meagre) GDP growth stemmed almost exclusively from the contribution of net exports (in this respect, Hungary's growth pattern was similar to that of Germany where net exports have also been the key driver recently).

Box 2

Estimated contributions to the GDP growth: an illustration of projected growth drivers

Contributions of individual GDP components to overall growth depend on their shares in GDP and current growth rates. In 2006, for example, final consumption accounted for 69.3% of GDP in the Czech Republic; gross fixed investment for 26.9%; exports for 77.6%; imports for 73.8% (at previous year's prices). The (preliminary) real GDP growth rate in 2007 was 6.2%. Consumption, investment, exports and imports rose by 6.2%, 4.5%, 13.6% and 11.6%, respectively (all preliminary data – see the respective country table for the Czech Republic). The contribution of consumption to the 6.2% GDP growth rate was 4.3 percentage points (4.3 = 0.062 x 69.3%); of investment 1.1 p.p. (1.1 = 0.045 x 26.9%); of exports 10.6 p.p. (10.6 = 0.136 x 77.6%); of imports (minus) 8.5 p.p. (8.5 = 0.116 x 73.8%). The trade balance thus contributed 2.2 p.p. (2.2 = 10.6 p.p. – 8.4 p.p.). Our projected contributions for 2008-2010 take into account the wiiw growth forecasts of household consumption and gross fixed capital formation (see the respective country tables) and the changing shares of individual final demand components. Changes in relative prices and other items (change in stocks and statistical discrepancy) have been disregarded for want of data and, together with net exports, included in the residual. Furthermore, we assume that final consumption is growing in line with projected household consumption. The estimated contributions of the main components to GDP growth are shown in Figure 2.

wiiw expects that household consumption will continue to play a decisive role as a growth driver in all NMS in the years to come (even in Hungary, we expect growth in household consumption to recover gradually). This will be associated with rising wages and incomes in general, as well as with expanding consumer credits – albeit somewhat slower than over the past few years. Moreover, household consumption accounts for more than half of GDP in all NMS (except the Czech Republic and Slovenia) and thus has the greatest impact on overall growth performance (Table 1).

Several NMS have been enjoying a veritable investment boom recently. In Bulgaria, Latvia, Lithuania, Poland, Romania and Slovenia investments (gross fixed capital formation) grew at double-digit rates in 2007; this vibrant investment activity is expected by and large to continue – albeit at a reduced rate (particularly in Bulgaria, Poland, Romania, Slovakia and Slovenia – see Table 2). By way of contrast, rather anaemic investment growth in the Czech Republic (or stagnation in Hungary) is likely to accelerate over the next few years. This forecast is based on the following reasoning: all NMS will benefit from a substantial increase in transfers from the EU budget which will be used, *inter alia*, to upgrade existing infrastructure and thus stimulate both investment and construction activities.[3] FDI inflows will also remain strong (at least in 2008 – see Table 3) and the region will largely maintain its attractiveness as a location for both export and domestic market-

[2] Estonia, Latvia and Lithuania (not shown there separately) displayed in this respect growth patterns similar to Bulgaria and Romania – all with widening trade and current account deficits.

[3] The NMS received a record EUR 4.3 billion from EU structural and cohesion funds in 2007 (about 0.5% of their GDP) according to EU Regional Policy Commissioner Danuta Hübner (IP/08/204 Press Release, Brussels, 12 February 2008). Rough estimates suggest that transfers from the EU budget may amount to between 1% and 3% of GDP during 2008-2010. The additional aggregate demand will to a large degree be realized in the form of investments (depending on the absorption capacity of individual NMS).

Table 1

Consumption of households

real change in % against preceding year

	2000	2001	2002	2003	2004	2005	2006	2007 [1]	2008	2009	2010	in % of GDP 2007
										forecast		
Czech Republic [2]	1.3	2.3	2.2	6.0	2.9	2.3	5.4	6.2	4	5	5	48.0
Hungary [2)3)]	4.1	5.7	9.9	7.9	2.8	3.6	2.0	-1.3	1	4	4	65.2
Poland [2]	3.1	2.3	3.4	2.0	4.4	2.0	4.9	5.2	5	5	4	60.4
Slovak Republic [4]	2.2	5.7	5.5	1.6	4.2	6.5	5.9	7.8	7	5	7	55.1
Slovenia [2]	0.7	2.6	1.8	3.5	3.0	2.9	4.0	2.5	3	3	2.8	49.4
Bulgaria [3]	4.9	4.6	3.4	6.3	5.3	5.5	7.1	5.8	5.5	5.8	6.0	75.0
Romania [2]	-0.8	6.9	5.3	8.5	14.5	9.7	14.1	11	10	6	8	68.8
Estonia	8.8	7.1	10.9	9.6	6.7	10.6	15.1	9.1	8	7	8	52.3
Latvia	6.3	7.3	7.4	8.2	8.7	11.6	20.0	15.3	15	12	10	66.0
Lithuania	6.0	3.7	5.8	10.3	12.2	12.1	11.8	10.8	10	8	7	64.6

1) Preliminary. - 2) According to ESA'95 (FISIM adjusted and based on previous year prices). - 3) Actual final consumption of households. - 4) According to ESA'95 (FISIM adjusted).

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

Table 2

Gross fixed capital formation

real change in % against preceding year

	2000	2001	2002	2003	2004	2005	2006	2007 [1]	2008	2009	2010	in % of GDP 2007
										forecast		
Czech Republic [2]	5.1	6.6	5.1	0.4	3.9	2.3	5.5	4.5	3	4	5	24.3
Hungary [2]	7.7	5.2	10.2	2.2	7.6	5.3	-2.8	1.2	6.5	10	10	21.3
Poland [2]	2.7	-9.7	-6.3	-0.1	6.4	6.5	15.6	20.4	18	14	6	22.2
Slovak Republic [3]	-9.6	12.9	0.2	-2.7	4.8	17.6	8.4	7.5	7	7	7	25.9
Slovenia [2]	1.8	1.4	1.0	7.4	7.3	2.5	8.4	18	8	4	5	25.1
Bulgaria	15.4	23.3	8.5	13.9	13.5	23.3	17.6	24.0	18	16	14	28.0
Romania [2]	5.5	10.2	8.2	8.5	11.1	12.6	16.1	25	20	10	15	30.8
Estonia	14.3	9.7	24.1	19.2	4.4	9.9	22.4	4.1	5	7	7	30.8
Latvia	10.2	11.4	13.0	12.3	23.8	23.6	18.3	13.8	12	8	7	34.8
Lithuania	-9.1	13.5	10.9	14.1	15.5	10.9	17.4	16.8	15	13	11	26.9

1) Preliminary. - 2) According to ESA'95 (FISIM adjusted and based on previous year prices). - 3) According to ESA'95 (FISIM adjusted).

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

oriented investment projects – despite global uncertainties and rising production costs (see below). The risks emanating from global financial markets appear manageable: a large portion of investments to date has been financed from the firms' own resources thanks to their comfortable profits and liquidity situation (Poland is a case in point, but also elsewhere). Taken together, these sources of investment financing (and the fairly limited role of stock exchanges in investment financing in the region) will mitigate the potentially adverse external effects. The expansion of investments will thus contribute positively to GDP growth in all NMS. This effect will be particularly strong in Bulgaria, Hungary, Poland and Romania (as well as in the Baltic States where the shares of investments in the GDP are also rather high – see Table 2).

Table 3

Foreign direct investment (FDI) inflow to NMS

EUR million

	2005	**2006**	**2007** 1)	**2008** forecast	**2005**	**2006**	**2007**	**2008** forecast	**2007** 1) stock
					FDI net, % of current account deficit				EUR mn
Czech Republic	9,354	4,760	5,600	6,000	572	104	117	102	64,000
Hungary	6,172	5,680	3,000	4,000	73	47	18	56	67,000
Poland	8,317	15,198	15,400	16,900	144	92	109	88	110,000
Slovakia	1,952	3,324	2,300	2,000	56	97	85	72	30,000
Slovenia	473	512	900	1,200	-8	-24	-6	14	8,000
NMS-5	*26,268*	*29,473*	*27,200*	*30,100*	*138*	*78*	*84*	*80*	*279,000*
Bulgaria	3,103	4,364	5,687	5,200	121	107	89	84	23,000
Romania	5,213	9,060	7,069	8,000	76	86	41	42	42,000
Estonia	2,255	1,341	1,700	1,600	156	23	20	25	12,000
Latvia	568	1,326	1,500	1,600	29	33	30	30	8,000
Lithuania	826	1,448	1,500	1,600	37	48	38	30	11,000
NMS-10	*38,232*	*47,013*	*44,656*	*48,100*	*111*	*75*	*61*	*60*	*375,000*

Note: FDI net is defined as inflow minus outflow.

1) wiiw estimate.

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

Expanding foreign trade, diminishing role as a growth driver

Foreign trade has been one of the most dynamic components in the NMS economies, driven as it is by their integration into the world economy (in particular, the EU accession process), inflows of foreign direct investments and the related modernization and economic restructuring. Without doubt, all this has been one of the pillars of the countries' recent economic success. However, estimating (and especially forecasting) the direct effect of foreign trade on GDP growth is a rather difficult undertaking owing to conceptual problems and current global uncertainties.[4] Table 4 shows the latest trade developments according to customs statistics. In 2007, growth in NMS exports and imports (in EUR terms) slowed down slightly, yet remained in double digits (a nominal increase by

4 The available sets of data (customs statistics, balance of payments statistics and the national accounts) differ by wide margins owing to varying coverage, methodological differences and statistical concepts. Moreover, the estimates of real contributions of exports and imports to GDP growth (national accounts concept) would also require estimates of domestic and external price developments in exports and imports.

Table 4

Foreign trade of the new EU member states

(based on customs statistics)

		2002	2003	2004	2005	2006	2007 [1]	2006	2007 [1]
		EUR million						change in %	
Czech Republic	Exports	40,726	43,051	53,995	62,738	75,665	88,830	20.6	17.4
	Imports	43,025	45,243	54,824	61,441	74,262	85,729	20.9	15.4
	Balance	-2,298	-2,192	-829	1,297	1,403	3,101	.	.
Hungary	Exports	36,523	38,041	44,630	50,093	58,997	68,194	17.8	15.6
	Imports	39,939	42,189	48,550	52,996	61,394	68,639	15.8	11.8
	Balance	-3,417	-4,149	-3,920	-2,903	-2,398	-445	.	.
Poland	Exports	43,400	47,511	60,014	71,740	88,259	102,400	23.0	16.0
	Imports	58,307	60,288	71,812	81,530	101,160	118,400	24.1	17.0
	Balance	-14,907	-12,777	-11,798	-9,791	-12,901	-16,000	.	.
Slovakia [2)3)]	Exports	15,270	19,318	22,427	25,654	33,120	42,003	29.1	26.9
	Imports	17,517	19,923	23,686	27,571	35,292	42,586	28.0	21.3
	Balance	-2,247	-606	-1,259	-1,917	-2,172	-583	.	.
Slovenia	Exports	10,966	11,288	12,786	14,397	16,757	19,348	16.4	15.5
	Imports	11,578	12,242	14,146	15,804	18,341	21,407	16.1	16.7
	Balance	-612	-954	-1,360	-1,408	-1,584	-2,059	.	.
NMS-5	*Exports*	*146,885*	*159,209*	*193,852*	*224,621*	*272,798*	*320,775*	*21.4*	*17.6*
	Imports	*170,367*	*179,885*	*213,018*	*239,343*	*290,450*	*336,761*	*21.4*	*16.0*
	Balance	*-23,481*	*-20,677*	*-19,166*	*-14,722*	*-17,652*	*-15,986*	.	.
Bulgaria	Exports	6,063	6,668	7,985	9,466	12,012	13,462	26.9	12.1
	Imports	8,411	9,611	11,620	14,668	18,479	21,914	26.0	18.6
	Balance	-2,348	-2,942	-3,635	-5,201	-6,467	-8,452	.	.
Romania	Exports	14,675	15,614	18,935	22,255	25,850	29,380	16.2	13.7
	Imports	18,881	21,201	26,281	32,568	40,746	50,883	25.1	24.9
	Balance	-4,206	-5,588	-7,346	-10,313	-14,895	-21,502	.	.
Estonia	Exports	3,642	4,003	4,769	6,183	7,734	8,100	25.1	4.2
	Imports	5,080	5,716	6,703	8,204	10,699	11,100	30.4	3.7
	Balance	-1,437	-1,713	-1,934	-2,021	-2,964	-3,000	.	.
Latvia	Exports	2,418	2,560	3,204	4,110	4,686	5,727	14.0	22.2
	Imports	4,287	4,635	5,670	6,925	9,076	10,986	31.1	21.0
	Balance	-1,868	-2,076	-2,467	-2,816	-4,390	-5,259	.	.
Lithuania	Exports	5,524	6,158	7,478	9,490	11,263	12,522	18.7	11.2
	Imports	7,941	8,526	9,958	12,498	15,429	17,663	23.5	14.5
	Balance	-2,416	-2,368	-2,480	-3,008	-4,167	-5,142	.	.
NMS-10	*Exports*	*179,208*	*194,211*	*236,222*	*276,125*	*334,344*	*389,966*	*21.1*	*16.6*
	Imports	*214,966*	*229,574*	*273,250*	*314,206*	*384,880*	*449,307*	*22.5*	*16.8*
	Balance	*-35,757*	*-35,363*	*-37,028*	*-38,080*	*-50,536*	*-59,341*	.	.

1) Preliminary. - 2) From 2005 data refer to trade excluding value of goods for repair. - 3) From 2007 excluding indirect trade data.

Source: wiiw Database incorporating national statistics.

nearly 17% on average). Once again Slovakia recorded the most rapid export growth (close to 30%), followed by Latvia and the Czech Republic. A marked slowdown in export growth occurred in Poland, Bulgaria, Estonia and Lithuania (in the latter two countries this is attributed also to a decline in oil transit shipments). In the NMS-5 (except Poland and Slovenia), export growth outpaced import growth and the countries' trade balances improved. In the Czech Republic, the previous year's trade surplus more than doubled; even Hungary and Slovakia recorded a major drop in their trade deficits (in Hungary thanks to reduced private consumption and stagnating investments). By way of contrast, trade deficits expanded still further in Slovenia – and especially so in Bulgaria and Romania.

As mentioned above, in 2007 the estimated contribution of real net exports to GDP growth (according to the national accounts concept) was positive in the Czech and Slovak Republics (and immensely so in Hungary), whereas in all other NMS it was negative (there being a weak association between nominal changes in the trade balance and the respective contributions to the real GDP growth). wiiw forecasts of trade developments over the next few years (according to the balance of payments concept and therefore not entirely comparable with the customs statistics data in Table 4) reckon with further double-digit nominal growth in both NMS exports and imports (except for the Baltic States – see the respective country tables). The Czech Republic, Hungary and even Slovakia are expected to enjoy trade surpluses, whereas the remaining NMS will continue to accumulate deficits. In terms of contributions to GDP growth, only the Czech Republic, Poland and Slovenia are expected to enjoy a positive growth effect from net exports in 2010 (Figure 2). GDP growth in Bulgaria and Romania will suffer most from deteriorating real net exports – albeit to a lesser degree than has been the case in the recent past.

Robust growth of industry, competitiveness maintained

Another NMS success story over the past couple of years has been the impressive growth in industrial production – associated with the FDI inflows and the growth in foreign trade mentioned above. Over the period 2000-2007, NMS industrial output increased by nearly 60% – on average by 6.6% per year. Growth in 2007 was 8.4% on average for the NMS-10 (and more than 9% for the NMS-5); for both country groups, about 1 percentage point less than in 2006 (Table 5). In the years to come, wiiw expects most NMS to continue enjoying fairly high growth in industrial output (Latvia and Lithuania being exceptions), although Hungary will probably be the only country to surpass the peak growth of 2006-2007 (see Figure 3). Nevertheless, the projected average NMS industrial growth of some 8% per year during 2008-2010 is still above the countries' long-term average performance.

Industry has become a veritable engine of growth, especially in the NMS in Central Europe – and more particularly in Poland and Slovakia. Even in Hungary, where GDP grew by a meagre 1.3% and domestic demand essentially stagnated in 2007, industrial production expanded by 8% thanks to healthy export growth. Indeed, the NMS have become a preferred location for export-oriented production, attracting substantial amounts of foreign direct investments.[5] The resulting modernization of industry, product quality improvements and restructuring in general are helping the NMS to maintain their competitiveness – despite rising wages. Wage increases have been partly offset by productivity improvements which mitigate the increase in unit labour costs (ULC). Among

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5 About 40% of total FDI inflows to NMS went to manufacturing – see G. Hunya, *wiiw Database on FDI* (May 2007). The automotive industry cluster in the Czech Republic and Slovakia, and electro-technical industry in Hungary are the most outstanding examples.

the NMS in Central Europe, unit labour costs in industry increased by less than 6% in 2007 (and stagnated at a high level in Slovenia). In Bulgaria and especially in Romania, however, the recent upsurge in unit labour costs is most likely unsustainable for reasons of competitiveness (Figure 4). The ULC are, of course, not the sole determinant of competitiveness, not least because labour costs represent only part of the overall production costs. Nevertheless, they still figure prominently in companies' investment location decisions (as illustrated by the recent example of Nokia shifting its production of mobile phones from Germany to Romania).

Table 5

Gross industrial production

real change in % against preceding year

	2000	2001	2002	2003	2004	2005	2006	2007 1)	2008	2009	2010	Index 2000=100 2007
										forecast		
Czech Republic	1.5	6.7	1.9	5.5	9.6	6.7	11.2	8	8	9	8	161.4
Hungary	18.1	3.6	2.8	6.4	7.4	7.0	9.9	8.1	8	10	12	154.6
Poland 2)	6.7	0.6	1.1	8.3	12.6	3.7	11.2	10	10	8	8	157.4
Slovak Republic	8.5	6.9	6.3	5.0	4.1	3.8	9.9	13	12	10	7	160.1
Slovenia	6.2	2.9	2.4	1.4	4.8	3.3	6.1	7.0	5	4	4.5	131.3
NMS-5 3)	*7.3*	*3.2*	*2.1*	*6.7*	*9.9*	*4.9*	*10.7*	*9.4*	*9.2*	*8.6*	*8.4*	*156.9*
Bulgaria	8.3	1.5	6.5	14.1	13.9	10.0	8.2	8.5	8	9	10	181.6
Romania	7.1	8.3	4.3	3.1	5.3	2.0	7.2	5.4	6	6	7	141.3
Estonia	14.6	8.9	8.2	10.9	10.5	11.0	7.3	6	6	5	7	182.5
Latria	4.7	9.2	8.4	9.1	8.9	5.7	5.1	0.5	1	2	2	157.0
Lithuania	2.2	16.0	3.1	16.1	10.8	7.1	7.3	4.0	4	3	5	183.9
NMS-10 3)	*7.3*	*4.3*	*2.8*	*6.8*	*9.4*	*4.9*	*9.8*	*8.4*	*8.3*	*7.9*	*8.0*	*156.4*

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

Source: wiiw Database incorporating national statistics, forecast: wiiw

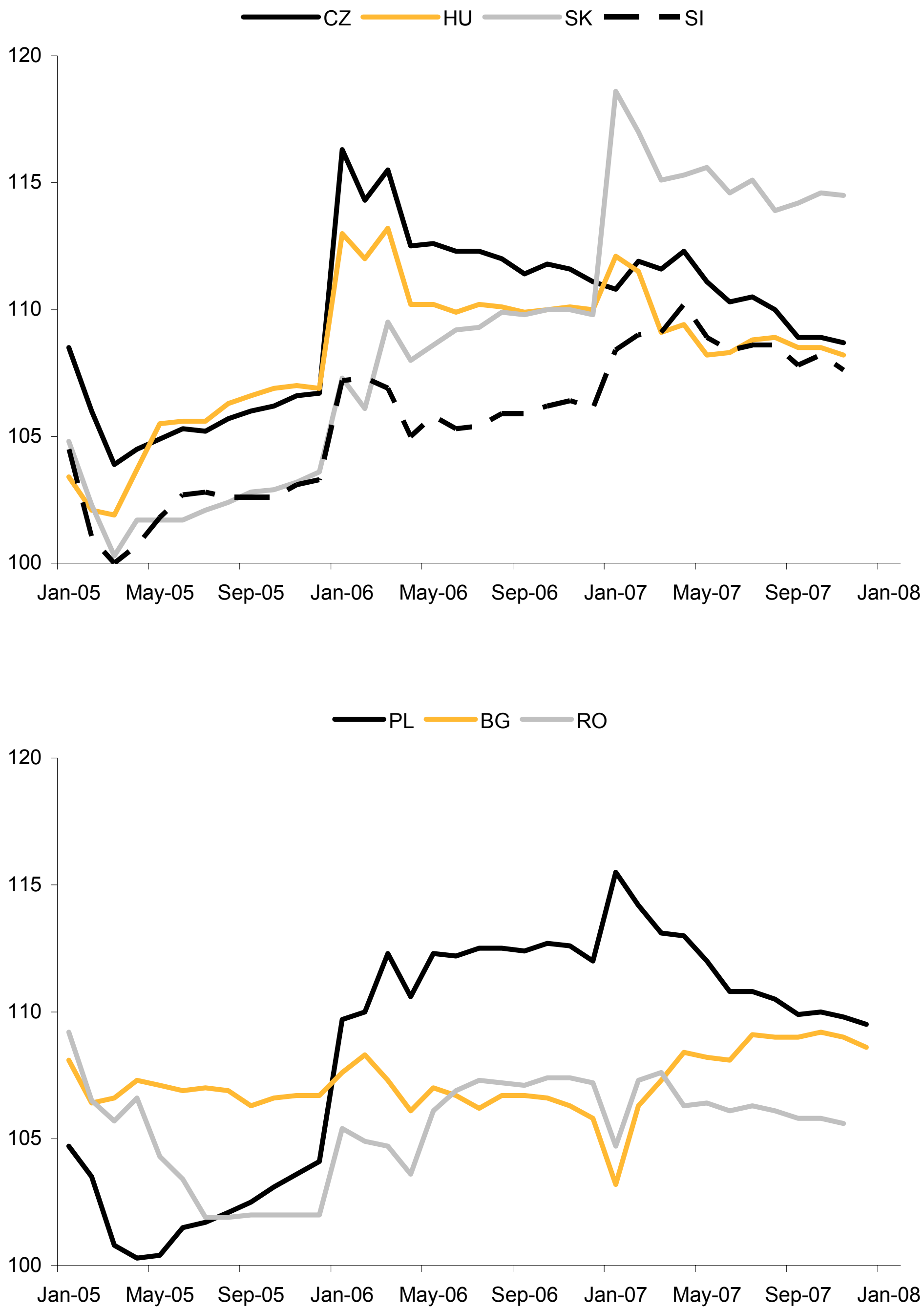
The majority of NMS still enjoy huge advantages in terms of labour costs over Western Europe – despite the rapid increase in ULC they have recently experienced (see Figures 5a and 5b, for details also Appendix Table A/2 and A/3: Indicators of Competitiveness). Nevertheless, given the competition for production locations and new investment projects both *within the region and without*, the fact that Romania, for example, now has the second highest ULC among the NMS (after Slovenia) is an obvious reason for concern over the sustainability of wage and exchange rate developments in that country.[6]

[6] Back in 2007 the textile industry in Romania was already suffering a setback, largely owing to the competition from China. Low-skill and labour-intensive industries accounted for some 30-40% of Romania's manufacturing exports in 2006 (only Bulgaria has a higher share of low-skill industries in exports – 56%). In other NMS (except Latvia and Lithuania), the group of labour-intensive industries plays a less prominent role in exports (Figure 6). In Hungary, the Czech Republic and Slovakia (as well as in China), all of which currently have lower unit labour costs than Romania, the technology-driven industries (such as motor vehicles, TV, radio, optical and medical equipment, office machinery and pharmaceuticals) play an increasingly prominent role in exports.

Figure 3

Gross industrial production, 2005-2007

cumulated, year-on-year, growth in %

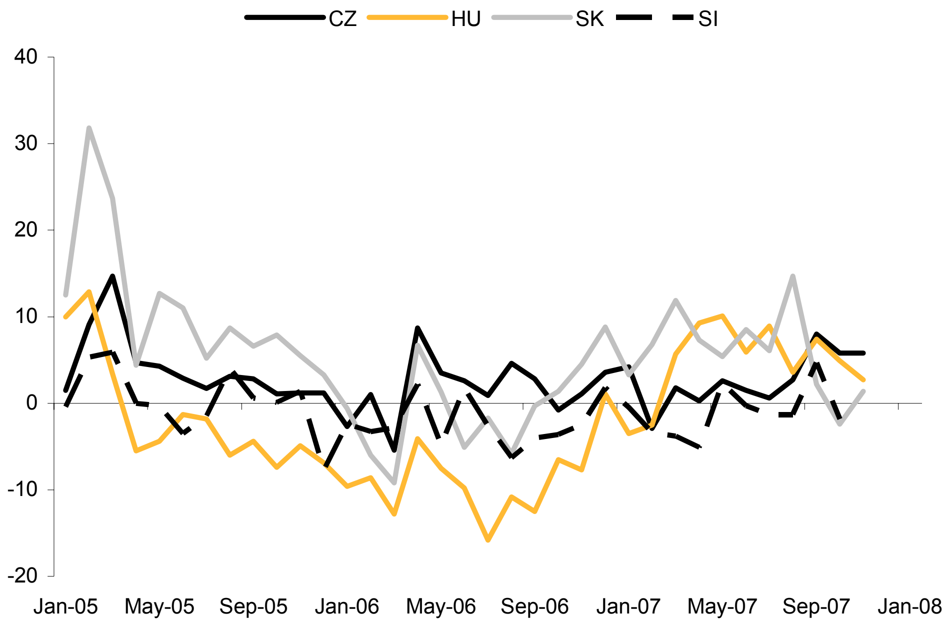


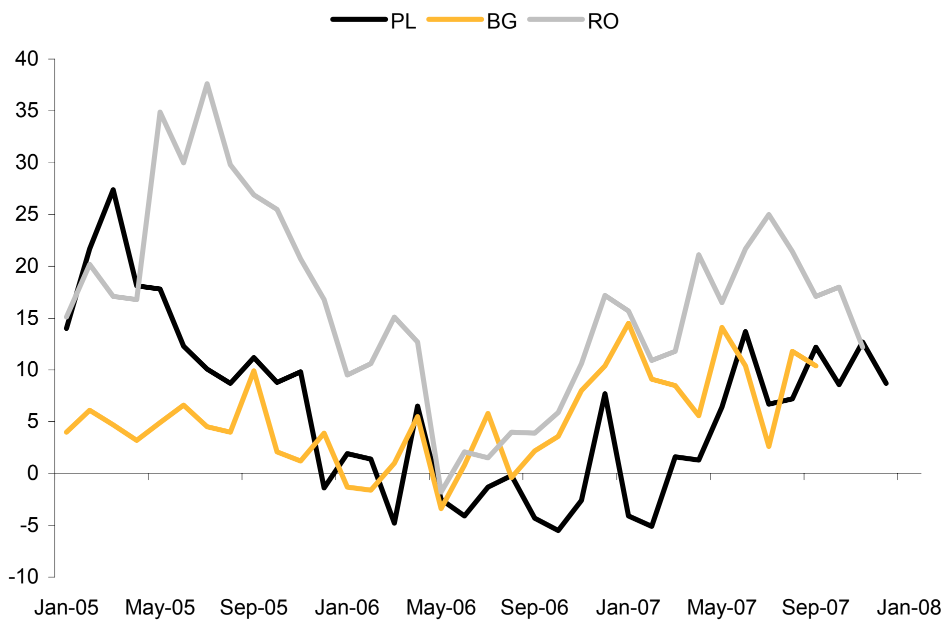
Source: wiiw Monthly Database incorporating national statistics.

Figure 4

Unit labour costs in industry, 2005-2007

EUR-adjusted, year-on-year, growth in %





Source: wiiw Monthly Database incorporating national statistics.

Figure 5a

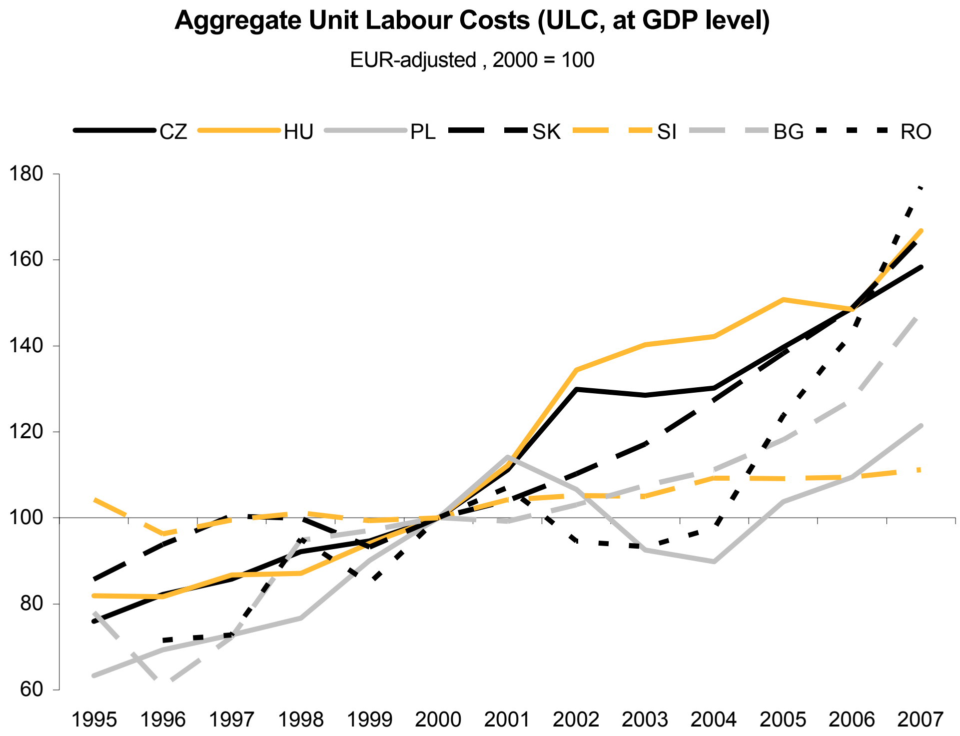
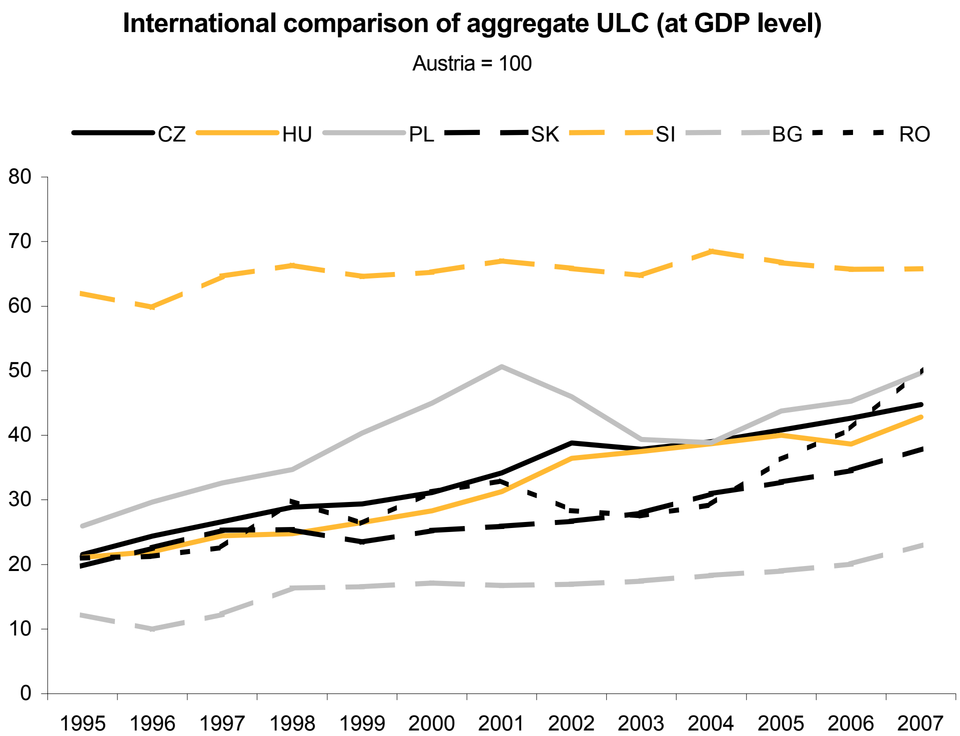
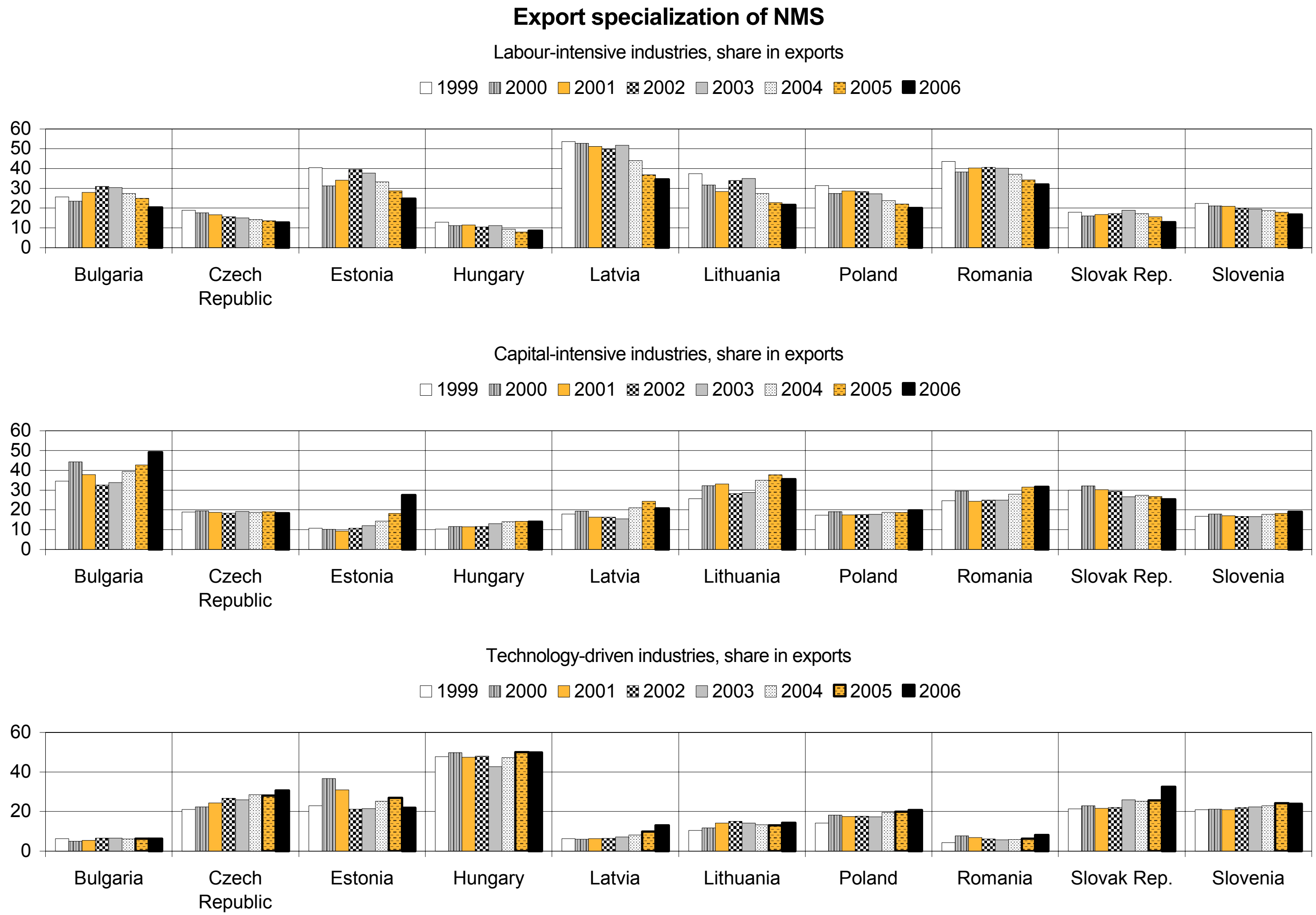


Figure 5b



Source: wiiw Annual Database incorporating national statistics.

Figure 6



Source: wiiw Annual Database incorporating national statistics, Eurostat.

A dangerous mix: higher inflation and nominal currency appreciation

Rising energy and food prices on world markets are also leaving their traces in NMS inflation figures. After a period of relative stability over the period 2005-2006, inflation picked up markedly in the course of the past year (Figure 7). The external inflationary pressures were further fuelled by home-grown factors such as wage increases, administered tariff and VAT tax adjustments. The latter had a bearing on the inflationary spike in Slovakia and Hungary as far back as 2006. The tax reform introduced in the Czech Republic at the beginning of 2008 will have a similar inflationary effect (in January the CPI jumped 7.5% year on year). Nonetheless, the general expectation is that the recent upsurge in consumer prices will be only temporary and the average annual inflation will settle down to below 3% in the NMS in Central Europe by 2010 and/or near or below 5% per year in the rest of the region (in Bulgaria and Romania the disinflation process will take longer). The European Central Bank will keep a watchful eye on price developments, especially in Slovakia, which is intent upon adopting the euro at the beginning of 2009. The recent experience of Slovenia (which joined the eurozone at the beginning of 2007), as well as that of Estonia and Lithuania two years ago with similar aspirations (rejected by the ECB), will surely affect the ECB decision on Slovakia's eurozone ambitions.

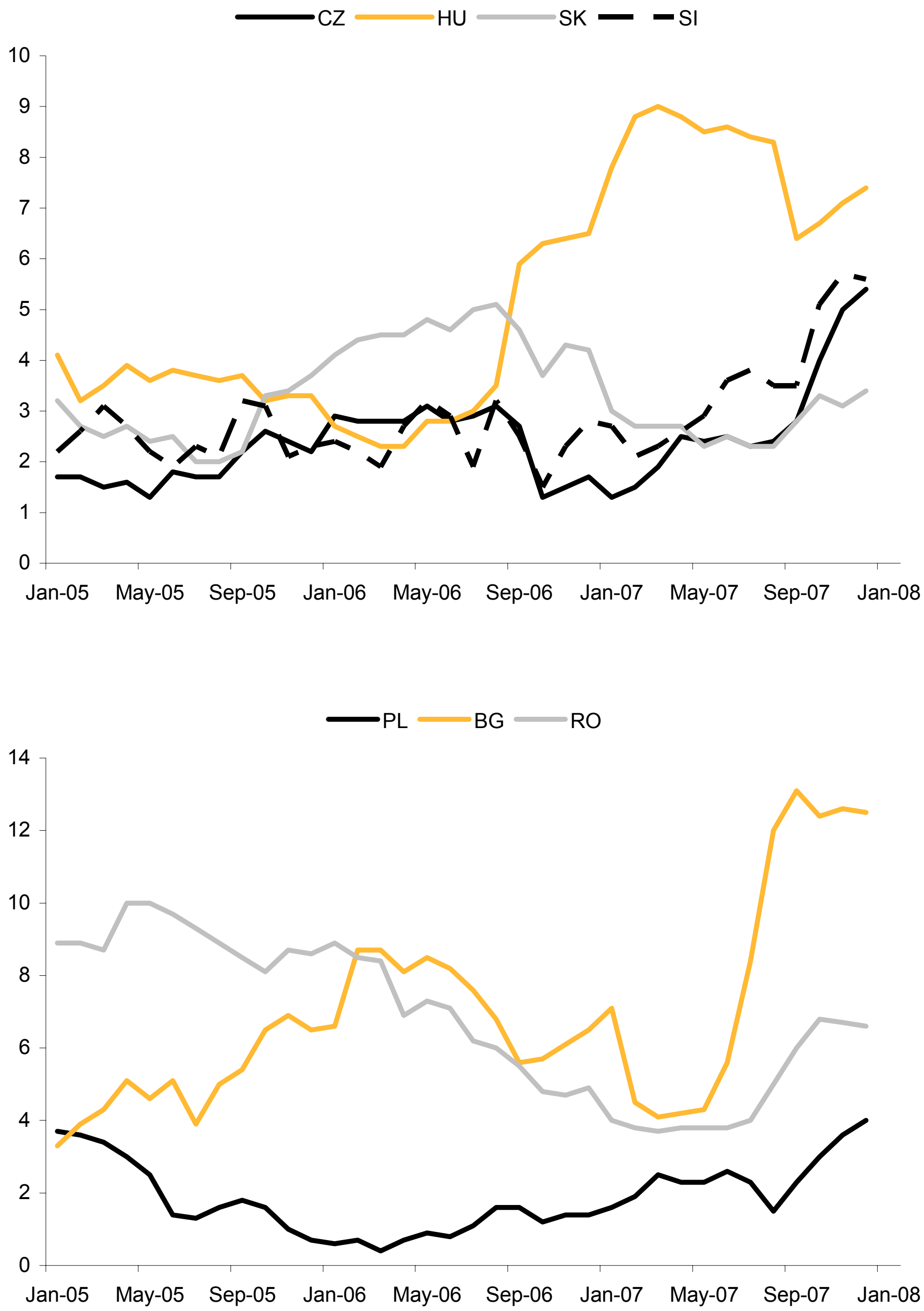
Monetary authorities usually respond to rising inflation by tightening monetary policy. To date the national central banks have remained cautious; they have not increased the key interest rates to any marked degree and the interest rate differential to the ECB rate is negligible (except for Hungary, Lithuania, Poland and Romania). The money market rates in the NMS have also moved closer to those in the euro area. Real interest rates remain rather low or even negative (in Bulgaria, the Czech Republic and Slovenia). However, changes in the monetary policy stance cannot be excluded, if prices go up. Moreover, higher interest rates may attract short-term capital, which – together with other foreign exchange inflows from FDI – will exert additional pressure on already appreciating exchange rates. Nominal appreciation of domestic currencies has been significant over the past few years, especially in the Czech and Slovak Republics, as well as in Poland and (until mid-2007) Romania (Figure 8). Even in other NMS whose currencies are pegged to the euro, the current sizeable inflation differentials have resulted in real currency appreciation. This has been particularly strong recently in Bulgaria, the Czech Republic, Romania and Slovakia (Figure 9). Apart from potentially destabilizing capital flows attracted by high interest rate spreads and currency appreciation – particularly in countries already suffering from high current account deficits such as Bulgaria, Romania and the Baltics – excessive real appreciation is by its very nature detrimental to trade competitiveness.[7]

7 Over the period 2000-2007, the Slovak koruna and Romanian leu appreciated in real terms (against the euro) by more than 50% (see Appendix Table A/2). As shown above, the effect of currency appreciation on exports has so far been apparently offset by the quality and productivity improvements. Appreciating currency (especially vis-à-vis the US dollar) also mitigated the impact of rising energy prices.

Figure 7

Consumer price inflation, 2005-2007

year-on-year growth in %

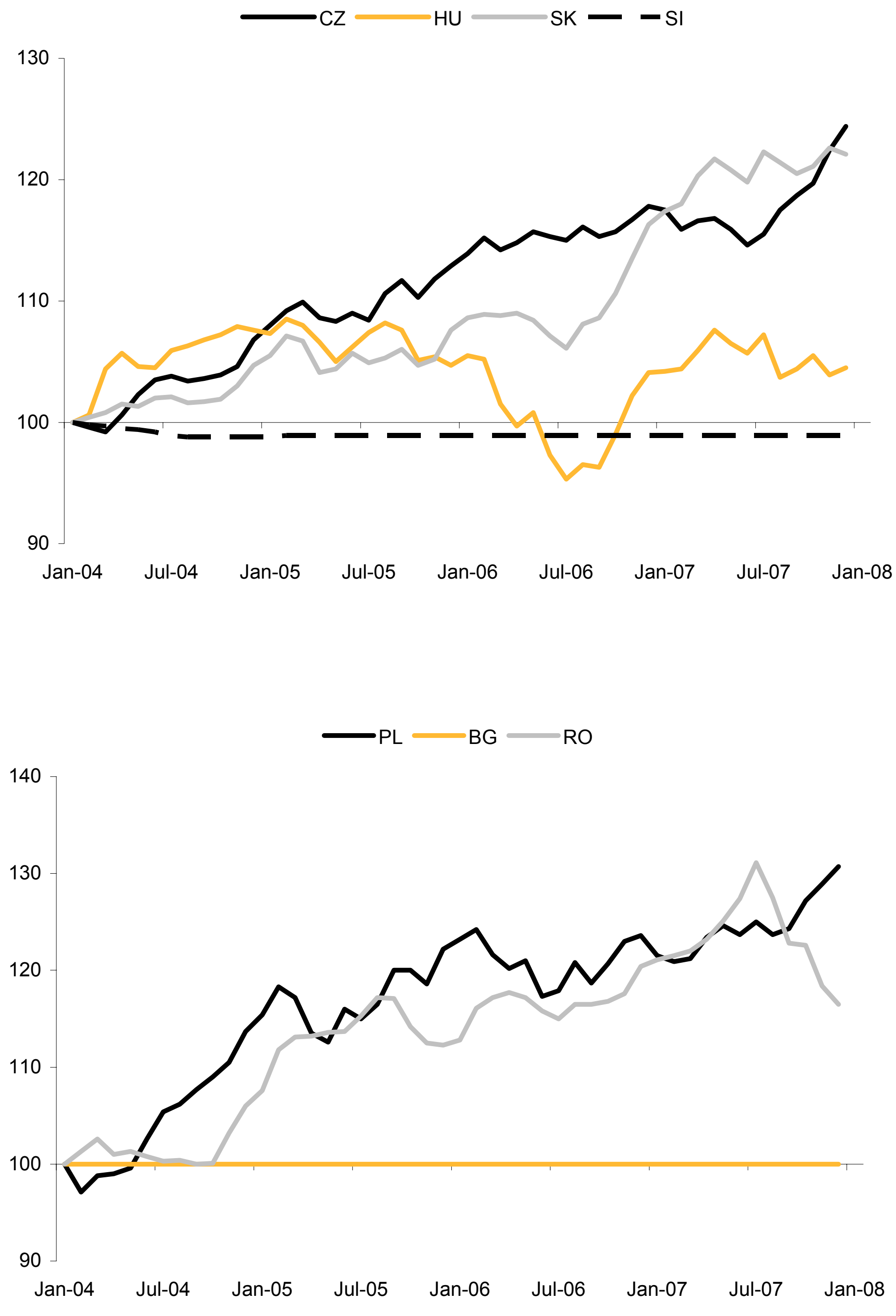


Source: wiiw Monthly Database incorporating national statistics.

Figure 8

Nominal exchange rates*, 2004-2007

NCU per EUR, monthly average, January 2004 = 100



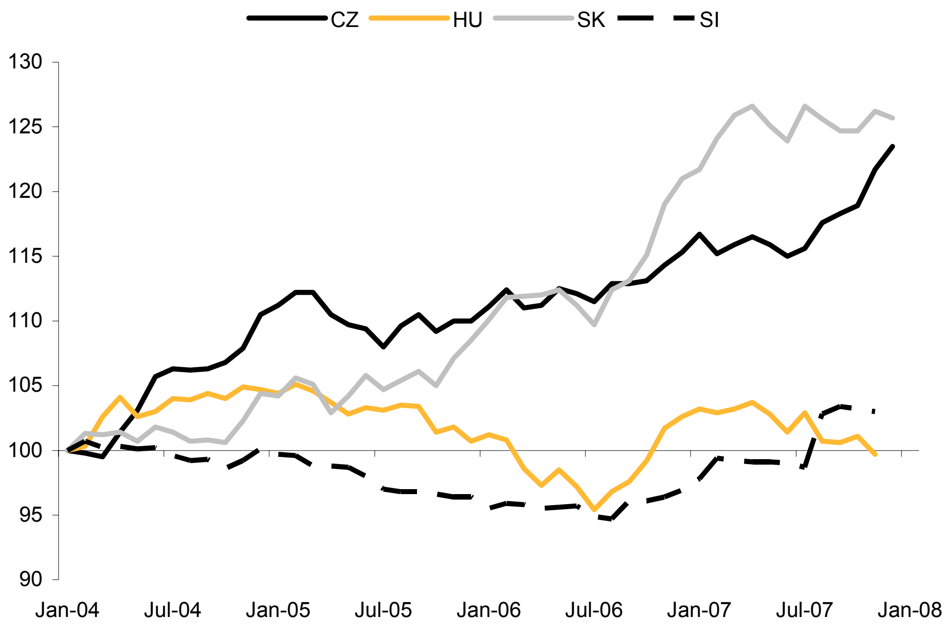
* Increasing line indicates appreciation.

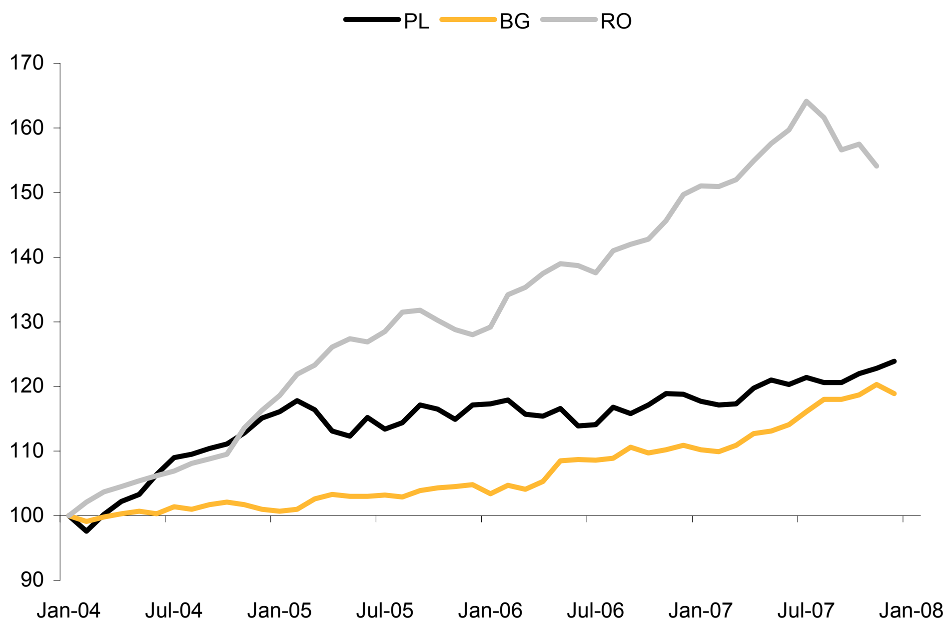
Source: wiiw Monthly Database incorporating national statistics.

Figure 9

Real appreciation*, 2004-2007

NCU per EUR, PPI-deflated, January 2004 = 100





* Increasing line indicates appreciation.

Source: wiiw Monthly Database incorporating national statistics.

Fiscal situation better than expected

Preliminary data suggest that in 2007 government finances performed better than expected in the majority of NMS – thanks to robust economic growth and higher inflation. Even Hungary's convergence programme successfully reduced the budget deficit by more than 3 percentage points of GDP (to less than 6% in 2007 – mostly thanks to lower interest payments and higher tax revenues), but the price paid was economic stagnation and public unrest. Moreover, given the fierce political opposition, it is not at all clear whether the next reform steps will be implemented as planned (or the recently adopted measures reversed). The Czech Republic also agreed on a reform of its public finances in autumn 2007. It envisages a gradual lowering and streamlining of tax rates (not strictly a flat tax, but a step in that direction), as well as the usual bundle of measures such as the abolition of certain social benefits, the introduction of health service fees and a raising of the retirement age. Most of those reforms tend to benefit those members of society who are better-off (lower taxes on higher incomes and the like) and are thus rather unpopular. The first tranche of the reform package was implemented in January 2008; the immediate effect was a spike in inflation on account of an increase in VAT on basic necessities. Similar to the Slovak Republic, the anticipated VAT and excise tax adjustments may have contributed to surprisingly high economic growth reported for the last quarter of 2007, yet their impact in the medium and long term is far less certain.

In common with elsewhere in Europe, public sector reforms (including health and social security systems) in the NMS are necessary. However, they are also highly controversial and extremely difficult to implement politically – especially given the fragility of governing coalitions. A comparison with Western Europe shows that in general, government expenditures in the NMS are not excessively high as a share of GDP (Hungary is an exception – see Table II). It is the relatively low state revenue (on average less than 40% of GDP in the NMS compared to 45% in the EU-15 in 2007) that may affect the long-term sustainability of public finances. Government deficits in the Czech Republic, Hungary and Poland will exceed the Maastricht threshold of 3% of GDP for another two years or so and accession to the eurozone will not feature on the agenda in the near future.[8]

Paradigm change: a shift from 'jobless' growth to labour shortages?

The situation on the NMS labour market has changed dramatically recently. In the period 1995-2004, unrelenting high unemployment and GDP growth rates below 5%, coupled with the current productivity catching-up potential, were seemingly persistent; the period in question was termed 'jobless' growth, i.e. a combination of the growth in output and productivity while employment stagnated or even declined.[9] However, over the past few years unemployment has started to decline rapidly; in 2007 the average rate of unemployment in the NMS-10 dropped below 10% on average (Table I). Even in Poland and Slovakia (both of which recorded unemployment rates close to 20% in as late as 2004), the unemployment rate dropped to 11% in 2007 and is expected to decline further. A number of factors are responsible for these encouraging labour market developments:

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8 The Baltic States will not be able to meet the Maastricht inflation criterion in the forecast period. The introduction of the euro has thus been postponed for a couple of years, in Latvia it is likely to happen in 2013 at the earliest, in Estonia and Lithuania probably one or two years prior to that.

9 Owing to the low elasticity of employment to GDP growth in the NMS it has been estimated that GDP growth below 4% per year would not be sufficient to generate new jobs and reduce unemployment – see P. Havlik and M. Landesmann (2005), 'Structural change, productivity and employment in the new EU Member States', in: 'Economic Restructuring and Labour Markets in the Accession Countries', Study conducted by wiiw and Alphametrics Ltd. on behalf of EU DG Employment.

demography, accelerated GDP growth and outward labour migration. However, declining unemployment on account of outward migration (especially after EU accession) is too simplistic an explanation: employment (and employment rates) in the NMS also started increasing after 2004 and employment growth seems to have accelerated recently (Table 6; see also Part D, chapter on 'Tightening labour markets').

Table 6

Employment, LFS definition, annual averages

	in 1000 persons	change in % against preceding year						Index 2000=100
	2007 1)	**2002**	**2003**	**2004**	**2005**	**2006**	**2007** 1)	**2007**
Czech Republic	4,922	0.3	-0.7	-0.6	1.2	1.3	1.9	104.0
Hungary	3,926	0.1	1.3	-0.5	0.0	0.7	-0.1	101.8
Poland	15,250	-3.0	-1.2	1.3	2.3	3.4	4.5	105.0
Slovak Republic	2,350	0.2	1.8	0.3	2.1	3.8	2.1	111.8
Slovenia	980	-0.7	-1.4	5.1	0.6	1.3	2.0	108.8
NMS-5 2)	*27,428*	*-1.6*	*-0.5*	*0.7*	*1.7*	*2.6*	*3.1*	*105.0*
Bulgaria	3,270	1.5	3.5	3.1	2.0	4.4	5.1	117.0
Romania	9,560	-11.5	-0.1	-0.7	-0.1	1.8	2.6	103.5 3)
Estonia	655	1.4	1.5	0.2	2.0	6.4	1.3	114.4
Latvia	1,115	2.8	1.8	1.1	1.8	5.0	2.5	118.5
Lithuania	1,540	4.0	2.3	-0.1	2.6	1.7	2.7	110.2
NMS-10 2)	*43,568*	*-3.5*	*0.1*	*0.5*	*1.3*	*2.6*	*3.1*	*106.1*

1) Preliminary. - 2) wiiw estimate. - 3) 2002 = 100.

Source: wiiw Database incorporating national statistics.

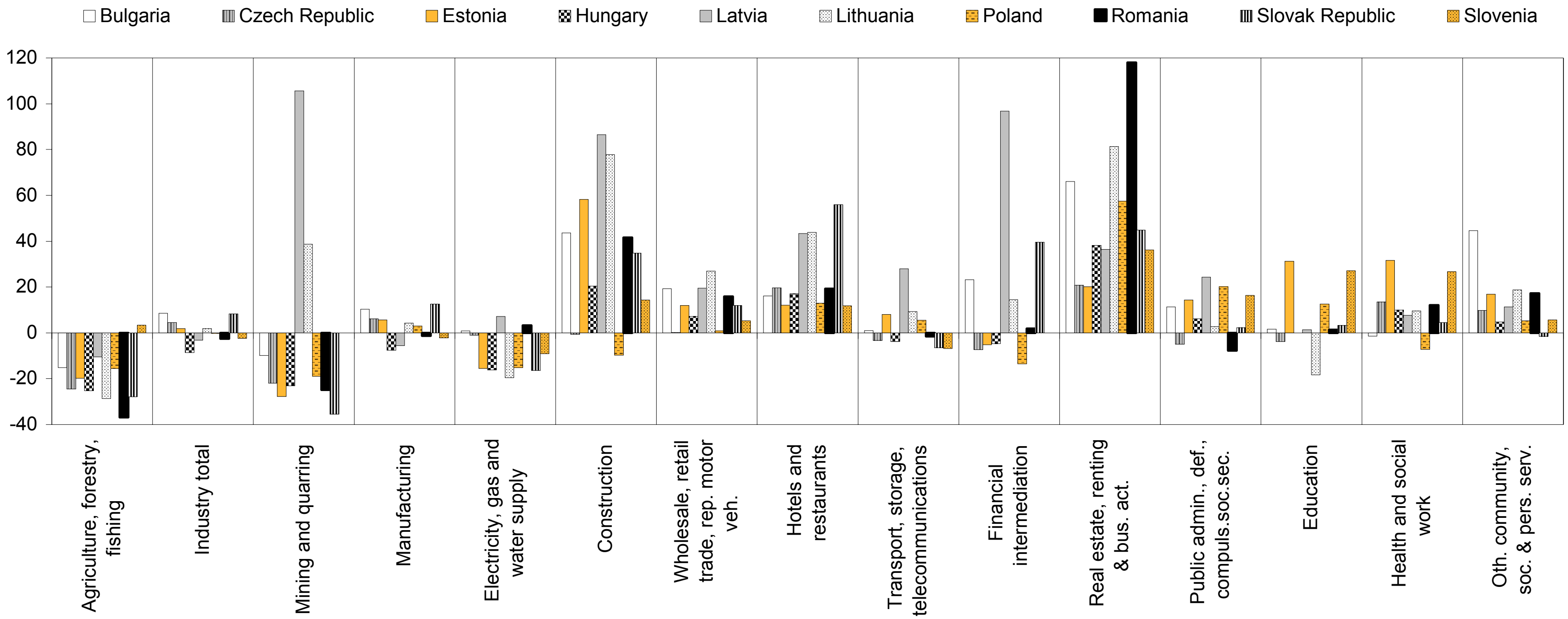
In fact, economic growth in the NMS is no longer 'jobless'. On the contrary, in the period 2000-2007 (and essentially after 2004) about 2.5 million new jobs were created in the NMS. This reversal of the labour market situation is truly dramatic: most countries in the region (not only the NMS, but also those further to the east such as Russia and Ukraine) are now reporting labour shortages – especially of skilled workers – which could well become a serious constraint on their economic growth. Once again, the situation is uneven across individual countries and sectors. Poland and Bulgaria reported the fastest employment growth in 2007. Only in Hungary has employment stagnated owing to the country's sluggish GDP growth. Over the period 2005-2007, the job vacancy rate showed a steady and significant increase. Together with low levels of unemployment, this may denote shortages of skilled workers and a tightening of labour markets (for details see Part D, chapter on labour markets).

At the same time, certain structural features of unemployment have remained unchanged or even deteriorated. Regional disparities continue to widen and interregional mobility is low. However, substantial progress towards reducing youth unemployment has been achieved, particularly in Poland and Slovakia (the two countries hardest hit in the past). Long-term unemployment, though declining in most countries of the region, is still above the EU-27 average, the only exceptions being Latvia and Lithuania. Slovakia is an outlier in this respect, with over 70% of the total unemployed accounting for long-term unemployment, the vast majority of whom are members of the Roma minority.

Figure 10

Employment by sectors

cumulated growth in %, 2000-2006

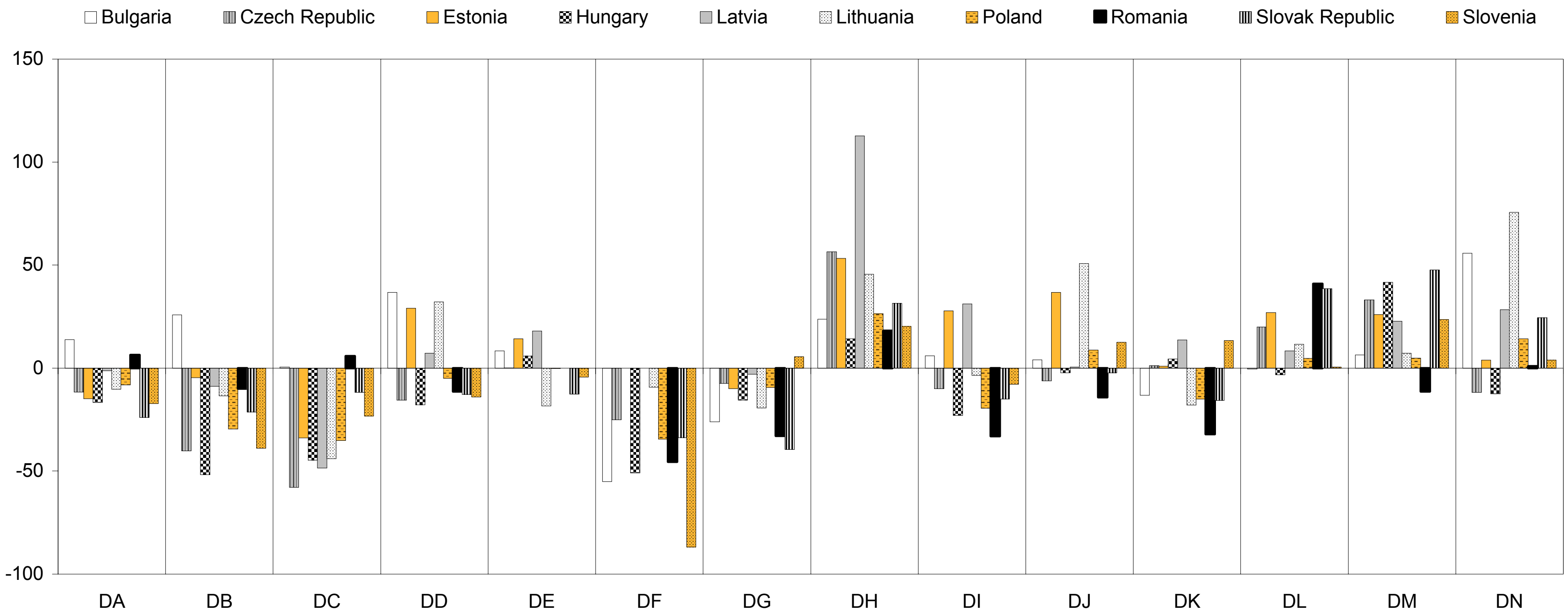


Source: wiiw Annual Database incorporating national statistics.

Figure 11

Employees in manufacturing industry

cumulated growth in %, 2000-2006



DA - Food products; beverages and tobacco
DB - Textiles and textile products
DC - Leather and leather products
DD - Wood and wood products
DE - Pulp, paper & paper products; publishing & printing
DF - Coke, refined petroleum products & nuclear fuel
DG - Chemicals, chemical products and man-made fibres

DH - Rubber and plastic products
DI - Other non-metallic mineral products
DJ - Basic metals and fabricated metal products
DK - Machinery and equipment n.e.c.
DL - Electrical and optical equipment
DM - Transport equipment
DN - Manufacturing n.e.c.

Note: Estonia, Latvia, Lithuania 2001-2005.

Source: wiiw Industrial Database incorporating national statistics.

On looking at individual sectors of the economy in order to identify potential growth constraints emanating from the tight labour market, a varied picture emerges again (Figure 10). Agriculture continues to shed labour in all NMS ('de-agrarianization') and industrial employment is growing modestly in Bulgaria, the Czech Republic and Slovakia ('re-industrialization'), while the construction sector and the services sector in particular have recorded the fastest rate of employment growth ('tertialization'). Employment increased in both market services (especially trade, tourism, real estate and other business activities) and non-market services (including public administration, health and social work, as well as other community services) in the period 2000-2006. These patterns of structural employment shifts are bringing NMS employment structures closer to those of more advanced West European economies. It is interesting to note that in countries with more advanced banking and financial sectors (the Czech Republic, Estonia, Hungary and Poland) employment in those sectors has dropped recently. In most sectors, shortages of labour are being reported and vacancies are difficult to fill owing to qualification mismatches, limited internal labour mobility and labour market rigidities.

Within industry, employment developments in individual manufacturing branches have again been highly diverse, reflecting the ongoing process of structural change (Figure 11). Generally in all NMS, both the labour-intensive branches (such as textiles and leather) and capital-intensive branches (such as coke, refined petroleum and chemicals) have been laying off workers. By way of contrast, rubber and plastics, electrical, optical equipment as well as the transport equipment – all of which are branches dominated by foreign investment companies – have increased employment in nearly all NMS. At the same time, those branches have achieved the most impressive improvements in labour productivity, despite being confronted with serious labour shortages, especially of skilled workers.[10]

Upbeat growth outlook, downside risks largely home-grown

The NMS experienced another year of high economic growth in 2007; some of them (the Czech Republic, Slovakia and Slovenia) even achieved their highest-ever GDP growth on record. They easily maintained the speed at which they were catching up with the more advanced West European economies – an annual difference of about 3 percentage points in GDP growth rates. According to revised estimates, the real per capita GDP (in Purchasing Power Parity – PPP terms) in the NMS reached 56% of the EU-27 average – about 5 percentage points more than at the time of their EU accession in 2004 (and 10 percentage points more than in 2000 – see Table II and Appendix Table A/1).[11] Slovenia, the Czech Republic and Estonia are now more affluent than Portugal (which has been trailing behind for the past decade); Slovenia may soon (around 2012) catch up with income levels in Greece.

wiiw short- and medium-term growth forecasts for the region are moderately optimistic. We expect those countries to stay on their catching-up trajectory (see individual country reports for details). The current turbulence on global financial markets is not going to hurt the NMS *directly* or seriously. Even the possible *indirect* effects (largely via an expected growth slowdown in Western Europe and rising

10 For a more detailed analysis of productivity and labour market developments see: P. Havlik, S. Leitner and R. Stehrer (2008), 'Growth Resurgence, Productivity Catching-up and Labour Demand in CEECs', *wiiw Statistical Reports*, No. 3, January.

11 The PPP estimates are based on the recently published ICP benchmarks for 2005, extrapolated by wiiw with GDP price deflators – see Appendix Tables A/1-A/3.

uncertainties) should not be too excessive. GDP growth in the NMS is projected to slow down from about 6% in 2007 to some 5% over the coming three years (Table I). After a temporary price spike over the period 2007-2008, inflation will gradually decline, yet in most NMS it will stay above that of the eurozone. The unemployment rate may drop below that of the eurozone as early as next year (in fact only in Poland and Slovakia is unemployment still higher). Economic growth will be mainly driven by rising consumption (supported by rising labour incomes) and by investments (including FDI). The latter will be bolstered by much higher transfers from the EU budget. Foreign trade will continue to expand, yet the contribution of real net exports to GDP growth will gradually diminish. Except for Bulgaria, Romania and the Baltic States, all of which remain vulnerable to external shocks, current account deficits in other NMS will not be excessively high. In sum, the NMS are expected to remain a region displaying dynamic growth in the years to come, maintaining their competitive advantages as attractive locations for both trading and investment purposes.

This fairly upbeat assessment of the NMS economic prospects represents a baseline scenario, predicated on a careful summary consideration of various aspects. The forecast risks are still tilted to the downside, i.e. the final outcome may be worse than outlined in the baseline. In general, several factors common to all NMS (apart from spillovers from the global turmoil) will be of crucial importance to the region's economic performance over the period 2008-2010 and beyond. Those factors should be closely watched (for country-specific risks see the individual country reports). They are:

- labour market shortages possibly hindering new investments (including infrastructure projects and construction) – all NMS are affected;
- cost-push inflation owing to large wage increases – Hungary, the Czech Republic, Poland, Romania, Slovakia and the Baltic States;
- financial market turbulence affecting credit-financed consumer spending and contagion effects reducing capital inflows;
- excessive currency appreciation and the potential loss of competitiveness – Romania and Slovakia;
- political instability leading to delays/reversal of necessary structural reforms – Hungary, the Czech Republic and Romania.

Country summaries

The medium-term outlook for the **Bulgarian** economy remains generally positive with GDP expected to grow by some 6% per year. While downside risks have recently increased, overall they are not expected to have a major impact on growth performance. The political situation is relatively stable and the current three-party centre-left coalition is likely to run its full term. Entry to the eurozone remains an important policy challenge, with high inflation being the main stumbling block. The authorities are currently targeting 2011 as the date for entry into the EMU.

In the **Czech Republic**, the low pace of capital formation is unlikely to accelerate in 2008. Growth of private and public consumption will be adversely affected by the reform of public finances calling for cuts in spending and higher indirect tax rates. High administratively induced inflation will be countered by higher interest rates which will strengthen the Czech koruna. Despite this, foreign trade is expected to continue performing strongly and the GDP growth will stay around 5% over the period 2009-2010.

Hungary's economic growth will gradually recover, as a result of a moderate upturn in household consumption and appreciable growth in investments, related partly to a substantial increase in the number of EU co-financed projects. Public consumption will continue to decline, but less steeply than in 2007. The gap between export and import growth rates will narrow sharply as import growth will be more dynamic than in the previous year owing to expected lively investment activities and a recovery of household consumption. Unemployment will remain unchanged, although jobs will be lost in the public sector. The targets envisaged by the government for public finances are realistic; the deficit may well be even somewhat smaller than projected.

Excellent results in the corporate sector will continue to support the swift pace of capital formation in **Poland**. Higher, but moderate inflation will be encountered by interest rate hikes that strengthen the Polish zloty. GDP will continue to grow over the period 2008-2010, although it will gradually lose momentum.

External uncertainties, inflation and devaluation pressures point to lower growth in domestic consumption in **Romania**. The slowdown in GDP growth will be modest in 2008 as government consumption and net exports are on the verge of increasing and agriculture is expected to recover. In 2009, fiscal stabilization and more modest wage growth will reduce economic growth still further. In the longer term, the results of the ongoing investment boom and returning currency stability will improve international competitiveness, thus stronger growth may resume in 2010.

Driven by both strong domestic and foreign demand, economic growth has picked up speed in **Slovakia**. Despite currency appreciation, the external position is improving. Both domestic and foreign investment will continue to support economic growth and competitiveness. However, FDI inflows will further focus on the more affluent western regions. Despite some weakening in GDP growth, the economic outlook for the coming years is encouraging.

GDP growth in **Slovenia** is expected to remain close to 5% in the years to come. Dampened growth will be attributable to a gradual reduction in investment, particularly in the construction sector where completion of the motorway network is projected for 2008. Growth in government and private consumption is likely to remain stable up until 2010. As a consequence of slower investment growth, imports will be moderate and the trade deficit will lessen. In the course of 2009 and 2010 the current account deficit is thus expected to decline in both relative and absolute terms.

From 2008 onwards **Lithuania** will experience a gradual slowdown in internal demand, while export performance in **Latvia** is also likely to deteriorate. In **Estonia** the decline in growth, which began in 2007 following a loss of momentum in investment and exports, is expected to continue until 2010. However, high inflation rates as well as current account deficits will only lessen in the medium term, since the Baltic States will continue to grow in line with potential output.

Part A: The new EU member states

Country reports

Anton Mihailov

Bulgaria: surging FDI keeps economy steadfast

Buoyant fixed investment drives GDP growth

GDP growth slowed down in the third quarter of last year but this was mostly due to an extremely bad harvest; performance in other sectors remained buoyant. Nevertheless, there are other indications of a possible future slowdown. In particular, there has been a notable deceleration in the growth of real retail sales. With private consumption slowing its pace, fixed investment (boosted by FDI) at present appears to be the key driver of aggregate growth.

After EU accession, the massive FDI inflows intensified and reached almost 20% of GDP in 2007. Nearly 60% of these inflows were channelled to the real estate market, including greenfield construction (up from some 35% in the previous two years). The red-hot Bulgarian real estate market topped the global charts in terms of the rise in housing prices in 2007. During the visit by President Putin in January 2008, Bulgaria finalized three big energy deals with Russia with long-term cross-border effects: the South Stream pipeline to transport Russian gas to Europe through Bulgaria; the construction of two nuclear reactors at Belene on the Danube river; and the Bourgas-Alexandroupolis oil pipeline to transport Russian oil to the Greek coast of the Aegean Sea.

Surging construction and fixed investment have been supported by an ongoing credit boom. In the past, the monetary authorities had made several attempts to cool down bank lending through administrative measures but these had to be lifted with Bulgaria's accession to the EU. In a renewed effort to restrain bank lending, the Bulgarian National Bank raised its mandatory reserve requirement from 8% to 12% in September 2007 but so far this intervention has not had the desired effect. In fact, credit to the non-government sector registered the fastest growth on record during 2007: the stock of outstanding claims grew by 62.5% year on year in December. Corporate lending grew faster than household credit (at rates of 70% and 52%, respectively), but household mortgage lending alone increased by some 75%.

One of the principal sources of the domestic credit boom has been external borrowing by Bulgarian commercial banks, most of which is subsequently channelled to domestic borrowers. So far the global financial turmoil has not affected the domestic credit market although borrowing from abroad softened somewhat in the last two months of 2007. There has been no deterioration in the quality of banks' portfolios so far either: at the end of November 2007, the share of substandard loans in the banking system as a whole amounted to 4.8% of all loans whereas the share of overdue credit was only 2%. However, banks are not immune to the adverse effects of an eventual economic slowdown or a downturn in the local housing market.

The labour market is tight and wage pressures push up inflation

In 2007 as a whole, the number of employed persons rose by some 5% while the average rate of unemployment dropped by 2 percentage points, repeating the labour market dynamic of 2006.

Importantly, this has been accompanied by increases in the activity rate, with the economically active population increasing by 4.5% in the period 2006-2007. The inflows from inactivity have been largely concentrated in the middle-aged cohorts. In Sofia city alone – which now accounts for a third of Bulgaria's population – the rate of registered unemployment in December was just 1.5%. Long-term unemployed (those without a job for more than a year) accounted for 56.6% of all unemployed. The share of older persons (aged 50 or more) accounted for 38.2% of all unemployed. In 2007, both these groups increased their shares in the total pool.

Labour shortages, in particular for skilled workers but also for some categories of unskilled labour, are becoming endemic and now affect virtually all sectors of economic activity. The situation is aggravated by the continuing leaks of skilled labour to higher-paid jobs abroad. Labour shortages are becoming important supply constraints in a number of sectors and may cause delays in the implementation of some big construction projects (such as highways, new power plants and other energy projects). A new policy measure to further stimulate job search was introduced in January, stipulating that those registered unemployed who systematically decline employment offers will be excluded from the social safety net. The government is also considering easing the restrictions on hiring migrant workers from abroad.

Consumer prices surged in 2007 (to 12.5% year on year in December) largely surpassing ex ante forecasts which stood at half that level. An important factor for the higher inflation, especially in the second half of the year, was the rise in food prices (by more than 20% year on year), reflecting poor harvests both in Bulgaria and internationally. The fast growth of wages in 2007 – due to pressures caused by the tightness of the labour market but also some populist moves by the government – was another pro-inflationary factor.

The outlook is still positive but downward revisions in forecasts are possible

The recent weakening of growth calls for a slight downward revision of earlier forecasts. Even if the causes of this slowdown are of a one-off nature (reflecting the dismal performance in agriculture), it now appears unlikely that GDP growth for 2007 as a whole will be above 6% as envisaged earlier. Moreover, it is likely that the slowdown might spill over to 2008. There are downside risks associated both with final demand and with some supply factors. One clearly visible trend is the slowdown in private consumption which was an important (though not single) growth driver in the past few years. Another important risk is associated with the possible fallout of the global financial turmoil. An externally-triggered liquidity squeeze on the domestic credit market could have a negative effect on both fixed investment and consumption. There are also uncertainties regarding external demand. Losses in competitiveness – associated with the fact that wage growth outpaces productivity – may also curb the growth of exports. The supply constraints associated with the tight labour market are also becoming more and more visible. In view of all these factors it appears that the most recent official mid-term forecast (prepared before the publication of the third quarter GDP figures) which envisaged annual GDP growth in the range between 6.5% and 7% for the period 2008-2010 probably needs to be trimmed down somewhat.

Due to the slowdown in private consumption, the positive contribution of domestic absorption to GDP growth was on the decline during 2007, but so was also the negative contribution of net exports. In principle, this is a healthy trend as it suggests less reliance of growth on domestic

Table BG

Bulgaria: Selected economic indicators

	2002	2003	2004	2005	2006	2007 1)	2008	2009	2010
								Forecast	
Population, th pers., end of period	7,846	7,801	7,761	7,719	7,679	7,640	.		
Gross domestic product, BGN mn, nom.	32,335	34,628	38,823	42,797	49,091	56,000	64,500	72,500	80,000
annual change in % (real)	4.5	5.0	6.6	6.2	6.1	6	5.5	6	6.2
GDP/capita (EUR at exchange rate)	2,101	2,263	2,551	2,827	3,260	3,740	.		
GDP/capita (EUR at PPP - wiiw)	6,310	6,710	7,290	7,890	8,600	9,390	.		
Gross industrial production									
annual change in % (real)	6.5	14.1	13.9	10.0	8.2	8.5	8	9	10
Gross agricultural production									
annual change in % (real)	5.3	-9.9	6.6	-6.0	-0.1	-21.9	.	.	.
Construction output total									
annual change in % (real)	2.7	5.6	35.2	31.8	4.5	.	.	.	.
Actual final consump.of househ.,BGN mn,nom.	24,823	27,444	30,155	33,556	37,897	42,000	.	.	.
annual change in % (real)	3.4	6.3	5.3	5.5	7.1	5.8	5.5	5.8	6.0
Gross fixed capital form., BGN mn, nom.	5,909	6,694	7,969	10,347	12,878	15,700	.	.	.
annual change in % (real)	8.5	13.9	13.5	23.3	17.6	24.0	18	16	14
LFS - employed persons, th, avg.	2,740	2,835	2,923	2,980	3,110	3,270	3,420	.	.
annual change in %	1.5	3.5	3.1	2.0	4.4	5.1	4.6	.	
Reg. employees in industry, th pers., avg.	666.8	689.5	695.8	693.0	694.3	.	.	.	.
annual change in %	1.3	3.4	0.9	-0.4	0.2	0.1	.	.	.
LFS - unemployed, th pers., average	592.4	448.7	399.7	334.2	305.7	245	220	.	.
LFS - unemployment rate in %, average	17.8	13.7	12.0	10.1	9.0	6.9	6.0	5.6	5.2
Reg. unemployment rate in %, end of period	16.3	13.5	12.2	10.7	9.1	6.9	6.2	.	.
Average gross monthly wages, BGN	257.6	273.3	292.4	323.7	354.6	415	480	.	.
annual change in % (real, gross)	1.5	3.7	0.8	5.4	2.1	7.9	5.1	.	.
Consumer prices, % p.a.	5.8	2.3	6.1	5.0	7.3	8.4	10	6	5
Producer prices in industry, % p.a.	1.2	4.9	6.0	6.9	9.2	8.6	7	.	.
General governm.budget, EU-def., % GDP 2)									
Revenues	39.6	40.3	42.0	41.6	40.3	39.7	.	.	.
Expenditures	39.7	40.3	39.7	39.6	37.1	36.7	.	.	.
Net lending (+) / net borrowing (-)	-0.1	0.0	2.3	2.0	3.2	3.0	.	.	.
Public debt, EU-def., in % of GDP 2)	53.6	45.9	37.9	29.2	22.8	20	18	.	.
Base rate of NB % p.a., end of period	3.4	2.9	2.4	2.1	3.3	4.7	.		
Current account, EUR mn	-403	-972	-1,307	-2,622	-3,935	-6,175	-6,200	-6,300	-6,400
Current account in % of GDP	-2.4	-5.5	-6.6	-12.0	-15.7	-21.6	-18.8	-17.0	-15.6
Gross reserves of NB excl. gold, EUR mn	4,247	4,981	6,443	6,816	8,309	11,215	.	.	.
Gross external debt, EUR mn	10,769	10,641	12,658	15,090	20,111	26,248 XI	.	.	.
Gross external debt in % of GDP	65.1	60.1	63.8	69.0	80.1	91.8 XI	.	.	.
FDI inflow, EUR mn	980	1,851	2,736	3,103	4,364	5,687	5,200	5,000	5,000
FDI outflow, EUR mn	29	23	-166	249	137	188	.	.	.
Exports of goods, BOP, EUR mn	6,063	6,668	7,985	9,466	12,012	13,412	15,300	17,200	19,000
annual growth rate in %	6.1	10.0	19.7	18.6	26.9	11.7	14.1	12.4	10.5
Imports of goods, BOP, EUR mn	7,941	9,094	10,938	13,876	17,574	20,831	23,000	25,200	27,200
annual growth rate in %	6.0	14.5	20.3	26.9	26.7	18.5	10.4	9.6	7.9
Exports of services, BOP, EUR mn	2,455	2,729	3,262	3,564	4,143	4,529	4,900	5,300	5,700
annual growth rate in %	1.1	11.1	19.5	9.3	16.2	9.3	8.2	8.2	7.5
Imports of services, BOP, EUR mn	1,950	2,176	2,606	2,745	3,172	3,515	3,860	4,250	4,650
annual growth rate in %	-7.1	11.6	19.8	5.3	15.5	10.8	9.8	10.1	9.4
Average exchange rate BGN/USD	2.077	1.733	1.575	1.574	1.559	1.429	.	.	.
Average exchange rate BGN/EUR (ECU)	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956	1.956
Purchasing power parity BGN/USD	0.556	0.557	0.576	0.593	0.624	0.637	.	.	.
Purchasing power parity BGN/EUR	0.651	0.659	0.685	0.701	0.742	0.779	.	.	.

Note: The term "industry" refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) According to ESA'95, excessive deficit procedure.

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

demand. However, as noted, a future surge in exports is less than certain. In any case, if growth becomes more export-oriented, the current account deficit might drop somewhat in relative terms while its absolute size will still remain significant.

Fixed investment (by both domestic and foreign investors) is likely to continue to be buoyant, providing a solid support to GDP growth. In November 2007, when the surplus in the consolidated general government budget was approaching BGN 4 billion (more than 7% of annual GDP), the government hastily approved extra spending of some BGN 1.4 billion, most of which was earmarked for infrastructure projects, adding to the activity of private investors. Nevertheless, it is obvious that the extraordinarily high pace of fixed investment seen in 2007 is not sustainable in the medium term.

Labour demand is likely to remain high, contributing to a growing tightness in the labour market. Employment should continue to rise mostly thanks to new entrants to the labour market and re-entries from inactivity. At the same time, unemployment rates are likely to stay relatively high due to structural problems such as skill mismatches and low domestic labour mobility.

All indications are that inflation rates will remain high in 2008. As of January, the minimum wage was raised considerably (from BGN 180 to BGN 220 monthly) in an attempt to offset the negative effect of the newly introduced flat 10% personal income tax on the disposable income of low-wage earners (the non-taxable income threshold of BGN 200 was scrapped in the context of this reform). Apart from this, all public servants were compensated through wage increases for possible negative implications of this tax. In addition, wages in the public sector will rise by 10% in July, while pensions will go up 9.5%. Undoubtedly, all wages in the economy will adjust upward in response to these changes, adding further pro-inflationary pressures. Some recent policy measures (such as the rise in excise taxes on cigarettes by 34% in January and the planned increased in regulated energy prices) will have a similar effect. One has also to take into account the carryover effects due to the inflationary surge in the second half of 2007. Thus, even if the government's rather optimistic forecast of 4% end-year inflation proves accurate (which is highly unlikely), the average annual inflation in 2008 will still be around 9% only due to carryover effects. A higher – but probably more realistic, in view of the factors outlined above – assumption of 8% end-year inflation would yield an average annual inflation above 11%.

The medium-term outlook for the Bulgarian economy remains generally positive. While downside risks have recently increased, overall they are not expected to have a major impact on growth performance. The political situation is relatively stable and the current three-party centre-left coalition is likely to complete its full term in office. Entry to the eurozone remains an important policy challenge, with high inflation being the main stumbling block. The authorities have at present set the target EMU entry date for 2011.

Leon Podkaminer

The Czech Republic: slowdown ahead

Stagnant capital formation

The fast GDP growth which has continued for three years is expected to slow down in 2008. Some early symptoms of the upcoming deceleration can already be detected in the available statistics for the closing months of 2007. The dynamics of industrial production has weakened quite strongly while the output of the construction sector stopped growing already at mid-year. The value of orders placed with construction sector companies (employing over 20 workers) fell by close to 6% in the third quarter of 2007. Concurrently these firms have started to reduce employment. These clear signs of an impending contraction of construction activity suggest a further deceleration of growth of investment into fixed productive assets and into new housing projects. In addition, the growth of retail sales has been faltering recently. Nonetheless, the overall growth rate in 2007, provisionally estimated at 6.2%, was still quite impressive – though one could nurture doubts about the quality of the Czech national accounts statistical reporting which exhibits a particularly high propensity to make frequent, and quite substantial, revisions. There is also the issue of a continuing massive accumulation of inventories, reported in the Czech national accounts. Rising inventories appear to have been responsible for about 1.2 percentage points of the overall GDP growth in the first three quarters of 2007, i.e. roughly as much as gross fixed investment.[12]

A stabilization (let alone reduction) of inventories would automatically reduce GDP growth in 2008. Apart from this, other demand-side factors will probably be determining the near-term developments. First, despite reportedly high levels of productive capacity utilization, apparently high average profitability of the non-financial corporate sector and relatively low interest rates, the growth of gross fixed capital formation – which has been consistently anaemic since 1996 – will probably slow down further.[13] The reason for this is that the overall conditions in 2008 are likely to be even less conducive to any extension of fixed investment. Investment conditions will deteriorate not only on account of generally depressed investors' sentiment – which is only natural under the turmoil spreading throughout the financial markets everywhere, including the Czech Republic; more importantly, investment conditions will not become any more favourable on account of the (generally expected) hikes in interest rates. Moreover, these conditions will be adversely affected by the upcoming repression of consumer spending which will be worsening the sales prospects of domestic firms. Some boost to investment can be expected as a result of increased EU transfers.

Reform of public finances affects growth

Consumer spending will be repressed in 2008 (which of course will also be restricting the overall GDP growth directly – and immediately) despite a continuing (and fairly strong) rise in average wages and expanding (albeit moderately) overall employment. The slowdown in the growth of private consumption primarily follows as a consequence of the reform of public finances (squeezed through the parliament by Mirek Topolánek's government in September 2007). The reform, modelled after the Slovak fiscal reform, overhauls the entire tax system. It also stipulates some effective cuts in social benefits/transfers and restricts the scope of public provision of various services (e.g. by introducing co-payments for health services rendered). The 15% flat tax on personal incomes which

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[12] It must be remembered that the current expansion of inventories comes after another fairly abnormal expansion in 2006. If one takes the official data at face value, the rise in inventories was responsible for 1.5 percentage points out of the 6.4% GDP growth in 2006.

[13] Gross fixed investment has on average grown by 2% p.a. since 1996 (while the GDP by 3.2%). The secular weakness of growth of investment in the Czech Republic must be qualified on account of its very high GDP share in the early 1990s (e.g. 32% in 1996). The current share (about 24%) is about the same as in other NMS. Fixed capital may have been too abundant, relative to the available labour resources. The average productivity of capital may be adequate, but its marginal productivity (i.e. the profitability on expanding the fixed capital stock) need not be high enough to justify high rates of investment growth.

Table CZ

Czech Republic: Selected economic indicators

	2002	2003	2004	2005	2006	2007 1)	2008	2009 Forecast	2010
Population, th pers., mid-year	10,201	10,202	10,207	10,234	10,267	10,326	.	.	.
Gross domestic product, CZK bn, nom. 2)	2,464	2,577	2,815	2,988	3,232	3,540	3,880	4,190	4,510
annual change in % (real) 2)	1.9	3.6	4.5	6.4	6.4	6.6	4.5	5	5
GDP/capita (EUR at exchange rate)	7,841	7,933	8,644	9,802	11,106	12,349	.	.	.
GDP/capita (EUR at PPP - wiiw)	14,420	15,220	16,260	17,160	18,500	20,080	.	.	.
Gross industrial production									
annual change in % (real) 3)	1.9	5.5	9.6	6.7	11.2	8.2	8	9	8
Gross agricultural production									
annual change in % (real)	-4.4	-7.6	14.9	-4.8	-4.2	.	.	.	.
Construction industry									
annual change in % (real)	2.5	8.9	9.7	4.2	6.6	6.7	.	.	.
Consumption of households, CZK bn, nom. 2)	1,248	1,317	1,399	1,443	1,554	1,700	.	.	.
annual change in % (real) 2)	2.2	6.0	2.9	2.3	5.4	6.2	4	5	5
Gross fixed capital form., CZK bn, nom. 2)	677.8	687.5	727.2	746.1	794.8	860	.	.	.
annual change in % (real) 2)	5.1	0.4	3.9	2.3	5.5	4.5	3	4	5
LFS - employed persons, th, avg. 4)	4,765	4,733	4,707	4,764	4,828	4,922	.	.	.
annual change in %	0.8	-0.7	-0.6	1.2	1.3	1.9	1.5	1	1
LFS - employed pers. in industry, th, avg. 4)	1,463	1,425	1,409	1,422	1,493	.	.	.	.
annual change in %	-0.1	-2.6	-1.1	0.9	5.0	.	.	.	.
LFS - unemployed, th pers., average	374.1	399.1	425.9	410.2	371.3	276.3	.	.	.
LFS - unemployment rate in %, average 4)	7.3	7.8	8.3	7.9	7.1	5.3	5.5	5	4.5
Reg. unemployment rate in %, end of period	9.8	10.3	9.5	8.9	7.7	6.0	6.5	.	.
Average gross monthly wages, CZK 5)	15,866	16,917	18,041	18,992	20,207	21,915	.	.	.
annual change in % (real, gross)	5.4	6.5	3.7	3.3	3.8	5.5	3.5	5	5
Consumer prices, % p.a.	1.8	0.1	2.8	1.9	2.5	2.8	5.0	2.8	2.5
Producer prices in industry, % p.a.	-0.5	-0.4	5.7	3.0	1.6	4.1	4	3	2
General governm. budget, EU-def., % GDP 6)									
Revenues	39.5	40.7	42.2	41.3	40.7	41.1	.	.	.
Expenditures	46.3	47.3	45.1	44.9	43.6	43.0	.	.	.
Net lending (+) / net borrowing (-)	-6.8	-6.6	-2.9	-3.5	-2.9	-1.9	-3.0	-2.7	-2.6
Public debt, EU-def., in % of GDP 6)	28.5	30.1	30.4	30.2	30.1	30.4	.	.	.
Discount rate, % p.a., end of period	1.8	1.0	1.5	1.0	1.5	2.5	3	2.5	1.5
Current account, EUR mn	-4,442	-5,028	-4,650	-1,638	-3,561	-4,100	-4,900	-5,500	-6,000
Current account in % of GDP	-5.6	-6.2	-5.3	-1.6	-3.1	-3.2	-3.3	-3.5	-3.5
Gross reserves of NB incl. gold, EUR mn	22,614	21,340	20,884	25,054	23,882	23,707	.	.	.
Gross external debt, EUR mn	25,738	27,624	33,212	39,379	44,263	47,400	.	.	.
Gross external debt in % of GDP	33.0	34.7	35.9	38.2	37.7	35.7	.	.	.
FDI inflow, EUR mn	9,090	1,875	4,009	9,354	4,760	5,600	6,000	.	.
FDI outflow, EUR mn	221	183	824	-12	1,073	800	1,000	.	.
Exports of goods, BOP, EUR mn	40,713	43,055	54,091	62,781	75,684	89,000	103,000	117,000	131,000
annual growth rate in %	9.2	5.8	25.6	16.1	20.6	18	16	14	12
Imports of goods, BOP, EUR mn	43,034	45,239	54,517	60,797	73,283	85,000	99,000	113,000	127,000
annual growth rate in %	5.7	5.1	20.5	11.5	20.5	16	16	14	12
Exports of services, BOP, EUR mn	7,502	6,880	7,761	9,478	10,603	12,000	13,000	.	.
annual growth rate in %	-5.3	-8.3	12.8	22.1	11.9	10	7	.	.
Imports of services, BOP, EUR mn	6,796	6,464	7,245	8,254	9,384	10,000	11,000	.	.
annual growth rate in %	9.3	-4.9	12.1	13.9	13.7	7	6	.	.
Average exchange rate CZK/USD	32.74	28.23	25.70	23.95	22.61	20.31	.	.	.
Average exchange rate CZK/EUR (ECU)	30.81	31.84	31.90	29.78	28.34	27.76	26.5	26.3	26.5
Purchasing power parity CZK/USD	14.32	14.02	14.27	14.40	14.19	14.26	.	.	.
Purchasing power parity CZK/EUR	16.76	16.60	16.96	17.02	17.01	17.08	.	.	.

Note: The term 'industry' refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices). - 3) According to new calculation. - 4) From 2002 weighted according to census 2001. - 5) Enterprises with more than 20 employees, including part of the Ministry of Defence and the Ministry of the Interior. - 6) According to ESA'95, excessive deficit procedure.

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

favours the higher-income strata will lower the entire household sector's overall propensity to consume out of disposable income. But the major role in restricting private consumption will be played by hikes in indirect tax rates (on basic necessities) and in some regulated prices. Changes in the indirect tax rates will hit, with full force, primarily the lower-income population groups which anyway will not benefit much from lower personal income taxation. Overall, the reform is likely to depress the growth of private consumption in 2008 by at least some 0.8 percentage points and reduce the overall GDP growth by at least 0.5 percentage points. The authorities believe that the 2008 growth slowdown will be temporary – and that the reform will serve good purposes in the longer-term perspective. Although the public finances may need to be reformed, the success of the current version of reforms is debatable: (i) public sector deficits are likely to remain excessive in many years to come – especially if the plans to gradually reduce the corporate income tax rate (to 19% in 2010) are carried through; (ii) higher household sector's saving propensity may be depressing private consumption permanently – without helping, in any identifiable way, to accelerate growth in fixed capital formation; (iii) labour market conditions need not be positively affected simply because there are already shortages of skilled labour. Cuts in social benefits are therefore irrelevant for raising the supply of such labour. (At best such cuts may perhaps increase the supply of labour offered by very low-skill individuals, not much in demand anyway.)

The reform of public finances has also an unwelcome shorter-term consequence in the form of much higher inflation in 2008. Higher indirect tax rates/regulated prices may result in CPI inflation higher by at least 2 percentage points. This is likely to induce hikes in interest rates and also to support a further strengthening of the Czech koruna. Neither of these effects will be conducive to GDP growth in 2008. Higher interest rates will have obvious impacts on both household consumption and fixed investment (also in housing) while a strongly appreciating koruna is no good news to export-oriented (and import-competing) firms.

The key role of foreign trade

With domestic demand unlikely to support fast growth in 2008, a good performance of foreign trade will be critical. In 2007 foreign trade performed very well, and that despite nominal (and real) appreciation much stronger than generally expected. A good performance in foreign trade may be more difficult to maintain because: (i) economic growth in major export destinations is likely to be slower than in 2007, and (ii) the strengthening Czech koruna may finally become a problem for some branches. On the other hand, the overall trade balance may improve further, and add more strongly to GDP growth (though perhaps not on the scale observed in 2005 when foreign trade generated 4.8 percentage points out of 6.4% of GDP growth). Further improvements on the external front are quite likely though, because: (i) the repressed growth in household spending may happen to be linked to some cuts in the demand for imports; (ii) growth in industrial unit labour (and other) costs is still quite moderate, labour productivity gains are still considerable; and (iii) the major (foreign-owned) export-oriented branches (such as the automotive industry) are still capable of increasing the supplies of competitively priced products.

After 2008 the overall growth is likely to accelerate again. The tax-induced inflationary impacts will wear off in the course of 2008. This will allow a substantial reduction in interest rates and may brake (or possibly reverse) the nominal appreciation tendency. Under such conditions consumer credit and growth in consumption and investment may accelerate, while a weaker Czech koruna may support some broader-based growth in exports.

Sándor Richter

Hungary: deficit reduction plan topped, economy supercooled

In 2007 the central government deficit amounted to only 77% of the planned target. Thus, despite GDP growth being substantially lower than envisaged (about 1.3% vs. 2.2%), the most important indicator of the Hungarian convergence programme – the general government balance/GDP ratio – turned out much better than expected. It amounted to 5.7% of the GDP, as compared to the original target of 6.8% or the latest government forecast in December, 6.2%. That means that in 2007, the budget deficit/GDP ratio fell by about 3.5 percentage points of the GDP year on year. The main explanatory factors for the smaller deficit are the lower than previously assessed interest payments on public debt and the substantially higher than expected revenues from taxes and charges. The bigger part of the additional budget revenues came from higher than planned tax revenues related to higher inflation, a smaller part from 'whitening' of the economy, i.e. the shift of activities from the shadow economy to the taxed one.

Austerity package *cum* bad weather

One reason for the slower than planned growth performance of the economy was the dramatic, about 16%, drop in agricultural output caused by bad weather. The cuts in government expenditures for the ambitious highway construction programme resulted in a strong decline in construction activities. By contrast, the dynamism of industry remained unbroken. Growth here, and especially in manufacturing, relied on rapidly increasing productivity and export sales. Engineering remained the driving force in industry, in particular electrical machinery, telecommunication equipment and computers. Output of the services sector increased at a slower pace than GDP: first, because of the declining performance in public administration, education, health and social services, which in turn was part of the austerity package; and second, due to the only marginal increase in services delivered by trade, hotels and restaurants, a consequence of falling household consumption, a 'collateral damage' of the stabilization programme.

Data on the final use of GDP display that growth in 2007 was virtually entirely attributable to foreign trade. Household consumption has probably declined by 1.2% to 1.5%; within this, social transfers in kind from the government fell much more strongly than household consumption expenditures. Government consumption decreased to a substantially larger extent. Gross fixed capital formation practically stagnated last year, with sharply diverging tendencies in the individual segments of the economy. Due to the fiscal consolidation measures, investment declined by one third in public administration, by about 15% in education and by 7-8% in health care. By contrast, manufacturing investment expanded by about 30%.

Improving foreign trade balance

Rapidly expanding industrial exports coupled with declining consumption and stagnating investment resulted in a remarkable improvement in foreign trade balances.

According to the customs statistics on commodity trade, exports rose by 16% and imports by 12% in 2007, and the trade balance improved by nearly EUR 2 billion compared to 2006. Commodity trade according to the balance of payments statistics is estimated to have turned into a surplus of

Table HU

Hungary: Selected economic indicators

	2002	2003	2004	2005	2006	2007 [1]	2008	2009	2010
								Forecast	
Population, th pers., end of period	10,142	10,117	10,098	10,077	10,066	10,046	.	.	.
Gross domestic product, HUF bn, nom. [2]	17,181	18,941	20,717	22,055	23,757	25,600	27,500	29,500	31,700
annual change in % (real) [2]	4.4	4.2	4.8	4.1	3.9	1.3	3.0	4.1	4.3
GDP/capita (EUR at exchange rate)	6,961	7,376	8,144	8,815	8,926	10,130	.	.	.
GDP/capita (EUR at PPP - wiiw)	12,580	13,110	13,670	14,390	15,260	15,870	.	.	.
Gross industrial production									
annual change in % (real)	2.8	6.4	7.4	7.0	9.9	8.1	8	10	12
Gross agricultural production									
annual change in % (real)	-4.1	-4.1	22.6	-9.5	-3.8	-16	16	5	5
Construction industry									
annual change in % (real)	17.5	2.2	6.8	18.8	-0.7	-10	10	5	10
Actual final consump.of househ,HUF bn,nom. [2]	11,348	12,920	13,863	14,911	15,743	16,700	.	.	.
annual change in % (real) [2]	9.9	7.9	2.8	3.6	2.0	-1.3	1	4	4
Gross fixed capital form., HUF bn, nom. [2]	3,958	4,177	4,651	5,017	5,155	5,460	.	.	.
annual change in % (real) [2]	10.2	2.2	7.6	5.3	-2.8	0.9	6.5	10	10
LFS - employed persons, th, avg.	3,871	3,922	3,900	3,902	3,930	3,926	.	.	.
annual change in %	0.1	1.3	-0.5	0.0	0.7	-0.1	.	.	.
Reg. employees in industry, th pers., avg. [3]	817.9	801.8	785.4	762.9	752.5	745	.	.	.
annual change in %	-1.9	-2.0	-2.0	-2.9	-1.4	-1.0	.	.	.
LFS - unemployed, th pers., average	238.8	244.5	252.9	303.9	316.8	312.0	.	.	.
LFS - unemployment rate in %, average	5.8	5.9	6.1	7.2	7.5	7.4	7.5	7.5	7.5
Reg. unemployment rate in %, end of period	8.0	8.3	9.1	9.3	9.1	9.5	.	.	.
Average gross monthly wages, HUF [3]	122,482	137,187	145,520	158,343	171,351	185,600	.	.	.
annual change in % (real, net)	13.6	9.2	-1.0	6.3	3.5	-5.5	.	.	.
Consumer prices, % p.a.	5.3	4.7	6.8	3.6	3.9	8.0	5.5	3.2	2.9
Producer prices in industry, % p.a.	-1.8	2.4	3.5	4.3	6.5	0.2	.	.	.
General governm.budget, EU-def., % GDP [4]									
Revenues	42.4	41.9	42.4	42.1	42.6	44.5	.	.	.
Expenditures	51.3	49.1	48.9	49.9	51.9	50.2	.	.	.
Net lending (+) / net borrowing (-)	-8.9	-7.2	-6.4	-7.8	-9.3	-5.7	-3.9	-3.0	-3.0
Public debt, EU-def., in % of GDP [4]	55.6	58.0	59.4	61.6	65.6	.	.	.	.
Base rate of NB, % p.a., end of period	8.5	12.5	9.5	6.0	8.0	7.5	.	.	.
Current account, EUR mn	-4,929	-5,933	-6,916	-6,013	-5,835	-4,700	-4,600	-4,500	-4,500
Current account in % of GDP	-7.0	-7.9	-8.4	-6.8	-6.5	-4.6	-4.2	-3.8	-3.5
Reserves total, excl. gold, EUR mn	9,887	10,108	11,671	15,678	16,349	16,330	.	.	.
Gross external debt, EUR mn	38,559	46,041	55,150	66,608	82,926	94,581 IX	.	.	.
Gross external debt in % of GDP	52.9	63.7	65.5	76.3	88.1	.	.	.	.
FDI inflow, EUR mn	3,185	1,888	3,633	6,172	5,680	3,000	4,000	5,000	5,000
FDI outflow, EUR mn	296	1,463	892	1,777	2,913	2,200	1,500	1,500	2,000
Exports of goods, BOP, EUR mn	36,821	37,907	44,779	50,120	59,079	68,530	76,800	86,000	96,300
annual growth rate in %	6.1	2.9	18.1	11.9	17.9	16	12	12	12
Imports of goods, BOP, EUR mn	39,024	40,805	47,232	51,610	60,001	67,200	74,600	82,800	91,900
annual growth rate in %	4.9	4.6	15.8	9.3	16.3	12	11	11	11
Exports of services, BOP, EUR mn	7,820	8,123	8,770	10,287	10,549	12,340	14,200	16,300	18,700
annual growth rate in %	-0.6	3.9	8.0	17.3	2.5	17	15	15	15
Imports of services, BOP, EUR mn	7,233	8,075	8,533	9,233	9,281	10,950	12,600	14,500	16,700
annual growth rate in %	16.6	11.6	5.7	8.2	0.5	18	15	15	15
Average exchange rate HUF/USD	258.00	224.44	202.63	199.66	210.51	183.83	.	.	.
Average exchange rate HUF/EUR (ECU)	242.97	253.51	251.68	248.05	264.27	251.31	252	251	250
Purchasing power parity HUF/USD	114.88	120.44	126.13	128.51	129.19	134.23	.	.	.
Purchasing power parity HUF/EUR	134.43	142.58	149.91	151.91	154.55	160.42	.	.	.

Note: The term "industry" refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) According to ESA'95 (from 2001 FISIM adjustment, estimate of illegal economy, real change based on previous year prices etc.) - 3) Enterprises with more than 5 employees. - 4) According to ESA'95, excessive deficit procedure.

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

EUR 1 billion last year, as against a deficit of the same magnitude in 2006. The current account deficit has probably declined as well, to an estimated EUR 4.5 billion. This deficit, combined with the capital account balance, constitutes the net external financing capacity of the economy, which may have remained well below EUR 4 billion, or 4% of the GDP.

Inflation accelerated in 2007. The annual average was 8%, with a 9% monthly inflation peak in March and decline thereafter until September, associated with the rise in regulated prices at the beginning of the year. From October inflation accelerated again, primarily as a consequence of higher food prices and fuel prices for motor vehicles.

Unemployment remained at the previous year's level, despite declining employment (by close to 5%) in public administration and services. This is due to more jobs in the private sector and the already mentioned 'whitening' of economic activities.

Recovery begins in 2008

In 2008 economic growth will accelerate to about 3%. This will result from a moderate upturn in household consumption and a considerable expansion of investments, related partly to a substantial increase in EU co-financed projects both from the outgoing 2000-2006 and the incoming 2007-2013 EU financial framework. Public consumption will still decline, but less steeply than in 2007. The gap between export and import growth rates will be much smaller, as imports will grow more dynamically than in the previous year due to the expected lively investment activities and the recovery of household consumption. Industrial growth will continue its longer-term trend. Agriculture and construction will attain high growth rates after the strong decline in both branches last year. Unemployment will remain unchanged, although jobs will be lost in the public sector.

The updated convergence programme of the Hungarian government reckons with 2.8% GDP growth and a 4% public deficit/GDP ratio for 2008. The primary deficit of the general government is expected to turn into a small surplus. (Starting from 2008, the draft budget submitted to the parliament may not assume a primary deficit.) Public debt is expected to grow marginally, reaching 65.8% of the GDP. The targets envisaged by the government for the public finances are realistic, the general government deficit will probably be even slightly smaller than planned. Accelerating economic growth, continued 'whitening' of economic activities, and also the somewhat higher inflation than planned by the government will ensure sufficient revenues from taxes and charges. On the expenditure side, some one-off items which burdened the budget last year will not pop up in 2008. Hungary's fiscal stance will not be essentially affected by the likely approval of the opposition's request, to be put to referendum in early March, to abolish the hospital and doctor visit fees which were introduced as part of the budget consolidation package, and the university fees set to be introduced from September 2008. The items that will probably be lost on the revenue side can relatively easily be compensated for either on the revenue or the expenditure side of the budget. The real significance of the referendum, however, is not related to the budget. The opposition party FIDESZ, standing head and shoulders above the government parties in public opinion polls, views the referendum as a vote of confidence and puts the legitimacy of the government in question should the proposals be approved. That raises the danger of political turbulence in spring.

Unpopular reforms and reformers

While structural reforms in the health care and pension systems, in education and concerning local governments are of vital importance to ensure the consolidation of the budget in the medium and long run, major changes have been initiated in the health care system only. But, the reformed system (to be introduced in 2009), with intended partial involvement of private capital, is an unfortunate compromise reflecting the fundamental division between the governing socialists and the liberals as concerns the ideas about the role of the state and the private sector, respectively, in the reformed health care system. The government's communication of the reform has been very poor as yet. The opposition attacks the reform with mostly populist criticism, without presenting a convincing alternative remedy. The government's incapability to convince the population and the interest groups involved of the merits of the new system coupled with the opposition's fruitless populism have created an embittered political climate in Hungary which threatens to block any further steps towards modernizing public finances.

The turmoil in international finances has had no considerable impact on the Hungarian economy. The absorption of the home-made shock created by the austerity package has as yet been a bigger challenge than facing the external effects. Hungary's development in 2009 and 2010 will be strongly influenced by the general elections in spring 2010. The main (optimistic) scenario reckons with a return to higher growth and Maastricht-compatible fiscal and inflation indicators, as envisaged by the convergence programme. Alternatively, however, a pessimistic scenario may be looming: a return of populist economic policy measures and irresponsible promises prior to the elections and, thereafter, a new government in office being hostage to its own promises.

Leon Podkaminer

Poland: expansion to continue

Good times for business

Strong expansion continued in 2007, with private consumption and gross fixed investment contributing most. The GDP growth rate for the whole of 2007 is about 6.5%, the best result since 1997. The fast rise in output of industry (gross value up 7.6% in real terms), and of construction in particular (GVA up 20%) has been continuing. Concurrently, there has been a steady rise in employment accompanied by a strong upward drift in wages. Despite this net profits of the corporate non-financial sector and of commercial banks rose impressively (by over 25% each).

Following a long-term trend, the Warsaw Stock Exchange (WSE) had performed very strongly in terms of new issues, rising turnover and price indices. The latter trend came to an end in mid-2007. Since July the WSE has been suffering as much as other bourses in Europe and elsewhere – and for much the same reasons. There can be little doubt that the enormous losses suffered during the second half of 2007 by WSE investors will have some real consequences. Some segments of the better-off strata which have been gambling on the WSE (either directly on their own or through various investment funds) will have to swallow the losses. This will not necessarily much reduce their current consumption. In the near future these investors are likely to prefer safe treasury debt or longer-term deposits with trusted banks. However, not only the better-off are directly affected by the

Table PL

Poland: Selected economic indicators

	2002	2003	2004	2005	2006	2007 [1]	2008	2009 Forecast	2010
Population, th pers., end of period	38,219	38,191	38,174	38,157	38,125	38,120	.	.	.
Gross domestic product, PLN bn, nom. [2]	808.6	843.2	924.5	983.3	1,060.2	1,157	1,252	1,364	1,469
annual change in % (real) [2]	1.4	3.9	5.3	3.6	6.2	6.5	5.5	5.3	5
GDP/capita (EUR at exchange rate)	5,485	5,020	5,341	6,401	7,138	8,026	.	.	.
GDP/capita (EUR at PPP - wiiw)	9,880	10,140	10,960	11,480	12,340	13,470	.	.	.
Gross industrial production (sales)									
annual change in % (real)	1.1	8.3	12.6	3.7	11.2	10	10	8	8
Gross agricultural production									
annual change in % (real)	-1.9	-0.8	7.5	-4.3	-1.4	.	.	.	.
Construction output total									
annual change in % (real)	-0.3	0.9	-7.0	1.5	13.7	16.7 [I-XI]	.	.	.
Consumption of households, PLN bn, nom. [2]	532.6	545.1	586.0	610.4	647.9	699	.	.	.
annual change in % (real) [2]	3.4	2.0	4.4	2.0	4.9	5.2	5	5	4
Gross fixed capital form., PLN bn, nom. [2]	151.5	153.8	167.2	179.2	208.9	257	.	.	.
annual change in % (real) [2]	-6.3	-0.1	6.4	6.5	15.6	20.4	18	14	6
LFS - employed persons, th, avg. [3]	13,782	13,617	13,795	14,116	14,594	15,250	.	.	.
annual change in %	-3.0	0.6	1.3	2.3	3.4	4.5	3	2	1
Reg. employees in industry, th pers., avg.	2,671	2,639	2,663	2,665	2,709	2,804	.	.	.
annual change in %	-5.3	-1.2	0.9	0.1	1.6	3.5	2	2	1
LFS - unemployed, th pers., average [3]	3,431	3,329	3,230	3,045	2,344	1,880	.	.	.
LFS - unemployment rate in %, average [3]	19.9	19.6	19.0	17.8	13.9	11.0	9	8	7
Reg. unemployment rate in %, end of period [3]	18.0	20.0	19.1	17.6	14.8	11.4	10	.	.
Average gross monthly wages, PLN	2,098	2,185	2,273	2,361	2,476	2,691	.	.	.
annual change in % (real, gross)	0.7	3.4	0.7	1.8	4.0	6.3	6	5	4
Consumer prices, % p.a.	1.9	0.8	3.5	2.1	1.0	2.5	2.5	3.5	2.6
Producer prices in industry, % p.a.	1.0	2.6	7.0	0.7	2.3	2.3	3.3	.	.
General governm.budget, EU-def., % GDP [4]									
Revenues	39.2	38.4	36.9	39.0	40.1	40.2	.	.	.
Expenditures	44.2	44.6	42.6	43.3	43.9	43.5	.	.	.
Net lending (+) / net borrowing (-)	-5.0	-6.3	-5.7	-4.3	-3.8	-3	-3.1	-3.0	-2.9
Public debt, EU-def., % of GDP [4]	42.2	47.1	45.7	47.1	47.6	42.1	.	.	.
Discount rate of NB % p.a., end of period	7.5	5.8	7.0	4.8	4.3	5.3	6	5.5	5
Current account, EUR mn	-5,399	-4,108	-8,682	-3,866	-8,787	-12,300	-16,800	-21,000	-23,500
Current account in % of GDP	-2.6	-2.1	-4.3	-1.6	-3.2	-4.0	-4.8	-5.5	-6.0
Gross reserves of NB excl. gold, EUR mn	27,367	26,000	25,904	34,536	35,235	42,812	.	.	.
Gross external debt, EUR mn	81,045	85,067	95,163	112,234	128,606	144,586 [IX]	.	.	.
Gross external debt in % of GDP	40.3	47.6	42.0	44.1	46.5	.			
FDI inflow, EUR mn	4,371	4,067	10,453	8,317	15,198	15,400	16,900	.	.
FDI outflow, EUR mn	228	269	668	2,756	7,134	2,000	2,200	.	.
Exports of goods, BOP, EUR mn	49,338	53,836	65,847	77,562	93,406	108,350	124,600	140,800	157,700
annual growth rate in %	6.0	9.1	22.3	17.8	20.4	16	15	13	12
Imports of goods, BOP, EUR mn	57,039	58,913	70,399	79,804	98,942	115,780	136,600	157,100	179,100
annual growth rate in %	3.5	3.3	19.5	13.4	24.0	17	18	15	14
Exports of services, BOP, EUR mn	10,545	9,850	10,815	13,105	16,354	19,600	22,500	25,900	29,800
annual growth rate in %	-3.4	-6.6	9.8	21.2	24.8	20	15	15	15
Imports of services, BOP, EUR mn	9,690	9,408	10,033	11,543	14,595	17,500	20,100	23,100	26,600
annual growth rate in %	-3.3	-2.9	6.6	15.1	26.4	20	15	15	15
Average exchange rate PLN/USD	4.08	3.89	3.65	3.23	3.10	2.77	.	.	.
Average exchange rate PLN/EUR (ECU)	3.86	4.40	4.53	4.03	3.90	3.78	3.6	3.6	3.75
Purchasing power parity PLN/USD	1.83	1.84	1.86	1.90	1.87	1.87	.	.	.
Purchasing power parity PLN/EUR	2.14	2.18	2.21	2.24	2.25	2.25	.	.	.

Note: The term "industry" refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices; revision in government sector, shadow economy, etc.). - 3) From 2003 according to census May 2002. - 4) According to ESA'95 excessive deficit procedure; forecast wiiw estimate.

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

collapse of the stock exchange indices. Losses have also been suffered by the private pension funds which manage huge portfolios financed by premiums compulsorily extracted from the bulk of the working population ('the second pillar' of the pension system introduced in 1999.

Strong pace of capital formation

All in all, the stock market turmoil will not have any dramatic direct effects on consumption and also on households' housing investment. The stock exchange has played a minor role as a source of investment finance in the corporate sector. Currently, own funds play the major role (for 46% of firms undertaking new fixed asset investments), followed by bank credit (for about 32% of firms). Such a structure of financing of fixed assets is not surprising, given the huge profits earned and the excellent liquidity position of the corporate sector. With abundant own funds, high profitability, high levels of capacity utilization (84% on average), relatively low interest rates and generally strong demand expectations, the corporate sector is currently set on a further expansion of investment in fixed assets. This augurs quite well for the overall volume of gross fixed investment in the whole year of 2008 – and for the production potential in the medium-term perspective.

Employment continues to rise, amid signs of persistent labour shortages (particularly in construction). Two thirds of firms report problems over recruiting personnel, increased labour turnover or permanently unfilled vacancies. However, the intensity of complaints over labour shortages seems to have decreased somewhat. Firms may have learned to function quite well without fully satisfying their demand for labour – e.g. through a more efficient use of available workforce. Labour shortages have increased the frequency and levels of wage hikes offered by employers. But generally wages in the corporate sector still trail behind the rising labour productivity. The advances in labour productivity and in the overall efficiency, however, have reduced incentives for very high price hikes. Inflation, though accelerating recently, is generally expected to calm down in the second half of 2008. The National Bank of Poland is likely to continue raising its interest rates. But this is really unlikely to be very productive, given the distress felt by financial investors and the anyway enhanced alertness of the banking sector. Worse still, higher interest rates are likely to keep the zloty strong, which appears to be a major problem particularly for import-competing and export-oriented firms.

A deceleration on the horizon

Barring some extraordinary events on the global level, Poland's economic prospects are, on the whole, positive at least in the medium-term perspective. But in 2008 GDP growth will be slower than in 2007 on account of (i) less advantageous performance of foreign trade (negative impact of strong currency, possible growth slowdown in major export markets), and (ii) the advance of less optimistic sentiments (affecting consumption and housing investment adversely). In 2009-2010 growth is likely to decelerate further though not really dramatically. Even if lower inflation permits a renewed relaxation of monetary policy and a possible weakening of the exchange rate, and hence somewhat improves the foreign trade performance, the investment boom is likely to come to a natural end.

In the early parliamentary elections held in October, the party of the Kaczynski brothers suffered a decisive defeat. The new coalition government has not only inherited the economy in a very good shape; it also confronts many serious unresolved legal, political and administrative problems – and an uncooperative (if not hostile) President. Moreover, it faces a wave of strikes of the public-sector employees (teachers, doctors, customs officers etc.) demanding higher wages. No doubt the term of the new government began turbulently and this may justify the gaffs and mistakes already made. What is more disquieting is that it does not really seem to know how to address the most urgent problems such as the collapsing public health service system.

Gábor Hunya

Romania: inflation target failed, more uncertainty ahead

The Romanian economy continued its fast expansion in 2007 despite the setback in agriculture caused by severe drought. Growth was pulled by private consumption and investment while curtailed by external deficits. In the second half of 2007, the country's exposure to world-wide price increases and capital squeeze accelerated inflation and fuelled currency depreciation. Higher inflation and interest rates together with exchange rate uncertainties will cool down the economy in 2008. But the government faces elections and may further relax wage and fiscal policies thus stimulating private demand. The combined result of external factors and government action may be a slowdown of growth. However, assuming average weather conditions, agriculture will recover thus adding to growth almost as much as other factors contribute to slowdown. Longer-term prospects are favourable as structural change is fast. But fiscal stabilization may come onto the agenda in 2009 causing some further slowdown.

Structural upgrading and labour shortages

Manufacturing industry output increased by about 6% in 2007, carried by strong expansion in the car industry, rubber and plastics and communication equipment manufacturing. By contrast, production of the clothing industry fell by 21% due to soaring wage costs and Chinese competition. These trends point to a technological upgrading of the production structure. Output growth was achieved at declining employment thus labour productivity increased by 10.5%. Labour costs expanded twice as fast as productivity which made structural change all the more necessary. The export structure dynamics reflect the output structure: exports of transport equipment and processed goods grew strongly while those of fuel and light industry consumer goods declined. Manufacturing output and exports can expand in the future due to two large FDI projects in the course of realization, Ford Motors in car manufacturing and Nokia in mobile phone production. The construction boom went on with 30% growth in 2007. Investor surveys show lasting optimism despite rapidly rising land prices and construction worker shortages.

Unemployment declined and labour shortages appeared in several sectors. The number of vacancies in the third quarter of 2007 was two times larger than of the registered unemployed. Shortages have emerged across all skill and occupation groups, with the exception of trade. Most in demand are highly skilled technical experts. The labour market is rigid as, despite strong demand, inactivity does not decline because of the basic lack of skills and educational deficiencies in the rural areas. Emigrants (estimated at about one tenth of the population) do not return home as foreign wages are still substantially higher than the rapidly rising domestic wages.

Expanding deficits, rising inflation

The budget deficit remained below 3% of GDP in 2007, one percentage point higher than in the previous year. A further expansion of the deficit can be assumed for 2008 due to the expected slower increase in revenues and soaring expenditures in the social security budget and for public sector wages. The budget law, based on meanwhile outdated growth and inflation assumptions, expresses the government's intention to share the benefits of economic growth with the less well-to-do segments of the population – minimum-wage earners, pensioners and public services employees. Still it claims that the 2008 budget is tight and reckons with a deficit below 3%, a figure doubted by most analysts. One can only hope that a more stable government coming to power after the elections towards the end of 2008 will show more restraint in the coming years. Until then, lax fiscal and wage policies may add to inflation.

Consumer price inflation accelerated in the second half of 2007 because of higher food prices and currency devaluation. The pass-over of high import prices was modest and one can expect more to happen during 2008. Energy prices for households are linked to the exchange rate and thus due to rise. More than half of the agricultural products used in the food industry is imported, which will also trigger inflation. Most of the downward trend in inflation up to mid-2007 was in fact based on currency appreciation, which has reversed. In addition, Romania has the obligation, under its EU accession treaty, to raise the prices of domestically produced gas (covering 60% of consumption) to the level of prices of imported gas. The government is eager to postpone this step until after the elections, but then the price rise will finally have to be introduced. Higher gas prices will severely hit the chemical industry but also other large energy users such as the cement and brick industries and slow down construction works. Thus the price hikes currently underway will not die off very soon, and inflation will slow down only gradually.

The Romanian currency suffered the biggest slide among the NMS currencies during the recent world-wide turbulence. We expect the RON/EUR rate to fluctuate between 3.5 and 3.8 for the rest of the year. In fact we consider the expected average rate at around 3.6 RON/EUR much more in line with economic fundamentals than the 3.3 rate in 2007. As a result, we expect an improvement in the foreign trade balance, since depreciation will put a brake on imports. Unfortunately, exports may not be much affected, as most of them come from large companies unable to react fast and much of the exports depend on imported components. Apart from importers, clients having contracted forex credits (half of the non-government credit) will be negatively affected by the weaker RON.

In 2007 the current account deficit jumped to about 15% of GDP; only 44% of it was covered by FDI. Despite high external deficits, official reserves increased. Excessive current account deficits had been easily financed in times of global liquidity. But, since liquidity has been squeezed lately both investors and banks have become more cautious and nervous. Their temporarily withdrawal from countries with vulnerable foreign positions such as Romania caused depreciation.

Growth slowdown in election years

Government policies are to a large extent paralysed until after the elections, the date for which is not set yet. If sticking to the rule, local elections should be held in June and parliamentary elections in November, while the president is to serve one more year. All polls point to a fall of the present coalition which has a minority in parliament and depends on the mercy of the Social Democratic Party. Polls also suggest that the oppositional Democratic and Democratic-Liberal parties, if winning, will need more than one coalition partner to form a new government. The major question is in fact not whether the current coalition will remain in power (they are doomed to fail for certain), but which

Table RO

Romania: Selected economic indicators

	2002	2003	2004	2005	2006	2007 1)	2008	2009 Forecast	2010
Population, th pers., mid-year	21,795	21,734	21,673	21,624	21,584	21,538	.	.	.
Gross domestic product, RON bn, nom. 2)	151.5	197.6	246.5	288.2	344.5	394	458	524	594
annual change in % (real) 2)	5.1	5.2	8.5	4.2	7.8	6.0	5.5	5	6
GDP/capita (EUR at exchange rate)	2,224	2,420	2,806	3,678	4,529	5,486	.	.	.
GDP/capita (EUR at PPP - wiiw)	6,000	6,490	7,360	7,930	9,140	10,140	.	.	.
Gross industrial production									
annual change in % (real)	4.3	3.1	5.3	2.0	7.2	5.4	6	6	7
Gross agricultural production									
annual change in % (real)	-3.5	7.5	18.1	-13.1	2.4	.	.	.	.
Construction output total									
annual change in % (real)	10.0	9.8	9.2	9.5	27.8	33.6	.	.	.
Consumption of households, RON bn, nom. 2)	102.7	128.2	167.2	197.0	233.2	271	.	.	.
annual change in % (real) 2)	5.3	8.5	14.5	9.9	12.6	11	10	6	8
Gross fixed capital formation, RON bn, nom. 2)	32.3	42.3	53.9	66.5	88.3	121	.	.	.
annual change in % (real) 2)	8.2	8.5	11.1	12.7	19.3	25	20	10	15
LFS - employed persons, th, avg.	9,234	9,223	9,158	9,147	9,313	9,560	.	.	.
annual change in %	.	-0.1	-0.7	-0.1	1.8	2.6	.	.	.
Reg. employees in industry, th pers., avg.	1,891	1,848	1,741	1,672	1,632	1,570	.	.	.
annual change in %	-0.5	-2.3	-5.8	-4.0	-2.4	-3.7	.	.	.
LFS - unemployed, th pers., average	845.3	691.8	799.5	704.5	728.4	670.0	.	.	.
LFS - unemployment rate in %, average	8.4	7.0	8.0	7.2	7.3	6.5	6.5	6.5	6
Reg. unemployment rate in %, end of period	8.4	7.4	6.3	5.9	5.2	4.1	.	.	.
Average gross monthly wages, RON	532.1	663.8	818.3	968.0	1,146	1,410	.	.	.
annual change in % (real, net)	2.4	10.8	10.6	14.3	8.9	15.4	.	.	.
Consumer prices, % p.a.	22.5	15.3	11.9	9.0	6.6	4.8	8	7	5
Producer prices in industry, % p.a.	23.0	19.5	19.1	10.5	11.6	8.1	.	.	.
General governm.budget, EU-def., % GDP 3)									
Revenues	37.6	32.1	31.2	32.2	32.9	33.9	.	.	.
Expenditures	39.6	33.6	32.7	33.6	34.8	36.8	.	.	.
Net lending (+) / net borrowing (-)	-2.0	-1.5	-1.5	-1.4	-1.9	-2.9	-4	-3	-3
Public debt, EU-def., % of GDP 3)	25.0	21.5	18.8	15.8	12.4	.	.	.	.
Discount rate, % p.a., end of period	20.4	20.4	18.0	7.5	8.8	7.5	.	.	.
Current account, EUR mn	-1,623	-3,060	-5,099	-6,888	-10,156	-16,872	-19,000	-21,000	-23,000
Current account in % of GDP	-3.3	-5.8	-8.4	-8.7	-10.4	-14.3	-14.9	-14.4	-13.6
Gross reserves of NB excl. gold, EUR mn	5,877	6,374	10,848	16,799	21,310	25,307	.	.	.
Gross external debt, EUR mn	16,200	17,835	21,505	30,914	41,152	57,000	.	.	.
Gross external debt in % of GDP	37.3	37.1	34.6	39.4	40.4	52.2	.	.	.
FDI inflow, EUR mn	1,212	1,946	5,183	5,213	9,060	7,069	8,000	.	.
FDI outflow, EUR mn	18	36	56	-24	337	100	100	.	.
Exports of goods, BOP, EUR mn	14,675	15,614	18,935	22,255	25,850	29,380	32,900	36,800	42,300
annual growth rate in %	15.4	6.4	21.3	17.5	16.2	13.7	12	12	15
Imports of goods, BOP, EUR mn	17,427	19,569	24,258	30,061	37,609	49,966	56,500	62,200	70,300
annual growth rate in %	8.6	12.3	24.0	23.9	25.1	32.9	13	10	13
Exports of services, BOP, EUR mn	2,468	2,671	2,903	4,102	5,587	7,533	9,790	11,750	14,100
annual growth rate in %	8.6	8.2	8.7	41.3	36.2	34.8	30	20	20
Imports of services, BOP, EUR mn	2,463	2,609	3,116	4,451	5,583	7,268	9,300	11,160	13,390
annual growth rate in %	2.5	5.9	19.4	42.8	25.4	30.2	28	20	20
Average exchange rate RON/USD	3.3055	3.3200	3.2637	2.9137	2.8090	2.4383	.	.	.
Average exchange rate RON/EUR (ECU)	3.1255	3.7556	4.0532	3.6234	3.5245	3.3373	3.6	3.6	3.5
Purchasing power parity RON/USD	0.9906	1.1822	1.2994	1.4210	1.4678	1.4761	.	.	.
Purchasing power parity RON/EUR	1.1592	1.3996	1.5445	1.6799	1.7459	1.8054	.	.	.

Note: The term "industry" refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) According to ESA'95 (from 2003 FISIM adjusted; real change based on previous year prices). - 3) According to ESA'95, excessive deficit procedure.

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

of the opposition formations, a Socialist-led coalition or one led by the Democrats, will be able to form the new government. The president will certainly use his power to support the latter. Anyway, as for economic policy, not much difference is to be expected.

External uncertainties, inflation and devaluation pressures point to lower growth of private demand in 2008. This may slow down economic growth by one or two percentage points. But government consumption and net exports are about to increase and there is also no sign of a setback in investment yet. In addition, the recovery of agriculture will add one or two percentage points to GDP following the year of poor harvests in 2007. Thus, while the structure of growth will be different in 2008 from what it was in the previous year, its speed may not decelerate all that much. For 2009 we expect fiscal stabilization, more modest wage growth and an average harvest, all cutting back the GDP growth rate to 5%. The results of the ongoing investment boom and a stable currency will improve international competitiveness in the long run, thus stronger growth may be resumed in 2010.

Zdenek Lukas

Slovakia: booming economy looking ahead to the euro

Fast growth backed by FDI

Slovakia remains one of the top expanding economies in Europe. Rising wages, credits and social transfers to households have boosted private consumption. Robust domestic and foreign investment in industry as well as infrastructure projects are fuelling gross fixed capital formation. In addition, since mid-2006, foreign trade has been contributing positively to GDP growth as exports are rising faster than imports. Boosted by rising production capacities at foreign-owned firms, exports of cars and TV sets expanded at the highest pace. Driven by very strong foreign demand, sales of chemicals (mostly plastics and plastic products) and semi-finished goods such as steel, iron, copper and paper are also enjoying high growth. Notwithstanding some slowdown, import growth remained high in 2007 as private consumers, encouraged by rising incomes and the appreciating Slovak koruna, purchased more foreign consumer goods. Furthermore, particularly foreign-owned assembling plants import parts, components and accessories of motor vehicles, and producers of electro-technical equipment purchase equipment and components abroad. Despite profit repatriation by foreign investors, the current account deficit dropped by more than 2 percentage points in 2007 (to below 5% of GDP).

Competitive economy, but strong west/east divide

Despite the appreciation of the domestic currency, the robustly expanding industrial exports remain competitive on the international markets. Unit labour costs in industry declined by about 4% in SKK terms (they grew by about 6% in EUR terms). At comparable productivity, wages in Slovakia are still lower than those in the Czech Republic, Hungary and Poland (and unit labour costs are thus lower as well). The strong economic expansion is supporting employment growth. However, labour market improvements have been selective and focused on the more prosperous western regions; the eastern and southeastern districts are still struggling with high unemployment as the bulk of FDI

Table SK

Slovak Republic: Selected economic indicators

	2002	2003	2004	2005	2006	2007 1)	2008	2009 Forecast	2010
Population, th pers., mid-year	5,379	5,379	5,383	5,387	5,391	5,399	.	.	.
Gross domestic product, SKK bn, nom. 2)	1,108	1,222	1,362	1,485	1,660	1,850	2,050	2,250	2,440
annual change in % (real) 2)	4.8	4.8	5.2	6.6	8.5	9	8	7	6
GDP/capita (EUR at exchange rate)	4,825	5,478	6,317	7,144	8,264	10,147	.	.	.
GDP/capita (EUR at PPP - wiiw)	11,070	11,490	12,360	13,560	14,990	16,720	.	.	.
Gross industrial production									
annual change in % (real)	6.3	5.0	4.1	3.8	9.9	13.0	12	10	7
Gross agricultural production									
annual change in % (real)	1.5	-2.4	5.6	-6.3	0.0	.	.	.	.
Construction industry									
annual change in % (real)	4.1	6.0	5.7	14.7	14.9	5.7	.	.	.
Consumption of households, SKK bn, nom. 2)	631.4	683.5	764.9	836.1	928.5	1,020	.	.	.
annual change in % (real) 2)	5.5	1.6	4.2	6.5	5.9	7.8	7	5	7
Gross fixed capital form., SKK bn, nom. 2)	303.5	302.8	326.4	394.3	436.2	480	.		
annual change in % (real) 2)	0.2	-2.7	4.8	17.6	8.4	7.5	7	7	7
LFS - employed persons, th, avg.	2,127	2,165	2,170	2,216	2,301	2,350	.	.	.
annual change in %	0.2	1.8	0.3	2.1	3.8	2.1	.	.	.
LFS - employed pers. in industry, th, avg.	640.9	634.1	641.3	649.1	666.4	.	.	.	.
annual change in %	1.9	-1.1	1.1	1.2	2.7	.	.	.	.
LFS - unemployed, th pers., average	486.9	459.2	480.7	427.5	353.4	292	.	.	.
LFS - unemployment rate in %, average	18.5	17.4	18.1	16.2	13.3	11	10	9	8.5
Reg. unemployment rate in %, end of period	17.5	15.6	13.1	11.4	9.4	8.0	7	6	6
Average gross monthly wages, SKK 3)	13,511	14,365	15,825	17,274	18,761	20,154	.	.	.
annual change in % (real, gross)	5.8	-2.0	2.5	6.3	3.3	4.5	3	.	.
Consumer prices, % p.a.	3.3	8.5	7.5	2.7	4.5	2.8	2.8	3	2.5
Producer prices in industry, % p.a.	2.1	8.3	3.4	4.7	8.4	2.0	4	.	.
General governm.budget, EU-def., % GDP 4)									
Revenues	36.6	37.7	35.6	35.6	33.9	33.2	.	.	.
Expenditures	44.8	40.5	38.0	38.4	37.7	35.9	.	.	.
Net lending (+) / net borrowing (-)	-8.2	-2.8	-2.4	-2.8	-3.7	-2.7	-2.8	-2.8	-3.0
Public debt, EU-def., in % of GDP 4)	43.4	42.4	41.4	34.2	30.4	.	.	.	.
Discount rate, % p.a., end of period	6.5	6.0	4.0	3.0	4.8	4.3	.	.	.
Current account, EUR mn 5)	-2,043	-1,747	-2,656	-3,268	-3,127	-2,600	-2,500	-2,750	-3,700
Current account in % of GDP	-7.9	-5.9	-7.8	-8.5	-7.0	-4.7	-4.0	-4.0	-5.0
Gross reserves of NB incl. gold, EUR mn	8,824	9,717	10,954	13,067	10,145	12,930	.	.	.
Gross external debt, EUR mn	12,655	14,654	17,421	22,705	24,449	29,000	.	.	.
Gross external debt in % of GDP	47.6	49.3	49.6	57.9	50.9	52.7			
FDI inflow, EUR mn	4,397	1,914	2,441	1,952	3,324	2,300	2,000	.	.
FDI outflow, EUR mn	12	219	-17	120	294	100	200	.	.
Exports of goods, BOP, EUR mn 5)	15,270	19,359	22,248	25,654	33,099	43,000	52,000	60,000	70,000
annual growth rate in %	8.2	26.8	14.9	15.3	29.0	29	22	15	17
Imports of goods, BOP, EUR mn 5)	17,517	19,924	23,485	27,571	35,120	43,000	51,000	58,000	69,000
annual growth rate in %	6.2	13.7	17.9	17.4	27.4	23	18	14	19
Exports of services, BOP, EUR mn 5)	2,958	2,912	3,000	3,542	4,313	5,300	6,300	6,900	7,600
annual growth rate in %	6.4	-1.5	3.0	18.1	21.7	22	19	10	10
Imports of services, BOP, EUR mn 5)	2,474	2,703	2,785	3,285	3,710	4,700	5,600	6,100	6,800
annual growth rate in %	10.3	9.2	3.0	18.0	12.9	26	19	9	11
Average exchange rate SKK/USD	45.34	36.77	32.26	31.02	29.72	24.69	.	.	.
Average exchange rate SKK/EUR (ECU)	42.70	41.49	40.05	38.59	37.25	33.77	33.0	32.9	32.9
Purchasing power parity SKK/USD	15.90	16.71	17.23	17.20	17.13	17.11	.	.	.
Purchasing power parity SKK/EUR	18.61	19.78	20.47	20.33	20.53	20.49	.	.	.

Note: The term 'industry' refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) According to ESA'95 (FISIM adjusted). - 3) From 2006 including wages of armed forces. - 4) According to ESA'95, excessive deficit procedure. - 5) Calculated from USD.

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

has been concentrated in the Bratislava region. The western part of the country is facing increasing bottlenecks concerning skilled industrial workers, partly because of the low labour mobility within Slovakia.

The left-oriented government, in power since summer 2006, is continuing with the pro-business agenda initiated by the previous centre-right coalition cabinet. As a result, Slovakia remains an attractive target for FDI, particularly in the automotive, electronics and steel industries. Because of labour shortages in the west, some big foreign investors are heading east. But, as for the two largest eastern urban regions (Košice and Prešov), the municipal heads there, with strong political ambivalence, have so far been unable to offer suitable industrial zones because of local land disputes. By contrast, some small municipalities, more ready for political compromise, are more successful. The best example is the Kechnec Industrial Park, near a small village located on the southeast border with Hungary, where the local authorities were able to attract a number of FDI enterprises (first of all the German automobile gear box manufacturer Getrag Ford). So far, the firms have invested some EUR 400 million in Kechnec. Economic development in eastern Slovakia is also hindered by the poor transport infrastructure.[14] The construction of a motorway connecting Bratislava and Košice should be completed within the next three years. Part of the highway construction is to be financed by the public-private partnership model, and the recently adopted legislation facilitates easier access to the required land plots.

Despite some risks, good prospects for GDP growth and euro adoption

Slovakia is the most enthusiastic country regarding an early adoption of the euro. Already on 26 September 2007, the cabinet approved a new law related to a smooth transition from the Slovak koruna to the euro. Fiscal discipline is crucial for meeting the Maastricht criteria and alleviating the risks of rising inflation after the planned accession to the eurozone in 2009. The general government deficit was at about 2.5% of GDP in 2007, after 3.7% recorded in 2006. Despite an expected upward correction, the country will very likely meet the 3% Maastricht limit as it is benefiting from the highest economic growth in its history that also boosts state revenues. The main challenge on the way to euro adoption is posed by inflation risks, related to rising energy and food prices, apart from demand-pull factors. The appreciating Slovak koruna is however working against strong inflationary pressures.

Economic growth will decelerate in the years to come, because the pre-year base value for further GDP expansion is very high and the high rate of industrial growth – mostly driven by the spectacular expansion of car and electro-technical manufacturing – will most likely slow down as well. However, pro-growth effects of large foreign direct investments will continue to support economic growth. Falling unemployment and rising incomes (both wages and social transfers) will stimulate domestic demand (both private consumption and investment). Although FDI-led investment growth may decelerate after three years of robust growth, investment will still support the economic expansion thanks to EU transfers financing ambitious infrastructure projects. Despite some risks related to weaker foreign demand, we believe that FDI-led companies will be able to find outlets for their products. As a result, foreign trade will contribute positively to GDP growth in the coming years as well. Increasing labour demand will help to reduce the unemployment rate further. However, the

[14] At the end of 2007, the European Commission approved all of the eleven operational programmes for Slovakia, totalling EUR 11.3 billion, for the period 2007 to 2013. More than one third of the funds is to flow to the eastern regions Košice and Prešov.

structure of unemployment (mostly long term and among the Roma minority) is unfavourable and may prevent a more radical fall in unemployment. Despite the expected foreign trade surpluses in the coming years, the current account deficit will probably stabilize at roughly 4% of GDP, largely due to increasing repatriation of profits by FDI companies.

Hermine Vidovic

Slovenia: rapid GDP growth with accelerating inflation

In 2007 Slovenia's GDP recorded the highest growth since gaining independence. Growth was backed by domestic consumption, in particular soaring investments, up almost 20%, while the contribution of foreign trade was negative. Lending activities both to the household and private sectors remained buoyant. Construction was one of the sectors benefiting most from rising investment, increasing its output by nearly one quarter. Industrial output expanded at a record rate of 7% in 2007, of which manufacturing was up 9%; at the same time labour productivity in industry was growing significantly.

Inflation not yet under control

High inflation has become the most debated economic issue in Slovenia recently. Inflation started to accelerate in mid-2007 following considerable price rises for food, beverages and in the hotels and restaurants sector. In general, it turned out that Slovenia is more affected by rising oil prices than other countries in the eurozone due to the higher weight of oil products in the consumer basket of households and the large share of food in Slovenian imports. Slovenian economists also blame weak competition in the country's food processing industry for the extraordinary price rises. Euro changeover effects were initially limited, but seem to have had a larger impact on inflation after the expiry of double pricing and of retailers' commitments not to raise their prices. Consumer prices rose by 3.6% on an annual average, and by 5.6% in December year on year.

The strong GDP growth was reflected in continued employment growth. Both the labour force survey and national accounts data indicate more than 2% growth in employment, mainly in the construction and services sectors, particularly in business services, but also in industry (after years of steady decline). Unemployment eased in 2007 to a record low of 5% measured by LFS and 7.5% based on registration data. The high levels of capacity utilization coincide with growing labour shortages; surveys conducted in companies quote shortages of skilled labour as the most serious barrier to production growth. The strong labour demand was also reflected in a higher vacancy rate and rising wages.

On the external side, imports increased somewhat faster than exports, resulting in a deterioration of the foreign trade deficit. Though FDI inflow more than doubled compared to a year earlier, Slovenia remains a net FDI exporter. The bulk of Slovenian foreign investment is targeted towards the successor states of the former Yugoslavia, encompassing a broad range of activities. Foreign indebtedness rose rapidly during 2007 and reached EUR 34 billion by the end of November, EUR 10 billion more than in December 2006. Part of that increase is due to obligations of the Bank of Slovenia towards the Eurosystem, about EUR 1 billion are related to the Eurobond issue of the Ministry of Finance in March and the remainder is due to banks borrowing abroad. Foreign net debt stood at only EUR 5.8 billion.

Table SI

Slovenia: Selected economic indicators

	2002	2003	2004	2005	2006	2007 1)	2008	2009 Forecast	2010
Population, th pers., mid-year	1,996	1,997	1,997	2,001	2,009	2,019	.	.	.
Gross domestic product, EUR mn, nom. 2)3)	22,758	24,716	26,677	28,243	30,448	33,400	36,300	39,300	42,400
annual change in % (real) 2)	3.7	2.8	4.4	4.1	5.7	6	4.7	4.5	4.8
GDP/capita (EUR at exchange rate)	12,080	12,692	13,402	14,114	15,162	16,542	.	.	.
GDP/capita (EUR at PPP - wiiw)	16,560	17,010	18,430	19,460	20,660	22,330	.	.	.
Gross industrial production									
annual change in % (real) 4)	2.4	1.4	4.8	3.3	6.1	7.0	5	4	4.5
Gross agricultural production									
annual change in % (real)	13.4	-12.4	17.3	0.2	-5.7	.	.	.	.
Construction output									
annual change in % (real) 5)	-3.4	-1.7	2.5	3.0	15.3	21.9 I-XI	.	.	.
Consumption of households, EUR mn, nom. 2)3)	12,267	13,358	14,196	14,968	15,956	16,500	.	.	.
annual change in % (real) 2)3)	1.8	3.5	3.0	2.9	4.0	2.5	3	3	2.8
Gross fixed capital form., EUR mn, nom. 2)3)	5,318	5,955	6,784	7,210	7,960	8,400	.	.	.
annual change in % (real) 2)3)	1.0	7.4	7.3	2.5	8.4	18	8	4	5
LFS - employed persons, th, avg.	910	897	943	949	961	980	.	.	.
annual change in %	-0.7	-1.4	5.1	0.6	1.3	2.0	.	.	.
Reg. employees in industry, th pers., avg. 6)	246.1	242.2	239.7	239.3	235.5	237.4 I-X	.	.	.
annual change in % 6)	1.1	-1.6	-1.0	-1.7	-1.6	0.9 I-X	.	.	.
LFS - unemployed, th pers., average	62.0	64.8	64.0	67.0	61.0	54.0	.	.	.
LFS - unemployment rate in %, average	6.4	6.7	6.3	6.6	6.0	5.2	4.9	4.7	4.6
Reg. unemployment rate in %, end of period	11.3	11.0	10.1	10.2	8.6	7.5	7.2	7	6.8
Average gross monthly wages, EUR 3)7)	982	1,057	1,117	1,157	1,213	1,280	.	.	.
annual change in % (real, net) 7)	2.1	1.8	2.1	3.5	2.5	4.5	.	.	.
Consumer prices (nat. def.), % p.a.	7.5	5.6	3.6	2.5	2.5	3.6	3.9	3.5	3
Producer prices in industry, domestic, % p.a.	5.1	2.5	4.3	2.7	2.3	5.4	4	3.8	3
General governm.budget, EU-def., % GDP 8)									
Revenues	44.6	44.4	44.2	44.5	44.1	43.0	.	.	.
Expenditures	47.1	47.1	46.5	46.0	45.3	43.6	.	.	.
Net lending (+) / net borrowing (-)	-2.5	-2.7	-2.3	-1.5	-1.2	-0.6	-1.4	.	.
Public debt in % of GDP 7)	28.4	27.9	27.6	27.4	27.1	25.6	.	.	.
Discount rate % p.a., end of period 9)	7.3	5.0	3.3	3.8	3.8	4.0	.	.	.
Current account, EUR mn	247.2	-195.7	-719.7	-561.4	-856.5	-1,600	-1,400	-1,200	-1,100
Current account in % of GDP	1.0	-0.8	-2.7	-2.0	-2.8	-4.8	-3.9	-3.1	-2.6
Gross reserves of NB excl. gold, EUR mn 10)	6,702	6,798	6,464	6,824	5,342	670	.	.	.
Gross external debt, EUR mn	11,524	13,225	15,343	20,508	24,034	34,007 XI	.	.	.
Gross external debt in % of GDP	48.7	52.8	57.5	72.6	78.9	.	.	.	.
FDI inflow, EUR mn	1721.7	270.5	665.2	472.6	511.7	900	1,200	.	.
FDI outflow, EUR mn	165.8	421.3	441.0	515.6	718.5	1,000	1,000	.	.
Exports of goods, BOP, EUR mn	11,082	11,417	12,933	14,599	17,028	19,900	22,200	24,400	27,500
annual growth rate in %	6.0	3.0	13.3	12.9	16.6	17	12	10	13
Imports of goods, BOP, EUR mn	11,347	11,960	13,942	15,625	18,179	21,450	23,600	25,700	28,900
annual growth rate in %	1.9	5.4	16.6	12.1	16.3	18	10	9	12
Exports of services, BOP, EUR mn	2,440	2,465	2,783	3,143	3,450	4,100	4,700	5,200	5,900
annual growth rate in %	12.0	1.0	12.9	12.9	9.8	19	15	11	13
Imports of services, BOP, EUR mn	1,820	1,925	2,095	2,294	2,584	3,100	3,500	3,900	4,300
annual growth rate in %	10.8	5.8	8.8	9.5	12.7	20	13	10	11
Average exchange rate EUR/USD 3)	1.003	0.864	0.803	0.804	0.797	0.730	.	.	.
Average exchange rate EUR/EUR (ECU) 3)	0.944	0.975	0.997	1.000	1.000	1.000	1	1	1
Purchasing power parity EUR/USD 3)	0.588	0.615	0.610	0.614	0.617	0.606	.	.	.
Purchasing power parity EUR/EUR 3)	0.689	0.728	0.725	0.725	0.734	0.741	.	.	.

Note: The term "industry" refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) According to ESA'95 (FISIM adjusted and real change based on previous year prices). - 3) Slovenia has introduced the Euro from 1 January 2007. For statistical purposes all time series in SIT as well as the exchange rates and PPP rates have been divided by the conversion factor 239.64 (SIT per EUR) to EUR-SIT. - 4) From July 2005 new methodology. - 5) Until 2003 Construction output in effective working time with 10 or more persons employed; from 2004 units with at least 20 employees. - 6) From January 2005 data from Statistical Register of Employment, years before from Monthly Report on Earnings. - 7) From January 2005 including legal persons with 1 or 2 employees in private sector. - 8) According to ESA'95, excessive deficit procedure. - 9) From 2007 European Central Bank Interest Rates. - 10) From January 2007 (Euro introduction) only the foreign currency reserves nominated in non-euro currency are included.

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

Government under pressure

2007 turned out to be a turbulent year in politics: It took nearly half a year to nominate and confirm a new central bank governor. In November, the former leftist diplomat Danilo Türk won the presidential elections against Lojze Peterle, member of the European Parliament and former conservative prime minister. The outcome was generally interpreted as a confirmation of the growing discontent with the right-wing government led by prime minister Janez Janša. In response to the 'lost' presidential elections and in anticipation of Slovenia's EU presidency, Mr Janša called a vote of confidence which eventually reconfirmed the government's term of office. The next parliamentary elections will be held in October 2008 and this time a change in the government is very likely. At the beginning of 2008 Slovenia took over the EU presidency as the first of the countries that had acceded the Union in 2004.

From high to more moderate economic growth

After last year's record expansion, GDP growth will decelerate to below 5% in 2008 owing to declining domestic demand, particularly lower investment growth, and weaker foreign demand. Housing is expected to weaken, while construction in infrastructure (motorways) will continue. With parliamentary elections ahead, government consumption may increase, and household consumption will grow by around 3%, largely because of significant wage increases in the public sector – based on the Collective Agreement for the Public Sector from July 2007. The volume of lending will taper off gradually due to the tightening of domestic banks' credit conditions. The slower pace of economic growth will be reflected in the labour market: employment is expected to grow by about 1% in the period 2008-2010 and unemployment will hover around 5% based on the LFS. Labour shortages will remain a limiting factor of production. The management of public finances is relatively good; however, the aim of balancing the general government budget by 2010 (as outlined in the Stability Programme Update) appears fairly ambitious. Foreign trade performance will largely depend on the international environment, the EU in particular, since Slovenia as a small and open economy is highly vulnerable to external risks. In view of the envisaged privatizations (telecom operator, insurance company), FDI inflows will increase in the coming years; at the same time Slovenian entrepreneurs will remain very active abroad, particularly in Southeast Europe. Inflation is expected to further accelerate in 2008 as long as prices of (imported) food and oil products are on the increase; an end of the price upsurge is not yet in sight.

Beyond 2008, wiiw expects GDP growth to remain between 4.5% and 5%. Dampened growth will be attributable to a gradual reduction of investment particularly in the construction sector where the completion of the motorway network is expected for 2008. Growth of government and private consumption is likely to remain stable up until 2010. As a consequence of slower investment growth, imports will moderate and the trade deficit will narrow. Thus, during 2009 and 2010 the current account deficit is expected to decline both in relative and absolute terms.

Sebastian Leitner

Baltic States: entering a chill-out phase

Moderation of domestic demand supports soft landing scenarios

2007 marks the turning point of the post-accession boom period in the Baltic States. In Estonia the turnaround occurred already in the first half of the year, while in Latvia and Lithuania signs of deceleration of growth have set in only recently. Nevertheless, the internal as well as external imbalances which emerged from soaring domestic demand will ease only in the medium term.

Investment activity has lost its role as a main driver of growth in Estonia, caused by the cooling of the housing market. A moderation of private investment is to be expected also for the years to come, as the recent lending boom to households came to an end due to rising interest rates, the already attained debt levels and aligned risk assessments by banks and consumers. Moreover, in the course of 2007 growth rates of retail sales plummeted. Private consumption will nevertheless continue to play an important role in keeping the annual growth rate of the economy above 5% in the medium run.

In Latvia and Lithuania, growth of household consumption decelerated slightly only in the second half of 2007, accompanied by a decline in retail sales growth as well as a decrease in net exports. Moreover, also here the slowing down of mortgage lending was accompanied by a decline in prices in the residential real estate market. Given high growth rates of compensation of employees, household consumption is expected to act as the main engine of growth in Latvia as well as in Lithuania also in the next years. However, real growth rates will come down in the medium term as the recent rise of demand above potential output has been followed by an unfavourable inflationary process. Rising interest rates as well as a deterioration of future prospects may also result in a reluctant development of investments undertaken by enterprises.

Unemployment rates reach an all-time low

The vigorous growth developments in the Baltic States in 2007 led to a further rise in employment rates, which reached 70% in Estonia and Latvia and 65% in Lithuania in the age group 15-64 by the end of the year. The fall in unemployment occurring in the period after EU accession was even more dramatic. In Lithuania the unemployment rate fell below 4% by the end of 2007, in Estonia and Latvia the annual rate is at about 5% and 6% respectively. This development is also associated with the increase in emigration for work purposes in recent years. Particularly Latvians and Lithuanians have taken the opportunity to find jobs abroad after their countries' accession to the EU.[15] Baltic employers today are confronted with shortages of labour supply, especially for skilled occupations in several manufacturing branches and service sectors. The governments of all Baltic States have therefore launched plans to further increase the number of work permits, in particular for Ukrainians, Russians and Belarusians. In the years to come the decline in activity, first of all construction, and in retail sector growth will ease the tensions on the labour market, resulting in only minor cuts in the unemployment rate as well as a reduction of employment growth.

15 See Part D, chapter 'Tightening labour markets' for a discussion of the magnitude of migration and its effects on labour market outcomes in the new member states.

Table EE

Estonia: Selected economic indicators

	2002	2003	2004	2005	2006	2007 [1]	2008	2009	2010
								Forecast	
Population, th pers., mid-year	1,359	1,354	1,349	1,346	1,344	1,342	.		
Gross domestic product, EEK mn, nom.	121,372	136,010	149,923	175,392	207,061	242,200	268,300	291,500	315,200
annual change in % (real)	8.0	7.2	8.3	10.2	11.2	7.0	6	5.5	6
GDP/capita (EUR at exchange rate)	5,709	6,422	7,101	8,327	9,850	11,539	.	.	.
GDP/capita (EUR at PPP - wiiw)	10,220	11,290	12,310	14,110	16,100	17,680	.	.	.
Gross industrial production									
annual change in % (real)	8.2	10.9	10.5	11.0	7.3	6.1	6	5	7
Gross agricultural production									
annual change in % (real)	-1.8	3.8	0.2	6.8	-1.0	.	.	.	.
Construction industry									
annual change in % (real)	24.8	7.6	11.3	19.8	22.5	.	.	.	.
Consumption of households, EEK mn, nom.	66,944	74,148	80,460	91,387	109,203	126,600	.		
annual change in % (real)	10.9	9.6	6.7	10.6	15.1	9.1	8	7	8
Gross fixed capital form., EEK mn, nom	36,140	43,089	47,091	53,743	70,569	74,700			
annual change in % (real)	24.1	19.2	4.4	9.9	22.4	4.1	5	7	7
LFS - employed persons, th, avg.	585.5	594.3	595.5	607.4	646.3	655.0	.	.	.
annual change in %	1.4	1.5	0.2	2.0	6.4	1.3	.	.	.
LFS - employed pers. in industry, th, avg.	144.4	150.0	160.9	157.9	154.0	.	.	.	.
annual change in %	-4.6	3.9	7.3	-1.9	-2.5	.	.	.	.
LFS - unemployed, th pers., average	67.2	66.2	63.6	52.2	40.5	32.0	.	.	.
LFS - unemployment rate in %, average	10.3	10.0	9.6	7.9	5.9	4.7	4.5	4	4
Reg. unemployment rate in %, end of period	4.8	4.4	3.5	2.7	1.4	2.2	.	.	.
Average gross monthly wages, EEK	6,144	6,723	7,287	8,073	9,407	10,900	.	.	.
annual change in % (real, gross)	7.6	8.0	5.2	6.4	11.6	9	.	.	.
Consumer prices, % p.a.	3.6	1.3	3.0	4.1	4.4	6.3	6	4	3
Producer prices in industry, % p.a.	0.4	0.2	2.9	2.1	4.5	8.3	5.5	.	.
General governm. budget, EU-def., % GDP [2]									
Revenues	36.0	36.4	35.9	35.4	36.6	37.2	37.8	38.0	37.5
Expenditures	35.6	34.6	34.1	33.4	33.0	34.6	36.9	37.2	36.5
Net lending (+) / net borrowing (-)	0.4	1.8	1.8	1.9	3.6	2.6	0.9	0.8	1.0
Public debt in % of GDP [2]	3.5	5.5	5.1	4.4	4.0	2.8	.	.	.
Money market rate, % p.a., end of period [3]	3.4	2.6	2.4	2.5	3.8	7.1	.	.	.
Current account, EUR mn	-825	-985	-1,177	-1,118	-2,051	-2,500	-2,400	-2,400	-2,400
Current account in % of GDP	-10.6	-11.3	-12.3	-10.0	-15.5	-16.2	-14	-13	-12
Gross reserves of NB excl. gold, EUR mn	964	1,089	1,311	1,642	2,114	2,218	.	.	.
Gross external debt, EUR mn	4,490	5,603	7,344	9,561	12,762	17,500	.	.	.
Gross external debt in % of GDP	57.9	64.5	76.6	85.3	96.4	113.1	.	.	.
FDI inflow, EUR mn	307	822	775	2,255	1,341	1,700	1,600	.	.
FDI outflow, EUR mn	140	137	217	507	876	1,200	1,000	.	.
Exports of goods, BOP, EUR mn	3,704	4,055	4,806	6,262	7,680	8,000	8,550	9,000	9,700
annual growth rate in %	-1.4	9.5	18.5	30.3	22.7	4.2	7	5	8
Imports of goods, BOP, EUR mn	4,883	5,430	6,436	7,798	10,027	10,400	11,000	11,500	12,500
annual growth rate in %	5.6	11.2	18.5	21.2	28.6	3.7	6	5	9
Exports of services, BOP, EUR mn	1,800	1,960	2,282	2,569	2,773	3,200	3,600	3,700	4,000
annual growth rate in %	0.1	8.9	16.4	12.6	7.9	15.4	13	3	8
Imports of services, BOP, EUR mn	1,168	1,227	1,415	1,741	1,962	2,200	2,450	2,600	2,800
annual growth rate in %	8.5	5.1	15.3	23.0	12.7	12.1	11	6	8
Average exchange rate EEK/USD	16.61	13.86	12.59	12.59	12.47	11.44	.	.	.
Average exchange rate EEK/EUR (ECU)	15.65	15.65	15.65	15.65	15.65	15.65	15.65	15.65	15.65
Purchasing power parity EEK/USD, wiiw	7.47	7.52	7.59	7.81	8.05	8.35	.	.	.
Purchasing power parity EEK/EUR, wiiw	8.74	8.90	9.02	9.24	9.57	10.21	.	.	.

Note: The term "industry" refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) According to ESA'95, excessive deficit procedure. - 3) TALIBOR 1 month interbank rate.

Source: wiiw Database incorporating national statistics; Eurostat; wiiw forecasts and European Commission (Autumn 2007).

Labour market developments resulted in fast growing wage rates in the Baltic region. Real wages soared by 17.6% in Latvia and more than 14% in Lithuania in 2007. Only in Estonia did wage rises weaken slightly compared to 2006, but the real growth rate still equalled 9%. As a consequence producer and consumer prices also surged in 2007, fuelled by rising prices for food and oil products. In Estonia and Lithuania consumer inflation rates, at 6.3% and 5.5% on average in 2007, are already cause for concern. In Latvia the situation is even more alarming: the growth of the annual CPI reached 9.7% in 2007 and 15.8% in January 2008. This induced the European Commission to warn the Latvian government in a report in February of the detrimental consequences that may arise from the ongoing wage–price spiral. It urged the Latvian government to tighten its fiscal policy and control wages in order to tame the overheating economy.

In 2008 inflation is expected to remain at high levels in all Baltic States; the governments have to increase excise duties in compliance with EU regulations, and further rises in input prices for energy are likely. Only thereafter, a gradual improvement is to be expected, assuming that wage growth attenuates in the public and private sectors. Given the time needed to ease the imbalanced growth, the Baltic States will not be able to meet the Maastricht inflation criterion in the forecast period. The introduction of the euro will thus have to be postponed for a couple of years – in Latvia to 2013 at the earliest, in Estonia and Lithuania probably one or two years in advance.

Loss in competitiveness to the detriment of Estonian and Latvian exports

The rise in wages much above productivity growth caused a loss in competitiveness, which is one reason for the deterioration of the export performance in all Baltic countries in 2007. Taking into account rising producer as well as export prices, real growth of goods exports virtually stagnated. In Estonia, in addition, a reduction of transit trade of oil products took place, caused by the rise in transport capacities of the Russian port of Primorsk. In Lithuania a fire in the refinery of Mazeikiu Nafta in October 2006 drastically reduced trade in oil and products thereof, which had accounted for nearly 25% of total exports in previous years. At the beginning of 2008 Mazeikiu restarted to operate at full production capacity. This is due to result in higher growth rates of goods exports in Lithuania in 2008 and 2009. The dominance of labour-intensive products in Latvia's export structure corroborates the assumption that the ongoing wage growth will lead to a deterioration of the export performance in the years to come. Moreover, due to the loss in competitiveness of the manufacturing sector growth of industrial production came to a halt, while Estonia and Lithuania posted a slowdown in 2007.

Since import growth fell in line with the development in exports, the negative contribution of net exports to GDP even fell in all Baltic countries throughout 2007. Nevertheless, the current account deficit rose yet another time in 2007, widening to more than 23% in Latvia. Also in Estonia and Lithuania the deficit, at about 16% and 12% respectively, was unsustainably high. The coverage by FDI has declined by and by in recent years in favour of inflows of loans to the predominantly foreign-owned banking sectors. The slight moderation of domestic demand from 2008 onwards should also result in a gradual improvement of the trade balance.

Ensuring energy security is top on the agenda for the Lithuanian government

In Lithuania the Chernobyl-type nuclear power plant of Ignalina, producing more than 70% of the domestic electricity supply, is to be shut down by the end of next year according to Lithuania's

Table LV

Latvia: Selected economic indicators

	2002	2003	2004	2005	2006	2007 1)	2008	2009 Forecast	2010
Population, th pers., mid-year	2,339	2,325	2,313	2,301	2,288	2,276	.	.	.
Gross domestic product, LVL mn, nom.	5,758	6,393	7,435	9,059	11,265	14,100	16,400	18,500	20,400
annual change in % (real)	6.5	7.2	8.7	10.6	11.9	10.8	8	7	6
GDP/capita (EUR at exchange rate)	4,226	4,263	4,790	5,603	7,006	8,816	.	.	.
GDP/capita (EUR at PPP - wiiw)	8,430	8,980	9,880	11,180	12,740	14,540	.	.	.
Gross industrial production									
annual change in % (real)	8.4	9.1	8.9	5.7	5.1	0.5	1	2	2
Gross agricultural production									
annual change in % (real)	4.0	2.7	3.6	9.2	-3.0	.	.	.	.
Construction industry									
annual change in % (real)	21.3	15.2	14.8	15.8	13.3	.	.	.	.
Consumption of households, LVL mn, nom.	3,567	3,973	4,538	5,461	7,260	9,300	.	.	.
annual change in % (real)	7.4	8.2	8.7	11.6	20.0	15.3	15	12	10
Gross fixed capital form., LVL mn, nom.	1,371	1,560	2,042	2,774	3,871	4,900	.	.	.
annual change in % (real)	13.0	12.3	23.8	23.6	18.3	13.8	12	8	7
LFS - employed persons, th, avg.	989	1,007	1,018	1,036	1,088	1,115	.	.	.
annual change in %	2.8	1.8	1.1	1.8	5.0	2.5	.	.	.
LFS - employed pers. in industry, th, avg.	193.1	197.6	191.2	179.5	186.8	.	.	.	.
annual change in %	3.7	2.3	-3.2	-6.1	4.1	.	.	.	.
LFS - unemployed, th pers., average	134.5	119.2	118.6	99.1	79.9	72	.	.	.
LFS - unemployment rate in %, average	12.0	10.6	10.4	8.7	6.8	6.1	5.5	5.5	6
Reg. unemployment rate in %, end of period	8.5	8.6	8.5	7.4	6.5	4.9	.	.	.
Average gross monthly wages, LVL	173	192	211	246	302	390	.	.	.
annual change in % (real, gross)	6.0	7.8	2.4	9.7	15.6	17.6	.	.	.
Consumer prices, % p.a.	1.9	2.9	6.2	6.7	6.5	9.7	9	6.5	5
Producer prices in industry, % p.a.	1.0	3.2	8.6	7.8	10.3	16.1	.	.	.
General government budget, EU-def., % GDP 2)									
Revenues	33.4	33.2	34.7	35.2	37.0	37.5	37.9	38.0	38.0
Expenditures	35.6	34.8	35.8	35.6	37.2	37.0	37.3	37.5	37.6
Net lending (+) / net borrowing (-)	-2.3	-1.6	-1	-0.4	-0.3	0.5	0.6	0.5	0.4
Public debt in % of GDP 2)	13.5	14.4	14.5	12.5	10.6	10.2	.	.	.
Discount rate, % p.a., end of period	3.0	3.0	4.0	4.0	5.0	6.0	.	.	.
Current account, EUR mn 3)	-656	-811	-1,423	-1,610	-3,571	-4,700	-4,900	-4,700	-4,900
Current account in % of GDP	-6.6	-8.2	-12.8	-12.5	-22.3	-23.4	-21	-18	-17
Gross reserves of NB excl. gold, EUR mn	1,209	1,150	1,403	1,883	3,320	3,825	.	.	.
Gross external debt, EUR mn	6,858	7,545	9,871	12,808	18,128	26,700	.	.	.
Gross external debt in % of GDP	69.4	76.1	89.1	99.4	113.1	133.1	.	.	.
FDI inflow, EUR mn 3)	269	270	512	568	1,326	1,500	1,600	.	.
FDI outflow, EUR mn 3)	3	44	88	103	136	100	150	.	.
Exports of goods, BOP, EUR mn 3)	2,694	2,804	3,395	4,313	4,883	5,400	5,900	6,450	7,050
annual growth rate in %	7.6	4.1	21.1	27.1	13.2	10.6	9.3	9.3	9.3
Imports of goods, BOP, EUR mn 3)	4,256	4,573	5,634	6,753	8,947	9,900	10,850	11,550	12,350
annual growth rate in %	6.5	7.5	23.2	19.9	32.5	10.6	9.6	6.5	6.9
Exports of services, BOP, EUR mn 3)	1,313	1,333	1,432	1,743	2,101	2,400	2,700	2,950	3,200
annual growth rate in %	-0.2	1.6	7.4	21.8	20.5	14.2	12.5	9.3	8.5
Imports of services, BOP, EUR mn 3)	741	822	947	1,256	1,571	1,700	1,850	1,950	2,100
annual growth rate in %	-1.1	10.8	15.3	32.5	25.1	8.2	8.8	5.4	7.7
Average exchange rate LVL/USD	0.6180	0.5714	0.5401	0.5651	0.5605	0.4818	.	.	.
Average exchange rate LVL/EUR (ECU)	0.5826	0.6449	0.6711	0.7028	0.7028	0.7028	0.7028	0.7028	0.7028
Purchasing power parity LVL/USD, wiiw	0.2495	0.2586	0.2736	0.2980	0.3249	0.3483	.	.	.
Purchasing power parity LVL/EUR, wiiw	0.2920	0.3062	0.3252	0.3522	0.3865	0.4260	.	.	.

Note: The term "industry" refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) According to ESA'95, excessive deficit procedure. - 3) Calculated from LVL.

Source: wiiw Database incorporating national statistics; Eurostat; wiiw forecasts and European Commission (Autumn 2007).

EU accession treaty. The Baltic States, together with Poland, plan to set up a new reactor at the same site. Preliminary agreements envisage that of the planned output of 3200 MW, 600 MW should be allocated to Estonia and Latvia respectively and 1000 MW to Lithuania and Poland respectively; the final deal is to be signed in July 2008. Since the new nuclear power plan in Ignalina will come on stream not earlier than 2015, more probably by 2020, the European Commission approved a EUR 170 million grant to build a gas-fired power plant as a temporary relief. Moreover, in February 2008 Lithuania and Poland agreed upon the construction, by 2012, of a high-voltage power line to enforce energy security in the region by linking the Baltics to Central and Western European power grids.

Fiscal policies not too ambitious in Latvia and Lithuania

In all Baltic States the gradual decline in the growth of private household demand will be cushioned by a rise in public expenditures in the coming years. The phasing-in of transfers from EU structural funds will induce permanently higher levels of investments in infrastructure.

In general all Baltic States have run roughly balanced budgets for several years, although Estonia was the only country to use fiscal policies as an instrument to actively curb domestic demand. In 2007 the Estonian government once again established countercyclical measures, attaining a budget surplus of 2.6%. With reduced momentum of the economy in 2008 to 2010, the rise in tax revenues should be lowered, but sound budget plans of the government still envisage a reasonable surplus. In Latvia, higher than envisaged tax revenues in the second half of 2007 resulted in a surplus of close to 1%. Given the overheated economy, government plans for the next years are not too ambitious, aiming at surpluses of below 1%. The fiscal plans of the Lithuanian government are even less ambitious: a budget surplus is expected not earlier than 2010. In 2008 a widening of the deficit will be induced, amongst other things, by the lowering of the flat tax rate from 27% to 24%. Due to high GDP growth rates and relatively favourable fiscal policies the level of public debt is comparatively low in all Baltic States, and falling continuously.

Although internal and external imbalances still threaten the Baltic economies, a soft landing is the most likely scenario for the medium term. From 2008 onwards a gradual slowdown of internal demand will be experienced in Lithuania, while in Latvia also the export performance will probably deteriorate. In Estonia the growth decline, which already evolved in 2007 due to a loss in investment and export momentum, is expected to continue until 2010. Nevertheless the GDP growth rates of the Baltic States are likely to remain among the highest in the group of the NMS also in the forecast period 2008-2010. A moderation of the high inflation rates and current account deficits is expected only in the medium term, as the Baltic States will continue to grow in line with potential output.

Table LT

Lithuania: Selected economic indicators

	2002	2003	2004	2005	2006	2007 1)	2008	2009 Forecast	2010
Population, th pers., mid-year	3,469	3,454	3,436	3,414	3,394	3,375	.	.	.
Gross domestic product, LTL mn, nom.	51,971	56,804	62,587	71,380	81,905	96,676	109,600	122,000	133,800
annual change in % (real)	6.9	10.3	7.3	7.9	7.7	8.7	8	7	6.5
GDP/capita (EUR at exchange rate)	4,329	4,763	5,276	6,055	6,989	8,296	.	.	.
GDP/capita (EUR at PPP - wiiw)	9,010	10,140	10,910	11,910	13,220	15,000	.	.	.
Gross industrial production									
annual change in % (real)	3.1	16.1	10.8	7.1	7.3	4.0	4	3	5
Gross agricultural production									
annual change in % (real)	6.5	11.7	2.1	1.1	-13.0	.	.	.	.
Construction industry									
annual change in % (real)	21.0	26.8	7.2	11.1	21.4	.	.	.	.
Consumption of households, LTL mn, nom.	33,264	36,333	40,649	46,309	53,310	62,500			
annual change in % (real)	5.8	10.3	12.2	12.1	11.8	10.8	10	8	7
Gross fixed capital form., LTL mn, nom.	10,549	12,024	13,968	16,302	20,291	26,000			
annual change in % (real)	10.9	14.1	15.5	10.9	17.4	16.8	14	12	10
LFS - employed persons, th, avg.	1,406	1,438	1,436	1,474	1,499	1,540	.	.	.
annual change in %	4.0	2.3	-0.1	2.6	1.7	2.7	.	.	.
LFS - employed pers. in industry, th, avg.	293.3	297.5	288.7	296.2	296.0	.	.	.	.
annual change in %	4.3	1.4	-3.0	2.6	-0.1	.	.	.	.
LFS - unemployed, th pers., average	224.4	203.9	184.4	132.9	89.3	68.0	.	.	.
LFS - unemployment rate in %, average	13.8	12.4	11.4	8.3	5.6	4.2	3.5	3.5	4
Reg. unemployment rate in %, end of period	10.9	7.7	6.5	4.1	3.7	4.3	.	.	.
Average gross monthly wages, LTL	1,014	1,073	1,149	1,276	1,496	1,800	.	.	.
annual change in % (real, net)	3.8	9.3	5.0	6.8	13.6	14.1	.	.	.
Consumer prices, % p.a.	0.3	-1.2	1.2	2.7	3.7	5.5	6	5	4
Producer prices in industry, % p.a.	-2.8	-0.5	6.0	11.5	7.4	7.0	.	.	.
General goverm.budget, EU-def., % GDP 2)									
Revenues	32.9	32	31.8	33.1	33.4	35.5	37.4	38.5	38.8
Expenditures	34.8	33.2	33.4	33.6	34.0	36.4	37.9	38.5	38.6
Net lending (+) / net borrowing (-)	-1.9	-1.3	-1.5	-0.5	-0.6	-0.9	-0.5	0	0.2
Public debt in % of GDP 2)	22.4	21.2	19.4	18.6	18.2	17.7	.	.	.
Money market rate, % p.a., end of period 6)	3.3	2.4	2.3	2.5	3.7	5.8			
Current account, EUR mn	-772	-1,116	-1,394	-1,481	-2,551	-3,450	-4,100	-4,200	-3,900
Current account in % of GDP	-5.1	-6.8	-7.7	-7.2	-10.8	-12.3	-13	-12	-10
Gross reserves of NB excl. gold, EUR mn	2,253	2,697	2,578	3,136	4,308	5,165	.	.	.
Gross external debt, EUR mn	5,945	6,670	7,687	10,587	14,442	19,800	.	.	.
Gross external debt in % of GDP	39.6	40.5	42.4	51.2	60.9	70.7	.	.	.
FDI inflow, EUR mn	772	160	623	826	1,448	1,500	1,600	.	.
FDI outflow, EUR mn	18	34	212	278	232	200	250	.	.
Exports of goods, BOP, EUR mn	6,363	6,773	7,478	9,490	11,263	12,500	14,500	16,500	18,500
annual growth rate in %	16.5	6.4	10.4	26.9	18.7	11.0	16.0	13.8	12.1
Imports of goods, BOP, EUR mn	7,770	8,262	9,398	11,849	14,600	16,400	19,000	21,500	24,000
annual growth rate in %	16.0	6.3	13.8	26.1	23.2	12.3	15.9	13.2	11.6
Exports of services, BOP, EUR mn	1,560	1,661	1,969	2,503	2,879	2,900	3,000	3,150	3,250
annual growth rate in %	20.7	6.5	18.5	27.1	15.0	0.7	3.4	5.0	3.2
Imports of services, BOP, EUR mn	986	1,114	1,313	1,655	2,018	2,300	2,500	2,650	2,800
annual growth rate in %	25.9	13.0	17.9	26.0	21.9	14.0	8.7	6	5.7
Average exchange rate LTL/USD	3.67	3.06	2.78	2.77	2.75	2.52	.	.	.
Average exchange rate LTL/EUR (ECU)	3.46	3.45	3.45	3.45	3.45	3.45	3.45	3.45	3.45
Purchasing power parity LTL/USD, wiiw	1.42	1.37	1.41	1.48	1.54	1.56	.	.	.
Purchasing power parity LTL/EUR, wiiw	1.66	1.62	1.67	1.75	1.83	1.91	.	.	.

Note: The term "industry" refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) According to ESA'95, excessive deficit procedure. - 3) VILIBOR 1 month interbank rate.

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

Part B: The countries of Southeast Europe

*Mario Holzner**

Home-grown growth continues, despite international and national(ist) risks

This chapter assesses the medium-term economic outlook for the countries in Southeast Europe. Those countries include EU candidate countries (Croatia, Macedonia and Turkey), as well as potential EU candidate countries (Albania, Bosnia and Herzegovina, Montenegro and Serbia). After a slight dip in growth in 2008, wiiw expects the whole region to enjoy faster growth in 2009 and 2010. Remittances and a credit boom will continue to fuel the core growth driver in the economies of Southeast Europe: domestic demand. Strong investment growth and incipient re-industrialization goes hand in hand with an increase in employment. Stable competitive performance (except for Serbia and Turkey) also provides a better environment for stronger export growth. Nevertheless, the net export position is still unfavourable for want of FDI and technology transfer. The slowdown in global growth, the hikes in oil, metal and food prices on world markets, as well as the subprime crisis are expected to have only a minor impact on the region. However, Serbia's unbalanced growth path in the wake of the Kosovo crisis poses a regional risk. Nevertheless, prospects of EU accession have improved for all countries, except Turkey.

Domestic demand remains the core growth driver

For most of the EU candidate countries as well as the potential EU candidate countries in Southeast Europe, final consumption is still the largest component of GDP growth (see Figure 1). In recent years, GDP growth has stood at around 5% in the candidate countries and at about 6% in the potential candidate countries. In the latter group, the impact of foreign trade is still somewhat negative and the forecast is that it will remain so over the medium term. In potential candidate countries such as Albania, Bosnia and Herzegovina, remittances from family members working abroad in tandem with a credit boom are fuelling both consumption and imports. This is not so much the case in the economically more developed candidate countries such as Croatia and Turkey, where the investment component in growth plays a greater role. Moreover, the impact of the external growth component is beginning to shift from the negative to the slightly positive – or at least strike a balance. wiiw expects this trend to continue in the years to come.

Improving growth prospects after a slight dip in 2008

Generally speaking, the GDP growth forecast for the candidate countries for the period 2008-2010 is fairly optimistic – even though growth in 2008 will cool off slightly in the wake of the slowdown in global growth, price turbulences and increased risk awareness. wiiw expects growth rates to rise from above 4% to around 5% and up to 6% by the end of the three-year forecast horizon (see Table 1). Similarly, after economic dynamism has sagged somewhat in 2008, the group of potential candidate countries is expected to experience faster growth to a level above 5%. Only Serbia with its unbalanced growth path is likely to stagnate at 5%.

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* V. Gligorov, P. Havlik, J. Pöschl and H. Vidovic (all wiiw) have contributed to this part of the report.

Figure 1

Drivers of GDP growth

contributions of main components to GDP growth, in %

Note: *Net exports including change in stocks and statistical discrepancies.

Source: wiiw Annual Database incorporating national statistics.

Table 1

Gross domestic product

real change in % against preceding year

	1995	2000	2001	2002	2003	2004	2005	2006	2007 [1]	2008	2009	2010	Index 2000=100 2007
											forecast		
Croatia	6.8	2.9	4.4	5.6	5.3	4.3	4.3	4.8	6	4.8	4.5	5	140.3
Macedonia	-1.1	4.5	-4.5	0.9	2.8	4.1	4.1	3.8	5	5	6	6	116.9
Turkey	7.2	7.4	-7.5	7.9	5.8	8.9	7.4	6.1	4.2	4	5	6	136.5
Candidate countries	*7.0*	*6.9*	*-6.4*	*7.5*	*5.7*	*8.3*	*7.0*	*5.9*	*4.4*	*4.1*	*5.0*	*5.9*	*136.3*
Albania	13.3	6.7	7.9	4.2	5.8	5.7	5.8	5.5	5.6	5.8	6.1	6.2	148.3
Bosnia and Herzegovina	50.0	5.5	4.5	5.5	3.0	6.3	4.3	6.2	5	4.5	5	6	140.4
Montenegro	.	.	-0.2	1.7	2.4	4.2	4.0	8.3	7	6	6	6	130.5
Serbia	.	4.5	4.8	4.2	2.5	8.4	6.2	5.7	7.5	5	5	5	146.6
Potential candidate countries	*.*	*.*	*5.0*	*4.4*	*3.1*	*7.4*	*5.6*	*5.9*	*6.7*	*5.1*	*5.2*	*5.4*	*144.7*

1) Preliminary.

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

Investment growth rates throughout the region are forecasted to be relatively high: around 8% (see Table 2). The two outliers are Albania and Croatia: the first being the poorest and the second the most developed country in the region. Gross fixed capital formation is expected to increase in Albania at double-digit rates while Croatia will only achieve half that. Projections of household consumption growth are quite similar, with average growth rates of around 5% in the years to come (see Table 3).

Table 2

Gross fixed capital formation

real change in % against preceding year

	1995	2000	2001	2002	2003	2004	2005	2006	2007 [1]	2008	2009	2010	in % of GDP 2007
											forecast		
Croatia	.	-3.8	7.1	13.9	24.7	5.0	4.8	10.9	7	6	5	5.5	30.3
Macedonia	10.2	-1.5	-8.6	17.6	1.1	10.9	-5.4	5	6	8	8	8	17.4 [2]
Turkey	11.6	16.9	-31.5	-1.1	10.0	32.4	24.0	14.0	6.2	6	8	10	20.8
Albania	.	38.1	24.6	4.5	17.9	2.7	11.2	7	8	10	10	11	39.2
Bosnia and Herzegovina	.	.	.	.	.	.	18.5	-13.2	9.9	8	8	10	24.5
Montenegro	.	.	16.7	-16.1		36.7	12	8	10	8	8	8	18.3 [2]
Serbia	.	.	.	.	.	.	5.0	15.2	12	10	8	8	17.6 [2]

1) Preliminary. - 2) Year 2006.

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

Table 3

Consumption of households

real change in % against preceding year

	1995	2000	2001	2002	2003	2004	2005	2006	2007 1)	2008	2009	2010	in % of GDP 2007
											forecast		
Croatia	.	4.2	4.5	7.7	4.6	4.8	3.4	3.5	6	4	3.5	4	56.0
Macedonia	-3.6	11.2	-11.6	12.5	-1.5	8.0	5.7	4	5	6	7	7	77.4 2)
Turkey	5.6	6.2	-9.2	2.1	6.6	10.1	8.8	5.2	2	1.5	2	4	65.1
Albania	.	2.6	-0.5	7.6	11.1	9.4	3.9	5.0	6	5	6	6	75.1
Bosnia and Herzegovina	.	.	.	.	.	.	6.2	4.5	6	3	5	5	95.1
Montenegro	.	.	4.7	6.4	.	16.0	2.8	10	8	6	7	8	73.1 2)
Serbia	.	.	.	.	.	.	5.0	5.4	6	5	5	5	67.4 2)

1) Preliminary. - 2) Year 2006.

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

Reindustrialization will gain momentum, as will employment

Higher investment activity has finally reached the region's ailing industrial sector. Given the exceptionally high world market prices for minerals and metals, some of the mining and metallurgical plants that lay idle have been re-activated. wiiw forecasts that for several countries in the region gross industrial production will outstrip overall economic growth in the medium term (see Table 4). This will apply particularly to Albania, Bosnia and Herzegovina and Turkey. Only in Montenegro will industrial growth lag appreciably behind the country's GDP growth rate. This country lives primarily off tourism and the 'hard sell' of its beautiful coast.

Table 4

Gross industrial production

real change in % against preceding year

	1995	2000	2001	2002	2003	2004	2005	2006	2007 1)	2008	2009	2010	Index 2000=100 2007
											forecast		
Croatia 2)	0.3	1.7	6.0	5.4	4.1	3.7	5.1	4.5	5.7	5	4.5	5	140.0
Macedonia 3)	-10.7	3.0	-2.9	-4.8	4.1	-2.2	7.1	2.5	3.7	5	5	5	107.2
Turkey	12.1	6.1	-8.7	9.5	8.7	9.8	5.5	5.8	5.5	5	7	9	140.5
Candidate countries	*10.4*	*5.6*	*-7.4*	*8.7*	*8.1*	*8.9*	*5.5*	*5.6*	*5.5*	*5*	*6.7*	*8.4*	*139.1*
Albania 4)	6.0	1.3	6.1	-5.1	29.0	14.1	2.5	7.3	8.0	7	8	7	176.1
Bosnia and Herzegovina 5)	.	7.9	4.9	5.7	5.1	12.0	11.0	11.7	7.0	6	9	10	173.2
Montenegro	.	4.2	-0.7	0.6	2.4	13.8	-1.9	1.0	0.1	3	4	5	115.5
Serbia	.	11.4	0.1	1.8	-3.0	7.1	0.8	4.7	3.7	5	5	5	115.9
Potential candidate countries	.	*9.9*	*1.2*	*2.1*	*0.6*	*9.0*	*2.9*	*6.2*	*4.5*	*5.2*	*6*	*6.1*	*129.5*

1) Preliminary. - 2) Enterprises with more than 20 employees. - 3) Excluding small enterprises. - 4) According to gross value added. - 5) wiiw estimates based on weighted averages for the two entities (Federation BH and Republika Srpska).

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

Table 5

Employment, LFS definition, annual averages

	in 1000 persons	change in % against preceding year						Index 2000=100
	2007 [1)]	2002	2003	2004	2005	2006	2007	2007
Croatia	1,600	4.0	0.6	1.7	0.7	0.8	0.9	103.0
Macedonia	590	-6.3	-2.9	-4.1	4.3	4.6	3.4	107.3
Turkey	22,700	-0.8	-1.0	3.0	1.2	1.3	1.7	105.2
Candidate countries	24,890	*-0.6*	*-0.9*	*2.8*	*1.2*	*1.3*	*1.6*	105.1
Albania [2)]	935	-6.9	-6.9	0.6	0.3	0.2	0.1	87.6
Bosnia and Herzegovina	850	.	.	.	.	.	4.8	.
Montenegro	175	2.9	.	.	-4.5	-0.3	-1.9	76.0
Serbia	2,600	-3.4	-2.7	0.4	-6.7	-3.8	-1.2	84.0
Potential candidate countries	4,559	.	.	.	.	.	*0.1*	.

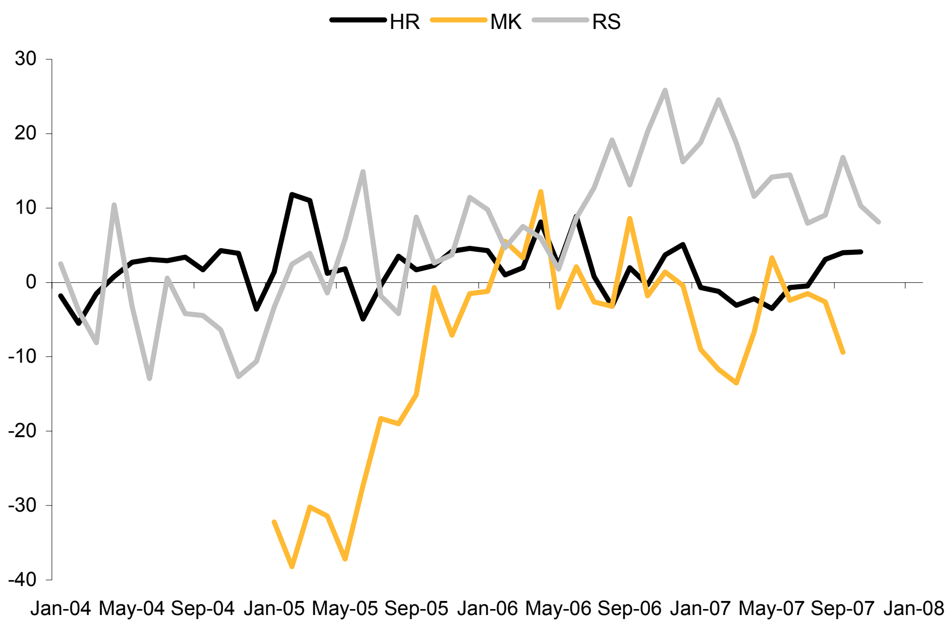
1) Preliminary. - 2) Registered employment.

Source: wiiw Database incorporating national statistics.

Figure 2

Unit labour costs in industry, 2005-2007

EUR-adjusted, year-on-year, growth in %



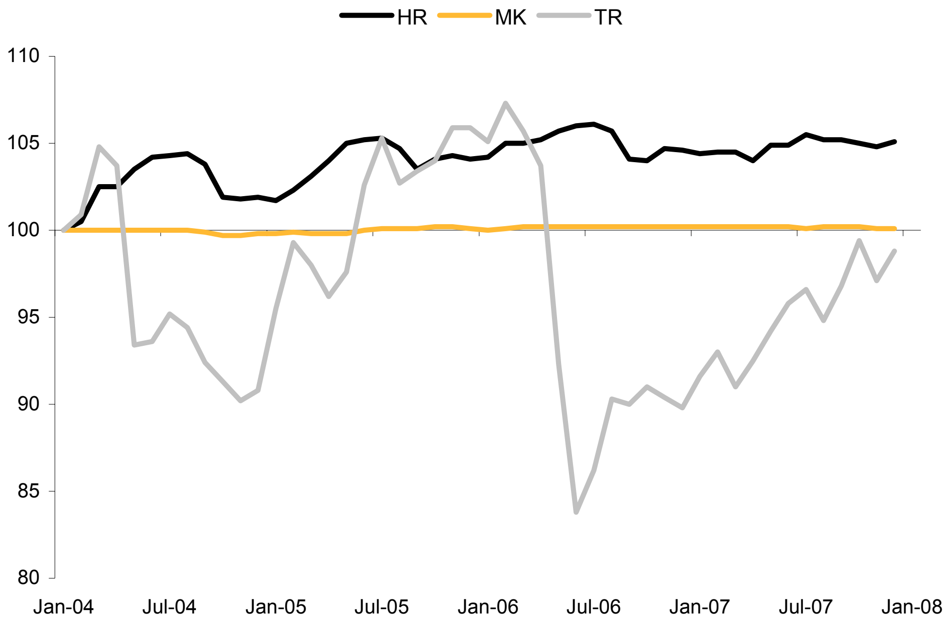
Source: wiiw Monthly Database incorporating national statistics.

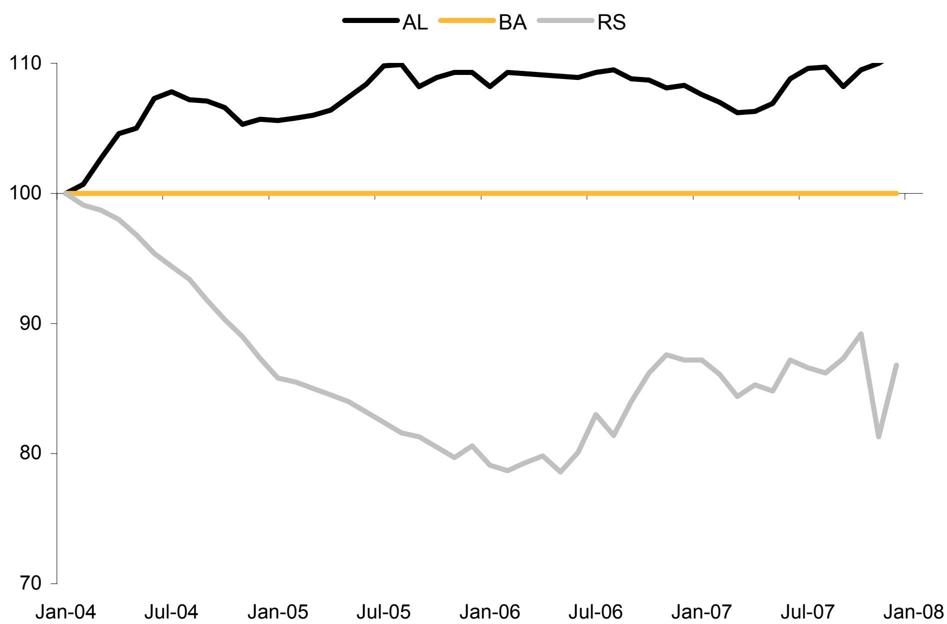
Except for Montenegro and Serbia, all the countries in the region will finally experience growth in employment (see Table 5). Construction and trade have proved to be the most dynamic sectors in terms of employment creation, with a spilt once again between the more developed candidate countries and the others. The first group managed to raise employment significantly above levels in 2000. The second group is still far from achieving that. This applies especially to Serbia. A laggard in terms of enterprise restructuring and privatization, it will still undergo a further labour shake-out in the foreseeable future.

Figure 3

Nominal exchange rates*, 2004-2007

NCU per EUR, monthly average, January 2004 = 100





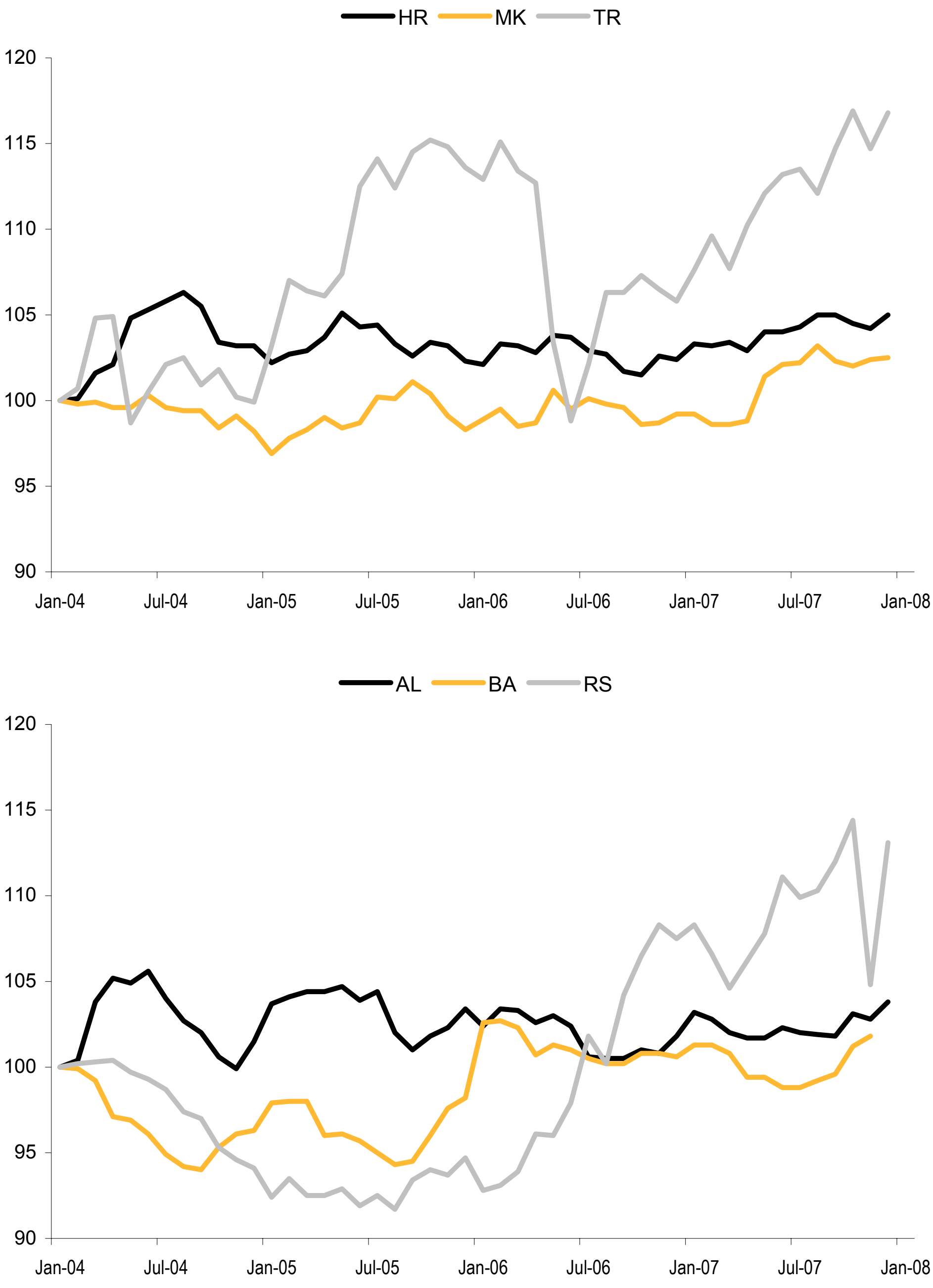
* Increasing line indicates appreciation. Serbia: based on end-of-month exchange rates.

Source: wiiw Monthly Database incorporating national statistics.

Figure 4

Real appreciation*, 2004-2007

NCU per EUR, PPI-deflated, January 2004 = 100



* Increasing line indicates real appreciation.

Serbia: based on end-of-month exchange rates. Albania, Bosnia and Herzegovina CPI-deflated.

Source: wiiw Monthly Database incorporating national statistics.

Competitiveness stable, except in Turkey and Serbia

In recent years international competitiveness of the region's economies has remained fairly stable; this is borne out, for instance, by the development of certain countries' unit labour costs in industry (see Figure 2). Two important exceptions are Serbia and Turkey. The nominal exchange rate against the euro in both countries is quite volatile. Both currencies have recently displayed a tendency to appreciate, while most of the other countries have more or less pegged their currency to the euro-anchor (see Figure 3). The situation becomes apparent when looking at the development of real appreciation (see Figure 4). While in most countries the real exchange rate hovers around the level of early 2004, the Turkish lira and Serbian dinar began appreciating from mid-2006 onwards. The inflation problem besetting both countries is partly self-induced as government expenditures tend to rise in the period leading up to elections.

Table 6

Foreign trade of Southeast European countries

based on customs statistics

		2002	2003	2004	2005	2006	2007 [1]	2006	2007
				EUR million				change in %	
Albania	Exports	359	396	487	530	631	782	19.0	24.0
	Imports	1,589	1,643	1,849	2,111	2,430	3,048	15.1	25.4
	Balance	-1,231	-1,247	-1,363	-1,581	-1,800	-2,266	.	.
Bosnia and Herzegovina	Exports	1,068	1,188	1,441	1,934	2,640	3,035	36.5	15.0
	Imports	4,115	4,253	4,758	5,715	5,823	7,106	1.9	22.0
	Balance	-3,046	-3,066	-3,317	-3,781	-3,183	-4,071	.	.
Croatia	Exports	5,187	5,468	6,453	7,065	8,253	9,000	16.8	9.0
	Imports	11,325	12,546	13,343	14,935	17,104	18,826	14.5	10.1
	Balance	-6,137	-7,079	-6,890	-7,870	-8,851	-9,826	.	.
Macedonia	Exports	1,180	1,208	1,347	1,642	1,912	2,449	16.5	28.1
	Imports	2,110	2,039	2,357	2,599	2,997	3,814	15.3	27.3
	Balance	-930	-830	-1,010	-957	-1,085	-1,365	.	.
Montenegro [2]	Exports	210	271	452	434	627	700	44.4	5.0
	Imports	593	630	869	940	1,483	2,100	57.7	40.0
	Balance	-383	-359	-416	-506	-855	-1,400	.	.
Serbia [3]	Exports	2,193	2,441	2,853	3,617	5,092	6,429	40.8	26.3
	Imports	5,919	6,603	8,679	8,470	10,448	13,338	23.3	27.7
	Balance	-3,726	-4,162	-5,826	-4,853	-5,356	-6,909	.	.
Serbia and Montenegro [3]	Exports	2,403	2,348	3,071	.	.	.	.	.
	Imports	6,660	7,007	9,153	.	.	.	.	.
	Balance	-4,256	-4,659	-6,082	.	.	.	.	.
Turkey	Exports	38,137	41,761	50,897	59,147	68,020	78,043	15.0	14.7
	Imports	54,478	61,248	78,530	94,015	111,096	123,909	18.2	11.5
	Balance	-16,341	-19,487	-27,633	-34,868	-43,076	-45,865	.	.

1) Preliminary. - 2) From 2004 including trade with Serbia & Kosovo. - 3) Excluding trade with Kosovo and Metohia.

Source: wiiw Database incorporating national statistics.

Poor net export position and the lack of FDI

Incipient reindustrialization and a more stable competitive environment have resulted in strong, double-digit export growth. However, the net export position throughout the region is still weak. All the countries are running extremely high trade deficits. In most cases, imports of goods are some two to four times higher than exports (see Table 6). Moreover, there is still no clear turnaround in sight. The dynamics of the situation are seesawing. Whereas in 2006 most countries recorded stronger export growth compared to import growth, the trend was reversed in 2007. Higher import prices, such as for oil, are one reason. Another, more fundamental reason might be that this group of countries has still not managed to attract enough FDI in general – and greenfield investment to manufacturing in particular.

Although FDI inflows have increased in recent years, forecasts for 2008 indicate stagnation and, in some cases, even a slight decrease (see Table 7). Overall FDI stock per capita is rather low compared to the NMS which in 2007 had accumulated on average EUR 3,700 in FDI per capita. Only Croatia and Montenegro surpass that level, while all the others not even reach half that. However, FDI is an important vehicle for technology transfer and lends significant impetus to the modernization of the export sector.

Table 7

FDI inflow to SEE

EUR million

	2005	2006	2007 [1]	2008 forecast	2005	2006	2007	2008 forecast	2007 [1] stock EUR mn
					FDI net, % of current account deficit				
Croatia	1,468	2,747	3,000	2,000	64	98	99	62	32,000
Macedonia	77	345	150	200	62	767	300	200	2,500
Turkey	8,286	15,765	15,000	15,000	41	57	3	0	100,000
Candidate countries	*9,831*	*18,856*	*18,150*	*17,200*	*43*	*62*	*12*	*7*	*134,500*
Albania	224	259	400	350	45	47	56	62	2,500 [2]
Bosnia and Herzegovina	478	564	1,630	600	30	58	116	44	5,000
Montenegro	393	644	800	800	247	91	46	56	2,500 [2]
Serbia	1,265	3,504	1,500	1,500	70	120	19	33	10,000 [3]
Potential candidate countries	*2,360*	*4,971*	*4,330*	*3,250*	*58*	*97*	*43*	*40*	*17,500*

Note: FDI net is defined as inflow minus outflow.

1) wiiw estimate. - 2) Cumulated flows. - 3) Cumulated FDI net flows.

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

International risks will have only a minor impact

Less dependence on foreign markets (i.e. low export shares in GDP) will heighten the countries' resistance to the growth slowdown in the global economy. Imports of manufactured goods may become even cheaper. This may not necessarily be the case for the prices of imported oil and agricultural products, both of which pushed inflation markedly upwards in this part of the world, too. However, in most cases inflation will not rise above 5%; and where it does, domestic factors will be largely responsible (as in Serbia). Nonetheless, given the energy intensity of their economies, the EU candidates and potential candidates in Southeast Europe will be slightly more exposed to oil and food price shocks than the NMS. As they have a lower level of domestic agricultural production, they will be more dependent on imports (with the exception of Turkey).

With regard to the risk of the US subprime crisis and housing bubble spilling over into the region, we would argue for caution, too. Housing prices in Southeast Europe are still comparable to those in the medium and lower price range in other transition economies (see Part D, chapter on financial vulnerability and bubbles). An apartment in the city centre of Belgrade, for example, costs only half as much as a comparable apartment in Vilnius. However, this is not to claim that there are no risks at all. If international investors start to withdraw completely from emerging markets, financing the current account deficit will give rise to concern – especially in the more indebted countries of the region, such as Croatia, Serbia and Turkey.

Nationalist risks more relevant for regional economic outlook – the Kosovo issue and its implications

In itself, Kosovo's declaration of independence will impact mainly on the newborn state itself, assuming smooth and non-violent development. Self-determination and the end of political uncertainty will stimulate investment and relieve the country of its economic agony. In this respect, the EU together with the World Bank is preparing to hold a donors' conference; it will probably take place in June 2008. Even the economic sanctions that Serbia is imposing will for the most part hurt Kosovo alone. There is a certain risk that the secession of Kosovo will act as a role model for the Serbian entity in Bosnia and Herzegovina (Republika Srpska); however, at the moment this risk is fairly low. In general, the region should not be affected that much, as long as the situation remains peaceful.

For years and decades (and some would even argue centuries), the Kosovo issue has haunted Serbian politics. The more or less pro-European Serbian government is trying to buy political stability in the country by sacrificing macroeconomic stability. Harassed by the radical nationalist opposition over the loss of the cradle of the Serb nation (Kosovo) and given the possibility of early parliamentary elections, the government will continue to pursue an expansionary fiscal policy in 2008. The major question will be that of financing the high (double-digit) current account deficit in the years to come. If no constructive solution is found, a decline in economic growth is inevitable. At the moment, muddling through still seems a possible option.

If nationalist risks prevail and the Serbian economy jolts to a sudden stop, it could have a significant impact on the neighbouring countries as well. Macedonia and Bosnia and Herzegovina, in particular, would be seriously affected, as for them Serbia is an important trading partner. On the other hand, if the risks associated with nationalism ease after Kosovo has declared its independence, it could have a positive impact not only on Serbia, but also on the whole region. Finally, the Western Balkans could reap a peace dividend and concentrate on European integration.

Prospects of EU accession improved

With the change of government in France, the prospects of both groups of candidate counties joining the EU have greatly improved. However, this does not hold true for Turkey, which still lacks the support of the majority of incumbent EU members. Croatia could become EU member in 2011. The other Balkan countries could make it to the EU around 2015 (see Table 8). In all likelihood, most of them will also try to adopt the euro at the earliest possible juncture (i.e. two years after accession). Two countries, Montenegro and Kosovo, have been using the euro as legal tender since 2002.

Interestingly enough, the EU will soon replace the UN as Kosovo's guardian protector, overseeing its smooth transition to independence. The EU mission (EULEX) will, *inter alia,* deploy 2,200 policemen, judges, prosecutors and other administrative personnel to Kosovo (the mission should be fully operational by June 2008). For the first 16 months of the mission, the EU budget has appropriated EUR 205 million. However, it is very likely that far more EU financial support, especially for infrastructure development, will pour into the country. In a manner of speaking, Kosovo is being joined by the EU.

Table 8

SEE EU accession forecast

	SAA	Negotiations	EU	Euro
Croatia	2005	2005	2011	2013
Macedonia	2004	2008	2013	2015
Turkey	.	2005	2015-2020	after 2020
Albania	2006	2009	by 2015	by 2017
Bosnia and Herzegovina	2008	2009	by 2015	by 2017
Kosovo	2009	2011	after 2015	since 2002
Montenegro	2007	2009	by 2015	since 2002
Serbia	2008 (?)	2009 (?)	after 2015	after 2017

Conclusions

The general assessment points to the following features:

- Slight dip in growth in 2008 and increase in growth in 2009 and 2010 expected
- Remittances and credit boom fuelling core growth driver: domestic demand
- Strong investment and reindustrialization accompanied by an increase in employment
- Stable competitive performance, except in Turkey and Serbia
- Continuing weak net export position due also to a lack of FDI and technology transfer
- Minor impact of global growth slowdown, commodity prices and housing bubble
- Serbia's unbalanced growth path in the wake of Kosovo crisis posing a regional risk
- The above notwithstanding, EU accession prospects improving for all, except Turkey

Country summaries

Albania could even profit from the high oil and metal prices on international markets. Promising oil and gas deposits are being explored and idle mines have been reopened. This resource blessing might help the country to speed up economic growth beyond its medium-term growth path (6%) in the years to come. Strong domestic demand growth (fuelled by remittances from Albanians working abroad) remains at the very core of the country's economic performance. Ailing infrastructure is the bottleneck to greater economic growth.

Bosnia and Herzegovina is likely to record GDP growth rates of less than 5% in both 2008 and 2009. Whereas the country is not exposed that much to turbulence on the international financial markets, recent hikes in energy and food prices have exerted a negative impact on household demand. This in turn has caused a deterioration of the trade balance, the high deficit of which reflects the domestic producers' lack of competitiveness. Consumer prices have dramatically increased: a fact that fuelled speculation about the sustainability of the currency board regime. The SAA is ready for signature; however, it is still not certain whether the country will adopt in time the reform package that the EU regards as a prerequisite.

After record growth in 2007, GDP will drop to below 5% in **Croatia** in 2008 owing to dampened private consumption. Backed primarily by domestic demand, economic growth will not change significantly up until 2010. The Croatian National Bank will adhere to its policy of combating inflation by further restricting bank credits. External imbalances are expected to remain at a high level in the years to come.

Short-term prospects for **Macedonia** are favourable with reasonable prospects of price stability and improving growth. In the medium term, foreign investments should increase and overall growth should accelerate, partly supported by an acceleration of the EU accession process.

In **Montenegro**, large inflows of foreign investment have pushed consumption and growth upwards. In the short term, this should continue to support stability as well. In the medium term, sustainability may be an issue; however, the chances are that strong growth will continue with improved EU accession prospects.

Political instability in **Serbia** will postpone policy adjustment, thus inducing inflationary pressures and moderating growth. In the medium term, reforms should accelerate with improved stability and stable growth of around 5% per year. The major risk lies in a deterioration of relations with the EU.

Turkey's exposure to turmoil on global financial markets is high since capital inflows are needed to cover major deficits in the current account. The country has become increasingly attractive to foreign investors on account of the high GDP growth, monetary stabilization based on high interest rates, fiscal austerity, a radical opening of asset markets to foreign investors and convincing steps towards consolidation: for example, in the banking sector. In both 2008 and 2009, GDP growth will hardly exceed 5%. A return to 'normalcy' featuring growth rates between 5% and 10% and significant deflation, is only likely to occur at a later juncture. 2008 will be a year marked by increased vulnerability.

Part B: The countries of Southeast Europe

Country reports

Mario Holzner

Albania: resource blessing

Increasing prices for natural resources have turned Albania into a potential exporter of oil, gas and metals. Old mines are being revived and new oil fields investigated. The resource blessing may help the country to accelerate economic growth above its medium-term potential growth path of 6% in the years to come – given continued strong domestic consumer demand and increased public investment in infrastructure.

New oil fields being explored

In early 2008 the Swiss-based Manas Petroleum Corporation announced that an independent resource evaluation has confirmed the existence of giant oil and gas prospects on the company's North-Albanian exploration blocks. Seismic analysis has revealed that the field might contain up to 3 billion barrels of oil as well as 3 trillion cubic feet of associated gas. Put in comparison, the 3 billion barrels of oil would be about one third of Norway's proved oil reserves. Even if only a fraction of this can be delivered it would be a strong income boost to a small and poor country such as Albania.

At the same time Australian Beach Petroleum announced to seek to drill for oil from off-shore reserves in the Adriatic Sea near the North-Albanian port of Durres. The exploration is expected to have the potential to yield reserves in excess of 100 million barrels of oil equivalent. Similarly, Canadian Bankers Petroleum has agreed to buy a half-interest in the right to evaluate and redevelop the Kucova heavy oil field in South-Central Albania, with an option to take the other half. The oil field is expected to have the potential of more than 490 million barrels of oil. Bankers Petroleum is already active in the nearby Patos Marinza field.

Interestingly enough, the Albanian government opened an international tender on 15 February to privatize ARMO. The company is a refiner which also sells motor oil and products through a small network of gas stations. Albania intends to sell 76% of ARMO's shares to a strategic investor.

Idle mines being reopened

However, the country does not only face an oil and gas rush but also a mining renaissance. Canadian Tirex Resources has started drilling on its 344 km² Mirdita property covering most of the traditional Albanian mining district north of Tirana. The project is expected to find multiple large deposits of copper, zinc, gold and silver mineralization. One of the initial drill targets is the Koshaj deposit, which was reported to be zinc-rich but was not mined because of the lack of zinc processing facilities in communist times. Similarly, an Austrian–Russian consortium is expected to invest in the Bulqiza chrome mine in the coming years.

Table AL

Albania: Selected economic indicators

	2002	2003	2004	2005	2006	2007 1)	2008	2009 Forecast	2010
Population, th pers., end of period	3,103	3,120	3,135	3,150	3,150	3,150	.	.	.
Gross domestic product, ALL bn, nom.	622.7	694.1	751.0	817.4	893.0	970	1,060	1,160	1,270
annual change in % (real)	4.2	5.8	5.7	5.8	5.5	5.6	5.8	6.1	6.2
GDP/capita (EUR at exchange rate)	1,521	1,622	1,881	2,094	2,303	2,491	.	.	.
GDP/capita (EUR at PPP - wiiw)	3,700	3,910	4,210	4,530	4,950	5,350	.	.	.
Gross industrial production									
annual change in % (real) 2)	-5.1	29.0	14.1	2.5	7.3	8	7	8	7
Gross agricultural production									
annual change in % (real) 2)	2.1	2.9	6.3	0.9	3.2	3	3	2	2
Construction output total									
annual change in % (real) 2)	21.5	23.4	7.9	11.9	6.9	5	10	11	12
Consumption of households, ALL bn, nom.	465.2	521.0	586.2	621.4	668.1	729	.	.	.
annual change in % (real)	7.6	11.1	9.4	3.9	5	6	5	6	6
Gross fixed capital form., ALL bn, nom.	236.0	280.9	279.4	296.9	320.0	380	.	.	.
annual change in % (real)	4.5	17.9	2.7	11.2	7	8	10	10	11
Reg. employment total, th pers., end of per. 3)	920.1	926.2	931.2	932.1	935.1	934	.	.	.
annual change in %	0.1	0.7	0.5	0.1	0.3	-0.1	.	.	.
Reg. unemployed, th pers., end of period	172.4	163.0	157.0	153.0	147.7	143	.	.	.
Reg. unemployment rate in %, end of period	15.8	15.0	14.4	14.1	13.6	14	13	12	11
Average gross monthly wages, ALL 3)	19,659	21,325	24,393	26,808	28,822	34,200	.	.	.
annual change in % (real, gross) 3)	8.1	6.0	11.2	7.3	4.9	15	.	.	.
Consumer prices, % p.a.	5.2	2.2	3.0	2.4	2.4	2.9	3.2	3.1	3.0
Producer prices in manufacturing ind., % p.a.	5.1	1.8	12.2	4.9	0.7	10	9	.	.
General governm.budget, nat.def., % GDP									
Revenues	24.8	24.1	24.5	25.0	25.3	.	.	.	.
Expenditures	30.9	29.0	29.6	28.4	28.5	.	.	.	.
Deficit (-) / surplus (+), % GDP	-6.0	-4.9	-5.1	-3.4	-3.2	-4.8	-8	-6	-4
Public debt in % of GDP 4)	60.1	54.7	55.6	56.9	55.6	.	.	.	.
Refinancing base rate, % p.a., end of period	8.5	6.5	5.3	5.0	5.5	6	.	.	.
Current account, EUR mn 5)	-422.5	-331.0	-287.9	-493.1	-534.6	-700	-550	-650	-830
Current account in % of GDP	-9.0	-6.6	-4.9	-7.5	-7.4	-8.9	-6.5	-7.1	-8.0
Gross reserves of BoA incl. gold, EUR mn 6)	813	813	1,005	1,202	1,363	1,462 XI	.	.	.
Gross external debt, EUR mn	1,189	1,110	1,224	1,374	1,445	.	.	.	.
Gross external debt in % of GDP	25.3	22.0	20.8	20.9	19.9	.			
FDI inflow, EUR mn 5)	141.4	156.9	278.4	224.2	258.6	400	350	.	.
FDI outflow, EUR mn	.	.	11.0	3.3	8.3	10.0	10	.	.
Exports of goods, BOP, EUR mn 5)	348	395	486	530	631	800	900	1,000	1,100
annual growth rate in %	2.4	13.3	23.0	9.2	18.9	27	13	11	10
Imports of goods, BOP, EUR mn 5)	1,567	1,572	1,762	2,007	2,316	2,800	3,000	3,400	3,700
annual growth rate in %	5.2	0.3	12.1	13.9	15.4	21	7.1	13	9
Exports of services, BOP, EUR mn 5)	612	633	808	967	1,195	1,300	1,500	1,800	2,000
annual growth rate in %	2.6	3.4	27.6	19.8	23.5	9	15	20	11
Imports of services, BOP, EUR mn 5)	621	705	848	1,108	1,262	1,300	1,500	1,600	1,800
annual growth rate in %	24.8	13.6	20.3	30.6	13.9	3	15	7	13
Average exchange rate ALL/USD	140.2	121.9	102.8	99.9	98.1	90.4	.	.	.
Average exchange rate ALL/EUR (ECU)	132.4	137.5	127.7	124.2	123.1	123.6	125	126	122
Purchasing power parity ALL/USD 7)	46.5	48.3	48.0	48.6	48.2	47.0	.	.	.
Purchasing power parity ALL/EUR 7)	54.4	57.1	57.1	57.4	57.3	57.5	.	.	.

1) Preliminary and wiiw estimates. - 2) According to gross value added. - 3) Public sector only. - 4) Based on IMF data. - 5) Until 2003 calculated from USD with the average exchange rate. - 6) Refer to total foreign assets of Bank of Albania. - 7) Benchmark results 2005 from Eurostat and wiiw estimates.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Additional investment in the energy sector

Albania's hydro-power potential is being further exploited as well. The Austrian utility company EVN won a tender to construct three hydro-electric power plants on the Devoll river in South Albania. Total output is expected to reach 400 MW. In a similar project the Italian Moncada wind power construction group received approval to build a wind farm that has a potential of 500 MW as well as to construct and operate an underwater power line between the Italian and Albanian coasts. Total investment is expected to come close to EUR 1 billion. Both projects are part of a general plan to overcome Albania's chronic power shortages.

According to the minister of economy, trade and energy, the energy crisis is to be resolved by mid-2009. Important projects underway include the new thermo-power station in Vlore, the 400 kV link with neighbouring Montenegro as well as a set of mobile emergency generators and a network of small hydro-power stations. Also, power supply to consumers who do not pay their energy bills will be cut, and electricity prices will have to be raised in order to render the state electricity company KESH able to operate according to market rules and prepare its privatization.

Favourable growth prospects

The overall growth prospects of the Albanian economy appear to be rather favourable given the expected investment in infrastructure. Strong domestic demand growth fuelled by remittances from Albanians working abroad is at the core of the country's economic performance. However, an improved business climate should also attract more FDI to the export sector, making this sector an engine of economic growth too. New discoveries of natural resources will be an additional source of foreign exchange. The GDP growth forecasts for the years 2008, 2009 and 2010 are thus at 5.8%, 6.1% and 6.2%, respectively.

Josef Pöschl

Bosnia and Herzegovina: the need to sign on the dotted line

In all likelihood, economic growth in Bosnia and Herzegovina (BiH) will have slowed down in the second half of 2007 and significant acceleration is unlikely in 2008. Even after the post-war consolidation phase (1996-1999), annual GDP growth in most years exceeded 5%. With growth rates ranging between four and five percent, 2007 and 2008 will be exceptions to the rule. Nevertheless, BiH's catching-up process will continue compared to the EU, where economic growth will also decelerate.

In 2007, foreign trade stopped promoting GDP growth. Export growth was strong, but import growth was even stronger. The impact of higher world market prices for energy and agricultural products became clearly visible. In more recent years, import data have fluctuated markedly. In 2005, imports boomed; in 2006 they stagnated, only to soar upwards again in 2007. Whereas the downturn in the period 2005-2006 was attributable to the introduction of VAT on 1 January 2006, the upturn in 2007 stemmed from the rise in world market prices mentioned above.

Table BA

Bosnia and Herzegovina: Selected economic indicators

	2002	2003	2004	2005	2006	2007 [1]	2008	2009	2010
								Forecast	
Population, th pers., mid-year	3,828	3,832	3,842	3,843	3,845	3,846	.	.	.
Gross domestic product, BAM mn, nom. [2]	12,829	13,443	15,786	16,928	19,106	20,400	22,500	24,100	26,100
annual change in % (real)	5.5	3.0	6.3	4.3	6.2	5	4.5	5	6
GDP/capita (EUR at exchange rate)	1,714	1,794	2,101	2,252	2,541	2,712	.	.	.
GDP/capita, incl. NOE (EUR at PPP - wiiw)	3,980	4,100	4,810	5,130	5,580	6,010	.	.	.
Gross industrial production									
annual change in % (real) [3]	5.7	5.1	12.0	11.0	11.7	7	5.5	9	10
Net agricultural production, total									
annual change in % (real)	7.9	-7.5	20.3	-3.1	.	.	.	.	.
Consumption of households,BAM mn,nom. [2]	.	.	15,018	16,514	18,064	19,400	.	.	.
annual change in % (real)	.	.	.	6.2	4.5	6	3	5	5
Gross fixed capital form., BAM mn, nom. [2]	.	.	4,044	4,889	4,480	5,000	.	.	.
annual change in % (real)	.	.	.	18.5	-13.2	10	8	8	10
LFS - employed persons, th, avg. [4]	.	.	.	.	811.0	849.6	.	.	.
annual change in %	.	.	.	.	.	4.8			
Reg employees total, th pers., end of period	637.7	634.0	638.4	642.4	652.8	679.2 I-X	.	.	.
annual change in %	1.9	-0.6	0.7	0.6	1.6	4.2 I-X	.	.	.
LFS - unemployed, th pers., average [4]	.	.	.	.	366.8	346.7	.	.	.
LFS - unemployment rate in %, average [4]	.	.	.	.	31.1	29.0	29	28	27
Reg. unemployment rate in %, end of period	40.9	42.0	43.2	44.2	44.8	43.4 X	.	.	.
Average gross monthly wages, BAM	660	717	748	798	869	939	.	.	.
annual change in % (real, net) [5]	-0.6	7.3	3.6	3.5	1.4	6.4	.	.	.
Consumer prices, % p.a. [6]	1.3	1.1	0.8	3.0	6.2	1.5	5.5	2	2
General governm.budget, nat.def., % GDP									
Revenues	40.0	44.8	40.4	41.1	44.8	44	45	44	43
Expenditures	40.1	44.0	38.8	38.7	41.9	42	43	42	41
Deficit (-) / surplus (+), % GDP	-0.1	0.8	1.6	2.4	2.9	2	2	2	2
Public debt in % of GDP	34.8	30.6	27.5	27.5	23.4	.	.	.	.
Current account, EUR mn [7]	-1,252	-1,439	-1,318	-1,605	-971	-1,400	-1,350	-1,300	-1,300
Current account in % of GDP	-19.1	-20.9	-16.3	-18.5	-9.9	-13.4	-11.7	-10.6	-9.8
Gross reserves of CB excl. gold, EUR mn [8]	1,270	1,428	1,779	2,160	2,787	3,273 IX	.	.	.
Gross external public debt, EUR mn	2,193	2,052	2,061	2,218	2,082	2,009 IX	.	.	.
Gross external public debt in % of GDP	33.4	29.9	25.5	25.6	21.3	.	.	.	.
FDI inflow, EUR mn	281.8	337.7	566.9	478.3	564.2	1,630	600	.	.
FDI outflow, EUR mn	.	.	1.3	1.0	1.8	.	.	.	.
Exports of goods, BOP, EUR mn [7]	1,169	1,303	1,677	2,087	2,687	3,100	3,650	4,350	5,250
annual growth rate in %	-7.8	11.5	28.7	24.5	28.7	15	18	19	21
Imports of goods, BOP, EUR mn [7]	4,692	4,974	5,355	6,091	6,093	7,400	8,000	8,750	9,700
annual growth rate in %	2.5	6.0	7.6	13.8	0.0	21	8	9	11
Exports of services, BOP, EUR mn [7]	552	636	696	767	885	1,000	1,150	1,300	1,450
annual growth rate in %	-0.7	15.2	9.4	10.2	15.3	13	15	13	12
Imports of services, BOP, EUR mn [7]	320	339	349	372	402	430	460	490	525
annual growth rate in %	6.2	5.9	3.0	6.5	8.2	7	7	7	7
Average exchange rate BAM/USD	2.077	1.734	1.576	1.573	1.559	1.438 I-XI	.	.	.
Average exchange rate BAM/EUR (ECU)	1.956	1.956	1.956	1.956	1.956	1.956	1.96	1.96	1.96
Purchasing power parity BAM/USD, wiiw [9]	0.720	0.722	0.719	0.727	0.748	0.722	.	.	.
Purchasing power parity BAM/EUR, wiiw [9]	0.843	0.855	0.855	0.859	0.890	0.883	.	.	.

1) Preliminary and wiiw estimates. - 2) From 2004 GDP figures include the Non-Observed Economy (NOE). - 3) wiiw estimates based on weighted averages for the two entities (Federation BH and Republika Srpska). - 4) Data based on LFS April 2006 and April 2007. - 5) wiiw calculation. - 6) Until 2005 costs of living, from 2006 harmonized CPI. - 7) Converted from the national currency. - 8) From 2006 inclunding investment in foreign securities. - 9) Benchmark results 2005 from Eurostat and wiiw estimates.

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

Hit by the hikes

BiH is heavily dependent on imports of crude oil and agro-food (agriculture and food processing). Both commodities have become more expensive. The performance of the agro-food sector is disappointing, given that BiH is a country where a large proportion of the population is engaged in farming. In BiH food-processors often find it less trouble to rely on imports: they find it easier to obtain good quality inputs in the quantities they need. Farmers, on the other hand, are angered by the lack of competitiveness that stems from the poorly developed logistics and institutional settings. Their organizations are pressing for tariff and non-tariff barriers. In January, the government yielded and introduced tariffs on imports of livestock. Throughout 2007, continuing pressure from the farmers upset matters in relation to the country's accession to CEFTA; in the meantime, however, BiH has joined CEFTA. WTO membership should follow soon.

The pronounced rise in world market prices for both cereals and energy has had a major adverse impact on real household incomes – and hence on private consumption. Higher energy prices translated into higher prices for household heating as well as for private and public transport. As cereals serve as inputs into both animal husbandry and bakery products, the price hike pushed costs up across broad segments of the food-processing sector (e.g., dairy products, meat and bread). In low-income countries such as BiH, a surge in food and energy prices delivers a swingeing blow to consumers' real incomes, since food and energy account for an ever-increasing large share of total household expenditures. In 2007 gross monthly wages averaged EUR 480; however, in some branches – especially those with a large female workforce – wages are far below average. For example, in December 2007 the union of textile workers in the Federation of BiH (FBiH) announced that it had reached an agreement on fixing the minimum wage at EUR 0.89 per hour: equivalent to a monthly wage slightly over EUR 150.

When the BiH bakeries increased their prices, it led to a public outcry and a wave of protests. In an attempt to soothe maters, the FBiH government set about restricting the increases in prices for bakery products and started purchasing grain to support the industry on the supply side and avoid bottlenecks.

Less consumption does not necessarily mean less investment

We cannot count on household consumption growing much in real terms in 2008. Higher prices for imported energy also mean higher costs for enterprises, all the more so given the energy-intensive production in the metallurgical sector, the country's largest industry. World market prices for some metals have increased and certain quarters in the BiH metallurgical industry have profited from that fact. Only in parts of the corporate sector might there be some slow-down in terms of investment growth. In recent years, construction activities have boomed in many parts of the country. Quite possibly, this trend will persist.

Troubles down at the rumour mill

Over the past few years, inflation has been very moderate. Up to mid-2005, the price index remained stable and even declined slightly over long periods of time. This was the outcome of the currency board regime and pegging to the euro. Even so, that regime has always been a bone of contention, albeit mainly academic in nature. Quite recently, the situation worsened: fears of devaluation were rife and people started hoarding euros. In mid-January, the governor of the central bank, Kemal Kozaric, hastened to assure the public that their devaluation fears were unfounded.

The currency is legally bound to the euro, thus making surprise devaluations quite impossible. Central bank reserves are sound (EUR 3.4 billion or one third of the annual GDP at the end of 2007).

Weakness at the helm

Some good news would help assuage public dissatisfaction with the current state of affairs. A signature under the Stabilization and Association Agreement (SAA) with the EU and the positive expectations associated therewith could send a much needed signal. The process has reached the initialization stage and might reach finalization in March 2008 – at least that is what the Slovenian EU presidency is hoping. Unfortunately once again, BiH politicians are up to their usual games. They agreed on police reform in principle and committed themselves to elaborating on details, only to have it prove too difficult and thus possibly not materialize in due time. Police reform, at least a 'soft' version of the same, is the main ingredient in the reform package that the EU wishes to see resolved first.

The inordinate difficulties associated with resolving matters at the upper level contrasts sharply with the good performance to be observed extensively at the lower – and local – levels of public administration. This, together with the population's eagerness to achieve a good measure of economic success, has turned BiH into a country characterized by 'business as usual'. Were it to focus more on strategic solutions at the top, the country could be much more affluent than at present. The relative weakness of the central government is evident in its treatment of the budget for 2008 amounting to some EUR 1.19 billion as compared to the FBiH budget of EUR 1.76 billion. Another telling feature is that by end of January 2008 the FBiH budget proposal had already sailed through parliament, whereas the central government budget was still floundering in all the toing and froing between the Council of Ministers and the BiH Presidency.

In BiH, exposure to the developments in energy and food prices is greater than exposure to the turbulences on the financial markets. As slower global GDP growth is likely to allow energy and cereal markets to recede into calmer waters, we can count on less inflation and slower import growth. The corporate sector's positive development should continue; thus, under 'normal conditions' we can reckon with higher growth in the period 2009-2010. As for SAA requirements, a last-minute solution is feasible. BiH may thus gain access to greater financial support in the near future. In that context, the problem that arises is one of an almost complete lack of ideas on how to use the funds once they become available – not to mention the lack of preparations for implementing those ideas.

Hermine Vidovic

Croatia: strong GDP growth and resurgent inflation

In 2007 Croatia recorded the fastest GDP growth rate in the past ten years, up 6%. The economic expansion was driven by domestic absorption, particularly rising household consumption, and to a lesser extent by investments. Growth of private demand nearly doubled compared to a year earlier and was boosted by rising disposable income due to growing employment and rising wages, repayment of pensioners' debt (debt arrears) and bank credits. In anticipation of the parliamentary elections, government consumption climbed noticeably. Foreign demand contributed negatively to

GDP growth. The deceleration of investment went along with slowing activities in construction. Industrial output growth decelerated in the course of the year, but was still substantially higher than in 2006.

Inflation was accelerating in 2007 and reached its highest level since the year 2000. The consumer price index rose by 5.6% in December year on year, indicating an annual inflation rate of 2.9%. Inflation was mainly fuelled by rising food prices (of both domestic and imported goods) and energy prices.

In 2007, employment growth benefited from the strong GDP expansion and rose by more than 3% based on registration data. New job creation was reported mainly in tourism and manufacturing. Registered unemployment, after a steady decline for six months, started to rise in September and reached 14.8% by the end of December. The LFS unemployment rate fell to 9.8% in the first three quarters of the year; youth unemployment fell to 23.5% and was 10 percentage point lower than in 2006.

Persisting external imbalances

On the external side, the deficit in merchandise trade continued to widen, while the surplus in services trade rose slightly due to increasing earnings from tourism. Expectedly, the current account deficit remained high, at about 7.5% of the GDP. Favourable FDI trends continued in 2007, with inflows worth EUR 3 billion, double the amount invested in 2006. A sectoral breakdown for the first three quarters of the year shows that the largest portion went into financial intermediation (mostly recapitalization of local banks by foreign owners). Croatian investment abroad averaged EUR 200 million p.a. over the period 2003-2007 and focused on the countries of the Western Balkans, in particular Serbia and Bosnia and Herzegovina.

Croatia's foreign debt grew at a lower pace than in earlier years and stood at EUR 32.6 billion by the end of December. Overall, from December 2006 foreign debt rose by EUR 3.4 billion, equalling around 87% of the GDP. Enterprise debt accounted for the bulk of the increase, with a share of over 40% of total debt, while the debt of the government and banks decreased further. The decline of the latter was first of all due to the restrictive measures set by the Croatian National Bank with respect to the limitation of bank credits.

Thanks to the favourable overall economic performance, the general government deficit was cut significantly: to 2.3% of GDP, from 3% in 2006. This is even lower than anticipated by the budget revision in June last year. Because of the parliamentary elections the 2008 budget has not yet been adopted and its basic assumptions are unknown. First conclusions can however be drawn from the coalition document, anticipating a gradual reduction of the budget deficit with fiscal balance being reached in 2010. This goal is apparently based on very optimistic assumptions (GDP growth above 6% and a relatively low inflation rate of close to 2% p.a.) and will probably not be met.

Following the parliamentary elections in November last year, a new government was introduced at the beginning of 2008. It is again headed by Ivo Sanader from the Croatian Democratic Union (HDZ), who formed a coalition with the Peasant Party (HSS), the Social Liberal Party (HSLS) and the Independent Serb Party (SDSS). Joining the EU and NATO membership are the two key priorities.

Table HR

Croatia: Selected economic indicators

	2002	2003	2004	2005	2006	2007 [1]	2008	2009	2010
								Forecast	
Population, th pers., mid-year	4,443	4,442	4,439	4,442	4,440	4,440	.	.	.
Gross domestic product, HRK mn, nom.	181,231	198,422	214,983	231,349	250,590	273,300	300,700	326,800	355,100
annual change in % (real)	5.6	5.3	4.3	4.3	4.8	6	4.8	4.5	5
GDP/capita (EUR at exchange rate)	5,507	5,906	6,462	7,038	7,708	8,390	.	.	.
GDP/capita (EUR at PPP - wiiw)	9,320	9,830	10,570	11,200	12,130	13,180	.	.	.
Gross industrial production [2]									
annual change in % (real)	5.4	4.1	3.7	5.1	4.5	5.7	5	4.5	5
Gross agricultural production									
annual change in % (real)	7.7	-15.9	11.9	-8.7	4.4	.	.	.	.
Construction industry, hours worked [2]									
annual change in % (real)	12.8	22.8	2.0	-0.8	9.3	2.4 I-XI	.	.	.
Consumption of households, HRK mn, nom.	108,027	115,081	123,123	131,671	140,261	153,000	.	.	.
annual change in % (real)	7.7	4.6	4.8	3.4	3.5	6	4	3.5	4
Gross fixed capital form., HRK mn, nom.	44,105	56,662	60,512	65,008	74,792	82,700	.	.	.
annual change in % (real)	13.9	24.7	5.0	4.8	10.9	7	6	5	5.5
LFS - employed persons, th, avg.	1,528	1,537	1,563	1,573	1,586	1,600	.	.	.
annual change in %	.	0.6	1.7	0.7	0.8	1	.	.	.
Reg. employees in industry, th pers., avg.	281.0	282.6	281.7	278.9	284.1	283.7 I-XI	.	.	.
annual change in %	-2.2	0.6	-0.3	-1.0	1.9	-0.1 I-XI	.	.	.
LFS - unemployed persons, average	266.0	256.0	249.5	229.0	198.5	182	.	.	.
LFS - unemployment rate in %, average	14.8	14.3	13.8	12.7	11.1	10	9.8	9.4	9
Reg. unemployment rate in %, end of period	21.3	18.7	18.5	17.8	17.0	14.8	14	.	.
Average gross monthly wages, HRK	5,366	5,623	5,985	6,248	6,634	7,028	.	.	.
annual change in % (real, net)	3.1	3.8	3.7	1.5	1.9	2.6	.	.	.
Consumer prices, % p.a.	1.7	1.8	2.1	3.3	3.2	2.9	5	4	3.5
Producer prices in industry, % p.a.	-0.4	1.9	3.5	3.0	2.9	3.4	3.5	.	.
General governm.budget, nat.def., % GDP [3]									
Revenues	46.3	45.1	44.9	44.5	44.8	.	.	.	.
Expenditures	50.6	50.1	49.5	48.3	47.0	.	.	.	.
Deficit (-) / surplus (+), % GDP [4]	-5.0	-6.2	-4.8	-4.0	-3.0	-2.3	-3	-2.5	-2
Public debt in % of GDP [5]	50.7	51.2	52.0	52.7	50.0	53	.	.	.
Discount rate % p.a., end of period	4.5	4.5	4.5	4.5	4.5	9.0	.	.	.
Current account, EUR mn	-2,099	-1,889	-1,454	-1,988	-2,644	-2,800	-2,900	-3,250	-3,500
Current account in % of GDP	-8.6	-7.2	-5.1	-6.4	-7.7	-7.5	-7.1	-7.3	-7.3
Gross reserves of NB excl. gold, EUR mn	5,651	6,554	6,436	7,438	8,725	9,307	.	.	.
Gross external debt, EUR mn	15,143	19,884	22,933	25,748	29,258	32,610	.	.	.
Gross external debt in % of GDP	62.2	76.6	81.8	82.1	85.6	87.4	.	.	.
FDI inflow, EUR mn	1,138	1,762	950	1,468	2,747	3,000	2,000	.	.
FDI outflow, EUR mn	607	106	279	192	163	220	200	.	.
Exports of goods, BOP, EUR mn	5,296	5,575	6,607	7,220	8,464	9,300	10,000	10,700	11,400
annual growth rate in %	-0.6	5.3	18.5	9.3	17.2	10	8	7	7
Imports of goods, BOP, EUR mn	11,254	12,546	13,331	14,738	16,808	18,500	19,900	21,000	22,200
annual growth rate in %	13.4	11.5	6.3	10.6	14.0	10	8	6	6
Exports of services, BOP, EUR mn	5,832	7,566	7,637	8,053	8,534	9,100	9,600	10,400	10,900
annual growth rate in %	6.4	29.7	0.9	5.4	6.0	7	5	8	5
Imports of services, BOP, EUR mn	2,548	2,633	2,868	2,735	2,824	2,770	2,900	2,950	3,000
annual growth rate in %	16.9	3.4	8.9	-4.6	3.2	-2	5	2	2
Average exchange rate HRK/USD	7.86	6.70	6.04	5.95	5.84	5.36	.	.	.
Average exchange rate HRK/EUR (ECU)	7.41	7.56	7.50	7.40	7.32	7.34	7.33	7.33	7.34
Purchasing power parity HRK/USD, wiiw	3.74	3.84	3.85	3.94	3.91	3.82	.	.	.
Purchasing power parity HRK/EUR, wiiw	4.38	4.54	4.58	4.65	4.65	4.67	.	.	.

Note: The term "industry" refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) Enterprises with more than 20 employees. - 3) On accrual basis. - 4) Including change in arrears and non-recorded expenditures. - 5) Including guarantees.

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

EU negotiations progressed only slowly in 2007. Altogether Croatia has opened 16 chapters out of 35 in its EU accession talks, with two of them temporarily closed. Provided that the negotiations are completed by 2009, Croatia might join the Union realistically by 2011.

GDP growth at a lower pace

In 2008 GDP growth will slow down from the very high rate achieved in 2007, to below 5%, due to dampened private consumption as a consequence of shrinking debt repayments to pensioners and credit restrictions set by the National Bank. Government consumption will slow to 'normal' levels in the post-election year. The Croatian National Bank will remain focused on fighting inflation with restrictions on banking placements and foreign borrowing, significant reduction of existing operations on the open market and defending the kuna's nominal exchange rate against possible depreciation. In response to the strong increase in food prices globally, as well as rising energy prices, inflation will remain high, especially in 2008. This has recently been confirmed by the National Bank Governor, who expects annual inflation of 6% in 2008.

The pace of GDP growth will decelerate further in 2009, associated with declining investment and the assumed weakening of private consumption growth; government consumption is expected to remain flat. Croatia's external performance will largely depend on the economic environment in its main trading partners. Import growth is expected to decelerate in line with declining investment growth. We expect the trade deficit to GDP ratio to exceed the 20% mark; consequently the current account deficit will remain at high levels. Further privatization deals, involving shipyards in particular, are in the pipeline and should contribute to substantial FDI inflows, thus covering part of the current account deficit.

Vladimir Gligorov

Macedonia: slowly improving

GDP growth in 2007 may have accelerated to around 5%. Inflation has edged up and further acceleration has been recorded at the beginning of 2008. Macroeconomic stability, however, is not threatened as the fiscal deficit is small and the current account almost balanced. The short-term prospects, therefore, are good and the medium-term prospects should even improve.

These developments are due to a large extent to the change in economic policy that has been implemented rather gradually in the past couple of years. The growing sense of political stability has allowed the government to feel more relaxed when designing fiscal policy. Thus, taxes have been lowered, while expenditures have been increased. Given that public debt is relatively low by regional standards, a small fiscal deficit has become almost the norm thus replacing the previous dogged commitment to fiscal balance.

On the other hand, the central bank has been feeling more secure in relaxing monetary policy because of the remarkable improvement in the current account. It is still not clear whether this is the consequence of improved statistics, which is quite probable, or reflects growing exports, in particular of iron and other metals, and soaring remittances. In any case, the main worry that pushed the central bank to pursue a tight monetary policy in the past, which was the worry about the

Table MK

Macedonia: Selected economic indicators

	2002	2003	2004	2005	2006	2007 1)	2008	2009 Forecast	2010
Population, th pers., mid-year 2)	2,020	2,027	2,033	2,037	2,040	2,045	.	.	.
Gross domestic product, MKD mn, nom.	243,970	251,486	265,257	286,619	308,772	332,000	356,000	389,000	425,000
annual change in % (real)	0.9	2.8	4.1	4.1	3.8	5	5	6	6
GDP/capita (EUR at exchange rate)	1,981	2,025	2,128	2,296	2,474	2,654	.	.	.
GDP/capita (EUR at PPP - wiiw)	5,170	5,300	5,760	6,250	6,630	7,120	.	.	.
Gross industrial production									
annual change in % (real) 3)	-4.8	4.1	-2.2	7.1	2.5	3.7	5	5	5
Gross agricultural production							.	.	.
annual change in % (real)	-2.3	4.5	6.8	0.3	0.5	.	.	.	.
Construction output, value added							.	.	.
annual change in % (real)	0.6	13.3	7.4	-4.2	0.7	.	.	.	.
Consumption of households, MKD mn, nom. 2)	188,179	191,873	209,075	222,726	239,000	.	.		
annual change in % (real) 2)	12.5	-1.5	8.0	5.7	4	5	6	7	7
Gross fixed capital form., MKD mn, nom. 2)	40,448	42,110	47,286	48,868	53,600	.	.		
annual change in % (real) 2)	17.6	1.1	10.9	-5.4	5	6	8	8	8
LFS - employed persons, th. avg.	561.3	545.1	523.0	545.3	570.4	590	.	.	.
annual change in %	-6.3	-2.9	-4.1	4.3	4.6	3.4	.	.	.
Reg. employees in industry, th pers., avg. 4)	110.9	106.7	101.5	125.7	.	.	.	.	.
annual change in % 4)	-9.5	-3.8	-4.9	-3.1	.	.	.	.	.
LFS - unemployed, th pers., average	263.5	315.9	309.3	323.9	321.3	320	.	.	.
LFS - unemployment rate in %, average	31.9	36.7	37.2	37.3	36.0	35.2	35	34	33
Reg. unemployment rate in %, end of period	.	.	.	.	.	.	.	.	.
Average gross monthly wages, MKD	19,025	19,950	20,771	21,330	23,036	23,900	.	.	.
real growth rate, % (net wages)	5.0	3.6	4.4	6.4	4.0	6	.	.	.
Consumer prices, % p.a.	1.8	1.2	-0.4	0.5	3.2	2.3	3	3	3
Producer prices in industry, % p.a.	-0.9	-0.3	0.9	3.2	4.5	1.7	3		
Gentral governm. budget, nat.def., % GDP 5)									
Revenues	34.9	33.4	33.2	35.2	33.7	34	.	.	.
Expenditures	40.0	34.5	33.2	35.0	34.2	34.5	.	.	.
Deficit (-) / surplus (+), % GDP	-5.0	-1.1	0.0	0.3	-0.6	-0.5	-1	-1	-1
Public debt in % of GDP	.	.	.	.	.		.	.	.
Discount rate, % p.a., end of period	10.7	6.5	6.5	6.5	6.5	6.5	.	.	.
Current account, EUR mn 6)	-400.9	-168.2	-362.7	-121.3	-44.9	-50	-100	-150	-150
Current account in % of GDP	-10.0	-4.1	-8.4	-2.6	-0.9	-0.9	-1.7	-2.4	-2.2
Gross reserves of NB, excl. gold, EUR mn	693	718	665	1,041	1,329	1,450	.	.	.
Gross external debt, EUR mn 7)	1,513	1,439	1,476	1,849	1,783	1,750	.	.	.
Gross external debt in % of GDP	37.9	35.1	34.1	39.5	35.3	32.3	.	.	.
FDI inflow, EUR mn 8)	.	100.4	260.7	77.2	344.8	150	200	.	.
FDI outflow, EUR mn 8)	.	0.3	1.0	2.3	0.1	0.1	0	.	.
Exports of goods, BOP, EUR mn	1,181	1,203	1,345	1,643	1,903	2,470	3,200	4,000	5,000
annual growth rate in %	-8.5	1.9	11.8	22.2	15.8	30	30	25	25
Imports of goods, BOP, EUR mn	2,036	1,956	2,259	2,501	2,923	3,400	4,100	4,900	5,900
annual growth rate in %	8.4	-3.9	15.5	10.7	16.9	16	20	20	20
Exports of services, BOP, EUR mn	.	335	364	416	477	580	700	800	1,000
annual growth rate in %	.	.	8.5	14.4	14.7	22	20	20	20
Imports of services, BOP, EUR mn	.	341	407	441	455	550	600	700	800
annual growth rate in %	.	.	19.3	8.3	3.2	21	15	15	15
Average exchange rate MKD/USD	64.74	54.30	49.41	49.29	48.79	44.71	.	.	.
Average exchange rate MKD/EUR (ECU)	60.98	61.26	61.34	61.30	61.19	61.18	61.2	61.2	61.2
Purchasing power parity MKD/USD, wiiw	19.98	19.78	19.06	19.06	19.20	18.65	.	.	.
Purchasing power parity MKD/EUR, wiiw	23.38	23.42	22.66	22.53	22.83	22.81	.	.	.

Note: The term "industry" refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) 2006 wiiw estimate. - 3) Enterprises with more than 10 employees, from 2004 new methodology, from 2007 new methodology and weighting system. - 4) From 2005 re-weighted data with information from pension and invalid insurance funds. Quarterly data are unweighted. - 5) Refers to central government budget and extra budgetary funds. - 6) Including grants. - 7) Medium- and long-term debt. - 8) Converted from USD with the average exchange rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

sustainability of the fixed exchange rate, has gone. With that, the improvement in the banking sector, due to increased competition, has led to a continuous decrease of interest rates. Macedonia did not experience the credit boom that has been pervasive in the region. This can be expected in the future.

Apart from the improved external balance, investments have also been growing. An important source of growth has been the rise in wages. The government realized that Macedonian wages have been depressed for too long and decided to raise public sector wages by 10% in the second half of 2007. This will have positive effects on growth, though it is obviously spilling over into rising prices too. Given that stable prices or even deflation have been the rule in the past few years, the acceleration of inflation may start to worry the central bank, though the correction is probably needed.

The government's key target is to attract foreign investments. Those have not been targeting Macedonia in the past. That was partly the consequence of the high risks for internal and external reasons. Also, structural reforms have not been pursued with the necessary determination and the implementation has often been worse than the declaration. It is still not altogether clear how committed is the government to structural reforms. It has been trying to improve the business climate and to offer advantages to foreign and investors in general. The results should be expected in the short and medium run.

The key to the removal of the residual political and policy risks is the speed-up of European Union integration. Macedonia is a candidate country, but the EU has been reluctant to set a date for the commencement of negotiations due to slow institutional improvement in Macedonia. It is expected that negotiations could finally start in the course of this year, perhaps as part of a more general speed-up of the process of EU integration in the wake of Kosovo independence. The latter event, if it goes smoothly, should also be beneficial to growth because economic improvement in Kosovo will be beneficial to Macedonia, Kosovo being an important economic partner.

Medium-term prospects are favourable due to macroeconomic stability and few sources of vulnerability. The one serious problem is in the labour market, as employment remains low and unemployment very high. It is conceivable that sustained growth will lead to continued improvement in the labour market. The main risks are that structural reforms will be delayed and EU integration will be slow. However, sustained growth should continue to reduce those risks over the medium run.

Vladimir Gligorov

Montenegro: is it sustainable?

Growth has been strong since the declaration of independence in May 2006. It has mostly been driven by consumption. Investments have also increased. Foreign investments have poured into real estate, especially on the coast. Significant investments have gone into tourism and into financial services. That has spurred growth of services, which accounts for most of the growth of production. Industrial output has continued to stagnate with no signs of a turnaround. Agriculture is not showing signs of improvement either.

Table ME

Montenegro: Selected economic indicators

	2002	2003	2004	2005	2006	2007 1)	2008	2009	2010
								Forecast	
Population th pers., mid-year 2)	617.1	620.3	622.1	623.3	624.2	625	.	.	.
Gross domestic product, EUR mn, nom. 3)	1,302	1,392	1,651	1,785	1,970	2,200	2,400	2,600	2,800
annual change in % (real)	1.7	2.4	4.2	4.0	8.3	7	6	6	6
GDP/capita (EUR at exchange rate)	2,109	2,244	2,654	2,864	3,156	3,520	.	.	.
GDP/capita (EUR at PPP - wiiw)	5,740	5,860	6,240	6,620	7,470	8,180	.	.	.
Gross industrial production 4)									
annual change in % (real)	0.6	2.4	13.8	-1.9	1.0	0.1	3	4	5
Net agricultural production	.	.	.	.	.				
annual change in % (real)	5.9	1.0	3.8	-0.9	1.9	.	.	.	.
Construction industry	.	.	.	.	.	.	.	.	.
annual change in % (real)	.	.	.	.	.	.	.	.	.
Consumption of households, EUR mn, nom. 5)	1,067	1,025	1,213	1,275	1,440	.	.	.	.
real growth rate, % 5)	6.4	.	16.0	2.8	10	8	6	7	8
Gross fixed capital form., EUR mn, nom. 5)	199	201	286	326	360	.	.	.	.
real growth rate, % 5)	-16.1	.	36.7	12	8	10	8	8	8
LFS - employed persons, th, Oct 6)	220.6	.	187.3	178.8	178.4	175	.	.	.
annual change in %	2.9	.	.	-4.5	-0.3	-1.9	.	.	.
LFS - employed persons in industry, th, Oct. 6)	.	.	30.9	29.2	26.5	26	.	.	.
annual change in %	.	.	.	-5.5	-9.3	-1.7	.	.	.
LFS - unemployed, th pers., average 6)	57.7	.	71.8	77.8	74.8	74	.	.	.
LFS - unemployment rate in %, Oct. 6)	20.7	.	27.7	30.3	29.6	30	30	28	27
Reg. unemployment rate in %, end of period 7)	.	32.9	29.3	25.2	20.5	17	17	.	.
Average gross monthly wages, EUR 8)	251	271	303	326	377	497	.	.	.
annual change in % (real, net)	.	9.3	9.1	6.7	12.0	15.0	.	.	.
Consumer prices, % p.a.	16.0	6.7	2.4	2.3	3.0	4.2	3	3	3
Producer prices in industry, % p.a.	14.5	4.5	5.8	2.1	3.6	7	3	.	.
Central governm. budget, nat.def., % GDP 9)									
Revenues	17.7	24.2	22.6	24.1	28.8	35	.	.	.
Expenditures	20.5	27.4	24.6	25.8	27.0	30	.	.	.
Deficit (-) / surplus (+), % GDP	-2.8	-3.1	-2.0	-1.7	1.8	5	0	0	0
Public debt in % of GDP	.	.	.	.	.	.	.	.	.
Discount rate, % p.a., end of period	.	.	.	.	.	.	.	.	.
Current account, EUR mn 10)	-163.4	-102.1	-119.6	-154.0	-511.9	-870	-720	-650	-700
Current account in % of GDP	-12.6	-7.3	-7.2	-8.6	-26.0	-40	-30	-25	-25
Gross reserves of NB, excl. gold, EUR mn	.	.	.	.	.	.	.	.	.
Gross external public debt, EUR mn	893.6	461.5	488.6	513.3	504.0	500.6 I-IX	.	.	.
Gross external public debt in % of GDP	68.7	33.2	29.6	28.8	25.6	22.8 I-IX	.	.	.
FDI inflow, EUR mn	.	43.8	52.7	392.7	644.3	800	800	.	.
FDI outflow, EUR mn	.	5.1	2.1	11.5	177.6	400	400	.	.
Exports of goods, BOP, EUR mn 11)	322.6	270.6	452.1	460.6	648.3	680	750	860	990
annual growth rate in %	37.1	-16.1	.	1.9	40.7	5	10	15	15
Imports of goods, BOP, EUR mn 11)	747.3	629.9	868.6	974.3	1,498	2,100	2,520	3,020	3,620
annual growth rate in %	3.4	-15.7	.	12.2	53.7	40	20	20	20
Exports of services, BOP, EUR mn	171.7	191.3	249.5	329.8	433.6	690	1,040	1,460	1,900
annual growth rate in %	14.3	11.4	30.4	32.2	31.5	60	50	40	30
Imports of services, BOP, EUR mn	71.7	79.7	101.4	134.3	217.1	230	250	280	310
annual growth rate in %	34.3	11.1	27.2	32.5	61.7	8	10	10	10
Average exchange rate USD/EUR	0.9456	1.1312	1.2439	1.2441	1.2556	1.3706	.	.	.
Purchasing power parity USD/EUR 12)	0.31	0.32	0.36	0.37	0.36	0.35	.	.	.
Purchasing power parity EUR/EUR 12)	0.37	0.38	0.43	0.43	0.42	0.43	.	.	.

Note: From 2002 the term "industry" refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) From 2003 according to census November 2003; 2006 wiiw estimate. - 3) Including non-observed economy. - 4) Excluding small private enterprises and arms industry. - 5) Unrevised data; partly wiiw estimate. - 6) From 2004 according to census 2003 and revisions based on ILO and Eurostat methodology. - 7) In % of unemployed plus employment (excluding individual farmers). - 8) In 2007 wage data refer to employees who received wages (previously wages were divided by all registered employees in enterprises); comparable value for 2006 433. - 9) Revenues excluding grants, expenditures excluding net lendig. - 10) Including all transactions with Serbia. - 11) From 2004 trade with Serbia and Kosovo based on customs statistics (before on ITRS) . - 12) Benchmark results 2005 from Eurostat and wiiw estimates.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

The most impressive has been the growth of foreign direct investment: it has doubled within the past two years. In 2007 the FDI inflow was roughly as large as the current account deficit, i.e., around 40% of GDP. Similarly, imports of goods have doubled, while exports have increased only modestly. Exports of services, however, have also almost doubled in the past two years. This puts the huge increase of the current account deficit in perspective. The latter is mainly the consequence of the large inflows of foreign investments. Montenegro uses the euro and has no recourse to monetary and exchange rate policies. Thus, a surplus on the financial and capital account translates immediately into a deficit on the current account.

The large current account deficit has raised the issue of sustainability. However, in a country that is using a foreign currency as legal tender, sustainability is not an issue of the exchange rate but of growth, and that means of consumption and investment. If inflows decline, imports will decline as well, and that will mean that consumption will have to decline too. Thus, in this policy context, the issue is whether growth is sustainable. Looking at the sources of growth, it seems that the prospects for further expansion of services are quite positive. Investments in tourism and in related activities, particularly in infrastructure, can be sustained for quite some time.

In view of the strong growth and also strong inflow of foreign investments, the fiscal policy has faced few challenges. Indeed, Montenegro reported a fiscal surplus in 2007 and there is no reason why this should not be the case this year as well. Given strong growth of demand, it may be necessary to plan for large fiscal surpluses, especially in view of accelerated inflation. Though growth of prices should moderate this year due to the stabilization of food and energy prices, there is some pressure on prices that is being generated by the growth of wages. In 2007, average wage rose by 15% and that has certainly contributed to the prices increases. Montenegro needs to pay attention to inflation if it does not want to face worsening competitiveness. Fiscal policy is clearly the only policy instrument that it can use.

Though it started late, Montenegro was able to sign the Stabilization and Association agreement with the European Union already in the autumn of 2007. Further steps in the process of EU integration depend on the development of appropriate administrative capacity. As a small state, Montenegro has shortages of bureaucratic personnel and that impedes the speed of institutional harmonization with the EU. On the positive side, it is politically stable and will present few if any problems once it joins the EU.

Short-term prospects are positive with GDP set to grow by 6% in 2008. In the medium run, there are risks to growth connected with the sustainability of foreign finances. However, the scope for improvement in the services sector is large enough for strong growth to be quite attainable. There is some residual risk to political stability due to slow democratization, but EU integration should help in that respect.

Vladimir Gligorov

Serbia: time to decide

Though the resolution of the Kosovo issue has been in the air since at least 2005, a decision has been postponed time and again. This influenced political stability in Serbia, which in turn put pressure on macroeconomic stability. This year, however, will be the one when the necessary political decisions will have to be taken. In mid-February, Kosovo declared independence. This has led to strained relations between Serbia and the European Union. The signing of the Stabilization and Association Agreement has been postponed and is awaiting the political decision in Serbia. That may have to be taken in early parliamentary elections, to be held perhaps in the second half of the year.

This political instability has influenced economic policy. The aim was to secure the stability of the government at the expense of macroeconomic stability. The same strategy was chosen for 2008. The fiscal policy was to be expansionary in order to secure increases in pensions, wages, and public investments. The central bank was supposed to keep inflation from getting completely out of control, but neither inflation nor external balances have been among the main priorities of the government.

The implicit strategy is to weather off the Kosovo separation and its aftermath and then to reconsider the economic policy mix and to speed up structural reforms. The expectation has been that a more ambitious stabilization programme and reform package will be adopted together with the budget for 2009. This strategy seems unrealistic now because early parliamentary elections are quite possible. If that proves to be the case, stabilization and reforms will be delayed for another year. That, however, seriously increases the risks of disorderly adjustment.

The key political instability is in the fact that the disenchanted opposition to EU integration, which includes some parties that are now in the government, commends the majority of the voters. Thus, early parliamentary elections can easily lead to the anti-EU coalition taking over the government. That would result in a major reassessment of the economic policy, but not in the direction currently being contemplated.

The key risk is that foreign investments will dry out and capital may even start to leave the country. Serbia has been running high current account deficits, last year of around EUR 5 billion, or around 16% of GDP. This year's deficit will have to be even higher if the projected growth rates of consumption and investment are to be realized. These foreign investments are increasingly debt creating, as the direct investment inflow has declined in 2007 and will probably not improve significantly in 2008. This is in part the consequence of the decision to sell the majority stake in the oil industry to Gazprom for only EUR 400 million. Other currently contracted or planned privatizations can hardly bring more than EUR 1 billion. That implies borrowing needs of at least EUR 3.5 billion this year, which is more than 10% of GDP. If the risk continues to increase, that will require significant adjustment in the interest rate and in the exchange rate with the acceleration of inflation. That would also imply a significant reduction of consumption and investment or a significant increase in public expenditures.

Assuming that the government and the public will be aware of these negative consequences of worsened political instability, it can be expected that measures will be taken to reassure foreign investors and to keep control over macroeconomic balances with a view to preserving stability and insuring a favourable outcome in the early elections, if those were to be held. In that case, GDP should still grow by around 5% and inflation should not accelerate further. The fiscal and current account deficits should continue to increase, but should prove to be manageable. Thus, short-term prospects should be favourable, but adjustment and structural reforms will prove to be necessary in the medium run.

Table RS

Serbia: Selected economic indicators

	2002	2003	2004	2005	2006	2007 [1)]	2008	2009	2010
								Forecast	
Population, th pers., mid-year [2)]	7,500	7,481	7,463	7,441	7,440	7,435	.	.	.
Gross domestic product, RSD bn, nom.	1,020	1,172	1,431	1,750	2,126	2,445	2,720	2,970	3,210
annual change in % (real)	4.2	2.5	8.4	6.2	5.7	7.5	5	5	5
GDP/capita (EUR at exchange rate)	2,242	2,408	2,643	2,834	3,399	4,106	.	.	.
GDP/capita (EUR at PPP - wiiw)	5,850	6,030	6,710	7,310	8,120	8,950	.	.	.
Gross industrial production [3)]									
annual change in % (real)	1.8	-3.0	7.1	0.8	4.7	3.7	5	5	5
Gross agricultural production									
annual change in % (real)	-2.1	-11.4	26.0	-3.4	-2.6	.	.	.	.
Construction output total									
annual change in % (real) [4)]	-7.4	10.8	3.5	2.0	7.7	.	.	.	.
Consumption of households, RSD bn, nom.	819.7	885.7	998.5	1,214.3	1,432.0	.	.	.	.
annual change in % (real) [2)]	.	.	.	5.0	5.4	6	5	5	5
Gross fixed capital form., RSD bn, nom.	120.5	188.9	253.3	302.0	374.4	.	.	.	.
annual change in % (real) [2)]	.	.	.	5.0	15.2	12	10	8	8
LFS - employed persons, th. Oct [5)]	3,000	2,919	2,931	2,733	2,631	2,600	.	.	.
annual change in %	-3.4	-2.7	0.4	-6.7	-3.8	-1.2	.	.	.
Reg. employees in industry, th pers., avg.	648.1	605.3	562.2	536.1	493.3	450	.	.	.
annual change in %	-8.0	-6.6	-7.1	-4.7	-8.0	-8.8	.	.	.
LFS - unemployed, th pers., Oct [5)]	459.6	500.3	665.4	719.9	693.0	700	.	.	.
LFS - unemployment rate in %, Oct [5)]	13.3	14.6	18.5	20.8	20.9	21.2	23	23	23
Reg. unemployment rate in %,end of period [6)]	30.5	31.9	26.4	27.1	27.9	32	30	.	.
Average gross monthly wages, RSD	13,260	16,612	20,555	25,514	31,745	38,744	.	.	.
annual change in % (real, net)	29.9	13.6	10.1	6.4	11.4	19.5	.	.	.
Consumer prices, % p.a.	16.6	9.9	11.4	16.2	11.7	7.0	6	4	3
Producer prices in industry, % p.a.	8.8	4.6	9.1	14.2	13.3	5.9	6	.	.
General governm. budget, nat.def., % GDP									
Revenues	39.9	40.3	41.2	.	.	.	.	.	.
Expenditures	43.2	44.2	42.6	.	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-3.3	-4.0	-1.4	1.4	-0.6	-0.5	-2	-1	-1
Public debt in % of GDP	.	.	.	.	.		.		
Discount rate, % p.a., end of period	9.5	9.0	8.5	8.5	8.5	8.5	.	.	.
Current account, EUR mn [7)]	-1,323	-1,257	-2,308	-1,790	-2,906	-4,800	-4,500	-4,500	-4,500
Current account in % of GDP	-7.9	-7.0	-11.7	-8.5	-11.5	-15.7	-13.6	-12.7	-12.0
Gross reserves of NB, excl. gold, EUR mn	2,077	2,728	3,008	4,754	8,841	9,616 [x]	.	.	.
Gross external debt, EUR mn	10,768	10,858	10,355	13,064	14,885	17,027	.	.	.
Gross external debt in % of GDP	64.9	63.3	57.1	63.8	55.3	.	.	.	.
FDI inflow, EUR mn [7)8)]	504	1,208	777	1,265	3,504	1,500	1,500	.	.
FDI outflow, EUR mn [7)]	.	.	.	18	17	600	20	.	.
Exports of goods, BOP, EUR mn [7)9)]	2,348	2,938	3,284	3,999	5,156	6,440	8,000	9,600	11,500
annual growth rate in %	15.5	25.1	11.8	21.8	28.9	25	20	20	20
Imports of goods, BOP, EUR mn [7)9)]	5,774	6,497	8,488	8,255	10,108	12,840	16,300	20,400	25,500
annual growth rate in %	25.3	12.5	30.6	-2.7	22.4	27	25	25	25
Exports of services, BOP, EUR mn [7)9)]	795	920	1,188	1,316	1,675	2,110	2,600	3,300	4,000
annual growth rate in %	16.0	15.7	29.2	10.8	27.2	26.0	25	20	20
Imports of services, BOP, EUR mn [7)9)]	657	741	1,047	1,321	1,724	2,210	2,800	3,400	4,100
annual growth rate in %	59.1	12.8	41.4	26.1	30.5	28	20	20	20
Average exchange rate RSD/USD	64.40	57.58	58.38	66.71	66.82	58.15	.	.	.
Average exchange rate RSD/EUR (ECU)	60.68	65.05	72.57	82.91	84.06	80.09	82	84	86
Purchasing power parity RSD/USD [10)]	19.87	21.94	24.04	27.21	29.59	30.04	.	.	.
Purchasing power parity RSD/EUR [10]	23.25	25.97	28.58	32.17	35.19	36.74	.	.	.

Note: The new ISO code for the Serbian dinar is RSD. From 2004 the term "industry" refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) wiiw estimate in 2005 and 2006 . - 3) From 2004 according to NACE and new weighting system. - 4) Gross value added. - 5) From 2004 according to census 2002 and revisions based on ILO and Eurostat methodology. - 6) Until 2003 jobseekers, rate in per cent of labour force excluding farmers. - 7) Converted from USD with the average exchange rate. - 8) Until 2004 FDI net. - 9) From 2006 including trade with Montenegro. - 10) Benchmark results 2005 from Eurostat and wiiw estimates.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

The medium-term prospects depend on these reforms being adopted and implemented. Assuming that is the case, Serbia should see strong and sustained growth especially if there is a speed-up in EU integration. All that development depends on the political decisions that will have to be taken this year under the strong negative influence of the secession of Kosovo. The baseline scenario is that Serbia will manage to make the right decisions, but the risks are now higher than at any time since 2003.

Josef Pöschl

Turkey’s economy dipping its toe in troubled waters

On occasion, revisions of statistical data can give rise to good news. The GDP per capita figures for Turkey will be close to EUR 5170 in 2007 compared to 4370 in 2006 (or EUR 8440 compared to EUR 7370 in PPP terms). The application of a new census methodology introduced in 2007 was the main reason for the marked increase. According to the latest findings, the population currently stands at slightly below 70.6 million: significantly below previous estimates (close to 73 million). The new results confirm that Turkish society is predominantly urban, with over 70% of the population living in cities and towns – and close to 18% in Istanbul alone. The majority of citizens are under the age of 30; those of working age (15-64 year olds) make up two thirds of the total population.

A present, Turkey’s GDP growth path appears less steep than it did up to mid-2006, when fears of overheating due to rapid credit expansion and accelerating inflation had strained investors’ confidence. Our optimistic growth estimate for 2007, 4.2%, is based on the assumption that growth in the third quarter, 1.5%, was a deviant occurrence. As the Central Bank’s business tendency survey of December 2007 suggests, a greater measure of optimism would hardly be justified. The real sector confidence index peaked at a value of 120 in April 2007, but had dropped to 101 by December. In that month for the first time in 2007, expectations were voiced of a possible decrease in output and employment over the coming three months confounding hopes of an increase. Domestic orders over the coming three months also gave rise to pessimism: fewer companies than before expected a year-on-year increase in their investments over the coming twelve months.

Headwind blowing from the global energy and grain markets

In terms of oil and gas transmissions from the Caucasus and Middle East to Europe, Turkey holds a key position, yet has almost no production of its own. Reliance on energy imports is high; in 2007 energy accounted for 20% of total imports or about 6.4% of GDP. Based on annual averages (1.1% appreciation), parity between the Turkish lira and the euro remained almost unchanged over the period 2006-2007. This led to the lira appreciating against the USD (by 9.4%): a factor that helped to cushion the impact of rising prices denominated in USD. Nevertheless, the hike in energy prices was one of the reasons for inflation scarcely slowing down over the same period. Other major factors were the increase in food prices due to the sky-rocketing world market prices for cereals (wheat +80% December-on-December) and the low rate of domestic production. A dry and hot summer led to poor yields across large sectors of the agriculture industry. Summers had been consistently hot and dry in recent years; however, the summer of 2007 was even worse. Turkey is a major producer of unprocessed and processed agricultural products; as a rule, it achieves high export surpluses in this commodity segment.

A teflon economy

As it stands now, the economy is much more crisis-proof than it was ten years ago. Market orientation is significantly more pronounced and economic activities benefit from a far more business-friendly environment. Two crises, one in 1999 and one in 2001, set in train a consolidation and acceleration of reform efforts. The general election results in 2002 were no less an important factor as they accorded a broad majority to a single party. The new government was able to push reforms through more easily. A major driving force for reform was the government's intention to pave the country's way into the EU in the foreseeable future.

In 2001, turmoil in the banking sector provoked a full-fledged crisis. Seven years later, however, the Turkish banking sector is far less likely to be destabilized, even in an environment characterized by adverse developments in global financial markets. Today, Turkey's banking sector is in much better shape. It comprises 50 banks, the largest five of which hold about 60% of the sector's assets (about EUR 300 billion in September 2007: equivalent to just over 80% of GDP in 2007). The asset share of foreign-owned banks is around 25%; however, the share of all banks with foreign shareholder participation is close to 50%. In September 2007, gross loans amounted to approximately EUR 144 billion (close to 40% of GDP and 80% compared to deposits). Almost half of the total was absorbed by Istanbul; two thirds were corporate loans; 30% were loans denominated or indexed in foreign currencies; and 42% were loans with a maturity of more than 24 months. Housing loans amounted to close on 11% of the loan total: a low proportion compared to the EU-25 average (35%) or the UK, the leader in this field (52%). As housing loans, unlike deposits, are long-term in nature, banks fund them through long-term loans from foreign currency resources that they then convert through SWAP operations. The banks' portfolios contain a high share of risk-free government debt securities, thus contributing to a very comfortable capital adequacy ratio (own funds in per cent of risk-weighted assets, 22% in December 2007).

The Central Bank's financial stability report of November 2007 analysed the banking sector's asset quality, liquidity, exchange rate and interest rate risks, profitability and capital adequacy. It concluded that the banking sector created a sound impression. Vulnerabilities included the large current account deficit, fragile confidence of savers and investors, a risk of sustained credit expansion, interest rate risks rooted in maturity mismatches between government securities and housing loans and deposits, sovereign risk due to large holdings of public sector debt and, finally, loans in foreign currency amounting to almost one third of all bank loans. Credit expansion slowed down after June 2006 displaying symptoms of a looming crisis whereupon the Central Bank injected a dose of monetary austerity. In real terms, loans grew by 40% in June 2006 (compared to June 2005), but only by about 12% in June 2007.

An economy with an Achilles heel

Most concern is expressed over the large deficit in the current account. In recent years, capital inflows did more than simply fill gap; they also nudged the Central Bank's foreign currency reserves up to EUR 49 billion. Over the period January-August 2007 reserves increased by EUR 7 billion only to slump by EUR 2 billion in the period September-November. Two major factors governed capital inflows in the period January-November 2007: foreign direct investment (close to EUR 11 billion) and inflows of 'other' investments (non FDI and non-portfolio) that were absorbed by the non-financial corporate sector (slightly over EUR 20 billion). Exposure to liquidity-driven flows is high. Thanks to substantial reforms in recent years, Turkey has acquired the image of having joined the club of successful catching-up countries. As a result, it has attracted all kinds of investment – including carry trade – thanks to its high interest rate differential compared to the Japanese yen, for example. In recent months, global liquidity conditions have been changing. Two outcomes are conceivable: either market liquidity suddenly being withdrawn or catching-up economies, including Turkey, becoming still more attractive. In the latter case, the country must present a convincing case in terms of economic fundamentals. In that context, the slowdown in growth coupled with disinflation lower than targeted by the Central Bank might prove awkward. Concerns also focus on the high trade deficit, which is mainly responsible for the large gap in the current account. Price levels in Turkey have clambered up to two thirds of the EU average. For Turkish producers of tradables, it is not easy to compete with foreign suppliers. Wages are much lower than in the EU, yet low productivity in large segments of the Turkish economy more or less offsets that advantage. As a result, within the production of tradables, a wide gap yawns between highly competitive sectors and companies and those performing poorly. Whereas Turkey has proven very successful in the production of machinery, electrical equipment and motor vehicles, part of the textile sector, a traditional lead sector in the Turkish economy, suffers from a lack of competitiveness. It is no surprise, therefore, that the trade deficit is high.

Turkish producers of tradables would lead a much easier life, were the exchange rate, for example, TRL 2.0 or 2.5 per EUR (up from the current rate of about TRL 1.8). The current account deficit would be lower, thus reducing dependence on capital inflows. Marked depreciation, on the other hand, would have an adverse impact on the international perception of the Turkish economy. It would be perceived as a return to instability, and confidence in the currency would suffer a blow. This, in turn, would support further dollarization/euroization. What we expect is a minor depreciation against the euro in 2008, but no lasting trend in that direction. Over the past few years, we have observed a firm Turkish response to US developments, especially where financial markets are concerned. The ups and downs of the Istanbul stock market in terms of the euro-based IMKB-100 Index reflect this: it stood at a value of approximately 1.8 during the financial turmoil in mid-2006, close to 3.5 in the first half of October 2007 and somewhat below 2.5 by mid-February 2008. By way of contrast, bond values did not fluctuate widely between late 2006 and mid-February 2008. In any event, we cannot exclude situations that encourage efforts to ‘buy’ stability through higher interest rates.

Light at the end of the tunnel: a return to more growth and less inflation

Marked adaptability to new developments is a characteristic feature of the Turkish business sector – and society as a whole. A growth path with rates between five and ten percent is what Turkey could achieve in the absence of external shocks. Over the long term, the rate of growth should return to that path.

As for inflation, Turkey has moved far away from a state where governments and a government-controlled monetary sector fuelled growth in aggregate demand, while the supply side, dominated by state-controlled enterprises, was turgid and cocooned in the mantle of protection against competition. Repeated threats of inflation spiralling out of control had been the outcome. Current inflation is of a different ilk; it is similar to inflation patterns we have observed in the transition countries in Central and Eastern Europe. A disinflation process is under way, but it is susceptible to interruption through external shocks. Prices for electricity will increase. They are regulated, yet despite rising costs the government vetoed price increases to avoid a loss in popularity in the run-up

Table TR

Republic of Turkey: Selected economic indicators

	2002	2003	2004	2005	2006	2007 1)	2008	2009	2010
								Forecast	
Population, th pers., mid-year 2)	69,302	70,231	71,152	72,065	72,974	70,586	.	.	.
Gross domestic product, TRY bn, nom.	277.6	359.8	430.5	487.2	576.3	653	740	830	935
annual change in % (real)	7.9	5.8	8.9	7.4	6.1	4.2	4.0	5	6
GDP/capita (EUR at exchange rate)	2,782	3,022	3,405	4,030	4,370	5,170	.	.	.
GDP/capita (EUR at PPP - wiiw)	5,590	5,600	6,280	6,590	7,370	8,440	.	.	.
Gross industrial production									
annual change in % (real)	9.5	8.7	9.8	5.5	5.8	5.5	5.0	7	9
Gross agricultural production									
annual change in % (real)	6.9	-2.5	2.0	5.6	2.9	.	.	.	.
Construction industry									
annual change in % (real)	-5.6	-9.0	4.6	21.5	.	.	.	.	.
Consumption of households,TRY bn, nom.	184.4	239.6	284.6	328.6	382.8	425	.		
annual change in % (real)	2.1	6.6	10.1	8.8	5.2	2	1.5	2	4
Gross fixed capital form., TRY bn, nom.	46.0	55.6	76.7	95.3	121.1	136	.		
annual change in % (real)	-1.1	10.0	32.4	24.0	14.0	6.2	6.0	8	10
LFS - employed persons, th, avg.	21,354	21,147	21,791	22,046	22,330	22,700	.	.	.
LFS - employed pers. in agricult. th, avg.	7,458	7,165	7,400	6,493	6,088	.	.	.	.
LFS - employed pers. in industry th, avg. 3)	4,912	4,811	5,017	5,456	5,674	.	.	.	.
LFS - employed pers. in services th, avg.	8,984	9,171	9,374	10,097	10,568	.	.	.	.
LFS - unemployed, th pers. average	2,464	2,493	2,498	2,520	2,446	2,490	.	.	.
LFS - unemployment rate in %, average	10.3	10.5	10.3	10.3	9.9	9.9	11	10	9
Reg. unemployment rate in %, average	1.9	2.5	.	.	.	.	.	.	.
Average gross monthly wages, manuf.ind., TRY 4)	.	.	1,030	1,162	1,304	1,420	.	.	.
annual change in % (real) 4)	-5.4	-1.9	.	4.3	2.4	0.2	.	.	.
Consumer prices, % p.a. 5)	45.0	25.3	10.6	8.2	9.6	8.8	9.0	7	6
Producer prices in manufacturing, % p.a. 5)	48.3	23.8	13.1	7.6	9.3	5.6	6.0	5	3
General governm. budget, EU-def., % GDP 6)									
Revenues	.	.	.	21.0	30.9	30.4	30.2	.	.
Expenditures	.	.	.	21.4	30.5	31.1	29.9	.	.
Deficit (-) / surplus (+)	.	-11.3	-5.8	-0.3	0.4	-0.7	0.2	-0.2	-0.1
Public debt, EU-def., in % of GDP 6)	93.0	85.1	76.9	69.6	60.5	54.1	50.0	.	.
Discount rate % p.a., end of period 7)	51.0	31.0	22.0	17.5	22.5	18	22		
Current account, EUR mn	-1,667	-7,083	-12,482	-18,167	-26,168	-29,000	-26,500	-28,000	-29,000
Current account in % of GDP	-0.9	-3.3	-5.2	-6.3	-8.2	-7.9	-6.9	-6.5	-5.9
Gross reserves of CB, excl. gold, EUR mn	25,562	26,616	26,436	42,823	46,251	49,200	.	.	.
Gross external debt, EUR mn	123,678	114,253	118,082	143,257	157,733	167,367	.	.	.
Gross external debt in % of GDP	77.4	56.3	50.4	46.8	51.0	44.0	.	.	.
FDI inflow, EUR mn	1,203	1,537	2,328	8,286	15,765	15,000	15,000	.	.
FDI outflow, EUR mn	177	439	693	875	722	1,400	1,500	.	.
Exports of goods, BOP, EUR mn	42,380	45,183	53,889	62,017	73,066	84,000	90,000	108,000	127,000
annual change in %	10.3	6.6	19.3	15.1	17.8	15	7	20	18
Imports of goods, BOP, EUR mn	49,983	57,504	73,102	89,115	105,882	117,000	120,000	140,000	160,000
annual change in %	17.5	15.0	27.1	21.9	18.8	11	3	17	14
Exports of services, BOP, EUR mn	15,113	15,881	18,531	21,597	19,443	20,000	19,500	22,000	24,000
annual growth rate in %	-13.9	5.1	16.7	16.5	-10.0	5	-3	15	10
Imports of services, BOP, EUR mn	6,923	6,617	8,165	9,180	8,892	10,000	10,200	11,000	12,000
annual growth rate in %	-5.3	-4.4	23.4	12.4	-3.1	10	2	10	8
Average exchange rate TRY/USD	1.5225	1.4983	1.4286	1.3480	1.4408	1.3054	.	.	.
Average exchange rate TRY/EUR (ECU)	1.4397	1.6949	1.7771	1.6771	1.8090	1.7891	1.93	1.93	1.91
Purchasing power parity TRY/USD	0.6126	0.7728	0.8109	0.8683	0.9009	0.8940	.	.	.
Purchasing power parity TRY/EUR	0.7169	0.9149	0.9639	1.0265	1.0716	1.0967	.	.	.

Note: The term "industry" refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) SIS projections. Figure for 2007 (end of year population) is based on new census methodology. - 3) Industry including construction. - 4) From 2004 including overtime payment. Real changes calculation until 2003 based on hourly wages. - 5) From 2004 new methodology. - 6) According to ESA'95, excessive deficit procedure. - 7) CBRT interest rate - overnight, lending.

Source: CBRT-EDDS (Central Bank of Turkey, Electronic Data Distribution System), SIS (State Institute of Statistics), SPO (State Planning Organization), UT (Undersecretary of Treasury), Eurostat; wiiw forescasts and European Commission (Autumn Report 2007).

to the elections. Estimates of growth in energy consumption in the years to come are high (5-10% per year); this suggests a need to build additional capacities. Currently, production is not profitable; moreover, money for investment is lacking. Current discussions focus on price hikes and comprehensive privatization as a prerequisite for investment in the sector: for example investment in a series of nuclear power stations.

EU integration, westernization: going through a lean period

In the 2007 elections, the ruling party secured an even larger majority so that basically the same government was able to proceed with its reform and integration policy. Among the general public, however, support for integration policies has diminished since Turkey's membership aspirations have provoked many negative responses from within the EU. Turkey's relations with the USA, which had been excellent for decades, have deteriorated in the context of the Iraq war. The United States cooperates closely with the government of the autonomous region in northern Iraq, which PKK units have started to use as a base for their attacks on Turkish security forces. Turkey intervenes on a reduced scale in the region, while trying not to compromise Turkish business interests. In fact, Turkish companies have contributed a lot to the reconstruction of Iraq, especially the northern province. Whereas relations with the major western powers are not free of tension, Turkey has successfully strengthened its ties with neighbouring countries. Ties with Israel have always been good and still are, despite some differences of opinion on the region's main problems. This policy of good neighbourly relations is in the interest of the Turkish business community, which is dominated by a dozen or so successful major holdings. As a rule, the founders' families still hold controlling stakes. For the most part, they started out years or decades ago from a single core activity, only to branch out later into many different sectors (such as manufacturing, trade, construction, banking, research and education and the media). They have expanded their production, trading and investment activities westwards and northwards (Bulgaria, Romania, Russia and Ukraine), as well as eastwards (Central Asia, Iran, Syria and other Arab countries).

At the technical level, EU integration is progressing. Turkey has done much to reform the economy's regulatory framework and the economy itself, as can be seen from the country's openness to foreign investors. The stumbling blocks are at the political level and in the EU. The reunification of Cyprus remains a problem. The Greek Prime Minister Kostas Karamanlis paid a three-day visit to Turkey in January 2008, which may perhaps contribute to finding a viable solution. The Greek Cypriot voters' declared preference for a new president in mid-February could also help to release the logjam.

Another problem relates to the difficulty Turkey has in granting its citizens freedom of expression, and yet another revolves around guaranteeing equal rights to the various religious and ethnic groups. The concept of a homogenous nation state, which Article 301 of the Turkish Penal Code terms 'Turkishness', was a founding principle of the Republic of Turkey; it has been fiercely defended ever since. However, large segments of Turkish society regard it as violation of their human rights. It is this kind of problem that nurtures the animosity that some EU citizens harbour towards Turkey and its joining the EU.

Part C: Selected NIS and China

Country reports

Peter Havlik

Russian Federation: slowdown in sight, external surplus shrinks

The Russian economy has been booming in the past couple of years and most analysts – including wiiw – have been busy repeatedly revising forecasts upwards owing to surging energy prices. GDP growth exceeded 8% in 2007 according to the preliminary official data, driven by a double-digit expansion of household consumption and even faster growth of investments. During the past five years, real GDP grew by more than 40% and even more so in euro terms. At purchasing power parity, Russian per capita GDP exceeded EUR 12,000 in 2007 – 50% of the EU average – and the speed of catching up has been impressive (nearly 20 percentage points since the year 2000). After the surge of export revenues during 2004-2006, the export volume grew only slowly last year while imports (in both real and nominal terms) soared by about 25%. As a result, the trade and current account surpluses diminished and the contribution of net exports to GDP growth was again negative. Higher oil prices helped to increase energy export revenues, yet proceeds from other exports – in particular metals – expanded even faster in 2007. The share of energy in total export revenues thus dropped by about 2 percentage points in 2007 (to 61%) but it is too early to say whether this signals a reversal of the earlier trend.

Russia is awash in money: both foreign exchange reserves and capital inflows are at record levels (the inflow of FDI in 2007 amounted to some EUR 35 billion), the government budget runs a large surplus and public foreign debt has largely been paid back. The shadow side of the current economic boom is – apart from growing assertiveness, nationalism and ugly remnants of Soviet stereotypes – the return of double-digit inflation and strong rouble appreciation in real terms.

Return of double-digit inflation

The appreciation pressure remains strong given the huge inflows of foreign exchange, despite some relief provided by the Stabilization and Development Funds which accumulate part of energy-related export revenues. The managed peg exchange rate regime (the rouble is pegged to a basket of US dollar and euro, with the share of the latter gradually increasing) and the full liberalization of capital account transactions (since June 2006) require massive currency interventions. The rapid growth of money supply makes meeting the CBR inflation target extremely difficult. Besides, consumer price inflation is fuelled by rising prices for food, energy and housing as well as by administered tariff adjustments. These factors will translate into double-digit annual inflation in 2008; the official inflation target of 6-7% is out of reach again (producer price inflation will be even higher).

Thanks to large windfall gains from high world market energy prices, the Russian government was able not only to repay nearly all outstanding public external debts (although private debt increased) but to raise salaries in the public sector and pensions as well. Besides, several national development projects (infrastructure, housing, health sector, education and agriculture) were initiated. The recently (May 2007) adopted three-year budget plan for the period 2008-2010 reflects some

Table RU

Russia: Selected Economic Indicators

	2002	2003	2004	2005	2006	2007 [1]	2008	2009	2010
								Forecast	
Population, th pers., end of period [2]	144,964	144,168	143,474	142,754	142,221	141,500	141,000	140,500	140,000
Gross domestic product, RUB bn, nom.	10,831	13,243	17,048	21,625	26,883	32,989	37,200	43,000	49,000
annual change in % (real)	4.7	7.3	7.2	6.4	7.4	8.1	6.4	6	5.5
GDP/capita (EUR at exchange rate)	2,514	2,641	3,310	4,290	5,536	6,642	.	.	.
GDP/capita (EUR at PPP - wiiw)	7,680	8,310	9,170	10,030	11,070	12,320	.	.	.
Gross industrial production									
annual change in % (real)	3.1	8.9	8.3	4.0	3.9	6.3	5.5	5	5
Gross agricultural production									
annual change in % (real)	1.5	1.3	3.0	2.3	3.6	3.3	.	.	.
Construction output total									
annual change in % (real)	2.7	14.4	10.1	10.5	18.1	18.2	.	.	.
Consumption of households, RUB bn, nom.	5,400	6,540	8,406	10,590	12,883	15,804	.	.	.
annual change in % (real)	8.5	7.5	12.1	11.8	11.3	13.1	12	8.5	6.3
Gross fixed capital form., RUB bn, nom.	1,939	2,432	3,131	3,837	4,957	6,940	.	.	.
annual change in % (real)	2.8	12.8	12.6	10.6	17.5	20.8	12.9	10.4	9.4
LFS - employed persons, th, avg.	66,659	66,432	67,275	68,169	68,693	70,528	70,300	70,500	70,600
annual change in %	2.4	-0.3	.	1.3	0.8	2.7	.	.	.
Reg. employment in industry, th pers., avg.	15,135	14,934	14,775	14,469	14,325	.	.	.	.
annual change in %	-1.2	-1.3	-1.1	-2.1	-1.0	.	.	.	.
LFS - unemployed, th pers., average	5,698	5,959	5,675	5,263	5,001	4,639	.	.	.
LFS - unemployment rate in %, average	7.9	8.2	7.8	7.2	6.8	6.2	5.8	5.5	5.5
Reg. unemployment rate in %, end of period	2.1	2.3	2.6	2.5	2.3	2.1	.	.	.
Average gross monthly wages, RUB	4,360	5,499	6,740	8,555	10,634	13,518	.	.	.
annual change in % (real, gross)	16.2	10.9	10.6	12.6	13.3	16.0	.	.	.
Consumer prices, % p.a.	16.0	13.6	11.0	12.5	9.7	9.1	10	9	8
Producer prices in industry, % p.a.	11.8	15.6	24.0	20.7	12.4	14.1	15	13	10
General governm.budget, nat.def., % GDP									
Revenues	32.5	31.3	31.9	39.7	39.7	40	41	.	.
Expenditures	31.6	29.9	27.4	31.5	31.3	36	38	.	.
Deficit (-) / surplus (+), % GDP	0.9	1.3	4.5	8.1	8.4	4	3	.	.
Public debt, nat.def., in % of GDP [3]	37.0	28.6	21.6	14.9	8.9	.	.	.	.
Refinancing rate of NB % p.a., end of per.	21	16	13	12	11	10	.	.	.
Current account, EUR mn [4]	30,788	31,330	47,868	67,851	77,091	56,000	25,000	5,000	-15,000
Current account in % of GDP	8.4	8.2	10.1	11.1	9.8	5.9	2.4	0.4	-1.1
Gross reserves of NB, excl. gold, EUR mn	42,290	58,531	88,663	148,094	244,190	317,220	.	.	.
Gross external debt, EUR mn	147,067	148,776	156,689	216,553	256,609	310,000	.	.	.
Gross external debt in % of GDP	45.0	41.4	34.8	34.2	32.5	33.8	.	.	.
FDI inflow, EUR mn [4]	3,660	7,041	12,422	10,354	24,496	34,380	40,000	.	.
FDI outflow, EUR mn [4]	3,736	8,606	11,085	10,258	18,570	25,000	30,000	.	.
Exports of goods, BOP, EUR mn [4]	113,468	120,265	147,358	195,894	243,793	258,000	265,000	275,000	285,000
annual growth rate in %	-0.2	6.0	22.5	32.9	24.5	6	3	4	4
Imports of goods, BOP, EUR mn [4]	64,470	67,304	78,327	100,787	132,106	165,000	200,000	230,000	255,000
annual growth rate in %	7.4	4.4	16.4	28.7	31.1	25	21	15	11
Exports of services, BOP, EUR mn [4]	14,393	14,359	16,564	20,064	24,808	28,000	30,000	32,000	35,000
annual growth rate in %	12.7	-0.2	15.4	21.1	23.6	13	7	7	9
Imports of services, BOP, EUR mn [4]	24,848	23,997	26,774	31,229	35,887	43,000	50,000	55,000	60,000
annual growth rate in %	8.2	-3.4	11.6	16.6	14.9	20	16	10	9
Average exchange rate RUB/USD	31.35	30.69	28.81	28.30	27.34	25.58	25.3	25.5	26
Average exchange rate RUB/EUR (ECU)	29.65	34.69	35.81	35.22	34.08	35.01	35.4	35	35
Purchasing power parity RUB/USD, wiiw [5]	8.47	9.45	11.03	12.74	14.29	15.84	.	.	.
Purchasing power parity RUB/EUR, wiiw [5]	9.70	11.02	12.92	15.06	17.04	18.87	21.6	23.1	24.8

Note: The term "industry" refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) Resident population. - 3) wiiw estimate. - 4) Converted from USD to EUR at the official cross exchange rate. - 5) wiiw estimates based on the 2005 International Comparison Project benchmark.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

important changes in economic policies. First, future budget revenues will depend less on energy proceeds (apart from the Stabilization Fund, which has been renamed Reserve Fund and will be maintained at 10% of GDP; another part of windfall proceeds from oil and gas exports will be accumulated in the newly established Development Fund). As a result, the share of budget revenues in GDP will decline by about 5 percentage points between 2007 and 2010. Second, government expenditures will increase (even as a share of GDP) with state-sponsored priority programmes to benefit most. In this way, the current government budget surpluses will be eliminated almost completely. The long-discussed controversial idea of Industrial Policy (IP) has apparently gained official blessing. The government-sponsored IP will offer targeted support to various public-private partnership projects in the automotive, aviation, shipbuilding and selected high-tech industries (such as nano, nuclear and space technologies).

Diversification with Industrial Policy tools

The main challenge for the Russian economy in the medium and long run is whether it will succeed in replacing energy exports as the key growth driver, and how it will cope with the acute demographic crisis (the population is projected to decline by nearly 10 million in the coming decade). The officially endorsed long-term development programme envisages in its 'innovation scenario' an ambitious economic diversification away from the current heavy reliance on energy and a gradual switch to innovation-based development supported by the above-mentioned IP, as well as the completion of reforms aiming at an improved climate for investments and entrepreneurship. Growing investments in transport infrastructure, education, health and R&D should help to generate an average annual GDP growth rate above 6% over the next decade. In this scenario, the Russian economy will restructure, become more efficient, modern and competitive. Alternative scenarios, based on continued reliance on energy resources, lower oil prices and less investments would generate GDP growth rates around 4-5% whereas the Urals oil price at last year's level (USD 70 per bbl) would help to keep GDP growth at 7% in 2008.

Growth slowdown inevitable, current account surplus disappears

The wiiw forecast for the coming years is closer to the official 'intermediate' scenario which reckons with ongoing reliance on the (modernized) energy sector, possibly with a few high-tech niches, and average annual GDP growth of around 5-6%. The expected growth slowdown appears inevitable, at least until the end of the decade before any (uncertain) modernization efforts start to bear fruit. Our forecast is based on relatively stable oil prices and limited effects of any (potential) impact of financial markets turmoil. Both private consumption and investments are expected to grow faster than GDP, real exports will continue to be sluggish while imports will expand roughly in line with private consumption. This implies an ongoing negative (albeit diminishing) contribution of real net exports to GDP and – in nominal terms – a gradual reduction of trade and current account surpluses (in fact, the current account surplus may disappear already in 2009). Inflation will remain stubbornly close to 10%. Assuming a fairly constant nominal rouble exchange rate, this implies continued real appreciation. The latter represents – apart from the less likely risk of an oil price collapse – the major challenge for Russian growth, restructuring and competitiveness owing to its adverse effect on unit labour costs.[16] Another potential risk is related to the danger of overheating in consumer and credit markets where especially consumer credits were growing particularly fast (by about 40% per year during 2006-2007, albeit from a low level). The danger of contagion from the current subprime crisis

[16] Average gross wages exceeded EUR 370 per month in 2007. During 2000-2007, unit labour costs in Russia were rising by more than 20% per year and are now already higher than in Bulgaria and Slovakia.

cannot be ignored either, particularly if the possible recession in the United States this year leads to a slump in global oil prices. However, the accumulated foreign exchange reserves (including the two Oil Funds) should help to avoid any major financial crisis.

Duo Medvedev-Putin potentially dissonant

The recent economic developments have been overshadowed by politics, in particular by the issue of Vladimir Putin's successor in March 2008. Putin's last-minute support of the United Russia party helped to secure it a comfortable majority in the Duma; his endorsement of Deputy Prime Minister (and Gazprom Chairman) Dmitri Medvedev as the preferred candidate while agreeing to serve as Prime Minister in the new government will secure Mr Medvedev's easy victory in the March presidential elections. There is little doubt that Mr Putin will dominate Russian politics in the years to come and the suggested constellation (President Medvedev and Prime Minister Putin) may lead to tensions, at least between their respective apparatuses. Nevertheless, the economic outlook remains broadly positive with both consumption and investment (including FDI) expanding. The risks of overheating in housing and credit markets appear manageable. With a stronger economy, more financial resources and power consolidation at home, Russia's self-confidence (as well as outward investments) will grow further – and this may lead to more conflicts with the West, although tensions may calm down after the elections.

Vasily Astrov

Ukraine: fiscal expansion at a time of boom

Economic boom continues

Available data reveal a picture of fast and generally balanced growth, albeit accompanied by strong and primarily 'cost-push' inflationary pressures. According to preliminary figures, in 2007 real GDP growth stood at 7.3% – about the same pace as in 2006, and slightly exceeding our earlier expectations. Most importantly, domestic demand kept its momentum, with household consumption and fixed capital investments growing by an estimated 14% and 20%, respectively. However, the main reason for the economy performing better than expected has been the good export dynamics – partly due to high international prices of metals and food, but also because of the booming exports of machinery and equipment, particularly to Russia.[17] Although the growth of imports exceeded that of exports once again (+34.2% vs. +27.9% in January-November in US dollar terms), the current account deficit must have been reasonably low, most probably below 3% of GDP. In addition, Ukraine attracted an estimated record-high FDI inflows – more than twice the current account deficit, persistent political instability notwithstanding. On the supply side, agriculture recorded a 5.6% decline due to poor grain harvests, but both manufacturing and services performed strongly, with machine building leading the growth (+29% in gross output terms, reflecting particularly the strongly expanding car production).

Following the pre-term parliamentary elections held in September 2007, a new coalition government was formed in December, with economic policy-making assigned almost exclusively to the Block of Yulia Tymoshenko (BYuT), and Ms Tymoshenko herself becoming prime-minister for the second

[17] According to the customs statistics, in January-November 2007 merchandize exports to Russia soared by 50% in US dollar terms, thus raising Russia's share in Ukraine's exports still further, to 25.9% of the total.

time.[18] Although this time, her premiership is likely to be less controversial than the first one in 2005,[19] the present coalition – possessing only a thin majority in the parliament – appears to be rather fragile. Also, it is split over several key issues. In the area of foreign policy, the new 'orange' government is predictably drifting away from Russia, and the efforts to bring the country closer to NATO have received a new impetus. At the same time, the authorities have generally agreed to the opposition's demand for a referendum on this not very popular issue. However, the timing of such a referendum remains uncertain, given the generally sceptical public attitude towards NATO membership.

Fiscal policy becomes more expansionary

In the area of the economy, a laxer fiscal policy is on the agenda after two years of a nearly balanced budget. A sizeable fiscal relaxation is envisaged in the central budget for 2008 adopted after the new government took office, although part of this relaxation was found already in the budget draft prepared by the previous government. The current budget version[20] envisages a deficit of 2.1% of GDP, which is to be covered by both borrowings (1.1% of GDP) and privatization receipts (1% of GDP). The minimum monthly wage (affecting wages in the public sector) was raised to UAH 515 as of January 2008 and will be adjusted further, to UAH 605 by December. Pensions were raised as well, as were childbirth grants in an attempt to counteract the dramatic demographic decline (simultaneously, they were differentiated according to the number of children in the family). Last but not least – and in line with Ms Tymoshenko's earlier electoral promises – the government has started the reimbursement of household savings in the state-owned Oschadbank, which lost their value in the wake of hyperinflation in the early 1990s after the collapse of the Soviet Union, with a generally flat compensation of UAH 1000 per depositor. For these purposes, the government has earmarked UAH 20 billion (corresponding to 2.2% of GDP) for 2008.[21] However, of this sum, only UAH 6 billion will come from the budget, whereas the rest is to be financed from privatization revenues in excess of the planned target.

Taking into account the full scale of the planned deposit compensations, the central budget deficit in 2008 should de facto reach some 3.6% of GDP. Given the very low level of public debt (12.6% of GDP) and the reasonably low yields offered on government bonds, there is little doubt that the planned deficit will be easily financed – even if the de facto privatization target appears to be overly ambitious. Besides, the social generosity should benefit the government of Ms Tymoshenko politically and improve her chances in the next presidential elections due at the end of 2009. Irrespective of whether her government will hold until then, she is widely seen as one of the two main contenders for the post, along with the opposition leader and former prime-minister Viktor Yanukovych (with the incumbent president Yushchenko seen as an outsider, at least at the moment). However, from the macroeconomic point of view, the fiscal expansion envisaged by the budget will work rather 'pro-cyclically': it will further fuel the already booming private consumption, adding to both rising imports and inflationary pressures.

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18 The other coalition partner is Our Ukraine-People's Self-defence (OUPS) of President Viktor Yushchenko.

19 For instance, she has largely distanced herself from the idea of large-scale re-privatizations – the policy move she was strongly advocating back in 2005.

20 The current budget version is preliminary, as further amendments are to be introduced until 1 March 2008.

21 Still, this is only a fraction of the officially acknowledged UAH 125 billion worth deposits to be repaid.

Table UA

Ukraine: Selected Economic Indicators

	2002	2003	2004	2005	2006	2007 [1]	2008	2009 Forecast	2010
Population, th pers., end of period	48,004	47,622	47,281	46,930	46,646	46,373	46,000	45,800	45,600
Gross domestic product, UAH bn, nom.	225.8	267.3	345.1	441.5	537.7	689	840	997	1,163
annual change in % (real)	5.2	9.6	12.1	2.7	7.1	7.3	6.5	6	6
GDP/capita (EUR at exchange rate)	931	928	1,100	1,467	1,814	2,140	.	.	.
GDP/capita (EUR at PPP - wiiw)	3,480	3,860	4,460	4,720	5,210	5,760	.	.	.
Gross industrial production									
annual change in % (real)	7.0	15.8	12.5	3.1	6.2	10.2	8	8	8
Construction output total									
annual change in % (real)	-5.8	26.5	17.2	-6.6	9.9	15.8	.	.	.
Consumption of households, UAH bn, nom.	124.6	146.3	181.0	252.6	315.3	.	.	.	.
annual change in % (real)	9.5	11.5	13.5	16.6	14.4	14	14	12	12
Gross fixed capital form., UAH bn, nom.	43.3	55.1	77.8	97.0	129.0	.	.		
annual change in % (real)	3.4	22.5	20.5	-0.3	18.7	20	15	15	15
LFS - employed persons, th, avg.	20,091	20,163	20,296	20,680	20,730	20,800	.	.	.
annual change in %	0.6	0.4	0.7	1.9	0.2	0.3	.	.	.
Reg. employees in industry, th pers., avg. [2]	3,578	3,416	3,408	3,416	3,362	3,279	.	.	.
annual change in %	-6.1	-4.5	-0.2	0.2	-1.6	-2.5	.	.	.
LFS - unemployed, th pers., average	2,141	2,008	1,907	1,601	1,515	1,420	.	.	.
LFS - unemployment rate in %, average	9.6	9.1	8.6	7.2	6.8	6.4	6.4	6.6	6.8
Reg. unemployment rate in %, end of period	3.8	3.6	3.5	3.1	2.7	2.3	.	.	.
Average gross monthly wages, UAH [2]	376.4	462.3	589.6	806.2	1,041.4	1,351.0	.	.	.
annual change in % (real, gross)	20.0	16.7	17.0	20.4	18.4	15.0	.	.	.
Consumer prices, % p.a.	0.8	5.2	9.0	13.5	9.1	12.8	14.5	12	10
Producer prices in industry, % p.a.	3.0	7.6	20.5	16.7	9.6	19.5	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	27.4	28.2	26.5	30.4	32.0	31.9	.	.	.
Expenditures [3]	26.7	28.4	29.7	32.2	32.6	33.0	.	.	.
Deficit (-) / surplus (+), % GDP	0.7	-0.2	-3.2	-1.8	-0.7	-1.1	.	.	.
Public debt in % of GDP	33.5	29.0	24.7	17.7	15.0	12.9	.	.	.
Refinancing rate of NB % p.a., end of period	7.0	7.0	9.0	9.5	8.5	8.0	.	.	.
Current account, EUR mn [4]	3,360	2,559	5,560	2,030	-1,289	-2,500	-4,500	-6,500	-9,000
Current account in % of GDP	7.5	5.8	10.6	2.9	-1.5	-2.5	-4.3	-4.8	-5.2
Gross reserves of NB excl. gold, EUR mn	4,088	5,348	6,977	16,058	16,587	21,634	.	.	.
Gross external debt, EUR mn	12,247	19,055	22,528	33,504	41,418	52,421 IX	.	.	.
Gross external debt in % of GDP	30.0	47.5	47.1	45.3	51.2	57.7 IX	.	.	.
FDI inflow, EUR mn [4]	734	1,261	1,380	6,263	4,148	7,000	7,000	.	.
FDI outflow, EUR mn [4]	-5	12	3	221	-106	700	500	.	.
Exports of goods, BOP, EUR mn [4]	19,770	21,013	26,906	28,093	31,048	36,300	40,000	44,000	48,000
annual growth rate in %	3.6	6.3	28.0	4.4	10.5	17	10	10	9
Imports of goods, BOP, EUR mn [4]	19,018	20,555	23,895	29,004	35,188	42,900	50,000	56,000	62,000
annual growth rate in %	0.9	8.1	16.3	21.4	21.3	22	17	12	11
Exports of services, BOP, EUR mn [4]	4,958	4,615	6,325	7,503	9,000	10,400	11,000	12,500	14,000
annual growth rate in %	11.2	-6.9	37.0	18.6	19.9	16	6	14	12
Imports of services, BOP, EUR mn [4]	3,743	3,934	5,329	6,054	7,305	8,400	10,000	11,500	12,500
annual growth rate in %	-6.3	5.1	35.5	13.6	20.7	15	19	15	9
Average exchange rate UAH/USD	5.327	5.333	5.319	5.125	5.050	5.050	5	4.9	4.8
Average exchange rate UAH/EUR (ECU)	5.030	6.024	6.609	6.389	6.335	6.918	8	7.4	6.7
Purchasing power parity UAH/USD, wiiw [5]	1.176	1.244	1.392	1.680	1.851	2.159	.	.	.
Purchasing power parity UAH/EUR, wiiw [5]	1.347	1.451	1.631	1.986	2.207	2.572	.	.	.

Note: The term "industry" refers to NACE classification C+D+E.

1) Preliminary and wiiw estimates. - 2) Excluding small enterprises. - 3) From 2004 including lending minus repayments. - 4) Converted from USD. - 5) wiiw estimates based on the 2005 International Comparison Project benchmark.

Source: wiiw Database incorporating national statistics; wiiw forecasts.

Inflationary pressures mounting further

In 2007, consumer price inflation soared to 16.6% on an end-year basis, largely due to galloping food prices (+22.9%). One 'cost-push' factor behind the rising inflation were the growing bottlenecks in some segments of the labour market. Official nominal wages rose on average by nearly 30% – far ahead of labour productivity (+7%), implying an increase in unit labour costs by 20%. At the same time, the surge in food prices has little to do with domestic 'overheating' but rather reflects the global trends: the growing world demand for food, particularly in developing countries, and the increased use of crops for biofuels production (although a poor grain harvest in Ukraine played a role as well). In Ukraine's case, food price inflation will probably persist also in 2008,[22] but it might be supplemented by rising energy tariffs. It remains to be seen how long the government will be able to ignore the long-standing necessity to adjust domestic tariffs to the ever growing energy import bill. Last year, tariff hikes for households were largely avoided in the run-up to parliamentary elections, and notwithstanding a 37% price hike for imported natural gas in January 2007. This policy has already brought the state-owned energy company Naftohaz on the verge of insolvency, whereas a renewed 38% hike in the border gas price (to USD 179.5 per thousand cubic metres) in January 2008 and the reportedly increased tax burden on Naftohaz will complicate the situation still further.

While the fiscal policy is going to be anything but restrictive, the inflation problem might be at least partly tackled by the monetary and exchange rate policies. One possible option is a re-valuation of the hryvnia, e.g. to UAH 4.9 per US dollar as mentioned by Ms Tymoshenko (from 5.05 now). Alternatively, in the medium term the authorities might switch from the current de facto exchange rate peg to the US dollar to inflation targeting, thereby letting the hryvnia float and almost inevitably appreciate – given the strong capital-related foreign exchange inflows. A stronger hryvnia appears justified against the background of the ever weakening US dollar, and given the modest role of the dollar-based countries in Ukraine's foreign trade. However, the wisdom of a shift to inflation targeting is questionable, at least at the moment. In particular, attempts to contain inflation, which is currently driven primarily by supply-side factors and tends to be highly volatile, might harm the real economy.

US crisis unlikely to have strong impact

The short- and medium-term economic prospects depend on the quality of domestic policy-making and partly also on the possible spillovers of the recent subprime crisis in the United States. However, the impact of possibly more restrictive lending policies by (especially foreign-owned) banks on private consumption and investments should not be overrated. While lending rates have indeed been on the rise recently, this reflects to a large extent a pick-up in inflation and higher inflationary expectations. Besides, business investments – unlike consumer expenditures – have so far been predominantly financed out of profits rather than by taking loans, although this is gradually changing. Still, we expect fixed capital investment in 2008 to cool down somewhat, given the risk of erratic policy moves on the part of the new government. At the same time, the government's generous social and incomes policy should offset any adverse effects of possible household credit tightening on private consumption. Also, prospects for exports are favourable given that world steel prices are expected to remain high, and Russia – Ukraine's biggest export destination – should prove highly resilient to the US crisis. Therefore, we forecast only a minor GDP growth slowdown to 6.5% this year, followed by another moderate slowdown in 2009-2010, after the effects of the fiscal impulse

[22] In January 2008 alone, consumer prices jumped by 2.9% (against December 2007), reflecting particularly the 4.3% rise in food prices.

have died down and with household indebtedness possibly approaching levels that would require a restrictive policy response by the National Bank.[23]

Nevertheless, the country's still high dependence on steel exports remains a factor of risk, and attracting more FDI should prove instrumental in diversifying Ukraine's economic structure. So far, FDI inflows have been largely targeting services (wholesale and retail trade, financial sector, real estate) rather than industry. Judging by the earlier experience of other countries, this may change following Ukraine's expected WTO accession this year.[24] Ukraine is offering a lucrative combination of a highly qualified and still cheap workforce, proximity to the EU markets and good market prospects both at home and in Russia, so that the overall prospects for FDI inflows into industry are good.[25] However, as exemplified by other countries' experience, the less pleasant side of such a development may be massive labour shedding as an initial result of the restructuring programmes. Unless the redundant labour force is absorbed by the expanding services sector, the situation in the labour market may temporarily deteriorate, bringing about a reversal of the earlier trend.

Olga Pindyuk

Kazakhstan: after temporary slowdown, growth accelerates again

Global financial crisis hits the economy

Kazakhstan's economy has been hurt the most among the CIS countries by the global financial crisis, due to the high dependence of the country's banking sector on external borrowing. In the second half of 2007, the growth of loans by liquidity-constrained Kazakh banks significantly slowed down – from 83.3% year on year in June to 44.4% y/y in December. The National Bank of Kazakhstan spent one quarter of its international reserves in order to mitigate liquidity constraints for the banking sector. The primary victims of the credit tightening have been construction and the real estate sector, as well as small and medium-sized businesses, which have been highly dependant on banking loans as their source of financing investment. The country's stock market, although showing somewhat increased volatility during the past several months, is too small to have any significant impact on the economy.

Regardless of the economic slowdown in the second half of 2007, GDP still demonstrated rather fast growth for the year as a whole (8.7% y/y, only 1.9 percentage points slower than in 2006), backed by strong consumption (both private and government) and investment. On the supply side, manufacturing industries and services (especially financial, construction and real estate)[26] contributed most to overall growth, while the mining industry showed only a meagre 0.8% growth. The primary reason for the sluggish development of the mining industry were bottlenecks in the oil-extracting capacities.

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[23] During 2007, outstanding credit to households nearly doubled, albeit starting from a fairly low level.

[24] Ukraine's WTO accession agreement was signed on 5 February 2008, but it still has to be ratified by the Ukrainian parliament.

[25] For instance, for 2008 we expect net FDI inflows in the tune of EUR 6-7 billion, of which at least EUR 2 billion should come from the planned takeover of five metallurgical assets of *Privat* by Russia's *Evraz Group*.

[26] The shares of manufacturing and services in GDP were 11.6% and 51.6% respectively in 2006. Construction, financial services and the real estate sector contributed about 60% to GDP growth in the first half of 2007.

Table KZ

Kazakhstan: Selected Economic Indicators

	2002	2003	2004	2005	2006	2007 [1]	2008	2009	2010
								Forecast	
Population, th pers., end of period	14,867	14,951	15,075	15,219	15,397	15,700	16,010	16,330	16,660
Gross domestic product, KZT bn, nom.	3,776	4,612	5,870	7,591	10,139	12,900	15,800	19,000	22,400
annual change in % (real)	9.8	9.3	9.6	9.7	10.6	8.7	6.5	7.5	8
GDP/capita (EUR at exchange rate)	878	1,833	2,313	3,029	4,185	4,946	6,000	7,500	8,900
GDP/capita (EUR at PPP - wiiw/WDI)	2,660	5,850	6,520	7,360	8,260	8,810	.	.	.
Gross industrial production									
annual change in % (real)	10.5	9.1	10.4	4.8	7.0	4.5	6.5	7	8
Gross agricultural production									
annual change in % (real)	3.4	2.1	-0.5	7.3	7.0	8.4	7.5	9	11
Construction output total									
annual change in % (real)	41.2	4.0	17.9	47.4	28.6	15.3	12	15	17
Private consumption, KZT bn, nom.	1,994	2,434	3,054	3,686	4,547	5,870	7,200	8,800	10,600
annual change in % (real)	1.0	11.9	14.1	10.9	12.7	9.5	10	12	12
Gross fixed capital form., KZT bn, nom.	907	1,063	1,472	2,123	3,084	3,234	4,000	4,900	5,900
annual change in % (real)	10.0	8.0	22.5	28.1	29.7	8.2	8	11	12
LFS - employed persons, th, avg.	6,709	6,985	7,182	7,261	7,404	7,680	.	.	.
annual change in %	0.2	4.1	2.8	1.1	2.0	3.7	.	.	.
Reg. employees in industry, th pers., avg.	824.0	855.2	869.6	891.8	904.5	940	.	.	.
annual change in %	-1.2	3.8	1.7	2.6	1.4	3.9			
LFS - unemployed, th pers., average	690.7	672.1	658.8	640.7	625.4	578.8	.	.	.
LFS - unemployment rate in %, average	9.3	8.8	8.4	8.1	7.8	7.0	6.8	6.5	6
Reg. unemployment rate in %, end of period	2.6	1.9	1.6	1.3	1.1	0.8	.	.	.
Average gross monthly wages, KZT	20,323	23,128	28,329	34,060	40,790	54,000	.	.	.
annual change in % (real, gross)	10.9	7.0	14.6	11.7	10.3	17	.	.	.
Consumer prices, % p.a.	5.9	6.4	6.9	7.6	8.6	10.8	13	10	9
Producer prices in industry, % p.a.	0.3	9.3	16.7	23.7	18.4	12.4	15	12	9
General governm.budget, nat.def., % GDP									
Revenues and grants	22.5	25.4	24.6	28.1	27.9	22.4	.	.	.
Expenditures and net lending	21.0	22.6	22.1	22.3	20.4	24.1	.	.	.
Deficit (-) / surplus (+), % GDP	1.4	2.7	2.5	5.8	7.5	-1.7	1.2	1.5	1.7
Public debt in % of GDP	3.2	3.6	3.9	9.3	11.3	7.1	.	.	.
Refinancing rate of NB % p.a., end of period	7.5	7.0	7.0	8.0	9.0	9.0	.	.	.
Current account, EUR mn [2]	-1,096	-246	278	-872	-1,409	-5,100	-6,000	-4,800	-3,000
Current account in % of GDP	-4.2	-0.9	0.8	-1.9	-2.2	-6.6	-6.3	-3.9	-2.0
Gross reserves of NB excl. gold, EUR mn	3,009	3,971	6,810	5,965	14,525	11,809	.	.	.
Gross external debt, EUR mn	19,367	20,302	26,323	34,874	58,491	74,300	.	.	.
Gross external debt in % of GDP	74.2	74.3	75.8	76.0	91.3	97	.	.	.
FDI inflow, EUR mn [2]	3,475	5,055	12,003	8,136	13,649	12,600	.	.	.
FDI outflow, EUR mn [2]	1,433	2,557	5,248	5,500	5,332	5,700	.	.	.
Exports of goods, BOP, EUR mn [2]	10,623	11,727	16,581	22,734	30,881	36,440	44,800	56,000	70,000
annual growth rate in %	7.4	10.4	41.4	37.1	35.8	18	23	25	25
Imports of goods, BOP, EUR mn [2]	8,518	8,466	11,120	14,442	19,216	27,290	36,000	45,000	54,900
annual growth rate in %	-196.7	-0.6	31.3	29.9	33.1	42	32	25	22
Exports of services, BOP, EUR mn [2]	1,632	1,517	1,617	1,790	2,237	2,660	3,100	3,600	4,100
annual growth rate in %	16.8	-7.0	6.6	10.7	25.0	19.0	17	15	15
Imports of services, BOP, EUR mn [2]	3,749	3,326	4,111	6,021	6,947	8,540	10,000	11,900	14,300
annual growth rate in %	-228.4	-11.3	23.6	46.5	15.4	23	17	19	20
Average exchange rate KZT/USD	153.28	149.58	136.04	132.88	126.09	122.50	117.6	115.2	114.1
Average exchange rate KZT/EUR (ECU)	144.68	168.79	169.04	165.42	158.27	167.75	164.6	155.6	151.7
Purchasing power parity KZT/USD, wiiw [3]	40.84	44.69	50.44	57.61	67.42	76.76	.	.	.
Purchasing power parity KZT/EUR, wiiw [3]	47.79	52.91	59.95	68.11	80.19	94.17	.	.	.

1) Preliminary and wiiw estimates. - 2) Converted from USD. - 3) Based on ICP benchmark results 2005 and wiiw estimates.

Source: National statistics; World Bank; wiiw forecasts.

The consequences for Kazakhstan's economy of the turmoil in world financial markets are expected to fully unroll in 2008, and GDP growth will slow down to 6.5% as a result. The banking sector will continue to suffer liquidity constraints, which will put some restraint on investment and also on household consumption growth.

Speeding up of economic growth in 2009-2010

Owing to the high resilience of the economy, the consequences of the liquidity crisis will be rather short-lived, and in 2009-2010 growth is expected to speed up to 7.5% and 8% respectively. This forecast is based on the following factors:

- Kazakhstan will be able to continuously benefit from its rich natural resources as prices of commodities (most importantly oil, but also metals) will remain high during the forecasting period. This will mean strong export and industrial growth. (In 2007, oil extracting accounted for 48% of industrial production, oil accounted for more than 60% of merchandise exports);
- growth of FDI will remain strong (FDI inflow accounted for about 65% of gross fixed capital formation in Kazakhstan in 2007.), with investment being directed primarily at oil-extracting capacities, which will support an increase in the sector's output. Investors' perception of safety of their investments in the country has improved, after the dispute over the Kashagan oil field was resolved at the beginning of the year to the mutual satisfaction of all sides of the conflict. Kazakhstan will remain quite an attractive destination for FDI compared to many other emerging markets, as risks of investment will continue to be considered relatively low. At the same time, public investment into infrastructure development is expected to surge as well;
- private consumption will be spurred by strong growth of household incomes, which in turn will be partly supported by increasing social expenditures;
- the political situation will remain stable with all powers consolidated in the hands of President Nazarbayev and his family.
- Consumer price inflation, which skyrocketed in 2007 (18.8% y/y in December), is expected to gradually decline in the coming years, as the shock of increased global food and oil prices will be absorbed and monetary and fiscal policy will be moderate in an attempt to strike a balance between the needs of macro-financial stability, on the one hand, and pursuing banking sector support and social policy goals, on the other. The tenge is expected to continuously appreciate over the forecasted period both in nominal and real terms, supported by strong inflows of export revenues and foreign investment.

Risks of the forecast

Major risks of the forecast are the following:

- in terms of politics, a possible risk is created by the intensified oppression of the opposition, which may raise concerns of the West and provoke internal conflicts;
- the increased power of Kazakh authorities to revise or cancel contracts with private companies may discourage investors from investing into oil extraction, which may lead to much slower growth of industrial output and oil exports. The attempts to renationalize the energy sector enterprises also create additional fears of investors;

- there still remains the risk of the real estate price bubble bursting in Kazakhstan, as prices of residential real estate have started to decline, while banks have limited issuance of mortgage loans. The government has been actively intervening to prevent the bubble bursting[27], thus the risk will become significant only if those government attempts should turn out futile.

Waltraut Urban

China: global slowdown helping to curb excessive growth

In 2007, the Chinese GDP expanded at a rate of 11.4% despite efforts by the Chinese authorities to cool down the economy. Growth was driven by investment and a surging trade surplus, but was supported by sound growth of private consumption as well. In 2008, the expected slowing down of the world economy and several administrative trade measures will put a certain brake on the expansion of exports. Also, government attempts to contain investment growth may become somewhat more effective. Yet private consumption will pick up due to fast rising incomes. Altogether, GDP growth is expected to decelerate in 2008, probably reaching 9.5%. However, if a certain 'decoupling' of the dynamic Asian economies from the downturn in the USA were to take place, growth may be even higher. On the other hand, there is a certain risk that an eventual crash on global stock markets will spill over to the Chinese stock market. Due to the large number of non-institutional investors in China, this may have a marked negative impact on private consumption and investment. The IMF estimates 10%, the World Bank and Chinese researchers less than 10% growth for 2008.

In 2009 and 2010, a certain recovery of the world economy will support Chinese exports, but as the government tries to follow a policy of qualitative (resource-saving) rather than quantitative growth, measures to contain growth may stay in place and the acceleration of GDP growth will be modest, probably not exceeding 10% in both 2009 and 2010.

Export-led growth losing steam

Looking at the demand side, net exports (exports of goods and services minus imports of goods and services) took a share of 8% in GDP and contributed about 2.7 percentage points to the overall GDP growth rate in 2007. Therefore, any deceleration of net exports will significantly lower overall growth. But it is most unlikely that net exports will expand at a similar pace in 2008, because of the already huge trade surplus and severe pressure from both the United States and the EU to increase imports and to contain exports. The expected slowing down of external demand will also affect Chinese exports and the excess liquidity and rising inflation will make the Chinese authorities more prone to letting the yuan further appreciate against the US dollar. Moreover, the anti-dumping measures taken by the US and the EU against certain Chinese products (such as steel, paper, leather shoes) as well as various administrative measures on the Chinese side to reduce exports will take effect in 2008 (e.g. reduced tax rebates for exporters, an export ban on coal, curbs on processing trade

[27] In an attempt to prevent an outright housing market crisis, the government established, at the end of 2007, a EUR 2.7 billion stabilization fund which will focus on helping the construction and property sectors. Besides, prudential regulations in the banking system have been further tightened to limit growth of bank credit and external borrowing, and the exposure of banks to the construction sector (limits on external borrowing, stricter asset classification rules and differentiated risk weights, as well as stricter collateral requirements were introduced).

etc.).[28] On top of that, recent complaints regarding the quality and related health hazards of Chinese products (such as toys) may dampen exports. We assume that the contribution of net exports to GDP growth in 2008 will be less than 1 percentage point. However, if the decline of demand from important trading partners is only moderate and if service exports associated with the Olympic Games in Beijing get a very strong boost, a higher contribution of net exports is possible.[29] For 2009 and 2010, export growth will pick up somewhat, but not too fast.

Robust investment activity to continue

Investment (gross fixed capital formation) takes a share of about 40% in GDP, which is extremely high by international standards. In 2007, investment in fixed assets increased slightly faster (in nominal terms) than in 2006, despite various measures of the Chinese authorities to curb investment growth in an attempt to prevent overheating of the economy and to avoid the building-up of an asset bubble. For 2008, we expect only a slight slowdown of investment activity. Real estate and infrastructure investment will continue to grow fast, driven by longer-term forces such as urbanization and overall development. Investment in successful industries will hardly suffer under any further tightening of monetary policy and increased credit squeeze as there are ample profits available for finance. (Profits rose 37% on average in 2007.) However, investment will slow down in sectors with excess capacities, such as the leather & shoe industry, the steel industry and in certain parts of the electronics industry. Capital formation in 2009 and 2010 will follow a similar pattern. There is, however, a certain downward risk if external demand declines more strongly than expected and if a crash on the global stock markets should spill over to China.

New challenges for foreign investors

In 2007 foreign direct investment increased in USD terms (82.6 billion) but decreased in EUR terms, due to exchange rate movements. Part of last year's FDI inflows could be related to the new tax law which took effect on 1 January 2008, stipulating a unified corporate tax rate of 25% for all enterprises (formerly the rate for foreign investment enterprises had been 15% while that for Chinese enterprises 33%). However, enterprises registered before the end of the year 2007 will be taxed at the favourable rates for another five years. We therefore expect FDI flows to decline in 2008. But there are other measures that will negatively influence the investment climate in the medium run. A new 'Anti-monopoly Law', coming into force in July 2008, requires security checks on foreign mergers & acquisitions. Further, there is the fear that the new Labour Contract Law will be enforced more strictly on foreign enterprises and will put them in a less competitive position. Finally, the revised 'Foreign Investment Industry Catalogue', taking effect in December 2007, is geared towards a change in the existing sectoral structure of FDI, with stronger emphasis on services and high-tech production and away from simple, export-oriented traditional manufacturing enterprises.

Higher incomes backing private consumption

Household consumption as a share of GDP has significantly declined over the past few years and took a relatively small share of about 36% in 2006.[30] For 2007, no data on private consumption are

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[28] The EU has to remove all quota restrictions on textiles as of the beginning of 2008, but because of an agreement with China on voluntary export restrictions, trade experts do not expect exports to increase dramatically.

[29] However, in China travel services typically take only a share of about 4% in the current account.

[30] Government consumption is comparatively small, reaching 14% of GDP in 2006.

Table CN

China: Selected Economic Indicators

	2002	2003	2004	2005	2006	2007 [1]		2008	2009 Forecast	2010
Population, mn pers., end of period	1,285	1,292	1,300	1,308	1,314	1,322		.	.	.
Gross domestic product, CNY bn, nom.	12,033	13,582	15,988	18,387	21,087	24,662		28,400	32,400	36,700
annual change in % (real)	9.1	10.0	10.1	10.4	11.1	11.4		9.5	9.7	10
GDP/capita (EUR at exchange rate)	1,212	1,126	1,094	1,374	1,606	1,794		.	.	.
GDP/capita (EUR at PPP - wiiw)	2,450	2,710	3,040	3,460	3,920	4,330		.	.	.
Industrial value added [2]										
annual change in % (real)	9.8	12.7	11.1	11.7	13.0	13.4		.	.	.
Agricultural value added										
annual change in % (real)	2.9	2.5	6.3	5.2	5.0	3.7		.	.	.
Retail trade turnover, CNY bn	4,814	5,252	5,950	6,718	7,641	8,921		.	.	.
annual change in % (real)	11.8	9.2	13.3	12.9	13.8	13.0		.	.	.
Total investment in fixed assets, CNY bn	4,350	5,557	7,048	8,877	11,000	13,724		.	.	.
annual change in % (nominal)	16.8	27.7	26.8	26.0	23.9	24.8		.	.	.
Employment total, mn pers., end of period	737.4	744.3	752.0	758.3	764.0	.		.	.	.
annual change in %	1.0	0.9	1.0	0.8	0.8	.		.	.	.
Staff and workers, mn pers., end of period [3]	105.6	104.9	105.8	108.5	111.6	111.7	I-IX	.	.	.
annual change in %	-2.2	-0.7	0.8	2.6	2.9	2.0	I-IX	.	.	.
Unemployment rate (urban) in %, end of per. [4]	4.0	4.3	4.2	4.2	4.1	4.0		4.3	4.3	4.2
Average gross annual wages, CNY [5]	12,422	14,040	16,024	18,364	21,001	22,222	I-IX	.	.	.
annual change in % (real) [6]	15.5	12.0	10.5	12.8	12.7	15.2	I-IX	.	.	.
Retail prices, % p.a.	-1.3	-0.1	2.8	0.8	1.0	3.8		.	.	.
Consumer prices, % p.a.	-0.8	1.2	3.9	1.8	1.5	4.8		5	4	3
General government budget, nat.def., % GDP										
Revenues	15.7	16.0	16.5	17.2	18.4	.		.	.	.
Expenditures	18.3	18.1	17.8	18.5	19.2	.		.	.	.
Deficit (-) / surplus (+), % GDP	-2.6	-2.2	-1.3	-1.2	-0.8	.		.	.	.
Refinancing rate of NB % p.a., end of per. [7]	2.7	2.7	3.3	3.3	3.3	3.3	I-IX	.	.	.
Current account, EUR bn	37.8	40.6	51.4	128.8	198.9	255.4		240	270	300
Current account in % of GDP	2.4	2.8	3.6	7.2	9.4	10.8		9.6	8.6	7.9
Gross reserves of NB excl. gold, EUR bn	273.1	319.3	447.7	694.2	810.0	1,038.2		.	.	.
Gross external debt, EUR bn	163.4	153.3	167.8	238.2	245.4	249.0	III	.	.	.
Gross external debt in % of GDP	11.8	11.8	11.8	12.5	12.2	.		.	.	.
FDI inflow, EUR bn [8]	52.6	41.6	40.3	63.3	62.2	60.3		50	.	.
FDI outflow, EUR bn [8]	2.7	-0.1	1.3	9.0	14.2	.		.	.	.
Exports of goods total, EUR bn [9]	347.6	387.3	435.5	609.3	771.3	888.7		.	.	.
annual change in %	15.9	11.4	12.5	39.9	26.6	15.2		.	.	.
Imports of goods total, EUR bn [9]	315.1	364.8	411.9	527.8	630.0	697.5		.	.	.
annual change in %	14.8	15.8	12.9	28.1	19.4	10.7		.	.	.
Trade balance of goods, EUR bn [9]	32.5	22.5	23.6	81.6	141.3	191.2		.	.	.
Average exchange rate CNY/USD	8.277	8.277	8.277	8.206	7.972	7.607		7.2	7.0	6.9
Average exchange rate CNY/EUR	7.753	9.366	11.276	10.261	10.015	10.426		11.5	10.5	9.7
Purchasing power parity CNY/USD, wiiw [10]	3.274	3.290	3.419	3.45	3.451	3.524		.	.	.
Purchasing power parity CNY/EUR, wiiw [10]	3.831	3.895	4.064	4.079	4.105	4.323		.	.	.

Note: CNY: ISO code for the Chinese yuan.

1) Preliminary and wiiw estimates. - 2) Including construction. - 3) Staff and workers (on duty) refer to persons who work in state-owned enterprises, urban collectives, shareholding ownership and foreign invested enterprises. - 4) Ratio of registered urban unemployed in per cent of urban employed and unemployed. - 5) Average gross annual wages of staff and workers, defined as: total wages of staff and workers on duty per average number of staff and workers on duty. - 6) Staff and workers cost of living index is used as deflator for calculating real wage. - 7) Overnight rate. - 8) Annual data are net investments drawn from the Chinese balance of payments. 2007 data are gross investments given by the Chinese Ministry of Commerce. - 9) According to customs statistics. - 10) wiiw estimates based on the 2005 International Comparison Project benchmark (World Bank) .

Source: China Statistical Yearbook; China Monthly Statistics; China Daily etc.; wiiw forecasts.

yet available. Taking retail trade turnover as a proxy, household consumption grew significantly faster in nominal terms (16.8%) than in the previous year, but growth probably slowed down in real terms due to higher inflation (retail prices: 3.6%, CPI: 4.8%), despite a substantial increase in real incomes. For the year 2008, we expect a slight acceleration of private consumption expenditure as the labour market – in particular for qualified labour – will remain tight and the new Labour Contract Law will help to enforce minimum wage levels. At the same time, high prices for agricultural products will support farmers' incomes. In 2009 and 2010 this trend may weaken somewhat.

Manufacturing affected most

On the supply side, the export-oriented manufacturing industry will be affected most by the slowing down of the economy. Services will be gaining relatively in the short and medium run. Agriculture will continue to grow less than the overall economy, but investment and urbanization will help to increase value-added per capita in the rural areas.

Special Note: A recent World Bank recalculation of purchasing power parities (PPPs) for more than 100 countries has led to a downward revision of China's GDP in PPP terms by 40%. The resulting smaller weight of China in the world economy in real terms has also led to a downward revision of world growth by 0.5 percentage points per annum in the years 2002-2007.[31]

[31] PPPs were extrapolated from price surveys in eleven major Chinese cities situated mainly in central and eastern provinces which may lead to a certain upward bias in average PPP and thus an underestimation of the real size of the Chinese GDP.

Part D: Special section on labour markets and financial vulnerability

Anna Iara, Robert Stehrer and Hermine Vidovic[*]

Tightening labour markets

This chapter looks at recent labour market developments in the new EU member states (NMS) and the countries of Southeast Europe (SEECs) and summarizes evidence on supply shortages that may arise. In respect of the NMS we also take a detailed look at changing labour demand by levels of educational attainment and occupational categories and discuss the effects of migration on labour supply in greater detail. Unfortunately analogous results cannot be reported in respect of the SEECs for want of data.

Table 1

Employment, unemployment indicators and job vacancy rates in the NMS, working-age population 15-64 (in %)

		Employment rate	Unemployment rate	Youth unemployment rate	Long-term unemployment [1)]	Job vacancy rate [2)]
Czech Republic	2005	64.8	8.0	19.2	53.0	1.4
	2007	65.8	5.5	11.0	53.3	2.7
Hungary	2005	56.9	7.2	19.4	45.1	1.0
	2007	57.3	7.3	17.6	47.6	1.3
Poland	2005	52.8	18.0	36.9	57.7	.
	2007	56.1	10.1	22.6	52.1	2.1
Slovakia	2005	57.7	16.3	30.1	72.0	0.8
	2007	60.3	11.4	20.5	73.9	1.1
Slovenia	2005	66.0	6.7	15.9	47.3	0.9
	2007	67.2	5.0	9.3	46.9	1.2
Bulgaria	2005	55.8	10.2	22.3	59.8	1.0
	2007	60.7	7.2	15.3	57.9	1.0
Romania	2005	57.6	7.5	20.2	56.3	1.7
	2007	58.4	6.8	20.6	51.2	2.1
Estonia	2005	64.4	8.1	15.9	53.4	2.4
	2007	69.2	5.0	11.2	49.3	3.4
Latvia	2005	63.3	9.0	13.6	45.9	1.3
	2007	67.0	6.4	11.7	26.1	2.0
Lithuania	2005	62.6	8.4	15.7	52.5	0.7
	2007	64.7	4.4	8.5	32.8	2.0
EU-27	2005	63.4	9.0	18.6	46.2	2.6
	2007	64.9	7.3	15.7	43.1	2.2

Note: Data for 2007 refer to the first three quarters average.

1) Long-term unemployment: share of unemployed for more than one year in total unemployed. - 2) Job vacancy rate: number of job vacancies / (number of occupied posts + number of job vacancies)*100.

Source: Eurostat Labour Force Survey (LFS) data; own calculations.

[*] We would like to thank P. Havlik, K. Laski, S. Leitner, J. Pöschl and S. Richter (all wiiw) for useful comments.

Labour market outcomes in the NMS

High GDP growth continued to be positively reflected in NMS labour markets. Overall, the NMS-10 recorded an increase of 1.3 million persons in employment in 2007. The high rate of job creation translated into a growth in employment and activity rates, with employment rates ranging from as low as 56% in Poland to 69% in Estonia (Table 1). Over the past two years the largest improvements in the employment rate were reported in Bulgaria, Estonia, Latvia and Poland. Together with Slovenia and Latvia, Estonia's employment rate already exceeds the current EU-15 average (66%).

Unemployment continued its downward trend; in 2007 it dropped to single digits for the first time (8.2%). That notwithstanding, certain structural features have remained unchanged or even deteriorated. Regional disparities continue to widen and interregional mobility is low. However, substantial progress towards reducing youth unemployment has been achieved, particularly in Poland and Slovakia (the two countries hardest hit in the past). The share of long-term unemployment, though declining in most countries of the region, is still above the EU-27 average (43%), the only exceptions being Latvia and Lithuania. Slovakia is an outlier in this respect, with over 70% of the total unemployed being in long-term unemployment, the vast majority of whom are members of the Roma minority.

Over the period 2005-2007, the job vacancy rate showed a steady and significant increase. Together with the low levels of unemployment, this may denote a shortage of skilled workers and a tightening of labour markets. The rise in vacancy rates was most pronounced in the Czech Republic, Lithuania and Estonia. Across the NMS, the highest vacancy rates were reported for Estonia, the Czech Republic, Romania, Poland, Latvia and Lithuania.

The countries of Southeast Europe

Labour markets in Southeast Europe have also started to improve in keeping with the marked economic upturn. Employment increased everywhere, except Serbia and Montenegro where it has continued to decline despite strong GDP growth. This would seem to imply that increased productivity rather than the creation of new jobs has been the driving force behind growth ('jobless growth'). Construction and trade proved to be the most dynamic sectors in terms of employment generation. The entire region is characterized by extremely low employment rates (Table 2). For example, in Bosnia and Herzegovina and Montenegro only about one third of the working-age population is in employment; in all other countries the employment rate hovers below 50%, the only exception being Croatia where a certain measure of recovery started back in 2002. In almost all countries in the region low female participation is the factor that impinges markedly on overall employment rates; it is most noticeable in Turkey.

Despite the ongoing recovery and rise in employment, unemployment shows little improvement with the exception of Croatia. In Turkey, unemployment hovers around 10%, reflecting the high employment rate that prevails in the large agricultural sector. High and persistent long-term unemployment has become a salient feature of labour markets in the region, except Turkey; those affected are running the risk of their skills being degraded and their having to quit the official labour market. The problem of long-term unemployment is much more severe in the SEECs than in the NMS; the proportion affected is far higher, ranging between 80 and 90% of total unemployed. Even in Croatia, the most advanced economy in the region, this share accounts for about 60%. Unemployment has a disproportionate impact on young people.

Table 2

Employment and unemployment indicators in Southeast Europe, working-age population 15-64 (in %)

		Employment rate	Unemployment rate	Youth unemployment rate	Long-term unemployment [1]
			in %		
Croatia	2005	55.0	13.0	32.3	58.5
	2007	56.9	10	23.5	60.9
Macedonia	2005	37.9	37.3	62.6	86.7
	2007	40.6	35	56.6	.
Turkey	2005	46.0	10.3	16.0	30.2
	2007	46.1	9.8	16.6	26.9
Albania	2005	50.3	14.4	.	92.3
	2007	48.7	13.8	.	91.5
Bosnia and Herzegovina	2005	29.7	31.1	.	85.9
	2007	31.2	29.0	.	86.1
Montenegro	2005	34.8	30.3	58.1	85.4
	2007	34.5	29.6	.	82.6
Serbia	2005	51.0	20.8	47.7	79.1
	2007	49.9	20.9	47.8	80.6

Note: Unless otherwise started data for 2007 refer to the first three quarters average. Albania, reg. data 2005 refer to 2004, 2007 refer to 2006. Bosnia and Herzegovina, LFS based on pop 15+, data 2005 refer to 2006. Serbia: data 2007 refer to 2006.

1) Long-term unemployment: share of unemployed for more than one year in total unemployed.

Source: National LFS data.

Turkeys' labour market differs in many respects from the situation in both the EU and the SEECs. Most remarkably, half of the persons employed are not part of the social security system. This may have been less of a problem in a predominantly rural society where mainly families tended for their relatives. In urban societies, however, family ties are less reliable in this respect. The need to establish a sufficient degree of social security presents a long-term problem for Turkey.

Changing demand for skills in the NMS

Over the past two years or so, the debate on growing supply problems for labour in general and skilled workers in particular has gained momentum in the NMS as more and more enterprises report problems in finding personnel. When compared to previous years when the debate was mainly on low employment growth, high and persistent unemployment rates and/or relatively low activity rates, this rapid change in the perception of labour market performance and its now being viewed from the standpoint of labour scarcity is striking to say the least. This might suggest that the looming problem of labour shortages largely reflects the relatively high growth rates of output over the past few years; it should thus be considered a business cycle phenomenon (which would also apply to Western European economies facing a similar problem). On the other hand this very phenomenon might underpin the structural problems besetting the NMS labour market.[32] Moreover, other problems might be impacting on the supply side, such as the demographic pattern in those countries (viz. an ageing population), outward migration patterns mostly applicable to skilled workers, younger workers remaining in education for longer periods (partly in response to a lack of demand in previous years) and insufficient regional mobility within countries.

That being said, it should however be noted that hard evidence on the exact magnitude of these shortage-related phenomena is missing since there are wide disparities across individual sectors and individual occupations within those sectors. This makes it difficult to quantify supply shortages. A further, albeit more conceptual problem is that of quantifying the magnitude of labour supply specific to a particular occupation within a sector, given the movement of labour between sectors and occupations. A similar qualification has to be made with respect to the possible causes of the growing labour shortage (see above). Lack of data (especially of compatible data over time) compounded by the different time-scales of the underlying causes (such as the rapid movement of business cycle phenomena on the one hand as against longer-term trends in demographic patterns on the other) makes it difficult to quantify exactly the relative importance of those potential explanatory factors.

Changing patterns in the demand for skills

The changing pattern in the demand for 'skills' can be measured in terms of educational attainment levels. Figure 1 highlights the shifts in the patterns of labour demand over the period 2000-2007. Data from the Eurostat Labour Force Survey (LFS)[33] permits a distinction between three types of employed persons according to their level of educational attainment: high, medium and low according to ISCED categories.

Demand for workers with a low level of education fell quite dramatically in all NMS over the period 2000-2007; the exceptions were Estonia and Latvia. Demand for workers with a medium level of education increased slightly over that period in most countries, with the exception of Poland and Romania where demand decreased somewhat. On the other hand demand for workers with degrees (tertiary education) has increased markedly in all countries, ranging from less than 4% (the Czech Republic) and about 10% (Poland) per year. Although – in particular in Poland – this might also have been influenced by an increase in the supply of highly educated workers (graduates from private universities) and should thus be interpreted with care, the trend towards an increase in relative and absolute demand for workers with a high level of education is quite apparent. This trend can be explained in a number of ways. The most obvious reasons are skill-biased technical change, structural change towards more skill-intensive industries or supply-side driven phenomena, such as an increase in the supply of workers with higher education. It should also be noted that these relative patterns have been less pronounced over the past two or three years (see Figure 1); this could already indicate supply shortages for this group of workers.

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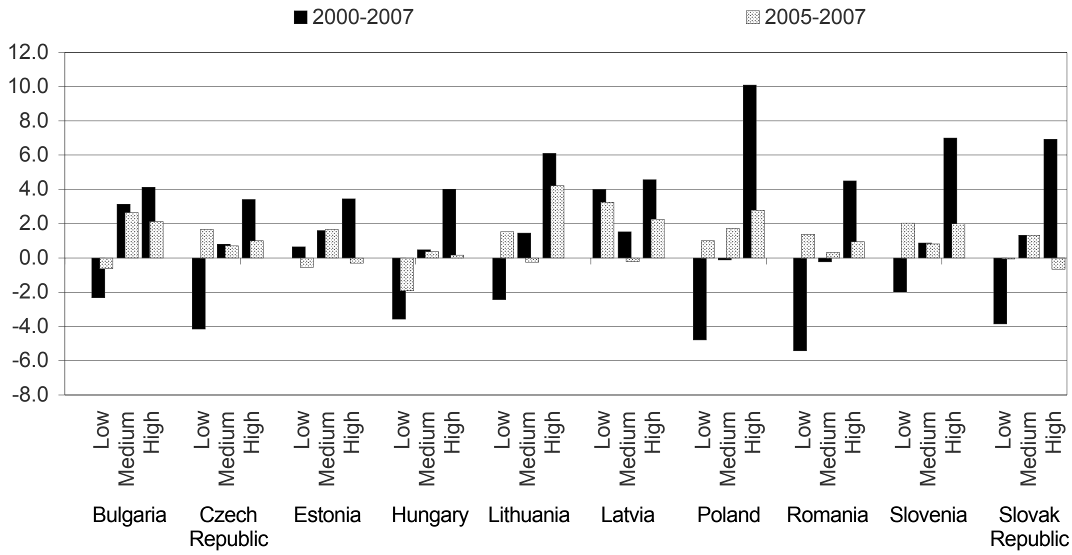
32 In phases of rapid output growth mobilizing discouraged workers or reintegrating long-term unemployed (owing to a lack of experience, discouragement, additional learning requirements, etc) can be problematic. Another issue relates to young workers not having had the chance to find an appropriate job over longer periods of time (see the high unemployment rates and low activity rates of young workers), and their not being (re)integrated in the workforce in the short term, as would be required by a booming economy.

33 In the following we use Eurostat Labour Force Survey (LFS) data on a quarterly basis. Values have been calculated by averaging over quarters. For 2007 only the first to third quarter are available.

Figure 1

Average annual changes in employment by educational attainment categories in %, 2000-2007 and 2005-2007



Source: LFS data; own calculations; Lithuania from 2001-2007.

The overall trend towards more skilled workers can also be observed when looking at shifts across occupations with different skill requirements. Table 3 presents the percentage changes of demand for five categories according to ISCO standards.

Table 3

Average annual employment changes by occupational groups in %, 2000-2007

Country	Blue-collar low-skilled	Blue-collar high-skilled	White-collar low-skilled	White-collar medium-skilled	White-collar high-skilled
Bulgaria	2.4	2.6	4.5	2.8	0.9
Czech Republic	-4.4	0.9	0.3	-0.7	2.4
Estonia	-1.1	2.8	3.2	2.7	2.2
Hungary	-0.8	-0.6	1.5	1.3	1.2
Latvia	-1.0	3.8	1.8	2.5	4.1
Lithuania	-3.1	2.8	0.9	-0.9	4.5
Poland	-1.8	0.6	2.1	0.2	2.3
Romania	-4.3	-1.1	4.2	-0.3	1.5
Slovak Republic	-1.3	2.1	2.7	-0.1	2.0
Slovenia	2.4	-1.1	0.7	-1.9	3.6

Notes: Data for 2007 refer to the first three quarters average

Blue-collar low-skilled: ISCO category 6 ‘Skilled agricultural and fishery workers’ and 9 ‘Elementary occupations’

Blue-collar high-skilled: ISOC category 7 ‘Craft and related trade workers’ and 8 ‘Plant and machine operators and assemblers’

White-collar low-skilled: ISOC category 5 ‘Service workers and shop and market sales workers’

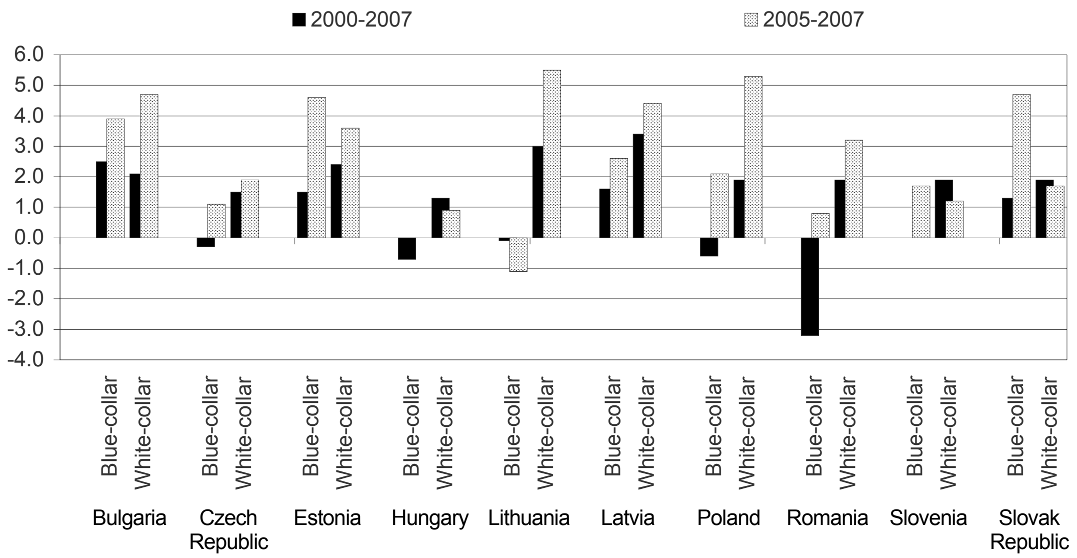
White-collar medium-skilled: ISCO category 4 ‘Clerks’

White-collar high-skilled: ISCO category 1 ‘Legislators, senior officials and managers’, 2 ‘Professionals’ and 3 ‘Technicians and associate professionals’

Source: LFS data; own calculations.

Figure 2

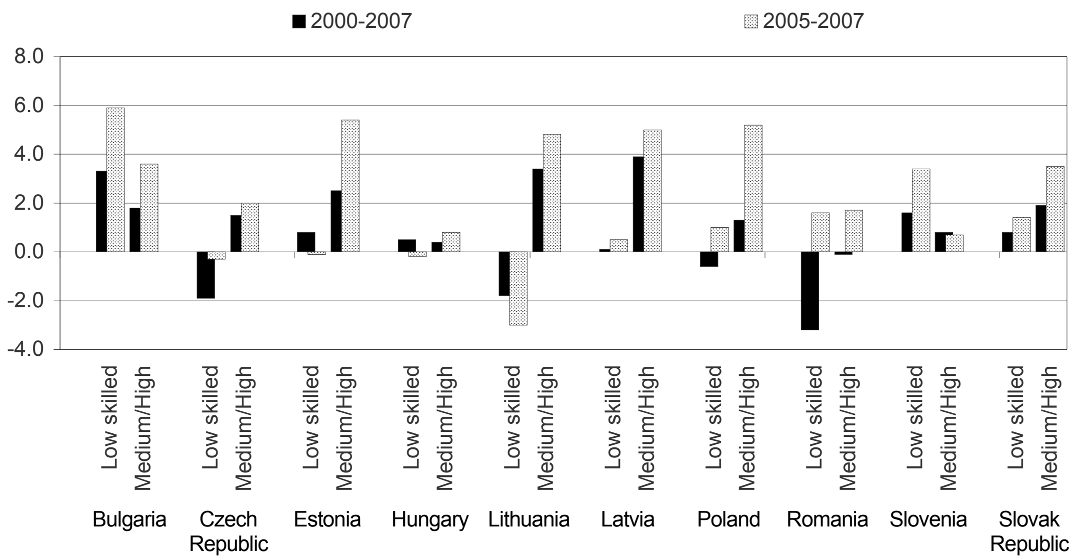
Average annual employment changes by occupational groups (blue-collar/white-collar) in %, 2000-2007 and 2005-2007



Source: LFS data; own calculations.

Figure 3

Average annual employment changes by occupational groups (low/medium/high) in %, 2000-2007 and 2005-2007



Source: LFS data; own calculations.

Although some substantial differences are to be found across countries, demand for blue-collar low-skilled workers can be seen to be either decreasing or almost stagnant, whereas the demand for white-collar workers is mostly on the increase. This can be more clearly seen in Figure 2 which plots the changes for blue and white-collar workers, respectively. In Stehrer (2005 and 2007) a shift-share analysis is used to disentangle the effects of changes in the industrial structure, occupational structures and employment demand by educational categories. The conclusion of Stehrer (2005) is that the effect of shifts in educational attainment levels within occupations and industries have a bearing on the shift towards workers with higher education. The structural change effect also shows a shift in the same direction, but is less pronounced. These findings are in line with the figures presented above.

The same conclusion holds true when grouping occupations in low-skilled (ISCO categories 5 and 6, i.e. blue-collar low-skilled and white-collar low-skilled) and high-skilled (ISCO categories 1, 2, 3, 5 and 7) as shown in Figure 3.

Table 4

Labour supply indicators by educational categories

		Working-age population in %	Activity rates in %		Unemployment rates in %	
		2000-2007	2000	2007	2000	2007
Bulgaria	Low	-3.4	38.6	37.5	28.1	18.8
	Medium	0.3	70.2	74.6	16.1	5.9
	High	2.4	83.1	86.5	7.3	2.6
Czech Republic	Low	-2.0	37.7	30.2	22.6	20.6
	Medium	0.8	79.0	76.3	8.0	4.9
	High	3.7	88.2	85.4	2.9	1.7
Estonia	Low	-0.3	40.4	38.2	25.3	12.3
	Medium	-0.6	76.5	78.2	14.9	4.9
	High	2.0	86.1	89.4	7.4	3.2
Hungary	Low	-2.9	33.1	33.1	11.4	17.2
	Medium	0.9	71.4	69.6	6.3	6.5
	High	4.5	83.5	82.4	1.6	2.8
Lithuania	Low	-2.9	34.7	28.3	25.9	7.8
	Medium	-0.2	76.4	72.6	20.2	5.1
	High	4.5	87.3	90.0	10.8	2.3
Latvia	Low	-0.5	37.2	43.8	22.8	11.7
	Medium	-1.0	74.1	78.4	15.2	6.1
	High	3.0	85.8	89.7	6.5	3.6
Poland	Low	-3.0	36.3	29.8	22.8	17.5
	Medium	0.2	74.8	67.9	17.0	10.8
	High	10.7	88.0	86.6	5.1	4.7
Romania	Low	-1.9	55.1	44.6	5.9	8.7
	Medium	0.3	74.2	69.3	9.5	7.1
	High	4.2	87.4	88.3	3.6	3.1
Slovenia	Low	-2.9	46.2	46.8	10.9	7.9
	Medium	0.3	73.7	74.7	6.9	5.0
	High	6.4	87.4	90.7	2.2	3.2
Slovak Republic	Low	-1.4	30.1	26.9	39.7	45.3
	Medium	0.6	79.9	76.1	18.1	9.6
	High	7.3	89.6	86.7	5.6	4.2

1) Data for Lithuania cover the period 2001-2007.

Source: LFS data; own calculations

Lack of space prevents us from giving a detailed outline of ongoing patterns of structural change and employment which have been analyzed in depth in a number of contributions (see Havlik, Leitner and Stehrer, 2008; Landesmann and Vidovic, 2007; Stehrer, 2007; Stehrer, 2005).

Supply side shifts

As mentioned above, the supply side changes could counter the shifts in demand towards workers with higher education or even drive this tendency. In Table 4 a closer look is taken at the supply side changes by categories of educational attainment.

In all countries, a supply shift towards workers with higher education (in particular, towards those with completed tertiary education and a degree) is to be seen. The magnitude of these supply side changes, however, is smaller than the demand shifts described above. Activity rates do not show a clear pattern; however, in some countries (for example, the Czech Republic, Hungary and Slovakia), these rates are even decreasing. However, activity rates for workers with medium and high education are already quite high: between 70-80 and 80-90 percent, respectively. The increased demand for labour with sluggish supply side reactions means that unemployment rates are falling, as indicated in the last two columns of Table 4. Unemployment rates have decreased in all countries (with the exception of Hungary); they are already quite low in most countries as far as workers with high education are concerned.

In conclusion, there is evidence of a shift towards workers with higher education having gained momentum in recent years as characterized by high overall growth rates. This demand shift seems to be only partly countered by supply-side adjustment processes as reflected in lower unemployment and rising activity rates.

Labour migrating from east to west in the enlarged EU

One possible (and oft discussed) reason for the tightening labour market situation is outward migration. For both waves of EU enlargement in 2004 and 2007, the accession treaties granted the incumbent EU members an opportunity to restrict temporarily inward work migration from the NMS[34] according to the '2+3+2' formula. This meant that incumbent members could initially enforce national or bilaterally agreed measures in order to regulate labour market access on the part of the new EU citizens for a period for two years, whereupon the restrictions had to be reviewed once again. The restrictions may be maintained for a further three years. Prolongation thereafter for a final period of two years is only possible in instances of serious disruption to the respective labour market or a threat thereof. The Community rules governing the free movement of workers will ultimately have to be applied in 2011 (for the NMS-8) and 2013 (for Bulgaria and Romania) at the latest. In the meantime, Austria and Germany still uphold their restrictions on migration from the NMS-8, while Belgium and France operate work permit systems (with simplifications for certain occupations) and Denmark sets minimum requirements that a migrant applying for a job has to meet. The other EU-15 countries grant free labour market entry to NMS-8 citizens, as do the NMS-8 countries. For Bulgarians and Romanians, free labour market entry is granted by Cyprus, the Czech Republic, the Baltic States, Finland, Poland, Slovakia, Slovenia and Sweden. Denmark applies the same minimum requirements that it sets for the NMS-8. Greece, Ireland, the Netherlands, Portugal, Spain and the United Kingdom have work permit systems, while Belgium, France, Hungary, Italy and Luxembourg

[34] Cyprus and Malta are exempt from these regulations.

operate similar systems with industry-specific simplifications. In Austria, Germany and Malta, the work permit systems remain in force unmodified.

New member states (2004 enlargement)

From the viewpoint of the NMS economies the supply side effects together with potential brain-drain effects might be of importance as they contribute to labour shortages in those countries. Owing to the inconsistencies and shortcomings of international migration statistics, insight into the extent and nature of post-enlargement intra-EU migration to date can only be drawn from heterogeneous and fragmented information; any such insights remain tentative. We have tried to provide an overview based on the available fragments of evidence.

Table 5

NMS-8 nationals in the EU-15, 2000-2006 (thousands)

	2000	2001	2002	2003	2004	2005	2006
Belgium	9.3	9.5	12.2	9.5	15.6	25.6	59.9
Denmark	8.7	9.3	10.0	10.2	10.5	11.3	13.3
Germany	416.5	434.6	453.1	466.4	480.7	438.8	481.7
Finland	12.9	13.9	14.8	15.8	16.5	18.3	17.8
France	37.8	44.9	44.9	35.1	43.0	46.8	29.6
Greece	13.8	12.7	14.9	16.4	15.2	20.6	20.1
Ireland	6.4	7.5	8.6	49.1	54.1	58.5	58.5
Italy	34.4	40.4	41.5	42.2	55.6	67.8	79.8
Luxembourg	1.1	0.7	1.2	1.1	1.1	0.7	0.7
Netherlands	9.4	10.2	11.2	12.2	13.1	17.9	23.2
Austria	60.4	53.4	44.6	41.0	53.7	80.5	78.9
Portugal	0.4	0.4	0.7	0.6	0.7	0.8	0.3
Sweden	23.0	23.9	22.9	21.4	21.1	23.3	26.9
Spain	10.6	19.3	30.0	41.5	46.7	61.8	74.3
United Kingdom	52.7	64.1	62.0	78.6	81.4	180.8	328.6
EU-15 total	697.3	744.8	772.3	841.1	909.0	1,053.4	1,293.5

Source: Eurostat. National data sources include labour force surveys (Belgium, France, Greece, Luxembourg, Austria, Spain, UK, Ireland), population registers (Germany, Denmark, Finland, the Netherlands, Sweden), and censuses (Ireland). On the Irish figure 2006, see footnote 37.

Table 5 shows the number of NMS-8 nationals resident in the EU-15 in the period of 2000-2006. Since 2003, the year immediately prior to EU-enlargement, their number grew from 840,000 to 1.3 million, implying an increase of 54%. The country figures reflect the configuration of the transitional arrangements pertaining to worker mobility: the number of NMS-8 citizens increased appreciably in the United Kingdom and Ireland, whereas the number of NMS-8 nationals almost stagnated in Germany, which until then had hosted the largest community of NMS-8 expatriates. In 2006, the share of the NMS-8 nationals residing in Germany accounted for only 37% of the EU-15 total (2003: 55%).[35]

[35] Note that the reliability of these figures is impaired by artefacts of data collection. For example, the decrease of the number in Germany 2005 against the previous year resulted from data cleaning. The Irish figures 2004 are estimates using 2002 Census and 2005 Labour Force survey data, and may erroneously ascribe part of the post-enlargement increase to the year 2003, so comparing the figures of 2005 and 2002 may be more appropriate to assessing the

The above data do not give a full account of the number of NMS-8 nationals actually present in the countries considered, since they exclude short-term migrants.[36] Furthermore, their year-on- year change is not equal to the total inflow of foreign nationals because numbers are reduced through naturalization. Furthermore, labour force surveys often provide biased figures in respect of foreign nationals, who are not accounted for in many countries (Martí and Ródenas, 2007). The figure of 460,000 is therefore at the lower end of the number of NMS-8 citizens who migrated to the old EU member states after their countries' accession. The figures are further put in perspective when compared with other sources. The most recent census established in spring 2006 that around 120,000 NMS-8 nationals 'usually reside' in Ireland: more than twice the LFS figure established a year earlier.

The United Kingdom has become the most important destination for migrant workers from the new EU members. Since May 2004 registration is mandatory for NMS-8 immigrants taking up employment. The number of initial applications to the Worker Registration Scheme (WRS) totalled some 743,000 in the period May 2004 to October 2007: some three times greater than the change in the resident NMS-8 population reflected in the above table. However, the WRS figures include short-term working migrants as well as migrants who have since returned home as no provision is made for de-registration. While these reasons inflate the figures, certain categories of migrant NMS-8 nationals are not covered.[37] Despite its extent and availability, the WRS thus fails to provide a source of reference as to the actual number of the working migrants from the NMS-8.

Table 6

Working-age NMS-8 nationals in other EU countries, 2006 (thousands)

	total population in the home country	working-age population in the home country	working-age population in other EU countries	share of working-age population in other EU countries, in %
Czech Republic	10,251	7,293	80	1.1
Estonia	1,345	917	16	1.7
Hungary	10,077	6,932	69	1.0
Lithuania	3,403	2,321	81	3.5
Latvia	2,295	1,580	28	1.8
Poland	38,157	26,892	645	2.4
Slovenia	2,003	1,407	38	2.7
Slovakia	5,389	3,862	85	2.2
Total NMS-8	72,920	51,206	1,043	2.0

Source: Maier (2007), own calculations, based on data from Eurostat.

magnitude of the post-enlargement change in the stock of NMS-8 nationals. For 2006, the Irish data report the same number of NMS-8 nationals as in the year before because of the lack of more recent consistent data.

36 Labour force surveys exclude individuals living in institutional dwellings, and they typically include individuals residing in the country for at least one year. In the United Kingdom, labour force survey data include individuals who regard their present address there as their principal residence, and those living in the same dwelling for at least half a year even if they do not regard it as their principal residence. In most countries, population registers do not include short-term migrants in the stocks of foreigners.

37 Namely the self-employed, those in employment for more than one year, family members of self-sufficient, retired or studying migrants, posted workers, and those who refuse to register. Migrant employees may, for example, refuse to register because of the registration fee (that has risen to GBP 90 from an initial sum of GBP 50) or for want of linguistic proficiency. Note that there is no penalty for failure to register. On the other hand, registration has its advantages because registered employees are entitled to some basic benefits.

Table 6 relates to the working-age population from the NMS residing in other EU member states, based on LFS data. According to those data, some 2% of the working-age population of the NMS-8 reside in other EU countries. In terms of migration propensity among the NMS-8, Lithuania leads with 3.5% of its working-age population residing in other EU countries. Poland, which is the main sending country in absolute terms, sends only 2.4% of its working-age population. The high concentration of the working migrants in the cohorts of those aged 15 to 34 implies that emigration rates are considerably higher in that narrower age group. When assessing the extent of the working population in this age group actually absent in the sending countries, it should further be borne in mind that LFS data exclude short-term migrants and tend to underestimate foreign residents.

Table 7

Polish population aged 15 and more in Poland, 2002, and Ireland, 2006, by education levels

Population aged 15 and more by education	Poland, 2002	Per cent 1)	Per cent 2)	Polish nationals in Ireland, 2006	Per cent 1)	Per cent 2)
primary completed	***8,808,487***	**28.2**	**29.6**	***1,902***	**2.8**	**3.5**
basic vocational	7,539,786					
lower secondary				5,752		
upper secondary				31,591		
secondary	9,184,496					
- of which general	2,802,025					
- of which vocational	6,382,471					
postsecondary	1,023,984					
total secondary	***17,748,266***	**56.7**	**59.6**	***37,343***	**54.6**	**68.6**
higher	3,203,566					
third level, non-degree				1,919		
third level, degree or higher				13,249		
total third level	***3,203,566***	**10.2**	**10.8**	***15,168***	**22.2**	**27.9**
other, incl. primary not completed	1,528,199					
not stated				3,115		
full time education not ceased				10,922		
- of which: at school, university etc.				1,205		
- of which: other				9,617		
total other, not stated, still in education	***1,528,199***	**4.9**	***excluded***	***24,859***	**20.5**	***excluded***
sum	**31,288,518**	**100**	**100**	**68,450**	**100**	**100**

1) Category 'total other' included. - 2) Without 'total other'.

Source: National Population and Housing Census 2002 (Poland), Census 2006 (Ireland).

Evaluations of the WRS (Border and Immigration Agency, 2007) and LFS data (Drinkwater et al., 2006; Barrett and Duffy, 2007) provide the following insights into the characteristics of the NMS-8 work migration to the two most important post-accession destinations: the UK and Ireland. The majority of the migrants are aged 16 to 35; this age group constitutes more than three quarters of the migrants. Males are slightly over-represented. In WRS files up to the third quarter of 2007, only 5% of the applicants stated that they were accompanied by dependants aged 17 or less. The level of occupational attainment displayed by the NMS-8 migrants is relatively low in both Ireland and the United Kingdom: most migrants fill jobs that only call for skill levels up to secondary education.

According to British LFS data, average earnings of recent NMS-8 migrants have been consistent at GBP 6 an hour: slightly above the minimum wage.

The brain drain issue, described as the deterioration of the human capital stock in a source country because of the over-proportional exodus of the better skilled, is a hotly debated aspect of international migration. Only scant evidence is available on the characteristics of emigrants; we thus have to rely on individual cases. For example, in the case of Poland, available data appear to confirm that the brain drain as such exists. Table 7 shows the education structure of the population aged 15 and more in Poland 2002 and that of the Polish population in the same age group residing in Ireland at the time of the census in 2006.[38] The data show that among the migrants the share of those with tertiary education is much higher and the share of those with only primary education is much lower than among the population in Poland, thus confirming the positive selection of work migration in terms of education levels. Against this background, the low occupational attainment of the NMS-8 migrants appears particularly worrisome.[39] To date, there is little evidence of the migrant workers upgrading their human capital when they work abroad: something that could benefit the source country economy upon the eventual return of those workers.

Bulgaria and Romania (2007 enlargement)

The LFS figures presented in Table 8 provide a first quantitative insight into the post-enlargement migration from Bulgaria and Romania to the other EU member states.

In 2007 the number of Romanian working-age migrants in the other EU member states increased by 20%, i.e. some 172,000 persons. The increase was largest in the EU countries in southern Europe that have recently become the favoured destinations for Romanian migrant workers: Spain, Italy and Greece.[40] Spain and Italy were in fact home to the largest Romanian migrant communities in the EU even before Romania joined the EU, these two countries having accounted for over four fifths of all Romanian migrant working-age nationals in the EU. Apart from the demand for migrant labour, the formation of Romanian migrant communities in those countries has been facilitated by their linguistic proximity. Germany used to be a target country for migrants from the European periphery, yet it hosted only 6% of intra-EU migration of Romanian workers in 2007. With a share of 1.3% in the total stock, the relative size of the Romanian working-age diaspora in Austria is negligible.

Spain has also become the number one destination for Bulgarian migration. In 2007, half of the Bulgarian expatriate working-age citizens in the EU resided in Spain. Thereafter Germany and Greece are equally important target countries for Bulgarian migrant workers, hosting 14% and 12% of those abroad, respectively. As for the Bulgarian citizens working abroad in the EU, their shift in numbers was diametrically opposed to that of the Romanians. Upon Bulgaria's accession to the EU, they decreased surprisingly by nearly 20%: a reduction of 47,000 persons. (Among the countries where country level data are available, the Bulgarian share only increased in Italy). It remains to be seen whether this decline indicates a change in Bulgarian migration patterns or whether it is a

[38] Data are not fully comparable: The Polish data indicate only those with unfinished primary education separately, while the Irish data have a separate category for those who are still in education at any level.

[39] Barrett and Duffy (2007) argue based on the econometric analysis of Irish LFS data that so far there is no evidence fof the integration of the NMS-8 migrants into the labour market in the sense of reducing the occupational gap.

[40] The data show the large increase of the stock of the Romanian citizens for Germany, close to 40%. However, the figures for 2005 and 2007 are at very similar levels, while the figure for 2006 is considerably lower, thus appearing to be an outlier.

transitory indication of extraordinary circumstances.[41] The figures may imply that among Bulgarians, many migrant workers intend to migrate for only a limited period of time: those individuals may well have returned home, given that free access to the labour market in the most important host country (Spain) scheduled for 2009 might encourage temporary migration. In contrast to the Bulgarians, Romanian migrant workers may be more inclined to set up long-term livelihoods in their destination countries. An obvious possible reason for this difference is that their speaking a Romance language substantially facilitates their integration in the two main destination countries: Italy and Spain. It should be noted that the increase in the number of resident migrants may not necessarily imply additional inflows, but may also reflect a shift among the present population from illegality to lawful terms of residence and work. The propensity to legalize their residence is again likely to be higher among those migrants who aim at a long-term stay in the host country.

Table 8

Resident working-age citizens of Romania and Bulgaria abroad in the EU, 2005-2007

	Romanian nationals, 1000s				**Bulgarian nationals, 1000s**			
	2005	**2006**	**2007**	**% change 2006 to 07**	**2005**	**2006**	**2007**	**% change 2006 to 07**
Belgium		5	10	100				
Germany	63	46	64	39	33	31	28	-10
Greece	16	16	20	25	23	26	25	-4
Spain	336	445	555	25	77	137	100	-27
France		23	24					
Italy		273	306	12		13	15	15
Cyprus	2	2	2	0	2	3	3	0
Hungary	22	21	21	0				
Austria	18	17	14					
Portugal	7	12	12					
United Kingdom	16	12	17		11	17	12	
Other EU	22	8	7	-13	18	20	17	-15
total	*502*	*880*	*1052*	*20*	*164*	*247*	*200*	*-19*
% domestic working-age population	3.34	5.86	7.00		3.06	4.61	3.73	

Source: Eurostat.

Table 8 further shows that the propensity to emigrate is much higher among the Bulgarian and Romanian nationals than among citizens from Central and Eastern Europe (see Table 6). On average, 5.5% of the working-age population of those two countries resided in other EU countries in 2006. The figures also confirm the Bulgarians' palpably lower propensity to migrate compared to the Romanians. The difference in that propensity even widened when the two countries joined the EU; it rose for Romania, but declined for Bulgaria. Bearing in mind that the working-age migrants are heavily over-represented among young adults, the figures imply a large reduction in the labour force aged up their mid-thirties, in particular in Romania. Considering that the LFS under-estimates the

[41] The slight decline in the propensity to migrate in Bulgaria is confirmed by the qualitative research of Mirchev (2007). Interestingly, while real per capita incomes and unemployment rates are comparable in Romania and Bulgaria, wages in Romania are much higher. This shows that propensities to migrate cannot be adequately explained by the main economic push factors of migration only.

migrant figures owing to non-response, the exclusion of short-term migrants and other reasons, the true extent of the population's absence in this age group in the sending countries is still larger.

In the context of international work migration, an important issue is the impact of work-related migration on human capital levels in the source country. One hypothesis posits that the opportunity to obtain higher returns to education by migration increases human capital investment in the sending countries so that a surplus of better educated people remains – the emigration of the higher skilled notwithstanding (Docquier and Rapoport, 2007). Empirical evidence from Romania on the effect of migration on children left behind shows the complex relationship between migration and human capital formation (Toth et al., 2007).[42] It is found that the inability of a working migrant to fulfil his or her parental role impacts negatively on the child's performance in school. In addition, according to that study, the children of migrants do indeed tend to value education higher because of their horizons having been widened by their parents' migration experience, but contrariwise many of them wish to follow their parents without further ado and assume low- skilled jobs abroad rather than continue their education at home.

[42] Toth et al. (2007) have discovered that at least one parent of up to 18% of the schoolchildren aged 11 o 14 is working abroad. In one fifth of the cases, both parents are working migrants who leave their children to relatives. Toth et al. (2007) also find positive effects of parents abroad on the well-being of the children in particular in terms of material wealth. Besides, it is found that the negative effects of the absence of a parent are not different from the lack of a parent due to other circumstances such as divorce.

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Financial vulnerability and bubbles

This chapter provides an initial assessment of potential financial vulnerability and the development of financial and housing bubbles[43] in the NMS, Southeast Europe and the major CIS countries. It should be noted that the data used were limited in terms of both quality and availability; they should thus be treated with caution. Also, we mainly present structural, long-term indicators, because short-term indicators are mostly available only *ex post*. However, in the wake of the US subprime crisis, financial vulnerability issues and bubbles have roused a lot of interest. Questions are being asked about the extent to which countries in transition are vulnerable to financial shocks and whether any potential for home-grown financial bubbles exists in the countries themselves. Private credit development, asset price bubbles and external debt are inextricably linked to each other. Rising expectations about existing bubbles may ultimately lead to restricted access to external funding. Moreover, sudden external financial shocks may cause home-grown asset price bubbles to burst. These developments might bear negative consequences for the real sector. For all that, however, certain market corrections in a timely manner might ultimately prove beneficial in the long term as they prevent excessive overheating.

Vulnerability to external financial shocks

In Table 1 we present some indicators that allow us to evaluate the region's exposure to external financial shocks. A large current account deficit that is insufficiently covered by net FDI inflows and high short-term external debt relative to a country's foreign reserves[44] would mean that a country is highly susceptible to the risk of losing access to external sources of funds. A high share of net portfolio investment in GDP is used as a measure of the risk associated with 'sudden' capital outflows. Of course, these general indicators may not enable us to detect certain country-specific peculiarities, which can prove significant in the event of a shock (a case in point being the banking sector in Kazakhstan and the over-concentration of external debt in one sector). That notwithstanding, the general indicators provide information that is quite adequate for our needs.

It should be noted that net portfolio investment is relatively low in all the countries analysed; only in Hungary, Ukraine and Slovakia was any notable influx of this type of investment in 2006. Overall, however, all the countries in the region mostly rely on direct investment and credits as sources of external financing.

As the indicators suggest, the region is rather heterogeneous in terms of financial vulnerability. The Baltic States stand out as the countries most exposed to external financial shocks. They have high current account deficits as shares of their GDP, with net FDI covering less than 40% of their current account deficits. They also have very high levels of short-term external debt (in Estonia and Latvia more than double the foreign exchange reserves[45]). Of the two new EU member states, Romania

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43 For a detailed study on housing bubbles see Balazs Egert and Dubravko Mihaljek (2007), 'Determinants of House Prices in Central and Eastern Europe', *Comparative Economic Studies*, Vol. 49.

44 We use the following benchmark proposed by Alan Greenspan in a speech on 29 April 1999 (http://www.federalreserve.gov/BoardDocs/Speeches/1999/19990429.htm): foreign exchange reserves should exceed scheduled amortizations of foreign currency debts (assuming no rollovers) during the following year.

45 It is worth noting that in the Baltic States a large proportion of the capital base increase has been made by foreign banks.

displays financial imbalances similar to the Baltic countries. Although Romania has a lower current account deficit to GDP ratio than Bulgaria, it has much lower net FDI inflows and a high level of short-term external debt. Of the candidate countries, Croatia in particular has a level of short-term foreign debt that is higher than its foreign exchange reserves (though lower than in Estonia, Latvia and Romania). In this instance, however, the current account deficit is not extremely large and is mostly covered by FDI inflows.

Table 1

Financial vulnerability indicators

	Current account, in % of GDP, 2007	Net FDI in % of current account deficit, 2007	Net portfolio investment in % of GDP, 2006	Short-term foreign debt in % of forex reserves, 2006
Czech Republic	-3.2	117.1	-0.8	43.8
Hungary	-4.6	17.0	5.9	88.9
Poland	-4.0	108.9	-0.8	38.8
Slovak Republic	-4.7	84.6	2.8	55.9
Slovenia	-4.8	-6.3	-4.7	76.3
Estonia	-16.2	20.0	-8.1	235.5
Latvia	-23.4	29.8	0.2	227.3
Lithuania	-12.3	37.7	-0.8	94.0
Bulgaria	-21.6	89.1	0.5	64.5
Romania	-14.3	41.3	-0.2	153.9
Croatia	-7.5	99.3	-1.6	114.3
Macedonia	-0.9	299.8	1.4	22.2
Turkey	-7.9	46.9	1.8	87.0
Albania	-8.9	55.7	0.4	36.5
Bosnia & Herzegovina	-13.4	116.4	0.0	40.2
Montenegro	-39.5	46.0	-0.2	.
Serbia	-15.7	18.8	.	.
Kazakhstan	-6.6	135.3	-3.5	57.5
Russia	5.9	-16.8	1.6	18.8
Ukraine	-2.5	252.0	3.4	43.4

Source: wiiw, World Bank, IMF and own calculations.

Potential EU candidate countries in the West Balkans have relatively high current account deficits, yet they also have relatively high inflows of FDI and are not that reliant on short-term external debt. Their exposure to external financial shocks can thus be considered moderate. The NMS-5, Macedonia, and selected CIS countries should be able to withstand external financial shocks relatively well. In general, they have modest current account deficits (Russia even has a surplus) and high inflows of FDI[46], while their short-term external debts are lower than their foreign exchange reserves.

[46] Negative figures of net FDI as a share of current account deficit for Russia and Slovenia are related to the fact that Russia has a current account surplus and Slovenia a negative net FDI position.

Asset price bubbles

As for the internal generation of financial market instability, attention is drawn to the financial bubbles indicators, more specifically those related to housing bubbles. Table 2 provides an overview. The first indicator – average growth of banking credit to the private sector over recent years – is a lag indicator. It shows once again that the Baltic States, Romania, Albania, Montenegro and most especially Kazakhstan, Russia and Ukraine, have experienced a dramatic boom in private credit (from very low levels). That credit was also invested in housing; real estate prices in a number of those countries are extremely high. By way of contrast, the movement in stock exchange indices from the peak levels in early August 2007 to beginning of February 2008 is a lead indicator. Certainly an element of international capital market contagion is at play. Apart from a general stock market decline in the wake of the recent global downturn, a number of countries have reported above-average declines. Apart from the stock exchanges in the Baltic States and Romania, this applies to the stock exchange in Poland and their tiny counterparts in Bosnia and Herzegovina and Montenegro. All this points to market corrections in order to realign previous market overshoots.

Table 2

Financial bubbles indicators

	Bank credit to private sector, av. growth, '01-'06	Stock indices 08/01/07 vs 02/01/08, % change	Apartment [1] price level per square metre, 2007, EUR	Average annual growth in apartment prices, '02-'07	Average annual growth in housing rents, '02-'07	Average annual growth of CPI, '02-'07
Czech Republic	4.8	-11.8	2367	10.5 [2]	3.4	2.0
Hungary	20.9	-17.4	1792	15.6 [2]	7.5	5.4
Poland	6.4	-21.2	3292	12.3 [2]	4.1	2.0
Slovak Republic	6.4	6.2	1292	15.8 [2]	11.8	4.9
Slovenia	20.7	-12.4	2467		6.6	4.2
Estonia	40.2	-33.8	2383	26.0	10.5	3.8
Latvia	48.8	-24.3	3020	30.0	8.7	5.6
Lithuania	39.1	-19.4	3792	20.2	12.1	2.0
Bulgaria	38.3	-12.2	1487	25.9	4.5	5.8
Romania	58.5	-24.4	2350	19.3 [2]	23.7	11.7
Croatia	20.3	-11.2	2215	3.4 [2]	7.8	2.5
Macedonia	14.8	-11.2	1133		1.6	1.4
Turkey	37.3	-13.3	2467		23.3	17.9
Albania	42.4		1225		4.6	3.0
Bosnia & Herzegovina	15.0	-32.4	1250		0.6	2.3
Montenegro	67.9	-29.0	2350		10.2	5.6
Serbia	24.7	-19.0	1750		25.9	12.1
Kazakhstan	61.0	-5.5	2069	56.4		7.7
Russia	43.1	-3.1	11501	28.1 [2]	29.6	12.0
Ukraine	53.4	2.1	2807	40.1		8.4

1) 120 m² apartment in the centre of the most important city. - 2) Average over the period 2002-2006.

Source: wiiw, IMF, European Council of Real Estate Professions, European Mortgage Federation, Global Property Guide, national statistical offices, real estate agencies, Bloomberg, national stock exchanges and own calculations.

Despite the difficulties of comparison, we also cite the prices (in euros per square metre) for a 120 m² apartment in the centre of the most important city in the respective countries.[47] The highest prices are to be found in the Baltic States, Poland, Ukraine and Russia. The other indicators used provide for the dynamics of apartment prices and rents over recent years compared to overall inflation trends. Both apartment prices and rents increased consistently to an exceptional degree, far in excess of the average CPI increase over the same period. The analysis suggests that especially in the Baltic States and Romania, a bubble has developed which is now underlying certain market corrections. A similar development can also be expected in Russia and the Ukraine.

Possible consequences

In order to assess more properly the sustainability of these developments, it would be necessary to form expectations of the development of risks in relation to (a) interest rates and (b) exchange rates. The widening of interest rate and yield spreads seems to indicate that in some cases countries may well face problems relating to the securement of future funding, debt repayments and dangers of default. Moreover, the recently observed acceleration of inflation may exert downward pressure on exchange rates; that in turn may call for an increase in interest rates in order to stabilize exchange rates. That would then put pressure on the prices of assets and debts, thus possibly leading to sustainability problems in terms of financial sector prices and exchange rates. For those countries firmly anchored in the EU and the euro, the risks of adverse developments may not be all that significant. Growth seems robust and credit expansion has still not led to overleverage of households, businesses or the public sector. In other countries, especially if they exhibit a number of these vulnerabilities, a certain measure of financial consolidation may prove necessary, possibly leading to a slowdown in growth.

We do not know the extent to which the banking sectors in the countries analysed may be affected by the subprime crisis. In most cases, it would seem that collateralized debt has not played any significant role. Barring unexpected developments, it is the global credit crunch that may well pose problems for countries facing significant credit needs owing to their high current account deficits.

[47] This type of apartment is not average but upper class. However, these figures are the only available that are comparable across countries.

Appendix

Selected Indicators of Competitiveness

Table A/1

GDP per capita at current PPPs (EUR), from 2007 at constant PPPs

	1991	1995	2000	2004	2005	2006	2007	2008	2009	2010	2015
								projection assuming 5% p.a. GDP growth			
Bulgaria	4,443	4,675	5,285	7,286	7,891	8,597	9,388	9,905	10,499	11,150	14,230
Cyprus	18,984	12,982	16,901	19,546	20,748	21,621	23,010	23,908	24,840	25,809	32,939
Czech Republic	8,800	10,146	13,036	16,259	17,156	18,504	20,075	20,979	22,028	23,129	29,519
Estonia	5,463	5,295	8,285	12,314	14,108	16,104	17,684	18,922	20,057	21,361	27,263
Hungary	6,777	7,339	10,379	13,673	14,393	15,263	15,869	16,345	17,015	17,747	22,650
Latvia	6,518	4,542	6,893	9,884	11,179	12,739	14,545	15,708	16,886	18,068	23,060
Lithuania	7,103	4,810	7,479	10,907	11,914	13,216	15,004	16,204	17,419	18,639	23,788
Malta	22,857	12,697	15,925	16,603	17,347	18,101	18,809	19,336	19,897	20,474	26,130
Poland	4,477	6,099	9,188	10,961	11,482	12,337	13,473	14,214	14,967	15,715	20,057
Romania	4,006	4,525	4,924	7,363	7,933	9,143	10,140	10,698	11,233	11,907	15,197
Slovak Republic	5,816	6,923	9,535	12,357	13,563	14,994	16,722	18,060	19,324	20,484	26,143
Slovenia	8,537	9,823	14,964	18,427	19,459	20,661	22,327	23,376	24,428	25,600	32,673
NMS-12	5,454	6,250	8,549	11,010	11,712	12,768	13,933	14,672	15,449	16,268	20,763
Croatia	6,029	5,736	8,112	10,571	11,196	12,133	13,183	13,816	14,437	15,159	19,348
Macedonia	4,273	3,991	5,123	5,760	6,245	6,629	7,118	7,474	7,922	8,397	10,717
Turkey	3,740	4,313	5,681	6,277	6,586	7,370	8,435	8,773	9,211	9,764	12,462
Albania	1,476	1,984	3,177	4,206	4,531	4,945	5,354	5,664	6,010	6,382	8,146
Bosnia & Herzeg.	.	.	3,489	4,808	5,127	5,583	6,008	6,278	6,592	6,987	8,918
Montenegro	.	.	5,442	6,236	6,623	7,466	8,178	8,669	9,189	9,740	12,432
Serbia	.	.	5,105	6,711	7,314	8,119	8,952	9,399	9,869	10,363	13,226
Kazakhstan	.	3,078	4,167	6,522	7,358	8,259	8,811	9,384	10,087	10,894	13,904
Russia	7,577	5,300	6,614	9,172	10,033	11,071	12,322	13,111	13,897	14,662	18,712
Ukraine	4,639	2,627	2,836	4,458	4,719	5,206	5,760	6,134	6,502	6,892	8,797
China	758	1,268	2,060	3,035	3,457	3,919	4,328	4,739	5,199	5,250	6,701
								projection assuming 2% p.a. GDP growth and zero population growth p.a.			
Austria	18,378	19,865	25,360	27,834	28,854	30,010	31,959	32,821	33,609	34,281	37,849
Germany	17,589	18,912	22,564	25,187	25,798	26,862	28,149	28,740	29,372	29,960	33,078
Greece	10,822	12,343	16,009	20,280	21,589	22,963	24,281	25,203	26,136	26,659	29,433
Portugal	10,527	10,991	14,857	16,147	16,892	17,521	18,232	18,596	18,987	19,367	21,382
Spain	12,465	13,444	18,539	21,863	23,069	24,703	25,308	26,068	26,667	27,201	30,032
USA	21,389	23,278	30,255	33,429	35,416	36,998	37,477	38,114	39,105	39,887	44,038
EU(15) average	16,017	16,969	21,892	24,440	25,246	26,373	27,738	28,292	28,858	29,435	32,499
EU(25) average	14,321	15,286	19,935	22,513	23,319	24,441	25,794	26,438	27,099	27,777	31,427
EU(27) average	13,637	14,591	18,990	21,600	22,400	23,526	24,859	25,506	26,169	26,849	30,526

European Union (27) average = 100

	1991	1995	2000	2004	2005	2006	2007	2008	2009	2010	2015
Bulgaria	33	32	28	34	35	37	38	39	40	42	47
Cyprus	139	89	89	90	93	92	93	94	95	96	108
Czech Republic	65	69	69	75	77	79	81	82	84	86	97
Estonia	40	36	42	57	63	68	71	74	77	80	89
Hungary	50	50	54	63	64	65	64	64	65	66	74
Latvia	48	31	36	46	50	54	59	62	65	67	76
Lithuania	52	33	39	50	53	56	60	64	67	69	78
Malta	168	87	84	77	77	77	76	76	76	76	86
Poland	33	42	48	51	51	52	54	56	57	59	66
Romania	29	31	26	34	35	39	41	42	43	44	50
Slovak Republic	43	45	50	57	61	64	67	71	74	76	86
Slovenia	63	68	79	85	87	88	90	92	93	95	107
NMS-12	40	43	45	51	52	54	56	58	59	61	68
Croatia	44	39	43	49	50	52	53	54	55	56	63
Macedonia	31	27	27	27	28	28	29	29	30	31	35
Turkey	27	30	30	29	29	31	34	34	35	36	41
Albania	11	14	17	19	20	21	22	22	23	24	27
Bosnia & Herzeg.	.	.	18	22	23	24	24	25	25	26	29
Montenegro	.	.	29	29	30	32	33	34	35	36	41
Serbia	.	.	27	31	33	35	36	37	38	39	43
Kazakhstan	.	21	22	30	33	35	35	37	39	41	46
Russia	56	36	35	42	45	47	50	51	53	55	61
Ukraine	34	18	15	21	21	22	23	24	25	26	29
China	6	9	11	14	15	17	17	19	20	20	22
Austria	135	136	134	129	129	128	129	129	128	128	124
Germany	129	130	119	117	115	114	113	113	112	112	108
Greece	79	85	84	94	96	98	98	99	100	99	96
Portugal	77	75	78	75	75	74	73	73	73	72	70
Spain	91	92	98	101	103	105	102	102	102	101	98
USA	157	160	159	155	158	157	151	149	149	149	144
EU(15) average	117	116	115	113	113	112	112	111	110	110	106
EU(25) average	105	105	105	104	104	104	104	104	104	103	103
EU(27) average	100	100	100	100	100	100	100	100	100	100	100

Sources: National statistics, Eurostat, wiiw estimates.

Table A/2

Indicators of macro-competitiveness, 2000-2007

EUR-based, annual averages

	2000	2001	2002	2003	2004	2005	2006	2007 prelim.
Czech Republic								
Producer price index, 2000=100	100.0	102.8	102.3	101.9	107.7	110.9	112.7	117.3
Consumer price index, 2000=100	100.0	104.7	106.6	106.7	109.7	111.8	114.5	117.8
GDP deflator, 2000=100	100.0	104.9	107.8	108.8	113.8	113.5	115.5	118.6
Exchange rate (ER), CZK/EUR	35.61	34.08	30.81	31.84	31.90	29.78	28.34	27.76
ER nominal, 2000=100	100.0	95.7	86.5	89.4	89.6	83.6	79.6	78.0
Real ER (CPI-based), 2000=100	100.0	107.0	118.1	112.2	112.7	120.4	126.9	130.1
Real ER (PPI-based), 2000=100	100.0	106.2	117.6	112.7	116.2	122.7	125.0	129.6
PPP, CZK/EUR	16.35	16.56	16.76	16.60	16.96	17.02	17.01	17.08
Price level, EU27 = 100	46	49	54	52	53	57	60	62
Average monthly gross wages, CZK	13,614	14,793	15,866	16,917	18,041	18,992	20,207	21,915
Average monthly gross wages, EUR (ER)	382	434	515	531	565	638	713	789
Average monthly gross wages, EUR (PPP)	833	893	947	1,019	1,064	1,116	1,188	1,283
GDP nominal, CZK mn	2,189,169	2,352,214	2,464,432	2,577,110	2,814,762	2,987,722	3,231,576	3,540,000
Employed persons - LFS, th., average [1)]	4,732	4,750	4,765	4,733	4,707	4,764	4,828	4,922
GDP per employed person, CZK	462,670	495,182	517,205	544,481	598,046	627,146	669,327	719,220
GDP per empl. person, CZK at 2000 pr.	462,670	472,202	479,682	500,295	525,659	552,427	579,751	606,234
Unit labour costs, CZK, 2000=100	100.0	106.5	112.4	114.9	116.6	116.8	118.5	122.9
Unit labour costs, ER adj., 2000=100	100.0	111.2	129.9	128.5	130.2	139.7	148.8	157.6
Unit labour costs, PPP adj., Austria=100	31.16	34.17	38.82	37.83	39.00	40.81	42.63	44.55
Hungary								
Producer price index, 2000=100	100.0	105.2	103.3	105.8	109.5	114.2	121.6	121.9
Consumer price index, 2000=100	100.0	109.2	115.0	120.4	128.6	133.2	138.4	149.5
GDP deflator, 2000=100	100.0	108.5	116.9	123.7	129.1	132.0	136.9	145.6
Exchange rate (ER), HUF/EUR	260.04	256.68	242.97	253.51	251.68	248.05	264.27	251.31
ER, nominal 2000=100	100.0	98.7	93.4	97.5	96.8	95.4	101.6	96.6
Real ER (CPI-based), 2000=100	100.0	108.3	118.0	116.1	122.3	125.8	120.1	133.2
Real ER (PPI-based), 2000=100	100.0	105.4	109.9	107.3	109.3	110.7	105.6	108.6
PPP, HUF/EUR	124.09	128.86	134.43	142.58	149.91	151.91	154.55	160.42
Price level, EU27 = 100	48	50	55	56	60	61	58	64
Average monthly gross wages, HUF	87,645	103,553	122,482	137,187	145,520	158,343	171,351	185,600
Average monthly gross wages, EUR (ER)	337	403	504	541	578	638	648	739
Average monthly gross wages, EUR (PPP)	706	804	911	962	971	1,042	1,109	1,157
GDP nominal, HUF bn	13,151	15,270	17,181	18,941	20,717	22,055	23,757	25,600
Employed persons - LFS, th., average	3,856	3,868	3,871	3,922	3,900	3,902	3,930	3,926
GDP per employed person, HUF	3,410,291	3,947,503	4,438,744	4,829,481	5,311,535	5,652,978	6,044,943	6,520,300
GDP per empl. person, HUF at 2000 pr.	3,410,291	3,639,593	3,796,394	3,903,242	4,113,642	4,282,559	4,417,203	4,478,228
Unit labour costs, HUF, 2000=100	100.0	110.7	125.5	136.8	137.6	143.9	150.9	161.3
Unit labour costs, ER adj., 2000=100	100.0	112.2	134.4	140.3	142.2	150.8	148.5	166.9
Unit labour costs, PPP adj., Austria=100	28.29	31.28	36.45	37.49	38.68	40.01	38.62	42.83
Poland								
Producer price index, 2000=100	100.0	101.6	102.6	105.3	112.7	113.4	116.1	118.7
Consumer price index, 2000=100	100.0	105.5	107.5	108.4	112.2	114.5	115.7	118.5
GDP deflator, 2000=100	100.0	103.5	105.9	106.2	110.6	113.6	115.3	118.2
Exchange rate (ER), PLN/EUR	4.011	3.669	3.856	4.398	4.534	4.025	3.895	3.783
ER, nominal, 2000=100	100.0	91.5	96.1	109.6	113.0	100.4	97.1	94.3
Real ER (CPI-based), 2000=100	100.0	112.9	107.2	92.9	91.3	102.8	105.0	108.3
Real ER (PPI-based), 2000=100	100.0	109.8	106.1	94.9	96.3	104.6	105.5	108.4
PPP, PLZ/EUR	2.118	2.167	2.140	2.178	2.209	2.244	2.254	2.254
Price level, EU27 = 100	53	59	56	50	49	56	58	60
Average monthly gross wages, PLN	1,894	2,045	2,098	2,185	2,273	2,361	2,476	2,691
Average monthly gross wages, EUR (ER)	472	557	544	497	501	586	636	711
Average monthly gross wages, EUR (PPP)	894	944	980	1,003	1,029	1,052	1,099	1,194
GDP nominal, PLN mn	744,378	779,564	808,578	843,156	924,538	983,302	1,060,194	1,157,300
Employed persons - LFS, th., average [2)]	14,526	14,207	13,782	13,617	13,795	14,116	14,594	15,250
GDP per employed person, PLN	51,245	54,872	58,669	61,921	67,021	69,661	72,648	75,889
GDP per empl. person, PLN at 2000 pr.	51,245	53,023	55,421	58,283	60,580	61,336	63,003	64,210
Unit labour costs, PLN, 2000=100	100.0	104.4	102.4	101.4	101.6	104.1	106.3	113.4
Unit labour costs, ER adj., 2000=100	100.0	114.1	106.6	92.5	89.8	103.8	109.5	120.2
Unit labour costs, PPP adj., Austria=100	45.00	50.63	45.99	39.34	38.87	43.79	45.30	49.10

1) From 2002 according to census 2001. - 2) From 2003 according to census 2002.

(Table A/2 ctd.)

(Table A/2 ctd.)

	2000	2001	2002	2003	2004	2005	2006	2007 prelim.
Slovak Republic								
Producer price index, 2000=100	100.0	106.5	108.7	117.8	121.8	127.5	138.2	141.0
Consumer price index, 2000=100	100.0	107.1	110.6	120.0	129.0	132.5	138.5	142.4
GDP deflator, 2000=100	100.0	105.0	109.1	114.9	121.6	124.5	128.2	131.1
Exchange rate (ER), SKK/EUR	42.59	43.31	42.70	41.49	40.05	38.59	37.25	33.77
ER, nominal, 2000=100	100.0	101.7	100.3	97.4	94.0	90.6	87.5	79.3
Real ER (CPI-based), 2000=100	100.0	103.1	105.8	115.9	126.3	131.8	139.6	154.6
Real ER (PPI-based), 2000=100	100.0	103.5	107.8	119.5	125.2	130.1	139.5	153.1
PPP, SKK/EUR	18.22	18.30	18.61	19.78	20.47	20.33	20.53	20.49
Price level, EU27 = 100	43	42	44	48	51	53	55	61
Average monthly gross wages, SKK	11,430	12,365	13,511	14,365	15,825	17,274	18,761	20,154
Average monthly gross wages, EUR (ER)	268	286	316	346	395	448	504	597
Average monthly gross wages, EUR (PPP)	628	676	726	726	773	850	914	984
GDP nominal, SKK mn	937,964	1,018,430	1,108,117	1,222,483	1,361,683	1,485,301	1,659,573	1,850,000
Employed persons - LFS, th., average	2,102	2,124	2,127	2,165	2,170	2,216	2,301	2,350
GDP per employed person, SKK	446,288	479,555	520,976	564,761	627,388	670,201	721,115	787,234
GDP per empl. person, SKK at 2000 pr.	446,288	456,675	477,653	491,696	515,902	538,401	562,711	600,484
Unit labour costs, SKK, 2000=100	100.0	105.7	110.4	114.1	119.8	125.3	130.2	131.0
Unit labour costs, ER adj., 2000=100	100.0	104.0	110.2	117.1	127.4	138.2	148.8	165.3
Unit labour costs, PPP adj., Austria=100	25.27	25.90	26.69	27.95	30.95	32.75	34.57	37.89
Slovenia								
Producer price index, 2000=100	100.0	108.9	114.5	117.3	122.4	125.7	128.5	135.0
Consumer price index, 2000=100	100.0	108.4	116.5	123.1	127.5	130.7	133.9	138.8
GDP deflator, 2000=100	100.0	108.6	116.9	123.5	127.6	129.7	132.3	136.9
Exchange rate (ER), EUR-SIT/EUR	0.8556	0.9063	0.9440	0.9752	0.9968	1.0000	0.9998	1.0000
ER, nominal, 2000=100	100.0	105.9	110.3	114.0	116.5	116.9	116.9	116.9
Real ER (CPI-based), 2000=100	100.0	100.1	101.2	101.5	100.7	100.7	101.0	102.2
Real ER (PPI-based), 2000=100	100.0	101.6	103.1	101.7	101.5	99.4	97.1	99.5
PPP, EUR-SIT/EUR	0.6116	0.6582	0.6885	0.7275	0.7249	0.7253	0.7337	0.7408
Price level, EU27 = 100	71	73	73	75	73	73	73	74
Average monthly gross wages, EUR-SIT	800	895	982	1057	1117	1157	1213	1280
Average monthly gross wages, EUR (ER)	935	988	1,041	1,083	1,120	1,157	1,213	1,280
Average monthly gross wages, EUR (PPP)	1,308	1,360	1,427	1,452	1,540	1,595	1,653	1,728
GDP nominal, EUR-SIT mn	18,214	20,396	22,758	24,716	26,677	28,243	30,448	33,400
Employed persons - LFS, th., average	901	916	910	897	943	949	961	980
GDP per employed person, EUR-SIT	20,215	22,267	25,009	27,554	28,290	29,761	31,684	34,082
GDP per empl. person, EUR-SIT at 2000 pr.	20,215	20,500	21,390	22,311	22,166	22,939	23,947	24,892
Unit labour costs, EUR-SIT, 2000=100	100.0	110.4	116.1	119.7	127.3	127.5	128.0	130.0
Unit labour costs, ER adj., 2000=100	100.0	104.2	105.2	105.0	109.3	109.1	109.5	111.2
Unit labour costs, PPP adj., Austria=100	65.24	67.02	65.83	64.72	68.55	66.72	65.69	65.82
Bulgaria								
Producer price index, 2000=100	100.0	103.8	105.0	110.1	116.7	124.8	136.3	148.0
Consumer price index, 2000=100	100.0	107.4	113.6	116.2	123.4	129.6	139.0	150.7
GDP deflator, 2000=100	100.0	106.7	110.7	112.7	118.5	123.0	133.0	143.1
Exchange rate (ER), BGN/EUR	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
ER, nominal, 2000=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2000=100	100.0	105.1	108.9	109.3	113.6	116.7	122.5	129.8
Real ER (PPI-based), 2000=100	100.0	102.6	104.4	108.9	112.8	115.4	120.3	127.5
PPP, BGN/EUR	0.6196	0.6508	0.6512	0.6594	0.6848	0.7007	0.7417	0.7787
Price level, EU27 = 100	32	33	33	34	35	36	38	40
Average monthly gross wages, BGN	225	240	258	273	292	324	355	415
Average monthly gross wages, EUR (ER)	115	123	132	140	150	166	181	212
Average monthly gross wages, EUR (PPP)	362	369	396	414	427	462	478	533
GDP nominal, BGN mn	26,753	29,709	32,335	34,628	38,823	42,797	49,091	56,000
Employed persons - LFS, th.,average	2,795	2,699	2,740	2,835	2,923	2,980	3,110	3,270
GDP per employed person, BGN	9,573	11,008	11,803	12,215	13,284	14,362	15,785	17,125
GDP per empl. person, BGN at 2000 pr.	9,573	10,317	10,661	10,841	11,209	11,675	11,869	11,966
Unit labour costs, BGN, 2000=100	100.0	99.2	103.0	107.5	111.2	118.2	127.4	147.9
Unit labour costs, ER adj., 2000=100	100.0	99.2	103.0	107.5	111.2	118.2	127.4	147.9
Unit labour costs, PPP adj., Austria=100	17.14	16.76	16.93	17.41	18.33	19.00	20.07	23.00

(Table A/2 ctd.)

(Table A/2 ctd.)

	2000	2001	2002	2003	2004	2005	2006	2007 prelim.
Romania								
Producer price index, 2000=100	100.0	138.1	169.9	203.0	241.8	267.2	298.1	322.3
Consumer price index, 2000=100	100.0	134.5	164.8	190.0	212.5	231.7	246.9	258.7
GDP deflator, 2000=100	100.0	137.4	169.6	210.3	241.8	271.3	300.9	324.8
Exchange rate (ER), RON/EUR	1.9956	2.6027	3.1255	3.7556	4.0532	3.6234	3.5245	3.3373
ER, nominal, 2000=100	100.0	130.4	156.6	188.2	203.1	181.6	176.6	167.2
Real ER (CPI-based), 2000=100	100.0	100.9	100.8	94.9	96.3	115.0	123.2	133.2
Real ER (PPI-based), 2000=100	100.0	104.7	107.9	106.6	115.1	136.1	149.0	166.0
PPP, RON/EUR	0.7276	0.9572	1.1592	1.3996	1.5445	1.6799	1.7459	1.8054
Price level, EU27 = 100	36	37	37	37	38	46	50	54
Average monthly gross wages, RON	284	422	532	664	818	968	1,146	1,410
Average monthly gross wages, EUR (ER)	142	162	170	177	202	267	325	422
Average monthly gross wages, EUR (PPP)	390	441	459	474	530	576	656	781
GDP nominal, RON mn	80,377	116,769	151,475	197,565	246,469	288,176	344,536	394,300
Employed persons - LFS, th., average [3]	10,508	10,440	9,234	9,223	9,158	9,147	9,313	9,560
GDP per employed person, RON	7,649	11,185	16,404	21,422	26,914	31,506	36,994	41,245
GDP per empl. person, RON at 2000 pr.	7,649	8,138	9,670	10,186	11,130	11,611	12,293	12,700
Unit labour costs, RON, 2000=100	100.0	139.7	148.2	175.5	198.0	224.5	251.0	299.0
Unit labour costs, ER adj., 2000=100	100.0	107.1	94.6	93.3	97.5	123.6	142.1	178.8
Unit labour costs, PPP adj., Austria=100	31.23	32.97	28.34	27.52	29.27	36.21	40.81	50.66
Estonia								
Producer price index, 2000=100	100.0	104.4	104.8	105.0	108.1	110.3	115.3	124.9
Consumer price index, 2000=100	100.0	105.8	109.6	111.0	114.4	119.1	124.3	132.1
GDP deflator, 2000=100	100.0	105.3	109.3	114.2	116.3	123.5	131.1	143.4
Exchange rate (ER), EEK/EUR	15.647	15.647	15.647	15.647	15.647	15.647	15.647	15.647
ER, nominal, 2000=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2000=100	100.0	103.5	105.1	104.4	105.3	107.3	109.6	113.8
Real ER (PPI-based), 2000=100	100.0	103.2	104.2	103.8	104.5	102.1	101.8	107.6
PPP, EEK/EUR	8.191	8.688	8.741	8.898	9.023	9.236	9.570	10.209
Price level, EU27 = 100	52	56	56	57	58	59	61	65
Average monthly gross wages, EEK	4,907	5,510	6,144	6,723	7,287	8,073	9,407	10,900
Average monthly gross wages, EUR (ER)	314	352	393	430	466	516	601	697
Average monthly gross wages, EUR (PPP)	599	634	703	756	808	874	983	1,068
GDP nominal, EEK mn	92,938	108,218	121,372	136,010	149,923	175,392	207,061	242,200
Employed persons - LFS, th., average	572.5	577.7	585.5	594.3	595.5	607.4	646.3	655.0
GDP per employed person, EEK	162,337	187,326	207,297	228,858	251,760	288,759	320,380	369,771
GDP per empl. person, EEK at 2000 pr.	162,337	177,962	189,667	200,387	216,493	233,805	244,316	257,946
Unit labour costs, EEK, 2000=100	100.0	102.4	107.2	111.0	111.4	114.2	127.4	139.8
Unit labour costs, ER adj., 2000=100	100.0	102.4	107.2	111.0	111.4	114.2	127.4	139.8
Unit labour costs, PPP adj., Austria=100	36.50	36.86	37.52	38.28	39.08	39.10	42.74	46.30
Latvia								
Producer price index, 2000=100	100.0	101.7	102.7	106.0	115.1	124.1	136.9	158.9
Consumer price index, 2000=100	100.0	102.5	104.4	107.5	114.1	121.8	129.7	142.3
GDP deflator, 2000=100	100.0	101.7	105.4	109.1	116.8	128.7	142.9	161.5
Exchange rate (ER), LVL/EUR	0.5600	0.5627	0.5826	0.6449	0.6711	0.7028	0.7028	0.7028
ER, nominal, 2000=100	100.0	100.5	104.0	115.2	119.8	125.5	125.5	125.5
Real ER (CPI-based), 2000=100	100.0	99.8	96.2	87.7	87.7	87.4	91.1	97.6
Real ER (PPI-based), 2000=100	100.0	100.1	98.2	91.0	92.9	91.5	96.3	109.1
PPP, LVL/EUR	0.2865	0.2894	0.2920	0.3062	0.3252	0.3522	0.3865	0.4260
Price level, EU27 = 100	51	51	50	47	48	50	55	61
Average monthly gross wages, LVL	150	159	173	192	211	246	302	390
Average monthly gross wages, EUR (ER)	267	283	297	298	314	350	430	555
Average monthly gross wages, EUR (PPP)	522	549	592	629	649	698	782	915
GDP nominal, LVL mn	4,686	5,220	5,758	6,393	7,435	9,059	11,265	14,100
Employed persons - LFS, th., average	941.1	962.1	989.0	1006.9	1017.7	1035.9	1087.6	1115.0
GDP per employed person, LVL	4,979	5,426	5,822	6,349	7,305	8,745	10,357	12,646
GDP per empl. person, LVL at 2000 pr.	4,979	5,335	5,526	5,818	6,256	6,798	7,247	7,832
Unit labour costs, LVL, 2000=100	100.0	99.2	104.2	110.2	112.3	120.4	138.9	165.8
Unit labour costs, ER adj., 2000=100	100.0	98.8	100.2	95.7	93.7	95.9	110.7	132.1
Unit labour costs, PPP adj., Austria=100	35.43	34.50	34.05	32.03	31.92	31.87	36.06	42.48

3) Methodological break in 2001/2002.

(Table A/2 ctd.)

(Table A/2 ctd.)

	2000	2001	2002	2003	2004	2005	2006	2007 prelim.
Lithuania								
Producer price index, 2000=100	100.0	97.0	94.3	93.8	99.4	110.9	119.1	127.4
Consumer price index, 2000=100	100.0	101.3	101.6	100.4	101.6	104.3	108.2	114.1
GDP deflator, 2000=100	100.0	99.7	99.8	98.9	101.5	107.3	114.3	124.1
Exchange rate (ER), LTL/EUR	3.6990	3.5849	3.4605	3.4528	3.4528	3.4528	3.4528	3.4528
ER, nominal, 2000=100	100.0	96.9	93.6	93.3	93.3	93.3	93.3	93.3
Real ER (CPI-based), 2000=100	100.0	102.3	104.1	101.1	100.2	100.7	102.2	105.3
Real ER (PPI-based), 2000=100	100.0	98.9	100.2	99.4	103.0	109.9	112.6	117.6
PPP, LTL/EUR	1.7451	1.7029	1.6622	1.6213	1.6703	1.7547	1.8260	1.9092
Price level, EU27 = 100	47	48	48	47	48	51	53	55
Average monthly gross wages, LTL	971	982	1,014	1,073	1,149	1,276	1,496	1,800
Average monthly gross wages, EUR (ER)	262	274	293	311	333	370	433	521
Average monthly gross wages, EUR (PPP)	556	577	610	662	688	727	819	943
GDP nominal, LTL mn	45,674	48,585	51,971	56,804	62,587	71,380	81,905	96,676
Employed persons - LFS, th., average	1,398	1,352	1,406	1,438	1,436	1,474	1,499	1,540
GDP per employed person, LTL	32,675	35,941	36,967	39,502	43,575	48,430	54,640	62,776
GDP per empl. person, LTL at 2000 pr.	32,675	36,034	37,041	39,950	42,927	45,152	47,796	50,573
Unit labour costs, LTL, 2000=100	100.0	91.8	92.1	90.4	90.1	95.1	105.4	119.8
Unit labour costs, ER adj., 2000=100	100.0	94.7	98.5	96.8	96.5	101.9	112.9	128.3
Unit labour costs, PPP adj., Austria=100	32.33	30.18	30.54	29.57	30.01	30.90	33.54	37.65
Croatia								
Producer price index, 2000=100	100.0	103.6	103.2	105.1	108.8	112.1	115.3	119.3
Consumer price index, 2000=100	100.0	104.9	106.7	108.6	110.9	114.6	118.2	121.6
GDP deflator, 2000=100	100.0	104.0	107.8	112.1	116.4	120.1	124.1	127.7
Exchange rate (ER), HRK/EUR	7.6350	7.4690	7.4068	7.5634	7.4952	7.4002	7.3226	7.3362
ER, nominal, 2000=100	100.0	97.8	97.0	99.1	98.2	96.9	95.9	96.1
Real ER (CPI-based), 2000=100	100.0	104.9	105.4	103.1	104.0	106.5	108.7	109.0
Real ER (PPI-based), 2000=100	100.0	104.7	105.8	104.9	107.1	107.0	106.2	106.9
PPP, HRK/EUR	4.2376	4.3240	4.3768	4.5450	4.5812	4.6520	4.6516	4.6692
Price level, EU27 = 100	56	58	59	60	61	63	64	64
Average monthly gross wages, HRK	4,869	5,061	5,366	5,623	5,985	6,248	6,634	7,028
Average monthly gross wages, EUR (ER)	638	678	724	743	799	844	906	958
Average monthly gross wages, EUR (PPP)	1,149	1,170	1,226	1,237	1,306	1,343	1,426	1,505
GDP nominal, HRK mn	152,519	165,640	181,231	198,422	214,983	231,349	250,590	273,300
Employed persons - LFS, th., average	1,553	1,469	1,528	1,537	1,563	1,573	1,586	1,600
GDP per employed person, HRK	98,209	112,757	118,607	129,139	137,589	147,075	158,001	170,813
GDP per empl. person, HRK at 2000 pr.	98,209	108,400	110,039	115,229	118,185	122,450	127,273	133,731
Unit labour costs, HRK, 2000=100	100.0	94.2	98.4	98.4	102.1	102.9	105.1	106.0
Unit labour costs, ER adj., 2000=100	100.0	96.3	101.4	99.4	104.0	106.2	109.6	110.3
Unit labour costs, PPP adj., Austria=100	63.47	60.24	61.72	59.59	63.50	63.20	63.96	63.54
Macedonia								
Producer price index, 2000=100	100.0	102.0	101.1	100.8	101.7	104.9	109.7	111.5
Consumer price index, 2000=100	100.0	105.5	107.4	108.7	108.2	108.8	112.3	114.8
GDP deflator, 2000=100	100.0	103.6	107.2	107.5	108.9	113.0	117.3	120.2
Exchange rate (ER), MKD/EUR	60.73	60.91	60.98	61.26	61.34	61.30	61.19	61.18
ER, nominal, 2000=100	100.0	100.3	100.4	100.9	101.0	100.9	100.8	100.7
Real ER (CPI-based), 2000=100	100.0	102.9	102.5	101.3	98.6	97.1	98.2	98.2
Real ER (PPI-based), 2000=100	100.0	100.5	100.1	98.8	97.3	96.2	96.1	95.3
PPP, MKD/EUR	22.77	23.15	23.38	23.42	22.66	22.53	22.83	22.81
Price level, EU27 = 100	37	38	38	38	37	37	37	37
Average monthly gross wages, MKD	17,958	17,886	19,025	19,950	20,771	21,330	23,036	23,900
Average monthly gross wages, EUR (ER)	296	294	312	326	339	348	376	391
Average monthly gross wages, EUR (PPP)	789	773	814	852	917	947	1,009	1,048
GDP nominal, MKD mn	236,389	233,841	243,970	251,486	265,257	286,619	308,772	332,000
Employed persons - LFS, th., average	550	599	561	545	523	545	570	590
GDP per employed person, MKD	429,919	390,185	434,620	461,351	507,189	525,662	541,322	562,712
GDP per empl. person, MKD at 2000 pr.	429,919	376,587	405,486	429,324	465,791	465,104	461,330	468,269
Unit labour costs, MKD, 2000=100	100.0	113.7	112.3	111.2	106.8	109.8	119.5	122.2
Unit labour costs, ER adj., 2000=100	100.0	113.4	111.9	110.3	105.7	108.8	118.6	121.3
Unit labour costs, PPP adj., Austria=100	36.13	40.37	38.76	37.64	36.72	36.85	39.40	39.76

(Table A/2 ctd.)

(Table A/2 ctd.)

	2000	2001	2002	2003	2004	2005	2006	2007 prelim.
Albania								
Producer prices, manufact.ind., 2000=100	100.0	92.8	97.5	99.3	111.4	116.8	117.7	129.4
Consumer price index, 2000=100	100.0	103.1	108.5	110.9	114.2	116.9	119.8	123.2
GDP deflator, 2000=100	100.0	103.3	105.8	111.5	114.1	117.4	121.6	125.0
Exchange rate (ER), ALL/EUR	132.58	128.47	132.36	137.51	127.67	124.19	123.08	123.62
ER, nominal, 2000=100	100.0	96.9	99.8	103.7	96.3	93.7	92.8	93.2
Real ER (CPI-based), 2000=100	100.0	104.1	104.2	100.5	109.2	112.5	113.7	113.8
Real ER (PPI-based), 2000=100	100.0	94.6	97.1	94.6	111.8	115.4	111.9	119.5
PPP, ALL/EUR	53.777	54.423	54.374	57.126	57.099	57.404	57.317	57.519
Price level, EU27 = 100	41	42	41	42	45	46	47	47
Average monthly gross wages, ALL [4)]	14,963	17,218	19,659	21,325	24,393	26,808	28,822	34,200
Average monthly gross wages, EUR (ER)	113	134	149	155	191	216	234	277
Average monthly gross wages, EUR (PPP)	278	316	362	373	427	467	503	595
GDP nominal, ALL mn	523,043	583,369	622,711	694,098	751,024	817,374	893,006	970,000
Reg. employment total, th., average [5)]	1,067	1,066	920	923	929	932	934	935
GDP per employed person, ALL	490,362	547,458	676,754	751,852	808,665	877,331	956,539	1,037,956
GDP per empl. person, ALL at 2000 pr.	490,362	529,837	639,576	674,287	708,581	747,466	786,951	830,186
Unit labour costs, ALL, 2000=100	100.0	106.5	100.7	103.6	112.8	117.5	120.0	135.0
Unit labour costs, ER adj., 2000=100	100.0	109.9	100.9	99.9	117.2	125.5	129.3	144.8
Unit labour costs, PPP adj., Austria=100	28.55	30.93	27.63	26.96	32.16	33.59	33.93	37.51
Bosnia and Herzegovina								
Producer price index, 2000=100	.	.	.	.	.	.	.	.
Consumer price index, 2000=100	100.0	103.2	104.5	105.7	106.5	109.7	116.5	118.3
GDP deflator, 2000=100	100.0	103.6	108.6	110.5	113.1	116.3	123.6	125.7
Exchange rate (ER), BAM/EUR	1.96	1.96	1.96	1.96	1.96	1.96	1.96	1.96
ER, nominal, 2000=100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Real ER (CPI-based), 2000=100	100.0	101.0	100.2	99.4	98.1	98.9	102.7	101.9
Real ER (PPI-based), 2000=100	.	.	.	.	.	.	.	.
PPP, BAM/EUR	0.812	0.824	0.843	0.855	0.855	0.859	0.890	0.883
Price level, EU27 = 100	42	42	43	44	44	44	46	45
Average monthly gross wages, BAM	539	598	660	717	748	798	869	939
Average monthly gross wages, EUR (ER)	276	306	337	367	382	408	444	480
Average monthly gross wages, EUR (PPP)	664	726	783	839	875	929	976	1,064
GDP nominal, BAM mn	10,714	11,599	12,829	13,443	15,786	16,928	19,106	20,400
Employed persons - LFS, th., average [6)]	636	633	632	636	636	640	811	850
GDP per employed person, BAM	16,853	18,321	20,311	21,141	24,812	26,433	23,558	24,011
GDP per empl. person, BAM at 2000 pr.	16,853	17,685	18,699	19,134	21,938	22,722	19,054	19,098
Unit labour costs, BAM, 2000=100	100.0	105.7	110.4	117.2	106.6	109.8	142.6	153.7
Unit labour costs, ER adj., 2000=100	100.0	105.7	110.4	117.2	106.6	109.8	142.6	153.7
Unit labour costs, PPP adj., Austria=100	30.63	31.93	32.42	33.91	31.40	31.54	40.16	42.73
Montenegro								
Producer price index, 2001=100	.	100.0	114.5	119.7	126.6	129.3	134.0	143.3
Consumer price index, 2001=100	82.1	100.0	116.0	123.8	126.8	129.7	133.5	139.2
GDP deflator, 2001=100	82.0	100.0	102.8	107.4	122.2	127.1	129.5	135.1
Real ER (CPI-based), 2001=100	83.9	100.0	113.6	118.9	119.2	119.4	120.3	122.5
Real ER (PPI-based), 2001=100	.	100.0	115.2	119.7	123.8	121.0	119.6	124.9
PPP, EUR	0.31	0.37	0.37	0.38	0.43	0.43	0.42	0.43
Price level, EU27 = 100	31	37	37	38	43	43	42	43
Average monthly gross wages, EUR	151	176	251	271	303	326	377	497
Average monthly gross wages, EUR (PPP)	492	481	684	708	711	755	893	1,155
GDP nominal, EUR mn	1,022	1,245	1,302	1,392	1,651	1,785	1,970	2,200
Employed persons - LFS, th., average	230	214	221	200	187	179	178	175
GDP per employed person, EUR	4,438	5,807	5,900	6,960	8,814	9,984	11,045	12,571
GDP per empl. person, EUR at 2000 pr.	4,438	4,759	4,703	5,312	5,909	6,438	6,991	7,624
Unit labour costs, EUR, 2000=100	100.0	108.9	157.2	150.1	150.7	149.1	158.8	191.7
Unit labour costs, PPP adj., Austria=100	24.05	25.82	36.26	34.10	34.86	33.64	35.10	41.84

4) Excluding private sector. - 5) From 2002 according to census 2001. - 6) Until 2005 registered employees, from 2006 based on LFS.

(Table A/2 ctd.)

(Table A/2 ctd.)

	2000	2001	2002	2003	2004	2005	2006	2007 prelim.
Serbia								
Producer price index, 2000=100	100.0	187.7	204.2	213.6	233.1	266.1	301.5	319.3
Consumer price index, 2000=100	100.0	193.3	225.4	247.7	275.9	320.6	358.2	383.2
GDP deflator, 2000=100	100.0	188.0	234.8	263.0	296.4	341.3	392.1	419.5
Exchange rate (ER), RSD/EUR	15.04	59.46	60.68	65.05	72.57	82.91	84.06	80.09
ER, nominal, 2000=100	100.0	395.3	403.5	432.5	482.5	551.3	558.9	532.5
Real ER (CPI-based), 2000=100	100.0	47.8	53.6	53.8	52.6	52.4	56.5	62.0
Real ER (PPI-based), 2000=100	100.0	46.9	50.3	48.8	46.7	44.7	47.6	51.6
PPP, RSD/EUR	10.4	19.1	23.2	26.0	28.6	32.2	35.2	36.7
Price level, EU27 = 100	69	32	38	40	39	39	42	46
Average monthly gross wages, RSD [7)]	3,799	8,691	13,260	16,612	20,555	25,514	31,745	38,744
Average monthly gross wages, EUR (ER)	72	146	219	255	283	308	378	484
Average monthly gross wages, EUR (PPP)	367	455	570	640	719	793	902	1,055
GDP nominal, RSD mn	397,656	783,897	1,020,117	1,171,564	1,431,313	1,750,459	2,125,800	2,445,000
Employed persons - LFS, th., average	3,094	3,106	3,000	2,919	2,931	2,733	2,631	2,600
GDP per employed person, RSD	128,538	252,414	340,014	401,414	488,362	640,393	808,077	940,385
GDP per empl. person, RSD at 2000 pr.	128,538	134,245	144,836	152,601	164,763	187,637	206,073	224,144
Unit labour costs, RSD, 2000=100	100.0	219.0	309.8	368.3	422.1	460.1	521.2	584.8
Unit labour costs, ER adj., 2000=100	100.0	193.6	268.3	297.5	305.7	291.6	325.8	383.7
Unit labour costs, PPP adj., Austria=100	13.44	25.66	34.59	37.80	39.51	36.76	40.27	46.81
Russia								
Producer price index, 2000=100	100.0	119.1	133.0	153.8	190.7	230.2	258.7	295.1
Consumer price index, 2000=100	100.0	121.6	141.1	160.2	177.9	200.1	219.5	239.5
GDP deflator, 2000=100	100.0	116.5	134.7	153.5	184.4	219.8	254.4	288.8
Exchange rate (ER), RUB/EUR	26.029	26.130	29.647	34.686	35.814	35.218	34.079	35.010
ER, nominal, 2000=100	100.0	100.4	113.9	133.3	137.6	135.3	130.9	134.5
Real ER (CPI-based), 2000=100	100.0	118.5	118.7	113.1	119.0	133.3	147.8	153.3
Real ER (PPI-based), 2000=100	100.0	117.2	116.1	114.1	134.0	157.4	174.4	189.0
PPP, RUB/EUR	7.535	8.596	9.700	11.021	12.924	15.061	17.041	18.872
Price level, EU27 = 100	29	33	33	32	36	43	50	54
Average monthly gross wages, RUB	2,223	3,240	4,360	5,499	6,740	8,555	10,634	13,518
Average monthly gross wages, EUR (ER)	85	124	147	159	188	243	312	386
Average monthly gross wages, EUR (PPP)	295	377	450	499	521	568	624	716
GDP nominal, RUB bn	7,306	8,944	10,831	13,243	17,048	21,625	26,883	32,989
Employed persons - LFS, th., average	65,070	65,123	66,659	66,432	67,275	68,169	68,693	70,528
GDP per employed person, RUB	112,273	137,334	162,477	199,350	253,410	317,220	391,347	467,738
GDP per empl. person, RUB at 2000 pr.	112,273	117,901	120,598	129,841	137,444	144,318	153,821	161,960
Unit labour costs, RUB, 2000=100	100.0	138.8	182.6	213.8	247.6	299.3	349.1	421.5
Unit labour costs, ER adj., 2000=100	100.0	138.2	160.3	160.5	180.0	221.2	266.6	313.4
Unit labour costs, PPP adjusted	0.069	0.095	0.110	0.110	0.124	0.152	0.183	0.216
Unit labour costs, PPP adj., Austria=100	13.22	18.02	20.33	20.05	22.88	27.43	32.41	37.60
Ukraine								
Producer price index, 2000=100	100.0	108.7	112.0	120.5	145.2	169.4	185.7	221.9
Consumer price index, 2000=100	100.0	112.0	112.9	118.8	129.5	147.0	160.4	180.9
GDP deflator, 2000=100	100.0	109.9	115.6	124.9	143.8	179.1	203.6	243.2
Exchange rate (ER), UAH/EUR	5.029	4.814	5.030	6.024	6.609	6.389	6.335	6.918
ER, nominal, 2000=100	100.0	95.7	100.0	119.8	131.4	127.0	126.0	137.6
Real ER (CPI-based), 2000=100	100.0	114.5	108.2	93.2	90.7	104.2	112.2	113.2
Real ER (PPI-based), 2000=100	100.0	112.3	111.3	99.4	106.8	123.3	130.1	138.9
PPP, UAH/EUR	1.2196	1.3133	1.3469	1.4506	1.6313	1.9861	2.2074	2.5720
Price level, EU27 = 100	24	27	27	24	25	31	35	37
Average monthly gross wages, UAH	230	311	376	462	590	806	1,041	1,351
Average monthly gross wages, EUR (ER)	46	65	75	77	89	126	164	195
Average monthly gross wages, EUR (PPP)	189	237	279	319	361	406	472	525
GDP nominal, UAH mn	170,070	204,190	225,810	267,344	345,113	441,452	537,667	689,000
Employed persons - LFS, th., average	20,175	19,972	20,091	20,163	20,296	20,680	20,730	20,800
GDP per employed person, UAH	8,430	10,224	11,239	13,259	17,004	21,347	25,936	33,125
GDP per empl. person, UAH at 2000 pr.	8,430	9,299	9,725	10,620	11,827	11,921	12,739	13,623
Unit labour costs, UAH, 2000=100	100.0	122.5	141.8	159.4	182.6	247.7	299.5	363.3
Unit labour costs, ER adj., 2000=100	100.0	128.0	141.7	133.1	138.9	195.0	237.7	264.1
Unit labour costs, PPP adj., Austria=100	15.27	19.27	20.76	19.20	20.40	27.92	33.37	36.59

7) Until 2000 wiiw estimate.

(Table A/2 ctd.)

(Table A/2 ctd.)

	2000	2001	2002	2003	2004	2005	2006	2007 prelim.
Austria								
Producer price index, 2000=100	100.0	101.5	101.1	102.7	107.7	110.0	113.2	117.8
Consumer price index, 2000=100	100.0	102.7	104.5	106.0	108.2	110.7	112.4	114.9
GDP deflator, 2000=100	100.0	101.8	103.2	104.4	106.6	108.5	110.4	113.0
Real ER (CPI-based), 2000=100	100.0	100.5	100.2	99.7	99.6	99.8	99.1	98.9
Real ER (PPI-based), 2000=100	100.0	100.3	100.5	101.5	104.1	101.8	99.9	101.5
PPP, EUR	1.0355	1.0683	1.0481	1.0465	1.0378	1.0327	1.0376	1.0245
Price level, EU27 = 100	104	107	105	105	104	103	104	102
Average monthly gross wages, EUR	2,390	2,428	2,483	2,530	2,577	2,639	2,708	2,762
Average monthly gross wages, EUR (PPP)	2,308	2,272	2,369	2,417	2,483	2,556	2,610	2,696
GDP nominal, EUR mn	210,392	215,878	220,841	226,175	236,149	245,330	257,897	272,855
Employed persons - LFS, th., average [8)]	3,686	3,711	3,762	3,794	3,744	3,824	3,928	4,034
GDP per employed person, EUR	57,083	58,169	58,701	59,622	63,074	64,149	65,651	67,633
GDP per empl. person, EUR at 2000 pr.	57,083	57,162	56,872	57,086	59,177	59,116	59,453	59,858
Unit labour costs, EUR, 2000=100	100.0	101.4	104.3	105.8	104.0	106.6	108.8	110.2
Unit labour costs, PPP adjusted	0.52	0.53	0.54	0.55	0.54	0.55	0.57	0.57

8) From 2004 new methodology.

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

EUR-SIT: SIT divided by fixed parity before 2007 (1 € = .239.64 SIT).

PPP rates have been taken from Eurostat based on the new benchmark results 2005. Albania, Bosnia and Herzegovina, Montenegro and Serbia are integrated in this results for the first time. Available data 2005 and 2006 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.

Sources: National statistics; WIFO; Eurostat; Purchasing power parities, 2005 benchmark year, OECD November 2007; wiiw estimates.

Table A3

Indicators of macro-competitiveness, 2000-2007

annual changes in %

	2000	2001	2002	2003	2004	2005	2006	2007 prelim.	2000-07 average
Czech Republic									
GDP deflator	1.5	4.9	2.8	0.9	4.5	-0.2	1.7	2.8	2.4
Exchange rate (ER), CZK/EUR	-3.4	-4.3	-9.6	3.3	0.2	-6.6	-4.8	-2.0	-3.5
Real ER (CPI-based)	5.6	7.0	10.3	-5.0	0.5	6.8	5.4	2.5	4.0
Real ER (PPI-based)	4.2	6.2	10.7	-4.2	3.1	5.6	1.9	3.7	3.8
Average gross wages, CZK	6.4	8.7	7.3	6.6	6.6	5.3	6.4	8.5	7.0
Average gross wages, real (PPI based)	1.4	5.7	7.8	7.0	0.9	2.2	4.7	4.2	4.2
Average gross wages, real (CPI based)	2.4	3.8	5.4	6.5	3.7	3.3	3.8	5.5	4.3
Average gross wages, EUR (ER)	10.2	13.5	18.6	3.2	6.4	12.8	11.8	10.7	10.8
Employed persons (LFS) [1)]	-0.7	0.4	0.8	-0.7	-0.6	1.2	1.3	1.9	0.5
GDP per empl. person, CZK at 2000 pr.	4.3	2.1	1.1	4.3	5.1	5.1	4.9	4.6	3.9
Unit labour costs, CZK at 2000 prices	1.9	6.5	6.1	2.2	1.5	0.2	1.4	3.7	2.9
Unit labour costs, ER (EUR) adjusted	5.6	11.2	17.4	-1.1	1.3	7.3	6.5	5.9	6.6
Hungary									
GDP deflator	9.7	8.5	7.8	5.8	4.4	2.2	3.7	6.4	6.0
Exchange rate (ER), HUF/EUR	2.9	-1.3	-5.3	4.3	-0.7	-1.4	6.5	-4.9	-0.1
Real ER (CPI-based)	4.7	8.3	9.0	-1.6	5.3	2.9	-4.6	10.9	4.3
Real ER (PPI-based)	4.0	5.4	4.3	-2.4	1.9	1.3	-4.6	2.8	1.5
Average gross wages, HUF	13.5	18.2	18.3	12.0	6.1	8.8	8.2	8.3	11.6
Average gross wages, real (PPI based)	1.7	12.3	20.4	9.4	2.5	4.3	1.6	8.1	7.4
Average gross wages, real (CPI based)	3.4	8.2	12.3	7.0	-0.7	5.0	4.1	0.3	4.9
Average gross wages, EUR (ER)	10.4	19.7	25.0	7.3	6.8	10.4	1.6	13.9	11.7
Employed persons (LFS)	1.2	0.3	0.1	1.3	-0.5	0.0	0.7	-0.1	0.4
GDP per empl. person, HUF at 2000 pr.	3.9	3.7	4.3	2.8	5.4	4.1	3.1	1.4	3.6
Unit labour costs, HUF at 2000 prices	9.3	13.9	13.4	8.9	0.6	4.5	4.9	6.8	7.7
Unit labour costs, ER (EUR) adjusted	6.2	15.4	19.8	4.4	1.4	6.0	-1.5	12.3	7.8
Poland									
GDP deflator	7.2	3.5	2.3	0.4	4.1	2.7	1.5	2.5	3.0
Exchange rate (ER), PLN/EUR	-5.1	-8.5	5.1	14.1	3.1	-11.2	-3.2	-2.9	-1.4
Real ER (CPI-based)	13.9	12.9	-5.0	-13.3	-1.7	12.6	2.1	3.1	2.6
Real ER (PPI-based)	8.9	9.8	-3.3	-10.6	1.5	8.5	0.9	2.8	2.1
Average gross wages, PLN	11.6	8.0	2.6	4.2	4.0	3.8	4.9	8.7	5.9
Average gross wages, real (PPI based)	3.5	6.3	1.6	1.5	-2.8	3.1	2.5	6.2	2.7
Average gross wages, real (CPI based)	1.3	2.4	0.7	3.3	0.5	1.7	3.8	6.0	2.5
Average gross wages, EUR (ER)	17.6	18.1	-2.4	-8.7	0.9	17.0	8.4	11.9	7.4
Employed persons (LFS) [2)]	-1.6	-2.2	-3.0	0.6	1.3	2.3	3.4	4.5	0.6
GDP per empl. person, PLN at 2000 pr.	6.0	3.5	4.5	3.3	3.9	1.2	2.7	1.9	3.4
Unit labour costs, PLN at 2000 prices	5.3	4.4	-1.9	0.8	0.1	2.6	2.1	6.6	2.5
Unit labour costs, ER (EUR) adjusted	11.0	14.1	-6.6	-11.6	-2.9	15.5	5.5	9.8	3.9
Slovak Republic									
GDP deflator	9.4	5.0	3.9	5.3	5.9	2.4	2.9	2.3	4.6
Exchange rate (ER), SKK/EUR	-3.5	1.7	-1.4	-2.8	-3.5	-3.6	-3.5	-9.3	-3.3
Real ER (CPI-based)	13.8	3.1	2.6	9.5	9.0	4.3	5.9	10.8	7.3
Real ER (PPI-based)	10.1	3.5	4.2	10.8	4.7	4.0	7.2	9.8	6.7
Average gross wages, SKK	6.5	8.2	9.3	6.3	10.2	9.2	8.6	7.4	8.2
Average gross wages, real (PPI based)	-3.8	1.6	7.0	-1.8	6.5	4.3	0.2	5.3	2.3
Average gross wages, real (CPI based)	-4.9	1.0	5.8	-2.0	2.5	6.3	3.9	4.5	2.1
Average gross wages, EUR (ER)	10.4	6.4	10.8	9.4	14.1	13.3	12.5	18.5	11.9
Employed persons (LFS)	-1.4	1.0	0.2	1.8	0.3	2.1	3.8	2.1	1.2
GDP per empl. person, SKK at 2000 pr.	2.9	2.3	4.6	2.9	4.9	4.4	4.5	6.7	4.1
Unit labour costs, SKK at 2000 prices	3.6	5.7	4.5	3.3	5.0	4.6	3.9	0.7	3.9
Unit labour costs, ER (EUR) adjusted	7.3	4.0	6.0	6.3	8.8	8.5	7.7	11.0	7.4
Slovenia									
GDP deflator	5.4	8.6	7.6	5.6	3.3	1.7	2.0	3.5	4.7
Exchange rate (ER), EUR-SIT/EUR	5.9	5.9	4.2	3.3	2.2	0.3	0.0	0.0	2.7
Real ER (CPI-based)	0.9	0.1	1.1	0.3	-0.8	0.0	0.3	1.2	0.4
Real ER (PPI-based)	-2.6	1.6	1.5	-1.4	-0.2	-2.0	-2.4	2.4	-0.4
Average gross wages, EUR-SIT	10.6	11.9	9.7	7.5	5.7	3.6	4.8	5.5	7.4
Average gross wages, real (PPI based)	2.8	2.8	4.4	4.9	1.3	0.9	2.5	0.5	2.5
Average gross wages, real (CPI based)	1.6	3.3	2.1	1.8	2.0	1.1	2.3	1.9	2.0
Average gross wages, EUR (ER)	4.5	5.7	5.3	4.1	3.4	3.3	4.8	5.5	4.6
Employed persons (LFS)	1.7	1.7	-0.7	-1.4	5.1	0.6	1.3	2.0	1.3
GDP per empl. person, EUR-SIT at 2000 pr.	3.9	1.4	4.3	4.3	-0.7	3.5	4.4	3.9	3.1
Unit labour costs, EUR-SIT at 2000 prices	6.5	10.4	5.2	3.1	6.4	0.1	0.4	1.5	4.1
Unit labour costs, ER (EUR) adjusted	0.6	4.2	1.0	-0.2	4.1	-0.2	0.4	1.5	1.4

1) From 2002 according to census 2001. - 2) From 2003 according to census 2002.

(Table A/3 ctd.)

Table A3 (ctd.)

	2000	2001	2002	2003	2004	2005	2006	2007 prelim.	2000-07 average
Bulgaria									
GDP deflator	6.7	6.7	3.8	1.8	5.2	3.8	8.1	7.6	5.4
Exchange rate (ER), BGN/EUR	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	8.2	5.1	3.7	0.3	3.9	2.8	5.0	5.9	4.3
Real ER (PPI-based)	12.7	2.6	1.8	4.3	3.6	2.3	4.2	6.0	4.6
Average gross wages, BGN	11.7	6.9	7.3	6.1	7.0	10.7	9.5	17.0	9.5
Average gross wages, real (PPI based)	-5.0	3.0	6.1	1.1	0.9	3.6	0.3	7.8	2.2
Average gross wages, real (CPI based)	1.2	-0.4	1.4	3.7	0.8	5.4	2.1	8.0	2.7
Average gross wages, EUR (ER)	11.7	6.9	7.3	6.1	7.0	10.7	9.5	17.0	9.5
Employed persons (LFS)	-2.8	-3.4	1.5	3.5	3.1	2.0	4.4	5.1	1.6
GDP per empl. person, BGN at 2000 pr.	8.4	7.8	3.3	1.7	3.4	4.2	1.7	0.8	3.9
Unit labour costs, BGN at 2000 prices	3.0	-0.8	3.9	4.3	3.5	6.3	7.8	16.1	5.4
Unit labour costs, ER (EUR) adjusted	3.0	-0.8	3.9	4.3	3.5	6.3	7.8	16.1	5.4
Romania									
GDP deflator	44.2	37.4	23.4	24.0	15.0	12.2	10.9	7.9	21.3
Exchange rate (ER), ROL/EUR	22.5	30.4	20.1	20.2	7.9	-10.6	-2.7	-5.3	9.4
Real ER (CPI-based)	16.7	0.9	0.0	-5.9	1.5	19.4	7.2	8.1	5.7
Real ER (PPI-based)	20.1	4.7	3.0	-1.1	7.9	18.3	9.5	11.4	9.0
Average gross wages, ROL	47.8	48.6	26.1	24.8	23.3	18.3	18.4	23.0	28.3
Average gross wages, real (PPI based)	-3.7	7.6	2.5	4.4	3.5	7.0	6.1	13.8	5.1
Average gross wages, real (CPI based)	1.5	10.5	2.9	8.2	10.2	8.5	11.1	17.4	8.7
Average gross wages, EUR (ER)	20.7	13.9	5.0	3.8	14.2	32.3	21.7	29.9	17.3
Employed persons (LFS) [3)]	-0.3	-0.6	.	-0.1	-0.7	-0.1	1.8	2.6	0.3
GDP per empl. person, ROL at 2000 pr. [3)]	2.4	6.4	.	5.3	9.3	4.3	5.9	3.3	4.6
Unit labour costs, ROL at 2000 prices [3)]	44.4	39.7	.	18.4	12.8	13.4	11.8	19.1	19.2
Unit labour costs, ER (EUR) adjusted [3)]	17.9	7.1	.	-1.4	4.5	26.8	15.0	25.8	11.5
Estonia									
GDP deflator	5.4	5.3	3.8	4.5	1.8	6.2	6.2	9.3	5.3
Exchange rate (ER), EEK/EUR	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	2.1	3.5	1.5	-0.6	0.8	1.9	2.2	3.8	1.9
Real ER (PPI-based)	0.6	3.2	1.0	-0.4	0.6	-2.3	-0.3	5.7	1.0
Average gross wages, EEK	10.5	12.3	11.5	9.4	8.4	10.8	16.5	15.9	11.9
Average gross wages, real (PPI based)	5.4	7.6	11.1	9.2	5.3	8.5	11.5	7.0	8.2
Average gross wages, real (CPI based)	6.3	6.1	7.6	8.0	5.2	6.4	11.6	9.0	7.5
Average gross wages, EUR (ER)	10.5	12.3	11.5	9.4	8.4	10.8	16.5	15.9	11.9
Employed persons (LFS)	-1.2	0.9	1.4	1.5	0.2	2.0	6.4	1.3	1.5
GDP per empl. person, EEK at 2000 pr.	9.1	9.6	6.6	5.7	8.0	8.0	4.5	5.6	7.1
Unit labour costs, EEK at 2000 prices	1.3	2.4	4.6	3.6	0.3	2.6	11.5	9.7	4.4
Unit labour costs, ER (EUR) adjusted	1.3	2.4	4.6	3.6	0.3	2.6	11.5	9.7	4.4
Latvia									
GDP deflator	2.8	1.7	3.6	3.6	7.0	10.2	11.1	13.0	6.5
Exchange rate (ER), LVL/EUR	-10.2	0.5	3.5	10.7	4.1	4.7	0.0	0.0	1.5
Real ER (CPI-based)	12.1	-0.2	-3.6	-8.8	-0.1	-0.3	4.2	7.2	1.1
Real ER (PPI-based)	7.4	0.1	-1.9	-7.3	2.0	-1.5	5.3	13.3	2.0
Average gross wages, LVL	6.1	6.3	8.8	11.3	9.6	16.5	23.0	29.0	13.6
Average gross wages, real (PPI based)	5.4	4.6	7.7	7.8	0.9	8.1	11.6	11.1	7.1
Average gross wages, real (CPI based)	3.4	3.7	6.8	8.1	3.2	9.2	15.5	17.6	8.3
Average gross wages, EUR (ER)	18.1	5.8	5.1	0.5	5.3	11.2	23.0	29.0	11.9
Employed persons (LFS)	-2.8	2.2	2.8	1.8	1.1	1.8	5.0	2.5	1.8
GDP per empl. person, LVL at 2000 pr.	10.0	5.7	3.6	5.3	7.5	8.7	6.6	8.1	6.9
Unit labour costs, LVL at 2000 prices	-3.6	0.6	5.0	5.7	1.9	7.2	15.4	19.3	6.2
Unit labour costs, ER (EUR) adjusted	7.4	0.1	1.5	-4.5	-2.1	2.4	15.4	19.3	4.6
Lithuania									
GDP deflator	0.5	-0.3	0.1	-0.9	2.7	5.7	6.6	8.6	2.8
Exchange rate (ER), LTL/EUR	-13.4	-3.1	-3.5	-0.2	0.0	0.0	0.0	0.0	-2.6
Real ER (CPI-based)	14.4	2.3	1.8	-2.9	-0.9	0.5	1.5	3.1	2.4
Real ER (PPI-based)	28.4	-1.1	1.3	-0.9	3.6	6.7	2.5	4.4	5.3
Average gross wages, LTL	-1.7	1.2	3.2	5.8	7.2	11.0	17.2	20.3	7.8
Average gross wages, real (PPI based)	-15.2	4.3	6.2	6.3	1.1	-0.4	9.1	12.4	2.7
Average gross wages, real (CPI based)	-2.7	-0.1	2.9	7.1	5.9	8.1	13.0	14.0	5.9
Average gross wages, EUR (ER)	13.5	4.4	6.9	6.0	7.2	11.0	17.2	20.3	10.7
Employed persons (LFS)	-4.0	-3.3	4.0	2.3	-0.1	2.6	1.7	2.7	0.7
GDP per empl. person, LTL at 2000 pr.	8.5	10.3	2.8	7.9	7.5	5.2	5.9	5.8	6.7
Unit labour costs, LTL at 2000 prices	-9.4	-8.2	0.4	-1.9	-0.3	5.6	10.7	13.7	1.0
Unit labour costs, ER (EUR) adjusted	4.7	-5.3	4.0	-1.7	-0.3	5.6	10.7	13.7	3.8

3) In 2002 no comparable growth rates available due to methodological break in employment. Average 2000-2007 is calculated without 2002.

(Table A/3 ctd.)

Table A3 (ctd.)

	2000	2001	2002	2003	2004	2005	2006	2007 prelim.	2000-07 average
Croatia									
GDP deflator	4.7	4.0	3.6	4.0	3.9	3.2	3.4	2.9	3.7
Exchange rate (ER), HRK/EUR	0.7	-2.2	-0.8	2.1	-0.9	-1.3	-1.0	0.2	-0.4
Real ER (CPI-based)	3.5	4.9	0.5	-2.2	0.9	2.4	2.0	0.3	1.5
Real ER (PPI-based)	4.4	4.7	1.0	-0.8	2.1	-0.2	-0.8	0.7	1.4
Average gross wages, HRK	7.0	3.9	6.0	4.8	6.4	4.4	6.2	5.9	5.6
Average gross wages, real (PPI based)	-2.5	0.3	6.5	2.8	2.8	1.4	3.2	2.5	2.1
Average gross wages, real (CPI based)	0.7	-0.9	4.3	2.9	4.3	1.0	2.9	3.0	2.3
Average gross wages, EUR (ER)	6.2	6.3	6.9	2.6	7.4	5.7	7.3	5.7	6.0
Employed persons (LFS)	4.1	-5.4	4.0	0.6	1.7	0.7	0.8	0.9	0.9
GDP per empl. person, HRK at 2000 pr.	-1.1	10.4	1.5	4.7	2.6	3.6	3.9	5.1	3.8
Unit labour costs, HRK at 2000 prices	8.2	-5.8	4.4	0.1	3.8	0.8	2.2	0.8	1.7
Unit labour costs, ER (EUR) adjusted	7.4	-3.7	5.3	-2.0	4.7	2.1	3.2	0.6	1.2
Macedonia									
GDP deflator	8.2	3.6	3.4	0.3	1.3	3.8	3.8	2.4	3.3
Exchange rate (ER), MKD/EUR	0.2	0.3	0.1	0.5	0.1	-0.1	-0.2	0.0	0.1
Real ER (CPI-based)	3.6	2.9	-0.4	-1.2	-2.6	-1.6	1.2	-0.1	0.2
Real ER (PPI-based)	5.9	0.5	-0.4	-1.3	-1.5	-1.2	-0.1	-0.8	0.1
Average gross wages, MKD	9.0	-0.4	6.4	4.9	4.1	2.7	8.0	3.8	4.8
Average gross wages, real (PPI based)	-1.5	-2.4	7.3	5.2	3.2	-0.5	3.3	2.0	2.0
Average gross wages, real (CPI based)	3.1	-5.6	4.5	3.6	4.5	2.2	4.6	1.4	2.2
Average gross wages, EUR (ER)	8.8	-0.7	6.3	4.4	4.0	2.8	8.2	3.8	4.6
Employed persons (LFS)	0.8	9.0	-6.3	-2.9	-4.1	4.3	4.6	3.4	1.0
GDP per empl. person, MKD at 2000 pr.	3.6	-12.4	7.7	5.9	8.5	-0.1	-0.8	1.5	1.5
Unit labour costs, MKD at 2000 prices	5.2	13.7	-1.2	-1.0	-4.0	2.8	8.9	2.2	3.2
Unit labour costs, ER (EUR) adjusted	5.0	13.4	-1.3	-1.4	-4.2	2.9	9.1	2.2	3.1
Albania									
GDP deflator	4.0	3.3	2.4	5.4	2.4	2.8	3.6	2.9	3.3
Exchange rate (ER), ALL/EUR	-9.8	-3.1	3.0	3.9	-7.2	-2.7	-0.9	0.4	-2.1
Real ER (CPI-based)	8.8	4.1	0.0	-3.5	8.6	3.0	1.1	0.1	2.7
Real ER (PPI-based)	13.2	-5.4	2.6	-2.6	18.1	3.2	-3.0	6.9	3.9
Average gross wages, ALL	17.7	15.1	14.2	8.5	14.4	9.9	7.5	18.7	13.2
Average gross wages, real (PPI based)	10.5	24.0	8.6	6.5	2.0	4.8	6.8	7.9	8.7
Average gross wages, real (CPI based)	17.7	11.6	8.5	6.1	11.1	7.3	5.0	15.3	10.2
Average gross wages, EUR (ER)	30.5	18.8	10.8	4.4	23.2	13.0	8.5	18.1	15.6
Registered employment, total [4)]	-0.8	-0.1	-0.1	0.3	0.6	0.3	0.2	0.1	0.1
GDP per empl. person, ALL at 2000 pr.	7.5	8.1	4.3	5.4	5.1	5.5	5.3	5.5	5.8
Unit labour costs, ALL at 2000 prices	9.5	6.5	9.5	2.9	8.9	4.2	2.1	12.5	6.9
Unit labour costs, ER (EUR) adjusted	21.4	9.9	6.3	-1.0	17.2	7.1	3.0	12.0	9.3
Bosnia and Herzegovina									
GDP deflator	4.1	3.6	4.8	1.7	2.4	2.9	6.3	1.7	3.4
Exchange rate (ER), BAM/EUR	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real ER (CPI-based)	2.9	1.0	-0.8	-0.8	-1.3	0.8	3.9	-0.8	0.6
Real ER (PPI-based)	.	.	.	.	.	.	.	.	.
Average gross wages, BAM	7.2	10.9	10.4	8.6	4.3	6.7	8.9	8.1	8.1
Average gross wages, real (PPI based)	.	.	.	.	.	.	.	.	.
Average gross wages, real (CPI based)	2.2	7.5	9.0	7.5	3.5	3.6	2.5	6.5	5.2
Average gross wages, EUR (ER)	7.2	10.9	10.4	8.6	4.3	6.7	8.9	8.1	8.1
Employed persons (LFS) [5)]	-0.8	-0.4	-0.2	0.7	0.1	0.7	1.1	4.8	0.7
GDP per empl. person, BAM at 2000 pr.	6.4	4.9	5.7	2.3	14.7	3.6	5.0	0.2	5.3
Unit labour costs, BAM at 2000 prices	0.7	5.7	4.4	6.2	-9.0	3.0	3.7	7.8	2.7
Unit labour costs, ER (EUR) adjusted	0.7	5.7	4.4	6.2	-9.0	3.0	3.7	7.8	2.7
Montenegro									**2001-07**
GDP deflator	.	22.0	2.8	4.4	13.8	4.0	1.9	4.4	7.4
Real ER (CPI-based)	.	19.1	13.6	4.7	0.3	0.1	0.8	1.8	5.5
Real ER (PPI-based)	.	.	15.2	3.9	3.4	-2.3	-1.1	4.4	3.8
Average gross wages, EUR	.	16.8	42.6	7.8	11.7	7.8	15.6	31.7	18.6
Average gross wages, real (PPI based)	.	.	24.5	3.2	5.6	5.6	11.6	23.1	11.9
Average gross wages, real (CPI based)	.	-4.1	23.0	1.1	9.1	5.4	12.2	26.4	10.0
Employed persons (LFS)	.	-6.9	2.9	-9.3	-6.3	-4.5	-0.3	-1.9	-3.8
GDP per empl. person, EUR	.	30.8	1.6	18.0	26.6	13.3	10.6	13.8	16.0
GDP per empl. person, EUR at 2000 pr.	.	7.2	-1.2	12.9	11.2	9.0	8.6	9.1	8.0
Unit labour costs, EUR at 2000 prices	.	8.9	44.3	-4.5	0.4	-1.0	6.5	20.8	9.7

4) From 2002 according to census 2001. - 5) Until 2006 based on registered employees.

(Table A/3 ctd.)

Table A3 (ctd.)

	2000	2001	2002	2003	2004	2005	2006	2007 prelim.	2000-07 average
Serbia									
GDP deflator	81.0	88.0	24.9	12.1	12.7	15.1	14.9	7.0	28.8
Exchange rate (ER), RSD/EUR	28.2	295.3	2.1	7.2	11.6	14.2	1.4	-4.7	27.1
Real ER (CPI-based)	37.5	-52.2	11.9	0.6	-2.2	-0.4	7.8	9.7	-2.0
Real ER (PPI-based)	51.6	-53.1	7.2	-3.0	-4.4	-4.3	6.6	8.4	-3.0
Average gross wages, RSD	90.7	128.8	52.6	25.3	23.7	24.1	24.4	22.0	44.9
Average gross wages, real (PPI based)	-5.9	21.9	40.2	19.8	13.4	8.7	9.8	15.2	14.8
Average gross wages, real (CPI based)	6.2	18.4	30.9	14.0	11.1	6.8	11.4	14.1	13.9
Average gross wages, EUR (ER)	-8.8	102.2	49.5	16.9	10.9	8.6	22.7	28.1	25.4
Employed persons (LFS)	-0.3	0.4	-3.4	-2.7	0.4	-6.7	-3.8	-1.2	-2.2
GDP per empl. person, RSD at 2000 pr.	4.8	4.4	7.9	5.4	8.0	13.9	9.8	8.8	7.8
Unit labour costs, RSD at 2000 prices	81.9	119.0	41.4	18.9	14.6	9.0	13.3	12.2	34.4
Unit labour costs, ER (EUR) adjusted	-13.0	93.6	38.6	10.9	2.7	-4.6	11.7	17.8	16.3
Russia									
GDP deflator	37.7	16.5	15.7	14.0	20.1	19.2	15.7	13.5	18.8
Exchange rate (ER), RUB/EUR	-0.8	0.4	13.5	17.0	3.3	-1.7	-3.2	2.7	3.7
Real ER (CPI-based)	19.5	18.5	0.2	-4.8	5.3	12.0	10.9	3.7	7.9
Real ER (PPI-based)	41.7	17.2	-0.9	-1.8	17.4	17.5	10.8	8.3	13.1
Average gross wages, RUB	46.0	45.7	34.6	26.1	22.6	26.9	24.3	27.1	31.4
Average gross wages, real (PPI based)	-0.4	22.4	20.4	9.1	-1.2	5.2	10.6	11.4	9.4
Average gross wages, real (CPI based)	20.9	19.9	16.0	11.0	10.4	12.8	13.3	16.5	15.0
Average gross wages, EUR (ER)	47.2	45.2	18.6	7.8	18.7	29.1	28.5	23.7	26.7
Employed persons (LFS)	3.4	0.1	2.4	-0.3	1.3	1.3	0.8	2.7	1.4
GDP per empl. person, RUB at 2000 pr.	6.4	5.0	2.3	7.7	5.9	5.0	6.6	5.3	5.5
Unit labour costs, RUB at 2000 prices	37.2	38.8	31.6	17.1	15.8	20.9	16.6	20.7	24.5
Unit labour costs, ER (EUR) adjusted	38.3	38.2	15.9	0.1	12.1	22.9	20.5	17.5	20.1
Ukraine									
GDP deflator	23.1	9.9	5.1	8.0	15.2	24.6	13.7	19.4	14.7
Exchange rate (ER), UAH/EUR	14.5	-4.3	4.5	19.8	9.7	-3.3	-0.8	9.2	5.8
Real ER (CPI-based)	9.9	14.5	-5.5	-13.8	-2.7	14.9	7.7	0.9	2.8
Real ER (PPI-based)	1.2	12.3	-0.9	-10.7	7.4	15.5	5.5	6.8	4.3
Average gross wages, UAH	29.6	35.2	21.0	22.8	27.6	36.7	29.2	29.7	28.9
Average gross wages, real (PPI based)	7.3	24.4	17.5	14.1	5.9	17.2	17.9	8.6	13.9
Average gross wages, real (CPI based)	1.1	20.7	20.0	16.7	17.0	20.5	18.4	15.0	16.0
Average gross wages, EUR (ER)	13.3	41.2	15.8	2.5	16.3	41.4	30.3	18.8	21.8
Employed persons (LFS)	0.6	-1.0	0.6	0.4	0.7	1.9	0.2	0.3	0.5
GDP per empl. person, UAH at 2000 pr.	5.2	10.3	4.6	9.2	11.4	0.8	6.9	6.9	6.9
Unit labour costs, UAH at 2000 prices	23.2	22.5	15.7	12.5	14.5	35.7	20.9	21.3	20.6
Unit labour costs, ER (EUR) adjusted	7.6	28.0	10.7	-6.1	4.4	40.3	21.9	11.1	13.9
Austria									
GDP deflator	1.8	1.8	1.4	1.2	2.1	1.8	1.8	2.3	1.8
Real ER (CPI-based)	0.5	0.5	-0.3	-0.5	0.0	0.1	-0.7	-0.2	-0.1
Real ER (PPI-based)	-0.3	0.3	0.2	1.0	2.6	-2.3	-1.8	1.6	0.1
Average gross wages, EUR	2.4	1.6	2.3	1.9	1.9	2.4	2.6	2.0	2.1
Average gross wages, real (PPI based)	-1.5	0.1	2.7	0.3	-2.9	0.3	-0.3	-2.0	-0.4
Average gross wages, real (CPI based)	0.0	-1.1	0.5	0.5	-0.2	0.1	1.1	-0.2	0.1
Employed persons (LFS) 6)	0.4	0.7	1.4	0.8	0.0	2.1	2.7	2.7	1.4
GDP per empl. person, EUR at 2000 pr.	2.9	0.1	-0.5	0.4	2.3	-0.1	0.6	0.7	0.8
Unit labour costs, EUR at 2000 prices	-0.5	1.4	2.8	1.5	-0.4	2.5	2.0	1.3	1.3
Unit labour costs, ER (EUR) adjusted	-0.5	1.4	2.8	1.5	-0.4	2.5	2.0	1.3	1.3

6) From 2004 new methodology.

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

Sources: National statistics and wiiw estimates.

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